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## THE EUROPEAN UNION DEFORESTATION-FREE REGULATION (EUDR) ON SUPPLY CHAIN CREATING RISKS OF UNCERTAINTY IN THE PALM OIL INDUSTRY

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### RESUME

With the implementation of the EUDR policy, commodities/products that are allowed to enter the EU market are those that are free of deforestation and forest degradation, comply with legality in the producing country, and pass due diligence. The implementation of the EUDR has the potential to create global risks and uncertainties in the global palm oil industry. Some of these include uncertainty in global regulations, non-compliance with WTO/TBT regulations, differences in legislative regulations between the EU and Indonesia, the potential disruption of global palm oil and product supply chain, increasing production costs, the potential establishment of EU monopsony power, and the potential exclusion of smallholders from the global palm oil supply chain.

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### INTRODUCTION

The European Union has enacted the European Union Deforestation-free Regulation on Supply Chain policy. This policy is outlined in Regulation (EU) 2023/1115 of the European Parliament and of the Council of 31 May 2023 on the making available on the Union market and the export from the Union of certain commodities and products associated with deforestation and forest degradation and repealing Regulation (EU) no. 995/2010 (or abbreviated as EUDR).

The EUDR policy was published in the EU Official Journal on 9 June 2023 and was implemented as a binding regulation as of 29 June 2023 (PASPI Monitor, 2022<sup>a</sup>; PASPI, 2023<sup>a,b,c</sup>). In the implementation, business actors (operators/traders) are given a grace period of 18 months, during which all operators/traders are required to comply with the regulation by 29 December 2024. Meanwhile, Smallholder Enterprises (SMEs) are given a longer transition period of 24 months, or the SMEs must adhere to the regulation starting 29 June 2025.

The enforcement of the EUDR introduces a range of new risks and uncertainties for the palm oil industry. The EUDR approach covering palm oil supply chains (upstream-downstream) throughout the world, traceability, and landscape/geolocation creates various uncertainties and risks that have never existed before. The implementation and compliance process of the EUDR demands high complexity and entails time, skills, and costs, thereby potentially disrupting the global palm oil supply chain.

This article will discuss how the EUDR principles are implemented. Then there will also be a discussion regarding the potential for EUDR to become a new source of risks and uncertainties for the global palm oil industry.

### THE COMPLEXITY OF EUDR IMPLEMENTATION

The EUDR policy is aimed at reducing deforestation and forest degradation worldwide (European Commission, 2018, 2021; Council of European Union, 2022; EU, 2023). To achieve this goal, efforts are made to decouple deforestation and forest degradation from the supply chain of commodities (and derivative products and related by-products) that pose a high risk of deforestation (high-risk commodity deforestation). One product categorized as high-risk is palm oil.

In general, the EUDR regulations (especially Articles 1 & 3) state three main principles (PASPI Monitor, 2022a; 2023b). **First**, it emphasizes free of deforestation and forest degradation. Commodities/products that are allowed to enter and exit the EU market must be free of deforestation and forest degradation with a cut-off date of 31 December 2020. If indeed the EUDR sets this cut-off date, then Indonesia's existing oil palm plantations covering an area of 16.3 million hectares in 2020 are no longer a target for deforestation issues under the EUDR. This is because these existing oil palm plantations were built before 2020. However, if the oil palm plantations were established after 2020, their products (including derivative products and by-products) cannot enter the EU market for both EU consumption and re-export purposes.

Even though the deforestation cut-off date in question is after 31 December 2020, by following the EUDR regulations, existing oil palm plantations must still be equipped with the necessary coordinates/polygons (geolocation) and production information. The plantation and production data are presented digitally following established EU standards. Information on the origin of the land for plantations will also likely be requested in the EUDR for due diligence purposes in the future.

EUDR is implemented in multi-product, multi-stage industry, multi-country, multi-ecosystem, multi-farming/plantation complexity with high variation. One can imagine the complexity, time and energy required as well as the huge costs that must be incurred to provide geolocation and information on plants, production, and others from 16.8 million hectares of Indonesian oil palm plantations and 25 million hectares of world oil palm plantations, not to mention the world's soybean plantations covering 130 million hectares spread across various countries in the world.

**Second**, the commodities/products produced must comply with the applicable laws and regulations in the producing country. Geolocation data and bioinformation (plant/production) must still be completed with all the legalities of oil palm plantations in accordance with applicable laws and regulations in Indonesia.

This level is also full of uncertainty. What laws and regulations does the EUDR refer to that must be complied with, considering that there are at least 33 laws in Indonesia related to the palm oil industry? Of these numerous legalities for oil palm plantations, only Cultivation Rights (*Hak Guna Usaha/HGU*) has geolocation, while others generally do not specifically designate geolocation, but these activities and legalities must be digitized. Is compliance with these laws and regulations valid enough by only attaching administrative evidence or does it also require empirical evidence? One can also imagine the complexity, time, effort, and costs required to fulfill the EUDR requirements.

**Third**, due diligence along the palm oil supply chains, starting from oil palm plantations, CPO Mills, storage/logistics warehouses, transportation/shipping, refinery industry, to processing plants/traders. This due diligence includes: (1) gathering information, (2) risk assessment, and (3) risk mitigation. This due diligence aims to trace (traceability) aspects related to geolocation, plantation/product bioinformation, legal compliance, stock/logistics, and others along the upstream-downstream palm oil supply chain, which will then be certified.

This supply chain due diligence contains various uncertainties and high complexity because it is dealing with multi-edible oil produced from multi-stage industry, multi-country, multi-ecosystem, multi-farming/plantation, each of which has varying characteristics and cannot be equalized. For example, the EU food industry which generally uses multi-edible oils (palm oil, soybean oil, rapeseed oil) must be able to carry out due diligence (traceability) along the supply chain on each vegetable oil used, where each vegetable oil comes from the supply chain of millions of fields/plantations (multi-farming/plantation) with multi-ecosystems and multi-stage industries in various countries (multi-

country). Although due diligence can be carried out using a digitalization system, its application and realization is not easy and is very expensive.

### RISKS AND UNCERTAINTIES OF THE EUDR

If the EUDR policy is implemented, it will create a few global risks and uncertainties, including in the global palm oil industry. There are at least seven risks and uncertainties resulting from the implementation of the EUDR.

**First**, the EUDR policy is the imposition of EU regulations on other countries. Anu Bradford from Columbia University refers to what the EU does as the “Brussel Effect” (Barford, 2020), where EU regulations contradict international consensus. A country's policies that affect the interests of other countries can only be implemented after being notified and agreed upon internationally. The EUDR policy should have been notified to the WTO first, and if agreed upon, then implemented internationally. Such actions conducted by the EU can be considered a form of neo-imperialism that should be avoided by the EU, which has a history of imperialist-colonialism in the past. If these actions are allowed to continue, it will undermine the credibility of multinational institutions (such as the WTO) in the global community and create international trade uncertainty.

**Second**, the EUDR policy also has the potential to violate WTO/GATT provisions. In the context of the world's vegetable oils, the EUDR is only applied to palm oil and soybean oil. This policy is not applied to rapeseed oil and sunflower oil (as well as 10 other types of vegetable oils), produced by both the EU and other countries. In the consumption of vegetable oils, there is a substitutive relationship between vegetable oils (Morgan, 1993; Parcell, 2018; Kojima *et al.*, 2016; Santeramo, 2017; Shigetomi *et al.*, 2020) making all vegetable oils relatively the same or “like product”.

The implementation of EUDR is considered discriminatory and has the potential to conflict with GATT/TBT principles (Articles I/III:4 GATT Article 2.1 TBT Agreement, Article XI:1 GATT 1994) and impedes trade (Article 2.2 TBT Agreement). The EUDR policy that demands compliance with governance, regulations and laws violates or does not align with international regulations and rules. In addition to degrading the global community's trust in the WTO, this can also create uncertainty in global vegetable oil trade.

**Third**, differences in the definitions of forests, deforestation and forest degradation vary between countries (PASPI, 2023; Purnomo, 2023). Apart from the differences in the definition of forests, there are also differences in policies and legislative regulations applicable in the EU and Indonesia (Purnomo, 2023).

The differences in the definitions of forests, deforestation and forest degradation have caused the presence of the EUDR to create uncertainty in the implementation of the EUDR (PASPI Monitor, 2022<sup>a,b</sup>). Shrubs (in cultivation areas), rubber plantations and coffee/cocoa plantations meet the criteria for forests in the European definition of forest, so if they are converted into oil palm plantations, the EU sees it as a form of deforestation. On the other hand, in the definition of forests in Indonesia, shrubs in cultivation areas, rubber plantations, coffee/cocoa plantations, are not considered forests. So, if they are converted into oil palm plantations, it is not deforestation. These differences in definition, coupled with the use of satellite imagery to depict the landscape, further increase the risk of uncertainty.

**Fourth**, the implementation of EUDR can disrupt/disturb global palm oil business and trade processes. The implementation of EUDR, starting from digital geolocation, digitalization of legality, compilation of supply chain information from upstream to downstream, and the due diligence process is extremely complex and difficult to imagine being completed before December 2024. Unlike vegetable oils from annual crops which are harvested seasonally, palm oil are harvested day to day on a rotational basis, making compliance with the EUDR regulations challenging. During the EUDR implementation process, it has the potential to disrupt or even disturb the production process at the level of oil palm plantations, CPO Mills, and downstream industries and global palm oil trade. This

also has the potential to disrupt the global palm oil market and threaten the harvest of Fresh Fruit Bunches (FFB).

**Fifth**, the increase in the cost of providing palm oil from upstream to downstream. Implementing EUDR requires significant time, energy/capacity, and costs (Hadi, 2023; Unnithan, 2023; Lukman, 2023). This implies an increase in production costs in the global supply of palm oil. Who will bear the costs of implementing EUDR? Can the EU consistently pay premium prices for EUDR-compliant palm oil? Learning from the experience of implementing the RSPO, even though the RSPO originated in Europe, it turned out that European were unwilling to pay premium prices for certified sustainable palm oil (CSPO) and preferred cheaper, albeit unsustainable (Annunzita *et al.*, 2019; Hinkes and Christoph-Schulz, 2019; RSPO, 2020).

**Sixth**, the potential to dominate and exploit palm oil producers. The implementation of the EUDR, which is directly controlled by the EU, places the EU and its business actors as the sole buyer (monopsony) in the EU market. This monopsonic position and power are then transmitted by actors along the palm oil supply chain from downstream to upstream, causing FFB producers to suffer from the exploitation of this monopsonic power. In other words, the EUDR has the potential to become a new style of "*Vereenigde Oost-Indische Compagnie* (VOC)" for palm oil.

**Seventh**, it has the potential to drive smallholders out of the global palm oil supply chain. The implementation of the EUDR (digital geolocation, production information, legality, and due diligence) with its own capabilities makes it certain they will struggle to meet the EUDR requirements (Hadi, 2023; Unnithan, 2023; Lukman, 2023). In the context of minimizing risks, oil palm plantation companies also prefer to save their supply chains to comply with the EUDR. This condition has the potential to exclude smallholders from the global palm oil supply chain. If this condition occurs, it will create various serious social, economic, security and political issues. The EUDR will turn into a deadly EU instrument that displaces smallholder oil palm plantations and impoverishes smallholders and their families.

## CONCLUSION

The EUDR policy was implemented as a binding regulation as of 29 June 2023 with an implementation grace period of 18 months for operators/traders and 24 months for Smallholder Enterprises (SMEs). With the implementation of the EUDR policy, commodities/products that are allowed to enter the EU market are those that are free of deforestation and forest degradation, comply with legality in the producing country, and pass due diligence.

Palm oil (including its derivatives and by-products) falls into the category of products classified as high-risk in the EUDR. Despite the 16.8 million hectares of existing oil palm plantations in Indonesia having passed the deforestation and forest degradation cut-off date, Indonesian palm oil industry actors still need to adhere to the principles outlined in the EUDR. This means that the palm oil industry and Indonesia (as the world's largest palm oil producer) will still be affected by the enforcement of this policy.

The implementation of the EUDR has the potential to create global risks and uncertainties in the global palm oil industry. Some of these include uncertainty in global regulations, non-compliance with WTO/TBT regulations, differences in legislative regulations between the EU and Indonesia, the potential disruption of global palm oil and product supply chain, increasing production costs, the potential establishment of EU monopsony power, and the potential exclusion of smallholders from the global palm oil supply chain.

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