

Policy Brief No. 12

Oil Palm Productivity Remains Limited as Price of Cooking Oil Soars in Indonesia

by Nisrina Nafisah & Felippa Amanta

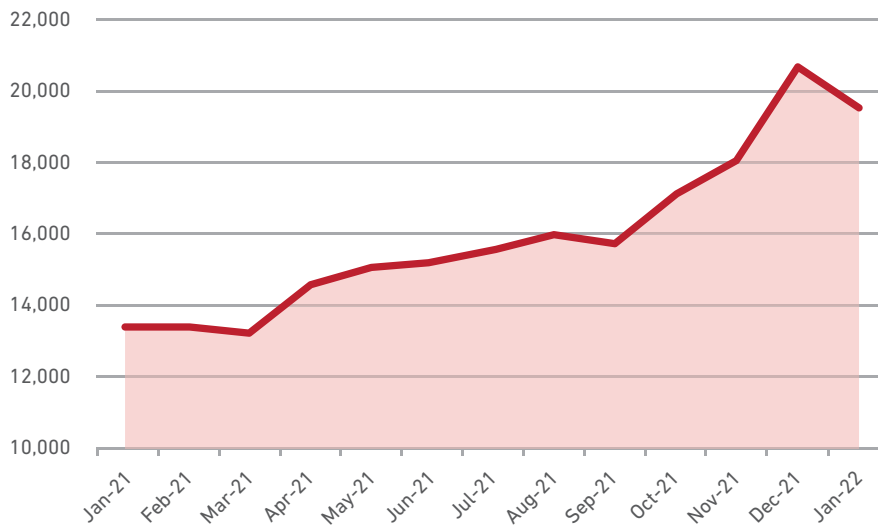


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The high price of cooking oil in Indonesia has been under the spotlight from the fourth quarter of 2021 up to the beginning of 2022. Between March and December 2021, Index BU RT¹ recorded a 56% price increase that peaked at IDR 20,667/liter in December. Although the price of cooking oil has since gone down to IDR 19,555/liter by January 2022, it remained expensive as it was still 46.2% higher than the price in January 2021.

¹ Index Bu RT (or Bulanan Rumah Tangga) is a simple tool developed by the Center for Indonesian Policy Studies that tracks the prices of staple food items that are consumed in Indonesia. The index provides an indication of how much Indonesians spend on staple food commodities and compares this spending with neighboring countries, which include Malaysia, the Philippines, Singapore, and Thailand. This comparison aims to show how much money Indonesian families could save in staple food expenditure if the prices were as cheap as in neighboring countries. Index Bu RT also observes how much prices have changed over time. More information on the index and its methodology can be found in <http://hakmakmur.cips-indonesia.org/#section-index>.

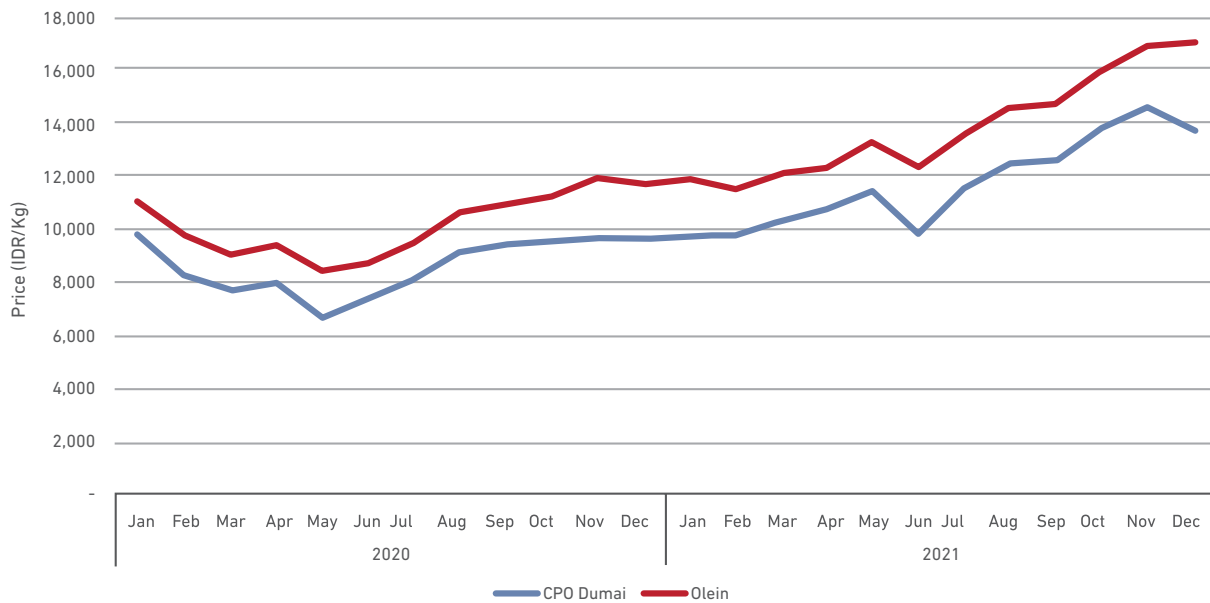
Figure 1.
Price of Cooking Oil in Indonesia (IDR), January 2021 - January 2022



Source: Index BU RT

The cooking oil commonly consumed in Indonesia is produced from crude palm oil (CPO) (Ministry of Trade, n.d).² The price of CPO in Indonesia is mainly pegged to the auction price set by *PT. Kharisma Pemasaran Besar Nusantara* (KPBN) Dumai, a subsidiary of Nusantara Plantation Holding Company (*PT. Perkebunan Nasional Holding* or PTPN), that directly correlates with international CPO prices. The price of cooking oil in Indonesia is thus directly affected by international CPO prices (Figure 2). Throughout 2021, the international price of CPO significantly increased by 36.3% compared to 2020 (Palm Oil Magazine Indonesia, 2022). By January 2022, the price had peaked at IDR 15,000/kg, the highest price ever recorded in history as reported by Palm Oil Indonesia (2022) quoting KPBN Director, Rahmanto Amin Djatmiko. The high price was attributed to supply shortages amidst increasing demands in many parts of the world as economies were recovering from the second wave of COVID-19.

Figure 2.
International Prices of CPO and Olein, January 2020 - December 2021



Source: Ministry of Trade, 2021

² Cooking oil that is processed from CPO is called refined, bleached and deodorized (RBD) olein.

Director General of Domestic Trade at the Ministry of Trade, Oke Nurwan, as quoted by *Ekonomi Bisnis*, attributed the supply shortage to a reduction in productivity of oil palm plantations owned by state-owned enterprises, the private sectors and smallholder farmers in both Indonesia and Malaysia (Timorria, 2021), the two main palm oil producers that together supply at least 85% of the world's palm oil production (CPOPC, 2021). It was also seen as a spillover effect of the decreasing production of other vegetable oils such as rapeseed oil and soybean oil, which has caused demands for alternatives such as palm oil to rise (CPOPC, 2021).

CPO production in Indonesia itself has shown a downward trend since 2019. In 2021 it further decreased by 0.9% to 46.89 million tons (Table 1). Detailed data on the ending stocks of CPO in 2021 were not yet publicly available at the time of writing, but the Council of Palm Oil Producing Countries (CPOPC) Outlook 2022 Report indicates that the ending stocks in Indonesia were below the average level of 4 million tons.

Table 1.
CPO Production in Indonesia, 2018-2021

Year	CPO Production
2018	43.11 million tons
2019	47.18 million tons
2020	47.03 million tons
2021	46.89 million tons

Source: Indonesian Palm Oil Association (*Gabungan Pengusaha Kelapa Sawit Indonesia* or GAPKI), 2021

The Director of KPBN, as quoted in several media websites (*Palm Oil Magazine Indonesia*, 2022; Arief, 2022), and the CPOPC 2022 Outlook Report, further attributed the declining palm oil production to three main factors. The first factor is the labor shortage in Malaysia. The COVID-19 lockdown has limited mobility and caused oil palm plantations to limit the number of their workers and as a result, many workers had to return to their hometowns. Shortage of labor in oil palm plantations reduces production capacity. The second factor is bad weather, which has led to flooding in oil palm plantations and disrupted productivity. The third factor is the high cost of fertilizers that has limited oil palm farmers' access to affordable fertilizers. Prices of nitrogen and phosphate-based fertilizers that are often used by oil palm farmers rose by 50-80 percent in mid-2021 due to supply chain disruption during the pandemic, rising freight cost, higher demand, and higher input cost. With fertilizers being a major cost component in palm oil production, accounting for 30-35% of total production costs (CPOPC, 2021), expensive fertilizers would increase production costs. Smallholder farmers unable to afford the cost would then reduce their fertilizer application and consequently this will lower yields. The high cost of fertilizers may significantly affect palm oil production by smallholder farmers who contribute up to 34% of Indonesia's palm oil output³ (Saleh et al., 2018; USDA, 2021).

Among the causes of low oil palm productivity, the problem of access to fertilizers among oil palm farmers was recently highlighted in the Indonesian media. Minister of Trade, Muhammad Lutfi claimed in a press release quoted by *KataData* (Arief, 2022) that access to affordable fertilizers and distribution of subsidized fertilizers were key to meeting global demand for palm oil, which is predicted to increase by 6.5% (Table 2) in 2022. Domestically, the demand for palm oil processed into cooking oil for household consumption is also expected to increase. Meanwhile, the use of fertilizer among oil palm farmers decreased due to limited availability of subsidized fertilizer in 2021. As quoted by *KataData*, the Minister indicated that the dismal actual allocation of the targeted amount of subsidized fertilizer has led to a lack of access to affordable subsidized fertilizers among oil palm farmers. The Minister of Trade further emphasized that the availability of affordable fertilizers for oil palm farmers will be one of the main agenda of the closed coordination meeting regarding the farmer's group proposal for subsidized fertilizers (*Rencana Definitif Kebutuhan Kelompok* or RDKK) in 2022.

³Smallholder farmers manage around 40% of total oil palm plantation in Indonesia. Though, they often face challenges accessing high-quality agricultural inputs, including fertilizers.

The gap between the available and the requested amount of subsidized fertilizers is addressed in CIPS policy paper on fertilizer and seed subsidies, and the solution to the problem is not as simple as merely increasing the supply of subsidized fertilizer to fulfill the proposed needs of farmers. CIPS' study found that the scarcity of subsidized fertilizer is not the only shortcoming of the fertilizer subsidy program. The price disparity between subsidized and unsubsidized fertilizers has led to suboptimal input use of fertilizers among farmers that discourage optimal yield. As farmers' use of fertilizer often depends on its cost, the price disparity can lead them to overly consume chemical fertilizers that are subsidized or reduce their fertilizer usage altogether if left with the alternative to buy more expensive fertilizers. The creation of a secondary market from subsidized fertilizer is also a problem, which could distort prices and exacerbate the lack of access for farmers to affordable fertilizer. One of CIPS policy recommendations to address the issue with fertilizer subsidy is a gradual reform of the government's input subsidy program to full market mechanism (Alta et al., 2021).⁴

Table 2.
Estimated Demand for Palm Oil Import 2020 - 2022

	2020/21 estimated imports (mil tonnes)	2021/22 estimated imports (mil tonnes)
India	8.5	8.6
China	6.8	7.2
EU-27	6.2	6.9
Others	26.1	27.9
World	47.6	50.6

Source: CPOPC Outlook 2022, 2021 (data derived from USDA and Refinitiv)

Beyond the immediate palm oil productivity problems, there are also other long-term issues related to oil palm productivity that add to the complexity of palm oil problems, such as the lack of new replanting of oil palm plantations, which would lead to weaker output growth.

In addition to declining oil palm plantation productivity, increasing global demand for palm oil-based biofuel (Khatiwada et al., 2021) could also potentially reduce the supply of CPO for cooking oil production. Countries including Indonesia, have been implementing biodiesel programs that require blending of diesel fuel with biofuel.⁵ According to the Indonesian Palm Oil Association (GAPKI), the share of CPO production for biofuel has increased by 24% from 2019 to 2020 and this increase was followed by a reduction in the share of CPO processed into food commodities such as cooking oil in Indonesia (GAPKI, 2022).

In order to curb the rising price of cooking oil at the consumer level, the government has responded with several policy instruments. The policies include cooking oil subsidies, domestic market obligation (DMO), and domestic price obligation (DPO) that require CPO exporters to sell 20% of their export volume for domestic consumption at a set price of IDR 9,300/kg,⁶ and the setting of a ceiling price for cooking oil at IDR 11,500/liter for bulk cooking oil and 14,000/liter for premium packaged cooking oil under Ministry of Trade Regulation No. 6/2022. Despite these efforts, the policies were only short-term in nature and could hurt producers and farmers, as well as exacerbate supply shortages if the price of CPO and cost of production remained high. During the implementation of the 'single price' or subsidy policy in mid-January 2021, supply shortages in some retailers remained a problem (Jannah, 2022).

GAPKI, as quoted in Antara News (2022), expected the supply of CPO to remain limited until March 2022, which also meant that the price of CPO and cooking oil will likely remain high.

⁴For detailed analysis on the fertilizer subsidy program, see Alta et al. (2021).

⁵Indonesia has begun implementing the B30 program that requires the blending of 30% Biodiesel with 70% diesel fuel type to produce B30 Biodiesel products. By 2025, Indonesia has targeted to implement its B30 program to its transport, industrial, commercial, and power generation sectors (Ministry of Energy and Mineral Resources, 2019). The biofuel that is used in Indonesia is mainly sourced from palm oil.

⁶The Domestic Market Obligation and Domestic Price Obligation is also applied to Olein, which is a derivative of CPO that is used as the raw material for cooking oil. The DPO for Olein is set at IDR 10,300/kg.

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