

Subject: EU-Indonesia trade relations

Scene setter

The Commission and the Government of Indonesia are currently in the process of preparing the launch of bilateral free trade negotiations. A joint Vision Group recommended such negotiations in its report published in June this year (so called Comprehensive Economic Partnership Agreement or CEPA) and the Indonesian Government is now engaged in obtaining the necessary domestic support for the idea.

Internally, Indonesian industry is struggling with the effects of other FTAs, especially with China, and calls for more protectionist measures rather than trade liberalisation. These developments have probably influenced the recent reshuffle of the Government on 18 October with the unexpected departure of Trade Minister Mari Pangestu (so far very supportive of the Vision Group and its recommendations) replaced by Harvard-educated and investment banker Gita Wirjawan who has been (and continue to be) the Chair of the Indonesia Investment Board during the last two years. Also due to the changes in the Government, preparatory talks with the EU have lost momentum after the summer and continue now at a more technical level.

Line to Take

- The joint EU-Indonesia Vision Group report has highlighted the challenges we are facing and clearly suggests that status quo is not an option. It proposes to start quickly the process for the negotiation on comprehensive free trade agreement.
- To this respect, the Commission is prepared to engage in bilateral FTA talks with countries in South East Asia which are ready to and capable of negotiating a comprehensive FTA.
- This obviously includes Indonesia and the preparatory discussions could continue as soon as Indonesian Government has concluded its internal consultation process.

Background

Indonesia's economic growth is – despite global crisis – impressive (6.4% in 2011). However, even though EU industry present in Indonesia is doing well, new ('fresh') EU investment and trade flows still remain behind the level of other ASEAN countries such as Thailand and Malaysia. EU industry is complaining of market access issues and lack of regulatory transparency (predictability).

The EU is not taking advantage of this expanding economy of 240 million consumers. Trade and investments are far below potential, mostly due to the difficult trade and investment climate and lack of awareness of the opportunities.

In 2007 the EU launched FTA negotiations with a group of 7 out of 10 ASEAN members. This has proved overly challenging. After two years of negotiations, it became apparent that the levels of ambition between ASEAN and the EU did not match. Therefore a joint decision was taken in March 2009 to "take a pause" in the regional negotiations.

Until the time is ripe for re-engaging at the regional level (that still remains the ultimate goal), the EU is open to engage on bilateral negotiations with those individual ASEAN members ready to do so. These FTAs are intended to become building blocks for a future agreement in the regional framework.

We have so far launched negotiations with Singapore and Malaysia. Vietnam, Thailand and, most recently, Philippines asked to open preliminary talks with the EU.

Indonesia has started showing an interest to join the bilateral process only in 2010 by welcoming and actively participating to the EU-Indonesia Vision Group (see below), which recommended starting negotiations for a 'Comprehensive Economic Partnership Agreement'.

Indonesia is expanding its network of regional and bilateral trade agreements (China, Japan, Korea, India, Australia, Pakistan and talks with EFTA and Turkey) and this process is already showing an impact on the export shares in the countries where the EU is losing ground (from 14% to 8%) to the advantage of China and Japan (and other ASEAN countries).

Still, Indonesia already benefits of a rather open access to the EU market (around 12 billion exports per year) thanks to the structure of its trade and the benefit of the GSP scheme. Meanwhile, the domestic industry is struggling with the implementation of other agreements signed by ASEAN with regional partners (especially China) and is asking the Government for further delays and increased protection.

EU-Indonesia Vision Group and CEPA negotiations

During the last bilateral meeting with President Yudhoyono in December 2009, both sides agreed that trade and investment is an area where the bilateral relationship had great potential to develop and that there was need to explore ways to strengthen these ties. The leaders therefore decided to set up a "Vision Group" tasked to examine how to increase trade and investment between Indonesia and the EU. This project was in line with the positive political climate created by the partial resolution of the air ban and the consequent signing of the PCA, and had the objective of maintaining the momentum in the bilateral relations while buying some time to deal with the pressures of some sectors of the domestic industry, which is very much concerned about recent opening to other regional partners (especially China).

The main recommendation of the Group, presented to the Trade Ministers in May 2011, was to launch negotiations for an ambitious agreement denominated Comprehensive Economic Partnership Agreement (CEPA). The proposed agreement would be a comprehensive one, constructed like a pyramid based on three main pillars: Market access, Facilitation of trade and investment and Capacity building. This is very much similar to the Indonesia-Japan EPA.

From the EU perspective, an agreement with Indonesia would be of high interest given to its size and our declining market share in the country. However it will also be challenging in terms of substance. In this respect, the reaction of the Indonesian Government to the recommendations of the Vision Group which called for the launch of CEPA negotiations is encouraging.

The Indonesian Government is currently consulting the main stakeholders on these recommendations, but also on the more detailed contents of a possible agreement ("socialisation campaign"). This will pave the way in Indonesia to the formal decision (by the President) to open negotiations. So far the reaction from the local industry (Chamber of commerce KADIN and employers' Association APINDO) and, surprisingly, from trade unions has been positive, highlighting in particular the complementarities between the two economies and the importance of closer bilateral ties. Negotiations can start only after an in-depth discussion on key aspects of the agreement in order to evaluate their readiness to take commitments on critical aspects of services, market access and procurement. This will be reflected in the so-called "scoping paper" to be presented to the Member States ahead the formal start of the negotiations.

An offer to start this preliminary "scoping" exercise has been presented to Indonesia in occasion of the last bilateral working group on trade and investment before the summer. However, no official answer has been received so far and unofficial signals are showing the need for Indonesia to take some additional time to consult internally all the stakeholders before engaging with the EU.

In a recent bilateral meeting, the new Trade Minister Gita Wirjawan confirmed the need for more stakeholders' consultations and promised to send a feedback on the scoping paper by May 2012.