

Voluntary Partnership in Palm Oil Trade: A Sustainable Approach for Malaysia

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The EU Renewable Energy Directive supplementing Directive 2018/2001 of Renewable Energy Directive II (EU RED II) was enforced by the European Parliament to restrict and ban palm oil biofuel by 2030. Malaysia found the EU RED II as discriminatory towards palm oil as the directive classifies the commodity as 'unsustainable' by causing deforestation and climate change. The EU RED II is further perceived as harmful to the socio-economic well-being of palm oil planters and alleged to have disregarded implementation of sustainable palm oil agricultural sustainable practices and strategies in conformity with Sustainable Development Goals (SDGs) 2030 in Malaysia. This paper found that environmentally sustainable practices in Malaysia's palm oil sector are actively promoted which can only boost trade relations through a voluntary partnership scheme as an approach to resolve the EU's position on palm oil biofuel. The approach taken in Indonesia's timber production dispute with the EU is recommended.

Key words: *Palm oil, Malaysia, sustainable, environment, partnership.*

Introduction

Malaysia produces about 39% of world palm oil and 44% of world exports and, accounts for 12% and 27% of the world's total production and exports of oils and fats. CPO output in Malaysia is likely to be approximately 19.5 million tonnes in 2018, slightly lower than the 19.92 million tonnes in 2017. The EU is the second largest importer of Malaysian palm oil after India with 12 % purchase of total palm oil in 2018. The implications from the Malaysia-EU palm oil dilemma, however, has reflected a decrease in the country's export to the EU by four percent (4%) from a total of 1.99 million tonnes in 2017 to 1.91 million tonnes in 2018. The deflated data is connected to the ongoing criticism against environmental impacts arising

from palm oil linked activities in Malaysia which has recently reached another level of potential dispute between Malaysia, Indonesia and the European Union nations.

The classification of palm oil as ‘*high ILUC (indirect land use change) risk*’, in the EU Renewable Energy Directive supplementing Directive 2018/2001 of Renewable Energy Directive II (EU RED II) adopted by the EU, has raised contentious remarks and rejection by palm oil producer nations, namely Malaysia and Indonesia. Malaysia claimed that EU RED II is clearly a form of disguised restriction on international trade as protectionist measures against palm oil where the adopted regulation has a strict requirement against crops for feedstock biofuels which cause deforestation and greenhouse gases emissions. The data compiled to support the adoption of EU RED II showed that palm oil has been associated with the highest level of deforestation (over the period 2008-2015) where 45% of the expansion of palm oil took place in high carbon stock areas. In the EU, biofuels are listed as part of the EU’s strategy to increase renewable energy utilisation in the economic bloc. The EU RED II therefore includes new frameworks and rules to ensure that biofuels are sustainable and do not cause deforestation from indirect change of land use of rain forests or grasslands. The EU RED II Directive which is already in force includes a new approach ensuring that crops used for the production of biofuels: are not sourced from recently deforested areas or peatlands – no matter where they are produced –, and they have not merely displaced other production to other high-carbon, high-nature value areas elsewhere. Palm oil that is certified as low ILUC-risk can continue to benefit from incentives and exemptions remaining for planting on unused lands and for small holders particularly in Indonesia and Malaysia.

The EU considers EU RED II as WTO compatible since EU RED II establishes sustainability criteria for biofuels and biomass that are global, objective and non-discriminatory and do not single out any specific biofuel or feedstock. Furthermore, the EU RED II sustainability criteria identifies sustainable biofuels that are eligible for public support or accounted against the EU and national renewable energy targets and, do not limit the market access of imported biofuels to the EU.

Multilateral pressure on the EU will intensify as Malaysia takes a step to jointly challenge the EU RED II with other members of the Council of Palm Oil Producing Countries (CPOPC) including Indonesia and Colombia through WTO dispute settlement mechanism. The CPOPC stated EU RED II used a ‘*scientifically flawed*’ concept that targets palm oil and ‘*makes no attempt to include broader environmental concerns*’ linked to other vegetable oils.

Despite the trade uncertainty over palm oil and biofuel production caused by the Malaysia-EU palm oil dilemma, the former firmly upholds the nature of domestic palm oil agricultural practices that embeds sustainable and efficient methods to combat deforestation in operations.

In the next part, the paper reviews related measures to strengthen sustainability of the palm oil industry mainly through a certification system as a tool to refute misconceptions and allegations on processes of palm oil production in Malaysia, besides branding the system as a nationwide sustainability initiative with transparency throughout the value chain.

Sustainable Approaches Adopted by the Palm Oil Industry in Malaysia

The impacts of palm oil sector on the environment as a direct cause of deforestation, contributing to greenhouse gas (GHG) emissions through fires and planting on drained peat lands, and lack of good governance and transparency, have urged Malaysia to push for good practices through third party independent certification systems. Voluntary certification schemes have a coverage of approximately 30% of the oil palm cultivated area globally. As such, the footprint of voluntary certification schemes will never be able to completely reach 100% of the potential users of the certification system (Kumaran, 2019).

The establishment of the Roundtable on Sustainable Palm Oil (RSPO) in 2004 was considered as a catalyst for change in the industry as it forms a multi stakeholder council that developed the first global voluntary standards for the sustainable production of palm oil and, as a multi-actor arrangement to improve the conditions of palm oil production and its expansion (Schouten and Glasbergen, 2011). It has more than 4000 members from 92 countries as of October 2018 with more than 2,891,000 hectares of certified Sustainable Palm Oil production area (RSPO, 2019). The RSPO was established to promote growth and use of sustainable oil palm products through credible global standards and engagement of stakeholders. A set of environmental and social criteria must be complied to by companies to produce Certified Sustainable Palm Oil (CSPO) which minimizes negative impact of palm oil cultivation on the environment and communities in palm oil-producing regions. RSPO certification acts as an assurance to buyers of palm oil products that the standard of production is sustainable based on RSPO Principles & Criteria for Sustainable Palm Oil Production by accredited Certifying Bodies, and can be withdrawn at any time in case of infringement of the rules and standards. However, the nature of compliance remains voluntary. In Malaysia, a similar palm oil certification scheme known as Malaysian Sustainable Palm Oil (MSPO) was introduced and is crucial to ensure sustainability measures are complied with in Malaysian palm oil production.

The palm oil industry in Malaysia also complies with Hazard & Critical Control Points (HACCP) and is actively pursuing ISO 14000 standard series discussions and formulations notably on climate change, life cycle analysis (LCA), eco-labelling & Design for the Environment (DFE), environmental communications, and environmental management systems (EMS). These strategies are aimed at reducing the impact of the industry on the environment in oil palm plantation, palm oil mills and refineries. Other noteworthy sustainability measures adopted by the Malaysia palm oil producers are provided in Box 1.



As the harm to the environment caused by palm oil activities has resurfaced during the last two decades caused by alleged excessive deforestation and frequent bouts of haze pollution in Malaysia and Indonesia, international criticism and reaction from the global community to halt the palm oil industry has elevated. This is perceived to be due to visible side-effects of habitat loss and destruction by alleged acts of burning natural forests and draining carbon-rich peatland to cultivate new plantations in these countries. The vital approach by Malaysia to reduce or mitigate effects of palm oil production through regulatory measure is seen in the enforcement of the Environmental Quality Act (EQA) 1974. The legislative requirement to prevent fires or open burning in Malaysia can be found in Section 29A of EQA 1974 that prohibits open burning activities. This particular provision was introduced in the EQA 1974 in light of the impacts of 1997-1998 haze pollution that shrouded Malaysia, Indonesia and Singapore and was allegedly caused by burning of forests making way for palm oil plantations. If open burning occurs on any premises, the owner or occupier of the premise who has control over such premise shall be liable to a fine or to imprisonment or both as provided in the provision. Open burning activities are specified in the Environmental Quality (Declared Activities) (Open Burning) Order 2003 except for certain open burning activities which are allowed but, must be carried out through proper supervision and control.

Box 1: Sustainability practices by the Malaysian palm oil industry

Implementing Good Agriculture Practices (GAP)
Implementing Codes of Practices (COPs)
Completed MPOB LCA Studies along oil palm supply chain
National Land Code 1965
Land Acquisition Act 1960
Environmental Land Conservation Act 1960 revised in 1989
Quality Act 1974 (Environmental Quality) (Prescribed Premises) (Crude Palm Oil) Regulation 1977
Environmental Quality (Clean Air) Regulation 1978
Environmental Quality (Prescribed Activities) (Environmental Impact Assessment) Order 1987
Workers' Minimum Standard of Housing & Amenities Act 1990
Occupational Safety & Health Act 1977
Pesticides Act 1974 (Pesticides Registration) Rules 1988
Pesticides (Licensing for sale & storage) Rules 1988
Pesticides (Labeling) Regulations 1984
Factories & Machinery (Noise Exposure) Regulations 1989
Protection of Wildlife Act 1972
Recycling of oil palm biomass and optimisation of fertiliser inputs
Adopting Zero Burning & Re-planting Policy: accumulation of soil carbon in the plantation
Land Management & planting of leguminous cover crops
High Conservation Value Forest (HCVF)
Integrated Pest Management
POME treatment system

Source: MPOCC and MPOB

Malaysia Sustainable Palm Oil (MPSO) Certification Scheme

The national certification scheme which aims to cover the entire palm oil planted area is by implementing the Malaysian Sustainable Palm Oil (MSPO) Certification Scheme which was set up in October 2015 by the Malaysian Palm Oil Certification Council (MPOCC). The objective of MSPO is to operate a credible and internationally recognised palm oil certification scheme towards promoting sustainable management of palm oil industry in Malaysia (MPOCC, 2017). As of January 2017, the total planted area certified under MSPO is 221,575.14 ha covering the three regions of Malaysia i.e. Peninsular, Sabah and Sarawak

(MPOCC, 2017). In total, 61% of palm oil areas is owned by private enterprises followed by independent smallholders accounting for 17% of the total palm oil area planted in Malaysia (Kushairi, 2019).

MSPO also provides for palm oil management certification and supply chain certification which allows for development of certification standards, accreditation requirements and notification of certification bodies, application by potential clients for certification audits, supply chain traceability requirements, guidelines for auditing, peer reviewing of audit reports, issuance of logo usage licences and procedures for handling of complaints. In essence, local palm-oil producers will have to comply with the environmental standards outlined in the MSPO certification scheme, including observing a total ban on the use of chemical pesticides, it prohibits large-scale land acquisitions (popularly known as land grabs) often carried out by foreign corporations in co-operation with national governments for palm-oil production. The MSPO standards or MS 2530:2013 are currently applied under the MSPO Certification Scheme that was formed based on domestic laws and regulations, and best management practices on sustainability, encompassing the three pillars of sustainability i.e. economically viable, socially acceptable and environmentally sound. The standards are currently voluntary and industry driven committing the palm oil industry players to meet sustainability requirements (Kumaran and Singh, 2016). However, the MSPO certification scheme is to become mandatory by end 2019 for palm oil plantations, independent and organised smallholdings and palm oil processing facilities.

The MSPO Standards contain seven (7) principles forming the general requirements of a management system framework based on the three pillars and covers the themes of management, social equity, environmental protection and economic progress. Each of the 7 Principles have specific criteria and indicators that are used by the Certification Bodies (CB) during the auditing process to determine compliance. The 7 Principles are: Principle 1, Management commitment and responsibility; Principle 2, Transparency; Principle 3, Compliance to legal requirements; Principle 4, Social responsibility, health, safety and employment conditions; Principle 5, Environment, natural resources, biodiversity and ecosystem services; Principle 6, Best Practices and; Principle 7, Development of new plantings. Once compliance with the standards is determined by the CB, the palm oil management entity will be awarded MSPO certification with a validity period of 5 years. Annual surveillance and monitoring audits will be conducted to ensure continued compliance by the entity.

Diverse strategies for improvement have been continuously employed by the MPOCC to meet compliance of the MSPO Certification Scheme. These include the conduct of nationwide independent certification audits against the MSPO standards, MSPO Roadshows for palm oil growers, smallholders and palm oil mills, training of peer reviewers who will be

able to carry out independent review of audit reports, endorsement of training providers who can carry out training for MSPO auditors, certification bodies workshops, forums to engage with the environmental and social NGOs to further enhance the scheme, improvement in the audits by carrying out witnessing of certification audits and accreditation audits (Kumaran, 2019). Positive impacts of MSPO are evident by its legality compliance and more importantly, by the implementation of best agricultural practices to meet the demands of the environmentally sensitive markets for certified sustainable palm oil. The reported data by MPOCC for total MSPO certification achievement in Malaysia has risen in 2018 with more than 1,089,000 ha of certified areas awarded with certification which clearly marks commitment by all relevant stakeholders.

As the MSPO is considered as a new sustainability certification scheme at the global level, it is not without issues and challenges that seemingly are plaguing the entire approach to ensure sustainable palm oil production in Malaysia. One persistent setback is the lack of recognition and acceptance of the MSPO Certification Scheme in environmentally sensitive markets such as the EU, USA and Australia (Kumaran & Singh, 2016). This particular issue has become a thorn in the Malaysian palm oil industry particularly for exports to global markets. Considerable efforts to build confidence at the international level remain strong by raising awareness of its credibility and integrity. Against the background of the EU-RED II Directive, this paper suggests a feasible approach to resolve the palm oil trade between Malaysia and the EU based on diplomatic negotiations between Malaysia and the EU to ensure sustainability of palm oil biofuel exports.

Sustainable Options for Malaysia for Palm Oil Biofuel Export Trade

In response to the EU Delegated Act (RED II) by the EU to restrict and ban palm oil by 2030, Malaysia may be tempted to retaliate with reciprocal measures. Recent reports have emerged that Malaysia and Indonesia will jointly challenge the RED II at the WTO on the primary reason that EU RED II is *'discriminatory'* against the palm oil economies of countries which produce palm oil. The EU RED II is seen as *'a brazen disrespect to global trading norms and country sovereignty as it ignores ASEAN government driven certification schemes, namely the ISPO and MSPO'*. The Malaysia Palm Oil council warns that the EU rules could deliver a *'significant blow to the palm oil industry'* where the EU is the largest market after India (Peter, 2019). Malaysia may place legal punitive tariffs on European goods costing the EU billions of dollars in lost export revenue, and moving away towards other nations that are willing to trade in palm oil.

Options to resolve the palm oil dilemma between Malaysia and the EU may vary and, it may possibly rest on how crucial Malaysia's interest in palm oil exports is to the EU. Three (3) possible approaches (not exhaustive) that can be adopted by Malaysia may be as follows:

- a. Malaysia proceeds with a legal complaint to the WTO to challenge the EU RED II, which is the current leaning to resolve the palm oil issue;
- b. Pursue trade arrangements with other countries with lesser import requirements; and
- c. Pursuing a common ground through voluntary partnership via negotiations.

This paper suggests towards a more diplomatic approach on reaching a common ground as fostered by ASEAN-EU international relationship and, also considering the value of the EU's investments in Malaysia. For this purpose, option (c) shall therefore be discussed as a feasible option to the Malaysia-EU palm oil crisis.

Securing the EU market for Malaysia's palm oil is important for at least there (3) reasons. First, the EU is Malaysia's second biggest export market after India where total exports for India until June 2019 are 2,585,225 tonnes followed by the EU with 1,123,318 tonnes (MPOB, 2019). Hence, any form of trade sanctions would significantly affect export performance. Secondly, the EU has one of the most stringent requirements for imports and, securing the EU market will therefore make it simpler to pierce other external markets (Devarajan, S, 2018). Thirdly, palm oil is important to the Malaysian economy as the sector is the largest agricultural contributor to Malaysia's gross domestic product (GDP) with a total of RM44.8 billion or 3.8 per cent of the GDP contribution in 2017. Therefore, it can be surmised that it is in Malaysia's interest to find an approach that considers sustainability standard setting in global value chains to resolve the current dilemma. Observations from a political risk consultant asserts that the EU policy on biofuel will not likely change as European countries will not want to be seen to be arguing against a policy which is seen as positive in terms of promoting environmental sustainability (Peter, 2019). Thus, it may lead to a trade impasse between Malaysia and the EU if both parties refuse to compromise on their policies on palm oil and biofuel production. Furthermore, it is found that retaliatory action by developing countries is the least desirable strategy in the face of protectionist measures as aggregate losses double when compared to no action is taken by the developing countries (Devarajan, S, 2018).

In that light, the negotiating experience between Indonesia's government and the EU on Indonesia's *Sistem Verifikasi Legalitas Kayu (SVLK)* or timber legality assurance system can be an example to build a partnership arrangement between Malaysia and the EU to resolve the disputed palm oil directive.

Indonesia's Timber Exports Dispute Resolution

Between 2001 and 2008, the international community began applying pressure on producer and consumer countries to address the challenge of illegal logging and associated trade. Indonesia was a key target of these pressures, given its place as a major supplier of forest

products to consuming countries such as the United States, Japan, China, and Europe. According to some estimates, as much as 40% of wood entering the European Union from Southeast Asia, primarily from Indonesia, was illegal and largely transhipped through China and with the country of origin mislabelled (WWF 2008).

Over the past 30 years, hundreds of millions of cubic meters of illegal timber in Indonesia have been rubber stamped as “legal” and taken out of the country to feed international trade networks (Obidzinski, K., 2007). This issue on illegal logging became a highly sensitive political issue that was tacitly understood to be taboo in any discussion pertaining to sustainable forest management (SFM) in Indonesia. Indonesia’s timber exports dispute with the EU relates to such allegations of illegal logging (Lawson, S. & McFaul, L, 2010) that led to domestic and international efforts in shaping the timber legality verification. In the early 2000s, Indonesian government and civil society began efforts to directly address illegal logging through timber legality verification, although domestic support was initially weak (Pohnan, E et.al, 2014). Indonesia began developing its Timber Legality Assurance System (TLAS), locally known as *Sistem Verifikasi Legalitas Kayu (SVLK)* in 2002, as a market mechanism to counter illegal logging, through a multi-stakeholder process that included members from civil society rather than being solely formed by the Indonesian government. More than a decade later, the timber legality verification is enshrined in legislative commitments and is seen as one of the most promising mechanisms for addressing illegal logging in Indonesia and throughout the global forest product supply chain (Cashore and Stone 2013).

The advent of banning illegal logging in the EU began in 2001 when a ministerial summit took place in Bali. A number of non-binding commitments were made to raise the profile of illegal logging, building upon the G8’s major initiative to address various global forestry issues (Brack and Chatham House, 2003). This summit is where Forest Law Enforcement and Governance (FLEG) efforts first began taking shape, until the European Union formally adopted the Forest Law Enforcement, Governance and Trade (FLEGT) Action Plan in 2003 as a new way of addressing illegal logging through supporting good forest-governance efforts while highlighting the need to promote responsible trade of forest products.

The rise of the FLEGT process was directly assisting Indonesia’s enforcement on the logging ban and, served as a wake-up call to Indonesia’s national union of timber concessionaires, *Asosiasi Pengusaha Hutan Indonesia (APHI)*. The association realised if continued resistance to efforts of enforcing the logging ban is prolonged, this may threaten Indonesia’s access to the EU export market indefinitely.

The SVLK soon became law in 2009 while Indonesia was in the midst of negotiations with the EU to develop a Voluntary Partnership Agreement (VPA) through the FLEGT process.

A VPA is a creation of a trade agreement that provides timber producer countries with market access to the European Union in exchange for formal commitments to developing a timber legality assurance system that will ensure the legality of all forest products exported to the European Union. This unique arrangement between Indonesia and the EU on illegal logging is based on the national laws of Indonesia and reciprocal obligations.

Formal negotiations between Indonesia and the EU began in March 2007 but halted only a few months later after several initial points of contention led Indonesia to stop the talks. One was the lack of a legal mechanism that would criminalise the importation of illegal forest products by EU citizens, creating a mutual adherence to legality for both Indonesia and the European Union. Another concern was that a VPA would not stop neighbouring countries, such as Malaysia and China, from laundering Indonesian timber and then exporting them as Malaysian or Chinese products. Both of these concerns were addressed through the creation of the EU Timber Regulation.

Indonesia then began adjusting TLAS/SVLK regulations in accordance with the strict requirements as negotiations progressed with the EU. The EU recognized the TLAS/SVLK as a mandatory certification for all timber and wood product exports for the EU market in 2016 which allows certified timber and wood products from Indonesia to enter the EU market without undertaking the process of due diligence.

Such positive result of the SVLK in the forestry sector should be considered as a model to seek common ground between Malaysia and the EU in the current palm oil disagreement which would require the EU to agree to initial negotiations with the Malaysian government to recognise MSPO to fulfil the EU's strict requirements on sustainable biofuel and palm oil production. In tandem with this initiative, continuous efforts to ensure MSPO becomes a national mandate on certification must be advocated at all levels of stakeholders in the palm oil sector particularly smallholders of palm oil plantations in Malaysia.

Conclusion

The EU may be faced with a potential international dispute to challenge the RED II at the WTO as the palm oil producers i.e. Malaysia and Indonesia are struggling to accept the impacts of the EU regulation on phasing out biofuel by 2030. An adverse outcome from this controversial issue on sustainability of palm oil production in Malaysia can be negated through a meaningful negotiation to elevate MSPO as an internationally recognised certification system with a legal due diligence mandate. Therefore, it is imperative that a compromise on a certification scheme, standards and compliance thereof must be encouraged to attain optimum sustainable practices in the palm oil industry at all levels. The current situation between Malaysia and the EU simply presents a unique opportunity for



palm oil producers and importers to strengthen and improve confidence in palm oil in the future.

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