

## INDONESIAN PALM OIL GOVERNANCE: FINDING THE BALANCE OF DOMESTIC AND EXPORT INTERESTS

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### RESUME

*Indonesia has been facing a significant increase in palm cooking oil prices for the last five months. The government continues to implement various policies, but these policies have not been effective in overcoming the high price of palm cooking oil. The government is currently re-implementing the DMO-DPO policy for CPO to stabilize domestic palm cooking oil both its availability and prices. This government policy is part of the governance of the palm oil industry, which has been implemented since the 1970s and continues to change according to the developments and challenges of the times. These palm oil policy regimes create pluses and minuses so that can learn the lessons to build the governance of the palm oil industry in the future. Based on the historical analysis of the national palm oil policy regime, which is also supported by data and empirical studies, it shows that to deal with the increasing world price of palm oil and its derivative products (e.g. palm cooking oil), the combination of export levy policies associated with the downstream of domestic palm oil is carried out through three downstream pathways (oleofood complex, oleochemical complex, and biofuel complex) is the best solution. If the government wants the price of palm oil and palm cooking oil to be cheaper, then the policy that can implement is to temporarily increase the export levy tariff.*

## INTRODUCTION

For five months (January–May 2022), the Indonesian government has struggled to manage the palm cooking oil industry amid a significant increase in global palm oil prices. Based on World Bank's data (2022), global palm oil prices have increased from USD 537 per tonne in January 2019 to USD 1,823 per tonne in March 2022.

During this period, the government carried out policies starting from the One Price Policy (*Kebijakan Satu Harga*), Domestic Market Obligation (DMO) and Domestic Price Obligation (DPO), Bulk Cooking Oil Subsidy Policy (*Kebijakan Subsidi Minyak Goreng Curah*), and social assistance (BLT *Minyak Goreng*) (PASPI Monitor, 2022). These policies have not been effective in overcoming the dynamics of palm cooking oil, so the government has re-enacted the regulation on the Temporary Export Prohibition Policy for CPO and Palm Cooking Oil Raw Materials from April 28 to May 22, 2022. After revocating the export ban policy, the government re-imposed the DMO-DPO policy on May 23, 2022. The purpose of implementing this policy is to maintain the stability of domestic palm cooking oil.

Maintaining a balance between domestic and export interests has long been a target for the governance of the Indonesian palm oil industry in the post-coconut oil eras. From the 1970s until now, the palm oil industry's trade governance regime has changed according to the developments and challenges of the times.

Starting from the DMO and DPO regimes with the orientation of the palm oil industry focusing on fulfilling the need of the domestic market. This policy had experienced a relaxation of export orientation while maintaining domestic needs through the Export Tax instrument. Furthermore, the policy began to focus on developing domestic downstream to export processed products while still paying attention to domestic needs through the Export Levy instrument.

This article will discuss the evolution of the Indonesian palm oil industry governance to balance domestic with export interests from 1970 to 2021. And then, we will discuss the lessons of these policies that can take to

build the governance of the palm oil industry in the future.

## THE DMO AND DPO REGIMES

Before to 1970, cooking oil consumption in Indonesia was still dominated by coconut cooking oil (Larson, 1990; Idroes, 2001; Djunaedi and Gonarsyah, 2002; PASPI Monitor, 2021). However, after 1970, the domestic cooking oil industry switched to using Crude Palm Oil (CPO) as a raw material for cooking oil. A shortage of copra caused this transition during that period.

From 1971 until today, there have been three policy regimes or governances of the Indonesian palm cooking oil industry, which stabilize palm cooking oil for domestic and export markets (Sipayung, 2018). The Domestic Market Obligation (DMO) and Domestic Price Obligation (DPO) took place from 1973 to 1990. This policy required the allocation of CPO produced by a state-owned company (formerly known as the State Plantation Company) to be marketed for the domestic cooking oil industry at a price determined periodically by the government.

A state-owned company produced approximately 50–80 percent of national CPO production from 1971 to 1994. During this period, Bulog was also assigned by the government to control the distribution of CPO and palm cooking oil. The DMO and DPO policies in that period were fully controlled by the government both on the production side and on the distribution side of CPO and palm cooking oil.

However, have the DMO and DPO policies succeeded in stabilizing domestic palm cooking oil? This question can be answered by describing the impact of implementing DMO-DPO policy in Indonesia from the 1970s to the 1990s. There were four impacts of implementing the DMO-DPO policy during that period.

**First**, the CPO export share decreased while the share of domestic consumption increased. Before 1978, most of Indonesia's CPO production was for the export market, but export share gradually declined after 1978. The same thing happened to Palm Kernel Oil (PKO), where the export share decreased and the domestic consumption

share increased. In other words, for the first time in the history of the Indonesian palm oil industry, there has been a significant change in market orientation from export orientation to the domestic market.

**Second**, the actual price of CPO in the domestic market is generally above the government-stipulated CPO price (maximum price) both in rupiah and in US dollars. **Third**, there is a significant disparity in CPO prices between the domestic market (actual) and export prices (FOB Belawan), causing smuggling from the domestic market to the foreign market. This condition is possible due to the significant incentive from the disparity in the price of CPO between the price set by the government and the export price. The volume of CPO smuggled into foreign markets is estimated to be quite large because the price formed through the mechanism in the domestic market (the actual price) is higher than the price set by the government.

**Fourth**, a significant disparity in CPO prices between the export market (FOB Belawan) and the world market (Rotterdam). This indicates that the domestic market orientation policy adopted by the government in that period was also used by intermediary traders/buyers of world CPO by suppressing the purchase price of CPO from Indonesia. Global CPO players read the domestic market orientation policy as uncertainty in Indonesian supply, so they respond by suppressing prices (managing risk).

**Fifth**, the price of palm cooking oil in Indonesia fluctuated from 1980 to 1994. Overall, its average price increase during the policy was 6.4 percent, or roughly the same as the inflation rate. Thus, this policy can have failed to maintain the stability of domestic palm cooking oil.

Tomich and Mawardi (1995) analyzed the impact of this policy over the period 1978–1987. The study results reveal that the policy is detrimental to producers and consumers. The policy provides nominal protection on oil palm plantations with a proportion of up to 9 percent. Meanwhile, palm cooking oil consumers pay around 6–12 percent above the parity price of imported palm cooking oil. During the period 1982–1987, the total losses for consumers reached Rp. 880 billion and losses for producers

reached Rp. 387 billion. In addition, Indonesia has also lost the opportunity to earn a large amount of foreign exchange and has lost its market in the global market.

### BUFFER STOCK AND EXPORT TAX REGIMES

This regime was implemented from 1992 to 2015, with various variations in the implementation. Under this regime, there are three crucial policies: export tax for CPO and its derivative products, buffer stock management by Bulog, and requiring CPO production from an own-state company to fulfill domestic needs at prices below market prices.

The determination of the amount of the export tax was initially carried out by considering the world CPO price. The government periodically sets the basic price (FOB CPO price is not subject to export tax) and determines the export price (FOB price). The amount of the export tax is determined by the difference between the export price and the basic price multiplied by the tariff.

The export tax formula changed in 1997 to become an ad valorem tax and expanded to palm oil derivative products. The CPO export tax once reached 60 percent during the 1998 economic crisis, and then decreased to 3–5 percent in the period 2001–2005.

The main objective of implementing the export tax policy during this period was to ensure the stabilization of domestic palm cooking oil procurement and prices. Therefore, the amount of export tax for derivative products (such as RBD Olein) is higher than for upstream products (such as RBD Palm Oil and CPO).

In the 2005–2015 period, the export tax policy has increasingly extended into derivative products. Furthermore, the stipulation of an export tax since 2011 has begun to accommodate palm oil downstream by imposing lower export taxes on downstream products.

Can the export tax regime be said to be successful in stabilizing domestic palm cooking oil? Implementation of export tax policy for CPO and its derivative products during 2000–2008 showed that FOB CPO prices and domestic market prices tended to

increase. Domestic CPO prices are below FOB prices with disparities ranging from 5–42 percent, or an average of 17.5 percent. The proportion of these disparities is higher than the average CPO export tax in that period, which ranged from 1.5–6.5 percent.

The exciting thing is that Indonesia's CPO export share increased from 58 percent in 2000 to 74 percent in 2008, even reaching 78 percent in 2006. Despite growth in absolute terms, the share of domestic consumption decreased from 42 percent to 22 percent in the period. This condition indicates that most of Indonesia's CPO is for the export market. Even though the government imposes an export tax at increased rate, CPO producers still prefer to sell to the export market and they have to pay export taxes rather than sell it to the domestic market.

So, did the CPO export tax policy fail? The answer to this question depends on what indicators are used. If the indicator is the domestic CPO price, the export tax policy is successful because the CPO price in the domestic market is lower than the CPO export price. If there is no export tax, then the domestic CPO price will be close to the export price or equal to the export parity price.

The results of the Larson study (1996) prove that declining income in oil palm plantations (including smallholder plantations) is higher than the total revenue of export taxes received by the government and the benefits (consumer surplus) enjoyed by domestic palm cooking oil consumers. In addition, the decreasing export revenue due to this policy was far greater than the government's revenue from export taxes.

In other words, implementing the export tax policy reduces people's welfare (worse-off). The benefits (better-off) enjoyed by the government and consumers are smaller (in monetary terms) compared to the losses (worse-off) experienced by oil palm plantation actors, including smallholder plantations.

## REGIMES OF EXPORT DUTIES, EXPORT LEVIES AND DOWNSTREAM

This regime has been occurring since 2015 until now. The objectives of implementing the three policies are: (1) ensuring the availability of palm oil as raw materials for domestic downstream industries; (2) securing the domestic supply and price of palm cooking oil; and (3) supporting palm oil downstream.

To encourage the downstream of domestic palm oil, international trade policy changes were made from an export tax policy to an export duty policy for CPO and its derivative products. To accelerate the downstream, Indonesian government has integrated the export duty and export levy since 2015.

Three pathways of palm oil downstream have been implemented since 2011 (Sipayung, 2018; PASPI Monitor, 2021), including the oleofood complex, oleochemical complex, and biofuel complex (including mandatory biodiesel). These palm oil downstream pathways are intended to increase the added value of domestic palm oil products and change the composition of Indonesian palm oil exports.

The export levy policy is implemented in a progressive, flexible and proportional manner to support domestic downstream. Tariffs for export levies on raw materials (CPO), which are higher than those for derivative products, will accelerate the development of domestic palm oil downstream.

The combination of three policies are export levy, downstream policy (3 pathways) and mandatory biodiesel policy, are grand policies for palm oil industrialization. Their combination also reflects the governance carried out by Indonesia as the "king" of world palm oil. Then a critical question arises, are the export levy and downstream regime successful in balancing domestic interests with exports?

With the downstream policy, consumption of CPO in the domestic downstream industry has increased relatively quickly. Domestically processed CPO and PKO accounted for only 73 percent of total national CPO and PKO production in 2015. In 2021, domestic CPO and PKO

processing will account for 93 percent of total national CPO and PKO production. The most extensive use of raw material consumption (CPO+PKO) for domestic use is for food products at 8.9 million tons (49 percent), then the biodiesel industry at 7.3 million tons (40 percent), and the oleochemical industry at 2.1 million tons (11 percent).

The data also shows that most of the final product produced by palm oil downstream in Indonesia until 2021 is food products. The increasing use of CPO in food products impacts increasing the availability of palm cooking oil (and other oleo food) in the country. Palm cooking oil production increased from 6.1 million tons in 2015 to 8.9 million tons in 2021. This product is intended to meet domestic and export needs.

In the downstream oleochemical complex pathway, production of basic oleochemical has increased from 6.6 million tons to 12.9 million tons in 2016-2020. The impressive growth was due to the increase in Methyl ester from 3 million tons to 8.59 million tons during that period. The growth of the oleochemical industry cannot be separated from the downstream palm oil ecosystem that the Indonesian government has built since 2011 (Sipayung, 2018; PASPI Monitor, 2021).

In the downstream biofuel complex pathway, Indonesia's biodiesel production has increased from 1.7 million kiloliters to 8.9 million kiloliters in the 2015–2021. Based on APROBI's data in 2022, there are 32 biodiesel factories in Indonesia with an installed capacity of biodiesel plants reached 17.14 million kiloliters. Indonesia is the world's top-3 largest biodiesel producer.

The consistent downstream of domestic palm oil especially in 2015-2021, has changed the composition of Indonesian palm oil exports, which are more dominated by processed products. The composition of Indonesian palm oil exports in 2015 consisted of crude palm oil (CPO+CPKO) with a share of 27 percent, processed products (63 percent) and palm oil-based final products (10 percent). Meanwhile, the composition of Indonesian palm oil exports in 2021 is changing and more dominated by processed products with a share of 80 percent, followed by the final product (13 percent), while the share of CPO and CPKO exports is only 7

percent. The export value of palm oil and derivative products in 2021 will reach USD 36.2 billion and export levies of IDR 71 trillion. This data was recorded as the highest record in history (PASPI Monitor, 2022).

What about domestic palm cooking oil stabilization? The increase in domestic palm cooking oil production reflects increased in their availability. This is also confirmed by the rise in domestic consumption of palm cooking oil from 10.7 kg per capita in 2000 to 19.7 kg per capita in 2020 (PASPI Monitor, 2021).

The combination of export levy policies and domestic downstream has also made domestic palm cooking oil prices cheaper than international prices. In 2021, the average world price of RBD Olein (FOB Belawan) will reach around USD 1.133 per tonne. Meanwhile, domestic bulk palm cooking oil prices are only USD 1,048 per tonne, or 7 percent lower than the RBD Olein price in the global market. The price of simple packaged cooking oil is USD 1.105 per tonne in Indonesia, or 2 percent lower than the international price. This means that the export levy on palm oil and its derivatives can make domestic palm cooking oil prices lower than world prices.

Likewise, in January-April 2022, the average world RBD Olein price reached USD 1,576 per tonne. Meanwhile, the average domestic price of bulk cooking oil is USD 1,295 per ton, approximately 18 percent lower than the global price. Compared to the price of domestic packaged cooking oil in Indonesia, which is USD 1,498 per tonne and premium packaged cooking oil is USD 1,558 per tonne, domestic prices is still around 1-5 percent lower than the world price.

The empirical evidence above shows that the combination of export levy policies aimed at the success of three pathways of domestic palm oil downstream seems to balance domestic interests (stabilization of palm cooking oil and encouraging domestic downstream) and export interests (foreign exchange and government revenue). Regarding the price of domestic palm cooking oil, although it tends to increase, the price increase follows the increase in world palm oil prices. The price of domestic palm cooking oil in Indonesia is more affordable than the international price. This also means that if the

government wants the domestic palm oil price to be lower than the world price, the policy implemented is temporarily increasing the export levy tariff.

## CONCLUSION

The DMO and DPO policy regimes in 1971–1990, which Indonesian government fully controlled, proved unable to balance domestic and export interests. In addition to creating a black market and smuggling, Indonesia has also lost foreign exchange and export markets.

The export tax policy regime imposed by the Indonesian government from 1991 to 2015 has succeeded in making CPO and RBD Olein prices cheaper and also encouraged smuggling. In addition, the policy is also less effective in supporting domestic downstream and reducing foreign exchange.

Meanwhile, the export levy policy regime designed to support domestic palm oil downstream has proven to balance domestic interests (palm cooking oil stabilization and deepening domestic downstream) with export interests (foreign exchange and government revenues). Implementing this policy can also increase the production of palm cooking oil so that the price in the domestic market is lower than the international price.

In order to deal with rising world palm oil prices, a combination of export levy policies related to the downstream of domestic palm oil is carried out through three downstream pathways (oleofood complex, oleochemical complex, and biofuel complex) is optimal choice. If the government wants the domestic palm oil price to be lower than the world price, the policy implemented is temporarily increasing the export levy tariff.

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