

# ACP palm oil sector development and the debate on sustainability certification

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## Growing demand for certified sustainable palm oil in OECD countries

In recent years, a trend has developed in OECD countries for ‘certified, sustainable palm oil’ (CSPO). Manufacturers of end consumer products, such as Mars, Mondelez, Hershey, Kellogg’s, Nestlé, Pepsico, Danone, General Mills and Unilever, as well as entire national industries for processing and using palm oil in Belgium, the Netherlands, France, Germany, Austria and Switzerland, have all made commitments to 100% sourcing of CSPO in response to NGO and ethical consumer concerns over the impact of palm oil production on tropical rainforests, biodiversity and climate change.

For these companies “the cost of moving towards traceable and sustainable palm oil is marginal compared to the long-term effects of negative publicity.” In 2013, consumer groups criticised Kellogg’s, following reports that its supplier “had provided it with illegally grown palm oil from Indonesia”. According to Euromonitor, because of deforestation and environmental concerns, if “just 1% of Kellogg’s consumers were to stop buying its products, company sales could fall by US\$200 million”. Kellogg’s therefore announced its intention to only source sustainably certified and fully traceable palm oil. Moving to sustainable and fully traceable sourcing of palm oil was seen as the commercially sensible choice.

In many instances, 2015 has been set as the target date for conversion to 100% sustainably sourced palm oil. Some companies are meeting targets ahead of schedule,<sup>1</sup> while steady progress is being made under national commitments to sustainably sourced palm oil (the Dutch palm oil processing industry reached 41% CSPO sourcing in 2012.<sup>2</sup>

Even though the shift to sustainable sourcing may be gaining pace, analysis from HSBC suggests that the supply of sustainably certified palm oil continues to outstrip demand. In 2012, only 48% of CSPO was sold as such, which is attributed to the differing priorities of consumers in OECD and

emerging markets (accounting for 80% of global demand). In emerging markets palm oil is primarily used for cooking, with price considerations the primary concern.

Despite these differing consumer concerns, the assertion in October 2012 by the Executive Director of the Round Table on Sustainable Palm Oil (RSPO) that CSPO sales were on the verge of “exponential growth” would appear to be well founded. In April 2014, RSPO reported a 49% increase in the “physical uptake of CSPO” from 340,668 to 506,586 tonnes, in the first quarter (Q1) of 2014 compared to Q1 of 2013. Meanwhile, sales of GreenPalm certificates (which use a ‘book and claim’ system) expanded by 54% from 555,906 to 853,338 tonnes over the same period. This suggests that demand for sustainable palm oil is indeed beginning to take off, as more and more international companies and national industries in OECD countries commit to exclusively using CSPO.<sup>3</sup>

Differing consumer concerns related to palm oil in different markets mean that the urgency of getting to grips with sustainability certification issues varies across ACP countries, depending on the markets currently being served or targeted by new investments in palm oil production.

The leading palm oil producer in the Pacific ACP region, New Britain Palm Oil Limited (NBPOL), which has operations in Papua New Guinea and the Solomon Islands, has been producing exclusively sustainably certified palm oil since 2012.<sup>4</sup> The operations of NBPOL are fully integrated with processing facilities in the UK, which directly supply a range of European food product manufacturers. A new commercial agreement was concluded in June 2013 to supply “350,000 tonnes of fully traceable segregated palm oil per year” to processing facilities in the UK and Germany. Food manufacturers committed to sustainable sourcing welcomed this development.<sup>5</sup>

By contrast, in West Africa, where there is a large trade deficit in palm oil, recent investments are largely oriented towards serving national and regional markets.<sup>2</sup> Here, the imperative to meet sustainability standards is less acute, since there is little demand for sustainability certification in regional markets.

Nevertheless there can be little doubt that the development of sustainable palm oil is reaching a critical juncture, potentially throwing up a range of policy challenges for ACP governments.

## The RSPO and systems of sustainability certification

The main forum involved in the move towards CSPO production is RSPO, which was formally established in April 2004.<sup>7</sup> Currently RSPO has three main types of CSPO supply chain. In descending order of certification costs, these are:

- **Segregated CSPO** – where certified palm oil “is physically separated from non-certified palm oil all the way from the certified mill to the end user”;
- **Mass balance CSPO** – which mixes certified and non-certified palm oil, to avoid the costs of keeping the two entirely separate;
- **Book and claim CSPO** – which is “a certificate trading system separate from the physical trade in palm oil”. Retailers or manufacturers buy certificates alongside their palm oil needs, with the certificate payment going directly to the CSPO producer. However, the palm oil physically used is not necessarily sustainably produced.<sup>8</sup>

The GreenPalm scheme, which experienced the highest rate of growth in the first quarter of 2014, and which accounted for 62.75% of sustainable palm oil sourced in the first quarter of 2014,<sup>9</sup> is a ‘book and claim’ based scheme.

However, there is a growing debate in OECD countries over the book and claim mechanism of sustainability certification, which does not guarantee end users the actual presence of sustainably produced palm oil in their final product. A growing preference is emerging in OECD countries for segregated palm oil, whereby sustainably produced palm oil is certified, stored, refined and shipped separately from all other sources of palm oil.

## The evolving debate on sustainable palm oil production

The emerging preference for segregated palm oil supply chains arises from growing NGO criticism of the rigour with which RSPO requires compliance with sustainability commitments. According to a review compiled by the World Wide Fund for Nature (WWF) of company reporting under the RSPO scheme, only “a handful” of RSPO members were “making adequate progress on the road to 100% RSPO compliance”.<sup>10</sup>

The review found that just over a third of RSPO members had some certified estates, accounting for only 37% of the total area of palm oil harvested, while less than a third of RSPO members had time-bound plans for certifying those smallholder producers with which they had long-term contractual relationships. This slow progress in certifying smallholder palm oil producers may be of concern in some ACP countries.

The WWF report also found that only 54% of RSPO members “had set themselves any sort of time-bound plan for certification of their estate land” (and 36% with a target date of 2015 or sooner). Overall it was concluded that the majority of RSPO members needed to “move much faster if the RSPO is to reach its goal of transforming the palm oil sector toward 100% sustainability”.<sup>10</sup>

Although WWF subsequently welcomed revised RSPO principles as “a step in the right direction”, it was nevertheless argued that these moves were insufficient to ensure that producers fully account for greenhouse gas emission and prevent deforestation and clearance of carbon-rich peat land. Environmental NGOs have therefore urged RSPO to become far tougher in making its members comply with sustainability requirements. Greenpeace indeed went further, claiming that “many confectioners are sidestepping responsibilities on sustainable palm oil by only ensuring that products meet ‘inadequate’ RSPO standards.” Pressure is thus mounting for major confectionery industry players to “go beyond RSPO standards and to procure from ‘truly sustainable’ sources”.<sup>11</sup>

Mars has publicly agreed with Greenpeace that “RSPO standards are not enough,” and has pledged to introduce a new policy on palm oil in 2014. Other industry players have also responded. Ferrero, for example, has made the commitment to achieve 100% traceable, segregated, RSPO-certified palm oil by the end of 2014 and further pledged that its suppliers will not clear high-carbon stock forests or use fire to clear lands. Similarly, “Nestlé has pledged not to be associated with deforestation and has a responsible sourcing policy in place,” while Mondelez International “plans to publish an action plan... that will detail steps to eliminate by 2020 palm oil supplies that are produced on illegally held land”.<sup>12</sup>

These debates resulted in the 2013 launch of the Palm Oil Innovation Group (POIG), with NBPOL playing a leading role. This new multi-stakeholder initiative is “committed to reinforcing and improving” the RSPO principles and criteria, by recognising the attainment of higher standards than those currently required under the RSPO scheme. Membership of the POIG initiative is only open to producers with a proven track record of producing palm oil to the highest standards of sustainability. Specifically, to become part of the initiative, palm oil companies must “have achieved at least 50% RSPO certification... and commit to 100% certification within two years of joining”.<sup>4</sup> This suggests that in the coming years pressures will mount for a deepening of

sustainability requirements, which are likely to move away from ‘book and claim’ systems of certification towards fully segregated CSPO supply chains, thus guaranteeing the sustainability of the palm oil physically present in any given product.

There are implications here not only in terms of sustainability certification but also the method of sustainability certification that ACP governments should seek to promote. In this context, it should be noted that as demand for fully segregated CSPO increases, the costs of certification are likely to decrease, since the costs of processing, shipping, storing and delivering segregated palm oil will be reduced.<sup>2</sup>

These developments form part of wider calls for an expansion of sustainability requirements, and relate not only to enforcing existing requirements but also to addressing sustainability requirements in the whole palm oil production process. In February 2014, concerns were expressed over the methane gas emissions from wastewater produced during palm oil processing, because each wastewater pond annually releases methane “roughly equivalent to the emissions from 22,000 vehicles”. This has led to calls for methane capture and utilisation to form part of future sustainability certification requirements.<sup>13</sup>

## Implications of current debates and trends of ACP palm oil producers

Bearing in mind mounting criticism of the impact of a rising global demand for vegetable oils in general, and palm oil in particular, on deforestation, the environment and climate, food processors could adopt two options, namely:

- sourcing from companies that “pledge to only expand new production onto non-forest lands and work to increase crop yields through a combination of improved breeds and management practices”; or
- “switch to vegetable oil inputs that do not directly cause deforestation (e.g. corn, sunflower, rapeseed)”.<sup>14</sup>

In terms of OECD demand, therefore, the possibility exists that palm oil could be relegated to the status of a “vegetable oil of last resort” if sustainability concerns are not addressed across the whole sector.

A trend of switching away from palm oil is already apparent. For example, in 2012 a French retail chain began advertising “palm oil free products”, in response to consumer concerns over the environmental damage, deforestation and loss of species arising from conventional palm oil production.<sup>15</sup> NGO campaigns have also resulted in several large food processors and distribution chains committing to either CSPO sourcing or eliminating palm oil completely from their products or shelves. In 2010, only 16 products were registered with palm-oil-free claims. By 2012 this had increased to 72, and by July 2013 a further 66 new products carrying such claims had been introduced onto the market.<sup>3</sup>

There are also growing fears that consumer concerns over the environmental consequences of palm oil production could be used by lobbies of alternative oil crop producers to promote forms of ‘eco-protectionism’. According to reports carried on the website *Foodnavigator.com*, the United States Environmental Protection Agency (US EPA) implemented rules on palm oil in 2012 that were “designed to punish the crop”. While the US EPA maintained that the rule “was designed to protect the global environment”, it was nevertheless seen as reflecting the concerns of the American Soybean Association, which has long envisaged “a looming threat from palm oil” to the dominance in the edible oil market enjoyed by soybean oil.<sup>16</sup>

## Policy challenges and issues arising for ACP governments

The move towards certified sustainable palm oil that is physically traceable from final product to sustainably farmed palm oil trees, and the potential extension of sustainability requirements to embrace minimising greenhouse gas emission from palm processing waste, potentially poses a range of international and domestic policy challenges for ACP governments.

At the international level, this requires active ACP engagement with debates on the definition of sustainable palm oil production. The ACP-based company NBPOL plays a leading role in debates on tightening up sustainability principles and criteria in response to evolving consumer concerns and the associated issue of ensuring “increased market recognition” (i.e. generating price premiums for the sustainability investments made). This is a resource that ACP policymakers could tap into when engaging in these evolving policy debates.

A close monitoring of trends in end user requirements is also necessary, since there is little point in investing in sustainability certification systems that will not meet future end user requirements. At present, sustainability requirements are largely private sector defined, however, there are several points of interface with public policy. For example, the EU’s Renewable Energy Directive has established specific sustainability criteria for biofuels, which must be complied with if the biofuels produced are to be counted towards the attainment of agreed EU targets for the reduction of greenhouse gas emissions.<sup>17</sup> This implies a role for OECD governments in determining the parameters for climate-related sustainability claims.

Closely related to this topic are government regulatory frameworks that govern labelling claims. It would appear that the role of governments in defining what climate, environmental and sustainability claims can be made on product labels requires careful consideration. Put simply: should this be purely a private sector responsibility or is there a public sector responsibility to ensure that climate-related claims are science based and do not mislead consumers, to the advantage of certain groups of producers?

Overshadowing the issue of the legitimate role of government in setting parameters for sustainability claims are concerns over the scope for eco-protectionism,<sup>18</sup> given the domestic constituencies that have interest in the market for alternative vegetable oil products. The debate in OECD countries on the scope for using tariff policy to motivate the shift towards sustainably certified palm oil procurement is just the tip of the iceberg.

Greater clarity on what is meant by sustainability and what criteria are applied in making sustainability-related claims could potentially help ensure that consumers make informed decisions in light of growing environmental concerns, while avoiding the emergence of abusive ‘eco-protectionism’.

In the coming years, the debate on sustainability certification of palm oil is likely to shift to the depth of the sustainability commitments required. The issue of methane capture could then come to the fore, providing an interface between international and domestic policy dimensions. While any methane capture requirement would involve significant investment costs, it would not only result in energy cost savings but could also open up a new revenue stream, through the sale of electricity to other users. The potential for developing new revenue streams will be strongly influenced by government energy policy regarding the terms and conditions for energy sales by new suppliers, both directly and through the existing grid system.

Investments in methane capture also raise concerns relating to the distribution of costs and benefits of sustainability certification along supply chains. This may require ACP government initiatives with regard to regulating the distribution of costs and benefits of sustainability certification along palm oil supply chains, particularly where smallholders play a role. This raises the broader question of the role of ACP governments in supporting cost-effective access for



smallholder producers to sustainability certification. Currently, with the exception of NBPOL, private sector players are making only limited progress in this area.

Although the urgency of getting to grips with sustainability certification of palm oil for ACP producers varies depending on the market being targeted, one should bear in mind that reputational damage to palm oil as a preferred vegetable oil is likely to carry implications for long-term demand, not only in OECD countries but, over time, beyond. Purchasing priorities are likely to change as incomes grow in emerging markets. This may in part be driven by corporate-level conversions to 100% sustainable sourcing of palm oil. These commitments may leave little room for major multinational end consumer product manufacturers to differentiate their production for OECD markets (where demand for 100% sustainable sourcing of palm oil is growing) from their production for emerging markets (where no such demand for sustainable production currently exists).

Thus, while sustainability certification may not be an immediate market priority in West Africa, it would appear advisable to build the future evolution of sustainability requirements into current investment plans. Across the ACP the requirements could be carried out by:

- basing sustainability certification for new palm oil projects not solely on ‘book and claim’ certification systems, but also by building in scope for ensuring a low-cost transition to the establishment of segregated CSPO supply chains;
- building methane capture and utilisation into new investments, particularly in countries where problems of centralised electricity supply exist and where opportunities exist for both meeting future sustainability requirements and opening up new revenue streams;
- deepening ACP engagement in dialogues around the future evolution of palm oil sustainability standards, in order to ensure their transparency and predictability.

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