



Global
Landscapes
Forum

White Paper

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Investing in no-deforestation commodities

The case of palm oil

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Unilever; Climate Policy Initiative (CPI); World Economic Forum (WEF); Tropical Forest Alliance 2020 (TFA2020);
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Objectives

This session takes a holistic approach to the growing agenda of removing deforestation from palm oil supply chains, using the specific example of Indonesia. The cluster weaves several complementary strands of ongoing work together and combines analysis at three levels: (i) enterprise, looking specifically at oil palm growers, (ii) landscape, and the partnerships required in a landscape management approach, and, (iii) national, exploring the role of public policy and finance, and other relevant actors. More specifically, the session will:

- Present a framework for 'the business case for change' at the corporate level. This combines a focus on identifying:
 - financial Value at Risk from deforestation with,
 - the extent to which this financial Value at Risk can be mitigated through different options to deliver 'no-deforestation' palm oil, taking into account the associated costs and risks of those options.
- Explore the partnerships required and benefits of a landscape management approach in facilitating traceability and sustainability commitments alongside economic, social and environmental benefits at scale.
- Discuss the role of government and other key organizations in the design and delivery of strategic policy interventions and financial transactions and services to help effect change, with a specific focus on blended financial structures.

What do participants need to know about the topic?

- Palm oil is a highly efficient and profitable vegetable oil in terms of output per hectare, and has the potential to satisfy growing global vegetable oil demand while simultaneously delivering positive social and economic benefits.
- However, some historical production models have put widespread and unsustainable pressure on tropical forests and the people who depend on them.
- The production map is complex, including 1.5 million smallholder growers who supply 30% of Indonesian production. Supply chains are further complicated as crude palm oil is refined into a number of derivatives, which then form only a small fraction of the ingredients of final products.
- Over the last two years, there has been a plethora of private and public declarations on land use change and tropical deforestation. Announcements—such as the New York Declaration on Forests in September 2014—have created a global timeline to cut natural forest loss in half by 2020 and strive to end it by 2030.
- Recent analysis estimates that time-bound pledges now cover over 90% of the global traded palm oil market, yet challenges remain over a range of issues linked to implementation of these pledges.
- Indonesia has ambitious 2020 palm oil production targets and an ambitious goal to reduce greenhouse gas emissions—predominantly from deforestation—by at least 26% nationally over the same time frame.
- There are opportunities to grow the value of oil palm without driving losses of high conservation areas and environmental services, by increasing productivity across the supply chain, putting land to its best uses, and increasing protection for environmentally valuable lands and resources.
- Smallholder farmers—broadly separated into independent smallholders and those who are part of a collective or partnership arrangement (of which the 'plasma' structure is well known)—have a well-documented potential to increase both profitability and yield. They are therefore a key stakeholder in the drive to reduce the deforestation footprint of Indonesian palm oil.

Some key facts on Indonesian palm oil

Indonesia currently produces approximately 31 million tonnes palm oil each year. Of that:

- Roughly 6 million tonnes are for domestic consumption.
- Roughly 6 million tonnes are used for other industries in Indonesia.
- Roughly 20 million tonnes are exported – about 45% to USA and Europe, about 55% other (mostly India, China).
- Roughly 10.5 million ha of Indonesia (an area slightly larger than Switzerland) is currently under oil palm in a mixture of estate plantations and smallholder plantations.
- Roughly 43% of the area (roughly 4 million ha) is under smallholder cultivation.
- Roughly 45% of smallholders are plasma farmers and about 55% are independent farmers.
- The productivity of palm oil is lower among smallholders: about 2 tonnes/ha compared to about 6-7 tonnes/ha on plantations.

What are the current challenges in relation to your topic?

- Lack of common understanding of the nature of risks created by deforestation and the associated quantified financial Value at Risk for a company. Similarly, lack of common understanding of how this risk can be mitigated and the quantified costs and additional risks generated by pursuing these options. This makes it difficult to motivate the private sector to sustainable change, and to understand which risks and costs need to be addressed at the company level or externally.
- Which costs and risks related to more sustainable production models are most material to the private sector? Will they ensure a transition to more sustainable practices at scale?
- Over and above improved practices and operations, how can risks and costs can be distributed throughout the oil palm value chain via financial engineering to minimize them?
- What is the potential for change through interventions in both the 'real' and 'financial' economies?
- What blend of public and private finance is most likely to support reduced deforestation and improved agricultural productivity? (i.e. can public finance be targeted at areas where private sector finds it difficult to see competitive risk-adjusted return on investment?)
- What is the role of financial products and services in smallholder production systems?

Which concrete measures do you propose to overcome these challenges? (*financial tools and instruments, broad frameworks, policies, etc.*)

- In the short to medium term, identify a range of strategic interventions that can (i) create a competitive risk-adjusted return through lower risks and/or costs, and through increasing returns, and (ii) facilitate access to capital where required. This capital might not flow for a variety of reasons, including a lack of appropriate financial instruments, capital constraints within financial institutions, and issues such as liquidity risk, deal size or concerns over land tenure. Some recent developments for a domestic fund supported by the government and palm oil producers within Indonesia are of interest in this regard.
- Over the longer term, more comprehensive structural reforms in political, economic and societal structures (the 'enabling conditions') to address the underlying drivers of the relevant risk categories.
- As well as a framework that embeds a temporal dimension, the solution space can be divided into 'real economy' interventions (i.e. those that impact actors in a landscape directly through various points along a supply chain) and 'financial economy' interventions (i.e. changes to the rules and norms that impact the financial sector, which in turn might alter the price and availability of capital, which potentially *indirectly* impact actors in a landscape).

What are the remaining open questions?

- How might measures prevent the emergence of a 'two tier' market that doesn't contribute to results at a national level?
- Will the increased focus on a domestic biofuels market create challenges for any of the existing proposals for more sustainable palm oil production?
- What are the metrics used to measure success?

What are your proposed milestones for implementation?

- TBC. This will be determined over the course of the cluster discussion but might include COP21 in Paris in December 2015, CGF/TFA2020/WEF events etc.?

Who (*organizations, sectors, stakeholder groups, etc.*) carries responsibility for / can support implementation?

- TBC. This will be determined over the course of the cluster discussion but will most likely include national governments, supply chain actors, financial institutions, civil society and other actors such as smallholder associations.

Background documents

Opportunities for Increasing Productivity & Profitability of Oil Palm Smallholder Farmers in Central Kalimantan. Online at: <http://climatepolicyinitiative.org/publication/oil-palm-smallholder-farmers-study/>

Landscape of Public Climate Finance in Indonesia. Online at: <http://climatepolicyinitiative.org/publication/landscape-of-public-climate-finance-in-indonesia-3/>

TFA2020 Website: <http://www.tfa2020.com/index.php/about-tfa2020>

Towards a Sustainable Financial System in Indonesia, UNEP Inquiry. Online at: <http://www.unep.org/inquiry/Portals/50215/Documents/Indonesia-Towards-a-Sustainable-Financial-System.pdf>



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