

# Due diligence in the supply chain as an instrument to reduce the impact of products placed on the European market with regards to deforestation and forest degradation

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## Introduction

The EU, some of its Member States and the UK have initiated several strands of work considering the possible establishment of regulatory instruments with regards to due diligence in the supply chain and, more specifically, as one of the possible ways to reduce the impact of products placed on the European market with regards, to deforestation and forest degradation.

Especially with reference to the activities of several Member States on this subject, it is important that the EU ensures no distortions in its internal market. This is also important with regards to the new relations between the EU and the UK. Given that whether the producers are European or British, the value chains for the tyre and rubber industry are the same and the same is also the origin of the natural rubber used, coherence between prospective policy choices on due diligence of the EU and of the UK will be necessary.

In this context, this paper includes some specificities related to the natural rubber supply chain and their implications on the possible options currently on the table.

The European tyre and rubber industry also plans to complete this initial contribution by replying to the various public consultations currently open and remains available to answer any question that the legislators might have.

## The Specificities of the Tyre and Rubber Industry in Relation to Natural Rubber

What is Natural Rubber?

- Natural Rubber is a key ingredient in tyres and many other products;
- It is a strategic raw material for the Automotive Sector, which accounts for 88% of its consumption;
- 70% of the natural rubber harvested globally goes to tyre production;
- It is essential for all types of vehicle tyres, securing global transport of goods.
- Natural Rubber accounts for 34 % of the tyre manufacturers raw materials costs;
- EU Tyre industry is 100% import dependent;
- 76% of natural rubber is mostly grown in South-East Asia;
- 85% is produced by smallholders;
- It is listed by the EU/European Commission as a Critical Raw Material since 2017;
- Natural rubber has a low substitutability.

Issues connected with Natural Rubber as a raw material:

- High level of supplier country concentration (91% from only 5 countries on two continents);
- Weak supply and demand equilibrium, which results in a risk of temporary and long-term supply deficit. This relates to the inability to react quickly to unexpected demand increases and decreases due to the seven year gestation period before trees can be tapped for material. Moreover, the fact that 85% of natural rubber is supplied by smallholders means that unexpected significant drops in demand (an example is the Covid19 crisis) would propel farmers to leave the market for other means of income;
- Long supply chain with many interlocutors;

- Very limited traceability in the natural rubber supply chains due to structural reasons. Natural rubber's processor supply base zones are extensive. 80% of the raw material comes from a radius of 150-200 km of the processor location, 15% comes from 200-500 km, and 5% comes from >500 km. For comparison: pulp and wood is no more than 100 km, and palm oil is no more than 50/75 km as fruits need to be processed within 24 hours of harvesting;
- Natural Rubber is a non-perishable good, it can be stored for long time, resulting in partial and temporary stocks created at any aggregation point along the supply chain and "first-in first-out" principle is not the norm. This also explains why natural rubber can travel long distances.
- Supply is heavily volatile due to natural disaster (like floods or drought) disease and trade disruptions;
- Growing demand, bringing sustainability issues to address: Environmental, Social, Economic;
- Yield in certain areas is much lower than in others. This can be improved through better education and practices. (Yield in Indonesia →700kg/ha/year; yield in Cote d'Ivoire →1700kg/ha/year)

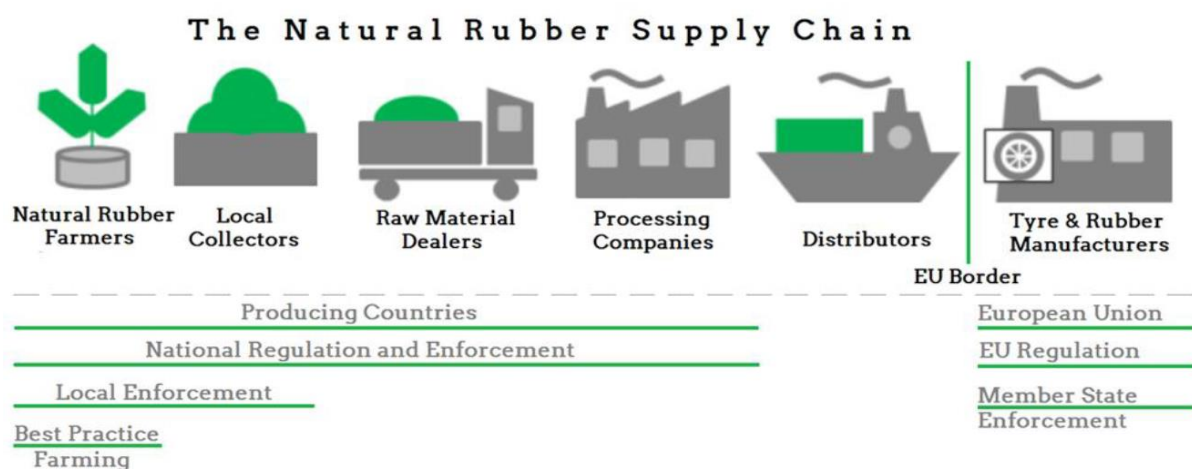
Diving deeper in some of the specific characteristics listed above:

1. **Complete reliance of the industry on imports from a few countries:** today, Indonesia, Thailand, Vietnam and Malaysia produce the vast majority of the world's natural rubber, but plantations in Africa and China start to pick up some of the increased world demand. Imports into the European Union primarily originate in Indonesia, Thailand, Côte d'Ivoire and Malaysia, representing some 85% of the total EU imports.

→The import options for the tyre and rubber industry are limited and the global demand for natural rubber is growing, particularly from the very countries that produce Natural Rubber.

2. **Natural rubber a critical raw material for the EU:** Natural rubber is the only forest-based raw material considered as critical by the EU. It is therefore key that distortions on the natural rubber value chain should be avoided, particularly given the growing competition for the purchase of such commodity.
3. **Many layers between the farmers and the product manufacturers:** natural rubber is a vital agricultural product or commodity playing a major role in the socio-economic fabric of many developing and newly industrialised countries. Up to 20 million families are fully or partially dependent on rubber cultivation for their basic source of livelihood often dominated by small-hold and micro farming.

After collecting the latex sap, the raw natural rubber is refined to convert it into a refined raw natural rubber product. This is done by a high number of producers and local, regional, national and international processors and traders before arriving at the final industrial user making the rubber products.



4. **Growing demand, bringing sustainability issues:** ETRMA and several of its members are participating stakeholders in The Global Platform for Sustainable Natural Rubber (GPSNR) (<https://www.gpsnr.org/>).

Initiated by CEOs of the World Business Council for Sustainable Development's (WBCSD) Tire Industry Project (TIP) in 2018 and driven by a Working Group of TIP member companies.

Now...

It is a **multi-stakeholder initiative** with members from the natural rubber value chain: Producers, Processors, and Traders; Tire Makers and Other Natural Rubber Makers/ Buyers; Car Makers, Other Downstream Users, and Financial Institutions; Civil Society, and – since late September 2020 – also the category of Smallholders is part of the GPSNR.

GPSNR will work with its stakeholders to **define and implement guidelines for companies to achieve a sustainable natural rubber supply chain**. To achieve that, the GPSNR will work to harmonize standards to improve respect for human rights, prevent land-grabbing and deforestation, protect biodiversity and water resources, improve yields, and increase supply chain transparency and traceability.

## Recommendations of the Tyre and Rubber industry

According to the proponent Institution, in the EU and the UK, several options are proposed as a way to reduce the impact of products with regards to deforestation and forest degradation, e.g. voluntary or mandatory policy instruments, due diligence, labelling, certification, etc.

### General considerations

#### a. State of play, and principles of Better Regulation

When taking regulatory action on supply chains, this should take into account their specificities and ensure that these obligations have a step-by-step approach, so that all actors in the value chain can adapt. Despite the industry's work at international level through the GPSNR, it is important to understand that, because of its very structure and differently from other commodities, the work on traceability in the natural rubber industry is still at its early stages. This limited experience translates in a still limited impact on local business practices and habits. This is particularly true in the case of smallholders, who are key actors in the natural rubber value chain. These make up approximately 85% of the natural rubber supply and are estimated to be more than 6 million farmers with an average of 1.5 hectares each and provide the raw material to ca. 500 rubber processing factories globally.

As a result, to guarantee the sustainable impact on the entire value chain of any new measure, the starting level of each sector should be taken into account.

→ Before choosing a regulatory instrument, the very feasibility of any option should be thoroughly investigated. In this context, the overall recommendation is that **a proper impact assessment is carried out for the supply chain of each of the identified forest risk commodities** before any regulatory initiative is taken and that the **principles of better regulation are applied**. This is particularly relevant with regards to the **need to ensure coherence with other EU policies and avoid any distortion on fragile and critical supply chains**.

→ Furthermore, the timeline for implementation of the chosen policy instrument should take into account the specificities of the industry, striking a difficult balance between what is needed and what is possible for each value chain.

#### b. Impact on the level playing field

It is also of great importance that any legislative initiative will not put business on the UK/EU markets at a disadvantage compared to international competitors. This is particularly important with respect to enforcement.

Natural rubber is a global commodity. For instance, China represents 40% of the world's rubber consumption. Changes, restrictions, or requirements not broadly implemented or not supported globally may create a non-competitive situation for consumers and industries on a market with unprecedented and strict regulations.

→ The objective of establishing an international level playing field should be pursued through any regulatory initiative – including due diligence.

→ The initiative should stipulate upfront how compliance and market surveillance will be ensured.

This cannot be left to secondary legislation as the very feasibility of any due diligence regulation will depend on its architecture, implementation and enforcement.

→ Deforestation should be approached not only with intra-EU legislation, but also through EU's trade agreements and other appropriate treaties and commitments with non-EU countries.

#### c. Precision of the scope and obligations

It is key that **any legislative initiative should be as precise as possible, particularly concerning definitions and procedures**. This is to avoid all possible grey zones with regard to implementation and enforcement.

#### d. Diversity of stakeholders in the value chain

The diversity of size and characteristics of EU industry should also be taken into account as well as its ability to reach supply chain players beyond EU jurisdiction. This is particularly relevant for SMEs, which constitute the backbone of the European Rubber Goods Industry as well as for smallholders, whose possibility to implement complex schemes is limited. Yet, the inclusion also of smallholders is critical because prevention of deforestation and improvement of social and economic situations largely falls within their actions and interests. Measures should be designed proportionately and effectively.

→ Modulate the scope of any new regulatory instrument to take into account the characteristics of various industry sectors. All players should be included, but in a proportional way.

→ Measures should be tailored to the role, power, and resources of players in the value chain.

#### *Due diligence in the supply chain*

The option that seems to attract most attention is that of establishing a system of due diligence in the supply chain.

According to the [OECD Due Diligence Guidance for Responsible Business Conduct](#), supply chain due diligence is an ongoing, proactive and reactive process through which companies monitor and administer their purchases and sales with a view to ensuring that they do not contribute to conflict or related adverse impacts. According to a more comprehensive view, this also includes impacts on environment and climate, human rights (including labour rights) and health risks.

Therefore, given this vast description, the European tyre and rubber industry has first of all the need to understand the regulatory instruments, scope, objectives and implementation – whether due diligence might be applied generally or only with regards to deforestation and forest degradation.

#### Specific considerations on due-diligence obligations

##### a. The scope of the value chain concerned:

Obligations on companies should focus as a first step on their tier one suppliers. Indeed, as indicated above, some value chains are highly fragmented, and ensuring the vision of the whole supply chain is difficult. Attention should be made on the risk-based approach (see point c. below).

##### b. The need to focus on genuine impact on the ground:

To achieve the objectives of due diligence in terms of environmental and human rights impacts, it is necessary to give priority to products and aspects of the supply chain that are at risk in terms of environmental and human right impacts.

Available data suggest there is a strong correlation of the “supply and demand” market situation with the most salient sustainability risks in the natural rubber supply chain. In periods of strong natural rubber demand (e.g. 2009 – 2013) the deforestation of rain forests to expand production areas have set environmental risks into focus. In the current period of strong supply and comparably low demand, the deforestation risk has strongly decreased and social risks predominantly of smallholders come into focus. Any regulation for risk-based due diligence must account for risk prioritization changes based on the global supply and demand situation. Most positive impact can be achieved by building capacity (incl. but not limited to Good Agricultural Practices, productivity increases, strengthening local communities, ...) at the smallholder level in order to create a resilient natural rubber value chain. This can only be achieved if all relevant players of the value chain incl. governments cooperate.

Thus, any due diligence obligation should focus on the genuine positive impact on the ground rather than on reporting.

That is why any due diligence legislative proposal should ensure:

- That it is risk-based: what matters is to base any assessment on risk rather than on exhaustively;
- That it focuses on continuous improvement through mitigation measures which are what is really needed in order to ensure a positive evolution within the value chain.

#### c. The involvement of the EU towards third countries:

It is very challenging to implement and enforce any regulation regarding activities in third countries without the involvement and commitment from these countries: industry has limited enforcement instruments, particularly given the many layers between the producers and the manufacturers and the limited choices for imports of this critical raw material.

→ There is the need to ensure that **manufacturers are not given responsibilities beyond their reach**: local governments are key actors in ensuring that due-diligence is applied and industry cannot take their place in doing so. The processes and resources implemented in a due diligence activity should be proportionate, effective and define the liability of EU based enterprises;

→ It should be **the role of the EU to ensure a dialogue with producing third countries on best practices and implementation on international human rights and environmental engagements**. All levers of the European Union in terms of cooperation and trade with third countries should contribute to this evolution.

Furthermore,

→ **The consequences on small farmers should be considered when building a mandatory due-diligence system**. It will be impossible for them to show compliance through a mandatory due-diligence system. As a consequence, if due-diligence obligations were to be applied only to product manufacturers, there would be a risk of distortions in the natural rubber value chain as purchasing natural rubber only from big estates would not be sufficient to meet the needs of the tyre and rubber sector. This may have ultimately an adverse effect on the ground, by limiting the access of small farmers to some suppliers, and us bringing more economic pressure on them.

→ Attention should be given to the involvement of stakeholders on risk assessment and mitigation measures.

## *Other possible options*

### **a. Labelling (whether voluntary or compulsory)**

The European tyre industry has a vast experience when it comes to labelling. Tyres are labelled for rolling resistance, wet grip and rolling noise in the EU since 2012. Precisely due to this experience, and given our learnings from the market over the last decade, our sector discourages the option to label “deforestation-free products”.

→As stated in the general considerations, traceability in the rubber industry is still in its early development, needs time to mature and to be assessed, and at this stage it would be impossible to apply effectively any sort of a deforestation-related label. Moreover, a premature imposition of such a label, or an attempt to combine the fight against deforestation with the existing EU tyre label, might have adverse consequences on the industry, not gain consumers’ understanding, and ultimately not meet the regulatory objectives.

→ Adding a further option to the existing tyre label regarding deforestation and/or forest degradation would increase the complexity of the label and would decrease its readability and clarity – discouraging its use by consumers. [A study carried out for the European Commission](#) on the effectiveness of the label on consumers choices showed that only about half of the consumers were able to understand the label and that price still played a major role in tyre choice, despite the labelling information.

→A separate label would also be detrimental and of difficult use both for tyres – as this would create confusion between the different labels – as for other rubber products, these are often small and parts of other value chains – and therefore difficult to label.

### **b. Third-party certification**

Whilst third party certifications can be a useful instrument and of support for certain actors, any legislation should be clear, transparent and enforceable even without the support of such certifying bodies.

By the same token, whilst existing certifications should continue existing, ETRMA warns against the creation of new mandatory certification systems, for the same structural reasons explained above, and for likely higher costs and complexity disproportionate to potential benefits.

As a result, ETRMA recommends the following:

→Any legislative initiative should be easily implementable and enforceable. The use of certification tools to help achieve objectives should not be mandatory and other assurance models could be considered as well.

→To ensure ease of implementation and enforcement, legal questions regarding liability and responsibility should be clarified.

## **THE EUROPEAN TYRE & RUBBER MANUFACTURERS ASSOCIATION**

The European Tyre & Rubber Manufacturers Association (ETRMA) and its members count around 4.400 companies in the EU employing directly about 370.000 people. ETRMA tyre corporate companies represent globally 73% of world sales and 7 out of 10 world leaders are our Members. We have strong presence in the EU and candidate countries with 93 tyre-producing plants and 16 R&D centres.