

BRIEFING


Origin: DG TRADE

- Subject: FTA with Indonesia
- Meeting: Commissioner Malmström /Minister Lembong, Indonesia
- Date: 5 April 2016
- Venue : Brussels

SCENE SETTER


Your meeting with Minister Lembong takes place the day after FTA scoping discussions, which he will have co-chaired. This is the fourth time you meet Minister Lembong since his appointment last summer after a cabinet reshuffle (Istanbul G20 in October; Nairobi MC10 in December, Davos in January). In Chiang Mai you also briefly exchanged views with the ministry's Director General and recently appointed chief negotiator for the EU-Indonesia FTA ('CEPA' for Indonesia), Pak Iman Pambagyo.

4(1)(a)



While the scoping text reaffirms Indonesia's willingness to negotiate, protectionist measures persist, e.g. entry port restrictions for EU fruit and vegetables; local content requirements and barriers in sectors of interest to EU investments; quantitative restrictions and other discriminatory measures. These contradict the spirit of the scoping paper and future FTA negotiations. It will therefore also be important to receive assurances from Minister Lembong that Indonesia is willing to address some of the most important restrictive measures EU industry is facing in Indonesia before the start of negotiations.

out of scope



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OBJECTIVES

- Welcome Indonesia's counterproposal for a scoping paper of 18 March, which represents progress in most areas.
- Convey your message on the result of the scoping meeting and next steps leading up to President Widodo's visit [to be updated after 4 April]
- Encourage continuation of reforms and stress need to address protectionist measures as they go against the spirit of the scoping paper and what is needed for successful CEPA/FTA negotiations.

- 4(1)(a) + out of scope

SPEAKING POINTS/ KEY MESSAGES**FTA Scoping**

- The EU welcomes the important progress, which Indonesia's scoping counterproposal of 18 March represents. This paves the way for positive language on on-going discussions towards the conclusion of the scoping exercise and negotiations of a CEPA/FTA.

[Placeholder – awaiting the result of the scoping meeting on 4 April]

- We continue to commend your efforts to reform your economy - and we look forward to the swift implementation of the packages announced by President Widodo during last autumn. Is Indonesia preparing additional reform packages?
- We also expect that the current protectionist measures are removed and business climate improved: this is essential to create a framework conducive for successful CEPA/FTA negotiations and to have coherence between the scoping paper and measures on the ground.
- For instance, imports into Indonesia of EU fruits and vegetables are only allowed if such products are not available or are needed in Indonesia and are subject to a 'countryt recognition agreement' that Indonesia insists can only be

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concluded with individual Member States rather than with the EU. Indonesia also maintains export restrictions on raw materials and export taxes on a variety of products, such as raw materials, palm oil, cocoa, wood, leather. Also, EU investments in Indonesia suffer from local content requirements in many sectors (telecom, oil and gas, retail, etc) and from minimum investment requirements.

out of scope

Government	Percentage
Current government	85%
Previous government	15%

[illegible]

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- out of scope

FLEGT-VPA

- The full implementation of the FLEGT-VPA agreement, as originally planned in 2016, would be an important step in our relations and a highly symbolic achievement.
- In this regard, the final step towards full implementation of the agreement continues to be blocked due Indonesia's decision to exempt furniture from the scope of application of the verification system under the VPA.
- Is there any chance that Indonesia may review this decision?

Defensives:

4(1)(a)

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BACKGROUND

General

Indonesia is a growing economy (although the growth rate, 5% in 2014, is slowing down) as well as the largest and most populated in ASEAN (about 40% of ASEAN GDP and 250 million people). However, trade and investment flows, though solid, only rank fifths for the EU in ASEAN. Indonesia has, in recent years, tried to develop its manufacturing sector, neglected due to an over reliance of commodity exports, and climb up the value-added ladder by introducing a number of protectionist measures. The results are a high number of import/export restrictions as well as local content requirements and a relatively limited exposure to trade (43.2% of GDP, the lowest rate among ASEAN partners).

On 9 September 2015, President Joko Widodo announced the first in a series of reform packages, which aim at de-regulating and boosting Indonesia's business and investment in infrastructure. This is a positive sign, but robust implementation of announced measures, and further reform, is needed to shift Indonesia's trade policy direction. With isolated exceptions (restrictive import measures for tyres have been removed; modification of certain foreign equity caps and some opening of other sectors of interest to the EU), most protectionist measures persist in all areas and legislation is often a "moving target" (i.e. measures range from non-automatic import licensing to barriers in all sectors, including SPS and quantitative restrictions for plant and animal products; local content requirements; restrictive investment measures. The Law of 2014 on halal rules, if fully implemented, may be extremely trade distortive and is attracting more and more attention from EU and international business).

If protectionist measures remain unchanged, they would seriously hamper the outcome of a possible FTA. Since coming into office, Minister Lembong has made genuine efforts to change the trajectory of Indonesia's trade policy and, backed by President Widodo, he has been proactive and vocal about improving business climate and sees the negotiation of a CEPA/FTA with the EU as a priority.

- Indonesia is the EU's fifth trade partner in ASEAN.
- The EU is Indonesia's 4th trade partner, after China, Singapore and Japan.
- Trade in goods in 2015: €25,3 bn; (EU imports: €15.3 bn; EU exports: €9.9 bn)
- EU has a negative trade balance: €5,3 bn, most of which in the agricultural sector. Indonesia's main exports are commodities, textiles and footwear. EU mainly exports manufactures, machineries and appliances, transport equipment, chemical products.
- Trade in services in 2014: EU imports: M€1894; EU exports: M€4107 ;
- EU FDI stock in Indonesia: €25,8 bn in 2014, making Indonesia the EU second destination in ASEAN after Singapore.

Scoping and negotiations for an FTA were resumed on 11 September 2015, after being stalled since 2013. Despite some movements and a show of goodwill, positions still resulted in divergences, confirming that Indonesia was not able at that time to engage at the same level of ambition as Vietnam or the Philippines.

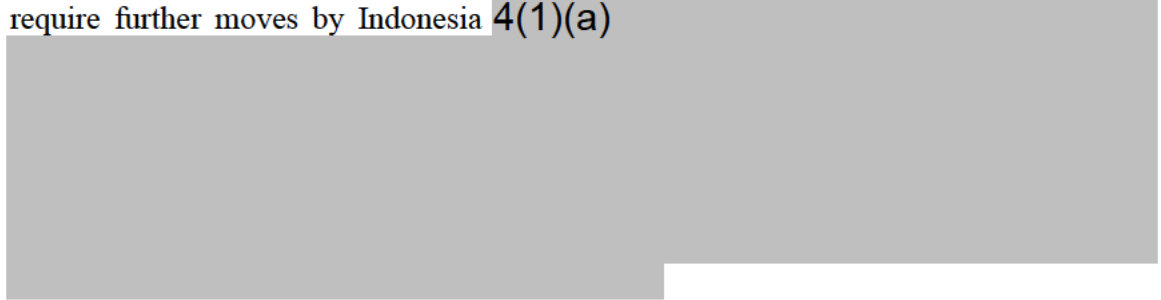
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After a lengthy delay, reflecting internal difficulties and poor co-ordination, on 18 March the Minister delivered what he had promised and provided Indonesia's scoping counterproposal. To accelerate progress towards launching FTA negotiations- and making it a deliverable for the President's visit of 21 April, Minister Lembong proposed to hold a scoping meeting before the President's visit. The meeting will be held on 4 April *[update after 4 April; indicating outcome and outstanding issues, if any]*.

The counter proposal makes progress in most areas (trade in goods, SPS issues, competition policy, investment issues and services), where previously bracketed text is now partly of fully accepted. On the other hand, there are important parts which still require further moves by Indonesia **4(1)(a)**



At the same time, the EU also should seek further assurances of Indonesia's willingness to address persisting protectionist measures, which are not conducive for FTA negotiations. **4(1)(a)**



The EU internal process for starting negotiations with ASEAN countries (based on the 2006 mandate): Once the scoping exercise is finalised, the final scoping paper needs to be presented to EU Member States together with an assessment by the Commission on the value of a FTA with Indonesia (this is an internal qualitative assessment with some economic parameters). The final endorsement by Council to launch FTA negotiations might take several weeks after the presentation of the agreed scoping paper. In the case of the Philippines it took approximately six weeks.

While this makes it difficult to formally announce the start of negotiations by the time of President Widodo's visit on 21 April, it should nevertheless - if we are able to come to a satisfactory conclusion with Indonesia in the next few weeks - be possible to announce the successful conclusion of the scoping and the Commission's intention to request Member States' approval to move ahead with the launch of negotiations.

Following the meeting planned on 21 April in Brussels, the EU and Indonesian Presidents will have at least two further opportunities to meet in the next six months: at the ASEM Summit in Ulan Bator on 15-16 July and at the G20 Summit in Hangzhou on 4-5 September. Note that HR/VP Mogherini will travel to Jakarta on 8-9 April.

It should also be noted that if the Commission makes public its recommendation to launch negotiations - with the approval of Member States - you should also be ready to confirm that although we will not do a formal Impact Assessment (as the ASEAN

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mandate already is agreed, and as confirmed in an earlier Jour Fixe discussion), we will do a SIA which will include also Human Rights.

FLEGT-VPA


The EU/Indonesia FLEGT (Forest law enforcement, Governance and Trade) -VPA agreement entered into force on 1 May 2014. It aims at the sustainable management of forest resources and enhances the market acceptance of Indonesian forest products on the EU market and globally (the EU currently imports about 1 bn Euros of wood products, including pulp and paper). Indonesia is the first country in the region to have a FLEGT-VPA agreement in force. With Ghana, it is the agreement closest to full implementation.

The FLEGT licensing was agreed to become operational in the first quarter of 2016. Under the EU legislation, FLEGT licenses allow imports to be automatically considered as legally harvested and therefore compliant with the EU timber regulation, which prohibits any trade in illegal timber and timber products. In fact, once the licensing is operational only timber which has been verified as compliant with relevant Indonesian legislation through its SVLK (sistem verifikasi legalitas Kayu) would be issued a FLEGT licence and can without further checks enter the EU market.

The legal basis of the FLEGT –VPA is the common commercial policy. DG ENV is chef de file for the agreement and related regulations. A joint action plan is the tool monitoring the progress towards full implementation. The Joint Working Group met on 27 January 2016 to review the Indonesia-EU Action Plan on Advancement of VPA Implementation. The Group found significant progress towards completing the Plan.

However, there are also some pending issues. A couple of months ago, on the grounds that de-regulation is necessary, Minister Lembong unilaterally decided to exclude furniture from the scope of application of the verification system under the EU/Indonesia FLEGT -VPA (Voluntary Partnership Agreement) against illegal timber. Reportedly, the decision was taken without consulting other responsible ministries (Environment and Forest). As long as this decision is maintained, the system cannot be fully implemented. Furthermore, furniture is one of the most visible wood products of Indonesia and lack of legality certificates would affect Indonesia's image.

4(1)(a)



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Palm oil

Indonesia perceives EU legislation in various fields as a threat to its exports of palm oil to the EU and a recently, a high level delegation has conveyed its concerns to DG TRADE and DG ENV. In particular, EU food labelling legislation in force since 31 December 2014, which requires indication of the type of vegetable oil on products as well as EU sustainability criteria for biofuels (which include requirements for GHG emission savings) have contributed to this perception, despite being non-discriminatory and applying to all products irrespective of their origin in or outside the EU.

In addition, the French Parliament is currently discussing a broad law on biodiversity which, though initially not based on broad consensus, now proposes an additional tax on palm oil and is now approaching adoption (adopted by the National Assembly on 17 March, it still has to be discussed by the Senate). The French Biodiversity Bill would create an additional tax on palm oil, palm kernel oil and coconut oil destined for human consumption, either directly or as a component of food products. However this additional tax would not need to be paid for these vegetable oils if they meet certain environmental sustainability criteria. Those criteria are not clear yet.

The proposed tax is evidence of civil society concerns on deforestation and land grabbing by large companies, which motivate the contribution by certain environmental NGOs to negative palm oil campaigns. The Commission is closely following the debate and it will assess the proposed measure once/if it enters into effect.

The EU remains Indonesia's second largest export market for palm oil, after India (54% of EU market or 3,7 million tonnes in 2014); for 2015 complete data not yet available, but are expected to be stable. Most palm oil enters the EU duty free. On the other hand, biodiesel imports have been decreasing due to EU anti-dumping duties. Indonesia requested the establishment of a WTO dispute settlement panel (stage: panel composition), but administrative WTO obstacles have so far delayed works. 4(1)(a)



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Annexe: CV Minister Lembong

Contact person:

4(1)(b)

DG TRADE C2

☎ 4(1)(b)

With input by: 4(1)(b), TRADE F1, 4(1)(b), TRADE D1

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