

## Meeting with the Chairmen of KADIN/APINDO – Indonesian Business Organisations

### Scene setter

You will be meeting with the Chairmen of two leading Indonesian Business organisations, Mr Suryo Sulisto, Chairman of KADIN (The Indonesian Business Chambers), and Mr Sofjan Wanandi, Chairman of APINDO (The Indonesian Employers Association). Both are leading figures in the Indonesian business world, and generally pro-European, and keen on deepening ties with EU industry, to promote higher levels of bilateral trade and investment. It is also expected that the President, Mr Jakob Friis Sorensen, of the Eurocham Indonesia, the European business organisation in Indonesia, shall participate, alongside a few select European CEOs of leading European companies from a wide range of sectors (TOTAL, Airbus, Unilever, IKEA, and BMW, and possibly some others).

The EU has a very close working relationship with Chairman Suryo. We worked together particularly closely on issues such as the Comprehensive Economic Partnership Agreement dialogue, the annual EU-Indonesia Business Dialogue, and the ASEAN-EU Business Summit.

KADIN is very much viewed as the most powerful voice of Indonesian business (along with APINDO). While the EU and KADIN may not agree on every issue, KADIN has been broadly in favour of the CEPA with the EU (indeed participated in the Vision Group report/recommendations) art 4.1.(a)

Pak Suryo's predecessor, Pak Hidayat, is the current Minister for Industry. Pak Suryo accompanies the President on most State visits (since they have also a business/trade angle).

The EU has a very close working relationship with Pak Sofjan. We have worked together particularly closely on the CEPA. APINDO is very much viewed as one the **most powerful voices** of Indonesian business (along with KADIN). While the EU and APINDO will not see eye to eye on every issue (e.g. APINDO has come out broadly in favour of protectionism of retail /distribution sector), APINDO has been **broadly in favour of the CEPA** with the EU and can assist sometimes on market access issues affecting European interests (obviously a key player in the wage debate which is important for many EU investors).

art 4.1.(a)

The fact that he is Catholic and of Chinese ethnicity, yet wields so much power publicly, is testament to his **powerful connections** and strategic actions. After the elections, both KADIN and APINDO will (whatever happens to Golkar) have privileged access to the new President and government.

The key point of interest for KADIN and APINDO in terms of bilateral relations with EU focuses on the prospects for an FTA (or CEPA as it is called in Indonesia). However, there are doubts about the level of ambition on the Indonesian side, and to what extent there are factions within these two

organisations which actually oppose wide and deep liberalisation in terms of opening up sectors, notably services sectors, and lowering barriers of entry for foreign firms, hereby putting competitive pressure on domestic industry. Indonesian industry may rather be content with a shallow agreement (without adherence to common rules in key areas such as procurement, IPR and SPS/TBT, and excluding several key sectors) focusing on market access for Indonesian companies to the large EU market. Our key message continues to be that the EU remains ready and willing to launch negotiations for a CEPA with Indonesia, as long as we maintain an ambitious and comprehensive common approach. We strongly believe that such an agreement would produce significant mutual economic benefits for the industry of both partners.

In terms of future EU-Indonesia relations, there is massive potential to increase trade and investment flows. That is why Indonesia should eventually support the negotiation of a CEPA with the EU. CEPA will take our economic relationship to the next level. Europe's economy today is stronger and more resilient. As the EU remains the world's largest economy, the largest trading bloc and the biggest source of foreign direct investment in the world, we remain a very attractive trading partner for Indonesia, especially in the wake of a normalisation in China's growth rates.

art 4.1.(a)

It is hoped that this stance will change with the new administration. The EU has commissioned an independent study to show the trade and investment benefits to Indonesia of deepening relations with the EU. The new Indonesian administration that will be inaugurated in October will have a chance to make a fresh start with the CEPA file. Our new administration in the EU will also be keen to take a new look at trade relations with Indonesia.

**Objective(s):** To reaffirm our readiness and willingness to negotiate a Comprehensive Economic Partnership Agreement with Indonesia, based on an ambitious scoping document, which should benefit both partners, and boost two-way trade and investments.

**Line to take on EU/Indonesia relations**

- While the EU/Indonesia trade and investment relations are good, I think we both agree that there is **considerable scope for improvement**.
- The EU stands firm in its commitment **and willingness to launch negotiations for a comprehensive CEPA** as soon as we are able to agree on the scope and level of ambition of such negotiations. The joint Vision Group report from 2011 sets out clearly the mutual benefits – in particular increased exports from Indonesia to EU of \$9.8 billion representing an increase of 1.3% to Indonesian GDP.
- Regrettably, there is **still an important gap in ambitions** between our two sides in the scoping exercise. In order to move forward we need to see greater ambition from Indonesia on issues such as: services, investments and procurement, to ensure that the future CEPA brings new market access opportunities for economic operators and a more predictable investment and business climate.

## **Speaking Points:**

### **On bilateral trade and investment relations**

- The EU with its large consumer market of more than 500 million people, comprising one fifth of the world economy and one fifth of world trade, and under one single trade regime, facilitates the market opportunities for Indonesian companies.
- Similarly, Indonesia with its rapidly growing middle-class, and its strategic location in the ASEAN, provides attractive trade and investment opportunities for EU companies.
- The full potential of this dynamic relationship has clearly not been tapped, as trade and investment levels are well below of what could be expected given the size of both markets.
- For example, Indonesia ranks only as number 25 among European markets for exports, lower than for example Malaysia, Thailand or Singapore despite the fact that Indonesia is by far the largest economy in the ASEAN. As regards EU investments, during the period 2004 – 2011 Indonesia received only 12% of all EU investments flowing into the ASEAN region, and only 0.4% of all EU FDI to the world in 2011.

### **On the CEPA**

- In terms of future EU-Indonesia relations, there is massive potential to increase trade and investment flows.
- CEPA will take our economic relationship to the next level. Europe's economy today is stronger and more resilient.
- We sincerely hope that the new incoming Government in October will be able to take a fresh look at relations with the EU, in order to enable us to re-launch the discussions for a CEPA.

- The EU stands firm in its commitment **and willingness to launch negotiations for a comprehensive CEPA** as soon as we are able to agree on the scope and level of ambition of such negotiations.
- The joint Vision Group report from 2011 sets out clearly the mutual benefits – in particular increased exports from Indonesia to EU of \$9.8 billion representing an increase of 1.3% to Indonesian GDP.
- A CEPA would maximise the benefits of trade liberalisation based on EU and Indonesia trade complementarity.
- Such an agreement would facilitate more FDI from the EU to help Indonesia develop a diversified and higher value added industrialisation, as well as help develop Indonesia into a manufacturing hub in the ASEAN, if not the whole Asian region.
- Furthermore, the expected establishment of the ASEAN Economic Community in 2015, will make it even more imperative for Indonesia to ensure a fully competitive, investment-friendly and open environment so as to be able to meet the challenges brought about by market liberalization and regional trade integration. Concluding an FTA with the EU could provide up-front benefits of attracting investments and creating a market ready for such change.
- Several sectors in the Indonesian economy, such as the auto manufacturing, pharmaceutical, textiles, garments and footwear, and food processing, to only mention a few, would stand to benefit from lower tariffs and enhanced market access.
- EU investments would also bring with it capital investment, advanced technology, technical know-how and innovations, investment in R&D, and human resources and skills development.
- Furthermore, EU companies would bring with them a special corporate role model as they tend to apply some of the highest standards in the world as concerns labour and social rights, and environmental protection.

## **Defensive Points**

- **Should the Indonesians accuse the EU of lack of ambition with regard to the launch of the scoping exercise and the CEPA negotiations with Indonesia:**

I wish again to dispel any doubts or intentional misunderstandings: the launch of talks on a scoping exercise in 2012 unveiled an important lack of ambition from Indonesia's side in the procurement, services and investment sectors as well as the extent of liberalization. This was the reason which did not allow progressing in a meaningful manner. We must see this gap reduced for constructive, realistic talks to start. We therefore look forward to receiving positive signals in this regard from Indonesia and are willing to engage. The forthcoming EU/Indonesia Working group on trade and investment expected to be held in mid-March 2014 can be an opportunity to hold a first exchange of views.

- **If asked about AD measures on biofuel**

Let me assure you that the current anti-dumping and anti-subsidy biodiesel investigations are highly technical proceedings **based on strict legal WTO requirements**. **The Council adopted on 19 November 2013 a regulation imposing definitive anti-dumping measures on biodiesel from Indonesia (and Argentina) which entered into effect on 27 November 2013.** The rights of defence of the Indonesian producers, guaranteed under WTO rules, are fully respected.

- **If asked about Indonesian palm oil exports and future possible restrictions on the EU market:**

In the EU, there are currently **no restrictions on imports of Palm Oil** as such, and the product enters in fact under **0% MFN tariff rate**. In fact, the EU is the **second largest export market** for Indonesian Crude Palm Oil, accounting for more than 1 billion euros worth of exports. Amendment of the EU sustainability criteria for biofuel currently under decision making process or future EU food labelling rules equally apply to all products irrespective of their origin and are **non-discriminatory**.

## BACKGROUND

### The profiles of the two Chairmen

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[REDACTED]

### Political and Economic context of bilateral EU-Indonesia relations

Parliamentary elections in Indonesia have been held in April 2014 and the Presidential elections, shall take place on July 9, 2014. Indonesia is increasingly recognized as **a key global player**, both politically and economically (part of ASEAN, APEC, G20; now hosting the WTO MC9; biggest ASEAN economy (over 40% of ASEAN GDP), second fastest GDP growth after China in G20 heading to become a \$1 trillion economy by 2014).

art 4.1.(a)

[REDACTED]

With a widening trade deficit, signs of a weakening economy (weak fiscal position due to fuel subsidies, lower investments and falling Rupiah) and the proximity of 2014 elections, Indonesia is increasingly leaning towards **import substitution trade policy and protectionist measures** (third in the EU's protectionism reports, after Argentina and Russia, in number of measures in

place since 2008). While EU business continues to do well in the Indonesian market, the business environment remains highly unpredictable.

Realistically, negotiations for a CEPA (the way Indonesia likes to call an FTA) are unlikely to start in 2014, mainly because of the big gap in ambition between the EU and Indonesia, as demonstrated in the scoping exercise, but also due to the upcoming Indonesian elections (and post-elections adjustments) and the end of term of the Commission. So far, we have not witnessed a more ambitious stance in the scoping exercise where the Ministry of Trade seem to have limited influence over more powerful ministries such as the Ministry of Industry, and Ministry of Economic Co-ordination. We hope that our willingness to engage may bring some changes in attitude. However Indonesia's negative stance in the on-going FTA negotiations with S.Korea and EFTA is not a promising sign.

### **Elections 2014 and their possible impact**

On July 9<sup>th</sup>, 185 million Indonesian voters will chose the sixth President since the country's independence. Following the decision by Golkar's Chairman Aburizal Bakrie not to stand for President, the election has become a two-horse race between Jakarta Governor Joko Widodo ("Jokowi"), and former special forces general Prabowo Subianto. The fourth largest party, President Yudhoyono's Partai Demokrat decided to sit on the fence while waiting for the final election results. The latest polls suggest a very tight race, and the outcome may be very narrow for either winner, making markets jittery, and with possible adverse impact on currency and stock markets following the election results (as already the Parliament is seen as rather split and weak).

While the election campaign has been far more focused on personalities than on policy programmes, it is worth highlighting a few themes which have been dominating the political discourse. First is economic nationalism. Both candidates have promised to defend the interests of Indonesian businesses and consumers by painting a largely negative (and inaccurate) picture of foreign businesses as predators aiming to exploit Indonesian resources. Indeed the rhetoric of economic nationalism is so pervasive that no candidate or party questions its basic premises. Whether such policies would be put in place is a different matter, and as usual in Indonesia, pragmatism is likely to prevail. The possible review of the current mineral export ban, which is hurting Indonesia's export capacity is a classic example of shooting your own foot type of policy. Inevitably, it will come under closer scrutiny as pragmatism prevails. A second theme is welfare provision, an issue close to Jokowi's heart given that he made it a key policy issue during his tenure as Jakarta Governor. As of late, Prabowo has joined the bandwagon, making speeches about the need to care for the disadvantaged by providing welfare nets. In terms of economic policy, the differences between the two candidates are less pronounces, with both emphasising economic nationalism, and improved tax collection. Given the



rather protectionist stance of Jokowi's party, the PDI-P, fuel subsidy reforms, labor market reforms, and state enterprise reform may prove difficult. On the other hand, a Jokowi Presidency, could bode well for clean governance, bureaucratic/institutional reform, and improved land administration. This is why markets tend to prefer Jokowi over Prabowo.

In terms of economic policy, and possible impact, observers believe that once in power, both candidates would be prudent and pragmatic, adapting to Indonesia's realities, given the external and domestic environment. Some of the protectionist tendencies we have seen in the past may continue, but overall, Indonesia will continue to attract large flows of investments, and should be able to maintain a relatively decent GDP growth rate. In terms of economic policy, successive governments have been known to nominate competent technocrats for key positions such as the Central Bank Governor and Finance Minister position, who can ensure responsible monetary and fiscal policies.

Whoever takes office in October will inherit a widening budget deficit, a ballooning fuel subsidy bill, and difficult negotiations over a new minimum wage. The key issue that remains to be seen is to what extent either of the candidates, whoever wins the elections, will be able to tackle the real structural issues faced by Indonesia, and described above, which could ensure the higher growth rates needed to take the economy to more advanced levels. At the same time, it should be born in mind, that whatever the powers of the President, he will have to work closely with the Parliament which wields significant powers over key legislation passage (such as on the fuel subsidies). The international markets have already reacted negatively to the rather split Parliament with no single majority, which makes it quite divisive, and which may reduce the prospects for passing sensitive economic reforms.

In terms of future EU-Indonesia relations, there is massive potential to increase trade and investment flows. That is why Indonesia should eventually support the negotiation of a CEPA with the EU. CEPA will take our economic relationship to the next level. Europe's economy today is stronger and more resilient. As the EU remains the world's largest economy, the largest trading bloc and the biggest source of foreign direct investment in the world, we remain a very attractive trading partner for Indonesia, especially in the wake of a normalisation in China's growth rates. However, Indonesia considers that it has not benefited from the FTAs with China, Japan and Korea and "nationalism" prevails over "liberalisation". In the CEPA scoping process, Indonesia has not shown the level of ambition necessary (like Thailand) for the EU to launch formal negotiations. It is hoped that this stance will change with the new administration. The EU has commissioned an independent study to show the trade and investment benefits to Indonesia of deepening relations with the EU. The new Indonesian administration that will be inaugurated in October will have a chance to make a fresh start with the CEPA file. Our new administration in the EU will also be keen to take a new look at trade relations with Indonesia.

## **EU-Indonesia Trade and Investment Relations**

### **Trade in Goods**

**Relations between Indonesia and the EU are substantial:** bilateral merchandise trade amounted to EUR 24 billion in 2013 resulting in a sizeable EUR 4.6 billion surplus for Indonesia (source: Eurostat).

The EU is Indonesia's second largest non-oil and gas export destination after China (share 11.1%, source: BPS) and the third largest source of non-oil and gas imports after China and Japan (9.5%, BPS). For the EU, Indonesia is the 25<sup>th</sup> largest import source (share 1%) and the 33<sup>th</sup> largest export destination (share 0.6%).

**Trade flows between Indonesia and the EU complement each other.** Indonesia's exports to the EU are mainly represented by agricultural products, minerals, textiles, and (semi) manufactured goods. EU exports to Indonesia mainly consist of high-tech machinery, transport equipment, manufacturing goods, and chemicals. EU products are important for the development of the Indonesian infrastructure and upstream industry and for consumers' demand. Over half of Indonesia's and EU's exports to each other consist of intermediate goods. Around 40% of Indonesia's exports to the EU are made up by consumption goods, while capital goods made up around 40% of Indonesia's imports from the EU in 2012.

### **Trade in Services**

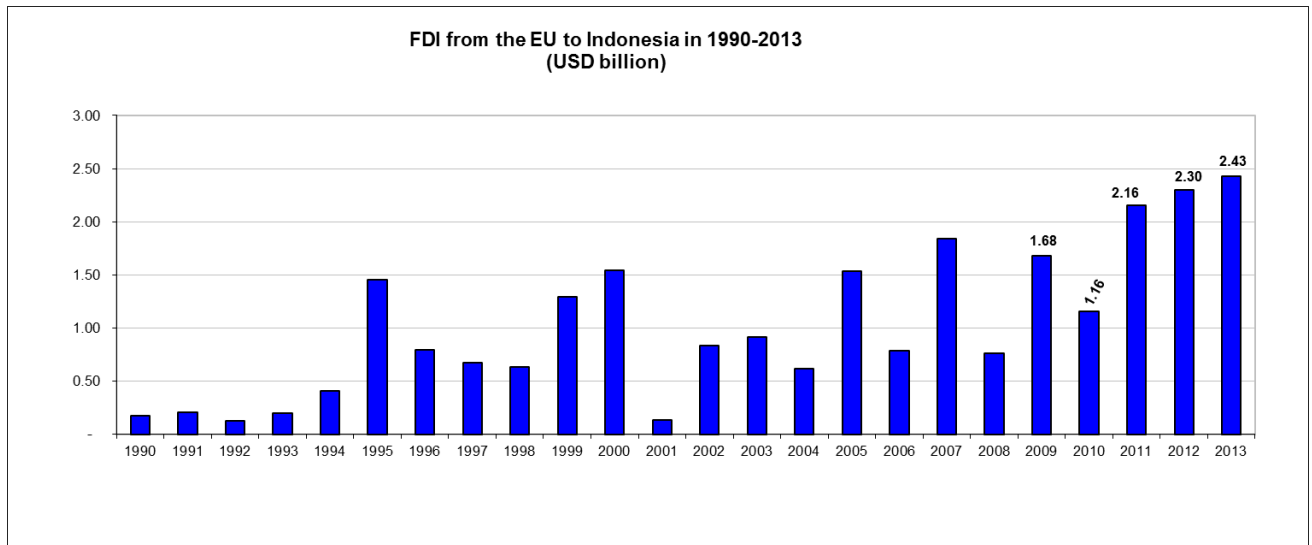
Rapidly expanding, the services sector is contributing more to economic growth and job creation worldwide than any other sector. Services are important for the developed as well as for developing country economies. The sector of services account for around three-quarters of the EU GDP and for 50% of Indonesia's GDP.

**Indonesia's trade in services with the EU has increased** during the last 7 years. Indonesia's services' exports to the EU amounted to EUR 1.5 billion and imports from the EU reached EUR 2.4 billion in 2012.

Indonesia has a comparative advantage vis-à-vis the EU in labour-intensive services: tourism, transportation and construction. New potential export opportunities are also emerging in communication, IT and business services. In 2010, Indonesia exported mostly tourism and transport services to the EU, while the EU mainly exported business, IT and transport services to Indonesia.

### **Foreign Direct Investment (FDI)**

**The EU remains Indonesia's second largest source of Foreign Direct Investments.** During the period 1990 – 2013 FDI from the EU to Indonesia amounted to USD 24.6 billion (data source: BKPM, excluding oil & gas and finance).



Source: BKPM (data excludes oil & gas, finance)

**A EuroCham study has found that 1.1 million Indonesians are employed by 1,000 European firms who have invested over USD 130 billion in Indonesia. The EU invests in sectors with highly added value. EU investments in Indonesia are mostly allocated in mining, infrastructure and manufacturing, especially chemical and pharmaceutical, and food industries.**

**EU investments have brought significant benefits to Indonesia in terms of:**

**Technology Transfer and Higher Added Value.** FDI from the EU has brought technological spill-over, as European companies usually use the most modern technology available in the world.

**Labour Absorption and Human Capital Development.** Investment from the EU to Indonesia has also helped to develop Indonesia's human capital as European companies prioritise human capital development through different training programmes in Indonesia and abroad.

**Development of Local Markets.** As a result of foreign competition, the domestic Indonesian market enjoys higher productivity, more efficient resource allocation, lower prices, and bigger choice for consumers.

**Environmental and Social Benefits.** European companies spent **USD 500 million on CSR programs world-wide in 2011 alone.** The EU is one of the world leaders in green initiatives.

**Opportunities for investment in Indonesia are numerous,** including infrastructure, green economy, services and manufacturing. Under The Master Plan for the Acceleration and Expansion of Indonesia's Economic Development (MP3EI) Indonesia's total infrastructure investment needs will be around USD 162 billion (IDR 1,786 trillion) between 2011 and 2025 or USD 11 billion per year. Similarly, multiple opportunities exist in the green sector due to Indonesia's commitment to decrease its greenhouse gas emissions by 26% by 2020 with its own resources and by 41% with international assistance.

	FDI to Indonesia in 2013	No of Projects	New FDI (million USD)
1	Japan	958	4,712
2	Singapore	1,592	4,670
3	USA	210	2,435
4	EU	902	2,414
5	South Korea	807	2,205

Source: BKPM

Investments made by EU companies in Indonesia over the last couple of years, display the diversity of sectors and importance for the economic development in Indonesia in terms of capital investment, job creation, technology transfer and market development. Among them, a few examples that could be highlighted include:

In the **cosmetics sector**, L'Oréal announced on November 7, 2012, the opening of its largest factory in the world. With a staged investment totalling around USD 130 million , this new factory will serve as the production hub for the South-East Asian region.

In the **furniture business**, IKEA will open three stores in Indonesia with a total investment of \$300 million over the next few years, after signing a franchise agreement with PT Hero Supermarket. IKEA plans to open the first store in July 2014 in Jakarta in a step that marks its further expansion in ASEAN after it successfully opened a store in Bangkok in 2012, and following its presence in Malaysia, and Singapore.

In the **auto sector**, the development of Pirelli Tyre factory, a co-operation with PT Astra Otoparts Tbk, started in the fourth quarter of 2012. The Pirelli's tyre factory will approximately need an investment of US\$120 million. The factory is expected to start operating in 2014. By 2016, the factory will be fully operational with seven million units of tyres produced per year – 25 percent of Pirelli's total global production.

In the **pharmaceutical sector**, PT Bayer Indonesia invested up to USD 20 million in 2012 to expand its production capacity to support the company's business growth in domestic and export markets. The investment was used to build a new factory in order to increase the production capacity of OTC (over the counter) products.

### **CEPA discussions**

The EU has already concluded comprehensive Free Trade Agreements in Asia, with Korea in 2010, and most recently with Singapore. We have started negotiations with Japan, and the US, two major trading partners of the EU. In the ASEAN region, apart from having concluded a comprehensive agreement with Singapore, we are in the process of negotiations with Thailand, Malaysia, and Vietnam. We are making good overall progress in these negotiations. We believe that Indonesia would also offer an excellent case for starting

negotiations. Once agreements are concluded with further ASEAN countries, the risk is that Indonesia will lose attractiveness, and lag behind further in terms of trade and investment.

The Vision Group in 2011, recommended that both parties aim at an ambitious and comprehensive agreement, a Comprehensive Economic and Co-operation Agreement (using the 'FTA' word is taboo in Indonesia, and CEPA is another term for the equivalent of an FTA) that would help liberalise significantly trade between the EU and Indonesia, including in services and investment. The report of the Vision Group pointed to several facts which underpin the case for such an agreement. A CEPA would maximise the benefits of trade liberalisation based on EU and Indonesia trade complementarity. Such an agreement would facilitate more FDI from the EU to help Indonesia develop a diversified and higher value added industrialisation, as well as help develop Indonesia into a manufacturing hub in the ASEAN, if not the whole Asian region.

The EU is the largest trade partner with which Indonesia has a trade surplus of 4.6bn euros. However, even at a high of 24 billion euros in 2013, overall bilateral trade is well below some of other smaller countries in the region (Singapore – 52 billion euros, Malaysia – 35 billion euros and Thailand - 32 billion euros in 2012), despite the fact that Indonesia is the largest economy in the ASEAN. For Indonesia, the EU is also one of the largest sources of FDI. However, during the period 2004 – 2010 Indonesia received only 1.6% of all EU FDI going into Asia, and only 6% of all EU investments flowing into the ASEAN region. Indonesia should not fear any negative impacts of a future CEPA with the EU, as our economic and trade structures are highly complementary, hereby providing a significant potential to expand trade and investment.

As far as the potential impact on FDI inflows and investment in manufacturing, agro-industry and services sector is considered as a result of concluding a CEPA, this should not be underestimated in our view. It is well recorded that investment goes hand in hand with trade liberalisation, and opening up a wide range of sectors to FDI, will bring important benefits. This would be coherent as regards the revision of the 'Negative List', and Indonesia's ambition to open up several sectors to investors. The EU as a leader in infrastructure development and key services sectors, could contribute significantly to the required capital needs over the next decades provided that the investment climate is conducive.

More generally, concluding a CEPA with the EU would help develop the Indonesian economy, by attracting investments, creating jobs, expanding exports and ensuring higher economic growth. Several sectors in the Indonesian economy, such as auto manufacturing, pharmaceutical, textiles, garments and footwear, and food processing, to mention a few, would stand to benefit from lower tariffs and enhanced market access. EU investments would also bring with it capital investment, advanced technology, technical know-how and innovations, investment in R&D, and human resources and skills development. Indonesian consumers would stand to benefit from a wider choice of products, lower prices and enhanced competition. In addition, in the longer perspective, a bilateral CEPA with Indonesia would set out a transparent, stable and predictable regulatory environment which would give a clear signal to EU investors, as companies have a wide choice of investment locations in Asia.

Against this background, it is disappointing that the latest Indonesian scoping proposal which was presented to the EU side in May 2013 does not yet show enough ambition to warrant the launch of negotiations. It falls well short of the ambitions set out in the 2011 Vision Group report. The proposal also backtracks on areas already agreed at the last scoping meeting in October 2012. Indonesia does not want to address at all public procurement, elimination of export duties and animal welfare. There is no commitment of level of overall liberalisation coverage (despite the Vision Group's endorsement of 95%). Indonesia's level of ambition remains too low across the board on SPS, Services, Investment, Public Procurement and IPR

The current economic challenges faced by both the EU and Indonesia could present an opportunity. A CEPA with the EU would provide a predictable and comprehensive framework to mould our trade and investment relations. The EU remains ready and willing to launch negotiations for a CEPA with Indonesia, as long as we maintain an ambitious and comprehensive common approach. We strongly believe that such an agreement would produce significant mutual economic benefits. However, realistically, the CEPA negotiations will not start before 2015 (after the elections in July 2014, and the settling in of a new Government by October). While this is far from ideal, the EU wants to avoid the current EFTA scenario where negotiations have started but are effectively blocked since the Indonesian side is insisting on only liberalising in sectors where EFTA makes investment promises; something EFTA countries cannot do. Accordingly, in the meantime, we continue to make the clear the message that the EU is ready, willing and able to negotiate a CEPA with Indonesia as soon as both sides have endorsed a deep comprehensive scoping paper. The EU has requested a respected Indonesian think tank to undertake a new study (building on the Vision Group report) to show that a CEPA will increase trade for both sides and also EU investments in Indonesia by assuring a more transparent and predictable regulatory framework.

**Contact(s):** art 4.1(b)