CHAPTER 4

PROBLEMS AND ISSUES FACING THE MALAYSIAN PALM OIL INDUSTRY IN THE MARKETING OF PALM OIL OVERSEAS

In the international market, palm oil competes directly with other 16 others oils and fats. It also competes with palm oil produced by other producer countries. The usage of these oils are easily substitutable. The main competing oil are soybean oil, sunflower oil, rapeseed oil, cottonseed oil, peanut/groundnut oil, coconut oil, olive oil, palm kernel oil, linseed oil, sesame oil, corn oil, butter, lard, fish oil, castor oil and tallow.

World output for these oils and fats has increased significantly over the years as producer countries strive for self sufficiency and increased foreign exchange earnings. The production for these oils and fats is expected to increase further in the coming years (See Appendix 4).

The increase in the world's output of edible oils and fats has increased the intensity of competition and has made it difficult for Malaysian palm oil to increase its share without sacrificing its price.

4.1 Palm oil has to be sold at a discount to other soft oils.

A major issue facing the palm oil industry in recent years has been that palm oil has to be sold at a discount to other soft oil such as rapeseed oil, soybean oil and sunflower oil in the international market. The relationship between CIF Rotterdam crude palm oil prices compared with EU soybean oil, rapeseed oil and sunflower oil is tabulated below:
**PRICE COMPARISON TABLE**
**JANUARY TO DECEMBER, 2001**

<table>
<thead>
<tr>
<th>Period</th>
<th>Crude palm oil, rott_PRICE</th>
<th>Soybean oil, rott_PRICE</th>
<th>Sunflower oil, rott_PRICE</th>
<th>Rapeseed oil, rott_PRICE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan</td>
<td>254</td>
<td>306</td>
<td>386</td>
<td>338</td>
</tr>
<tr>
<td>Feb</td>
<td>240</td>
<td>302</td>
<td>390</td>
<td>338</td>
</tr>
<tr>
<td>Mac</td>
<td>254</td>
<td>329</td>
<td>430</td>
<td>363</td>
</tr>
<tr>
<td>Apr</td>
<td>251</td>
<td>321</td>
<td>436</td>
<td>379</td>
</tr>
<tr>
<td>May</td>
<td>234</td>
<td>295</td>
<td>431</td>
<td>375</td>
</tr>
<tr>
<td>Jun</td>
<td>255</td>
<td>315</td>
<td>443</td>
<td>367</td>
</tr>
<tr>
<td>Jul</td>
<td>330</td>
<td>409</td>
<td>495</td>
<td>425</td>
</tr>
<tr>
<td>Aug</td>
<td>362</td>
<td>422</td>
<td>504</td>
<td>449</td>
</tr>
<tr>
<td>Sept</td>
<td>310</td>
<td>382</td>
<td>503</td>
<td>440</td>
</tr>
<tr>
<td>Oct</td>
<td>277</td>
<td>376</td>
<td>522</td>
<td>434</td>
</tr>
<tr>
<td>Nov</td>
<td>323</td>
<td>388</td>
<td>620</td>
<td>452</td>
</tr>
<tr>
<td>Dec</td>
<td>338</td>
<td>403</td>
<td>651</td>
<td>460</td>
</tr>
</tbody>
</table>

*Source: Oil World*

From the price comparison, we note that from January to December 2001 palm oil has been traded mostly at a discount to other major soft oil.

Most of the time palm oil exporters have to sell at a discount in order to maintain or increase sales volume. Considering that palm oil and these oils are interchangeable in their main uses, palm oil should not be traded at a discount over these soft oils most of the time.

The degree of substitution prevailing among various oils is proxied by their price correlation coefficients. Price of oils and fats which can be readily substituted with each other are likely to be highly correlated. As shown in the table below, cross correlation of the prices of major oils are high. Thus, it can be deduced that they are close substitutes to each other.
### CROSS CORRELATION OF OILS AND FATS PRICES

<table>
<thead>
<tr>
<th></th>
<th>Crude palm oil</th>
<th>Crude soybean oil</th>
<th>Crude sunflower oil</th>
<th>Crude rapeseed oil</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude palm oil</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crude soybean oil</td>
<td>0.882969563</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crude sunflower oil</td>
<td>0.820064679</td>
<td>0.925033166</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Crude rapeseed oil</td>
<td>0.886355122</td>
<td>0.975803285</td>
<td>0.938606664</td>
<td>1</td>
</tr>
</tbody>
</table>

Source: Rotterdam price from Jan. 1985 to Dec. 2001

Note that the comparision is made against soybean oil, rapeseed oil and sunflower oil because these oils are major edible oils in the world.

### 4.2 Palm oil faces unfair trade competition in the international market

Other than competition from other edible oils, exports of Malaysian palm oil is made difficult by a number of unfair trade practises in the international market such as the EU’s oilseed subsidy, The Export Enhancement Programme in the US and discriminatory tariff.

#### 4.2.1 The European Union's (EU) Oilseed Subsidy Programme

The oilseed subsidy programme was started by the EU after US embargo on soybean exports in 1973. In order to be self-sufficient in oils and fats, the EU under the Common Agriculture Policy (CAP) subsidised farmers to encourage them to grow oilseed crops like rapeseed, sunflowerseed and soybean. These subsidies have not only caused the increase in production of oils and fats in the world but also has allowed the EU to export their surplus at lower prices than the actual production cost. The United States Department of Agriculture in 1989 reported that by 1987, the EU soybean producers were receiving two to three times the world prices and the combined production of soybean, rapeseed and sunflowerseed rose from an average of 2.6 million tonnes from 1975-1979 to 7.5 million tonnes from 1984-1988.
4.2.2 The Export Enhancement Programme Of the United States

In retaliation to the EU's oilseed subsidy, the United States introduced the Export Enhancement Programme. Under this programme, American exports are subsidised in selected destinations to counter the EU oilseed subsidy. It was reported that in 1988, 74.6% of total 1.43 million tonnes of vegetable oil exported by the United States was subsidised.

4.3 Tariff Barriers

Other than the non-tariff barriers in the form of subsidy and unfair trade practices mentioned above, palm oil export from Malaysia also faces tariff barriers set up by local governments.

For example, in the European Union, an import duty of 9% is levied on all processed palm oil and 3.8% for crude palm oil. The duty is discriminatory against Malaysia's palm oil players. This is because it is not feasible for Malaysia's industrialist to export crude palm oil as the export duty is high. Exports of crude palm oil will be feasible only in special case where the government grants the product tax exemption status.

India, another major market for oils and fats has imposed a duty on palm products between 65 percent and 92.4 percent. Imports of soyabean and related products were imposed a maximum tariff of 45%, sunflower oil and related product 75%, rapeseed and related products 75%. Hence, palm oil compares unfavourably to soybean oil in India.
4.4 Import Quota

The potential growth in demand for some countries is limited as there is quota being imposed on palm oil imports. For example, in China, a quota of 2.4 million tonnes is imposed on palm oil imports.

4.5 Payment problem

The potential for growth in demand for edible oil is greatest in lesser developed countries like China, Pakistan and India where the population is high. However, the major problems in exports to these countries is their lack of foreign exchange.

4.6 Competition from other palm oil producing countries

There is also increasing threat of competition from palm oil produced by other producing countries. In 1990, Malaysia produced about 57% of the world's palm oil. Although a leader, it faces competition from other producing countries especially Indonesia, which produces about 19% of the world's output. Also the production cost in Indonesia is reported to be lower than in Malaysia. Based on the unpublished report done by the Malaysian Industrial Development Authority (MIDA) in 2001, the average cost for producing a tonne of crude palm oil in Malaysia is USD211. In Indonesia the production cost is much lower at USD153 per tonne.

The growth in palm oil production in the world has been significant in the last 10 years. Production volume doubled from 11.027 million tonnes in 1990 to 23.0 million tonnes in 2001. In terms of share of the edible oils market, palm oil's share has grown from 13.7% in 1990 to 18.9% in 2000.
The growth in world output for palm oil is expected to continue in the next decade. According to Oil World’s forecast, palm oil production by 2020 will be about 40.8 million tonnes.

As the volume of production increases in these countries, the pressure on price is expected to increase further, unless new demands for the oil is created.

4.7 Domestic factors which hinders the efforts to market palm oil overseas

Apart from the problems and issues faced in the international market, the Malaysian palm oil industry also faces a number of domestic problems which have been hindering its efforts in the marketing of palm oil in the international market in the world. The problems are as follows:

4.7.1 Fragmented Industry Structure

As shown in Chapter 3, the industry is made up of a number of players. The two most important players are the producers and the refiners. Each of these groups have their own profit objectives. While producers seek to obtain the highest price possible for their output (i.e. crude palm oil), refiners who are purchasers of these output favors a lower price. With lower price, refiners will be able to obtain a better refining margin.

4.7.2 Excess refining capacities

There are a total of 46 refineries currently in operation in Malaysia having a total installed capacity of about 15.48 million tonnes per annum. (Appendix 3).

However, the current total production of crude palm oil in the country is only about 11 million tonnes per annum. The excess refining capacity has led to a situation where demand exceeds supply in domestic crude palm oil supply. This gives producers strong bargaining power and allows them to control the price of crude palm oil.
4.7.3 Manipulation of supply and stock level

Producers are often accused of controlling their supply to the market to push up prices. This happens especially when prices are moving up, there is a tendency for producers to hold stock in order to get a better price later. However, their action will lead to an increase in stock levels.

4.7.4 Competition amongst refiners

The large number of refineries and the excess capacities have allowed buyers the opportunities to make the refiners compete against each other. The competition forces the price down.

The strong bargaining position of the suppliers/producers and the strong bargaining position of the buyers have put refiners in a position where they have to pay a high price for their crude palm oil inputs and to accept the low prices offered in the international market for their output. The situation has resulted in refiners facing negative margins i.e. where the price difference between the processed palm oil and crude palm oil is not enough to meet production cost.

All the domestic problems and issues discussed so far have been acting against the development of an effective palm oil promotion and marketing program. The conflict between the producers and the refiners have made it difficult for the industry to face the challenges in the international market.