

Briefing Paper: Implications of the EU Deforestation Regulation (EUDR) for oil palm smallholders

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Summary

- Oil palm smallholders are important stakeholders of the palm oil value chain.
- EUDR is likely to further exclude smallholders from the EU market as they may have problems in showing proof on the legality of their land and geo-location of their production areas.
- In line with the spirit of the UNSDGs, the European Commission and Member States should look into how the Regulation can be implemented in a way that improves smallholder inclusivity.

1. Purpose

This paper provides an overview of the reality of oil palm smallholders with regard to their ability to meet the increasingly stringent sustainability and traceability requirements by the global supply chain. By providing this information we hope to clarify the potential impacts of the new [EU Deforestation Regulation \(EUDR\)](#) on smallholder inclusivity of the palm oil value chains.

2. The Concern

On 6 December 2022, the EU Council and Parliament reached a provisional deal on a proposal to minimize the risk of deforestation and forest degradation associated with products that are imported into or exported from the European Union. The new regulation, referred to as the EU Deforestation Regulation (EUDR) would strengthen the EU's position as the champion of deforestation-free supply chains. The EU already leads the world in the procurement and use of certified sustainable palm oil (CSPO) that meet certification standards such as the Roundtable on Sustainable Palm Oil (RSPO). In 2021, 93% of European imports of palm oil were certified as sustainable, of which 67% was 'Segregated RSPO certified' which meant that the palm oil entering the EU can be traced to the plot at which it was originally produced. The EU's demand for CSPO is mainly satisfied by the larger producers who are capable of meeting the stringent sustainability and traceability requirements. Smallholders, even



*Smallholders weighing Fresh Fruit Bunches in Indonesia.
Photo- Teoh Cheng Hai*

though they collectively account for 35% to 40% of the global production, have only a small share of the EU market. Globally, smallholders produce less than 10% of the total RSPO Certified Sustainable production, while independent smallholders (who are not formally associated with plantation companies) account for less than 2% of total volume of RSPO-certified palm oil. These stringent sustainability requirements and the lack of appropriate supply chain mechanisms have limited the access of smallholder products to the EU market. The introduction of the new EUDR is likely to further exacerbate this situation and could contribute to excluding smallholders from the EU market.

3. Understanding the reality of smallholders in the palm oil value chain

Oil palm smallholders are important stakeholders in the palm oil value chain. They account for about 41% and 27% of total oil palm planted areas in Indonesia and Malaysia, respectively. Smallholders account for about 35% - 40% of the global production of palm oil. They are essentially small-scale farmers growing oil palm as their primary source of income, often using family labour to cultivate the land. The oil palm industry plays a key role in transforming the livelihood of the rural communities in palm oil producing countries, alleviating poverty by providing employment opportunities and generating income as well as enhancing social development. As such, the oil palm industry can play an important role in contributing positively towards achieving the 2030 Agenda for Sustainable Development and its 17 Sustainable Development Goals (SDGs).



Fresh Fruit Bunches along the road in Kapuas Hulu Regency, West Kalimantan, Indonesia. © Yohanes Koko

Smallholders are defined by the size of holding and typology. The RSPO defines smallholders as having less than 50 hectares of oil palm but national definitions vary; in Malaysia, smallholders are those with up to 40 hectares (100 acres) while in Indonesia, the Agrarian law defines smallholders as having less than 25 hectares and Law 19/2013 stipulates 2 hectares. Smallholders are generally classified as ‘scheme smallholders’ and ‘independent smallholders’:

- Scheme smallholders are usually formally associated with a plantation company or palm oil mill. According to the RSPO, they are “farmers who do not have enforceable decision-making power on how they operate their land and their production practices, and/or the freedom to choose how they use their land, the types of crops to plant, and how they manage them.”
- Independent smallholders (ISH) are farmers who are not associated with companies/mills and have the freedom to decide on the type of crop to be planted and how to manage their farm

Scheme smallholders (who are also called ‘plasma’ smallholders in Indonesia), by virtue of their association with plantation companies or palm oils are part of the supply-base of the latter, receive technical agronomic and logistics support and are certified for sustainable palm oil production along with the palm oil mill. Their entire crop of Fresh Fruit Bunches (FFB) are sold to the associated mill. On the other hand, independent smallholders depend on middlemen or agents or sub-agents for support for collection and disposal of their FFB harvest to third party mills. The process flow of FFB

crops harvested from independent smallholder plots is shown in Figure 1 which is based on a case study in Rantau Prapat in Indonesia in 2018.



Figure 1. Process flow for FFB harvested from smallholder plots until delivery to the palm oil mill in Rantau Prapat, Indonesia, Source: Teoh, C.H., Fitriyardi, T. and Syakib, R. 2022. IR 4.0 agriculture solutions for oil palm smallholders. MOST Vol 31 No 1 (2022)

Many palm oil mills rely on third party suppliers for FFBs to meet the needs of their milling capacity. In Indonesia, it is a common practice for oil palm companies to rely on one or two big traders and sub-agents to secure this FFB supply from local independent smallholders. The smallholder does not have any direct contact with the mill and his/her only interface in the supply chain is with the sub-agents. Consequently, most palm oil mills do not know exactly where FFB traders who supply them get their FFB from, as shown in the above case study. The transactions between the smallholder and agent/sub-agent are informal and based on trust and there is minimal documentation, apart from a 'receipt' of the number and weight of FFB bunches collected and payment. In many instances, the FFB is delivered by the smallholders to independent collection centres. As these centres combine the FFB crop from many smallholders, the receiving mill will not be able to trace the source of the FFB.

4. Obligations of 'operators' with regard to EUDR

Under Article 3 of the EUDR, an 'operator' who 'places relevant commodities and products on the Union market or exports them from the Union market' must ensure that

- a. "they are deforestation-free;
- b. they have been produced in accordance with the relevant legislation of the country of production; and
- c. they are covered by a due diligence statement as laid down in Article 4(2)"

Among the information required to demonstrate compliance with the EUDR, operators must provide "geo-location coordinates, latitude and longitude of all plots of land where the relevant commodities and products were produced, as well as date or time range of production".

The key actors in the supply chain of palm oil are shown in Figure 2. Apart from plantations and smallholders, the various players could be ‘operators’ that export palm oil in various forms/products into the EU market. Through chain-of-custody or supply chain traceability mechanisms, these players would be able to demonstrate compliance with the EUDR requirements but the burden of proof of deforestation-free and legally compliant production of the primary raw material, i.e. fresh fruit bunches, rests entirely on plantations and smallholders. While the plantations and scheme smallholders that receive agronomic, technical, and logistical support from associated plantation companies, may be able to demonstrate compliance with EUDR requirements, it will be challenging for independent smallholders (the weakest link in the supply chain) to do so. Specifically, they may have problems in showing proof on the legality of their land and precise geo-location of their production areas.

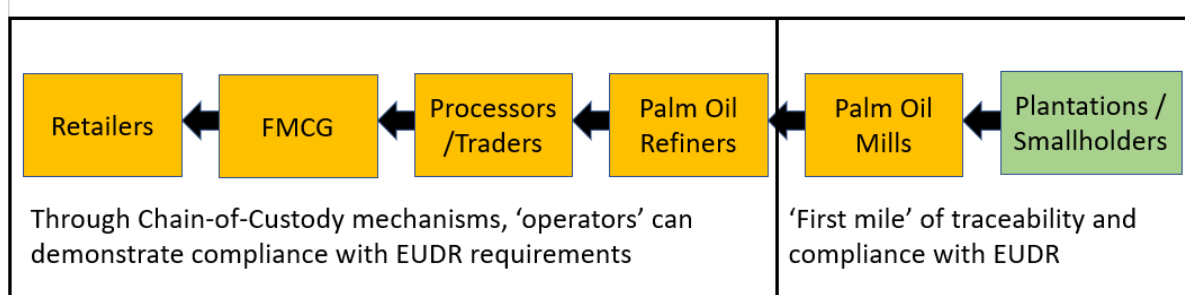


Figure 2. Key players along the palm oil supply chain

5. Implications of the EUDR requirements for oil palm smallholders

The challenges in the production of sustainable palm oil are well documented. A diagnostic study commissioned by the International Finance Corporation (IFC) in 2013¹ on 1069 smallholders in various locations in Indonesia showed that challenges faced by smallholders in sustainable production include less suitable soils, poor management capacity and low adoption levels of good agricultural practices (GAP), weak farmer organization, lack of access to good quality planting material and other production inputs. Access to credit is often cited as a major constraint for smallholders as they often do not have the necessary collateral such as land titles to borrow from financial institutions.

With regard to the EUDR, a recent survey was conducted by researchers from the Indonesian environmental NGO Madani on the impact of the new EU regulatory framework on independent smallholders in four palm oil-producing districts in the country. The survey found that only smallholders in the region Tanjung Jabung Barat are ready to comply with the EU deforestation regulation. The researchers identified traceability as the biggest challenge for independent smallholders to overcome. According to the survey, only 0.2% of respondents were able to sell their palm fruit to mills directly or through cooperatives. The rest had to rely on an informal network of intermediaries and middlemen, making it difficult to trace the palm oil back to its origin. This problem is worsened by a lack of documentation of transactions, with only 12.8% of respondents keeping sales records of every transaction. Madani also called the EU regulation an opportunity for Indonesia to build a partnership with the EU to improve palm oil governance. If the EU fails to help producing countries like Indonesia with complying with the regulation, it will push producers to

¹ IFC 2013. Diagnostic Study in Indonesian Oil Palm Smallholders: Developing a better understanding of their performance and potential.

export more of their commodities to countries with weaker environmental regulations, shifting the problem to other regions. (Jong, H.N. 2023).²

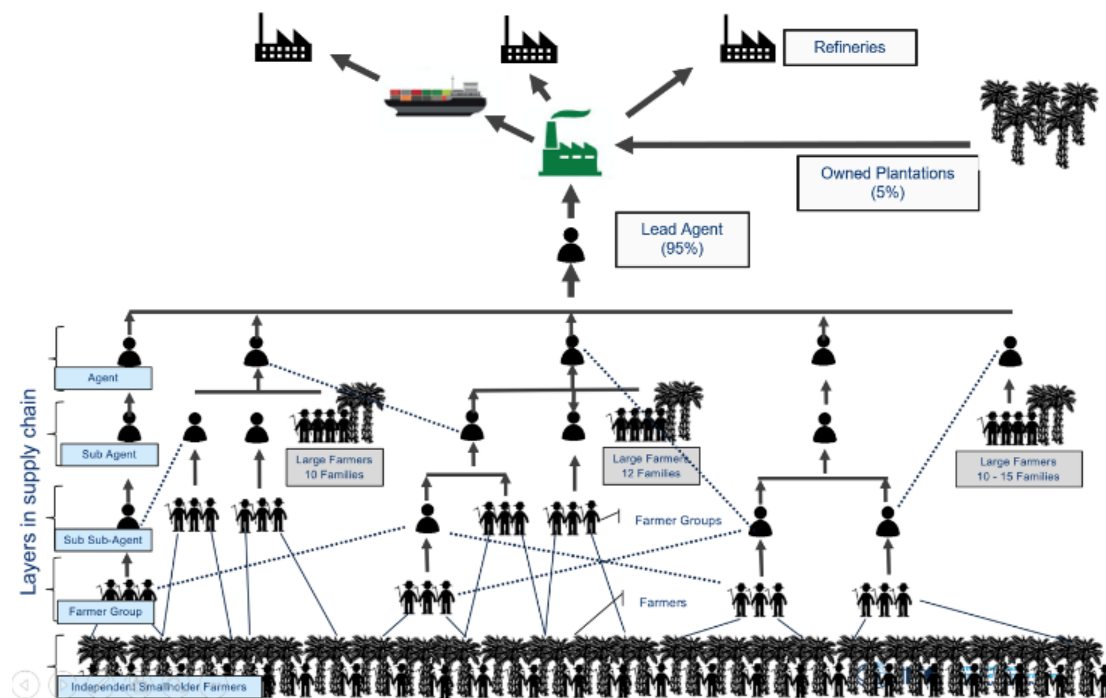


Figure 3. Understanding the independent smallholder supply chain. Source: Andi Wahyuni, B. and Kukeawkasem, Y. 2019. IFC Indonesia Palm Oil Development for Smallholders. RSPo Linking and Learning Seminar at RT17, Bangkok.

Figure 3 shows the complex upstream smallholder supply chain, based on a study in an IFC project on independent smallholders in Indonesia in 2019. The study uncovered many layers of actors in the smallholder supply chain from the individual smallholder to collectors, sub-sub agents and sub-agents before they reach the main or lead agent and finally the palm oil mill. Transactions among the supply chain actors are informal and based on trust and there is minimal documentation. As the smallholder crop collected by the sub-agents or in collection centres are not segregated or documented, it is not possible for the main agent and palm oil mill to know the exact original source for the purchased FFB crop.

This situation poses a serious constraint towards compliance of the EUDR which requires operators importing oil palm (products and derivatives) into Europe to provide geolocations (and polygon maps, if the plot is more than four hectares) of the imported products, and to ensure traceability to the plot. Surely it is possible to organise this information but it is likely that costs of organizing compliance are higher than the additional market value generated.

6. Recommendations

As the supply chain of independent smallholders is generally opaque and informal and there is often minimal documentation of transactions between the smallholder and agents, sub-agents, middlemen and other players, there is a severe risk that the EUDR will further excludes oil palm smallholders from the supply chains to Europe. To ensure the overarching UN SDG philosophy of

² Jong, H.N. 2023. For Indonesian smallholders, EU deforestation rule is a threat — and an opportunity. Mongabay, 4 January 2023

“leave no one behind” and minimize the risk of further exclusion of smallholders from the EU market, the European Commission and Member States could look into how the Regulation can be implemented in a way that improves smallholder inclusivity. This requires significant support in particular regarding critical issues and challenges associated with organising traceability.

Solutions could include:

- Assess the challenges and potential impact of the regulation on oil palm smallholders as soon as possible, so that practical measures can be developed to facilitate the participation of smallholders.
- As soon as possible: start large scale engagement and consultation to discuss what is needed to comply with the regulation for stakeholders in the oil palm sector in producing countries
- Recognize the efforts taken to ensure the sustainable development of palm oil in producing countries including the mandatory sustainability standards such as the Malaysian Sustainable Palm Oil (MSPO) and the Indonesian Sustainable Palm Oil (ISPO) as important avenues to drive compliance with national laws and regulations and the absence of deforestation (Articles 3(a) and 3(b) of the EUDR. It should be noted that the 2020 revision of MSPO standards ensures that certified sustainable palm oil has not been produced from deforested land after December 2019.
- Immediate action on the provisions of Article 28 of the Regulation: strong and structured partnerships between the EU and the palm oil producing countries to create an enabling environment, including potential dialogue on innovative financial instruments to prevent further development of oil palm in forest areas, legality and compliance with the EU Regulation. This could include:
 - Ensure both governments and companies invest in smallholder capacity building to support the ability smallholders and representative organizations to comply with the EUDR
 - Support for national legal sustainability schemes and national landscape initiatives, including training on governance, plots mapping and land title registration to help to achieve accurate traceability and sustainable development as well as help protect the legal rights of indigenous communities.
 - The support for modern and easy-to-use technology and end-to-end traceability systems to enable full and updated farm traceability data at the national level that correspond to the land ownership boundaries. Technical support to smallholders on determining the geolocation of their oil palm plots would be of particular relevance.
 - The identification of practical solutions on how to share traceability data along the supply chain that are consistent with personal data privacy protection legislation in certain producing countries.
 - The development of innovative Financial Mechanisms that could compensate local communities for not converting their lands and community forests into oil palm plantations, with due respect and recognition of the customary land rights of indigenous peoples and local communities.
 - To support smallholders in high deforestation risk areas to move away from oil palm cultivation and seek alternative livelihoods.
- To minimize the risk of excluding independent smallholders from supply chains, investigate ways to introduce systems or mechanisms to ensure that sourcing from independent smallholders can continue. This could include reviewing options to develop mechanisms for preferential sourcing from independent smallholders.