

Towards a (more) sustainable palm oil: what role for importing countries?

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The numerous environmental and social costs of palm oil have often been highlighted. Over the last decade, numerous sustainability initiatives and commitments at various scales have emerged. This has led to a particularly tangled and sensitive situation which tends to favor contrasted and equally unsustainable positions: either abandoning any claim to promote sustainable palm oil, or on the contrary banning consumption of palm oil altogether. The first option would accelerate the destruction of globally important biodiversity hotspots, the disappearance of traditional communities and the worsening of already degraded working conditions in the sector. The second option would further reduce market opportunities of producers engaged in a sustainability approach and would lead the sector to focus solely on consumer regions that are less sensitive to these issues.

Consuming countries in the North, because they appear more sensitive to these issues than other regions, need to identify and encourage sustainable palm oil production methods, while supporting a more effective regulation of other methods of production. In this perspective, this Policy Brief characterizes the different palm oil production patterns in Southeast Asia, identifies the contributions and limitations of existing sustainability initiatives in the region, and issues recommendations for actors in importing countries and more generally those of the palm oil sector.

RECOMMENDATIONS

1. In South-East Asia, any palm oil sustainability initiative should aim at better regulating large scale plantation practices while encouraging the development of smallholders, the impact of the former on social and environmental issues being in most cases way more important than that of the later.
2. Existing initiatives (certifications, corporate commitments, landscape approaches) need to be strengthened to improve the sustainability of industrial production.
 - In the case of certification, independent audit systems must sever the link between audited companies and auditing firms. Stronger control of these auditing firms is also necessary. The approval procedure should strengthen the requirements concerning the training of auditors. In addition, forests with high environmental value (high conservation value [HCV] or high carbon stock [HCS]) must be recognized in the criteria for certification.
 - In the case of corporate commitments, a better understanding of the negotiations between buyers and suppliers of palm oil would help identify possible margins of progress.
3. Governments and development operators of importing countries, in particular developed countries, should strengthen cooperation with producing countries in order to foster the development of policies that simultaneously allow independent smallholder to capture a greater share of added value and encourage conservation regulation in high environmental and social value areas.

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1. TELLING APART TWO MODES OF PRODUCTION WITH RESPECT TO SUSTAINABILITY

In South-East Asia, two main categories of palm oil producers coexist:

- Industrial plantations, which are generally carried out by large capital companies, sometimes subsidiaries of large trusts, and which invest significantly in this production: purchase of concessions, land management (including wetlands reclamation), building and maintaining mills, etc.
- Independent smallholders, mostly family farms of 25 ha maximum who install oil palm on their land, in place of other crops (rice, avocado, pineapple) or of forest.¹

In Indonesia and Malaysia, about 60% of production is provided by industrial plantations. However, out of the 4 millions people working in the palm oil sector, 30 to 40% are smallholders. Recent research suggests their practices appear more sustainable than industrial production with respect to the three dimensions of sustainable development:

- In economic terms, the monthly income of Indonesian independent smallholders is said to be 50% higher than that of plantation workers² (bearing in mind that the average monthly wage of plantation workers generally hardly covers their needs).
- With respect to social concerns, warnings regarding poor working conditions and infringement to forest populations' land rights are almost exclusively linked to industrial plantations;
- In the environmental field, smallholders are much less implicated in deforestation than industrial plantations. This is exemplified by the deforestation dynamics of Sumatra, where most of Indonesia's production is concentrated and where, between 2000 and 2010, 89% of the area deforested for palm oil was due to large scale/industrial plantations. One reason is that independent producers' oil palms have

replaced rice or rubber trees more often than forest.³

While smallholders depend on mills and transport infrastructure that are generally provided by industrial plantations, there are few technical or economic reasons why harvesting and primary processing could not be carried out in a decentralized manner, as economies of scale in the palm oil sector are low.⁴ From a quantitative point of view, it would also be possible to substantially improve the productivity in smallholder plantations. Such an increase could be sufficient to meet the growing international demand, at least partially, and only if the share of palm oil used for biofuel slightly decrease, in particular in Europe.⁵

Data collected so far therefore suggest that taking action to improve the sustainability of the sector means simultaneously (a) favoring independent producers while monitoring their environmental and social performance to continue improving their level of sustainability and (b) better regulating industrial production. Certification initiatives, as well as other private sustainability approaches and their contribution to a more sustainable palm oil sector should therefore be assessed with respect to both of these objectives.

2. LIMITATIONS OF CERTIFICATION AND OF THEIR ALTERNATIVES

2.1. Certifications

Certification schemes are based on a set of principles and indicators which producers and supply chain operators have to comply with to get certified. Their compliance is assessed through third party audits and then attested through a label/certificate. Such schemes, and their governance, can be private (i.e. NGOs and companies defining the rules together) or public (the government defines and run the mechanism and attributes certificates).

The first-born certification in the palm oil sector, the Roundtable for Responsible Palm Oil (RSPO) is private. It was initiated by WWF and companies of the sector, and dates back to 2004. It now covers 17% of the global production and coexists with other standards; two of which are private and voluntary - the International Standard for Carbon

1. Two types of small producers are generally distinguished: those linked to an industrial plantation, called tied smallholders (over the last four decades, Indonesian policies have required large scale plantations to develop between 80 % and now 20 % of their concession for tied smallholder), and independent smallholders. Insofar as the practices of the former are strongly conditioned by the terms of their association with the industrial plantation and where they are numerically fewer, the emphasis when referring to smallholders will be placed above all on independent smallholders - although this last category is itself very heterogeneous.

2. Barral, S. (2015). *Capitalismes agraires : économie politique de la grande plantation en Indonésie et Malaisie*. Paris, Presses de Sciences Po, 238 p.

3. Lee, J.S.H. et al. (2014). Environmental Impacts of Large-Scale Oil Palm Enterprises Exceed that of Smallholdings in Indonesia. *Conservation Letters*, 7 (1), 25-33.

4. Hayami, Y. (2002). Family Farms and Plantations in Tropical Development. *Asian Development Review*, 19 (2), 67-89.

5. Transport & Environment (2016). *Europe keeps burning more palm oil in its diesel cars and trucks*.

Certification (ISCC) and the palm oil declination of the Sustainable Agriculture Network standard; and the last two are governmental mandatory standards for local producers, the Indonesian Sustainable Palm Oil and the Malaysian Sustainable Palm Oil.

The scope and effectiveness of certification initiatives are based on the assumptions that: (1) certified oil is sold at a higher price than uncertified oil; (2) this additional payment leads to a change towards more sustainable practices; and (3) compliance with certification provisions is guaranteed without possibility of evading the system. For South-East Asia, these three hypotheses are only partially true, irrespective of the system under consideration.

(1) Certification provides a very low economic incentive. While nearly 20% of the production is certified today (adding up ISCC and RSPO's certified production), less than half is actually sold at a certified price. Since the certification premium rarely exceeds 5%, it has virtually no impact on the net income of producers, even when considering improvements in productivity and input reductions.⁶ Moreover, the economic incentive is non-existent for all the operators that sell in countries with low demand for certified products, such as China, India or Indonesia (these three countries alone account for nearly 40% of demand).

(2) Certification schemes do not really induce significant changes in practices. On the one hand, such changes depend on the level of requirement imposed by different standards, which are far from homogeneous. On the environmental side for example, not all standards recognize forests with high conservation value (HCV) or high carbon stocks (HCS), although this recognition is known to be the only way to ensure that palm oil does not come from deforestation. On the other hand, most certification schemes mainly require operators to provide auditors with impact assessments, legality documents, action plans, or evidence that awareness and information procedures have been put in place. Requirements for actual changes in production and operational practices represent less than a quarter of the RSPO criteria and about half for ISCC. Industrial groups, which are well versed in reporting to their shareholders, have thus managed to comply with certification procedures without significantly transforming their practices. While independent smallholders have recently been identified as one of the priority targets for all

standards, certification remains costly and complex for them, even though criteria and indicators have been adapted. Certification only yields a very low additional income, no significant increase in their market opportunities, and no way to differentiate themselves from industrial producers.⁷

(3) The conflict management procedures and the penalties incurred are insufficient to ensure compliance with the certification criteria. Conflicts of interest between auditees and auditors and their consequences are well documented and the management of potential disputes is often slow and partial.⁸

2.2. Corporate commitments going beyond certification

Faced with the limits of certification, some NGOs have turned to the purchasing and leading companies in the sector, often already members of the RSPO, to require additional guarantees with respect to deforestation, peatland destruction and ill-treatment of local populations. Such commitments, known as “No Deforestation, No Peat, No Exploitation” commitments with reference to the first policy presented by Wilmar in December 2013, now cover nearly 90% of the oil traded on world markets. The approach relies on a twofold hypothesis: (1) that committed companies will increase their level of transparency by making public their supply chain; and (2) that they will be able to bring their suppliers to gradually align with their own commitments.

This approach has generated significant advances for some plantation companies.⁹ To date, its impact however is not as strong as expected. The power of buyers on suppliers does not appear as great as envisaged initially, since many of the largest companies in Indonesia have not yet transformed their practices to comply with the requirements of buyers.¹⁰ Besides, this approach is hampered by a lack of alignment between buyers' requirements

6. Preusser, S. (2016). *Correlating Economic and Financial Viability with Sustainability for Palm Oil Plantations*. Kuala Lumpur, Round Table on Sustainable Palm Oil, 52 p.

7. Hidayat, N. et al. (2016). On The Profitability of Sustainability Certification: An Analysis among Indonesian Palm Oil Smallholders. *Journal of economics and sustainable development*, 7 (18), 45-62.

8. EIA (2015). *Who watches the watchmen? Auditors and the breakdown of oversight in the RSPO*. London, Environmental Investigation Agency, 23 p, McDonald, K. et al. (2016). *The Complaints System of the Roundtable on Sustainable Palm Oil (RSPO)*. Corporate Accountability Research, 72 p.

9. http://www.aidenvironment.org/wp-content/uploads/2016/08/NEWSLETTER-AIDENVIRONMENT-ASIA_-IMPACTS-OF-NO-DEFORESTATION-POLICIES_EN_DEF.pdf

10. ten Kate, A. et al. (2016). *2016 Sustainability Benchmark: Indonesian Palm Oil Growers*. Washington D.C., Chain Reaction Research, 16 p.

and the policy orientations of producer countries, which focus primarily on economic development in rural areas.

2.3. Landscape approaches

Aiming to respond to these shortcomings, a third kind of approaches, termed «landscape approaches», have developed since the beginning of this decade. Landscape approaches are based on negotiating a sustainable land use plan between all the players in an administrative territory and then translating it into local regulation, while providing specific support to small independent producers.

International NGOs and local governments have initiated such approaches in about ten Indonesian territories. Projects rely on two key ideas: (1) the remuneration of «performing» territories via climate finance and the implementation of an adapted metric;¹¹ and (2) focusing buyers' procurement policies on these areas (so-called «jurisdictional» certification approach, e.g. in Sabah State of Malaysia). Hindsight is still lacking on the effectiveness of these approaches, but their implementation appears as rather complex and time-consuming.

3. GUIDELINES FOR PROMOTING THE SUSTAINABILITY OF PALM OIL PRODUCTION

3.1. Improving large-scale plantations' performances

Regarding certification schemes, improvement avenues rest first on developing independent audit systems, in which the direct client-supplier relationship between the auditee and the auditor need to be cut. One option for that would be the development of «auditing fund», managed by the organisations in charge of running a certification scheme: instead of hiring directly an auditing company, a producer will have to pay the auditing fees to the RSPO or the ISCC, who will in turn hire the auditing company.

Strengthening the procedures for disputes settlement is an important point as well, to allow in particular for better consideration of the point of view of the local population.¹²

Lastly, ensuring the recognition of HCV and HCS forests, in all existing standards, is key.

11. Nepstad, D. *et al.* (2013). More food, more forests, fewer emissions, better livelihoods: linking REDD+, sustainable supply chains and domestic policy in Brazil, Indonesia and Colombia. *Carbon Management*, 4 (6), 639-658.

12. Silva-Castañeda, L. (2012). A forest of evidence: third-party certification and multiple forms of proof—a case study of oil palm plantations in Indonesia. *Agriculture and Human Values*, 29, 361-370.

Measures supporting the demand for certified oil to ensure a higher market value and new market opportunities for sustainable production should also be considered. They would however only make sense if certification schemes have been strengthened beforehand: there would be no point in increasing demand if certified production methods remain unsustainable.

3.2. Better documenting the negotiation between supply chain actors to reinforce the effectiveness of corporate commitments

Approaches based on private commitments rely heavily on an externalization of constraints to producers, assuming that the market power of buyers will be sufficient to constrain their suppliers. The efficiency of this operating mode at large scale has still to be proven. Corporate commitments could however benefit from a better understanding of buyer/supplier negotiation conditions, in particular on the compensation offered by buyers to their suppliers in exchange for their alignment with increasingly demanding requirements.

3.3. Strengthening international cooperation to transform agricultural and rural development policies

Until now, neither certification schemes nor corporate commitments have proven up to the task of supporting independent production. To do so would indeed mean (re)orienting economic and rural development policies. In this perspective, the EU, its businesses and its civil society should reinforce the dialogue with producing countries, with a twofold objective:

(1) Developing a sector-based policy that would structure the supply capacity of independent producers and enable them to capture a greater share of the added value, for example through the development of cooperative agricultural models. The work of development agencies in that sector, in which they often have an extensive experience, could be supported.

(2) Supporting ongoing discussions in producing countries towards the legal recognition of the protected status of high conservation value and high carbon stock forests. Such decisions would namely support countries in the implementation of their commitments under the Paris Climate Accord, which include large-scale actions targeting land-use,¹³ and which could mobilize part of the climate finance funds. ■

13. Boer, R. *et al.*, 2016. *Pathways to deep decarbonizing agriculture, forest and other land uses sector in Indonesia*. Bogor, Deep Decarbonization Pathways Project, 50 p.