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Achieving a high-productivity, sustainable palm oil sector in Indonesia: a landscape management approach

June 2015

Working Paper

Goal:

A growing number of government, business and civil society, including Unilever and IDH, have a goal of **transforming the Indonesian rural economy by 2020, to deliver net positive environmental impacts and improve smallholder farmer livelihoods**. This requires a **focus on transforming the oil palm sector** from being a driver of deforestation, to one that is **highly productive and sustainable**.

Challenges:

This transformation will require collective action from government, business and community actors to address the following key challenges:

- How to achieve the goal at least cost, while ensuring supply chain security for business investors
- How to engage a critical mass of government, business, smallholder farmers and civil society actors to share both the burden & the benefits of transformation
- How to demonstrate to consumers and civil society whether the goal has been achieved.

Climate Policy Initiative is supporting Unilever and IDH to develop a landscape management strategy and implementation pathway to address these challenges.

Supply chain traceability - a first step...

In 2013, in support of its overall goal to facilitate the transformation of the Indonesian oil palm sector into a highly productive, sustainable sector, Unilever launched its sustainable palm oil policy, which has three main components: **halting deforestation; protecting peat land; and driving positive economic and social impact**.

At the same time, Unilever announced a commitment to trace the palm oil purchased by Unilever to certified plantations. This is an important step to achieving its long-term sustainability goals, providing necessary information about where Unilever's palm oil comes from.

In 2014, Unilever made considerable progress on tracing its supply to the mill level; 70% of its palm oil supply chain is now traceable to known mills.

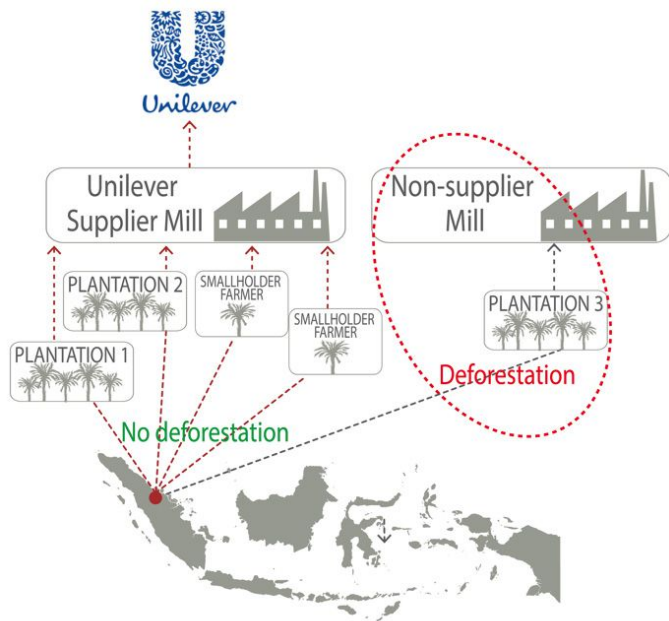
Globally, Unilever now knows of 1,800 crude palm oil mills engaged in the processing of its palm oil. Further work is now underway to trace the origin of the palm oil used in its products back to plantations to fully understand the impacts of Unilever's supply chain on the environment and on farmers' livelihoods.

Through the Traceability Working Group, IDH has been helping to convene private sector actors throughout the oil palm value chain to build common understanding of what traceability entails and develop methods for addressing the initial challenges to transparently delivering on traceability commitments.

Unilever Supply Chain Traceability:



Challenge: traceability alone cannot deliver net positive impacts



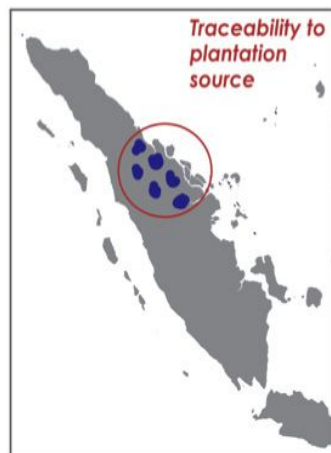
Knowing the origin of companies like Unilever's supply of palm oil is an important first step. But to achieve the ambitious shared goal of a net positive environmental impact and improved smallholder farmer livelihoods, we need to go beyond traceability.

Unilever and IDH have commissioned the development of a delivery strategy to achieve their medium to long-term environmental and livelihood goals, initially focused on the key landscapes from which Unilever sources.

Beyond Traceability: Taking a Landscape Management Approach

A landscape management approach is an innovative solution to deliver our shared goals. This approach involves partnerships to manage agricultural production and ecosystem protection across a connected area of

land at scale, as opposed to current approaches that primarily involve a range of business, smallholder farmer and government actors managing smaller dispersed patches of land more independently.



The landscape management approach goes beyond traceability, which can only manage environmental and livelihood benefits on a plantation-by-plantation basis, to deliver both supply chain security for business, as well as net positive environmental impacts and improved smallholder farmer livelihoods at scale.

The steps of a landscape management approach:

The key steps for taking a landscape management approach include the following:

1. Define the landscape boundaries
2. Partner with business, smallholder farmers and government within the landscape area
3. Map and allocate land within landscape to its highest value or best use
4. Increase productivity and support community and government to protect valuable ecosystems
5. Monitor and report results

We will now walk through each of these steps, including some examples of how they apply to Unilever's supply chain.

1. Define the landscape boundaries

The boundaries of a landscape are determined by considering three perspectives:

1. Business investment perspective
2. Environmental perspective
3. Governance perspective.

The ideal boundaries from these three perspectives are often not completely aligned. So deciding the landscape boundaries will require consideration of the specific context. *The primary goal is to deliver the greatest net positive environmental & livelihood benefits, with least impact to business investment.*

Sei Mangkei Landscape Management Pilot: defining the boundaries

Unilever is investing in a palm kernel fractionation facility in Sei Mangkei, North Sumatra in Indonesia that will help drive industry transformation and deliver on its 2020 sustainability goals. Working with government, business and smallholder farmer partners, Unilever will trial a landscape management approach in this region. As a first step, the boundaries for the pilot area need to be defined.

From a *business investment perspective* the boundaries need to align with the supply shed that will supply palm kernel oil or just palm kernels to be crushed in to the new facility - which is currently estimated to require at least a 100km radius from the facility.

From an *environmental perspective*, the landscape area should include valuable peat and forest ecosystems that will be protected through the landscape partnership. This will enable the landscape partners to demonstrate greenhouse gas emission reductions and a net positive impact on the landscape environment.

From an *administrative perspective*, the landscape area should be aligned with district boundaries.

In balancing these perspectives, the districts of **Simalungun, Serdang Bedagai, Asahan, Labuan Batu Utara & Batu Bara are proposed for the landscape pilot**. These districts contain more than 40% of North Sumatra's oil palm, with a high concentration of smallholder farmers. They also contain 25% of North Sumatra's peat soils & 10% of it's forests (more than 250,000 hectares), of which around one third are located outside the forest estate, and hence liable for conversion and offering a significant opportunity to test the landscape management approach.



2. Partnering with business, smallholder farmers and government within the landscape area

Implementing the landscape management approach will require a coalition of government, business and smallholder farmers, with support from civil society. While this adds complexity, in the long term it will reduce risks and share the costs of transformation. Partnering to take a landscape management approach offers the greatest benefits from a business investment, environmental and livelihood perspective.

What are the respective roles of government, business and farmers?

1. *Government agencies have the authority to manage land-use planning across national, provincial and district jurisdictions. They can optimize land-use plans to ensure land resources are allocated to their highest value purpose, a key element of a landscape management approach that seeks to increase productivity while protecting high value ecosystems (see step 3 for more detail).*
2. *Governments also set the fiscal frameworks that can be adjusted to better incentivize sustainable land use allocation by local governments and high productivity agriculture by business & smallholder farmers.*
3. *Smallholder farmers are land-owners and significant sources of agricultural commodities, particularly of palm oil in Indonesia, where smallholder farmers manage an estimated 40% of oil palm plantations. This means smallholder farmers are important partners to successfully transform the sector to deliver high productivity, sustainable palm oil. Supporting their improved productivity and integrating their activities into the oil palm value chain can*

also help deliver improved livelihoods – a key goal of the landscape management approach.

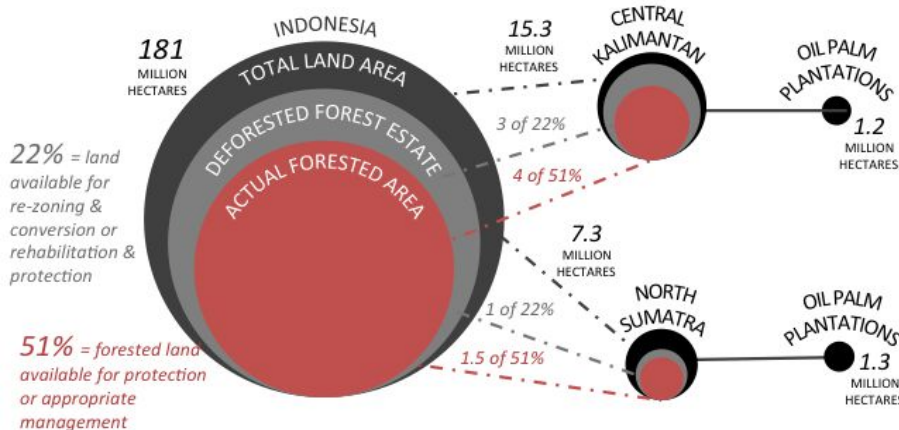
4. *Business is generally best placed to deliver productivity gains within agricultural supply chains, owing to their ability to innovate and access to finance, technology and logistics systems.*
5. *Business and government are a source of finance to fund the transformation of agricultural value chains & the protection of valuable ecosystems, while sharing benefits equitably with local communities.*

3. Map and allocate land within landscape area to its highest value or best use

There are *significant opportunities for government to improve land-use planning within key landscapes to provide better protection of forest ecosystems & release suitable land for high productivity agriculture.*

For example, in North Sumatra, there is an estimated 1.1 million hectares of degraded land inside the forest estate that has potential to be used more productively – either through rezoning to enable agricultural production, or rehabilitation and protection. The potential to use land more effectively is even greater in Central Kalimantan, where there is an estimated 5.3 million hectares of degraded land within the forest estate.

The landscape management pilot partnership in Sei Mangkei will support regional government partners in improving land use planning, and in allocating land to its highest value purpose. This will involve supporting them to clarify and appropriately allocate licenses and property rights, strengthening management and protection of high value ecosystems in land-use plans, improving land-use zoning (including potentially releasing suitable degraded lands for agricultural uses).



Central Kalimantan has an estimated 7.5 million hectares of remaining forest & 5.3 million hectares of degraded lands.

North Sumatra has an estimated 2.6 million hectares of remaining forest & 1.1 million hectares of degraded lands.

Aligning fiscal frameworks to promote sustainable investment:

Aligning fiscal frameworks to make high productivity, sustainable oil palm a more attractive investment proposition, as opposed to lower productivity or expansive agriculture, for the full range of business actors (smallholder farmers, small-medium enterprises and multi-national companies) is a key element of the landscape management approach. For example, changes could include adjusted tax frameworks that promote higher productivity or incentivize locating new developments outside high value ecosystems.

Climate Policy Initiative is working with the Indonesian Ministry of Finance to assess opportunities to better align the fiscal framework to promote better land-use management and allocation by business investors and local government.

4. Increase productivity within sectors and supporting protection of valuable ecosystems

In addition to supporting improved land-use allocation, the landscape management approach focuses on optimizing productivity within land-use sectors, including sharing benefits equitably & developing appropriate financing mechanisms to fund the protection of valuable ecosystems.

For example, opportunities for optimizing productivity within the oil palm value chain include:

1. Strengthening industrial organization, including partnership arrangements throughout the value chain. For example, arrangements between smallholder farmers and companies to reduce conflict, minimize risks, deliver extension services & livelihood benefits.

Supporting smallholder farmers: a landscape management pilot in Sei Mangkei

According to the recent Indonesian Agricultural Census, an estimated 332,868 households manage 526,510 hectares of smallholder oil palm plantations in North Sumatra. More than 40% of these households, and 35% of the smallholder farmer land area, are located within the Sei Mangkei pilot landscape area. Given smallholder farmers manage such a significant proportion of the oil palm area in North Sumatra, ensuring their plantations are located on suitable environmental lands, are highly productive and effectively integrated into business supply chains is a high priority. A landscape management strategy will best enable net positive environmental impacts, as well as supporting improved farmer livelihoods and supply chain security for business investors.

In partnership with IDH and PTPN III, Unilever has initiated a program to support smallholder farmers in the Sei Mangkei area. Initially, in 2015 & 2016 this will focus on supporting 320 independent farmers to increase their productivity and become RSPO certified. By 2018, the program aims to work with partners through the landscape management pilot to scale up support for smallholder farmers in the broader Sei Mangkei landscape area to deliver larger scale environmental impacts and improved livelihoods.

This partnership will also help to systematically address the challenge of smallholder farmer replanting to ensure supply chain security and sustained environmental and livelihood benefits. The vast majority of smallholder farmer plantations in North Sumatra were planted in the late 1990s, with around two thirds of the area expected to need replanting before 2020. Financing this replanting in line with both environmental and livelihood goals will be critical. Unilever, IDH and Climate Policy Initiative are designing a comprehensive approach to addressing the replanting challenge, and will provide recommendations on the most suitable organizational models and financial structures to scale up support for smallholder farmers throughout the Sei Mangkei landscape area.

2. Optimizing business finance for companies and smallholder farmers (for example, by lowering the cost of finance or directing investment to parts of the value chain that can deliver the most productivity gains), including through the development of credit and risk management instruments
3. Optimizing business investment policy, including for tax arrangements, other fiscal incentives, public spending & revenue/benefit sharing related to the land use sector
4. Improving access to energy & infrastructure
5. Improving logistics & technology.

5. Monitor and report results

The landscape management approach allows Unilever and IDH to meet their goal of delivering net positive environmental impacts and improving smallholder farmer livelihoods.

To determine progress and success in meeting these goals, the landscape management approach includes monitoring and reporting of results.

Government monitoring systems for land-use and local livelihoods / development, or existing public tools, such as WRI's Global Forest Watch, can facilitate monitoring at a landscape scale. This is expected to reduce the costs, which are significantly higher when monitoring on a plantation-by-plantation basis, and it will also help to increase comparability and transparency.

Summary: benefits of taking a landscape management approach

Unilever and IDH's goal is to transform the Indonesian rural economy by 2020, to deliver net positive environmental impacts and improve smallholder farmer livelihoods. A landscape management approach facilitates the achievement of this goal through the allocation of land to its highest value use, by maximizing productivity, and by distributing benefits equitably, while supporting Unilever's supply chain. Plantation-by-plantation programs, in comparison, can only ensure site-specific impacts.

The landscape management approach will also provide measurable impacts on the environment and on livelihood improvements at scale. Ultimately, the landscape management approach can transform the Indonesian oil palm sector into one that is highly productive and sustainable.

From a business standpoint, this approach will help manage medium to long-term business risk and costs, building supply chain security within targeted landscapes and promoting consumer confidence.

About Unilever

Unilever is one of the world's leading suppliers of Food, Home and Personal Care products with sales in over 190 countries and reaching 2 billion consumers a day. It has 172,000 employees and generated sales of €48.4 billion in 2014. Over half (57%) of the company's footprint is in developing and emerging markets. Unilever has more than 400 brands found in homes around the world, including Persil, Dove, Knorr, Domestos, Hellmann's, Lipton, Wall's, PG Tips, Ben & Jerry's, Marmite, Magnum and Lynx.

Unilever's Sustainable Living Plan (USLP) commits to:

- Decoupling growth from environmental impact.
- Helping more than a billion people take action to improve their health & well-being.
- Enhancing the livelihoods of millions of people by 2020.

For more information about Unilever, please visit www.unilever.com. For more information on the USLP: www.unilever.com/sustainable-living/.

About IDH

IDH accelerates and up-scales sustainable trade by building impact oriented coalitions of front running companies, civil society organizations, governments and other stakeholders that will deliver impact on the Millennium Development Goals 1 (poverty reduction), 7 (safeguarding the environment) and 8 (fair and transparent trade).

Our Initiative for Sustainable Landscapes works in six landscapes in Africa, Asia and South America. The initiative will deliberately work beyond the farm-level to support food production, ecosystem conservation, and rural livelihoods across entire landscapes in an integrated manner.

About CPI

Climate Policy Initiative works to improve the most important energy and land use policies around the world, with a particular focus on finance. An independent organization supported in part by a grant from the Open Society Foundations, CPI works in places that provide the most potential for policy impact including Brazil, China, Europe, India, Indonesia, and the United States.

Our work helps nations grow while addressing increasingly scarce resources and climate risk. This is a complex challenge in which policy plays a crucial role.

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