

RESEARCHERS AT SINGAPORE'S *INSTITUTE OF SOUTHEAST ASIAN STUDIES* SHARE THEIR UNDERSTANDING OF CURRENT EVENTS

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Struggle for sustainability in palm oil industry shows results

By Khor Yu Leng

SUMMARY

Palm oil has become the key supplier to the global edible oils market. Continued oil palm development should be a good thing as it is the most effective supplier in terms of low land usage, and it brings much needed development to poor tropical developing regions. However, it is a monoculture tree crop that has been severely criticized in recent years for supplanting forest and peat lands in areas with unmatched biodiversity and which are inhabited by poor indigenous tribes. Oil palm's extensive expansion in Indonesia and Malaysia has been cost-efficient and much higher yielding than major competitor oils such as soy and rapeseed. One group of transnational NGOs, led by the WWF, has pressured large Southeast Asia-based corporate growers as well as multi-national consumer brands to accept Europe-centric voluntary certification standards. Simultaneously, escalating NGO campaigns, including boycotts, have been led by another set of NGOs including Greenpeace and Friends of the Earth. Thus, since about 2003, the net impact of various NGO pressures has helped to rein in the speed and prospects for oil palm expansion in Indonesia and Malaysia by large corporate growers. The authorities in Indonesia and Malaysia have reacted by creating their own certification schemes in the hope of using the WTO framework and government-to-government negotiations to ensure market access and acceptance for one of their key export sectors.

INTRODUCTION

Palm oil is the key supplier to the global oils and fats market. Since 2003, palm and palm kernel oils have been the top produced and traded oils in the world. In 2011¹, they had a combined global output of 55.8 million metric tonnes (MT), compared to soybean oil's volume, which was 41.8 million MT and rapeseed oil, at 23.5 million MT. Respectively, their share of global oils and fats production were 31, 23 and 13 %. About 85 % of the world's palm oil are produced (and exported) by just two countries: Indonesia and Malaysia.

Oil palm development should be a good thing as it is the most effective supplier in terms of low land area usage, and it brings much needed development to poor tropical developing regions. For both Indonesia and Malaysia, the palm oil industry is a key sector, accounting for over 5% of GDP each. While large corporate growers are the dominant players and several are vertically integrated, smallholders supply up to as much as 40% of the market. An estimated 4.5 million people earn their living from it in developing countries, and many more benefit indirectly.

Unlike competing plantation crops, oil palm offers a tree cover. The total area used for agro-industrial palm oil production globally has grown to over 14 million hectares (ha). In 2011, soybeans (crushed for its meal in animal feed and for its oil) were grown on just over 30 million ha² and produced 41.8 million MT of oil to palm and palm kernel oils of 55.8 million MT.

However, the oil palm is a monoculture tree crop that has been severely criticized in recent years for supplanting forest and peat lands in areas with unmatched biodiversity and which are inhabited by poor indigenous tribes. Transnational non-governmental organizations (NGOs) have pressured all parts of the palm oil supply chain and even its bankers over its negative environmental and social impacts i.e. its non-sustainable approach. Escalating NGO campaigns, particularly from Europe, since 2003 have seriously reined in the speed and prospects for oil palm expansion by big corporate farmers.

NGOs COMBAT OIL PALM EXTENSIFICATION

“Large corporate growers have acceded to NGO pressures, as these have resulted in high-key boycotts by the likes of Unilever and Nestle. Many large companies have signed on as members of the Roundtable on Sustainable Palm Oil (RSPO) initiated by the World Wildlife Fund for Nature. Multi-national consumer brands are being persuaded to change their buying policies, with potential global implications.”³ The RSPO was established and registered in Switzerland in 2004. Key RSPO launch efforts in 2003 coincided with the

¹ Oils and fats industry statistics in this section are from “Malaysian Oil Palm Statistics 2011” from the Malaysia Palm Oil Board.

² American Soybean Association data at <http://www.soystats.com>.

³ Khor, Yu-Leng. “The oil palm industry bows to NGO campaigns,” *Lipid Technology*, Vol. 23 No. 5. May 2011.

time when palm and palm kernel oils achieved top ranking in the world oils and fats industry by volume.

Earlier, in the late 1990s, the emergence of the Southeast Asian haze problem had raised awareness of open burning in Sumatra, especially problematic when peat lands were involved. This transnational pollution engulfs large parts of Sumatra, Peninsular Malaysia, Singapore and beyond, in a seasonal haze each year. The national media in Malaysia downplayed the role of its corporate plantations in Indonesia, and instead, the media placed much of the blame on uneducated Indonesian small farmers and other local sources of pollution⁴. However, in the late 2000s, satellite imagery studies came increasingly into vogue, with some key academic studies being done including those by Miettinen⁵ and Koh⁶. Several studies by NGOs superimpose haze emitting hotspots (and other alleged infractions) on plantation concession maps. "Too Green to be True. IOI Corporation in Ketapang District, West Kalimantan," by Milieudefensie and Friends of the Earth Europe, March 2010, is one such report. These studies are uncomfortably revealing and they suggest that several large companies, including Wilmar, Golden Agri and Indofood Agri have also been associated with open burning at some point⁷. IOI Corporation (and others) point out that open burning is done by third parties in their concession areas. Varkkey argues that regionalized plantation companies may have gotten off lightly for several years, as many had the protection of political patrons⁸. With the smart use of satellite imagery by NGOs, many plantations reiterated their commitment to zero-burn policies. IOI Corporation⁹ said that it "is monitoring and preventing third-party burning activities" and it hoped that "those who wish to express serious allegations against us will only do so after conducting more careful research."

Peat lands are one of the hottest environmental issues in the palm oil industry, due to serious greenhouse gas (GHG) emissions when they are developed or cleared. Indonesia has been the key focus of concerns since recent acreage growth has been in Sumatra and Kalimantan, where there are substantial peat lands as well as high density forest and biodiversity. Indonesia is the biggest producer of palm oil, with about 22.3 million tonnes or 48% of world output in 2010. It has overtaken Malaysia, where new concessions are scarcer due to earlier rapid expansion of oil palm. For Malaysia, Sarawak remains a risky frontier growth area due to large peat lands and its native customary right areas.

Indonesia is frequently reported to be deforesting at the rate of about one (1) million ha per year. Half could be due to oil palm new plantings, and the rest to logging, mining and

4 Varkkey, Helena, "Malaysian investors in the Indonesian oil palm plantation sector: home state facilitation and transboundary haze," *Asia Pacific Business Review*, Dec 2012.

5 Several reports, including Miettinen and Liew, "Degradation and Development of Peatlands in Peninsular Malaysia and the Islands of Sumatra and Borneo since 1990," *Land Degradation and Development*, 2010.

6 Koh, Lian-Pin et al., "Remotely sensed evidence of tropical peatland conversion to oil palm," *Proceedings of the National Academy of Sciences of the United States of America*, 7 March 2011.

7 Varkkey, Helena, "Malaysian investors in the Indonesian oil palm plantation sector: home state facilitation and transboundary haze," *Asia Pacific Business Review*, Dec 2012.

8 Varkkey, Helena, "Malaysian investors in the Indonesian oil palm plantation sector: home state facilitation and transboundary haze," *Asia Pacific Business Review*, Dec 2012.

9 IOI corporation, "IOI Corporation's Response to Recent Publication by Milieudefensie," 26 March 2010.

urban creep. However, Indonesian authorities routinely point out that the larger cause of deforestation is population growth and urban creep. The impact of deforestation and peat land development has made Indonesia the world's third worst carbon emitter, after the USA and China.¹⁰

The oil palm industry in Indonesia and Malaysia continues to be affected by European NGO campaigning. While growers have ramped up the production of Certified Sustainable Palm Oil (CSPO) under the RSPO, some NGOs have campaigned even harder against the largest growers and buyers. Greenpeace vs. Sinar Mas (a unit of Golden Agri-Resources) started in 2008 and resulted in the Sinar Mas-The Forest Trust-Nestle deal, where the grower promised a stop to deforestation and peat land development, apparently accepting a 35 tonnes of carbon per ha (tC/ha) ceiling for land development. With the RSPO scheme and the Sinar Mas deal, there has been a shift to a slower growth trajectory as new plantings take up to a year to effectuate and portions of current land banks may be out-of-bounds.

SUSTAINABILITY, THE RSPO AND GOVERNMENT REACTIONS

Many large companies have signed on as members of the Unilever-supported RSPO. This is a multi-stakeholder voluntary certification scheme that wants to bring together the palm oil value chain with NGOs and financiers. Its strategies explicitly exclude producer country governments, which are viewed as stumbling blocks. However, they embrace governments in consumer countries, to create more pressure on producers to comply with its scheme. Via a two-prong "shun it, tax it" strategy, the RSPO wants government procurement to shun non-certified palm oil (to trigger other buyers to do likewise) and it also asks for a higher differential tariff against the same. RSPO has been the monopolistic certification standard for traditional palm oil uses¹¹. Thus, the "shun it, tax it" approach is de facto regressive; since RSPO is dominated by the largest corporate growers, and it has very low participation from small estates and small farmers.

RSPO standards go beyond national rules and regulations, to incorporate best agricultural practices, rigorous environmental and social standards with annual audits. RSPO standards forbid clearing primary forest and areas with high conservation values and discourage extensive peat land development. Growers are also supposed to obtain 'free prior and informed consent' from local people before opening new plantations. It requires all the estate areas of its grower members to be certified on a challenging time frame. This "clause 4.2.4" means that the RSPO differs markedly from its "cousin" organization for soy certification where the area for certification is up to the soy grower's market decision. The so-called uneven playing field vis-à-vis their soybean oil competitors chafes at palm oil producers.

¹⁰ Jakarta Post. Various news articles. 2010 and 2011.

¹¹ In the EU bio-diesel sector, ISCC certification has the monopolistic position. Only recently, the RSPO added bio-diesel certification, to compete with it.

The RSPO has been a resounding success. In about 8 years, it has achieved a 14% market share in terms of commodity production¹². By comparison, the WWF's first commodity roundtable, the Forest Stewardship Council or FSC, which has been in existence 18 years, only has a market share of about 5% in 2011. Thus, FSC only achieved about one-third of RSPO's impact in more than double the time. In 2012, the RSPO started to undergo its first review to expand and strengthen its principles and criteria. The 18-year old FSC had only held one review so far. Oil palm growers frequently say that they think the RSPO the most stringent agri-certification program. The serious disappointment has been that the take-up of sustainability certificates by buyers—presently only at 50%—has lagged seriously.

Growers had hoped that the premium for CSPO would cover their cost of certification and more. In the face of the glut of RSPO certificates, the price for GreenPalm certificates (the premium via the book and claim supply chain's online trading system) fell from USD40 per MT to USD2.25 per MT on 17 March 2013. At one point, it even dived to 30 US cents¹³ prior to a major boom in membership of consumer goods manufacturers in the RSPO that is related to the WWF's efforts to name and shame those with no or low commitment to buying sustainable palm oil.

"Palm oil sustainability experts often estimate the direct and immediate indirect cost of RSPO certification at USD 6-12 per MT for corporate growers. Smallholders have been slower to get onto the programme; growers often say that a fair premium is needed to help this group". The immediate costs of certification are not a real concern for the largest growers. At the Asia Oils & Fats International Conference held in Kuala Lumpur in October 2010, crude palm oil production cost was estimated at RM1,300 or USD433 per MT. At the time, prices were heading toward RM3,000 or USD1,000 per MT and now they hover around RM2,500 or USD833. Thus, complaints of poor cost recovery attract little sympathy outside the plantation industry. However, the costs and opportunity cost of certification, and uncertainty are expected to increase over time as the RSPO's requirements expand and its standards become more stringent.

The keenest RSPO participants are public-listed plantation companies. For lack of alternatives (until this year), the RSPO has become a requirement for selling palm oil products to the global brand names. The large plantations already have the best practices and as such can afford to keep to RSPO standards. In particular, those with trade interests in Europe have been setting up traceable segregated supply chains. In the meantime, others are being left behind. Moreover, it is feared that errant growers have accelerated land clearance. Curbs on expansion by large corporate growers may also benefit smaller growers and farmers, with limited net impact on overall expansion. If so, the RSPO may have generated some unintended damage while giving a 'pat on the back' to the big boys. Indeed, official data for 2000-2010¹⁴ report that area growth was 10.2% each year for

¹² RSPO, market information on its website, 2012.

¹³ Khor, Yu-Leng, "Greenpalm CSPO premium dives to 30 cents," *Khor Reports Palm Oil blog*, 6 September 2011.

¹⁴ Indonesia Directorate General of Estates.

Indonesian smallholders, faster than the 6% growth for big private enterprises. In general, growth has been slowing, but it remains robust in Indonesia, with smallholders taking the lead. The general slowing (to 7.2% per year post 2000 versus 10.6% per year over the last 44 years¹⁵) is attributed to the larger base and also to a recent shift towards a moderated pace of growth that is driven by higher costs and also sustainability issues.

Governments in developing countries have been adjusting to the need for more sustainable growth strategies. They point out that they are merely following the development path that developed countries took in yesteryear. Indonesia and Malaysia officials routinely point out that tree cover in their countries is still about 50 %, which is higher than the 25 % in many developed countries. However, they have also been making some progressive moves. Arguably, Indonesia seems more engaged with sustainability issues if one looks at the number of high-level initiatives. Malaysia has upheld its 50 percent forest cover commitment, but it has lacked other major policy shifts until this year. 2013 is expected to see the launch of two Malaysian sustainability certification efforts.

Indonesia's initiatives include:

- A 2-year moratorium on rainforest logging, and will receive up to USD1bn in aid from Norway to help preserve forests.
- A moratorium on the issuance of new licenses for development of oil palm plantations on peat lands and primary forests.
- Restorings 300,000 hectares of damaged forest per year to maintain biodiversity.
- Enforcing the law against the illegal trade of species or illicit forest conversion in protected and conservation areas.
- The introduction of a mandatory Indonesia Sustainable Palm Oil (ISPO) standards.

IMPACT ON COMPANIES

The pace and prospects for oil palm acreage growth are increasingly constrained. While macro data is hard to obtain and review, a micro analysis of plantation company reports does provide a picture of the adoption of alternative growth strategies by plantations. The case study of the slowing of new plantings or new plantation land development at Wilmar is also instructive. In recent years, the annual expansion of planted areas of the 10 largest plantations has increasingly decelerated from 33,000 ha to 11,300 ha and 9,300 ha per year.¹⁶ The fastest growth has been boosted by big mergers and acquisition. These include Wilmar's merger with PPB Oil Palms and Indofood Agri's purchase of a stake in London Sumatera, both in the financial year 2007. Since then, the large plantations have tried to

¹⁵ Indonesia Ministry of Agriculture.

¹⁶ Khor, Yu-Leng, "Trends in planted area for the Top 10", Khor Reports Palm Oil blog, July 2011.

increase land banks via far-flung geographic diversification, joint ventures, smallholder developments and crop diversification. NGO campaigning has followed them to new geographies.

Wilmar alerted investors at its briefing in August 2012 to land bank uncertainties and further slowing in new plantings. New plantings have decelerated, and tremendously so in recent years. At end 2006, Wilmar's plantation land bank had stood at over 210,000 ha, with 66,367 ha planted. That year, it planted an additional 4,931 ha. Wilmar states in its Annual Report for that year that it "set a target of 15,000 ha per annum for new plantings, which will be revised upward to 40,000 ha when the proposed merger with the Kuok Group's plantation business is completed (in 2007)"¹⁷. The company's aspirations for new plantings have not been achieved. While it had new plantings of some 34,000 ha in 2007, this slowed to 5,132 ha in 2010. The inability to ramp up expansion is likely explained by the uncertainty over a sizable chunk of its land bank. However, its implied (certain) reserves stood at some 84,000 ha in 2011 so the relatively slow new planting pace of 2,650 ha for that year is notable.

The core issues in sustainability have been shifting from the environmental to the social. An examination of the new plantings submissions by some RSPO members indicates a high level of scrutiny by NGOs over plantation development and quite a few complaints of violation of the principle of "free, prior and informed choice". Up to end August 2012, RSPO grower members made 22 submissions covering some 370,000 ha of concession area¹⁸. The equivalent of 43 % of these areas has attracted some complaint. Two were formally submitted to the RSPO (one each for Wilmar and Herakles Farms), but most others are public denunciations.

NGOs are also actively assisting discontented local peoples in disputes with plantations. In practice, it may be hard to distinguish the dispossessed from those regretting earlier acceptance of land compensation deals (when commodity prices were lower). Relatively high prices have made many acutely aware of the opportunity lost. While a multitude of factors are at play, many palm oil experts say that social issues are probably the biggest problem today¹⁹. A review of complaints against large plantations in their new plantings and regular operations confirms this. Wilmar has faced the dual problem of land bank uncertainty as well as slow new plantings. These are increasingly common problems for the large corporate growers. These indicators are key determinants of medium-term organic growth.

Latest developments point to the reemergence of fundamental environmental issues. High carbon stocks are a fundamental concern for NGOs seeking to prevent deforestation and to allow mature scrubland and degraded forest regrowth. A measurable ceiling aims to limit new development of oil palm plantations. The NGO-preferred ceiling level of 35 tC/ha is equivalent to some measures of the time averaged carbon stock in an oil palm estate over 25-30 years. This ceiling is being implemented in a pilot by Golden Agri-Resources, the second largest plantation in the world by land bank. This has the potential to seriously

¹⁷ Wilmar International Limited, Annual Report and Company Briefings, various years.

¹⁸ RSPO website, data on new planting submissions, accessed 31 August 2012.

¹⁹ Khor, Yu-Leng, Interviews with senior managers of plantations, Khor Reports, June-Aug 2012.

cut the area considered plantable in Kalimantan from a typical 60-65 % down to 45 % (excluding 20 % for smallholder schemes).

It seems that the RSPO has wrought fundamental changes with heavy material impact on the top plantations, and ushered in a new phase of slower judicious growth. Many growers once viewed certification standards as a technical, quality management or corporate social responsibility matter. Some also use it as a means of gaining competitive advantage over rivals, for better market access to the top global buyers²⁰. Now, many find that it can impact their growth trajectories.

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Khor Yu Leng is a Visiting Fellow at ISEAS. She specializes in customized industry research and strategic analysis on agribusiness in Southeast Asia and frontier markets.

20 Khor, Yu-Leng, *Interviews with senior managers of plantations, Khor Reports, June-Aug 2012.*

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Editor: Ooi Kee Beng

Institute of Southeast Asian Studies
30, Heng Mui Keng Terrace
Pasir Panjang,
Singapore 119614
Main Tel: (65) 6778 0955
Main Fax: (65) 6778 1735

Homepage: www.iseas.edu.sg