

EU-Indonesia FTA Relations: Palm Oil – In for a Rough Ride?

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In light of the sixth round of the EU-Indonesia Free Trade Agreement (FTA) negotiations held on 15th October 2018 in Indonesia, this paper aims to explore the issues surrounding the production of palm oil, which has emerged as a contentious subject in palm oil producing countries and the EU alike. While the European Commission is keen on forging closer economic ties through FTAs with partners such as Indonesia, there have been opposing voices coming from within the EU's parliamentary body. In the case of Indonesia, concerns have been that the FTA between the EU and Indonesia would only exacerbate the negative environmental and social effects of the palm oil industry. In addition to this, the phasing out of the use of palm oil in biofuels in the EU by 2030 has arguably led to a lot of uncertainties with regards to the future of the Indonesian palm oil industry. Consequently, it appears likely that the FTA negotiations between the EU and Indonesia are in for a rough ride.

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This paper expresses the view of the authors and not the European Institute for Asian Studies

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Introduction

As a former Dutch colony, palm oil was first introduced to Indonesia by the Dutch administration, which initially started establishing palm oil plantations along the east coast of Sumatra. Palm oil is a labour and land-intensive crop, of which both varieties are readily available in Indonesia, despite showing signs of decline over the years due to rapid development and modernisation. However, whilst many controversies still surround it, the heyday of palm oil appears to have passed. Initially, under the Renewable Energy Directive (RED) agreement, the use of food crops in biofuels was deemed as a clean source of energy², and was highly promoted and encouraged within the EU. However, there has since been a growing realisation that the EU's ambition to create a more environmentally-friendly future would be futile if the use of environmentally damaging vegetable oils (such as palm oil) in biofuels remain part of its environmental strategy.

The main objective of this paper is to lay out the various implications stemming from the EU's decision to phase out the use of vegetable oils in biofuels. In particular, I will be focusing on the impact it will have on the Indonesian economy and how it is creating a stumbling block to EU-Indonesia FTA negotiations. It is also worth investigating the plausible solutions to create a win-win situation for both the EU and Indonesia.

Palm oil: a politically controversial commodity

The sixth round of FTA negotiations between the European Union (EU) and Indonesia was held from 15-19 October 2018 in Palembang, Indonesia. Unlike the second, third and fourth round of negotiations, palm oil and sustainability issues were not mentioned in the report of the fifth round of negotiations, with the sixth not yet released. This might have been attributed to the controversies which are currently circulating around palm oil, with the EU planning to phase out the use of palm oil in biofuels. Under the revised RED agreement by the EU Commission, food-based biofuels are capped at 3.8 percent. The phasing out of the use of palm oil in biofuels is merely exacerbating the tension that is already present in the FTA negotiations. Environmental issues such as deforestation and pollution also act as a major stumbling block in these negotiations, with other aspects such as concerns over human and local indigenous people's rights occasionally entering the limelight. Non-governmental organisations (NGOs) including the World-Wide Fund for Nature (WWF), Greenpeace and Friends of the Earth (FoE) have been stepping up on their campaign efforts in an attempt to boycott palm oil. Apart from the NGOs, political actors including the Greens and the European Free Alliance (EFA) in the European Parliament have also been actively voicing their concerns regarding the use of vegetable oils in biofuels.

Despite this, the major point of contestation concerning palm oil production is arguably pollution, manifested in the form of an annual haze in Southeast Asia, which is caused predominantly by the burning of forests in Indonesia. Due to its tangible nature, as the haze could be seen and smelt by large swathes of the population, pollution is often cited

² Obidzinski, K., Andriani, R., Komarudin, H., & Andrianto, A. (2012). Environmental and Social Impacts of Oil Palm Plantations and their Implications for Biofuel Production in Indonesia. *Ecology and Society*, 17(1).

as the main reason why the production of palm oil needs to be curbed, not just in biofuels, but also in everyday household goods and cosmetic products.

For the Indonesians, the EU's decision to stop the imports of palm oil is more than a mere loss of a profitable market. To them, it is a form of trade boycott and protectionist measure. Often, palm oil is naturally associated with Indonesia, since, together with Malaysia, it produces close to 85 per cent of the world's palm oil³. As of 2016, Indonesia produces 36,000,000 metric tons of palm oil⁴, taking the place of the world's main palm oil producing country. The EU palm oil market "accounts for 17 percent (4.37 million tonnes) of Indonesia's palm oil exports". In 2017, vehicles "burned 51 percent of all the palm oil used in Europe"⁵. With more than half of the palm oil imported into the EU used for biofuels, and another half used in food and cosmetics, the gradual phasing out of palm oil in biofuels is expected to hit the palm oil producing countries hard. This is especially the case for Indonesia, as the world's main palm oil exporter. This being the case, it is not surprising that the phasing out of crop-based biofuels is seen as a big loss to the Indonesian economy.

Together with palm oil, other crops such as soybean and rapeseed are also used in biofuels in Europe. Though less controversial than palm oil, these alternative crops make up a total market share of 80 percent⁶. For instance, soybean contributes 19 per cent, either directly or indirectly, to deforestation worldwide, with palm oil making up 8 per cent⁷. Due to the widespread amount of media attention placed on the deforestation issues related to palm oil, it has received a lot of backlash from various interest groups and NGOs⁸. The negative image attached to palm oil has resulted in it receiving a disproportionate amount of focus, diverting attention away from the equally negative environmental impact of livestock such as beef. For example, forest areas need to be first cleared to make way for pasture. On the other hand, palm oil is a highly efficient crop due to its high yield per hectare, requiring considerably less fertiliser and pesticide when compared to other crops like soy and rapeseed. It is also less expensive in terms of production costs. As a result, there exists an evident paradox of palm oil. While it is detrimental to the environment, palm oil is also the highest yielding amongst other oil-producing crops.

Finding the middle ground between development and environment

As a country that is still developing, a main priority of the Indonesian government is the economy. While poorer nations arguably consume less than the wealthy nations, and live more sustainably than them, the repercussion of development is such that the environment is often compromised. The 'grow first, clean up later' environmental strategy might have worked for the developed world in years gone by, however the same cannot be said for

³ European Palm Oil Alliance. (n.d.).

⁴ Indonesia-Investments. (2017, June 26).

⁵ EU motorists forced to burn more palm oil and rainforest to meet. (2018, June 7). Retrieved from <https://www.transportenvironment.org/news/eu-motorists-forced-burn-more-palm-oil-and-rainforest-meet-green-energy-targets---new-data>

⁶ Phase out vegetable oils biofuels by 2020, environment MEPs tell. (2017, March 9). Retrieved from <https://www.transportenvironment.org/press/phase-out-vegetable-oils-biofuels-2020-environment-meps-tell-commission>

⁷ Cuyper D, Geerken T, Gorissen L, Lust A, Peters G, Karstensen J, Prieler S, Fisher G, Hiznyik E and Van Velthuisen H. (2013) *The Impact of EU Consumption on Deforestation: Comprehensive Analysis of the Impact of EU Consumption on Deforestation*. Brussels: European Commission.

⁸ Armstrong, P. (2010, March 20). Greenpeace, Nestlé in battle over Kit Kat viral. Retrieved from <http://edition.cnn.com/2010/WORLD/asiapcf/03/19/indonesia.rainforests.orangutan.nestle/index.html>

the developing world today. Developing countries have to play by the international rules and norms created by the developed world. Today, in the face of global pressure brought about by climate change and global warming, such a strategy is no longer possible and is simply unimaginable without facing strong opposition from environmental and other interest groups.

The palm oil industry in Indonesia has a substantial percentage of smallholders, making it a source of livelihood and income for many. For instance, in 2008, smallholder plantations were responsible for the bulk of the palm oil production in Indonesia which make up more than 41 percent, producing "6.6 million tonnes of palm oil"⁹. This is also one of the reasons accounting for the difficulties in ensuring traceability amongst these smallholders, which lack the incentives to commit to considerably expensive sustainable palm oil efforts. At the same time, the industry is one of the areas where rural households receive the opportunity to improve on their socio-economic status¹⁰. It is estimated that the employment brought about the oil palm supply chain "could reach about 6 millions lives"¹¹ and possibly help to raise these people out of poverty.

The search for sustainable supply of commodities

According to the United Nations (UN) Department of Economic and Social Affairs' Population Division, while the growth of the world's population has slowed down somewhat in recent years, it is still projected to maintain its present upwards trend. This is demonstrated in the graph below¹². There are however variations within the population growth rates across different regions, with Africa expected to take up more than half of the projected growth in world population from now till 2050¹³, with Asia following closely behind. This is in stark contrast to Europe's projected growth rate.

⁹ World Growth. (2011). *The Economic Benefit of Palm Oil to Indonesia*. World Growth.

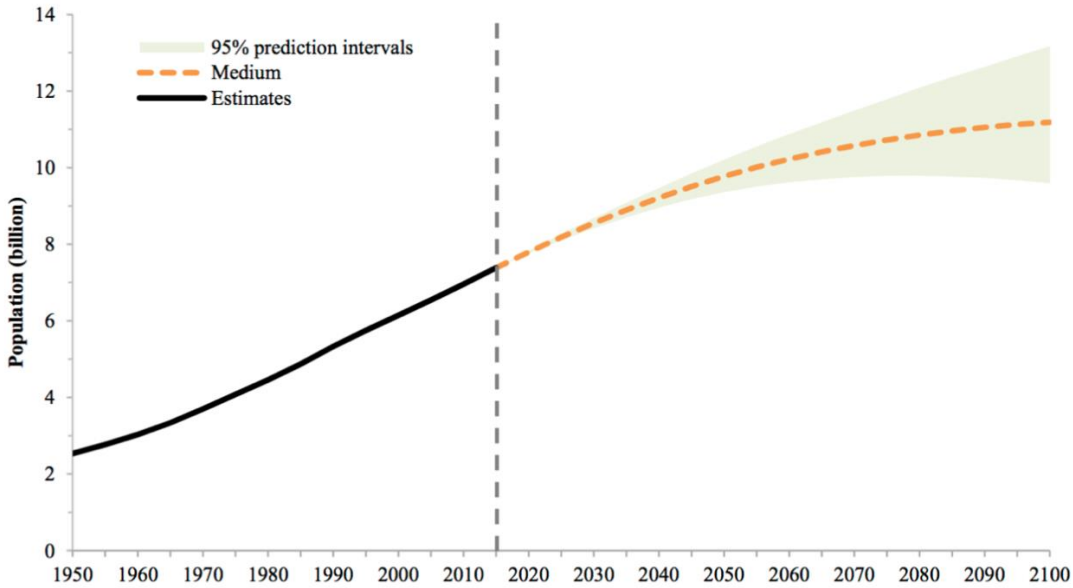
¹⁰ Development Solutions. (2018). *Sustainability Impact Assessment (SIA) in support of Free Trade Agreement (FTA) negotiations between the European Union and Republic of Indonesia*. European Commission.

¹¹ Goenadi, D. H. (2008). *Perspective on Indonesian Palm Oil Production, Paper presented on the International Food & Agricultural Trade Policy Council*. Bogor, Indonesia.

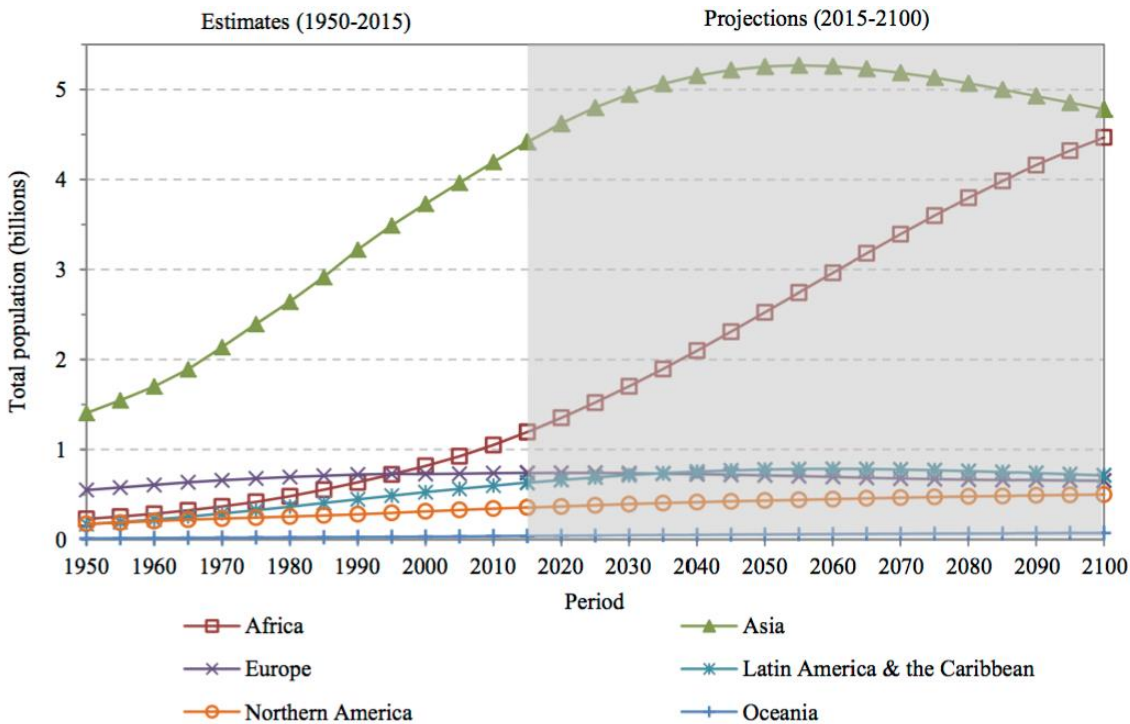
¹² United Nations, Department of Economic and Social Affairs, Population Division. (2017). *World Population Prospects: The 2017 Revision, Key Findings and Advance Tables*.

¹³ United Nations, Department of Economic and Social Affairs, Population Division, p. 2.

Graph 1: Population of the world: estimates, 1950-2015, and medium-variant projection with 95 per cent prediction intervals, 2015-2100¹⁴



Graph 2: Population by region: estimates, 1950-2015, and medium-variant projection, 2015-2100¹⁵



¹⁴United Nations, Department of Economic and Social Affairs, Population Division, p. 2.

¹⁵United Nations, Department of Economic and Social Affairs, Population Division, p. 3.

With the population growth in Asia and emerging markets like Africa projected to rise in the near future, when this is considered alongside the growth of the middle class in these regions, the global demand for (high-end) food products such as meat is expected to increase too. For a stabilised market like the EU where there is no significant rise in population or middle-class growth, restricting palm oil import to the EU is likely to have little effect in steering the world's consumption of fats. This being the case, it is arguable that the EU is looking in the wrong direction for achieving sustainable palm oil consumption. While the EU's efforts to pressurise palm oil producing companies to increase their production of sustainable palm oil should be maintained, it would also be of benefit to devote some of these efforts to the markets which are consuming palm oil the most. This also implies that the world's supply of fats, which include oils, will have to match rising global demand for these commodities. Thus, the issue at hand here is; whether to eventually phase out the use of palm oil even in household goods and products (besides biofuels) and replace it with other more reputable but equally or more environmentally damaging crops, or whether to put pressure on the whole industry with the aim of achieving sustainable palm oil altogether.

Sustainable certification system

From lipstick to spreads such as Nutella, a lot of household goods that we see on the supermarket shelves contain palm oil. It is almost impossible to fully eradicate the presence of palm oil in food or cosmetic products. Given the situation, rather than attempt to eliminate the presence of palm oil in our products through labelling campaigns, it may be worth considering to the reorientation of the industry as a whole.

The current prominent palm oil certification system founded in Malaysia, the Roundtable Sustainable Palm Oil (RSPO), is especially critical when determining whether businesses which purchase palm oil can receive an assurance that the palm oil is certified as sustainable. For these businesses, having a credible reputation is the key to garnering consumers' support and gaining a foothold in the EU market. The RSPO is a non-profit organisation that brings together stakeholders from seven sectors, including oil palm producers, "to develop and implement global standards for sustainable palm oil"¹⁶. It is worth noting that a distinction should be made between segregated sustainable palm oil and non-segregated palm oil. In order to qualify to use the RSPO trademark, it is necessary to be able to demonstrate that the type of palm oil used in the product "has been segregated throughout the supply chain and is traceable directly back to its RSPO-certified source"¹⁷. Unfortunately, at present, it appears that the food industry does not always have the capability to pay for segregated palm oil. Another consideration would be the risk of squeezing small-scale producers out of the market due to their inability to compete. Since it seems that palm oil is not going to be leaving anytime soon, the solution might not be to avert the whole palm oil industry altogether. Rather, resources could be pooled to encourage the creation of a more sustainable palm oil industry, and to push Indonesia and Malaysia to strive for high standards of quality certified sustainable palm oil. After all, the

¹⁶ About us. (n.d.). Retrieved from <https://rspo.org/about>

¹⁷ Scott-Thomas, C. (2015, June 02). Could Europe's drive to segregated palm oil exclude small producers?. *Food Navigator*. Retrieved from <https://www.foodnavigator.com/Article/2015/06/02/Could-Europe-s-drive-to-segregated-palm-oil-exclude-small-producers>

"EU currently accounts for over 70 percent of the sales of physically certified palm oil under the RSPO"¹⁸.

Of course, in reality, this requires a lot of intensive Research and Development (R&D) investment and effort. It is also a challenge to get smallholders committed to this push for greater sustainability, where costs represent a major obstacle. However, it is still of great importance to continue reaching out to these smallholders. They might be small landowners, but they are critical stakeholders. An example is the Small-Scale Funding Agreement (SSFA) signed between the United Nations Environment Project (UN Environment) and the RSPO, which "aims to support oil palm smallholder farmers toward improved livelihood and sustainable production"¹⁹.

Policy recommendations

For the Indonesian government, it might be wise to rethink the level of profitability of the palm oil industry. The negative externalities resulting from the forest fires are not small either. For instance, during the Southeast Asia haze in 2013, it was estimated that the Indonesian government spent around 475 trillion rupiah (41 billion USD) dealing with the problem.²⁰ Other than the financial costs incurred, health issues related to the haze such as respiratory problems are a continuing cause of concern. It might be the time for the government to reconsider the economic value of industry, especially if the occurrence of forest fires cannot be kept to a minimal. The bottom-line of this is, palm oil in itself is not a detrimental crop. However, the environmental, health, and economic implications that come with it are undesirable. Given that FTA negotiations are still ongoing, with the seventh round of negotiations to be held in Brussels next March, the EU and Indonesia should work together and see if there are other industries in Indonesia that are worth investing time in. Should such a major industry ever become part of history one day, there would have to be alternative industries so that Indonesia's development would not be hindered. These industries would also have to provide quality employment opportunities for Indonesians. Thus, it would definitely be in the best interest of the Indonesian government, under President Joko Widodo's leadership, to continue to work on the diversification of its exports. Looking ahead, the world can only accommodate palm oil if it is planted, grown, harvested and used sustainably. There is arguably room for negotiation in the EU with regards to palm oil only if palm oil practices are kept "green" and "clean", especially since almost half of palm oil imports are still used for food and cosmetic products and not just in biofuels.

Nonetheless, the decision makers in Brussels are urged to follow through the EU's commitments to the developing world in continuing to encourage the ongoing efforts towards the boosting of the sustainable palm oil industry. Any abrupt changes in bilateral trade relations are likely to dampen motivation. This is especially so since the EU is the

¹⁸ Why does the EU's recent Resolution on Palm Oil matter to ASEAN? (May 12). Retrieved from <http://www.siiainline.org/why-does-the-eus-recent-resolution-on-palm-oil-matter-to-asean/>

¹⁹ UN Environment Project and RSPO Commit to Improving Livelihood of Palm Oil Smallholders | Articles. (2017, November 16). Retrieved from <https://rspo.org/news-and-events/news/un-environment-project-and-rspo-commit-to-improving-livelihood-of-palm-oil-smallholders>

²⁰ Chan, F. (2016, January 19). \$47b? Indonesia counts costs of haze. *The Straits Times*. Retrieved from <https://www.straitstimes.com/asia/47b-indonesia-counts-costs-of-haze>

main market demanding sustainable palm oil. So long as the interested parties are in the game, palm oil producers will feel pressure to play according to the rules.

Keeping Indonesia on board in the rules-based international trading system is in the vested interest of the EU, something that would be guaranteed through the establishment of a formal trade agreement. It is also in Indonesia's interest to maintain this system. So long as the EU has bargaining chips with Indonesia such as an access to its market, it is difficult to see why Indonesia would give up on its endeavours to pursue an FTA with the EU. With that in mind, the EU should leverage this and try to steer Indonesia towards attaining the EU standards, a point from which they can aim to guarantee a fully clean and sustainable palm oil industry in the long-term. Given that the order has long been created and maintained, there are evidently no other viable options to take if Indonesia wants a slice of the EU market. This point arguably represents the greatest stake for the EU when considering attempts to bind Indonesia in to the rules-based, liberal international trading system.

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