



LMC



Lessons Learned? Governments Policies and Their Impacts on Palm Oil Trade in 2022.

Dr Julian McGill

2022 PORAM Forum

Policy makers face an impossible task as they are torn between two directly conflicting political necessities:

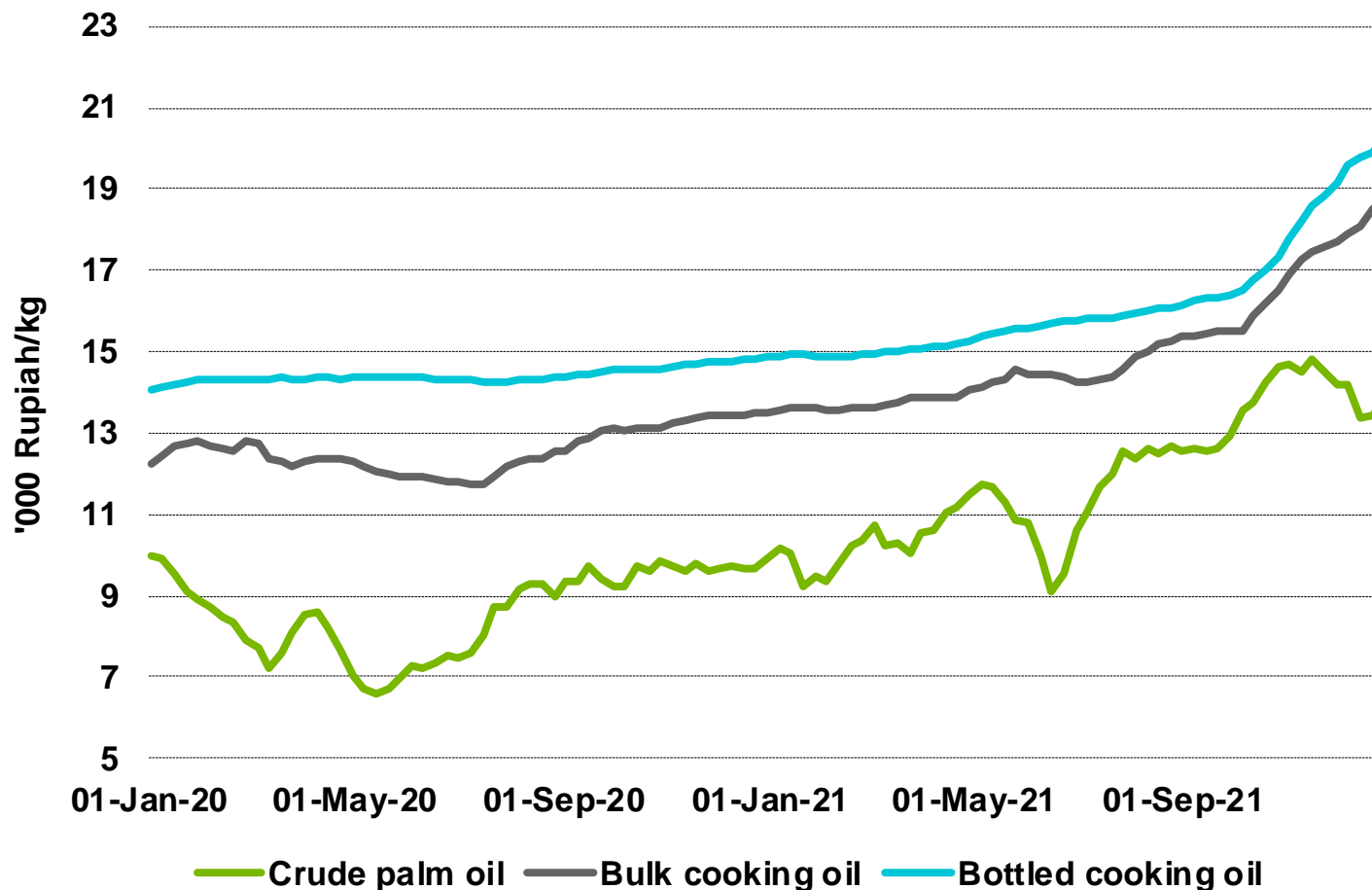
1. To keep prices **low** to help urban consumers.
2. To keep prices **high** to support farmers.

The job of an agricultural economist is much easier.

My aim today is not to unduly criticize the policy makers who are torn between these impossible decisions, but to describe how a better understanding of the role of the processors may help in the future.

As well as to recount what was – with hindsight – a fascinating period in the palm oil market.

Indonesian CPO, bulk cooking oil and bottled cooking oil prices, 2020-2021



The raw material (crude palm oil) fluctuate much more strongly than he cooking oil.

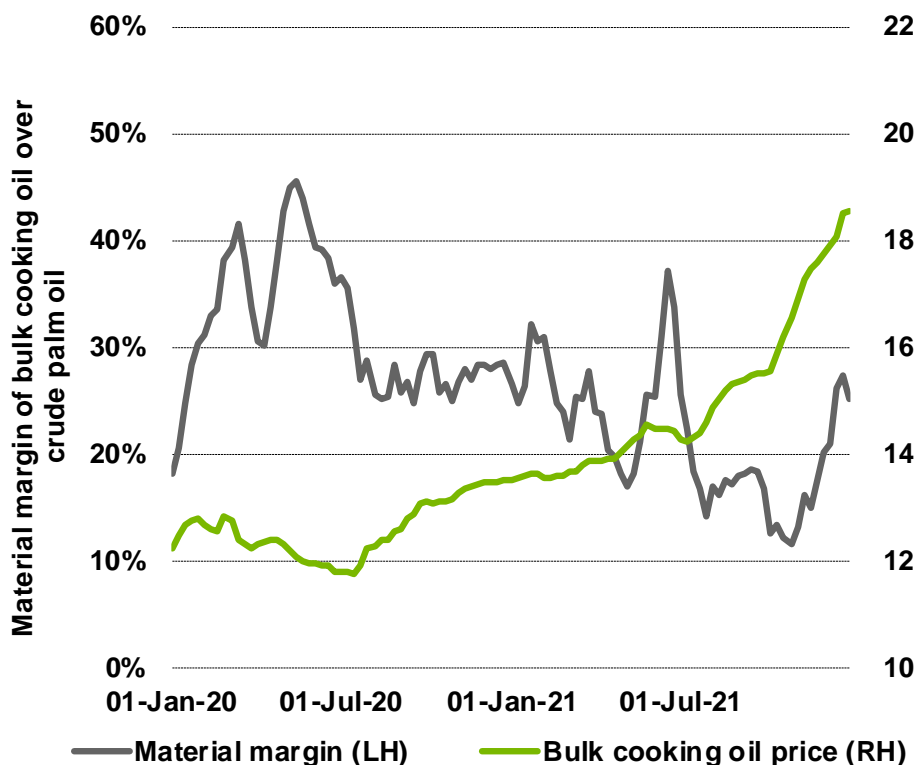
Bottled cooking oil prices are also more stable than bulk cooking oil.

By the end of 2021 cooking oil prices were a third higher than at the beginning of the year.

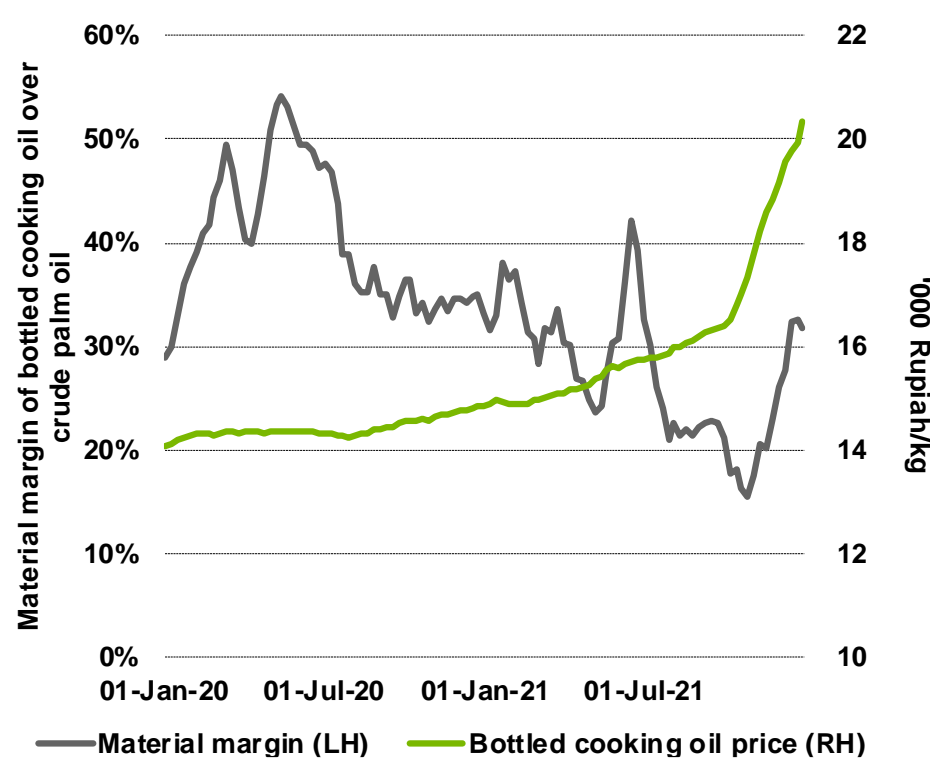
Though they remained much lower than world prices, due to Indonesian export duties.

- The diagrams below show a rough indication of material margins – measured by the difference between the raw material, crude palm oil, and the cooking oil price.
- Actual margins will reflect packing cost, distribution, marketing and sales costs as well as the lag between buying and selling.
- The diagrams show, however, that higher raw material costs are only passed on to the consumer with a lag, particularly for bottled oils.

Material margin and bulk cooking oil price

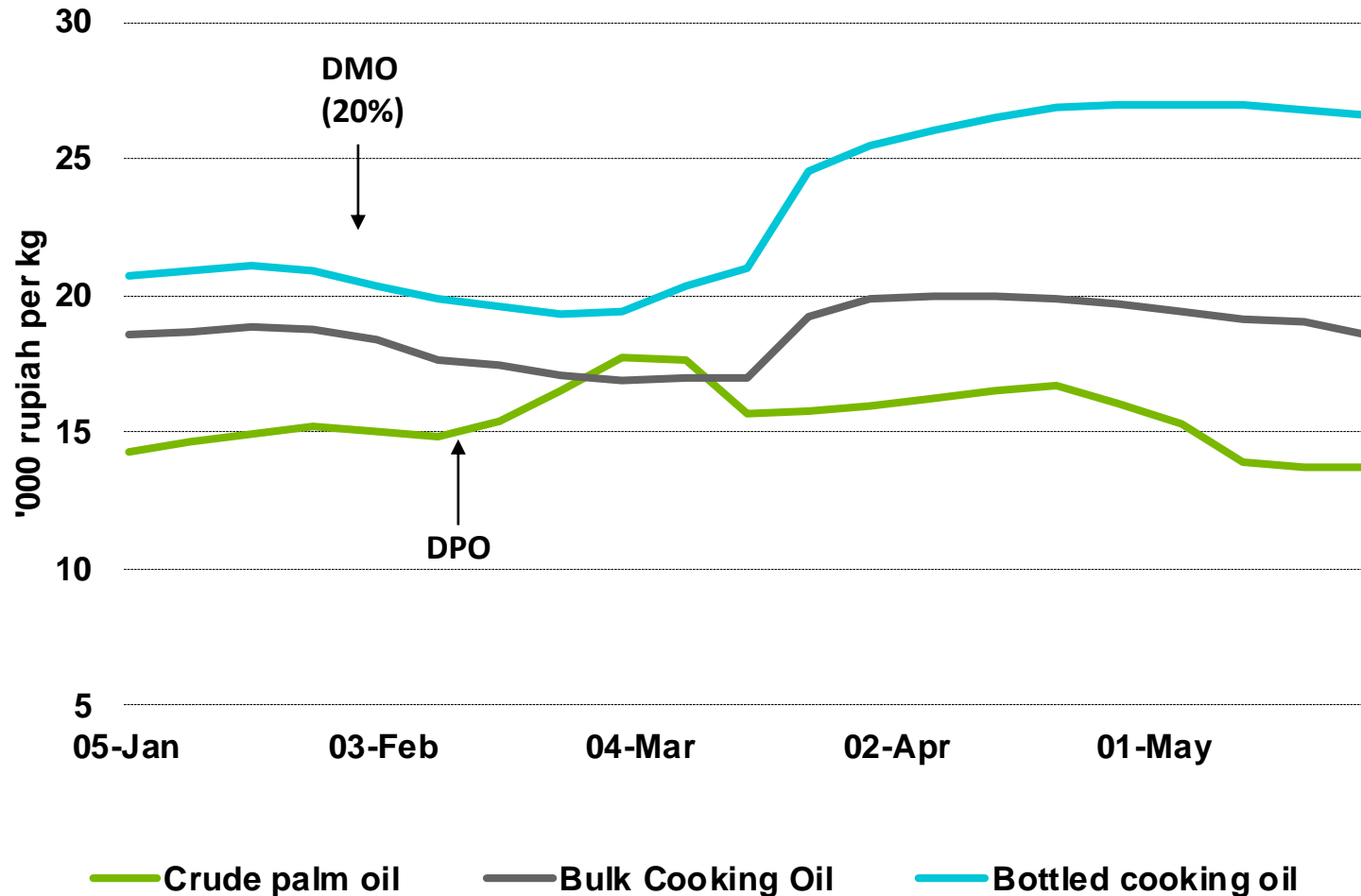


Material margin and bottled cooking oil price



The state intervenes... and increases the price!

Indonesian CPO, bulk cooking oil and bottled cooking oil prices, 2022



To reduce cooking oil prices, on the 27th of January, the Minister of Trade introduced a Domestic Market Obligation (DMO) requiring that 20% of export volume be sold locally as cooking oil.

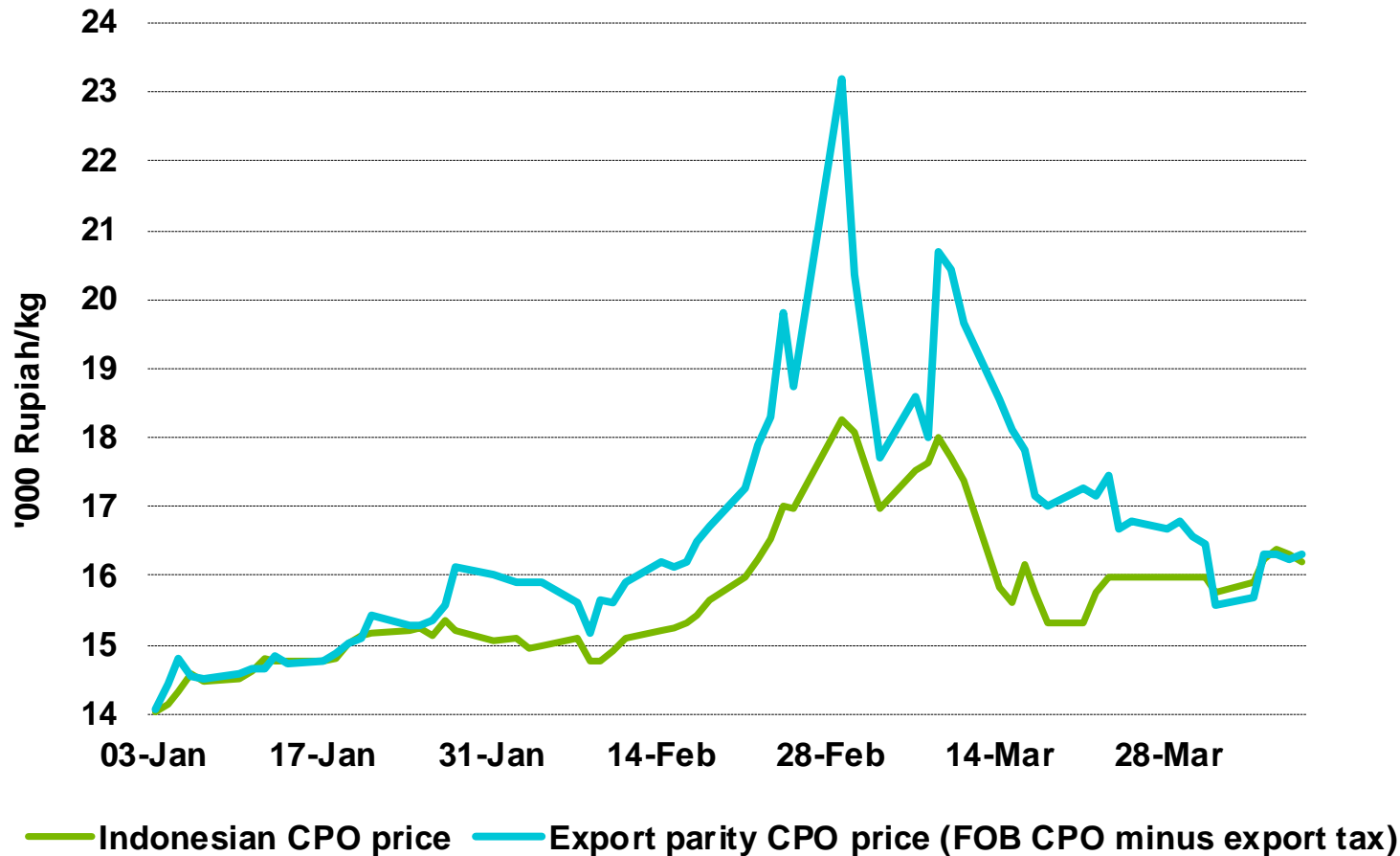
These Domestic Price Obligation (DPO) followed on the 1st of February requiring:

- Bulk oil to be sold a 11,500 Rp/litre (12,366/kg)
- Packed oil at 13,500-14,000 Rp/litre (14,500-15,050 Rp/kg)

These prices were far below CPO prices, which were about to rally....

Slow exports of CPO forced up the export price

Indonesian (KPB) CPO price, bulk cooking oil price and export parity price (FOB minus export tax), 2022



Selling cooking oil at the fixed DPO prices was very unprofitable.

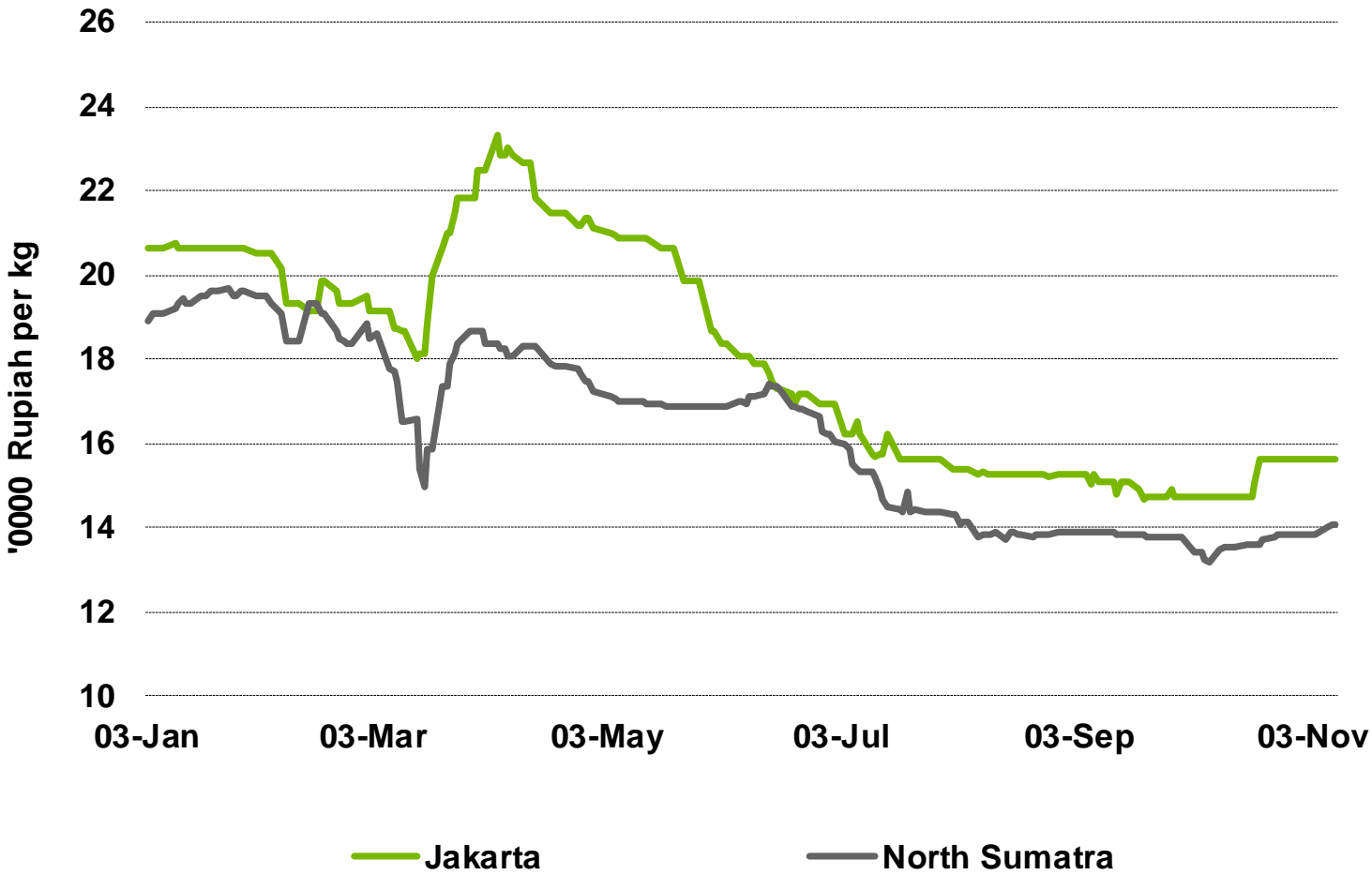
For palm oil producers obtaining the export permits could make it worthwhile, but they struggled to generate them:

- What if you don't refine palm oil or sell cooking oil?
- Can olein sales be used for CPO export permits?
- Are export permits transferable and are they subject to VAT?
- Who needs to sign the export permit?
- Will the policy last?

So exports slowed and world prices shot up over fear of CPO availability.

Internal distribution was a major problem

Bulk cooking oil prices in Jakarta and North Sumatra (Medan), 2022



The government set one cooking oil price for the entire country, covering 17,500 different islands. In the main palm producing regions, such as North Sumatra, prices declined but producers couldn't sell sufficient cooking oil. At the same time shortages in Jakarta lead to significantly during Ramadan and around *Lebaran* (the festival at the end of Ramadan).





Masyarakat saat antri membeli minyak goreng murah. (KOMPAS.com/ ELSA CATRIANA)

<https://money.kompas.com/read/2022/02/07/112809326/saat-cari-minyak-goreng-saja-susah>

With cooking oil prices fixed at below cost – and cost increasing with higher CPO prices – reselling fixed price cooking oil became lucrative.

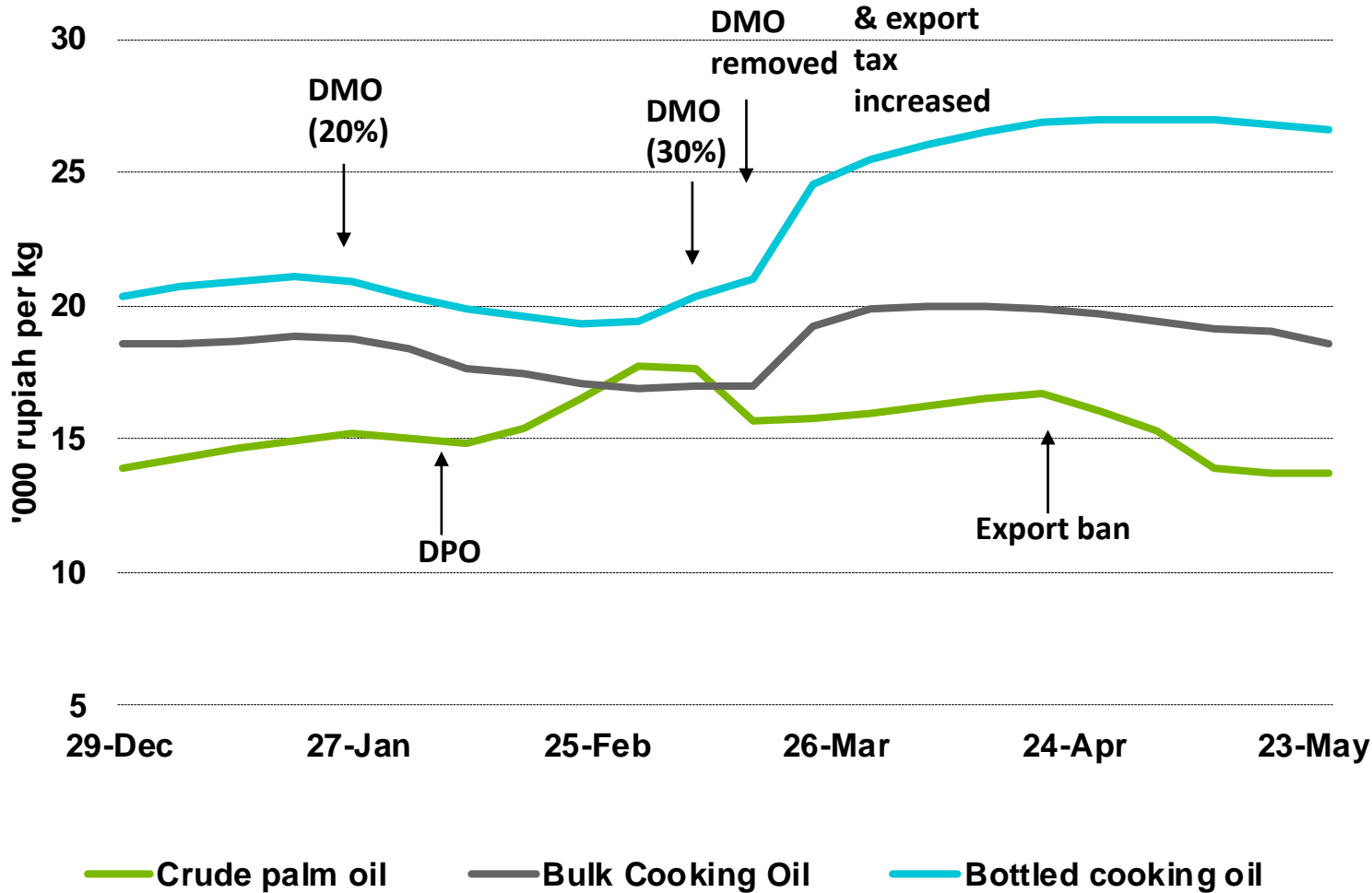
At the same time, some branded cooking oil producers refused to sell at the mandated prices arguing it would devalue their brand. (Buy one get one free offers were sometimes used).

Because bottled was still more profitable than bulk, availability of bulk oil also declined. Shortages ensued.

The Indonesian state couldn't intervene as it can only supply around 4% of monthly consumption via state agencies (BULOG and PTPN)

An export ban is adopted

Indonesian CPO, bulk cooking oil and bottled cooking oil prices, 2022



The Ministry, doubled down increasing the DMO to 30%. As shortages remained the DMO/DPO was relaxed (and export taxes increased).

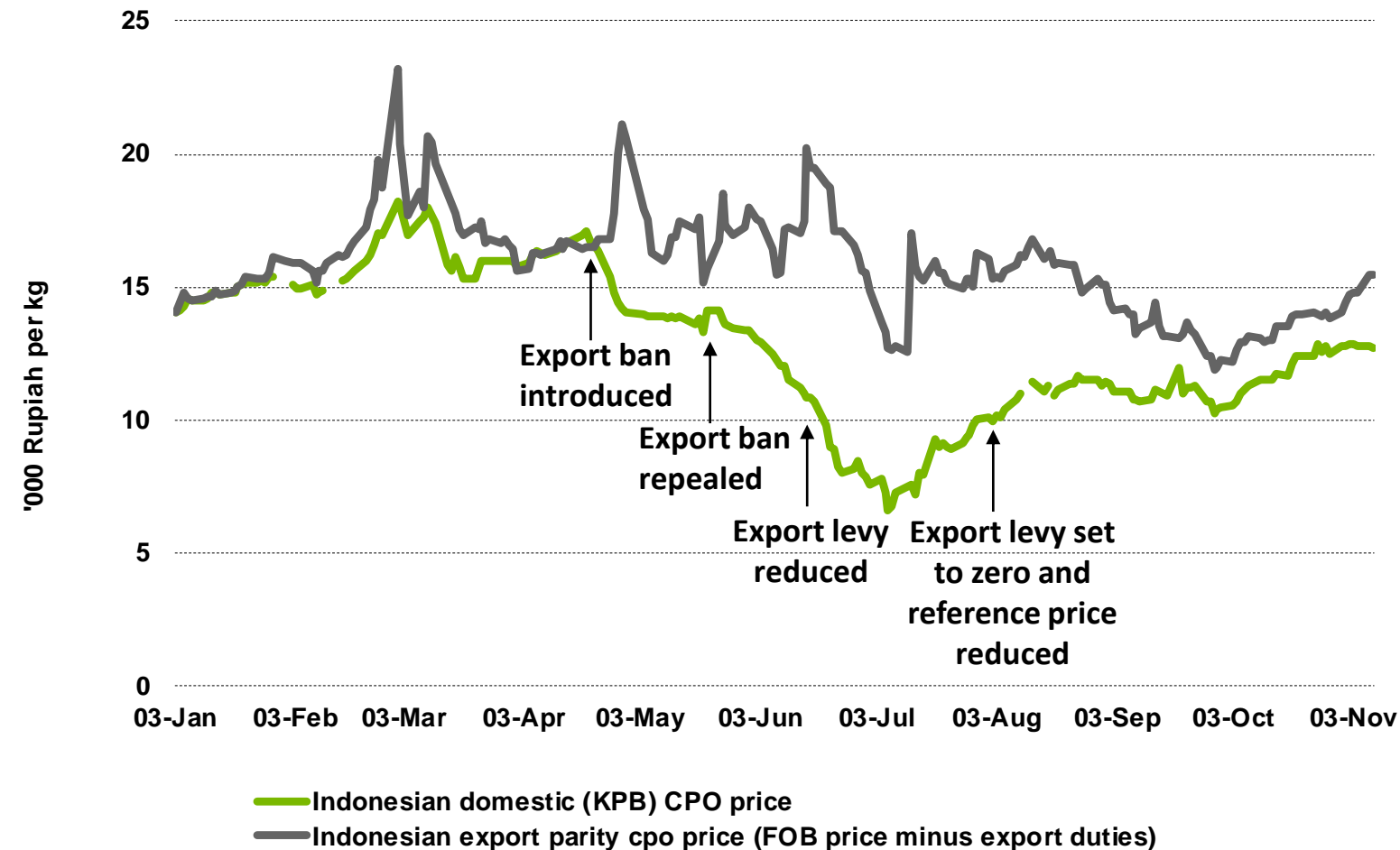
As the government relaxed cooking oil controls, supply recovered but prices were still too high to be politically acceptable.

The government now considered direct subsidies but how quotas would be allocated and traced was unclear. In addition agreement could not be reached between the Ministry of Trade and Ministry of Finance.

An export ban was introduced on the 28th of April.

Export ban decoupled export parity and local prices LMC¹

Indonesian domestic crude palm oil (CPO) prices against export parity prices, 2022



The export ban was effective, decoupling export parity and local CPO price. After one month on the 23rd of May it was repealed. Low exports and rising seasonal output filled storage (incl. in barges). Exports still needed permits and cooking oil demand was too weak to generate them. Chaos in shipping pushed up stocks further, reducing CPO prices by a third. Supporting farmer livelihoods now became a political necessity. Duties were slashed, to stimulate exports and DMO requirements were tweaked.



With hindsight, the cost of the Indonesian policy far outweighed the benefits from the (eventual) reduction in cooking oil prices.

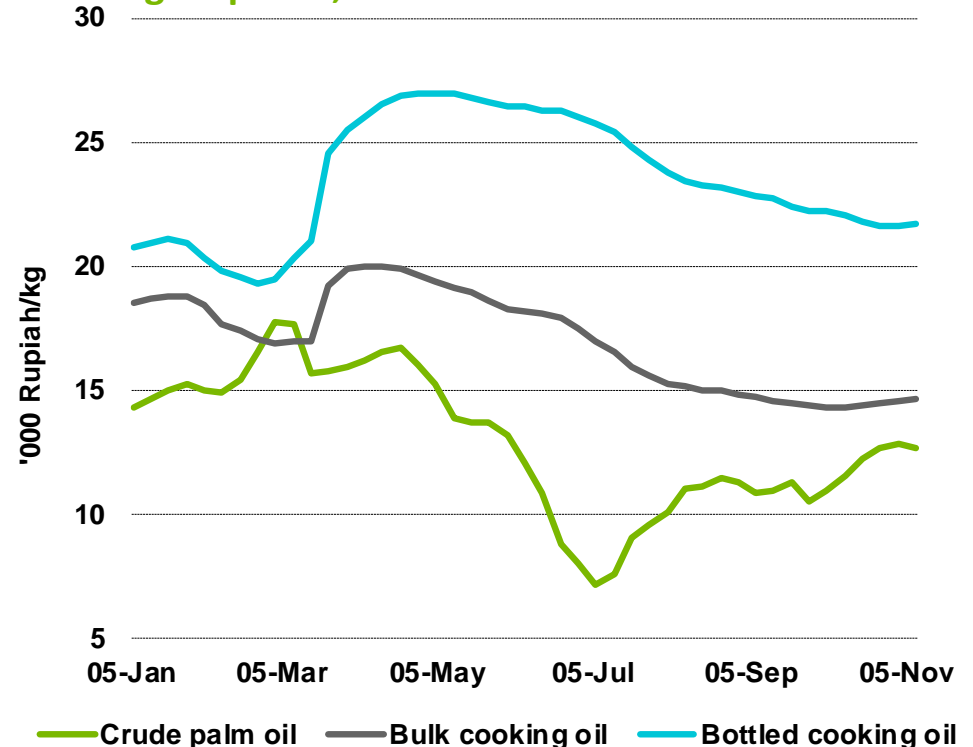
The Domestic Market Obligation policy had worked previously in coal, but palm oil had a more complex value chain. In addition, oil palm producers could not switch off production.

The main problem, however, was the expectation that cooking oil prices would decline almost immediately.

Four lessons are important:

1. Commodity price cycles move significantly less quickly than the news cycle.
2. Retail prices are much stickier than raw material prices.
3. Distribution is difficult, the much-scorned middlemen are needed.
4. Price signals guide market participants, where there is a margin there will also be a way to exploit it.

Indonesian CPO, bulk cooking oil and bottled cooking oil prices, 2022



Shortage of cooking oil in supermarkets

By **ERCY GRACELLA AJOS** - June 28, 2022 @ 8:15am



An almost empty shelf of cooking oil seen at a supermarket in Kuala Lumpur yesterday. - NSTP/ EIZAIRI SHAMSUDIN

- Malaysia has both the direct distribution of subsidized oil and a policy to fix maximum prices.
- Distributing subsidized cooking oil can be difficult (particularly when used cooking oil is worth more than cooking oil).
- Fixed prices are currently based on last month's prices plus a variable margin.
- As a result, there is no incentive to sell cooking oil when prices are declining.
- In addition, it is unclear how this helps buyers?

<https://www.nst.com.my/news/nation/2022/06/808737/shortage-cooking-oil-supermarkets>



Other publications

Oxford

LMC International Ltd
4th Floor, Clarendon House
52 Cornmarket Street
Oxford OX1 3HJ
UK

Tel: +44 1865 791737

Email: info@lmc.co.uk

New York

LMC International Ltd
1350 Avenue of the Americas
Floor 2
New York, NY 10019
USA

Tel: +1 212 586-2427

Email: info@lmc-ny.com

Kuala Lumpur

LMC International Ltd
SO-30-8, Menara 1
No. 3 Jalan Bangsar
KL Eco City
59200 Kuala Lumpur
Malaysia

Tel: +603 2202 1414

Email: info@lmc-kl.com

