Improving Indonesia’s Palm Oil Sustainability Through Financing: A Study on Disconnects and Potential Policy Solutions

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Improving Indonesia’s Palm Oil Sustainability Through Financing: A Study on Disconnects and Potential Policy Solutions

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Abstract

The European Union’s Second Renewable Energy Directive (RED II) has brought significant discourse on Indonesia’s palm oil sector. Following growing global initiatives in sustainable palm oil, Indonesia should focus on improving palm oil sustainability rather than rely on markets that accept the country’s palm oil as is. However, there are still disconnects in sustainable palm oil, especially in the financial aspects. Therefore, this research aims to identify significant disconnects and propose solutions within a financing context. The disconnects include the absence of mandatory policies for sustainable palm oil financing, limited adoption of sustainability policies by smaller financiers, concerns about ISPO robustness, inadequate financial incentives for smallholders in certification, challenges in accessing finance for smallholders, and administrative barriers to accessing replanting funds. To address these disconnects, the research proposes several solutions. First, to mandate sustainable palm oil financing in POJK 51 and the green taxonomy. Second, provide capacity building for local banks and mandate measures to gradually finance sustainable palm oil. Third, strengthening ISPO by adopting global measures, adopting robust means of verification, and implementing further requirements to enable traceability. Fourth, provide incentives for certification to smallholders, alongside expanding the CPO Fund’s role to help finance smallholder certification and legalization. Fifth, upscale schemes of step up loans and successful practices of plasma programs for smallholder palm oil. Sixth, simplify CPO Fund requirements for replantation. Overall, this research hopes to provide recommendations on governing sustainable palm oil through financing, particularly through insights on what policies are needed.

Keywords: financing, disconnects, palm oil sustainability, renewable energy directive, solutions.
associated with the highest level of deforestation, a concern for the EU. The directive includes gradually phasing out biofuels that use oil certified as significant indirect land-use change (ILUC) risk, such as palm oil, by 2030. In 2022, the EU adopted the Regulation for Deforestation Free Supply Chains, which requires all relevant companies to conduct strict due diligence if they are placed on the EU market or export from it: palm oil, cattle, soy, coffee, cocoa, timber, and rubber, as well as derived products.1

Indonesia is the world’s largest exporter of palm oil; alongside the high productivity, the country’s industry also contributes to deforestation. A 20-year (1995-2015) land cover analysis estimated that palm oil plantation expansion occurred at an average rate of 450,000 ha per year, leading to average deforestation of 117,000 ha per year.2 However, 2010-2015 has shown a decreasing trend of palm oil-related deforestation. A more recent study found that over nineteen years (2001-2019), palm oil expansion doubled, reaching 16.24 million hectares in 2019, and accounted for a third of total deforestation (2.85 million hectares).3 The study also noted recent decreases in deforestation (2017-2019). In summary, deforestation still occurs due to palm oil industries in Indonesia, but there are promising trends.

CPO production in Indonesia has remained high in recent years. In 2021, Indonesia exported 34.2 million tons of palm oil, marking a 10.1% increase from 2017. The production also increased by 22.84% to 46.89 million tonnes. In 2017, the EU was the second-largest importer of Indonesia’s palm oil. This import volume decreased gradually, especially in the three largest EU importers, the Netherlands, Spain, and Italy. As the largest palm oil producer, Indonesia has challenged the EU’s decision through the World Trade Organization.4 An estimated 16 million Indonesians depend on the country’s palm oil industry, a crucial sector, as recognized by the Coordinating Ministry of Economy.5 However, as mentioned before, Indonesia still maintains strong

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4 World Trade Organization, Dispute DS593 European Union – Certain Measures Concerning Palm Oil and Oil Palm Crop-Based Biofuels.
5 Kementerian Koordinator Bidang Perekonomian Republik Indonesia (Coordinating Ministry for Economic Affairs), “Industri Kelapa Sawit Indonesia: Menjaga Keseimbangan Aspek Sosial, Ekonomi, dan Lingkungan - Kementerian Koordinator Bidang Perekonomian
export earnings through comparisons between 2021 and 2017. The Indonesian Palm Oil Association (IPOA) has stated that Indonesia should not worry about exports to the EU, as there is a recorded rise in exports to other markets, namely China, India, United States, Pakistan, Malaysia, Bangladesh, Egypt, and Russia, alongside previous European countries such as The Netherlands and Italy.\(^6\) The association representatives specifically mentioned the United States had moved into Indonesia’s third largest palm oil importer, increasing their imports from 400,000 to 2 million tonnes.

However, as a long-term strategy, Indonesia should not misplace focus on markets that will take the country’s palm oil product as is (certified and uncertified). But instead, focus on improving the country’s palm oil to become sustainable. There are three main reasons to build this rationale; first, RED II prohibits non-sustainable palm oil, and if Indonesia can improve most of its palm oil production, the EU would be a more accessible market. Second, global initiatives for sustainable palm oil are becoming more common. Third, Indonesia’s efforts to reduce palm oil-related deforestation have shown promising progress and should be continually supported.

In regards to adhering to sustainable palm oil, despite the RED II’s phasing out of high ILUC (Indirect Land-Use Change) risk biofuels, such as palm oil, the EU has emphasized that they are not blindly against palm oil. In a 2019 press release, the EU stated that they are open to palm oil as long as it is produced sustainably and does not contribute to deforestation through ILUC. This potential provides a pathway for better trade relations between Indonesia and the EU if Indonesia can show more significant commitment and uptake of sustainable palm oil. By adopting sustainable practices and ensuring that their palm oil industry does not contribute to deforestation, Indonesia can meet RED II requirements and maintain the EU as a broadly accessible market.

Additionally, growing global initiatives for sustainable palm oil are either directly or indirectly promoting sustainable palm oil. Two of the most notable were the establishment of the Roundtable for Sustainable Palm Oil in 2004 to support and verify sustainable practices of palm oil production, as well as the New York Declaration on Forests in 2014, which aims to halve the loss

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of forests by 2020 and end it by 2030. These establishments were followed up by the Amsterdam Declaration (on Palm Oil and Deforestation in 2015) by several European countries, reiterating the New York Declaration and supporting the Paris Agreement. Several well-known initiatives, including RED II, followed afterward. But, the sustainable palm oil initiative was also promoted in other regions through the Singapore Alliance for Sustainable Palm Oil (SASPO) in 2016, North American Sustainable Palm Oil Network (NASPON) in 2017, Sustainable Palm Oil Coalition for India (I-SPOC) in 2018, and China Sustainable Palm Oil Alliance (CSPOA) in 2018. On the other hand, various UN Agencies and development partners have made it part of their mission to promote sustainable palm oil, especially in Indonesia.

Besides, regarding Indonesia’s efforts, positive progress has been shown in halting palm oil-related deforestation. Trends show a slowing in deforestation rates in Indonesia. Indonesia also has various efforts that can be built upon to promote sustainable palm oil. Indonesia joined the Roundtable on Sustainable Palm Oil (RSPO) in 2004, triggered the establishment of the Indonesian Sustainable Palm Oil (ISPO) certification in 2011, following the Indonesian Palm Oil Association (Gabungan Pengusaha Kelapa Sawit Indonesia or GAPKI) departure from RSPO. On the policy front, Indonesia developed the National Action Plan for Sustainable Palm Oil for 2019-2024. Furthermore, in 2020, Indonesia established the Presidential Regulation No. 44 of 2020 on the Sustainable Palm Oil Plantation Certification System and the Ministry of Agriculture Regulation No. 38 of 2020 on implementing Indonesian Sustainable Palm Oil Plantation Certification. These efforts provide a strong foundation for Indonesia to enhance its palm oil industry’s sustainability and meet the criteria set by the European Commission under the RED II directive.

However, although Indonesia does have a good foundation to further uptake sustainable palm oil, its efforts have been hampered by several deficiencies in certification. As of 2021, ISPO covered 35.4% of Indonesia’s palm oil area. This is considered slow progress, as The Presidential Regulation No 44 of 2020 targets 100% certification by 2025. Furthermore, independent smallholders face obstacles in meeting certification’s legal and financial requirements due to land legality issues, awareness issues, financing issues, and limited incentives. ISPO costs a substantial amount, without any implications on the

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8 Pramudya EP et al., “Incentives for Palm Oil Smallholders in Mandatory Certification in
additional increase in the product price. Smallholders are the key to improving Indonesia’s sustainable palm oil, as they account for 41% of all plantations and are less surveilled than large scale plantations.

On the other hand, a key aspect of sustainable palm oil is replanting. Currently, smallholders cannot ensure replanting, as palm oil plantations are a capital-intensive business. Consequently, the government has employed the CPO Fund (Badan Pengelola Dana Perkebunan Kelapa Sawit or BPDPKS) to utilize part of the CPO tax returns to replant forests. Recently, the government increased the subsidy to 30 million IDR per hectare, requiring it to blend it with other financial services (such as bank loans). The government targeted a replanting of 540,000 hectares from 2017-2023 but only managed to replant 278,200 hectares of it by 2022. This is due to legality issues and constraints from smallholders, land use data management issues, and lengthy requirements to apply for the fund. On the other hand, smallholders without legal land documents cannot apply for loans, thus being unable to conduct further sustainable practices.

By examining the problems faced by Indonesia’s palm oil industry, commonalities around the financial aspects are found. Challenges around high costs, lack of financing, and little incentives are frequently stated. Moreover, it does not make sense for uncertified palm oil plantations to certify themselves due to a lack of financial benefits. Other issues that are in confluence of financial issues are smallholder capacity issues, smallholder legality (land ownership) issues, and administrative issues for CPO Fund utilization. Consequently, one of the key aspects that should be focused on to improve Indonesia’s palm oil sustainability is the financial aspect.

Alongside ensuring that certification and sustainable practices make sense for palm oil plantations (are financially beneficial), financing can be used as a

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Indonesia” Land 2022, 11, 576. https://doi.org/10.3390/land11040576


compliance intervention. Financing can also be a prerequisite to ensuring that plantations adhere to sustainability standards. Financial services can require that loans for palm oil plantations can be approved if certain sustainability measures are met. Consequently, one viable pathway to improving palm oil sustainability in Indonesia is analyzing the financial side of palm oil businesses and developing policies enabling incentives and compliance.

Various research has touched upon the financial aspects of palm oil production, particularly on the needs for additional financing, incentives, and cost-benefit feasibility. But few have offered a comprehensive recommendation on the financing aspect as a solution. Therefore, this research aims to provide key recommendations on the financing side for enhancing sustainable palm oil in Indonesia, based on the plethora of scientific publications that have discussed Indonesia’s palm oil. This research asks two research questions. First, “What are the disconnects in the current financing for sustainable palm oil?” Second, “How can those disconnects potentially be solved in a financing context.” The research question is answered through a thorough purposive review of the literature on financing issues in Indonesia’s sustainable palm oil aims and best practices that can be upscaled and frequent recurring recommendations. The research will mainly utilize content analysis as the analysis method.

This research will eventually contribute to a proposed comprehensive recommendation for sustainable palm oil in Indonesia, alongside key policy recommendations that need to be uptaken by the government. The outcomes of this study have the potential to inform policymakers, industry stakeholders, and financial institutions on how to develop effective financing strategies that support sustainable palm oil production. This research will play a pivotal role

in promoting the long-term viability and environmental sustainability of the palm oil sector in Indonesia.

II. CONCEPTUAL FRAMEWORK

To guide the study’s literature review, a conceptual framework is developed. The study will examine various aspects in the existing landscape of palm oil financing and sustainability efforts. In developing this conceptual framework, initial desk studies were done to understand the landscape of sustainable palm oil financing efforts. The understanding of the current landscape is seen in Figure 1.

Figure 1. Landscape of Sustainable Palm Oil Financing Efforts

![Diagram showing the landscape of sustainable palm oil financing efforts]

Source: Authors' analysis

Areas to investigate in the literature review derive from understanding current efforts and pathways. The issues surrounding enablers and their influence on sustainable palm oil outcomes will be investigated. In particular, the literature review will look to explore disconnects as well as solutions within:
a. Overall governance on achieving sustainable palm oil in Indonesia.
b. Financial policies and incentives
c. Financing from the financial services industry
d. ISPO certification implementation
e. Palm oil plantation adherence efforts and partnerships (plasma program)
f. CPO Fund implementation

Various areas explored in this framework are related to the financial aspect of the palm oil industry. Obvious areas that are financing in nature are the financial policies and incentives needed for sustainable palm oil, as well as how current financiers provide means for palm oil production. Additionally, the CPO Fund was a financing body meant to assist (provide subsidies) for replanting efforts by smallholders without sufficient financial capacity. On less obvious aspects, as mentioned before, there is also a financing aspect to ISPO. Particularly in the costs of ISPO and whether or not ISPO certification leads to improved product pricing, sales, and overall business improvements. Palm oil industry adherence is also interrelated with financial policies and financial barriers that cause difficulties in shifting to sustainability practices.

III. THE DISCONNECTS WITHIN THE FINANCING LANDSCAPE FOR SUSTAINABLE PALM OIL

A. DISCONNECTS IN FINANCIAL REGULATIONS FOR SUSTAINABLE PALM OIL

Currently, there are no policies that mandate financial services to support sustainable palm oil in Indonesia. The Financial Services Authority (Otoritas Jasa Keuangan or OJK) has unveiled Regulation of the Financial Services Authority (POJK) Number 51 of 2017 on the Implementation of Sustainable Finance for Financial Services Institutions, Issuer Companies, and Public Companies. However, this regulation, in particular, does not provide detailed mandates on “what to finance” and “not to finance” in detail. Rather, it only mandates requirements for sustainability reporting, sustainable finance action

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plan development, and sustainable finance staging for financial services. “What to finance” is detailed in additional guidelines.

OJK provided two guideline documents for financial services, (1) The Technical Guidelines for Implementing Sustainable Finance for the Banking Sector and (2) The Indonesian Green Taxonomy 1.0. The technical guideline provides 12 key sectors that banks should finance and noted financing for RSPO and ISPO certified palm oil as an example of sustainable credit.14 Similarly, the Green Taxonomy categorizes palm oil in the green (sustainable) bracket if it is ISPO and RSPO certified and the yellow bracket if it is ISPO certified and has other self-declaratory or legal proof of sustainable practices.15

OJK also provided a specific guideline for palm oil financing, which is not mandatory or legally binding. The Guideline for Palm Oil Plantation and Industry Financing or Credit (Pedoman Kredit Pembiayaan Perkebunan Dan Industri Kelapa Sawit). The guideline enlists several criteria on which palm oil plantations to finance to promote sustainability, which are; (1) Legality of Plantation Business, (2) Requirements Related to Palm Oil Management and Production Techniques, (3) Requirements Related to the Supply of Fresh Fruit Bunches (Legal and Traceable), (4) Requirements Related to Work Rights and Safety, and (5) Taxes Due Diligence in Oil Palm Plantations.16 However, as it is not mandatory, the guideline will only have an impact if banks voluntarily adopt this as their internal policy.

The key issue of these documents is that they are voluntary, particularly, Indonesia’s green taxonomy is designed mainly as a guidance rather than a mandatory instrument. This falls out of the norm of green taxonomies; as compared to the EU’s and China’s green taxonomy, Indonesia’s taxonomy is the only one that is voluntary.17 Moreover, Indonesia’s taxonomy is not supported by incentives and disincentives. As stated in the taxonomy’s

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15 Otoritas Jasa Keuangan (Indonesia Financial Service Authority), Taksonomi Hijau Edisi 1.0 [Green Taxonomy 1.0] (Jakarta: Otoritas Jasa Keuangan, 2022).

16 Otoritas Jasa Keuangan (Financial Services Authority of Indonesia), Buku Kredit Pembiayaan Perkebunan Dan Industri Kelapa Sawit [Credit Book for Financing Palm Oil Plantations and Industries] (Jakarta: Otoritas Jasa Keuangan, 2019).

introduction, Indonesia’s current taxonomy aims to provide a transition to sustainable finance; thus it is not mandatory. But, there are opportunities to enforce the taxonomy through policies that require mandatory disclosures of taxonomy-relevant investments.\(^\text{18}\)

In regards to policies that provide incentives for sustainable palm oil financing, incentives are conventional and do not push for sustainable palm oil practices. The MoF Regulation on Bioenergy Development And Plantation Revitalization Credit No. 117 of 2006 (Kredit Pengembangan Energi Nabati dan Revitalisasi Perkebunan), or KEPN-RP, provides loan incentives have been to banks as well as interest subsidies to palm oil plantations.\(^\text{19}\) Moreover, Government Regulation No. 18 of 2015 on Income Tax Facilities for Investment in Certain Business Fields and/or in Certain Regions (Tentang Fasilitas Pajak Penghasilan Untuk Penanaman Modal di Bidang- Bidang Usaha Tertentu dan/atau di Daerah-Daerah Tertentu), provides tax allowances for investors of certain palm oil industries in certain regions.\(^\text{20}\) However, there is no specific mandate that financing should be given to certified palm oil plantations.

A widely recognized program used to finance many MSMEs is the People’s Business Credit Program (Kredit Usaha Rakyat or KUR). In which the government provides various incentives to the financier to ensure that the bank is more inclined to finance MSMEs that may or may not be bankable.\(^\text{21}\) Mainly, the government provides banks with incentives in loan guarantees and pays (or subsidizes for the business) part of the loan interest to the bank providing KUR. The program has financed palm oil plantations, and at times in combination with the CPO Fund.\(^\text{22}\) However, like other programs or financial incentives for banks, KUR has no sustainability safeguards for palm oil.


In summary, the sustainable finance regulation and green taxonomy currently do not mandate any measures for financial services institutions to finance sustainable palm oil. Moreover, government programs that provide a form of guarantee or loan interest payment for banks also do not mandate any measures in the context of sustainable palm oil. Consequently, a disconnect is prevalent in financing policies for palm oil plantations. However, the pathway to promote sustainable palm oil from a financing standpoint may be more effective through strengthening POJK 51 of 2017 and the green taxonomy rather than KUR, KEPN-RP, and tax allowance regulation. If improved, the former measures can alter bank financing policies without needing any changes from the latter.

B. DISCONNECTS IN FINANCIAL SERVICES INDUSTRY FINANCING

The largest financiers for palm oil are banks and have been growing for a substantial amount of time, growing 78% annually from 2006-2015. This trend has continued in 2021, alongside concerns that approximately 85% of banks in Malaysia, Indonesia, and Singapore are financing forest-risk palm-oil clients who possess a confirmed record of poor environmental record. Most of these banks were identified to have ESG policies, in which their financing preferences have been violated. In Indonesia’s case, this is due to the lenient (or voluntary) regulatory frameworks ensuring sustainable palm oil financing.

However, it is important to note that most of Indonesia’s big banks have unveiled an ESG Strategy and specific policies on palm oil financing. For instance, Bank Mandiri and Bank BNI, two of the largest financiers for Indonesia’s palm oil, have stated that they will only finance certified (ISPO) palm oil which is legally sufficient and will not finance any peatland land use changes. Indonesia’s largest private bank BCA has stated that they will only finance ISPO/RSPO certified and legally sufficient palm oil plantations.

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A closer look at Indonesia’s bank financiers in palm oil, state-owned enterprises make up a substantial amount of palm oil financiers. From 2016 to April 2020, four state-owned banks substantially financed palm oil, namely Bank Mandiri (US$ 2.07 billion), Bank BNI (US$ 1.6 billion), Bank BRI (US$ 699 million), and Bank BTN (US$ 110 million). Prominent private banks such as Maybank, BCA, OCBC, Panin Bank, and others also financed palm oil in Indonesia.

However, the Forest and Finance platform, particularly noted that these banks still finance US$ 100 million to US$ 2 billion to big clients that have been flagged by an RSPO complaint, flagged by the Chain Reaction Research for increased ESG risks, or received negative media reports. However, it should be noted that flagging from these entities may not reflect the sustainability of the financed companies as a whole. Aforementioned banks may have their due diligence processes to evaluate the sustainability and ESG performance of their clients.

Besides the banks mentioned above, palm oil also receives financing from local community banks (Bank Perkreditan Rakyat or BPR). Such local banks are mandated from POJK 51 of 2017 to publish a sustainability report. However, as mentioned before, there are no mandates on palm oil financing. Moreover, local banks have less capacity and commitment to ESG and sustainable finance; thus few have declared a No Deforestation, No Peat and No Exploitation (NDPE) policy. Most local banks only require the legality of land and ownership to finance palm oil.

In the area of smallholder financing, which is not from banks, palm oil plantations receive financing from community-based microfinance and local credit-led microfinance. Community-based microfinance include Community Self-help Groups (Kelompok Swadaya Masyarakat or KSM) and Credit Unions (Koperasi Simpan Pinjam or KSP). Credit microfinance includes village credit banks (Bank Kredit Desa or BKD) and rural credit fund institutions (Lembaga Dana Kredit Pedesaan or LDKP). However, there is less awareness of sustainable palm oil plantations and scrutiny to pursue a NDPE policy in financing.

C. DISCONNECTS WITHIN ISPO CERTIFICATION

There are also disconnects within the Indonesian Sustainable Palm Oil (ISPO) certification. ISPO is mandatory for all palm oil companies within

Indonesia, different from RSPO which is voluntary. Although ISPO is strongly enforced by Indonesian law, there are criticisms in its effectiveness to safeguard human rights and the environment. A comparison between RSPO and ISPO found that the latter is more focused on national law, while RSPO adopts international accountability and human rights standards. The Forest Peoples Programme in 2017, ranked ISPO as the worst standard, out of seven examined standards. The study noted that ISPO has lenient water monitoring mandates, does not require documentation of customary land purchasing (only advocates one-off consultations), no requirement for smallholder contracts, poor labor standards, poor reference to gender considerations and others. ISPO has also been noted for disregarding input from indigenous peoples and local communities impacted by palm oil plantations.

Indonesia has unveiled a new ISPO, but there has been mixed reviews regarding the certifications’ renewal. The principle of protecting primary forest and peatland has been removed and replaced with the principle of transparency, raising concerns of potential rights violations. Although there are areas of improvement, particularly in the requirements of certain legal and documentation for fulfilling criterias set by ISPO and consequences for plantations that have not fulfilled ISPO. However, an Indonesian study, comparing the new ISPO to RSPO and MSPO shows that ISPO still has areas to improve upon. The study ranked ISPO as the least sufficient certification

31 Ibid.  
35 Ayu Wulandari and Muhammad Nasution, “Perbandingan Roundtable On Sustainable Palm Oil (RSPO), Indonesian Sustainable Palm Oil (ISPO), dan Malaysian Sustainable Palm Oil 131
system to provide clear indicators and means of verification.\textsuperscript{36}

Another issue is the unclear acceptability of ISPO palm oil in international markets, but improving on traceability may rectify this. An EU ambassador in 2018, stated that the EU does not have any policy or standard on certification, but does not view ISPO as a sufficient certification scheme.\textsuperscript{37} A 2023 study on traceability, noted that if Indonesia’s palm oil will be more competitive if they are traceable, improving sustainability and identifying lacking areas will also be easier.\textsuperscript{38} Strong incentives and disincentives are needed to enhance palm oil traceability.\textsuperscript{39}

D. DISCONNECTS WITHIN PALM OIL SMALLHOLDERS

There is a discrepancy between large palm oil plantations and smallholders in adhering to sustainable palm oil requirements. Palm oil-related plantations have higher scrutiny and incentives to pursue sustainability certification, as they will gain access to larger financing and access to foreign markets (through exports). Currently, there is good progress in large palm oil plantations, particularly in plantations that have the capacity for palm oil refinery, as 2020 noted that 83% of market refiners have unveiled an NDPE policy.\textsuperscript{40} However, smallholder plantations have less financing and market access, thus, are usually less concerned with sustainability and certification. Foreign markets, such as the EU,\textsuperscript{41} are currently requiring traceability, thus resulting in the exclusion of

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\textsuperscript{36} Ibid.


most smallholders.

Another issue in smallholder plantations is the poor ability to get sufficient financing. As mentioned in the previous paragraphs, large banks have shifted to ensuring that they finance ISPO (at least) certified plantations. In contrast, local banks will require the legality of land and plantation ownership. Meanwhile, most smallholders face illegality issues, as a 2019 study noted that 2.5 hectares of Indonesia’s palm oil plantation area is occupied illegally (or facing legality issues), of which 1.7 hectares are occupied by smallholders and 800,000 occupied by companies. For smallholders, the high costs for administrative requirements in pursuing land legality is also a challenge, a cooperative noted that its members spend IDR 500 million just for land legality.

Land illegality further causes the inability to access financing, as most financiers will also require business ownership certificates or permits to conduct cultivation business (Izin Usaha Perkebunan). However, the land illegality causes a further inability to apply for other permits that are a prerequisite, such as the Environmental Impact Analysis Permit (Analisis Mengenai Dampak Lingkungan or Environmental Impact Analysis or AMDAL) and or Statement of Ability in Environmental Management and Monitoring (Surat Pernyataan Kesanggupan Pengelolaan dan Pemantauan Lingkungan Hidup). Land legality is also a prerequisite for ISPO, thus posing a problem for smallholders with legality issues.

Poor access to financing leads to smallholders depending on informal loans, which are not sufficient for replanting efforts, or may not be provided informal loans for replanting, as palm oil, if done sustainably with poor capacity, is a resource-extensive business. This has led to the government to assist in replanting through subsidies from the CPO Fund blended with financing from KUR. However, such schemes require land legality and may.

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not be accessible to smallholders that most need them.\(^{45}\)

There are also various barriers to enhancing the certification rates of smallholders to ISPO. The certification currently costs IDR 750,000-IDR 1.2 million per hectare and must be approved by a certification body every year at the cost of IDR 400,000-IDR 500,000 per hectare.\(^{46}\) But does not provide any increases in CPO product pricing whatsoever. A study on ISPO in 2020 noted that most independent smallholder decisions not to certify are grounded in rational economic thinking.\(^{47}\) Besides costs and land legality issues, such rationale is also based on poor productivity; thus, investing in a poorly producing business may not be a top priority. Smallholders usually lack the technical capabilities to increase productivity and efficiency.

One way to solve the issues within smallholder financing and certification is through the plasma program. Indonesia has developed the plasma program since the late 1970s,\(^{48}\) and has continued it through Law No. 11 of 2020 on the Job Creation Law, Government Regulation No. 26 of 2020 on Implementation of the Agricultural Sector, and Ministry of Agriculture Regulation No 18 of 2021 on Facilitating the Development of Community Plantations. The regulations mandate that 20% of the plantation area is provided to foster smallholder plantations. Other facilitations include credit facilitation, capacity building, and profit sharing. However, many have stated that the current implementation of plasma programs favors large companies, as the Ministry of Agriculture Regulation No 18 of 2021 provides more leniency. Large plantations do not have to provide build [plasma] plantations and can replace such facilitation efforts with other facilitation activities, shifting the initial aims of agrarian reform.

Compliance in plasma programs is also problematic, as there are various news reports stating that large plantation companies are not holding up their

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end of the bargain.⁴⁹ There are issues with the one-roof approach, in which smallholders are asked to be employees for efficiency. Smallholders will receive funds but not substantial knowledge on operationalizing a palm oil plantation.⁵⁰ Solutions have been discussed, such as improving transparency of provided land from larger palm oil plantations, contractual agreements between smallholders and large palm oil and investigation into bad plasma program practices.⁵¹

E. DISCONNECTS IN CPO FUND IMPLEMENTATION FOR REPLANTING

The utilization of the CPO Fund in Indonesia faces several obstacles. According to a CNN Indonesia report (28 April 2021), the government’s palm oil replanting targets have not been fulfilled since the program began in 2011, only around 55,943 hectares were achieved from a targeted 185,000.⁵² Factors that contributed to this were administrative issues of “plantations that need to be outside of forests”, overlapping palm oil plantation data (maps), poor verification measures in providing technical recommendations for replanting, poor intra local government coordination, and poor profiling of potential beneficiaries.⁵³

From the aspects of the CPO Fund itself, administrative issues hinder the goal of replanting oil palm in Indonesia.⁵⁴ There are 38 requirements that need to be fulfilled by smallholders to be eligible to receive replanting funds. Moreover, many have noted that the IDR 30-35 million per hectare replanting

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⁴⁹ Muhammad Irham and Astudestra Ajengrastri, “‘Kami sudah sering dibohongi’ - Tiga generasi Suku Anak Dalam mengaku tertipu janji perusahaan sawit [We have often been lied to’ - Three generations of the Anak Dalam tribe admit that they were deceived by the promises of palm oil companies],” BBC News Indonesia, 22 May 2022, https://www.bbc.com/indonesia/indonesia-61482337.

⁵⁰ Ibid.


⁵³ Ibid.

assistance is not enough. Consequently, associations are pushing for a simplification of requirements and increases in funding from the CPO Fund. However, the government has only responded to the requests for funding increases, of which the CPO Fund should be blended with KUR financing to be sufficient.

On the other hand, as explained in the previous sub-section, smallholders require various support measures in improving their sustainability. Issues with legality, lack of financing, and issues in applying for certification are prevalent in smallholders. Consequently, several have called for the CPO Fund to expand its role, to not just provide replanting financing, but also help aid smallholders in other areas that need financing.

IV. GOOD PRACTICES POTENTIALLY UPSCALED AND ADOPTED

Several countries, including Malaysia and Brazil, have their own palm oil financing policies. Malaysia has Value-based Intermediation financing and investment guidelines issued by Bank Negara Malaysia (BNM) as the central bank; where these financial principles are similar to the principles of sustainable finance but only apply to Islamic financial institutions and some conventional banks. In 2020, BNM issued the Value-Based Intermediation Financing and Investment Impact Assessment Framework (VBIAF) Sectoral Guidelines on Palm Oil. The guide is aimed at financial institutions and investors to get a general perspective on the assessment criteria for financing and investing in the palm oil sector. Based on these guidelines, financial institutions are required to carry out impact-based identification, including identifying and balancing trade-offs between the benefits and risks of financing or investing in

56 Ibid.
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Meanwhile, Brazil has financing regulations that refer to the Sustainable Palm Oil Production Program (SPOPP), which is a form of response to the dire global energy crisis and the enactment of the Brazilian Biodiesel Law (UU 11.097, 13/01/2005) in 2005. SPOPP principally seeks to stimulate private sector investment in the palm oil sector to support domestic biodiesel targets and agricultural development policies without undermining ongoing efforts to protect high conservation value ecosystems and to encourage the integration of smallholders, making the palm oil sector more labor-intensive than capital-intensive.

This goal was achieved by the issuance of six regulations, two of which were the Agro-Ecological Zoning of Oil Palm Deforested Area of Amazon (ZEA-Palma) and the Program to Support Family Farming, also known as PRONAF eco. ZEA-Palma contains available and permitted areas for planting oil palm, namely areas that have been deforested before 2008 and have no conflict with primary forest areas, conservation units, and indigenous. PRONAF Eco explained financing regulations in the palm oil sector and inclusiveness through contract farming. PRONAF Eco provides loans at a concessional interest rate of up to US$25,000 to smallholders to cultivate oil palm on up to 10 ha of land. To receive the loan, farmers are required to sign a 25-year contract with the company, which in turn is required to commit to providing inputs and technical assistance to the farmer and guaranteeing the

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purchase of fresh fruit bunches (FFB) at a minimum price. This regulation states specifically that financing may only be made if the oil palm farm fulfills obligations under ZEA-Palma.  

Indonesia also has some good practices of palm oil financing, mainly through step-up interest loans. Financiers such as Golden Agri Resources, Bank Mandiri, and Bank BRI provide periodical subsidized or step-up interest rates. This allows farmers to pay a lower KUR interest rate when replanted trees are immature before switching to the commercial rate when trees have reached full production. Specifically, on Golden Agri Resources’ Innovative Financing Scheme, various additional assistance was provided alongside government support. Namely, the legalization of land ownership, the implementation of high-quality agronomic practices, meticulous seed selection, and the adoption of superior crop varieties to optimize yields. Moreover, the scheme actively promotes the attainment of ISPO certification, demonstrating a commitment to sustainable practices.

Brazil offers a range of incentives to promote the certification of the palm oil sector, benefiting both small and large producers and companies. These incentives aim to encourage sustainable practices and uphold environmental standards. Notably, companies with RSPO certification enjoy regulatory relief when exporting palm oil. Furthermore, tax incentives, including lower income tax rates, are provided to companies and small to medium-scale farmers participating in the Social Fuel Stamp (SFS) program—a social certification scheme designed to support sustainable palm oil production.

Meanwhile, to encourage increased palm oil certification, the Malaysian Palm Oil Certification Council (MPOCC) and the government stated that only producers and companies that had obtained MSPO before 1 January 2020 were entitled to MSPO incentives. The incentives are divided based


on several criteria, one of the main ones being the area of plantation land. Estates with areas ranging from 40.46 to 1,000 ha will be eligible for a full reimbursement of auditing expenses, including audit man-days, report drafting, stakeholder consultation, and peer review. Furthermore, they are entitled to 50% preparation cost claims for MSPO policies and system documents, social impact assessment (SIA), environment aspect and impact (EAI) report, high biodiversity value (HBV) report, training for Greenhouse Gas calculation, and internal audit and management review. The highest amount of compensation for preparatory expenditures is RM10,000. Estates with more than 1,000 ha and palm oil processing facilities such as mills, kernel crushers, refineries, oleochemical plants, and biodiesel plants are eligible for 30% audit fee incentives. In addition, organized smallholders are eligible for RM55 per acre to pay auditing, training, and social and environmental impact assessments.

V. CONCLUSION

The trade relations between Indonesia and the European Union (EU) have been strained due to concerns about deforestation and the EU’s regulations on palm oil imports. However, there is potential for improvement in these trade relations if Indonesia can demonstrate strong progress in the development of sustainable palm oil practices, as the EU has expressed openness to palm oil imports that are produced sustainably. By addressing the disconnects in the financing landscape and implementing effective policies that promote sustainability, Indonesia can showcase its commitment to mitigating deforestation risks and adhering to international standards. Such progress would not only contribute to the preservation of the environment but also serve as a foundation for rebuilding trust and strengthening trade relations with the EU. By demonstrating significant strides in sustainable palm oil development, Indonesia can create a positive narrative around its palm oil industry and position itself as a valuable partner in the global market.

This research has identified significant disconnects within the current financing landscape for sustainable palm oil in Indonesia. However, these disconnects also present an opportunity for Indonesia to address the challenges and improve the sustainability of its palm oil industry. By focusing on the financial aspect, Indonesia can bridge these disconnects and pave the way for positive change. Implementing a comprehensive financing framework that incentivizes sustainable practices, supports smallholders, and facilitates replanting efforts is crucial.
Several disconnects were found after exploring key areas in the financing landscape for sustainable palm oil. Such disconnects are concluded as follows:

1. There is no mandatory policy that ensures financial services institutions provide financing for sustainable palm oil.

2. Although the biggest palm oil financiers (banks) have adopted a NDPE policy, smaller scale financiers such as local banks and community-based microfinance have not.

3. There are potential concerns regarding the robustness of ISPO certification.

4. There is little to none financial incentives for smallholder plantations to certify themselves.

5. Smallholder plantations generally face issues in accessing sufficient finance, due to land legality issues, business ownership issues, and low productivity.

6. There are certain barriers to accessing replanting funds due to the CPO Fund’s administrative processes.

Several recommendations can be formulated to address these disconnects. It is crucial to establish a mandatory policy that ensures financial services institutions provide financing for sustainable palm oil. This policy should require banks and other financial institutions to incorporate sustainability criteria into their lending practices, specifically for palm oil plantations. Consequently, policies that can be improved to achieve this is the POJK 51 of 2017 on Sustainable Finance Implementation and The Green Taxonomy, specifically by enhancing these policies to mandate sustainable palm oil financing. Other enabling policies could also be adopted, such as financial incentives for financiers with good adherence or disincentives for non-adhering financiers.

It is also imperative to encourage smaller-scale financiers, such as local banks and community-based microfinance institutions, to adopt a No Deforestation, No Peat, and No Exploitation (NDPE) policy in their financing activities related to palm oil. This can be achieved through capacity building and regulations to “gradually” finance based on plantation sustainability
adherence. As currently, most of the aforementioned financiers do not have the same capacity to develop ESG and NDPE policies as sophisticated as large Banks. On the other hand, policy improvements should mandate financing for sustainable palm oil but also allow finance for plantations that are not yet sustainable to provide sufficient financing towards improving sustainability. Financing for plantations that are not yet sustainable should include a prerequisite of a commitment to ensuring that the financed plantation will certify their businesses.

To address concerns regarding the robustness of ISPO (Indonesian Sustainable Palm Oil) certification, it is crucial to strengthen the certification framework, improve on means of verification and traceability. In the certification framework, ISPO lacks behind other certifications because it is too focused on national standards, while other certifications such as RSPO continuously improves. Regular reviews and updates should be conducted to align the ISPO certification with evolving sustainability best practices, international standards, and market requirements. Means of verification indicators should also be strengthened and be robust enough to ensure sustainability measures are being met. On the other hand, ISPO should push itself to adopt requirements for product traceability.

To address the lack of financial incentives for smallholder plantations to certify themselves, it is crucial to implement targeted support mechanisms and financial incentives that encourage and facilitate certification. Such could be developed through regulations that ensure incentives for certification, integration with programs that provide access to credit and financing, as well as facilitations on improved market linkages. The government could also provide additional funding arrangements for smallholders through the CPO Fund. The fund can widen its role to not just provide replanting financing but also to aid financing in land legalization and ISPO certification.69

To address the challenges faced by smallholder plantations in accessing sufficient finance, it is crucial to adopt financing schemes that allow for growth and guided improvement of smallholders toward sustainable palm oil. The aforementioned best practices provide examples of innovative financing initialized by the private or public sector. Step-up interest loans could be further mainstreamed, as it provides sufficient financing for production and replanting. Good practices of the plasma program that facilitate legality improvements, ISPO certification, train good agricultural practices, and provide financing for

non-sustainable smallholders to become sustainable could also be upscaled and mainstreamed. Incentives should be provided for large plantations that partner with smallholders, and provide assistance. Such incentives could be in the form of tax incentives or additional funds from the CPO Fund.\(^70\)

To address the barriers in accessing replanting funds due to the administrative processes of the CPO Fund, the government should simplify application procedures and administrative requirements. The government and CPO Fund should identify essential documents necessary for the application process and eliminate unnecessary or redundant paperwork. This will streamline the process for smallholders and increase the tendency for smallholders to request the replanting funds available.

It has to be mentioned that although financing has been a focus area in this study, another key disconnect hampering sustainable palm oil is governance. ISPO certification aims are enforced by the central government, but disconnects and low-functioning governance at the sub-national level as well as colliding policies.\(^71\) Consequently, addressing governance issues, especially at the sub-national levels is also a key pathway for sustainable palm oil development.

In conclusion, this research has shed light on the contentious trade relations between Indonesia and the European Union (EU) regarding palm oil, as well as the increasing global demand for sustainable palm oil. While the EU has imposed regulations and requirements on palm oil imports due to concerns about deforestation, there is still an opportunity for Indonesia to improve its palm oil industry through sustainable practices. The financial aspect has emerged as a crucial pathway for achieving this goal. By addressing the disconnects in the current financing landscape and implementing a comprehensive financing framework, Indonesia can incentivize sustainable practices and ensure compliance with international standards. This research highlights the need for better financial policies, financial incentives and assistance to support smallholders and reduction of barriers to access replanting funds. Ultimately, the policy recommendations aim to enhance the long-term viability and environmental sustainability of Indonesia’s palm oil sector. Particularly, by fostering positive trade relations with the EU and meeting global demand for sustainable palm oil.

\(^70\) Pareira, “Achieving Indonesian Palm Oil Farm-to-Table Traceability through ISPO-RSPO Harmonization.”

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