CHAPTER II
ECONOMIC RELATION, POLICY, AND PALM OIL ISSUE BETWEEN INDONESIA AND EU

This chapter contains a description of the relationship between Indonesia and the European Union that has been around for a long time, which has a significant influence on ASEAN in terms of politics, cooperation agreements, and trade relations. Besides, the author also describes the emerging trade issues, especially in palm oil export commodities where there are several issues present related to palm oil production, and the threat faced by palm oil producers due to the enactment of regulations on the Renewable Energy Directive.

A. Indonesia and EU Economic Relation

The cooperation between Indonesia and the European Union has been going on for a long time. The cooperation influenced by relations between the European Union and ASEAN. As one of the founders of ASEAN and a country that has a significant influence on the development of the Southeast Asian region, Indonesia certainly has many discourses on cooperation with various parties, especially the European Union as an ideal regional to date. The involvement of Indonesia in the cooperation of the European Union and ASEAN, which has been running for more than 38 years, appears in its participation in the signing of agreements on economic cooperation and development as a basis for institutional dialogue.

In the context of relations with the European Union, Indonesia has fostered harmonious cooperation bilaterally with individual EU member countries such as the Netherlands, Germany, France, Italy, Belgium, Denmark, and Eastern European countries such as Hungary, Czech, and Poland. The development of the bilateral relations between Indonesia and the EU is inseparable from the growing domestic and regional dynamics in the EU and Indonesia. On the other hand, Indonesia's domestic situation characterized by economic recovery activities, the development of the democratic process and the emergence of security disturbances.

For Indonesia, the EU is an important market and one of the primary sources of foreign investment in Indonesia. Bilateral trade between the two countries in 2010 reached USD 28.20 billion and continued show an increasing trend from year to year. At present, the European Union is the second largest export market that is very promising for Indonesia at 16.1% of the total value of Indonesian exports, equivalent to USD 14 billion. While in terms of imports, the European Union is Indonesia's fourth import source which posted a value of 12.7% or as much as USD 7 billion. On the other hand, in terms of the European Union it, in the economic field Indonesia only occupies the 37th position as the EU target or target market of 0.5%. In terms of being a source of imports, Indonesia was only ranked 23rd by posting a percentage of Europe's import value of only 1% (Revolvy.). Meanwhile, in terms of foreign direct investment, the European Union is the largest investor in the mining and petrochemical industries.

The EU and Indonesia have established relationships in various fields that have grown significantly in recent years as the essence of this relationship is a substantial commercial interest. With Indonesia, commercial relations reach a total value of €17 billion in annual trade and €4 billion in investment from EU companies, with the European Union being the second most important destination for Indonesian exports (except oil and gas). The two sides also made deep political friendships - which confirmed in November 2009 with the signing of the Partnership Cooperation Agreement (PCA) between the EU and Indonesia which strengthened the relations that Europe and Indonesia have been enduring for centuries and values and principles shared by the European Union and Indonesia (EU External Action, 2017).

The cooperation between Indonesia and the European Union is still ongoing, even increasing. However, keep in mind that the development of relations between Indonesia and the European Union cannot be separated from the dynamics that occur on each side. The European Union is one of the leading trade forces in the world with firm multilateral commitments. The European Union's single market, which applies in all 28 member countries today, makes the European Union an attractive market for other countries. Meanwhile, Indonesia is the largest economy in Southeast Asia and an essential partner for the European Union both in trade and investment, and furthermore, the good relations continued through CEPA.

A Comprehensive Economic Partnership Agreement (CEPA) between the European Union and Indonesia will improve economic relations between the two economies, and benefit both parties. The CEPA will provide access to EU member states to enter the considerable and currently experiencing Indonesian market growth and in particular to various service sectors. The CEPA will also provide opportunities for EU companies to use Indonesian resources as a tool for investment and economic activity in the future. Besides, the benefits of the agreement for the Indonesian economy will be far more significant. The Indonesian government formed a team under the coordination of the Ministry of Trade to begin reviewing the Partnership Agreement (CEPA). Through a mature scoping paper in negotiations, the implementation of the CEPA is expected to produce a mutually beneficial solution for both parties regarding the CEPA, especially negotiations on EU-Indonesia long-term cooperation.

At present, the government is preparing the position of Indonesia contained in a scoping paper between Indonesia and the European Union in Comprehensive Economic. Scoping paper includes general provisions covering objectives, market access, facilities, economic cooperation, and capacity building. Moreover, technical provisions covered among goods trade, service trade, investment, procurement of goods, intellectual property rights, business competition policies, and others.

The great benefits of the CEPA for Indonesia and the European Union for the economy cannot be denied. The need for a CEPA is urgent for Indonesia because greater market access to EU member countries can increase the performance of Indonesian exports in the EU market. Besides, because the two economies are complementary, greater market access for EU products will also increase the competitiveness of Indonesia's industry and investment for Indonesia.

The Indonesian economy has increased more than tripled in the last ten years and has become one of the countries with rapid economic development in Southeast Asia. Indonesia is the largest economy in the Association of Southeast Asian Nations (ASEAN), with around 35% of ASEAN GDP. Based on purchasing power parity (PPP), Indonesia's GDP was ranked 8th in the world in 2014, while in nominal GDP, Indonesia was ranked 16th in 2014 (Embassy of The

Republic of Indonesia). Indonesia's appeal lies in the fact that Indonesia is a growing market fast with more than 250 million people, with a favorable demographic profile and a large and rapidly growing middle class. The Indonesian economy can be calculated to be USD 1.8 trillion in 2030, and then become one of the countries with the largest economy in the world.

The European Union is one of the largest investors in Indonesia with Foreign Direct Investment (FDI) of USD 2.2 billion in 2015 and USD 3.7 billion in 2014. According to the Investment Coordinating Board (BKPM), between 1990 and 2014, the total EU FDI flowing in Indonesia reached USD 28.2 billion, with most of the investment in the chemical and pharmaceutical industries (USD 6.8 billion or 22.3% of the total EU FDI for Indonesia).

In May 2015, a study from Indonesia's leading institute, CSIS, assessed the potential benefits of signing the CEPA between the EU and Indonesia. If the CEPA can remove tariffs on all goods, the annual quantity to be imported by EU from Indonesia can increase by 5.4% compared to the previous value, an increase that is equivalent to an additional USD 1.1 billion. In addition to the effects of real trade creation, the research will also show other potential benefits.

The launch of the IEU-CEPA is a follow-up of the CEPA negotiation scoping paper agreement between Indonesia and the European Union, during a visit by Indonesian President Joko Widodo to Brussels, Belgium, on April 21, 2016. The CEPA negotiations will put Indonesia in a better position in the supply chain globally because the economies of both parties are complementary.

The European Union is one of Indonesia's largest markets for the issue of commodity exports abroad. The European Union, which consists of 28 countries, is Indonesia's second largest trading partner with total bilateral cooperation reaching IDR 253 trillion annually. Indonesia's exports to all European countries amount to IDR 177 trillion. Meanwhile, about Indonesia's palm oil exports, the EU was the second largest importer of Indonesian palm oil under India in 2015. With the number of Indonesia's exports to the EU amounting to 4.23 million tons, the EU is undoubtedly one of Indonesia's most important trading partners. Plus, in February 2016, Indonesia planned to increase trade relations with the EU and one of them was through increasing commodity exports. The Indonesian and EU governments have agreed to increase cooperation in the trade of commodities, such as palm oil and cocoa beans.

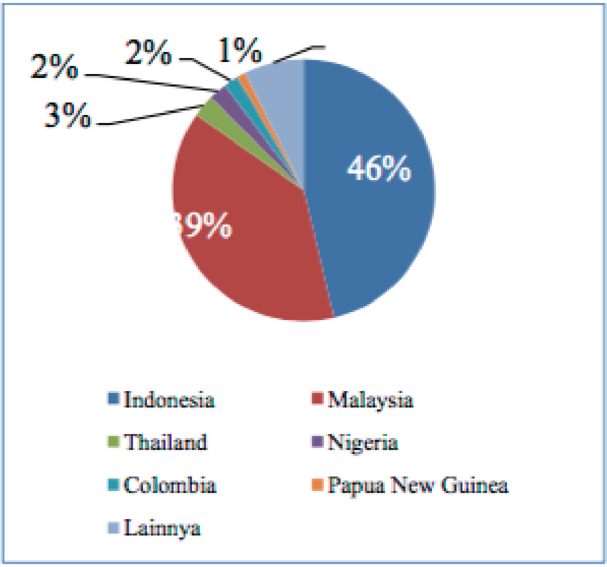
The interest brought by Indonesia in its trade relations with the EU is a large market for imports of palm oil. Palm oil exports to the EU certainly benefit both parties. Indonesia receives state revenues through exports, while EU needs for palm oil will be fulfilled. Plus, the EU itself cannot produce its palm oil, while Indonesia, which has vast forests, is indeed able to produce excessively to become commodities for export.

B. Indonesian Palm Oil Export to EU

Indonesia is currently the largest producer of palm oil worldwide. As the largest producer of palm oil, Indonesia sees the need for a growing share of palm oil as an opportunity to export. The value of Indonesian palm oil exports during the period 2007-2014 experienced fluctuations. The most significant export value of palm oil in 2011 and the lowest in 2007

(Ermawati & Septia, 2013). Palm oil is a leading commodity from the plantation subsector whose export performance is influenced by competitiveness and changes in market share that occur in both the domestic and international markets. As an export commodity, palm oil makes Indonesia the largest exporter of palm oil in the world, followed by Malaysia, Ecuador, Colombia, Thailand with export value reaching USD 4.2 billion in 2014 (UN Comtrade, 2019).

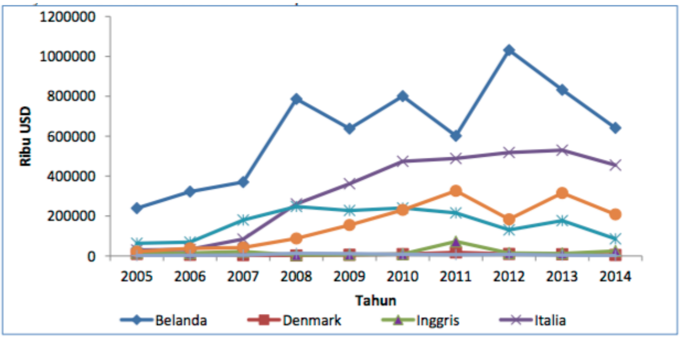
Figure 4.2 World's Largest Palm Oil Producer (2005-2014)



Source: FAO 2016 processed- (Novianti & Khairunisa, 2017)

Indonesia and Malaysia dominate global palm oil production. These two countries together account for around 85 percent of the total global palm oil production. Indonesia has palm oil producing centers in almost all regions of Indonesia. The average oil palm plantation is in Sumatra and Kalimantan. The largest Indonesian palm oil producer is in Riau Province which has an area of 2,296,849 hectares and produces palm oil amounting to 7,037,636 tons. Oil palm plantations in Indonesia are managed in three forms of governance namely People's Plantation, State Plantation, and Private Plantation. From all outside the area and production of Indonesian oil palm plantations, 51.6% is owned by Large Private Plantation, 41.5% is owned by People's Plantation, and State Plantation owns the rest at 6.9% (Diretorate General of Estate Crops).

Graphic 1.2 Export Value of Indonesian Palm Oil at the EU Market (2005-2014)



Source: UN Cumtrade 2016 processed- (Novianti & Khairunisa, 2017)

The development of Indonesia's palm oil exports to seven European Union countries, such as Netherlands, Denmark, Italy, Germany, Spain, and Greece are averagely experienced fluctuations with the increasing trend in the export value of Indonesian palm oil. In the picture above shows that the Netherlands is the export destination country with the highest export value among other EU member countries. Fluctuations in the value of exports to six countries in the EU caused by several factors such as the destination country's GDP, the country's total population, exchange rate, and economic distance (McAllister, 2018). Besides, the policy of the Renewable Energy Directive (RED) stipulated by EU authorities in April 2009 had a significant influence on the export value of Indonesian palm oil.

The European Union on April 23, 2009, made RED the overall policy for the production and promotion of energy from renewable sources in the EU. EU countries must ensure that at least 10 percent of their transportation fuel made from renewable sources in 2020. RED establishes the sustainability criteria for biofuels for all biofuels produced or consumed in the EU to ensure that they were produced sustainably and environmentally friendly (EC Europa).

The RED policy limits the use of oil palm-based biofuels because carbon savings from CPO-based biofuels are considered to fail to meet the target set by the EU by 35 percent. The limitation on the use of CPO-based biofuel can reduce the value of Indonesian palm oil exports to the EU. By making the difference between biofuels based on these criteria, it is not following the discipline set by the WTO because the sustainability criteria of this biofuel can affect international trade.

C. Palm Oil Issue in EU

In April 2017, the Indonesian government was shocked by the European Union Parliament's resolution not to buy palm oil for biodiesel in 2021 because it was considered not to be produced sustainably and triggered deforestation. The decision taken after the European Union Parliament agreed to use environmentally friendly renewable energy, stated in "Report on the Proposal for a Directive of the European Parliament and the Council on the Use of Energy from Renewable Sources." Parliament also agreed to suppress up to 7 percent of the use of palm oil for transportation renewable energy sources until 2030. The decision made the biggest CPO export producing countries such as Indonesia and Malaysia threatened to lose markets in the EU. When viewed on average, Indonesian and Malaysian CPO production is around 80 percent of world production. In Indonesia, responses come from various state actors, and deforestation of oil palm plantations which violates the principles stated in global palm certification or known as Roundtable Sustainable Palm Oil (RSPO).

The issue of environmental sustainability and social justice are the main principles that oil palm producing countries must adhere to, such as Indonesia. Nevertheless, the issue of sustainability and social justice is also an obstacle in the trade of oil palm from producer countries to consumer countries, such as the European Union. Before and after the establishment of the RSPO in 2004 until now. The issue of environmental sustainability and social justice was a continuous campaign carried out by non-governmental organizations (NGOs) at the local, national, international and transnational levels and their allies, both in oil-producing countries and in the country consumers in the EU. The issue of oil palm trade to the EU has turned out to be easy, namely only by having RSPO certification (Erman, 2017). The problem lies in a complicated process, requiring costs, judgments that are not "fair," and how plantation companies and oil palm farmers obtain RSPO certification as an "entry point" to smooth export of Indonesian palm oil to the EU.

The social issues that accompany the expansion of oil palm plantations and the trade in palm oil have received the attention of social scientists, from social conflicts, land conflicts, marginalization of indigenous peoples and their livelihoods, conflicts in labor relations, trade, to loss of biodiversity (Marti, 2008) The Varkkey study 2016 emphasized the relationship between the expansion of oil palm plantations and the politics of government patronage (Varkey, 2016). This politics of patronization has led to the government's ignorant attitude in dealing with issues of environmental sustainability and social justice as evidenced (Pye, 2010). The issue of environmental sustainability and social justice strengthened with global certification (RSPO) in 2004, so studies on global (RSPO) and national certification (ISPO and MSPO) also emerged (RSPO). Despite the positive effects of fulfilling the sustainability criteria in the ISPO principles on the trade in Indonesian palm oil to the European Union, there are also issues of controversy over environmental sustainability and social justice, including problems of deforestation, destruction of biodiversity, land conflicts, and indigenous peoples in around oil palm plantations (ISPO). Also, besides that this is also exacerbated by the rolling health issue that the body gives adverse effects due to consuming high saturated fat from palm oil.

The efforts to expand plantations and palm oil production are going due to an increase in demand, especially in the international market. However, unfortunately, the efforts to expand the land were criticized by several groups including NGOs. Thus, the Indonesian oil palm in its production and export process has faced obstacles and challenges. Pro-environment and western environment national and international non-governmental organizations (NGOs) are developing black campaign environmental issues. So that the target vision and mission of these objectives must be hindered, which makes it a challenge or even an obstacle to the role of palm oil in the global market, this obstacle is caused by the existence of issues or campaigns that negatively damage the environment, burning forests for expansion of oil palm land areas, and unhealthy oil palm.

As revealed by the Union of Concerned Scientist (UCS), one of the sources of global warming emissions that are strongly associated with palm oil is the drying and burning of carbon-rich swamps known as peatlands (UCS). Besides, Greenpeace investigated three plantations in West and Central Kalimantan where heavy fires were recorded during the 2015 haze crisis (Greenpeace). In each case, widespread deforestation and draining of peatlands have been widely recognized as the root cause of the fire crisis, including by the Indonesian government. With them, they see the consequences of the exploitation of oil palm plantations which have an impact on the surrounding environment. The issue continues until the emergence of a negative campaign becomes a black campaign in Europe.

The Negative Campaign is considered to have the potential to result in substantial state losses and have an impact on Indonesia's national economy. If it is associated with a negative campaign launched by European countries through NGOs because of their vegetable oil they are unable to compete with palm oil, so they always attack Indonesian plantation products. The European companies prevent the import of palm oil resulting from deforestation, so more precisely they apply deforestation-free.

D. EU Policy

There are several demands raised by the European Union on palm oil entering its territory; such demands include importing palm oil, both for food needs or industrial purposes, the European Union requires the production of sustainable palm oil. Besides, the European Union believes the use of palm oil for fuel production will endanger the continuity of other food security, especially for the poor. Therefore, its use as fuel is only permitted if it does not have a negative social impact. The European Union must demand that international agencies advance global efforts to improve ecological and social standards in the production of palm oil, and support the ongoing shrinkage of standards that apply worldwide.

From the demands submitted by the European Union, it can be seen that the European Union is implementing a regime shifting. In the case of palm oil, the European Union links trade issues to environmental issues. In its development, the European Union has approved the EU Emission Trading Scheme (EU - ETS), a policy approved by EU members to support products of countries that have low-carbon industrial sectors (Sparringa, 2018).

The EU ETS market uses a cap and trade system, namely cap (capped); The total emission of a country is limited to these restricted emissions, allowances will emerge (excess emissions that are not used). The EU ETS itself officially began in 2005 until 2013, EU ETS has been running in 3 different periods, namely the period 2005-2008, 2008-2012, and the most recently implemented period is 2013-2020. The 2008 scheme is called the "learning by doing" phase by making several more mature determinations, the second phase 2008-2012 is the commitment period of the Kyoto Protocol by implementing a National Allocation

Plan for each country that proposes a cap limit of the total emissions from the relevant installation, which then will be approved by the European Commission. With the EU ETS standard, palm oil products from Indonesia-Malaysia are considered not to meet these standards, the combined oil palm production between Indonesia and Malaysia is considered to produce carbon above the average threshold of 0.86 metric tons, or 860 kilograms of carbon dioxide produced from coconut plantations palm oil every day (Dutton, 2012). For this reason, the European Union decided to set an anti-dumping import duty while for Indonesia's bio-diesel and palm bio-fuel by 2.8 - 9.6 percent and take effect in July 2013.

Furthermore, what has recently become a serious threat to the largest producers and exporters for the EU is the regulation of Renewable Energy Directive II (RED II) along with the delegated act. This means that it tends to discredit Indonesian and Malaysian CPO. RED II Regulation is an EU policy related to the production and promotion of renewable energy which will take effect from 2020-2030. This policy stipulates that the EU must fulfill 32% of its total energy needs through renewable sources in 2030. To support it, the EU will issue a delegated act, which stipulates the criteria for high-risk and low-risk crops for land function change and deforestation.

The following are the results of the main agreement produced at the trilogy meeting on the June 14 Renewable Energy Directive II (RED II), 2018, including the European Commission, European Parliament, and the European Union Council stipulating:

- Set new, binding and renewable energy targets for the European Union for 2030, which is 32%, including a review clause in 2023 for increased target revisions

- Improve the design and stability of the support scheme for renewable energy
- Downsizing and significantly reducing administrative procedures
- Establish a clear and stable regulatory framework for self-consumption
- Increase the level of ambition for the transportation sector and the heating/cooling sector
- Improving and clarifying the sustainability of bioenergy use, considering among other things that biofuels should not be made from raw materials obtained from land of high biodiversity value, such as primary forests and other tree lands, protected areas or grasslands that have high biodiversity (EEAS Europa, 2018).

The European Union is a vast and vital market for international trade actors. Therefore, the EU makes a set of rules, high standardization, and a ban on regulating its import activities, which then becomes an obstacle for its exporters including Indonesia.