

Coping with Environmental Standards in Trade: Indonesian Experience with Sustainable Palm Oil Debate

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Abstract

Managing environmental standards as a form of environment-related trade barriers has become increasingly important for producing countries that are active participants in global commodity trading. Current international environmental standardization in trade, shows stronger tendency of convergence between sustainability criteria developed by the private sector and government regulations that apply in importing countries. Subsequently, such standards have overtime become guidelines for policy reforms in producing countries. To that end, the increasing role of private actors in pushing for higher environmental standards, has generated new dynamics in production-trade relations, which have overtime become increasingly complex. As a consequence, producing countries, now face multi-layered trade barriers before their products gain access to importing markets.

Keywords: environmental-related trade barrier, environmental standardization, sustainability, Indonesia, palm oil

A. INTRODUCTION

The debate over environmental issues has taken on increasing importance among international trading partners. With respect to palm oil, the intensification of global trade in the commodity has been accompanied by the tightening of environmental standards in the European Union as one of the leading palm oil importing regions. Using environmental standards as a trade barrier has the potential to reduce market access of palm oil exporting countries. Doubtless, Indonesia, which contributed 46 percent the world palm oil market² (2009) and has keen interest to maintain its market share, is one of the countries adversely af-

ected by such a development.

This article traces the trend in international environmental standards on palm oil trade. By assessing links between voluntary environmental standards developed by the private sector and policies adopted by governments in importing countries and producing countries, the paper attempts to determine the extent to which the relationships among these actors influence policy adopted in oil palm producing countries. By doing so, the article attempts to understand the governance structure of international environmental standardization mechanisms as well as discern relevant policy implications for Indonesia in strengthening its position in the global palm oil market.

B. WHO DEFINE ENVIRONMENTAL STANDARDS?

Despite efforts to liberalize trade through a series of negotiations involving governments, the use of environment-related trade barriers

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² "Malaysian Palm Oil Industry Performance," Global Oils and Fats Magazine, Vol.7, Issue 1, Jan-March 2010. http://www.americanpalmoil.com/publications/GOFB/GOFB_Vol7_Iss1-pullout1.pdf (August 20, 2011)

is still a common occurrence. Environment-related trade barriers take various forms. One such form environmental regulations and standards relating to product standards (specifying characteristics of acceptable products must have) and non-product standards (which refer to conditions under which products are made); both are legally binding. Environmental labelling is another form, which requires the provision of compulsory or voluntary information about the environmental impact of products as well as production condition to producers and consumers. The third form, entails economic instruments manifested in taxes and charges on products³.

The trend in current trade practices shows the involvement of both government and non-government actors in defining environmental standards. This is the case because of the relations between the state and the market, which have become increasingly dynamic, implying that standard setting process is no longer the monopoly of the government. There are three major actors of environmental standard setting, and they include importing countries, private actors, and producing countries. The interplay between these driving actors underlies policy reforms in producing countries. The modelling of international environmental standard setting is shown in Figure 1.

Several trends in environmental policies implemented by governments are discernible in developed countries. First, a shift from *non-discriminatory trade policies* to *process discriminatory trade policies* (from applying trade ban on timber products regardless of their sources to giving preferential market access to timber from sustainable forestry and the formation of groups of retailers who agree to buy a certain percentage of total timber purchases from sustainable sources, possibly at a premium price).⁴ Secondly, a shift from ensur-

³ "Environment-Related Trade Barrier and the WTO" (Center for Policy Dialogue Homepage, 2009). www.cpd.org.bd/pub_attach/OP77.pdf (August 10, 2011)

ing that proper regulations are in place to greater emphasis on 'precautionary principle' (taking action when the science is not clear, but where there is reasonable cause for concern). Thirdly, a shift from 'command and control' to 'market-based environmental policy', which involves partnerships and voluntary arrangements with business sectors.⁵

Different domestic standards may lead to tensions in trade relations. The fear is that in the absence of preceding negotiations between importing countries and producing countries, the demand for higher environmental standards has the potential to spark off accusation that importing countries are applying protectionist measures in the guise of pursuing environmental protection.

Even though gradual harmonization between national and other standards is more preferable in order to allow adaptation on the side of producing countries, the intermingling motives of environmental protection and environmental protectionism may contribute to the difficulty in resolving the international debate. In the process, power asymmetry may present its own challenges to efforts of producing countries to deal with higher environmental standards introduced by importing countries and the private actor. More politically powerful actors are likely to dominate the construction of sustainability frame as well as international environmental standardization mechanism. Importing countries with significant market share are especially in a more favorable position to impose environmental standards as part of terms of trade with producing countries in the aftermath of making changes in their trade policies.

⁴ Stefanie Engel "Achieving Environmental Goals in a World of Trade and Hidden Action: the Role of Trade Policies and Eco-Labeling," *Journal of Environmental Economics and Management* 48 (2004): 1123

⁵ This applies for example to EU context. See Wyn Grant, Peter Newell, and Duncan Matthews. *The Effectiveness of European Union Environmental Policy* (New York: St. Martin Press, 2000), 11-12

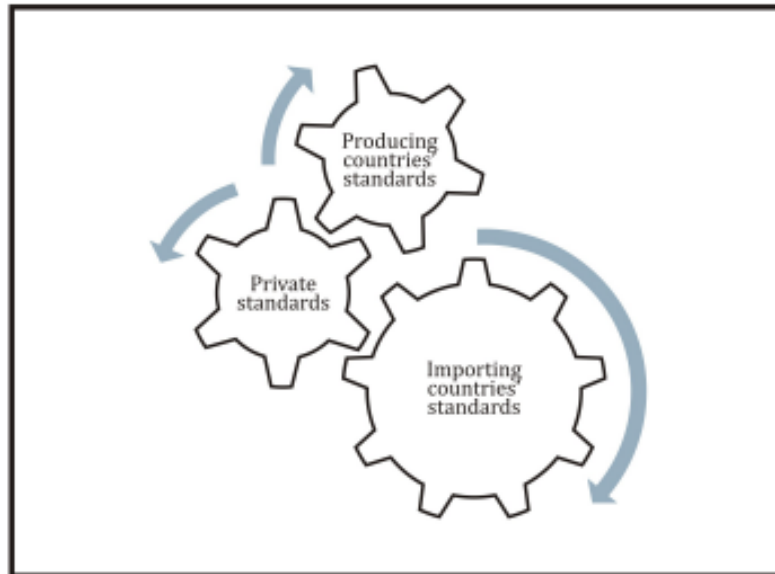


Figure 1
International Environmental Standardization

Outside the government sphere, the role of private actor in environmental standard setting may evolve through three phases (initiation, gaining widespread adoption, and political legitimacy). The first phase is developed among small communities in which actors assess the benefit of joining certification scheme. Here, firms which are closest to the standard join first. The second phase occurs when efforts to gain broader support from firms which are 'distant' from requirements and non-governmental organizations expect increases in requirements. At the same time, normative pressure from phase one combine with the emergence of shared norms and learning, leading to a redefinition of separate interests and the prerequisites for community building. The third phase is when environmental standard setting is considered a legitimate arena of authority.⁶

While private standards are voluntary in nature, government standards are compulsory and are expected to produce stronger implications for market access of products from pro-

ducing countries in the case of failure to comply. In this context, relations between government standards and private standards may be complementary if there is a need on the side of importing countries to include verification by third party to ensure compliance by producing countries. The role of private environmental standards, therefore, possibly extends their traditional scope beyond voluntary-based compliance mechanism, which will be discussed further in the later section of this article.

C. INDONESIA IN THE GLOBAL PALM OIL TRADE

Palm oil has become a very strategic commodity on the international market. As of July 2011, palm oil was considered as the most tradable vegetable oil in the world with total production of 50.26 Million Metric Tons.⁷ Based on list obtained from the Food and Agriculture Organization, 156 countries are involved in palm

⁶ Cashore et al., "Can Non-state Governance 'Ratchet-Up' Global Environmental Standards? Lessons from the Forest Sector." *RECIEL* 16, no.2 (2007): 163

⁷ "Major Vegetable Oils: World Supply and Distribution" (United States Department of Agriculture, 2011). <http://www.fas.usda.gov/psdonline/psd>

oil trading.⁸ Palm oil is used as feedstock for edible oil products, oleochemical and biofuel. An estimated 74 percent of global palm oil usage is for food products and 26 percent for industrial products. The largest consumers are India, China, EU, Indonesia, Malaysia, Pakistan, Thailand, and Nigeria – which together account for roughly 72 percent of total world consumption.⁹ Based on statistics, 10,403,000 tons out of 37,971,000 tons globally imported palm oil, is traded with various countries in non-major markets, which highlights the extent to which palm oil usage is worldwide.¹⁰ During 1995-2010 world demand for palm oil increased 32 million tons, with India consuming 5.7 million tons, 5 million tons went to China, 4.3 million tons were destined to the European Union, and the rest 17 million tons was consumed by other countries. In 2009, India became the leading global user and importer of palm oil, replacing EU's position.

As the largest palm oil producer coupled with its domestic capacity and international competitiveness, Indonesia has the potential to derive even more benefits from palm oil. With respect to domestic capacity, acreage of oil palm plantations in Indonesia reached 5,453,817 in 2005, and increased to 6,594,914 hectares, and 7,824,623 in 2006 and 2010, respectively. The expansion of area under oil palm plantations has been equalled with increase in production. Palm oil production reached 11,861,615 in 2005, increased to

17,350,848, and 19,844,901 in 2006 and 2010,¹¹ respectively. In future, availability of abundant land, which is lacking in other producing countries, may put Indonesia in a very strategic geopolitical position. Anyhow, Indonesia has become the main destination of foreign direct investment in oil palm plantation sector. The surge in World palm oil demand has served as a strong drive for national governments in tropical regions to invest more in this sector. Indonesia is today reckoned to be managing the largest oil palm plantations in the world. Oil palm plantation management in Indonesia is run by state-owned corporation (8 percent), private corporations (50 percent) and smallholders (42 percent).¹²

Though Indonesia continues to export CPO in its crude form, the national government is taking measures to scale up the production capacity of refined palm oil as well as strengthening downstream industries. The operations of most palm oil companies in Indonesia are still focused on upstream production, producing fresh fruit bunches and/or crude palm oil which they sell to larger trading companies, export-oriented companies and edible oil manufacturing companies for the domestic market. There are only a few large and fully vertically integrated companies which are involved in downstream processing as well as engaged in palm oil export activities¹³.

report.aspx?hidReportRetrievalName=BVS&hidReportRetrievalID=702&hidReportRetrievalTemplateID=5 (August 6, 2011).

⁸ Rhett.A Buttler and Lian Pin Koh. "Consumers should help pay the bill for 'greener' palm oil." (Mongabay, 2010). http://news.mongabay.com/2010/0112-palm_oil.html (August 16, 2011)

⁹ "Indonesia: Raising Global Demand Fuels Oil Palm Expansion," (USDA FAS Homepage, 2010). <http://www.pecad.fas.usda.gov/highlights/2010/10/Indonesia/> (August 12, 2011)

¹⁰ See Table 11 of USDA FAS Oilseeds Market and Trade Circular August 2011. <http://www.fas.usda.gov/oilseeds/circular/2011/Aug/oilseeds.pdf> (August 12, 2011)

¹¹ Indonesian palm oil production increased from 15,560,000 Tons in 2005 to 16,600,000 in 2006 while Malaysian production was instead decreasing from 15,485,000 Tons in 2005 to 15,290,000 Tons in 2006. See Table 11 of the USDA FAS Oilseeds Market and Trade Circular December 2007. <http://www.fas.usda.gov/oilseeds/circular/2007/December/oilseeds.pdf> (August 17, 2011)

¹² "Palm Oil Statistics." Directorate General of Estate Crops, Ministry of Agriculture, Republic of Indonesia, 2011

¹³ "Palm Oil Fact Sheet," (MVO, 2010). <http://www.mvo.nl/Kernactiviteiten/Marktonderzoeken/Statistiek/Factsheets/FactsheetPalmOil2010/tabid/2301/language/en-US/Default.aspx> (August 15, 2011).

The competitiveness of Indonesian palm oil has been rising in comparison with other producing countries in general and Malaysia as the main market competitor, in particular. Indonesian palm oil market is mainly concentrated in three main regions: Asia (72.81 percent), Europe (18.61 percent), and Africa (7.17 percent), wherein it outcompetes Malaysian palm oil. During 1999-2001 and 2005-2007 periods, the market share of Indonesian palm oil in Asia increased from 47 percent to 66 percent, while refined oil increased from 19 percent to 30 percent. In Europe, Indonesia's market share for CPO shrunk slightly from 38 percent to 37 percent. However, at the same time, Indonesia increased exports of refined palm oil from 18 percent to 30 percent. Meanwhile In Africa, Indonesia's CPO exports increased from 36 percent to 58 percent, while exports of refined oil increased from 27 percent to 39 percent.¹⁴ In light of that, there is little doubt that Indonesia already enjoys a very strategic position, which it can utilize to enhance its linkages with various segments of domestic palm oil producers and business players in the global palm oil value chain.

Palm oil sector has become a strategic source of revenue for Indonesia, as well as contributed significantly to improving living standards of many segments of Indonesian population. While in early 2000s palm oil sector contributed between 1.5 percent and 2 percent to national GDP, that figure rose to 4.5 percent in 2010 and 6-7 percent in 2011.¹⁵

^{16,17}Moreover, , about 3,700,000 people derive

¹⁴ Amzul Rifin. "Export Competitiveness of Indonesian Palm Oil Product," *Trends in Agricultural Economics* 3, no.1 (2010): 1-18

¹⁵ Colin Barlow, Zahari Zen, and Ria Gondowarsito, "The Indonesian Palm Oil Industry." (Malaysian Palm Oil Board, 2003) <http://palmoilis.mpob.gov.my/publications/opiejv3n1-8.pdf> (August 29)

¹⁶ "Indonesia: Benchmark for Sustainable Palm Oil in Emerging Markets." <http://www.valuenotes.com/businesswireArticle.php?ac=26937&at=I> (August 29, 2011)

¹⁷ "Indonesia: Raising Global Demand Fuels Oil

a living from palm oil sector , making it an important economic activity in efforts to eradicate rural poverty. Given the existing area covered by oil palm plantations today, Indonesia must utilize it to the best of its ability to elevate living standards of the affected communities. Thus, Indonesia should not only strive to maintain its position as the largest palm oil producer, but also importantly, must also seek various ways of increasing benefits the country can derive from trading palm oil by increasing the capacity of domestic industries generate innovations of downstream products. Managing palm oil sub sector, therefore, is a big stake for the Indonesian government.

D. ENVIRONMENTAL STANDARD SETTING

Despite high prospects of palm oil in future, the role of environmental standards has taken on increasing importance due to its adverse effect on ease of access of palm oil to importing countries, especially EU. One of the well known government-sponsored environmental standards used by importing countries is EU Renewable Energy Directive. However, Indonesia as major producing country introduced its own, known as Indonesian Sustainable Palm Oil (ISPO). Non-government actors, using Roundtable on Sustainable Palm Oil (RSPO) framework, have also developed voluntary certification of their own, adding to the existing scheme such as ISO 14001. There are differences in emphasis among producing countries, importing countries and private sector on what constitutes sustainability criteria. EU focuses more on environmental criteria while providing less attention to social issues. On the contrary, private standards under RSPO do emphasize not only environmental protection, but also pay attention to social issues such as the fulfilment of legal rights of the affected

Palm Expansion" (USDA FAS, 2010) <http://www.pecad.fas.usda.gov/highlights/2010/10/Indonesia/> (August 29, 2011).

communities in the development of oil palm plantations. Indonesia as a palm oil producing country, based its standard on the criteria introduced by RSPO which was adopted in the form of legislation with compulsory conse-

quences for all palm oil producers. A summary of sustainability criteria covered in these standards is presented in Table 1.

Non-government initiatives provided the initial driving force toward international en-

Table 1
Environmental Standards: Instruments, Definitions and Operational Indicators

	Importing countries	Private actors	Producing countries
Instruments	Directive 2009/28/EC	RSPO Certification	Indonesian Sustainable Palm Oil
Scope of sustainability issues	Environmental sustainability consists of two main sets of criteria to be fulfilled cumulatively, (i.e., are greenhouse gas emission savings and land-use requirements). ¹⁸	Legal, economically viable, environmentally appropriate and socially beneficial management and operations”	Economic, social and ecological appropriate according to Indonesian legislations
Operational indicators	<p><i>Greenhouse gas emission saving</i></p> <p>a) Default value (19 percent for palm oil without methane capture and 56 percent for palm oil with methane capture)</p> <p>b) Threshold value (35percent from 2010 to 2013; 50percent by 2017; 60percent by 2018)</p> <p><i>Land use requirements</i></p> <p>a) Biofuels shall not be made from raw material obtained from land with high biodiversity value, which includes primary forest and other wooded land, areas designated for nature protection or the protection of rare, threatened or endangered ecosystems or species, and highly biodiverse grasslands.</p>	<p><i>Principle 1 – Commitment to transparency</i></p> <p><i>Principle 2 – Compliance with applicable laws and regulations</i></p> <p><i>Principle 3 – Commitment to long-term economic and financial viability</i></p> <p><i>Principle 4 – Use of appropriate best practices by growers and millers</i></p> <p><i>Principle 5 – Environmental responsibility and conservation of natural resources and biodiversity</i></p> <p><i>Principle 6 – Responsible consideration of employees and individuals and communities affected by growers and mills</i></p> <p><i>Principle 7 – Responsible development of new plantings</i></p>	<p>a) Licensing and plantation management</p> <p>b) Implementation of technical guidance on oil palm planting and management</p> <p>c) Environmental management and monitoring</p> <p>d) Responsibility to labor</p> <p>e) Social responsibility</p> <p>f) Empowerment of community’s economy</p> <p>g) Sustainable improvement</p>

Table 1. Cont'

	<i>Importing countries</i>	<i>Private actors</i>	<i>Producing countries</i>
	<p>b) Biofuels shall not be made from raw material obtained from land with high carbon stock, namely wetlands, continuously forested areas, or land spanning more than one hectare with a certain minimum canopy cover.</p> <p>c) Biofuels shall not be made from raw material obtained from peatland, unless evidence is provided that the cultivation and harvesting of that raw material does not involve drainage of previously undrained soil.</p>		

Source: RSPO Homepage; Lendle and Schaus (2010: 2-5); Ministry of Agriculture, Republic of Indonesia (2011)

environmental standardization through the introduction of certification for sustainable palm oil with emphasis put on the production process based on sustainability criteria. Historically, environmental issues associated with palm oil production have emerged in public debate particularly since the occurrence of 1997 forest fires in Indonesia. Non government actors, both domestic and transnational environmental NGOs (World Wildlife Fund, Greenpeace and Friends of the Earth) have raised concerns about potential adverse ecological effects arising from oil palm plantation companies activities. In light of that, pressure has grown with

the main drive being to prevent deforestation and biodiversity loss, as well as curbing the emission of greenhouse gases to reduce and mitigate climate change. Meanwhile, the Forest Peoples Programme (FPP), Sawit Watch and Oxfam Indonesia have also raised their concerns over issues of social justice and land reform. In their advocacy, these organizations have pushed for an active role of the financial sector and the supply chain in efforts to influence policy in producing countries.¹⁹

After a series of multi-stakeholders' meetings, concerns which were raised by environmental groups and social NGOs, led to the in-

¹⁸ Andreas Lendle. "Sustainability Criteria in the EU Renewable Energy Directive: Consistent with WTO Rules?" (International Centre for Trade and Sustainable Development, September 2010) http://ictsd.org/downloads/2010/10/case_brief_renewable_energy_dir_v5.pdf (August 16, 2011).

¹⁹ Cheng Hai Teoh. "Key Sustainability Issue in the Palm Oil Sector." (International Finance Corporation Homepage). [http://www.ifc.org/ifcext/agricultconsultation.nsf/AttachmentsByTitle/Discussion+Paper/\\$FILE/Discussion+Paper_FINAL.pdf](http://www.ifc.org/ifcext/agricultconsultation.nsf/AttachmentsByTitle/Discussion+Paper/$FILE/Discussion+Paper_FINAL.pdf) (August 17, 2011).

roduction of private-based criteria of sustainable palm oil within the framework of the Roundtable on Sustainable Palm Oil (RSPO) in 2004. This forum consists of banks and investors, consumer goods manufacturers, environmental or nature conservation organization, oil palm growers, palm oil processors and traders, retailers and social or development organizations (NGOs). Transnational NGOs such as WWF, Greenpeace International, Friends of the Earth, OXFAM International, Forest Peoples Programme and Sawit Watch are active participants in this forum. WWF has been actively involved from the very beginning, largely involved in engaging actors in palm oil supply chain.²⁰

RSPO has become a focal point for oil palm planters and actors along the supply chain. This is demonstrated, by among others, the scope of certification in the total structure of global palm oil production as well as geographical coverage of RSPO certification. As of 2008, RSPO represented 40 percent of global palm oil production.²¹ In terms of geographic coverage, RSPO certification applies to palm oil producers in 8 major countries in Southeast Asia, Latin America, Africa and the Pacific. Currently, Indonesia is the second largest producer of RSPO-certified palm oil, contributing to 35% out of total 4.2 million tons of certified palm oil. The current estimated annual production capacity of RSPO-certified production units, 4.2 million tons of sustainable palm oil, equals about 9 percent of global production, estimated to be about 46 million tons annually. Malaysia contributes about 54 percent of the world's current RSPO-certified palm oil production capacity. Indonesia is second, with about 35 percent of the current global supply. Papua New Guinea and Colombia provide the

²⁰ Cheng Hai Teoh, *Ibid.*,

²¹ Greetje Schouten and Pieter Glasbergen, "Creating Legitimacy in Global Private Governance: The Case of the Roundtable on Sustainable Palm Oil," *Ecological Economics* (2011): 6, doi:10.1016/j.ecolecon.2011.03.012

remaining 10 percent and 1 percent respectively.²² To that end, RSPO is considered to have gained broader social legitimacy from various stakeholders.

Nonetheless, attitude toward environmental standardization seems to differ among importing countries. For example, Chinese palm oil buyers though acknowledge their contribution to environmental problems associated with using palm oil in producing countries, the implementation of environmental standards is not legally binding. Moreover, the national government does not have in place specific policies to that effect²³. This is also true in the case of India, which is committed to prioritizing the use of palm oil in meeting domestic needs.²⁴ However, the situation is EU is different. EU applies stringent sustainability criteria on outsourcing policy of biodiesel for transportation and bioliquids for energy provision. In fact, the policy has been largely responsible for driving the transformation of sustainability standardization in producing countries. Thus, there is no convergence in environmental standards importing countries apply on palm oil production.

EU has established environmental standards criteria as regards land use change and greenhouse gases emission in the recently adopted EU Renewable Energy Directive (RED) in 2009. The EU Renewable Energy Directive established mandatory national targets of 20% share of energy from renewable sources and a 10% share of energy from re-

²² "RSPO Trademark: Next Phase in Transformation to Sustainable Palm Oil," (RSPO European Union 2011) <http://www.rspo.org/?q=content/rsपो-trade-mark-next-phase-transformation-sustainable-palm-oil> (August 21, 2011)

²³ David Braun, "Supports for Sustainable Palm Oil Gains Traction in China" (National Geographic) http://newswatch.nationalgeographic.com/2009/07/14/palm_oil_statement_of_support/ (August 16, 2011).

²⁴ Meri Orth and Adriani Zakaria, "Indian Use of Indonesian Palm Oil," Aidenvironment Project Number A3004 (Amsterdam: Aidenvironment, 2010), 20.

newable sources in transport in Community energy consumption by 2020.²⁵ EU RED plays a crucial role in providing obligatory environmental measurements that should be implemented by producing countries. Issues regarding indirect Land Use Change (iLUC) highlight EU's approach in adjusting trade policy. iLUC is generated by the elevated demand for agricultural commodities as a consequence of biofuel consumption, which leads to displacement of pre-existing agricultural production into new areas either in the same country or in other parts of the world. It is assumed that this displacement will further affect grasslands, forests or other natural habitats; GHG emissions as a consequence of the release of carbon locked up in soils and biomass; and the loss of biodiversity.²⁶ Thus, iLUC is concerned with increasing supplies of relevant commodities without displacing existing production and ecosystem services to other lands, or by production systems that value and enhance ecosystem services.²⁷ In practice, mitigating iLUC is carried out in the absence of effective land use planning globally and robust land use planning at all levels.²⁸ On that note, therefore, policies on mitigating iLUC, represent a unilateral act by the European Union.

As part of implementing Renewable Energy Directive, EU plans to pursue three verification mechanisms to ensure that producers

comply with the rules. First, companies will have to report their sourcing of biofuel to EU member states. Second, EU will conclude bilateral and multilateral agreements with a provision on sustainability criteria with other countries. The use of the directive, however, is not conditional on successful conclusion of such agreements. Third, European Commission may decide if voluntary national and international certification schemes are sufficient with sustainability criteria of 35% greenhouse gas savings.²⁹

In this verification process, the convergence of market-based instruments with importing countries' instruments may intensify pressure on producing countries. On 10 September 2010, RSPO submitted two applications to the European Commission to seeking a formal recognition of the RSPO system and the RSPO- Renewable Energy Directive (RED) system as a voluntary scheme under EU Renewable Energy Directive (EU-RED) requirements. Following specific clauses in the EU-RED sustainability criteria, the Additional Guidance will allow palm oil producers whose plantings existed on or before January 2008, and palm oil processors whose mills were in operation before or on January 23, 2008, to fully comply with the EU-RED requirements until April 2013.³⁰ A manifesto by palm oil buyers in Netherland, which was issued in November 2010 and was communicated to Dutch Minister of Agriculture and Trade, affirmed further the commitment to outsource only sustainable palm oil under RSPO certification start-

²⁵ Article 13 of Directive 2008/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC, *Official Journal of the European Union*, June 5, 2009

²⁶ Catherine Bowyer, "Anticipated Indirect Land Use Change Associated with Expanded Use of Biofuels and Bioliquids in the EU - An Analysis of the National Renewable Energy Action Plans." London: Institute for European Environmental Policy, 2010.

²⁷ "Indirect Land Use Change Impacts of Biofuel" (IUCN). http://cmsdata.iucn.org/downloads/ec_iluc_consultation_iucn_submission_29_october_2010.pdf (August 10, 2011).

²⁸ "Indirect Land Use Change Impacts of Biofuel" Ibid,

²⁹ Fredrik Erixon, "Green Protectionism in the European Union: How Europe's Biofuels Policy and the Renewable Energy Directive Violate WTO Commitments." Brussels: European Center for International Political Economy, 2009.

³⁰ "RSPO Applies for Recognition as a Voluntary Scheme under EU Renewable Energy Directive Requirements," (RSPO 2011) <http://www.rspo.org/?q=content/rspo-applies-recognition-voluntary-scheme-under-eu-renewable-energy-directive-requirements> (14 August 2011)

³¹ "Dutch to use only certified palm oil by 2015,"

ing from 2015.³¹ This movement by Netherland and RSPO has strengthened the link between private standards and government standards in importing countries. The Netherland has significant share of palm oil trade among EU members. This is reflected in the fact that 2 million tons out of 5.4 million tons of palm oil imported into EU, enter through Netherland.³² The recognition of RSPO certification by EU, either collectively or as individual members, may present a more systematic challenge to Indonesia and other palm oil producing countries. Given its large market share (Figure 2), Netherlands has the potential to exercise political influence on the direction of policy transformation in palm oil producing countries in the event national governments take the step to formally recognize existing private standards, notably those developed by RSPO in the verification process.

E. IMPLICATION FOR INDONESIA

The Directive 2009/28/EC has some policy implications for Indonesia as well as other producing countries. With special reference to Indonesia, the implementation of the measures is likely to increase difficulties Indonesia face in catching up with EU standards. This is because 27 percent of palm oil concessions (planned plantations in 2006) in Indonesia are on peat-forests, while only 10 percent of plantations in Malaysia are on what used to be peat-forest land and the same figure for concessions as the one of Indonesia is expected. However, there is still sufficient room to expand palm oil production on degraded forests as well as on

rubber plantations, though the latter is less efficient. Therefore, in pursuant with Article 17 (3) (a) and (5) of the Directive, some Malaysian and Indonesian palm oil biodiesel may not meet the sustainability requirements³³. Furthermore, producing countries are obliged to prove that palm oil they are exporting is produced by oil mills which have facilities that capture methane. EU members may rely on the default value, while non-EU members rely on typical value, which exceeds the given threshold. This may create serious difficulties for producing countries, which are typically non-EU members to enter EU market.³⁴

However, failure to comply with the European Standards does not prevent Indonesian palm oil meant for biodiesel production purposes to enter EU market, but precluded from receiving subsidies from EU Member States, as well as excludes it from contributing toward the 10 percent target for renewable energy for transport by 2020³⁵. Such disincentive may dissuade EU buyers from purchasing Indonesian palm oil.

Standards in palm oil producing countries may become irrelevant and illegible if compared with higher standards imposed by private actors and importing countries. Thus, producing countries are seeking for a gradual adaptation that will be based on prevailing conditions at the national level. Nonetheless, such a policy means that producing countries will continue to face intense pressure, arising not only to use private standards by businesses,

(Mongabay 2010) http://news.mongabay.com/2010/1105-dutch_palm_oil.html (September 3, 2011)

³² "Manifesto of the Task Force Sustainable Palm Oil: Initiative to promote the use of RSPO certified palm oil in the Netherlands" (Taskforce duurzamepalmolie 2010) http://www.taskforce-duurzamepalmolie.nl/Portals/4/download/Manifesto_Task_Force_Sustainable_Palm_Oil.pdf (September 6, 2011), p.3.

³³ Andreas Lendle, "Sustainability Criteria in the EU Renewable Energy Directive: Consistent with WTO Rules?" (International Centre for Trade and Sustainable Development, September 2010) http://ictsd.org/downloads/2010/10/case_brief_renewable_energy_dir_v5.pdf (August 16, 2011).

³⁴ Gernot Pehnlet and Cristoph Vietze, "European Policies towards Palm Oil: Sorting Out Some Facts." Jena Economic Research Paper, 2009, www.jenecon.de (August 16, 2011).

³⁵ Vincent Pickett, "EU Directive: Implications for the Palm Oil Industry" (Speech at the International Palm Oil Congress, Kuala Lumpur, August 15, 2009).

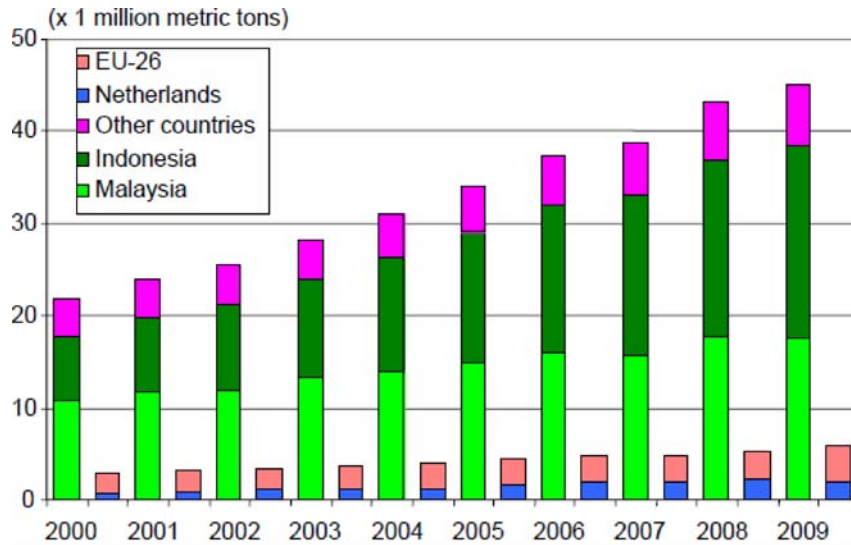


Figure 2
Global Palm Oil Production and EU Imports
Source: Task Force Sustainable Palm Oil (2010)

which is likely to increase costs for domestic business players, but also from governments in importing countries, which will be manifested in stricter environmental regulations.

That said, Indonesia can still have access the market for edible oil in major importing countries. Domestic policies can be case-selective in dealing diverse environmental criteria meted out by importing countries. Nonetheless, if Indonesia plans to increase its share in biofuel market, there is little else it can do other than taking measures necessary to comply with environmental standard in EU. Since its initial production in 2006, biofuel has been underutilized and has faced environment-related trade barriers. Besides, Netherland, Italy and Spain are accounting for more that 80% of Indonesian biodiesel export. Thus, the biggest challenge the Indonesian government faces, is to verify that palm oil feedstock from Indonesia meets EU requirements. Without being too optimistic, if current conditions persist, Indonesia will experience a 40 percent drop in biodiesel

exports to 195 million liters in 2011.³⁶

Indonesian experience highlights two issues. First, relates to whether Indonesia will comply or not with EU Directive. Recently, Indonesian government has taken unilateral measure involving the introduction of its own national standards manifested in Minister of Agriculture issued Ministerial Regulation No.19/Permentan/OT.140/3/2011 on Indonesian Sustainable Palm Oil (ISPO) issued on March 29, 2011. The objective of this regulation is to ensure that all oil palm planters meet national sustainability criteria. Moreover, compliance with the regulation is not voluntary, rather serves as launching pad for even stronger enforcement of relevant regulations related to oil palm plantation sector more comprehensively. The Unilateral measure may work if the national standard is accepted by some palm oil importing countries which are less concerned with environmental issues. Nonetheless, for the environmentally-concerned market, Indonesia must implement the verification mechanism, which will involve the third party if national standard have any chance of receiving acceptance.

By developing national standard, there is still an opportunity for Indonesia to elevate its

³⁶ Jonn P.Slette and Ibnu E Wiyono, "Indonesia Biofuels Annual 2010," GAIN Report Number ID 1033 (Jakarta: USDA FAS, 2010), 5

environmental standards to those that apply at the international level. This is through encouraging capacity building by national business players in the palm oil business to internalize environmental externalities in their operations right from upstream to downstream industry. The success in this sector may also trigger integration of environmental criteria among sectors. However, unless the capacity of the bureaucracy to effect collaboration in integrating environmental policy, trade policy, forest policy and agricultural policy improves, the cost of ensuring compliance may be very high.

The current situation attests to the reality that bilateral approach is still underutilized in building mutual understanding between importing and producing and exporting countries. On a bilateral basis, Indonesia may enter into negotiation with EU as an environmentally-concerned market, while building mutual adoption of environmental regulations in its trade policy with other major markets such as India and China. Nonetheless, this policy alternative is still grossly underutilized despite its strategic advantage for Indonesia. Unlike Malaysia, which has completed bilateral free trade agreement with EU, Indonesia has just embarked on it³⁷. This is applies to talks between Indonesia and India³⁸. The inclusion of environmental issues in this process is expected to play a crucial role in improving the possibility of adopting mutual environmental standards, not only for palm oil, but also other strategic primary commodities.

Bilateral negotiations can also facilitate

the development of economic incentives from environmentally concerned market segments. In the current debate among palm oil trading partners (particularly producing countries and importing countries), environmental standardization creates an unequal distribution of environmental cost which are met largely by producing countries. Palm oil producers have to bear the cost of certification as well as other costs that are necessary for compliance with either voluntary or compulsory standards. This is occurs at a time when palm oil importing countries or buyers have yet to show serious indication that they will apply appropriate policy measures to induce a shift in market preference to certified palm oil, which if materializes would increase the share of the cost of applying environmental related measures for importing countries, thereby reducing the high cost producing countries have to bear. Ideally, if international trade in palm oil is to provide non-discriminatory treatment for both producing and importing countries, trade negotiation should include the development of stages of adaptation, which are feasible to implement by both producing and importing countries. This would improve on the current condition, which is characterized by importing countries delinking their palm oil purchases from producing countries instantly with attendant social and economic costs.

The second issue that needs addressing is the extent to which Indonesia 'treats' private sustainability standards in meeting its trade objectives. The existing private certification by RSPO is to most circles socially legitimate, at least among international trading partners. In other words, if benchmarking through private voluntarism is an option, capacity and resources of oil palm planters (state plantations, private plantations or smallholders) are pivotal to enhancing Indonesia's international environmental competitiveness. While large oil palm plantation companies may adjust their firm-level strategies more easily, smallholders may face formidable difficulties in doing so. Many smallholders are part of a contract farm-

³⁷ Erwida Maulia."Indonesia, EU Seek "Ambitious" Free Trade Agreement".(Jakarta Post, June 15, 2011). <http://www.thejakartapost.com/news/2011/06/15/indonesia-eu-seek-ambitious-free-trade-agreement.html>

³⁸ RI Should Speed Up FTA Talks with India: Gapki".(Jakarta Post, February 22, 2011). <http://www.thejakartapost.com/news/2011/02/22/ri-should-speed-fta-talks-with-india-gapki.html> (September 6, 2011)

ing system that tie them with large plantations. Moreover, most of them lack sufficient requisite knowledge, technology and manpower in their production operations. If successful, the elevation of environmental standards by different segments of oil palm planters to national benchmarking may increase their competitiveness as they will be able to build linkages with the international market.

F. CONCLUSIONS

This article traces mechanisms that apply in setting international environmental standards, by focusing on the role of producing countries, importing countries and private actors. The case of palm oil demonstrates the tendency of increasing pressure for palm oil producing countries to comply with private environmental standard due to the adoption of private environmental standards by importing countries in the verification process. Thus, palm oil producing countries, are obliged to not only taking measures to meeting requirements set by importing countries, but also increasingly so, with more stringent environmental requirements, which the private sector must comply with.

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