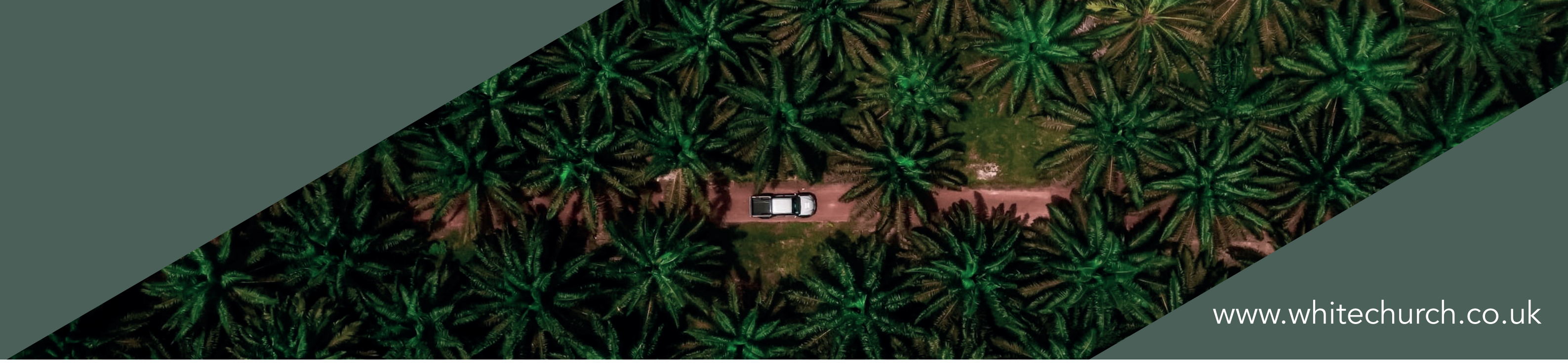
Palm Oil - Considerations for Sustainable Portfolios

Palm oil – it's everywhere. The creamy, semi-solid oil, derived from the fruit of the palm oil tree, is found in a truly dizzying array of consumer products. From food to cosmetics, biofuels to cleaning products, researchers estimate that almost half of all packaged supermarket products contain palm oil, or one of its derivatives. Palm oil has a number of attractive qualities – because it's a semi-solid at room temperature, it can be used to keep spreads spreadable. It's resistant to oxidation, giving products a longer shelf-life, and because it's stable at high temperatures, it gives fried products a crispy texture without compromising the look or smell of the food in question. Perhaps unsurprisingly, then, our hunger for palm oil is insatiable – in 2015/16, we consumed 59.4 million metric tons of the stuff. By 2021/22, this had risen to 73.9 million metric tons, a 24% increase in just 6 years.

This addiction to palm oil has not been without consequences, some of which are fairly well documented. The palm oil tree only grows within 20 degrees of the equator, a region also home to the world's tropical forests. Malaysia and Indonesia – islands which together represent some of the most biodiverse habitats on Earth – together account for nearly 90% of global supply. Increasing demand for palm oil has driven deforestation on a massive scale, threatening critically endangered species such as the Orangutan, pygmy elephant and Sumatran rhino. There are other issues too. The degradation of tropical forests is a double whammy for climate change. Trees are well known for their ability to absorb carbon, providing a natural sink for atmospheric carbon dioxide – when they are cut down, this sink is removed. At the same time, the underlying peat is drained to make it suitable for palm oil plantation. The drying out of these carbon rich soils releases huge quantities of greenhouse gases accumulated over many millennia. The industry has also been blighted by accusations of forced and child labour.

Given these problems, should ethically driven investors go cold turkey on palm oil? As usual, the issue isn't so black and white. Back in 2018, frozen food retailer Iceland announced it would stop using palm oil as an ingredient in all its own brand food by the end of the year. The campaign was supported by a hugely popular Christmas advert, highlighting the plight of the Orangutan. But fast forward to 2022, and Iceland has had to return to using palm oil, at least temporarily. The price of sunflower oil, a major alternative, has skyrocketed in the wake of Russia's invasion of Ukraine (the latter accounts for over one quarter of global supply). This leads us to the heart of our addiction with palm oil – compared to alternatives, oil palm is a very efficient crop. In 2018, palm accounted for 36% of global vegetable oil production. Soybeans, the next largest contributor, accounted for 25% of production. But while soybeans required 39% of the land set aside for vegetable oil cultivation, oil palm required just 8.6%. Iceland's alternative of choice, sunflower oil, accounted for 9% of global production, and required 8.3% of land. Of the common vegetable oils (soy, rape, olive etc.), none come close to palm in terms of yield per hectare – in fact, palm is roughly four times more efficient than sunflower, the second most productive oil crop. And this leads us to an inescapable conclusion – despite the damage caused by the proliferation of palm oil plantations, substitution with another crop would require substantially more land, risking even greater environmental harm.

Compared to some of the more 'traditional' vice products (e.g., tobacco), palm oil often falls somewhat lower down the rankings for investors wishing to incorporate ethical considerations. However, with biodiversity/natural capital moving up the agenda, perhaps this is about to change. Investors looking to consider palm oil have two options. The first, and we would argue least practical option, is to



exclude it from a portfolio entirely. But, given how widespread the use of palm oil is, this might prove harder than first thought. Certainly, none of the world's major indices would be considered palm oil free. We could look to reduce our exposure by excluding certain sectors, such as consumer staples. But with palm oil present across so many sectors, an investor seeking an exclusionary approach might find that their investment universe has been reduced to the point that true diversification is no longer possible. And don't forget, eliminating palm oil production might help prevent deforestation in one region, but demand for vegetable oil will still need to be met, most likely via cultivation of a far less efficient crop elsewhere in the world.

Rather than a hard exclusion, there is perhaps greater merit in selecting investments based on the sustainability of the underlying method. Palm oil can, and is, produced in a sustainable manner. The Roundtable on Sustainable Palm Oil (RSPO) was formed in 2004 in response to concerns about the impact palm oil was having on the environment and society. The RSPO sets standards for production and sourcing of palm oil, including policies to remove deforestation, conversion of natural ecosystems, and human rights abuses from supply chains. It also promotes transparency, helping consumers (and investors) to make informed decisions when it comes to palm oil sourcing. At this point, it is worth noting that the RSPO is far from perfect. Not least among the documented issues is a failure to account for past deforestation – that is, land cleared in recent decades by a third-party may now qualify for a sustainability label under the scheme. According to one study, this could lead to an 'infinite loop of meaningless certification'. In response, the RSPO set a deadline of November 2005, after which plantings may not replace primary forest. While imperfect, the RSPO is the industry standard for sustainable palm oil and as a forward-looking enterprise, it remains a force for good. Investors with concerns about their palm oil exposure should consider seeking fund managers with a policy of excluding those producers and consumers that are not certified by the RSPO, coupled with a wider policy on deforestation, to help minimise the impact of their portfolio.

For information on Sustainable Investments, please visit our website www.whitechurch.co.uk or contact a member of our Client Services Team on:
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Figures have been taken from the UN Food and Agricultural Organisation and the US Department of Agriculture.