

China's opportunity to build a sustainable soy trade and reverse global deforestation

A briefing for policymakers



Executive summary

China is the world's largest consumer and importer of soy. To meet market demand, China is currently importing large amounts of soy and other commodities whose production can drive deforestation in South America.

China is taking a strong stance on climate change and putting ambitious domestic policies in place. Emissions created as a result of imports are not currently addressed in national climate policy either in China or in other countries. However there are international precedents for addressing the deforestation impacts of timber imports, this type of measure is currently being considered in China for timber and could be applied to soy.

The current situation with soy imports creates market risk for Chinese companies. At the same time, there is also a market opportunity for China to lead the global trade in sustainable soy. Leading companies are already taking action. Increasing the availability of sustainable soy for import to China may require co-operation between China and other governments.

Based on experience of working with private sector and institutional actors in China and around the world, our recommendations for potential policy measures include:

- ▼ Providing guidance for Chinese companies on sustainable soy standards;
- ▼ Establishing a traceability and legality mechanism for soy imports;
- ▼ Providing incentives for companies to buy sustainable soy;
- ▼ Revising Green Credit Guidelines for Chinese banks to include deforestation risk;
- ▼ Requiring Chinese companies to disclose information about deforestation risk;
- ▼ Working with governments in South America to support their efforts to prevent deforestation and ensure a sufficient supply of sustainable soy to China.



What is the link between global greenhouse gas emissions and China's soy imports?

Globally China has become the largest importer and consumer of soy and in 2015 Chinese soy imports represented about 65% of the global soy trade, with imports supplying 85% of soy consumption in China¹.

Chinese imports have been growing steadily year on year².

As a result, China is currently importing large amounts of commodities whose production can drive deforestation, including soy, from Brazil and Latin America. The trade relationship with Brazil is particularly striking; almost 50% of soy imported to China is sourced from Brazil³, and trade with China accounted in 2015 for 42.5% of Brazilian exports of soy⁴.

The major soy trade flows between China and Brazil have an impact on global greenhouse gas emissions. In Brazil, large areas of forest land have been deforested for agricultural use including soy. China buys around the half of the soy exported by the ten Brazilian municipalities which have the most soy-related deforestation, and has commercial links with municipalities that deforested 1.98 million ha in 2015⁵.

China is taking a strong stance on regulating domestic greenhouse gas emissions, as demonstrated by the goals in its Nationally Determined Commitment⁶ under the Paris Agreement. China's 'Ecological Civilization' approach includes the establishment of a national carbon emissions trading market alongside numerous other environmental policies. China, the world's largest producer of goods, causes international concern because of the high emissions embodied in its exports.

Non-domestic greenhouse gas emissions associated with Chinese imports are not addressed in China's international climate commitments. It is not common practice for national climate policies in any country to address emissions in third countries and there has been a general lack of progress on this issue within the international community. The issue of indirect emissions is a sensitive one in China because numerous Chinese high-emitting industrial operations are producing goods for export which will be consumed in other countries. China, the world largest producer, causes international concern because of the high emissions embodied in its exports.

However, there is international precedent for addressing the issue of deforestation caused by imports. This has been studied in detail by the European Commission⁷ and the European Union has put in place some relevant policies. The Chinese government departments responsible for timber and wood products have analyzed the European Union Timber Regulations (EUTR)⁸ and considered the potential to introduce similar regulations in China. This research on timber could be used as the basis for analysis of the potential for Chinese import requirements around soy.

1. Economic Daily, published on October 18th, 2016. http://paper.ce.cn/jrb/html/2016-10/18/content_314770.htm

2. China Industry Information Net, <http://www.chyxx.com/data/jinchukou/201706/527883.html>
<https://resourcetrade.earth/data?year=2015&exporter=76&importer=156&category=87&units=value>

3. TRASE – Version 2.2 of Brazilian Soy, October 2017 release, <https://trase.earth/>

4. Ibid

5. [http://www4.unfccc.int/ndcregistry/PublishedDocuments/China First/China's First NDC Submission.pdf](http://www4.unfccc.int/ndcregistry/PublishedDocuments/China%20First/China's%20First%20NDC%20Submission.pdf)

6. Source: European Commission. (2013). The impact of EU consumption on deforestation: Comprehensive analysis of the impact of EU consumption on deforestation. Brussels: European Commission.
http://ec.europa.eu/environment/forests/impact_deforestation.htm

7. http://ec.europa.eu/environment/forests/timber_regulation.htm

How does the soy trade expose Chinese companies to business risk?

Companies which buy commodities produced in Brazil and Latin America are exposed to a number of business risks. These can include physical impacts such as supply uncertainty, reputational risk and access to finance for unsustainable practices.

Chinese companies are potentially exposed to business risk by importing soy from Brazil and Latin America, and are in a weaker position compared to international competitors due to their lack of risk awareness and risk management.

Of the 55 international companies which disclosed risk information about soy to their shareholders via CDP in 2017:

- ▼ 58% reported physical risks to their business;
- ▼ 38% reported regulatory risk;
- ▼ 67% reported reputational risk;
- ▼ Only 16% of companies involved in the soy trade were considering the business risks from deforestation on a time horizon longer than six years;
- ▼ No Chinese companies disclosed to CDP on soy risk.

28 international companies which operate in China disclosed information to their customers via CDP about business risk related to deforestation. Of these companies:

- ▼ 23 (82%) have risk assessment procedures in their direct operations;
- ▼ 16 (57%) have systems in place to trace, monitor or track the origin of raw materials;
- ▼ 3 (11%) have corporate targets to avoid deforestation impacts of their supply chains. This is the number of companies that disclosed having individual policies to address specific high-risk commodities such as soy.

At present Chinese companies do not have access to comprehensive guidance on sustainable soy at national level. The transparency of the China-Brazil soy trade is low and even though some Chinese companies prefer 'zero deforestation' soy it can be difficult for Chinese buyers to know whether the soybeans that they are purchasing have had negative impacts on forests.

Establishing green procurement standards and rules with Chinese characteristics at domestic level in order to halt deforestation in other countries would reinforce China's global leadership in fighting climate change and increase China's international prestige, as well as alleviating overseas greenhouse gas emissions caused by deforestation.

What are the market opportunities for China from sustainable soy?

China's soy exports are on the risk with 1.88 million tonnes of soy meal exported in 2016, a 10.63% rise from 2015⁹. Global demand for sustainable soy is growing due to increased awareness from end consumers.

For example, 54 major international companies have committed to remove deforestation from their supply chains by 2020¹⁰. It is likely that key markets for China such as the European Union will set sustainability requirements for imported soy in the near future, building on sustainability requirements that already exist for the timber trade.

Chinese companies and consumers are increasingly aware, through exposure to global markets and trade practices, of various international voluntary mechanisms and platforms to promote the production and purchase of sustainable agricultural commodities. These mechanisms and platforms

include the Round Table for Sustainable Palm Oil (RSPO), the Round Table for Responsible Soy (RTRS), the Sustainable Soy Trade Platform (SSTP), and the Soybean Sustainability Assurance Platform (SSAP). Pilot projects to promote responsible soy production using the RTRS platform has been implemented in the northeast of China¹¹.

Some Chinese companies are now taking action. For example, China National Cereals, Oils and Foodstuffs Corporation (COFCO) has said that it will make great efforts to remove deforestation risks from overseas procurement. Please see overleaf for more details.

COFCO's Commitment to Removing Deforestation from its Supply Chain¹²

In January 2017, at the World Economic Forum in Davos, Yu Xubo, COFCO's President described COFCO's commitment to eliminate deforestation from its supply chains. COFCO identified a business opportunity to make the company more competitive by attaching importance to sustainable development. Mr Yu said that Chinese customers have become more concerned about the carbon footprint of companies and that they are looking to buy products from responsible companies. Complying with the principles of sustainable development has become a competitive advantage for Chinese companies.

Mr Yu called on the private sector to take responsibility to drive the low-carbon transition. COFCO has already taken actions to utilize its global supply chain to promote climate change mitigation. It recognizes the great challenge for the food industry to produce more while reducing greenhouse gas emissions. He also observed that it is of great importance to address the problem of greenhouse gas emissions from land use change and deforestation caused by the expansion of agricultural production.

COFCO has calculated its carbon footprint and had this calculation externally verified. The company uses satellite imagery to ensure that its Brazilian bioethanol production does not cause deforestation, and has been working with international business partners to discuss the establishment of green supply chains.

9. <http://www.chyxx.com/industry/201708/551000.html>

10. <https://www.wemeanbusinesscoalition.org/commitment/remove-commodity-driven-deforestation-from-all-supply-chains-by-2020/>

11. <http://www.allaboutfeed.net/Feed-Additives/Articles/2012/8/Responsible-soy-enters-China-1057644W>

12. <http://paulsoninstitute.0507.net/index.php/paulson-blog/2017/03/07/the-power-of-cofcos-greening-supply-chain/>

Despite increasing awareness and leadership by Chinese companies, South American countries are not yet ready to produce sufficient sustainable soy to meet China's needs. At present, international companies which seek to avoid deforestation and are disclosing to CDP identify the uncertain supply of sustainable soy as a business risk and this situation would be exacerbated if substantial additional demand from China was to suddenly enter the market.

China's own soy production does not have the same deforestation risk as soy grown in Latin America. Chinese soy production of around 13 million tonnes/year¹³ is grown on existing farmland, and China has policies in place to convert degraded farmland

to forest¹⁴. However, China's domestic production currently makes up only a small percentage of total Chinese demand, putting the majority of China's soy consumption at risk of driving deforestation in other countries.

If China were to send a strong market signal that it will prefer to import sustainable soy in the near future, this would have a positive impact on production practices and supply in South America. This change will need to be accomplished over several years and will be implemented most effectively if China can work in partnership with the governments of the exporting countries in order to ensure a smooth transition to greatly increased sustainable soy production and exports from South America.



13. China Economy Net operated by China Economy Daily Press, http://www.ce.cn/cysc/sp/info/201702/09/t20170209_20066622.shtml

14. Regulations on Restoring Farmland to Forest issued by State Council in 2002 and revised in 2016, and The 13th Five Year Plan for Forestry Development

Opportunities to address issues and move towards 100% sustainable soy in China

Based on experience of working with private sector and institutional actors in China and around the world, our recommendations for potential policy measures include:

Providing guidance for Chinese companies on sustainable soy standards

- International voluntary schemes for companies that want to trade in sustainable soy are not consistent with one another, and this systemic complexity can create confusion among Chinese importers and processors. The government could benefit companies by publishing official guidance on these systems, and recommending which types of certification are most closely aligned with China's climate change commitments.

Establishing a traceability and legality mechanism for soy imports

- We recommend that the government consider drafting regulations to collect data on, monitor and encourage zero deforestation and sustainable soy imports. The creation of effective source identification and traceability mechanisms could involve both conventional certification systems and hi-tech spatial analysis through satellite imagery cooperation.

Creating favourable financing conditions for companies purchasing sustainable soy

- At present there is little incentive or reward for Chinese companies who import sustainable soy. The Ministry of Finance has a role to play in motivating importers to purchase a deforestation free soy product by creating favourable financing conditions. For example, there may be options to grant favourable financing conditions, such as lower loan interest, to companies which import sustainable soy.

Revising Green Credit Guidelines for Chinese banks to include deforestation risk

- China's Green Credit Guidelines require the Chinese banks and financial institutions to consider any environmental risks of projects before approval or investment. We recommend that the guidelines are updated to require a more detailed analysis on specific commodities, such as soy, in order to reduce the possibility of investors being exposed to deforestation-related risks.

Requiring companies to disclose information about deforestation risk

- In Aug 2017, the Ministry of Environment Protection released the draft Measures for the Enterprise or Institution to Disclose Environmental Information for public review and comment. The Ministry of Environmental Protection will also collaborate with Securities and Futures Commission to improve the depth of information disclosed by listed companies, so that investors and the public can accurately identify any exposure to environmental risks. We recommend that China extends its domestic environmental disclosure requirements to include climate change and deforestation risks, including those in supply chains.

Working with governments in South America to support their efforts to prevent deforestation and ensure a sufficient supply of sustainable soy to China

- China could work with governments to help them ensure that they are able to export a sufficient amount of sustainable soy imports to meet China's needs. This may include support for the efforts of those governments to sustainably manage their forests and agricultural land, for example through the internationally agreed REDD+ mechanism.

For more information please contact:

CDP Forests

Morgan Gillespy

Head of Forests, CDP
morgan.gillespy@cdp.net

Sareh Forouzesh

Project Manager, CDP
sareh.forouzesh@cdp.net

CDP China

Sabrina Zhang

Director, CDP China
sabrina.zhang@cdp.net

Li Fei

Senior Project Officer, CDP China
li.fe@cdp.net

CDP Policy and Public Affairs Team

Kate Levick

Director of Policy and Regulation, CDP
kate.levick@cdp.net

Luciano Santos

Forests Policy Project Officer, CDP
luciano.santos@cdp.net

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CDP Worldwide

Level 3
71 Queen Victoria Street
London EC4V 4AY
United Kingdom

Tel: +44 (0) 20 3818 3900
www.cdp.net
info@cdp.net

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