Scene Setter

Your first official meeting with Pak Gita Wirjawan, who took over as Indonesian Minister of Trade from Mari Pangestu last October, took place in December 2011 in the margin of the WTO Ministerial in Geneva. During that meeting, Minister Gita showed an interest for possible negotiations with the EU while asking more time for extended consultations with stakeholders in Indonesia before entering in negotiations ("socialisation").

Recently Minister Gita has received some support for moving ahead from business stakeholders namely KADIN Chair Suryo Sulisto and the Employers Association Chair Sofyan Wanandi and even from the Indonesian Parliament (Chair of Trade Commission).

However, at this stage, it is not entirely clear if these positive signals will result in more concrete proposals from the Ministry of Trade on the preparatory work for starting FTA negotiations, i.e. by launching the scoping exercise. Former Minister Pangestu has been heavily criticized for her too liberal approach, in particular in relation to the impact of the ASEAN-China FTA and the result of a recent study show little increase in manufactured exports to three main FTA partners (China, Japan and Korea).

In the meantime, Indonesia has introduced a number of new protectionist measures in areas such as standards, labelling and restrictions of port of entry. So far these measures have been mostly directed to non-EU partners (notably China) and have not substantially affected EU trade flows.

As a matter of fact, despite all the outcries in the media, in 2011 trade figures between EU and Indonesia are up by almost 16% resulting in record high trade numbers of 23.5 billion euro. However, these dynamic trade flows, explained mainly by the buoyancy of the Indonesian economy, cannot be considered satisfactory as we are witnessing a constant reduction in the EU market share that shrank by 3 percentage points in the last 5 years (down from 10.5% to 7.5%).
Meeting with Indonesian Trade Minister Gita Wirjawan
Date: 2nd April 2012
Place: Phnom Penh

Objectives/LTT

- Confirm the Commission interest in enhancing the long term perspectives of bilateral trade and investment relations, including the negotiation of an ambitious free trade agreement and listen to the Indonesian views on how to move the process forward.

- In case the Minister shows readiness to start the bilateral talks, remind him about the need for the EU to proceed with the preliminary technical work (scoping exercise) which is necessary before the formal launch of the negotiations.

- Express concern over some of Indonesia's recent trade measures, notably the revised draft trade law and recent regulations regarding pharmaceuticals and labelling.
Key Messages

- I have appreciated our first meeting in Geneva and share your views expressed in your letter on the positive outcome of it.

- We had a good discussion about the follow-up to the EU-Indonesia Vision Group recommendations and I understand well the need for you to complete the domestic consultation process.

- In terms of trade and investment flows, EU and Indonesia are long-standing partners. There is a mutual interest in pursuing closer commercial ties as our economies are complementary and I see clear benefits for both sides in bringing trade and investment relations to a higher level.

- Looking at the most recent trade figures shows that the current crisis in Europe has marginally affected trade with Indonesia. In 2011, our bilateral trade was up by almost 16% to over 23.5 billion euro – resulting in a trade surplus for Indonesia of more than 8 billion euro.

- European companies are also investing substantially in Indonesia, business and students exchanges are on the rise and we started some very interesting cooperation with KADIN and APINDO in support of our trade policy dialogue.
• In terms of your trade policy, I also register that Indonesia is already negotiating with EFTA and will soon start trade talks with South-Korea and Australia. How do these decisions influence our bilateral discussions on possible trade negotiations? Do you foresee an issue of resources and timing?

• I would also be interested in hearing how your internal consultation process is going? What kind of feedback are you receiving? When do you foresee to be ready for the next steps?

[Alternatively and in case Minister Gita would show readiness to engage more concretely in bilateral talks]

• I am glad to hear that you have positively concluded your internal consultation process and you are now ready to move on with FTA negotiations.

• As you know, according to our procedures we need to finalise a joint "scoping paper" with the aim to identifying the issues that should be included in the negotiations and ensuring that both sides have the same understanding of the objectives and level of ambition for a future FTA. On this basis I can go to EU Member States and with their green light we can officially launch the negotiations.

• Building on the work done by our Vision Group last year, and if there is general support for ambitious Comprehensive Economic Partnership Agreement negotiations within the Indonesian administration, the scoping exercise should be finalised quite quickly.
I therefore suggest that we forward an updated "scoping paper" adapted to the specific relations between Indonesia and the EU and start discussions on technical level as soon as you have been able to study this paper more in detail.

How do you see next steps? When would you aim to formally start FTA negotiations

**[Bilateral issues]**

- Despite the relatively rosy picture depicted by our bilateral trade and investment flows, I have to express the concern we have in Europe with some of the recent measures that Indonesia introduced to limit imports by using technical standards and other non tariff barriers.

- Although I can understand your wish to move up the added value chain, these measures will not be conducive to the competitiveness of Indonesian industry. Moreover, they are badly affecting the international image of Indonesia and the business perspectives of European companies in the country.

- This will deter European business from investing in Indonesia and - going in the opposite direction of your stated objective (also as Chair of the Indonesian Investment Board) to attract foreign capital and technology to support the country's development.
• Therefore, I would like to raise a few areas were I think we can work together towards finding positive solutions. We have already some precedents of good cooperation such as the recent deferring of the closure of Jakarta's sea-port for horticultural products.

• First of all, I would ask your support for a systematic and timely consultation on new legislation potentially affecting trade. This is what we are doing also with other partners. The recent draft Law on Trade is particularly important in this regard as it would directly affect our bilateral trade. My services have received the latest version and we regret that some of our comments regarding WTO-compliance had not been taken into account. I understand the motivation to have such a law to restrict influxes of cheap imports from, among others, China. But what can you do to ensure this law does not negatively impact traders and investors from Europe?

• Another area relates to the Investment Negative List, a subject you are still directly involved with as Chair of the Investment Coordinating Board (BKPM). The Indonesian Chamber of Commerce (KADIN) had hosted a number of consultations ahead of a potential revision of the list. It seems there would be a win/win for opening up to FDI in a number of sectors, such as pharmaceuticals, telecommunication and transport. Do you think the list will be revised this year? Would you be willing to have an early on consultation and joint work on certain key sectors that add value to the Indonesian economy?
• Finally, our exports have also been affected by issues related to labelling regulations and the introduction of new national standards. Although I understand the legitimate policy objectives of certain legislation, I would ask your support in finding practical solutions to avoid these regulations disrupting trade flows.

• Your predecessor indicated she would allow for post-import stickering (instead of pre-import labelling) and that this could be done in custom controlled warehouses. However, I understand that you are considering disallowing this practice shortly. In Europe such system is not considered a problem and you will find many Indonesian foodstuffs with stickers (mostly in English) explaining to the consumer the food contents. Can you update me on your current thinking on this?
Defensive Points

Illegal, Unreported and Unregulated fishing (IUU)

I have been informed that the EU legislation to prevent illegal and unreported fishing (IUU) may result in a ban on Indonesian fisheries exports. How we can avoid that?

- Under EU fisheries legislation, EU and third countries' authorities have to comply with their obligations to their Regional Fisheries Management Organisation (RFMO) in the context of IUU fishing practices (Illegal, Unreported and Un-regulated).

- The EU is engaged with the Indonesian authorities to how best to preserve global fishing stocks and Indonesia has proven cooperative on all fishing matters.

- The findings of a mission sent by the Commission last year showed shortcomings with respect to the implementation of the legislation and a serious follow-up by Indonesian authorities is therefore needed.

- I understand that there will be further discussions with the responsible Indonesian authorities on the best feasible way to implement recommendations to tackle IUU fishing practices, including the provision of technical assistance.
**Palm oil/Renewable Energy Directive (RED)**

**The EU sustainability criteria for biofuels are a barrier to trade for palm oil products**

- Crude palm oil is Indonesia's biggest export item to the EU and indeed, the EU buys 20% of Indonesia's national palm oil production. The largest part of these imports is demanded by the food and cosmetic industries and only a small fraction (less than 5%) is intended for the biofuel industry. Since the sustainability criteria only applies to the palm oil intended for biofuel production, great majority of your exports enters freely and without any further conditions to the EU market.

- Therefore, you can be reassured that there is no existing or planned restriction on oil palm imports from Indonesia. This would also not be acceptable under WTO rules. However, we must be aware that consumers in Europe and elsewhere are increasingly environmentally aware. As a result, producers are demanding more sustainable palm oil.

- It is positive to see the Indonesian industry through the Round Table for Sustainable Palm Oil (RSPO) and other routes committing to ensure greater sustainability of oil palm production.

- Also your government recognises this problem and some of its policies – such as the proposed ISPO (Indonesia sustainable palm oil) scheme seek to mitigate impact.
• The EU Renewable Energy Directive is part of the EU efforts to meet its greenhouse gas emission reduction commitments. It offers incentives to increase the consumption of sustainably produced biofuels. Indonesian palm oil producers meeting sustainability criteria can benefit from the expected increase in biofuels demand in Europe. The sustainability criteria are based on the best scientific information available.

• The EU is committed to cooperate with Indonesia to secure our trade in palm oil products and to boost exports of products that meet environment sustainability criteria. Specific cooperation activities are being prepared to promote the adoption of best practices by the industry and to support small holders in particular.

Contact:
DG TRADE C2
JAKARTA DELEGATION
Background

Minister Gita Wirjawan, a Harvard-educated investment banker, does not belong to any political group and is considered very close to the President.

As former (and still acting) Chair of the Indonesian Investment Board (BKPM) Gita has a clear agenda on improving the investment climate to attract more foreign investment to secure higher economic growth. However, he does not seem to have enough clout towards Parliament and the still strong protectionist forces within the Cabinet. Under his Chairmanship the investment regime in Indonesia has not been significantly liberalised, and his first moves as Trade Minister showed rather a protectionist reflex (starting with the introduction of export taxes on rattan) although not directly targeting EU export interests so far.

As a consequence of the change at the top of the Trade Ministry in October 2011, the EU-Indonesia preparatory discussions for a potential free trade agreement - as was recommended by the EU-Indonesia Vision Group (and very much supported by former Minister Pangestu) - have been slowing down. The new Minister Gita asked for a "reflection pause" on new FTA negotiations and the Ministry of Trade decided to postpone the regular discussions of our bilateral Working Group on Trade and Investment scheduled for last December. They also announced that they will not be ready to respond to the scoping paper proposal presented last June before spring 2012.

On the positive side, during a high level bilateral meeting with Presidents Barroso and Van Rompuy held in November 2011 in Cannes, the Indonesian President Yudhoyono, welcomed the recommendations of the Vision Group and agreed on the need for Trade Ministers and officials to continue their work with the aim at launching negotiations in 2012.

So far, Minister Gita has received clear support for moving ahead with negotiating a Comprehensive Economic Partnership Agreement (CEPA) from Chamber of Commerce KADIN (Chair Suryo Sulisto), the Employers Association APINDO (Chair Sofyan Wanandi) and even from the Indonesian Parliament (Chair of Trade Commission). Also his colleague has given his explicit support in a recent letter (attached to this briefing) to the EU.

However, at the same time the Government of Indonesia has published the results of a study into the benefits of FTAs concluding that liberalisation is not benefitting enough Indonesia (at least looking at the increased trade deficits with FTA partners such as China, Korea and Japan). Minister Hidayat commented this report by suggesting that before negotiating any new agreement, Indonesia should now make a cost and benefit analysis (coordinated by the Ministry for Economic Affairs) to allow an informed discussion at Cabinet level.
EU-Indonesia FTA state of play

The EU-Indonesia Vision Group delivered its recommendations in May 2011 to the Trade Ministers suggesting the start of a comprehensive economic partnership agreement (CEPA/FTA). The Vision Group Report is publicly available and a series of "socialisation" events have taken place in Europe and Indonesia.

The first reaction from industry representatives from both sides has been positive as they stress the complementary aspects of the two economies. The two most important business associations in Indonesia are supportive to the process even though some sector representatives expressed doubts (mainly in services areas) while others are expressing the 'usual concerns' about EU policies (such as RED, FLEGT, REACH and the EU food safety regime). Moreover, surprisingly, Indonesian trade unions expressed initial support, indicating EU companies have higher employment standards and are better in line with OECD best practice.

EU Member States, although not officially consulted yet, are sending positive signals (from both Jakarta and in Brussels) on the necessity and urgency to engage the largest economy in the region in a comprehensive free trade negotiation.

The previous Indonesian Trade Minister Pangestu was – in principle - a supporter of a CEPA with the EU, which explains some of this recent measures including a rattan export ban, upcoming export taxes, customs licenses, and re-introducing pre-import controls – all to fulfil the official Ministry of Trade objectives to "shift the consumption pattern: and reduce dependency on imported goods and building the appreciation towards domestic products".

A first informal meeting to prepare the ground for the scoping exercise prior to the formal opening of negotiations has taken place in the margins of the WGTI end of June 2011, but since then there has been no follow-up from the Indonesian side. This lack of response can be best understood from the above political context, the reshuffling in the Government and the cautiousness of the MoT preferring to wait for the results of the internal socialisation process.
Briefing
- Meeting with Indonesian Trade Minister Gita Wirjawan
- Date: 2nd April 2012
- Place: Phnom Penh

Background on bilateral issues

Investment: FDI limitations

In 2007, Indonesia revised its investment negative list (DNI), whereby limitations to foreign ownership were in certain cases modified or kept unchanged. To date, the main sectoral priorities are the following: in the telecom sectors there are important limitations concerning telecom towers and service providers; limitations exist for the courier/express delivery services, where minority ownership only is allowed and where the definition of universal service is still very broad; for maritime services, foreign investment is capped to 49%.

Moreover, recently, the Indonesian government adopted the horticulture law, whereby foreign ownership was lowered to 30% from the previous level of 95%. Limitations are also set in the pharmaceutical sector (manufacturing and distribution).

Labelling

Indonesia introduced mandatory labelling requirements for a large number of products, whereby labels need to get pre-approvals before the products are marketed in Indonesia. Labelling of products in customs warehouses in Indonesia prior to their placement on the market is not allowed. Industry is concerned that in the future the scope of these requirements will be expanded (e.g. to foodstuffs).

Despite commitment of previous Minister of Trade to allow for post-import stickering, de facto pre-import stickering was applied (notably at expense of Indonesian jobs). In addition, most recently, it was proposed to no longer allow 'stickering' but instead insist on 'labelling'. This would add cost and could deter small quantity exporters from market their products.

Pharmaceuticals: FDI limitations and problems with IPR/data exclusivity

Three main issues are affecting this sector:

a) Distribution of pharmaceutical products is closed to FDI and wholly foreign-owned manufacturing is not possible.

b) Decree 1010/2008 restricts imports of pharmaceutical products: i) Imports of drugs are only allowed on a "case-by-case" basis if they are needed for the national health program or if they are not manufactured locally; ii) Registration of drugs is only allowed for companies that have manufacturing in Indonesia.

c) Legislation on data exclusivity of pharmaceutical and agrochemical products incompatible with TRIPs Agreement.

Draft trade law
The Ministry of Trade started in 2009 the discussions on the first-ever Law on Trade, which is supposed to create a legal umbrella for all trading activities. The law has just been finalised within the Government and sent to the Parliament. Despite many requests, no formal foreign trade partner or business association has been consulted at this stage. During the WGTI in June 2011 the Ministry of Trade stated that the Government will further revise it, taking into account EU's comments and ensuring the compatibility with Indonesia's international commitments.

The purpose of the Law on Trade is to create a coherent, comprehensive legal umbrella for trade related activities: domestic and international trade, including coordination of international trade policies, standardization, licensing, consumer protection and trade promotion. The law is rather vague and would allow a wide interpretation by the Government on trade related issues, adding uncertainties to traders and industry. The law would allow the Government to take measures based on subjective assessments. The Minister can at any time, recalling "national interests", put an embargo on or limit imports or exports of goods.

Although suggested by the EU, the draft does not contain any reference to international agreement or to WTO compliance. It is also unclear by whom the law will be managed and overseen. Article 9 openly favors local products over foreign ones despite being a violation of GATT article 3. The penalties for non-compliance appear to be unusually severe. While this law seems to be drafted to counter trade from large 'deficit' countries such as China and the EU would arguably not be targeted by it, it creates high uncertainties with European traders and investors.

Illegal, unreported and unregulated (IUU) fishing Regulation

Since January 2010 only marine fisheries products validated as legal by the relevant flag state or exporting state can be imported to or exported from the EU. This is to ensure that all fishery imports have been caught according to laws prevalent in each region. The same rules apply to all countries (including EU).

The findings of a mission sent by the Commission last year showed serious shortcomings with respect to the implementation of the catch certifications scheme, the verification process; the management system applied to domestic and long distance fishing vessels and the sanction system with respect to infringements by Indonesian flagged vessels.

A serious follow-up by Indonesian authorities is therefore needed as the IUU regulation is rather strict and could ultimately result in trade restrictive measures which are not in anybody's interest. On the contrary, we want to ensure that EU's fishery imports from Indonesia (around 150 million euro/year of which 70 million affected by IUU) continues and even increases.

The Commission is ready to support this process with technical assistance and the Trade Cooperation Facility managed by Ministry of Trade already addresses this issue.
Background on economic developments

Indonesia is the largest ASEAN economy with 240 million inhabitants and an average GDP per head of around 4,000 US$ (at PPP). The Indonesian economy has recorded positive growth in the past years (6.1% in 2010 and 6.5% in 2011). High growth rates have placed Indonesia among the world's fifteen largest economies and the member of G-20. The growth, to some extent, has gradually translated into the improvement of prosperity indicators. The number of poor dropped by six million to 30 million (13%), and open unemployment dropped from 10% to 6.8%. However, the employment has been informal (69% of total employment), and not in terms of better quality jobs in the formal sector.

2011 growth of 6.5% was mostly driven by strong investment (+8.8%). The economy is expected to grow by 6.3% in 2012, largely supported by domestic demand. Capital inflows are still massive and volatile, but the authorities managed this well and Indonesia has - finally after the Asian crisis – reached again the investment grade at the end of 2011.

The top ten Indonesian export commodities were diverse between natural resources commodities and manufacturing products. The largest non-oil & gas import categories for Indonesia were capital goods and raw materials (machinery and mechanical appliances, metals, chemicals, plastics, cotton, etc).

In 2011, the EU continued to be the largest destination for non-oil and gas exports. Including oil and gas, the EU was Indonesia's 3rd most important export destination and import source after Japan and China.

EU is the second most important foreign investor in Indonesia. According to investment board BKPM, new investments from the EU into Indonesia reached USD 2.2 billion in 2011. Singapore remained the most important investor in Indonesia. EU's investments targeted mostly into transportation, mining and food processing sectors.

Despite the increasing investment levels, Indonesia's position in the world rank of investment climate further deteriorated. The World Bank's Doing Business Report 2011 ranked Indonesia at 121 out of 183 countries, a drop from last year's rank of 115. The legal environment is seen as improving. However, there are still legal uncertainties. Infrastructure investment is seen as inadequately low and rising FDI could help in this context. In addition, Indonesia did not increase its share in FDI inflows significantly in comparison to its Asian neighbours in recent years.
## MAIN ECONOMIC INDICATORS

<table>
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<tr>
<th>Indicator</th>
<th>Value</th>
<th>Unit / Year</th>
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<tbody>
<tr>
<td>Population</td>
<td>240,5</td>
<td>Million (2011)</td>
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<tr>
<td>Current GDP</td>
<td>599,4</td>
<td>Billion euro (2011)</td>
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<tr>
<td>GDP per capita</td>
<td>2,492,3</td>
<td>euro (2011)</td>
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<td>Real GDP growth</td>
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<td>% change over previous year (2011)</td>
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<td>GDP in Purchasing Power Parity</td>
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<td>Billion Current Int. Dollar (2011)</td>
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<tr>
<td>Budget deficit</td>
<td>1,3</td>
<td>% of GDP</td>
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<tr>
<td>Current Account Balance</td>
<td>0,2</td>
<td>% of GDP (2011)</td>
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<tr>
<td>Inflation rate</td>
<td>5,7</td>
<td>% change over previous year (2011)</td>
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<tr>
<td>Unemployment rate</td>
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<td>% of workforce (2011)</td>
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<td>World imports (goods)</td>
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<td>Billion euro (2010)</td>
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<tr>
<td>World exports (goods)</td>
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<td>Trade balance (goods)</td>
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<td>EU Imports (goods)</td>
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<td>EU Exports (goods)</td>
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<td>EU Trade balance (goods)</td>
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<td>EU Imports (services)</td>
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<tr>
<td>EU FDI outflows</td>
<td>0,6</td>
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**Sources:**
- IMF (World Economic Outlook), World Bank (WDI), IMF (DoTS), Eurostat (Comext)