

Invigorating The Indonesia–EU Partnership

Towards a Comprehensive
Economic Partnership Agreement

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Abbreviations

| | |
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| ACP | Africa, Caribbean and Pacific countries |
| ASEAN | Association of South East Asian Nations |
| BIT | Bilateral Investment Treaty |
| CEPA | Comprehensive Economic Partnership Agreement |
| DDA | Doha Development Agreement |
| ECAP | EU ASEAN Project on the Protection of IPR |
| EIB | European Investment Bank |
| EIBD | EU Indonesia Business Dialogue |
| EPA | Economic Partnership Agreement |
| EQI | Export Quality Infrastructure |
| FDI | Foreign Direct Investment |
| GATS | General Agreement on Trade in Services |
| GI | Geographical Indications |
| GSP | Generalized System of Preferences |
| IIGF | Indonesian Infrastructure Guarantee Fund |
| IPR | Intellectual Property Rights |
| MERCOSUR | Common Market Argentina, Brazil, Paraguay and Uruguay |
| MFN | Most Favored Nation |
| NTMs | Non Tariff Measures |
| PCA | Partnership and Cooperation Agreement |
| PPP | Public Private Partnership |
| REACH | Registration, Evaluation, Authorization & Restriction of Chemical substances |
| RoO | Rules of Origin |
| SPS | Sanitary and Phytosanitary measures |
| SVLK | Sistem Verifikasi Legalitas Kayu – Indonesia Timber legality System |
| TBT | Technical Barriers to Trade |
| TRIPS | Trade Related Intellectual Property Rights |
| UNECE | United Nations Economic Commission for Europe |



FOREWORD BY THE CO-CHAIRS



The history of the relations between Europe and Indonesia goes back several centuries and has been characterized by complementary aspects where natural resources abundant Indonesia provided the basic inputs to European countries in exchange for their capital and technology.

However, this stereotype of a North-South relation no longer reflects the reality of a world where demographic and economic growth has shifted to the East while the mature economies of the West are pursuing slower economic growth alongside bringing public finances under control.

Against this background, when the Indonesian President Susilo Bambang Yudhoyono met with the European

Commission President José Manuel Barroso in December 2009 they discussed ways of enhancing bilateral ties. The two Presidents agreed that the bilateral trade and investment relationship has great potential, and on the need to explore ways to strengthen these links. They therefore tasked a joint Vision Group to examine how to increase trade and investment between Indonesia and the EU.

For six months the Group worked in a truly joint fashion, openly discussing all of the issues relevant to the Indonesia -EU partnership including the potentially sensitive ones. The outcome of these discussions is included in this report and especially in the recommendations that have been submitted to political decision makers.

We believe that our joint Vision for invigorating the Indonesia -EU partnership, after being adequately discussed with the main stakeholders in both regions, should be promptly followed-up by the policy makers to contribute to ensuring economic growth and benefits to both partners in a globalised world.

Djisman Simandjuntak and Jacques Pelkmans

Co-chairs of the Vision Group to enhance trade and investment between Indonesia and the European Union.

TO THE READER

Indonesian President Susilo Bambang Yudhoyono and European Commission President José Manuel Barroso agreed in late 2009 to examine how commercial relations between the EU and Indonesia could be deepened. To carry forward their decision, they tasked a Vision Group of eminent persons from both Indonesia and the EU to produce recommendations on how to take relations to the next level. This is the Vision Group's final report to the two Presidents. It serves as a basis for public consultation and for defining parameters for possible future negotiations.

SUMMARY OF THE TERMS OF REFERENCE FOR THE VISION GROUP



President Susilo Bambang Yudhoyono met European Commission President José Manuel Barroso in December 2009 discussing ways of enhancing bilateral ties between Indonesia and the European Union: **The two leaders decided to set up a “Vision Group”** to examine how to increase trade and investment between the two partners. This Group consists of eminent persons including government officials, business and academia.

- **Business:** Chris Kanter (Vice Chair APINDO) and Maxi Gunawan (Head of Permanent Committee for International Institutional Cooperation Kadin)
- **Academic:** Djisman Simandjuntak (Executive Director of Prasetya Mulya Business School); Denni Puspa Purbasari (Economist – Gajah Mada University); Arianto A. Patunru (Head of the Institute of Economic Management of University of Indonesia)

The Specific Objectives of the Vision Group are:

- To provide a strategic view of EU-Indonesia trade and investment relations and identify on what basis EU-Indonesia trade and investment relationship can best be enhanced in an innovative way.
- To identify opportunities for fostering trade and investment between EU and Indonesia, bearing in mind the market characteristics and potential, evolution of bilateral flows and the challenges for realisation of this potential
- In this context, to explore the feasibility of an Economic Partnership Agreement and Free Trade Area between the EU and Indonesia.
- To provide recommendations to the Government of Indonesia, the EU, business community, and academia on how to realize this trade and investment potential

MEMBERS INDONESIA

- **Indonesian Government:** Muchtar (Head of R&D Department of Ministry of Trade); Agus Tjahajana Wirakusumah (Secretary General of Ministry of Industry); Martani Husseini, (DG Ministry of Fisheries); Achmad Kurniadi (Vice Chair, Investment Coordination Board BKPM); Zaenal Bachruddin (DG, Ministry of Agriculture)

MEMBERS EU

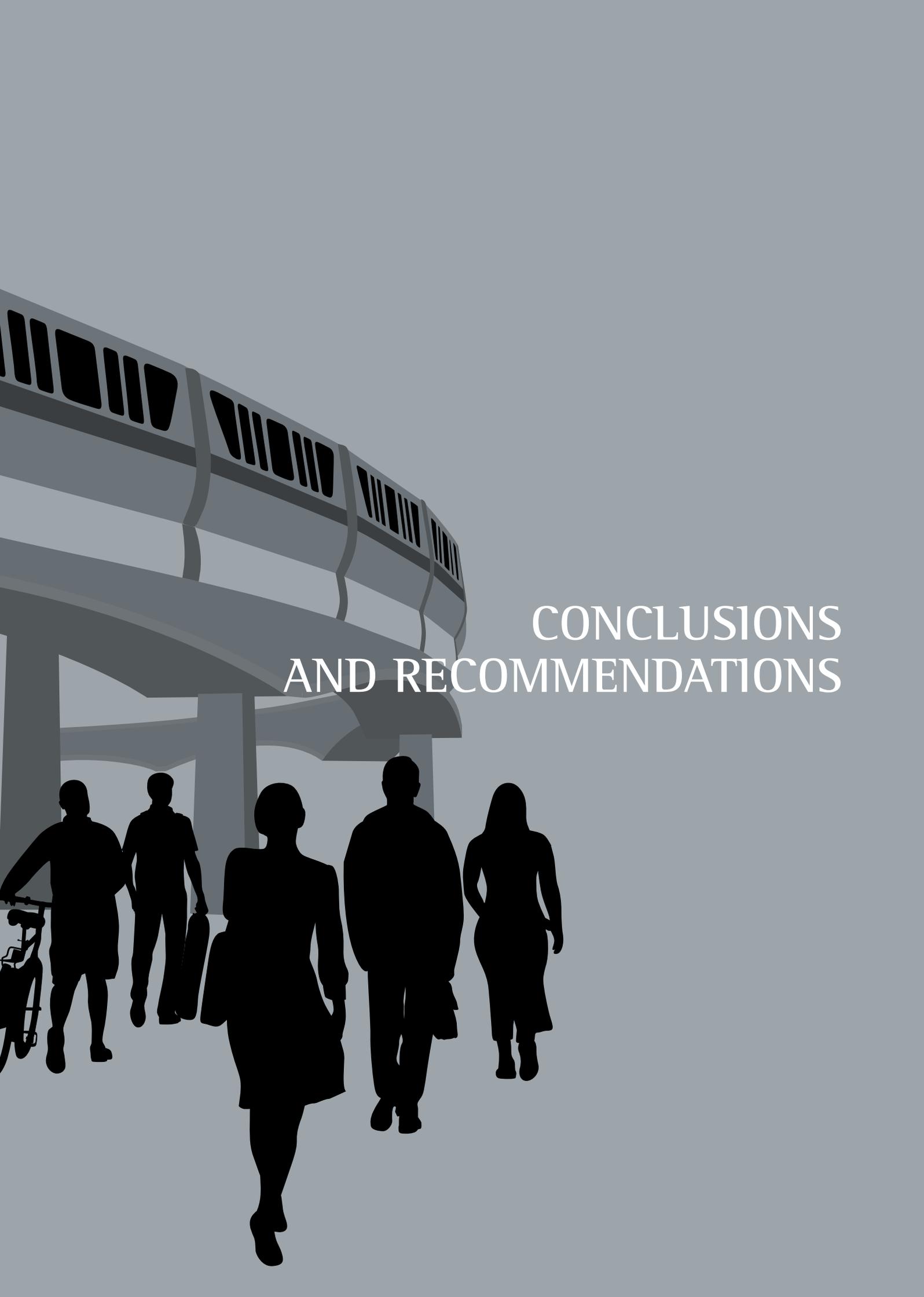
- **Government:** Lucian Cernat (European Commission/ DG Trade Chief Economist); Julian Wilson (Ambassador/ Head of Delegation EU Delegation in Jakarta); Laurent Lourdais (European Commission DG AGRI); Tadas Briedis (European Commission DG SANCO).
- **Business:** Erik Versavel (MD of ING Commercial Banking); Pascal Kerneis (Business Europe) and Jakob Sorensen (Maersk and chair of EuroCham)
- **Academic:** Prof. Jacques Pelkman (CEPS and College of Europe)

PROJECT GROUP JAKARTA

The Project Group provided technical and logistical support and comprised of Raffaele Quarto from DG Trade in Brussels; Walter van Hattum, Asa Larsson and Liis Elmik from the EU Delegation; Ibu Pradnya, Devy Panggabean and Nirwansyah from the Ministry of Trade and Terry Lacey and Raffaello Tarroni as supporting expert consultants.

The Vision Group presented its Recommendations to Indonesia’s Minister of Trade Mari Pangestu and European Commissioner for Trade Karel de Gucht in Jakarta on 4 May 2011.



The image features a light gray background with a stylized, modern transit structure on the left side. The structure consists of a curved, elevated walkway with a series of dark, rectangular openings along its length. Below this structure, several black silhouettes of people are walking towards the right. From left to right, there is a person with a bicycle, a person carrying a bag, a person in a dress, a person in a suit, and a person in a long dress. The overall aesthetic is clean and minimalist.

CONCLUSIONS AND RECOMMENDATIONS

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CONCLUSIONS

1. Relations between Indonesia and the EU are generally good and economic relations healthy. Nevertheless, the **status quo is unsatisfactory**, leads to underperformance and ever more missed opportunities for both partners in the longer run. Partners can profitably build on the recent deepening in their relations expressed in the Partnership and Cooperation Agreement.
2. However, as a strategic response to the dynamism of world business and active bilateral and regional economic diplomacy, an incremental approach will simply not do. Serving the long-run goals of open economic development and **sustainable growth** for the two partners requires a decisive new initiative.
3. Our Vision is that the **Indonesia-EU partnership has to be invigorated**, in the pursuit of the objectives of economic growth, job creation and poverty reduction.
4. Going for deeper economic relations between the EU and Indonesia, and with a wider scope, is the logical sequel of the steady stream of Indonesia's political, institutional and economic reforms. It is also most desirable for Indonesia achieving a sustainable high-growth path via much greater participation in global value-chains, with localized benefits for suppliers and the economy at large. It is equally a logical follow-up to the EU's trade policy since 2006, seeking 'deep' and ambitious economic partnerships with countries or regions having significant potential. The EU is rediscovering the new Indonesia with its large potential in terms of size, current and expected growth rates, the ongoing shift towards manufacturing exports, emerging services, increasing openness (especially vis-à-vis Asian partners) and macro-economic stability. For Indonesia, it is a strategic priority to invigorate its economic relations with the EU as its second largest export destination and the largest investor in the country. For Indonesia, the EU is promising as the biggest economy in the world, in terms of GDP, trade in goods and services, as well as incoming and outgoing stocks of FDI.
5. It is critical – especially for Indonesian decision-makers and stakeholders – to appreciate fully that a deep and invigorated economic relationship with the EU is not costly in the short-run. Quite the contrary, it will generate major economic benefits, quickly increasing over time with the shift to higher-value added goods and incoming direct investments. Indonesia and the EU are strongly complementary economies, which means that direct competitive rivalry in markets, where Indonesian domestic firms are active, will be rare or absent. Although adjustments in term of lesser growth or restructuring might occur in the short run in a few product-markets, most adjustments will consist of upgrading and internationalising, with better quality or newer product, hence, with highly positive results. The EU exports very different products to Indonesia than Indonesia to Europe. Indeed, in some sectors, this complementarity will be directly helpful to expand Indonesian exports based on components from EU companies and this is likely to be bolstered by EU investments building on Indonesian comparative advantages in the region as well as vis-à-vis Europe. Under this a new initiative, complementarity will

often be accentuated by the combination of trade and EU direct investments.

6. As a **guiding principle**, due consideration should be given to the different levels of development of the two partners. A deeper and wider partnership should therefore allow for flexibility. Another horizontal and crucial issue consists of sustainability and environment. Sustainability can, indeed should, be turned from an often negative perceived imposition into a promising and profitable opportunity. This is true both for exports and direct investments. For example, exports of sustainably produced timber and palm oil present enormous opportunities for Indonesia. Moreover, the greater the efforts at sustainability, the greater the benefits for EU investors and Indonesia.
7. It is also critical to **involve stakeholders** in the discussions on the new partnership possibilities at an early stage.

RECOMMENDATIONS

8. The Vision Group recommends the conclusion of an **ambitious bilateral agreement** between Indonesia and the EU.
9. This **Comprehensive Economic Partnership Agreement (CEPA)** should be based on a free trade area as the foundation in WTO terms, and have a triangular architecture: **market access, capacity building and facilitation of trade and investment**. The ambition of the CEPA would be present in all three elements. It is the complementarity and interaction, also over time, of these three elements which will engender the desirable development impact for Indonesia via higher-value-added exports and, at the same time, turn Indonesia into a more attractive market for EU goods and services as well as a promising investment location.
10. In terms of market access, it would consist of a **deep FTA**. This would imply access liberalisation in goods, services and direct investment, complemented by 'behind-the-border' commitments covering a range of sanitary and technical regulations issues based on internationally accepted requirements or standards where feasible. It should also include commitments on intellectual property rights protection and competition policy, taking note that Indonesia, as one of only few ASEAN countries, already having initiated such a policy. This should be linked with capacity building as well.
11. For the markets in goods, the Vision Group recommends a move to zero tariff for **95% of tariff lines with at least 95% of trade value** covered in a period of maximum 9 years. The time path ought to reflect fully the different levels of development of the partners: the EU would have a higher initial commitment and a faster dismantling period. A best-endeavour clause on the remaining 5% permits further progress in future. Safeguards and/or provisions on sensitive sectors may be incorporated. At the same time, credibility and ambition would be negatively affected if such provisions and their application would not remain truly exceptional and subject to objective criteria.
12. Market access for goods also depends critically on **overcoming or avoiding sanitary (SPS) and technical standards (TBT) issues and sometimes other non tariff measures (NTM)** such as onerous administrative requirements and excessive licensing. These questions should first of all be addressed on the basis of the WTO SPS and TBT Agreements, adhered to by both Indonesia and the EU. Where existing provisions would still be WTO inconsistent, the CEPA could be a first recourse to overcome it. On SPS and TBT questions, the three elements of the CEPA should be regarded as complementary, in particular capacity building.
13. For the purpose of the CEPA, **capacity building is defined as comprising three interactive levels**: (i) permanent dialogues, both business to business and business to government; (ii) technical dialogues and commitments, illustrated by proven examples in timber, fisheries and civil aviation; and (iii) financial cooperation to support tangible outcomes following suggestions from technical committees of the Joint Agreement. Under a CEPA, capacity building should go beyond the already existing, substantial efforts in a range of sectors. It is critical for effectiveness that capacity building is not merely output oriented (that is for example, that agreed efforts actually being undertaken to meet specific objectives), but outcome oriented (for example, that the capacity to comply with EU health, safety and environmental requirements is sufficiently improved for exports to reach the EU market). Capacity building efforts should therefore be measurable, and carefully targeted sectorally, for example on for SPS or TBT standards and subsequent results and regularly monitored in the Indonesia – EU dialogues.
14. **Combining facilitation and capacity building**, it is worth studying or otherwise considering how a more

systematic alignment between EU standards and conformity assessment systems and those of Indonesia can be achieved. In particular, the Vision Group recommends that the CEPA should identify priority sectors, every three years, where standards, testing, conformity assessment and accreditation can be aligned and propose solutions to facilitate improved access to both markets within a reasonable time-frame.

15. **For services, liberalisation would have to be Doha-plus in various ways.** The Vision Group recommends the binding of existing, actual liberalisation as a practical starting point. Beyond that, both partners should commit in a CEPA to certain levels of new openings in key services sectors so as to create new business opportunities. Liberalisation for services would naturally be linked with greater freedom to invest locally in services in Indonesia (whilst in the EU, given 'national treatment', Indonesian investment, which has now started, will find few obstacles).
16. The Vision Group recommends that the CEPA should include concrete measures to promote green components in EU-Indonesia trade and investment, while creating growth, value and jobs. This should result in the evolution of a competitive "green" business model which benefits both parties. This can be a platform for fighting climate change and protecting the environment. Capacity building and trade facilitation should be designed with sustainability objectives in mind.
17. Market access should include wide opportunities to invest locally. For Indonesia, EU business might invest in particular segments of the value chain, for re-export back to Europe. Perhaps an even greater win-win would result from improving market access for EU direct investment, using Indonesia as a production platform for sales to the wider ASEAN Economic Community. Given other emerging FTAs with the EU in the region, and given competitive conditions, greater market access would be a clear signal to EU investors to explore such win-win possibilities in Indonesia. Current EU FDI levels in Indonesia are relatively low. The CEPA should include measures and incentives to enhance the attractiveness of Indonesia for EU FDI and thus help increase EU FDI flows to Indonesia. Stimulated by the prospect of a CEPA, liberalization of restrictions on foreign ownership (equity caps), foreign business access and local content requirements – including public procurement – is expected and should stimulate increased FDI. This would be seen as an improvement of direct investment incentives by European business which, nowadays, often refrains from investing given stringent equity caps. Market access for direct investment (called pre-establishment in the EU) can be usefully complemented with investment protection (post-establishment). Today, Indonesia has agreed Bilateral Investment Treaties (BITs) with 17 EU countries. Given the EU Lisbon Treaty with new investment powers, the EU and Indonesia should aim to conclude, in the medium run, one single BIT to promote legal certainty for EU and Indonesian investors.
18. Effective market access is also determined by the IPR regimes of the two partners. Although IPRs are often crucial for the distinct competitive advantages of EU companies, given the EU's level of development. This is already applicable to some Indonesian companies. and will become more relevant in the future. With respect to Geographical Indications, Indonesia is interested in improving market access to the EU for a number of traditional quality food products by obtaining recognition as protected indications, thereby moving up the value added/quality level for its sales in Europe. Similarly the European GIs will seek a higher level of protection in Indonesia. More generally, IPR legislation in both EU and Indonesia is TRIPs consistent. The ambition of the CEPA would thus be to improve implementation and enforcement as well as to make the IPR-regime TRIPs-plus, where relevant. This should be addressed with the help of capacity building.
19. **Facilitation of trade and investment** should, in any event, build on current improvements in customs procedures and automation. Direct investment from EU companies can be profitably linked to infrastructure, public works in infrastructure and public/private partnerships (PPP). The European-Indonesian Business Dialogue has made joint proposals which we strongly support. We recommend their urgent follow-up to help lower the costs of logistics in Indonesia. European business has the funds, expertise/know-how and willingness to invest, based on such proposals. Effective facilitation of and investments in infrastructure linked to globalisation is vital for profitable incorporation of Indonesian and EU local establishments into global value-chains. In this way increased investment will interact much better with market access and capacity building. It will equally improve the competitiveness of Indonesian exports to the EU- especially in manufacturing - where internal and external competition is sharp on price and quality.

20. Furthermore, in order to increase the magnitude of the benefits of the proposed CEPA, on infrastructure development in Indonesia, the Vision Group recommends to future negotiators of the CEPA to discuss public procurement, notably in public infrastructure. The parties should agree on setting up transparency rules and the negotiation of additional levels of mutual access to the respective public markets.
21. It is recommended to open up possibilities for EU investors in **public works, especially in infrastructure and combined with public private partnerships (PPP)**, which are attractive for such investors. Poor infrastructure is a deterrent for FDI and the Vision Group therefore recommends to ensure the existing PPP model becomes fully functioning as soon as possible; the exact type and level of Government support (asset buy back, minimum revenue, expected commercial returns, etc.) needs to be identifiable in advance with clarity on risk/return parameters to attract foreign financial investors. We believe that the EIB can play an important role in this including possible support for the Indonesian Infrastructure Guarantee Fund (IIGF) where additional capital and capacity building are necessary. The Vision Group recommends that the one stop shop concept, as established in 2009, should be further improved - also in view of reducing the necessary licenses needed for investments - as a single point of contact for investors, both in Indonesia and EU Member States as a desirable example of facilitation.
22. **Capacity building** is already included in current EU-Indonesian cooperation and the recently signed PCA. We recommend a close coordination of programmes on the bottlenecks and capacity problems identified in this report, including specific SPS components such as laboratories, recognition, technical and administrative support to SMEs (for export purposes to the EU) including improvements to technical infrastructure for standardisation, testing, conformity assessment. The Vision Group recommends a broad range of mechanisms to set forth a process of capacity building that may eventually lead to mutual recognition. Rapid and careful follow-up will clearly require one or more and joint or technical committees under the CEPA. It will also be useful to involve EU business associations, linked with Indonesian business associations, since they are informed about EU requirements and customers' and consumer needs. Our report suggests building on existing efforts to improve Export Quality Infrastructure e.g. for fisheries and recommendations on energy and the 'green economy'.
23. The CEPA should have solid **'governance'** based on trust, friendship and rules. The specific follow-up of the CEPA treaty in its various areas of policy and capacity building requires permanent cooperation and consultation. Both partners should 'invest' in the proper working of the Agreement in this respect. Nevertheless, no matter how 'deep' economic relations are or will become, differences of opinion will emerge under any agreement anywhere in the world. The Indonesia-EU CEPA will be no different. Differences of opinion should not be allowed to simmer, let alone to turn into trade conflicts. Recent experience in timber shows that dialogue and concrete willingness to address issues, backed by technical cooperation, can work. The present dialogue on palm oil - the top Indonesian export product to the EU - and the EU RED directive should be pursued constructively. Dialogues and cooperation represent the spirit of working together which the Vision Group recommends. The CEPA should explicitly incorporate this idea. Firm dispute settlement, based on recognized international practice of today, should be included. Without that option the CEPA would lose credibility. However, given a credible dispute settlement, partners should nevertheless employ other mechanisms, including intense dialogue and technical cooperation, before resorting to dispute settlement.
24. The Vision Group recommends early consultation with stakeholders which is very important to generate strong and widely shared interest in a future CEPA and to craft political support for it among business people, government officials, politicians and civil society.
25. The Vision Group urges that prompt follow-up be given to its recommendations, notably that **socialisation/consultation will start immediately, as well as scoping (pre-negotiation consultations)** in accordance with prevailing procedures in respective parties. Indonesia and the EU should strive for the (announcement of) negotiations to commence soonest.
26. Once negotiations are launched, the Vision Group underlines that, the ambition and credibility of this **new and innovative initiative requires political determination to finish the negotiations rapidly, preferably within two years.**



ANALYSIS AND FINDINGS



Our Vision:

Invigorating the Indonesia–EU Economic Partnership



Relations between Indonesia and the EU are generally good and economic relations are healthy. There are nevertheless qualitative and measurable indications that the status quo is sub-optimal for both partners: in the last few years it has become increasingly clear that this status quo has led to underperformance in terms of mutual benefits and therefore can be improved for the future. A strategic reflection with respect to medium and long run policies of both Indonesia and the EU indicates that the status quo is at best lacking in ambition and fails to exploit the significant potential for further economic development.

We live in a dynamic world economy in which global companies, as well as countries or regional groupings, are continuously seeking new opportunities. Companies do this, among other ways, by re-arranging value-chains and the locations of their constituent components, and by acting on the rapid changes in market access and FDI prompted by the persistent impact of unilateral, bilateral and regional opening up of economies all over the world.

The EU-Indonesian relationship has adapted to this dynamic world to some degree in recent years, both bilaterally and via EU-ASEAN relations. The subsequent deepening of relations is supported by the EU's Generalized System of Preferences (GSP), and unilateral (applied) tariff reductions by Indonesia alongside its domestic reforms. We can profitably build on this deepening of trade relations, including on the Partnership & Cooperation Agreement (PCA), signed in 2009 and currently being ratified.

However, as a policy response to the dynamism of world business and international economic diplomacy, what has been done so far is insufficient. Serving the long run goals of economic development and sustainable growth for the two partners will require a more decisive, non-incremental initiative. **Our Vision is that the Indonesia–EU economic partnership has to be invigorated.**

An ambitious deepening of economic relations between the EU and Indonesia, whilst making them more encompassing, is also the logical sequel to the steady stream of profound political, institutional and economic reforms that Indonesia has undertaken since the late 1990s. It is also a logical follow-up to the EU's new trade policy since 2006, seeking 'deep' and ambitious economic partnerships with countries or groups having significant potential.

This report identifies how a new comprehensive agreement can build on what has been achieved so far and what its component parts should be. Since the Vision Group wants to be concrete in its delivery, the report suggests many specific components, without going so far as to pre-judge the eventual bilateral negotiations which political leaders may well decide to open.

Rationales for an Ambitious New Economic Partnership



Both Indonesia and the EU favour a finalisation of the Doha Round. Even so, the EU and Indonesia believe that active bilateral and regional economic agreements are an unavoidable necessity while the Doha Round is uncompleted. Every concluded FTA or Comprehensive Economic Partnership Agreement (CEPA) is likely to induce, in turn, one or more new FTAs with other trading partners in response to the first one.

This highly dynamic process alters market access and opportunities all the time. It has grown into a decentralized alternative to the Doha Round. For Indonesia and the EU, taking no initiative to team up for their mutual benefit is therefore a potentially costly option. After all, 'doing nothing' does not mean that market access and other opportunities will remain the same: they cannot as other countries and groups are signing new FTAs and CEPAs. The costs of such inertia increase over time as bilateral market shares in goods and services are likely to decline as

a result of the newly emerging bilateral status quo amidst continuous FTA activity by other trading nations or groups.

This then leaves the choice between a relatively unambitious, "shallow" FTA as a defensive response and a much deeper and more encompassing CEPA (Comprehensive Economic Partnership Agreement, a kind of FTA-plus-plus) as an offensive strategy. This constitutes the first rationale for a CEPA.

A second powerful rationale for a comprehensive agreement between Indonesia and the EU is also found in the recent internal and external economic policies of the two partners, irrespective of the economic diplomacy initiatives of other trading nations and groups. Having suffered from a deep negative growth in 1998 following the Asian financial crisis of 1997-1998, Indonesia engaged subsequently in comprehensive domestic reforms and returned, to relatively high growth rates in recent years



reaching almost 7% in the last quarter of 2010. External trade also expanded at an accelerating rate despite the 2008–2009 global crisis. This improvement in economic performance is remarkable given the background of a complex political transition to a much decentralized democratic political system.

Aware of the need to catch up with more developed neighbors in Asia, accelerating development is a very important priority for Indonesia's policy making. The government has made great efforts in recent years to de-bottleneck infrastructural development, alongside bureaucratic reform to mitigate or even remove inertia and to mobilize support for new economic development corridors. Assuming some success in bureaucratic reform, the average medium-term growth rate in Indonesia can rise to more than 7%. External trade and foreign investment are bound to benefit from such an acceleration and facilitation of development.

Boosting trade with the EU and investments by European companies (now one of largest traders and investors) plays an important element in Indonesia's development

strategy to maintain a balance in external economic relations as well as to access job-creating investments, technologies, and corporate governance and management practices.

The European Union trade policy strategy is summarized in its (2010) "*Trade, growth and World affairs*" communication, updating and refining its 2006 strategy 'Global Europe'. The EU has a long tradition of open markets, both internally to the EU via the single market as well as externally via multilateralism, regional and bilateral agreements and unilateral trade policies (such as the GSP¹). The only exception is temperate-zone agricultural products, but even in this segment, regional and bilateral agreements have increasingly 'softened' access in this area and this process might well continue, be it slowly, given the various FTAs being negotiated. For Indonesia, this exception seems anyway to be of marginal relevance.

The EU has practiced (ever since the 1957 Rome treaty) "national treatment" for incoming FDI. For services, it is

¹ As well as EBA, the Everything-But-Arms unilateral zero tariffs initiative for the 48 least developed countries.

also far more open (and committed) than the GATS has been able to accomplish until today. The EU regards market access and a solid anchoring into 'globalized value chains' via IPRs, investment liberalisation and legal certainty for its businesses as crucial for its long-run economic growth rate.

The 2010 strategy says: *"We should make good use of fast-growing regional trade in East Asia and pursue our strategic economic interests in that region, inter alia, by linking into the rapidly growing network of free trade areas ...We will therefore seek to expand and conclude bilateral negotiations with ASEAN countries, beginning with Malaysia and Vietnam, and to deepen our trade and investment relations with the Far East"*². A new ambition in terms of the proposed Indonesia-EU CEPA fits exactly to this strategy.

Third, a simple and static simulation model for bilateral liberalisation in goods and services shows positive economic gains for both economies. The positive growth impact of a comprehensive agreement is further enhanced by facilitation of investment in the form of FDI and even more as capacity building and complementary facilitation measures improve the capability of Indonesia to exploit these mutual market openings:

Given a simple static simulation, results show that: (a) immediate bilateral tariff elimination would increase Indonesian and EU welfare modestly – for Indonesia by 0.1 % of GDP, for the EU less; (b) only a limited number of sectors in Indonesia might risk some adjustment pressure and the likely causes of lack of competitiveness point to limited availability of technology, lack of capacity and inadequate infrastructure – all of which suggests a strong case for enhanced economic cooperation with the EU to help increase competitiveness

However, given a dynamic simulation that better reflects realistic potential impact of a comprehensive agreement, with FDI coming into Indonesia helping local capital accumulation, the results then show: (a) that long-run gains would be 1.3 % of GDP for Indonesia (some € 6.3 billion in 2010 GDP terms); (b) that Indonesian exports would increase by US\$ 9.8 billion in the longer run, especially for light industries and transport equipment, and that the Indonesian trade balance would increase by some US\$ 2 billion ; (e) the overall rise in Indonesian wages

would amount to 1.5%, with a positive impact on poverty alleviation as well³.

Yet larger gains could be reaped if the Indonesian economy can be stimulated by opportunities and incoming FDI, accompanied by expected improvements in infrastructure, allowing Indonesia to benefit from its dynamic comparative advantages and from higher value-added locally to support sustained higher incomes per capita. Even though the EU today is Indonesia's second largest source of investment, it still represents only 1.6% of EU investment in Asia. Clearly would conditions permit the investment levels from the EU could be far greater as European companies would favorably consider Indonesia more often (than they do today) when setting up or re-arranging parts of their value chains in Asia.

Fourth, an additional attraction of an "invigorating" of the Indonesian-EU economic relationship is that the complementarity between EU and Indonesia is rooted deeply in differences in physical endowments and resources, and demographics. This fundamental complementarity facilitates that the benefits of a CEPA be shared more equitably and lessens the probability of disruptive trade imbalances arising, as may have been seen with other agreements signed by Indonesia recently. Moreover, the economic complementarities of the partners have the effect of significantly reducing – or, in many sectors, avoiding – adjustment costs falling on workers or SMEs. Although from an economy-wide point of view such adjustments can be justified as a necessary (but temporary) cost incurred when seizing new opportunities by both sides, the actual benefit/cost ratios envisaged given the complementarity of the partner economies is likely to be far more favorable.

CEPA-stimulated FDI inflows from the EU are likely to be directed in the short-run at tapping existing complementarities more fully. However, they will also help diversify Indonesia's industries and exports, producing higher value-added and improved technology in Indonesia's key sectors as competencies improve among Indonesian workers and business people and the investment policy environment continues to improve.

² See COM (2010) 612 of 9 November 2010, Trade, Growth and World Affairs, p. 10

³ See annex 2 for a more detailed analysis

The Starting Conditions:

General Features



The existing EU and Indonesia alliance is extensive and important for both. A thriving economic partnership is paving the way for a closer political relationship to the benefit of future generations of Europeans and Indonesians. Political relations span from election observation, human rights and inter-faith dialogues to support in conflict resolution such in the case of the Aceh peace process. . People to people contacts are at an all time high. More than a million citizens travel between Indonesia and the EU each year. The EU provides 1000 grants per year to Indonesian students to study at European universities. Thanks to the Partnership and Cooperation Agreement, the EU and Indonesia have started cooperating in new areas of importance such as counter-terrorism and research and technology. Under the initiative on development through trade and investment, the EU and Indonesia mutually benefit from rapidly developing commercial ties.

The EU is Indonesia's second largest foreign investor. Over 700 EU companies are operating in Indonesia, providing directly more than 500,000 jobs, and indirectly an income to many more. The EU is Indonesia's second largest export market in goods with a value of € 14 billion in 2010. EU and Member States provide over € 700 million annually to Indonesia across diverse areas that are vital for future

prosperity such as education, health, trade and development sustainability.

The relations between EU as a developed economy and Indonesia as an emerging economy are strongly complementary in nature, thanks to different resources endowment, per capita incomes and wealth, and per capita stock of intangible capital. Indonesia's exports to the EU in 2010 consisted mainly of primary products (mostly palm oil and mining), some manufactures (including electronic and electrical goods) and textiles. On the other hand, EU exports to Indonesia were mainly manufactures: in particular in machineries, chemical products and transportation equipment (aircraft and ships).

Trade complementarity is also found in services and reinforced by the EU's direct investment in Indonesia. There may be some similarity in some categories, but the current complementary structure of trade between Indonesia and EU is one feature which is very promising from the standpoint of sharing the short-term benefits of a CEPA equitably.

Complementarity is not the whole story about bilateral relations. Shifts are in fact expected to occur under a CEPA in that strengthened foreign direct investment, capacity

building and facilitation would allow Indonesian business to move up the ladder to higher skill-intensive and knowledge-intensive products. Such shifts would make the EU-Indonesia relations more similar to trade among developed countries which is very largely intra-industry in nature. Nevertheless, high complementarity would ensure that CEPA would produce balanced outcomes in the short-run that would be conducive to longer-term restructuring while keeping adjustment costs low.

Trade in the real world is suppressed by a multitude of factors of which trade and investment barriers are of particular relevance to a CEPA. Fortunately, the last decades have witnessed rapid reduction of border barriers to trade in both Indonesia and EU. Through unilateral initiatives Indonesia has cut the level of tariff rates and restrictiveness of non-tariff barriers and restrictions on foreign direct investment to a low level. Moreover, about 58% of export of industrial products from Indonesia to the EU zero-duty under the GSP. On the other hand applied tariff rates on Indonesia's imports from the EU have fallen to a low level, partly because of the fact that Indonesia's imports from the EU consist largely of capital goods.

Non-tariff measures constitute a more challenging task for the CEPA. The more daunting task relates, particularly Technical Barriers to Trade (TBTs) and SPS. Many Indonesian products are perceived to have been unsuccessful to enter the EU markets because of failure to conform to regulatory requirements on health, safety or environment. Of the innovative elements expected from the CEPA, capacity building to raise the capability of Indonesian producers like farmers (including small, medium and large palm oil planters) fishermen, and furniture firms to comply with European standards is one of the most important features of a CEPA. Backed by financial support, such capacity building could lead to substantial trade expansion with associated positive impacts on poverty alleviation.

Direct investment is a very important component of EU-Indonesia relations. Currently this mostly concerns EU investment in Indonesia while the reverse flow remains limited in size and highly fluctuating in nature. The overall trend in Indonesia's investment policy has been toward greater openness. However, some aspects still seem unnecessarily restrictive and worrying in terms of reduced legal protection of investors' rights, such as restrictions on equity participation, considering the crucial importance of direct investment to the generation of dynamic effects to help propel the Indonesian economy up the development ladder,

the CEPA should include improvements in the investment climate. . With an improved environment business-to-business dialogue and other interactions as proposed under the auspices of the European Indonesia Business Dialogue would likely produce progressive growth in trade in goods and services and in direct investment flows.

Economic relations between the EU and Indonesia go far beyond trade in goods, services and commercial investments. Under the PCA and other schemes cooperation between Indonesia and EU extends to areas as diverse as competition, intellectual property rights, and sustainable development. A CEPA provides a good opportunity to strengthen cooperation in these and other areas.

The network of bilateral, sub-regional and interregional cooperation and trade agreements involving either Indonesia or the EU makes up another important factor in the EU-Indonesia relations. The EU is still evolving in terms of geographical coverage. It has deep agreements with several countries in Europe, including a Custom Union with Turkey. The EU grants preferential access under the GSP to developing countries, including quota and tariff free access to least developed countries under the 'Everything But Arms' deal. In addition, preferential access is provided for goods originating in the Africa, Caribbean and Pacific (ACP) countries under the Economic Partnership Agreements (EPAs). More recently, the EU has either concluded or is negotiating commercial FTAs with Chile, Mexico, and MERCOSUR. Under the Global Europe Strategy an FTA has been finalized with the Republic of Korea and negotiations concluded with Peru and Colombia. Negotiations with Singapore, Malaysia, India and Canada are well advanced. Likewise, the network of preferential agreements already involving Indonesia has expanded. ASEAN is evolving into an Economic Community. Through ASEAN, Indonesia's FTA links have expanded to Korea, China, Japan, India, Australia and New Zealand. Preferential agreements are also being explored with Turkey, Pakistan, Iran and others.

To summarize, the initial conditions facing Indonesia and EU are very promising for a successful CEPA. An architecture that includes innovative elements can produce substantial positive effects on economic diversification and output, employment, investment and poverty alleviation. It is also very important to keep in mind that, in the absence of a CEPA, both the EU and Indonesia will be negatively affected by trade and investment diversion arising from FTAs between the EU and Indonesia with other countries.

Architecture of the CEPA



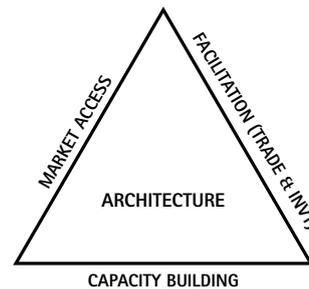
The Vision Group envisions an evolution in trade and investments which positively interacts with accelerating development, especially through value creation in more advanced goods and services sectors. In turn, this is expected to lead to poverty reduction and job creation, while pursuing a sustainable environment for both parties.

The Vision Group has endeavored to provide a “comprehensive” view on all aspects of the EU Indonesia economic relationship, given that the economies of the respective partners are complementary, not just in the sense that they are “not competing” but also that each side has “unique selling points” which can and should benefit the other.

This implies we do not just talk about tariffs and other barriers to market access, including direct investments, but also about infrastructure development, public private partnerships, possibly increased roles for export credit agencies and local content requirements. “Comprehensive” means too that efforts are required to more deeply engage European businesses with Indonesia. Both the layout of this report and the proposed architecture of the CEPA reflect this approach.

The basic architecture of an innovative Comprehensive Economic Partnership Agreement is constructed like a pyramid based on three main pillars

1. Market access
2. Facilitation of trade and investment
3. Capacity building



The CEPA has to be a comprehensive and integrated agreement promoting trade and direct investment as part of an overall relationship as incorporated in the PCA between Indonesia and the EU.

Moreover, the Vision Group recognizes the difference between the EU as a developed economy and Indonesia as an emerging economy. It therefore recommends that the different stages of development are reflected in all elements of CEPA.

This requires a new style of agreement incorporating the traditional provisions covering trade in goods and trade in services alongside far greater emphasis on newer components in such agreements designed to facilitate inward investment generating value-added for the economy through:

- The promotion of increased private sector participation in services and non-services sectors.
- Improved protection and implementation of intellectual property rights.
- A fundamental shift towards sustainable development backed by the capacity building needed to make it work.

Given the considerable progress already achieved by Indonesia and the EU on tariff reductions and liberalisation of trade, now is the right time and context for an

innovative agreement to bring momentum to Indonesian plans to strengthen and diversify its economy - using a trade and economic cooperation agreement to boost its competitiveness and investment climate.

To ensure maximum benefits from a comprehensive agreement between the EU and Indonesia, capacity building and trade facilitation are the primary vehicles to optimise market access whilst improving the operating and investment climate, building on the recently improved investment performance of Indonesia. The EU and Indonesia have already taken capacity building to a new level by developing a strong model to ensure opportunities for Indonesia are seized and hurdles encountered in penetrating the EU market are removed. This is articulated in three key areas:

1. **Dialogues to identify opportunities and remove hurdles.** Examples of this are the EU Indonesia Business Dialogue (EIBD) that allows business representatives from both partners to meet, network and discuss policy with the EU and Indonesian government. There are also regular government to government meetings where these issues are discussed. A key innovation here is that business to business dialogues directly influence resource allocation and have direct access to policy makers to communicate their needs.
2. **Technical Cooperation.** Technical bodies and institutions involved in the regulatory process are brought together to identify specific actions that will help realise opportunities or remove hurdles. Examples of this have been dialogues on fisheries to help ensure Indonesia's exports to the EU meet regulatory SPS requirements. Also agreements on air safety where technical dialogue has helped ensure Indonesian carriers can continue to fly into Europe.
3. **Financial Cooperation.** Financial support is provided by the EU to help address particular areas that come up in the dialogues or technical committees, ensuring that Indonesia can take advantage of opportunities in EU. At present, the EU is providing over €50 million to help Indonesia meet international export requirement or standards and to improve its competitiveness through the sustainability of production methods.

The comprehensive and ambitious concept behind the CEPA is based on the recognition of three trends and economic realities:

1. Increased cross-border flows of goods, services, capital, technology and people have diminished the importance of traditional trade measures, since great progress on liberalisation has already been made.
2. Drastic reduction in the costs of transportation and telecommunication technologies stimulates economic progress, nationally as well as internationally, in economic exchanges and over value chains. Economic development is increasingly market-led by consumers and the private sector and the task of governments is to help to adapt regulations to facilitate these newly liberated economic energies.
3. The short term context is a system of asymmetric economic relations between more developed economies and economies in transition leading in the medium term to a far more balanced global economic system with Indonesia playing a leading role as an emerging global economic hub based in Asia, and with Asia providing a major impetus for global economic growth.

Given these dramatic changes, the capacity of the Indonesian economy to exploit its comparative regional and global strategic advantage depends upon the rate at which economic growth could be sustained by the mobilisation of resources to improve production quality, services and standards. This is necessary in order to make good use of the economic opportunities afforded by a much deeper economic cooperation and trade agreement with the EU.

The following chapters cover the main areas to be included in the agreement starting with market access in goods, services and investment but looking also at public procurement, Intellectual Property Rights and competition. The Vision Group also discussed extensively some of the priority sectors for Indonesia and the EU, which have been included in annex 1.

Market Access in Goods



Nowadays, in trade relations – even between developed and developing countries – tariffs are not the important challenge. Effective market access means meeting all the technical and sanitary related regulations, to ensure access goes beyond so called ‘naked access’ at borders but amounts to effective market access including provisions covering TBTs, SPS and NTMs.

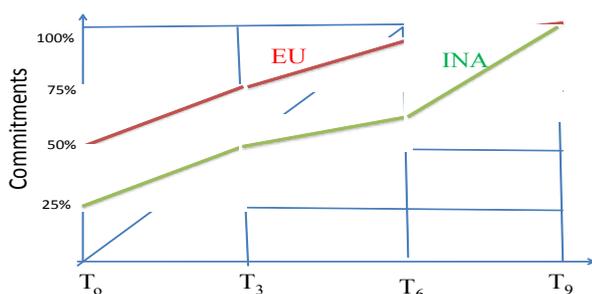
5.1 TARIFFS

The scope for tariff reductions in an EU-Indonesian bilateral context is limited by the existing level of tariff liberalization especially within the frameworks of WTO and ASEAN.

A simple comparative analysis of tariff lines shows that those are already relatively low. The simple average of MFN tariff applied, is 5.3% for the EU (2009) and 6.9% for Indonesia (2007) The Vision Group therefore recommends a move to zero tariffs for 95% of tariff lines (covering at least 95% of trade value) in a period of maximum 9 years. A best-endeavour clause on the remaining 5% should permit further progress.

Moreover, the Vision Group recognises that in an asymmetrical relationship the speed of implementation of tariff reductions takes into account the different levels of development. Still, as 60% of the tariff lines of the two parties are between 0 and 5% and 20% are already at zero, gains from tariff measures would be expected to be small. However, the positive impacts from simply dismantling tariffs cannot take into account the dynamic gains to be generated from, for example, increased investment, the liberalisation of services and the dismantling of non-tariff barriers.

Below, an example is given of how an asymmetric tariff liberalisation could be implemented. Legend: T=time in years; Commitments: % of tariff removed



Different speeds should apply to different products of different “sensitivities”. The least sensitive ones should be liberalised faster with the greater parts of commitment implemented at the time of entry into force of the agreement. The most sensitive ones could be liberalised more slowly. This approach should be adopted to give enough time to Indonesia to improve its preparedness for market opening, allowing for a higher likelihood that the benefits from the EU-Indonesia CEPA will be shared more evenly.

Finally, safeguards and provisions on sensitive sectors may be incorporated. At the same time, credibility and ambition would be negatively affected if such provisions and their application would not remain truly exceptional and subject to objective criteria.

5.2. TBTs AND NTMS

Market access for goods depends critically on overcoming or avoiding sanitary (SPS) and technical standards (TBT) issues and sometimes other non tariff measures (NTMs) such as onerous administrative requirements and excessive licensing. TBTs are technical regulations, standards, conformity assessment procedures and similar regulatory requirements (e.g. inspections, approvals) that might restrict trade. NTMs are a broader concept encompassing all barriers to trade other than tariffs and arise in many different forms (quotas, custom procedures, etc). The costs created by TBTs and SPS are a high burden, particularly for SMEs. Overcoming their negative side effects therefore becomes necessary.

Key instruments in the TBT field supported by the Vision Group are:

- » Promotion and enhanced effectiveness of technical assistance in the TBT area.
- » Greater harmonisation of technical regulations, standards and conformity assessment procedures, notably through greater use of international standards.
- » Pursuit of good regulatory practices to promote less onerous and burdensome technical requirements, including in the field of conformity assessment.
- » Enhanced implementation of TBT transparency provisions with a view to ensuring that WTO

Members have an effective opportunity to comment on regulatory initiatives by their trading partners.

The EU pursues a range of bilateral and regional initiatives aiming to reduce TBTs. These initiatives include regulatory cooperation (to make regulatory systems more compatible) and the provision of technical assistance for developing countries. The EU is supporting Indonesia in upgrading its conformity assessment and testing framework with a view of upgrading export quality infrastructure in selected sectors. This support has been ongoing since 2005 under the Trade Support Programmes.

The WTO SPS and TBT Agreements adhered to by both Indonesia and the EU should form the basis for tackling these issues. Where existing provisions would still be WTO inconsistent, the CEPA could be a first recourse to overcome the resulting problems. On SPS and TBT questions, the three elements of the CEPA should be regarded as complementary, in particular capacity building. **Concrete recommendations include:**

- » Indonesia and the EU should develop co-operation, capacity building, and conduct consultations in the field of technical regulations, standards and conformity assessment procedures in order to ensure effective and least-cost adaptation of regulatory frameworks. Such cooperation, capacity building, and consultations should include the participation of private business (see chapter 9 on cooperation)
- » A new step in the evolving relationship between Indonesia and the EU should be to establish a framework for joint efforts to ensure that technical regulations do not create unnecessary obstacles to trade and to strive to facilitate mutual recognition in the most appropriate and cost-effective manner. Methodology should be effective and transparent and based upon identified steps, milestones, and joint monitoring and reviews of outputs, outcomes, and impacts. In particular, “outcomes” reflects the capacity to meet the requirements for market access. Thus, implementation should take the form of a series of tangible improvements such as, at each stage, streamlined procedures with an increased scope for mutual recognition of laboratories, testing facilities and certification processes. This would lead to increased transfer of testing and certification functions from the EU to Indonesian institutions

within mutually agreed regulatory frameworks and reduced cost of the use of export quality infrastructure (EQI) for the private sector.

- » The scope and quality of joint dialogue under a future framework agreement should be such that any perceived shortcomings in compliance should lead to further dialogue where explanations can be sought and solutions identified. (See chapter 13). The same conceptual approach and procedural steps can be applied in respect of SPS and NTMs, so that the partners would rely upon the strength and effectiveness of their joint framework for dialogue to address outstanding issues and take mutually constructive steps to help resolving them.
- » The resolution of issues in relation to NTMs and TBTs should take priority in critical sectors such as fisheries, palm oil, wood products and furniture, agro-products and processed food.
- » Indonesia and the EU should cooperate, with the participation of their respective industries, to further enhance competitiveness, and to build the downstream industries of priority sectors including cocoa and oil palm (see annex 1).

5.3. SPS – SANITARY AND PHYTO-SANITARY MEASURES

The EU and Indonesia agree that the application of sanitary and phytosanitary measures should aim to protect human, animal or plant life or health in the territories of the EU and Indonesia. Moreover, both sides need to find ways to facilitate access to each party’s markets, while respecting legitimate objectives to safeguard human, animal and plant health. The two partners should aim to prevent and eliminate barriers to trade by improving transparency and bringing certainty and consistency to the application of SPS measures.

The EU and Indonesia should in particular seek to achieve transparency as regards sanitary and phytosanitary measures applicable to trade, working towards the establishment of mechanisms to facilitate trade, including pre-listing of food establishments, and working towards the recognition of disease-free health and pest-free areas when applied by the parties for both animal and plant diseases, while maintaining essential border checks. Moreover, both parties should foresee appropriate arrangements to address market access

barriers and to facilitate the resolution of differences. The EU applies control standards for food and food product hygiene, animal health and welfare, and plant health. It also provides rules on appropriate labelling for foodstuffs and food products. This policy follows a so-called 'From the Farm to the Fork' approach that ensures a high level of safety for foodstuffs and food products at all stages of the production and distribution chains. This policy is based on international standards and in line with WTO SPS Agreements.

In order to improve understanding on the SPS measures used by both parties, the EU and Indonesia should intensify cooperation aspects in the area of SPS and animal welfare. Common EQI issues for Indonesian industries marketing their products in the EU are related to testing and accreditation as in the case of fish and agri-foods, food safety and SPS requirements. The Indonesian National Agency for Food and Drugs (BPOM) is cooperating with the EU to establish a National Rapid Alert System for Food products in Indonesia. Through this program, the EU is providing technical assistance to strengthen national capacities in the risk management for food safety through establishing a national Rapid Alert System for Food in Indonesia. The mechanism

gathers and analyzes food safety information coming from border inspections and domestic market surveillance.

5.4. RULES OF ORIGIN

Rules of Origin (RoO) should be facilitating, not hampering trade. The Vision Group encourages the future negotiators to take a liberal view on this with a view to maximizing beneficial impacts. The CEPA should adhere to a RoO regime which is trade and investment friendly, also taking into account the ongoing reform of current EU RoO and planned negotiations with other ASEAN member states.

5.5. SAFEGUARDS MEASURES

Safeguards should be used as emergency measure only when imports surge in a manner disruptive to the economy. Indonesia and the EU are advised to build a joint mechanism to decide on future safeguards, based on objective criteria and short exit periods. This should be seen also in light of the dialogue/governance structure discussed in chapter 13.



Market access in Services



Services are of increasing importance to EU and Indonesia trade (representing in 2010 over 16% of overall trade). They are also an important component supporting the efficiencies of trade in goods. A strong part of the value-added in goods, once reaching consumers or business-to-business customers, originates from services. In many manufactured goods, services may account for one-third or more of value-added: the export of so-called “business services” are indeed now the major part now of the international trade in services. **Modern FTAs therefore incorporate significant market access obligations in both goods and services.**

In order to be competitive in any location, one needs to take both goods and services conditions into account. In addition, there are solid economic arguments for services best practise and external opening under a CEPA for the performance of services sectors as such, given their increasingly prominent role in the economy – in Indonesia and the EU. This is for example the case of information and communication technology services which contribute to spreading digital technology and allow SMEs to do business worldwide through e-commerce. This is even more so in the case of financial services, which contribute to the financing of trade

and the development of the local economy through lending. Insurance services are a back-bone of trade in goods, but also to the social security and pension systems and the financing of long term infrastructure projects. **For the CEPA to be meaningful in this respect, it should therefore be significantly above initial offers presented in the context of DDA services negotiations.** Both parties should commit to bind under the CEPA the existing current level of practice in the various services sectors, i.e. agree to consolidate their current level of opening to foreign economic actors. Moreover, both partners should commit to certain levels of new openings in key services, differentiated by mode and by sectors, in such a legal form that they effectively create new business opportunities and legal certainty for providers from the partners and for investors in services sectors. The principle of ‘asymmetry over time” (the EU opening immediately or rapidly, and Indonesia on schedules with a longer time horizon), differentiated by sectors and/or mode, could also be applied here.

Whereas consumption abroad (mode 2) might not represent a major problem between the two partners, selected (and perhaps conditional) opening under cross border services (mode 1) and especially further commitments under commercial presence abroad (mode 3) would need to be negotiated. The Vision Group is not proposing a detailed negotiation agenda in this area as contacts between negotiators could explore in greater detail the options and their feasibility. Still, strategic vision matters and the Vision Group suggest a few areas and aspects of services which might deserve attention (see annex 1 for details). These include investment restrictions in some Indonesian services sectors, which have to be in accordance with best practise of a modern economy. Their reform and opening could greatly contribute to the long term improvement of infrastructure in the Indonesian economy.

Investment



The EU is the leading FDI originator in the world, but Indonesia is only a moderate recipient: only 1.6% of tEU's FDI to Asia over the last ten years went to Indonesia and the EU's FDI remains heavily concentrated in China and Hong Kong. Nevertheless, Indonesia hosts around 700 companies of EU origin with an investment of EUR 50 billion and direct employment of 500,000 people; the multiplication factor to indirect employment is also very high.

EU companies have a greater tendency to invest in Indonesia, rather than simply trade. This is favourable for Indonesia's trade balance with the EU (€7 billion in surplus in 2010). Investment also provides employment, technology transfers and mutual prosperity. As Indonesia tries to dampen short term capital inflows ("hot money") in favour of long term capital investment, removing equity limitations would be a positive factor.

The Vision Group has come to the conclusion that investment between the EU and Indonesia can significantly expand. Easy gains could be made, if issues such as FDI limits, protection, IPR enforcement, regulatory consistency, infrastructure, tax policy & local content requirements are effectively tackled.

In 2009 Indonesia introduced a *one-stop service* for foreign investors in many districts. While there are still some problems with its implementation, it has helped to speed up the licensing process to establish foreign-owned companies in Indonesia. It is necessary to conduct capacity building for government officials in charge of licensing procedures and avoid a too high a turnover of trained officials. Indonesia should carefully consider the deterrent effects of equity restrictions in a world of many choices of locations. While an immediate change in the Negative List appears unrealistic, an incremental relaxation during a transitional period would be favoured by the Vision Group.

In respect of Indonesia's investment in the EU, major concerns include compliance with various technical, sanitary and, environmental requirements, marketing standards, product safety, packaging and labelling and some other industry-specific requirements. It will perhaps take a relatively long while before direct investment overseas rises in importance in the agenda of Indonesian companies.

The EU's potential priority sectors for investment in Indonesia includes infrastructure, chemicals, food, metal,

manufacturing and services (banking, express delivery, and logistics and construction).

7.1. ATTRACT FURTHER EU FDI TO INDONESIA: PRE-ESTABLISHMENT/FACILITATION

Limitation of foreign ownership: all equity caps and joint-ventures requirements are considered by investors as an impediment to do business. The preference of foreign investors is to have control over their investment. If a foreign company cannot have majority ownership, it means that it cannot run the investment as they would wish. Hence, it will not invest in the same way as in countries where this would be possible. It will not transfer technology, know-how and other in-house company expertise, since it would run the risk of losing these essential assets of the company. In fact, joint-venture obligation and equity caps – measures often used by countries as tools aiming at sharing the expertise with the local partner – are most of the time missing their goals and prompt investors to look for alternatives solutions in other more welcoming countries. These limitations still exist in some sectors on the current Negative List of Investment. However, this List will be reviewed regularly and for some sectors may become less restrictive.

Local content requirements: Global companies have often global product strategies that are established before entering one specific market. If the local content requirements fixed by a country are too stringent to a point that it would require the company to modify its production or supply chain, this is perceived as a disincentive to invest in such a market. See also Chapter 9 on Infrastructure.

Transparency and clarity in the regulatory framework: Since the early 1990s Indonesia has made significant progress in respect of decentralization and regionalization, which in some instances has created additional layers of decision making and competencies. The Vision Group advises to continue to ensure that all levels of government, central, provincial and district decide and implement decisions about FDI in a coordinated and simplified manner.

Independence of regulatory bodies: Since the introduction in Indonesia of the fair competition law in the 1990s, significant progress has been made to eliminate unfair competition. The Commission overseeing this law is an independent body. The Vision

Group advises to review regulatory authorities to ensure they can operate independently.

Taxation climate: From the Vision Group perspective, Indonesia and EU investors would benefit from a transparent and predictable treaty with all EU countries. In fact, Indonesia has ratified Double Taxation Avoidance Agreements with as many as 19 out of 27 EU Member States.

7.2. INVESTMENT PROTECTION POST-ESTABLISHMENT

As of April 2011, Indonesia has signed 66 Bilateral Investment treaties (BITs) with its counterparts, 16 among them with EU Member States (Belgium - Luxembourg, Bulgaria, Czech Republic, Denmark, Finland, France, Germany, Hungary, Italy, Netherlands, Poland, Romania, the Slovak Republic, Spain, Sweden and the United Kingdom).

These BITs give legal protection for post-establishment phase of investment. The elements of this agreement cover legal guarantees for:

- » Non-discriminatory treatment
- » Nationalization / expropriation
- » Compensation for losses
- » Subrogation
- » Transfer
- » Dispute settlement

These elements have been accommodated by Indonesia Law Number 25 of 2007 concerning investment and are in line with internationally accepted principles. The Vision Group recommends that the EU and Indonesia would conclude an ambitious investment protection agreement covering all EU member states⁴

7.3. INVESTMENT PROMOTION

Investment promotion efforts need to be enhanced in order to attract potential investment sources from EU countries into Indonesia. In fact, while the EU overall is the second largest investor in Indonesia, this is mainly thanks to some of the Member States. Promotion in the other EU countries could lead to further investments in Indonesia. Similarly, the EU could promote Indonesian investments to the EU as well.

⁴ According to new EU competence on investment provided for in the Lisbon Treaty.

Cooperation and capacity building



Thanks to the opportunities opened up by the Partnership and Cooperation Agreement, the EU and Indonesia have started cooperating in new areas such as on security issues, research and technology, human rights, cooperation on culture and education.

For the Vision Group, three pillars should underpin the successful industrial cooperation between the two economies: *liberalisation*, *facilitation* and *capacity building*. Based on experience, capacity building is becoming a critical tool to any successful bilateral economic agreement, especially in implementing economic agreements between an industrialised country and a developing country. Therefore, the conventional approach of liberalising an

economy through reduction and elimination tariffs, in order to facilitate and boost the trade, is now complemented with targeted cooperation activities.

Based on analyses conducted it has been indicated that some Indonesian products, mainly primary products and selected manufactured products are competitive vis-à-vis European products. It has also been shown that full trade liberalisation between the two sides is expected to create economic welfare and stimulate economic growth. However, it is important to note that, since the size and strength of the economies is different and the relevant infrastructure of the EU is more developed compared to Indonesia, it seems unavoidable that liberalisation of

trade will bring to bear considerable competitive pressure on some of Indonesia's industrial sectors. Therefore, it is proposed to support the adjustment of weaker Indonesian sectors via targeted cooperation.

Support for liberalisation is greatest when obtaining mutual benefits for both parties in a win-win situation. Ideally, both partners should define common interests in order to face future world economic development together. An important aspect of capacity building is that it can be undertaken immediately, even before CEPA finalisation, through existing programmes, such as the Trade Cooperation Facility and Trade Support Programme II. The Vision group has underlined that the CEPA concept is already working for the benefit of Indonesia through these existing programmes.

Tariff rates of both partners are already relatively low. Yet it is not easy for Indonesian products to enter the European market due to high standards and technical requirements. Similarly, Indonesian SPS rules do not recognise EU food safety standards, nor are EU technical laboratories recognised to test for Indonesian technical standards. The Vision Group concludes that a key to the success of the CEPA is that it must provide concrete means to bring industrial requirements, testing recognition and accreditation of certification, onto an equal footing and, if possible, to harmonise all of them around one set of international standards. This will facilitate the flow of goods between Indonesia and EU.

Where the key to industrial cooperation is moving towards harmonisation of standards, CEPA will include specific actions to align to a common set of standards, based on international rules, and recognition of conformity assessment and certification systems. An example of an activity that would enhance cooperation, harmonise standards and hence improve market access of the EU and Indonesia is the accession of Indonesia to the UN/ECE agreement for Indonesia's automotive components. The UN/ECE deals with the standardisation of products, including automotive products for international trade. These international standards have already been adopted by 55 countries while Indonesia is now preparing its accession. Activities leading to the accession of Indonesia to this international agreement could be linked to dissemination programmes for the Indonesian automotive industry.

Providing information on standards and their technical substance from both sides is crucial to ensure that

companies from both partners, especially SMEs, can comply with each other's requirements and realise the opportunities offered under the CEPA. One concrete example is to establish an EU-Indonesia helpdesk and standard information platform on each other's regulatory regimes.

Moreover, Indonesia would need to build up a strong certification and laboratory system to be able to fulfil technical regulations to enable its exporters to access EU markets. Several sectors could be targeted, notably: food and beverages, chemical products, agro-based industries, electrical and machinery components. Similarly, EU products have difficulties accessing the Indonesian markets due to the prevalence of mandatory domestic technical requirements and that EU laboratories are not recognised to conduct testing to meet these standards. As a first step, the cooperation programmes should aim at a better understanding of each other's regulatory frameworks and systems in order to facilitate market access. A strong emphasis should subsequently be put on building up the export quality infrastructure of Indonesia.

Cooperation should not only focus on market access but also through facilitation of direct investments, with a view to increasing the involvement of EU firms in Indonesia to enhance access to higher technologies and export quality infrastructure. There is extensive scope for cooperation and technical exchanges in sectors where the EU possesses cutting edge technology and know-how. This would facilitate EU exports and investments while helping Indonesia to access advanced technologies and to upgrade associated human resources. For example the development priorities of the Indonesia National Industrial Strategy include electrification, food security and the restructuring of capital goods, identifying lead sectors such as:

- Development of green products and use of alternative energy (e.g. biomass and electrification)
- Automotives and aircraft industries
- Telecommunication/electronics products
- Pulp and paper
- Textiles and the apparel industry

Public Procurement, Infrastructure and Public Private Partnerships



Poor logistics and infrastructure discourage foreign direct investment and trade. The Vision Group strongly advocates that a CEPA will not realize anywhere near its full potential unless it goes hand in hand with comprehensive progress in infrastructure development. The direct link with a CEPA can be found in public procurement and local content requirements, both items which can hinder, slow down and diminish progress in large projects, either because local content is not available or because global companies have global product requirements. The Vision Group argues that European industrial companies and financial investors are currently hesitant to deploy their extensive resources pending fundamental progress on Public Private Partnerships. Below are some suggestions on how to do this.

First, a CEPA should discuss public procurement, notably in public infrastructure. The parties should agree on setting up transparency rules and negotiate additional levels of mutual access to the respective public markets.

Second, such a dialogue should cover the most important supply constraints in Indonesia, which lie in its logistics and infrastructure. This includes power, transportation, roads, and ports. For example, transportation costs are the highest in ASEAN. Indonesia does not take advantage of its unique archipelagic geography; it does not have a good international hub port. Domestic ports are also hindered by sub-optimal performance due to lack of capacity or

poor management⁵. As a result there is a high degree of dis-connectivity⁶. External rating agencies have recently upgraded Indonesia's rating to BB+, one notch below investment grade.⁷ All cite poor infrastructure as a downside risk to reach investment grade. However, Indonesia is expected to reach investment grade in 2012, which could be a very good opportunity to attract more FDI, especially into infrastructure.

Third, a fully functioning Public Private Partnership model (PPP) for infrastructure development including local companies and investors is critical to achieve progress. In December 2010 Indonesia put in place new PPP legislation and the first projects are under way. Commonly identified obstacles include poor planning, coordination and prioritization. Clarity on risk / return parameters need to be covered.

Fourth, Infrastructure projects will continue to require Government support in the form of guarantees for asset buy backs, to ensure and underpin minimum revenue and expected commercial returns. For this to work properly and to create incentives for investors, the exact type and level of support needs to be identifiable in clear cut frameworks. Indonesia cannot afford to default on any of its support obligations now that it is on the way to attain Investment Grade. To take on high numbers of full fledged payment guarantees puts that objective at risk. Indonesia therefore needs to be very selective on guarantee deployment.

The Vision Group therefore argues that FDI and local content restrictions (40% in procurement of goods, services, construction work, also for Public Private Partnerships) are hindering the progress of infrastructure development

projects as they fail to create incentives and competitiveness for local and foreign companies. Local content is not necessarily available for certain projects so the requirement becomes impractical and a source of legal uncertainty. Such policies achieve the opposite of what is intended.

The Vision Group advocates a direct and substantial involvement of the European Investment Bank (EIB) in Indonesia's infrastructure development⁸. Another immediate opportunity consists in participation in and support for the Indonesian Infrastructure Guarantee Fund (IIGF) where additional capital and capacity building are both necessary⁹.

The Vision Group recommends the Indonesian Government puts in place a single point of entry for firms and to reduce the complexity of the decision-making processes with regard to infrastructure projects, including dealing with certain aspects of regionalization.

The Vision Group also suggests a review of recently implemented legislation which has improved the legal framework for core infrastructure sectors, such as telecoms, electricity, oil and gas and water, but while also creating some additional barriers to infrastructure development. All European export credit agencies are open regarding Indonesia and there does not appear to be a competitive disadvantage for European companies in respect of export financing. It is not clear if Europe's export credit agencies collaborate sufficiently on bids involving multiple suppliers and there may be room for improvement on this. Meanwhile export credit agencies, especially from major industrial countries such as China, Japan and Korea, are fiercely competitive. The Vision Group argues that joint marketing efforts are necessary to create more proactive interest from European exporters and to attract European capital.

5 In a study on land transportation costs, LPEM-FEUI (2008) found that the trucking costs for a typical good using a typical truck in Indonesia (a number of provinces in Sulawesi, Java, and Sumatra were sampled) could reach as high as USD 0.34 per kilometre. This is higher than the average ASEAN, namely USD 0.22 per kilometre. A follow up study by LPEM-FEUI (2010) tried to measure the trucking cost in provinces that rely on water/sea transportation in addition to land mode. It was hypothesized that for archipelagic country, water and sea transportation should be an advantage. However, the study found that the cost could reach even higher at USD 0.50 per kilometre.

6 Domestic dis-connectivity implies sharp differences in prices even for basic commodities, where prices in remote areas can be double those of national averages. For example, the price of medium rice was around IDR 4,000 in Java, Kalimantan, Sulawesi, and Nusa Tenggara but IDR 10,000 in Paniai, Papua.

7 Standard & Poor's, 8th April 2011. FitchRatings, 6th April 2011

8 EIB supports viable public and private sector projects in infrastructure, industry, agro-industry, mining and services. Under the current mandate of EIB - covering the period the 2007-2013 - the EIB is authorised to lend up to € 1 billion into Asia for financing operations supporting EU cooperation strategies. There are currently no EIB projects in Indonesia.

9 IIGF was set up in 2010 as a 100% State Owned Enterprise and is designed to be a credible guarantee provider. It acts as insurance company and collects insurance premiums. Initial capital was Rp 1 trillion (\$ 110 million); plus another Rp 1 trillion injected in 2010; hence total initial capitalization was \$ 220 million. IIGF was developed with assistance from the World Bank which provided \$ 500 million of guarantee support and from the Temasek Foundation which provided S\$ 474,000

IPR: GIs and Enforcement



Strong Intellectual Property Rights (IPRs) protection is crucial to stimulating entrepreneurship and fostering a creative economy. Counterfeit products are a threat to public health and safety and a good protection of IPR is key to research and development. Furthermore, trade and direct investments are attracted by high standards of IPR protection. Improving the legal framework and strengthening enforcement (border measures and domestically) constitute principal incentives for investors as well as for new entrepreneurs.

It is also in the interest of investors and companies that both parties provide for a system of administrative protection of IPRs, avoiding costly and burdensome legal action before Courts. For these reasons, a CEPA should include a full and detailed chapter on IPR, the objectives of which should be to:

- Facilitate the production and commercialization of innovative and creative products, and the provision of services, between the Parties.
- Increase the benefits from trade and direct investment through the adequate and effective protection of intellectual property rights and the effective enforcement of such rights.

With both parties complying with the TRIPS agreement, the IPR chapter should cover all categories of intellectual property namely: copyright and related rights, patents, trademarks, designs; layout-designs, geographical indications, protection of undisclosed information and plant variety rights.

Not surprisingly, both parties expressed special interest as regards Geographical Indications (GIs) since they are both rich in traditional knowledge, agriculture and foodstuffs. Both Indonesia and the EU have already developed a system of protection for their GIs. Economically and culturally, GI protection is becoming an increasingly important issue for producers and an important part of development strategy. GIs are not only to be seen as a way to grant a fair financial return for high quality products but also as a way to keep farmers and communities in rural areas and to manage land properly. Protection of GIs is therefore also a way to develop parallel economic activities (such as processing industries and tourism) retaining value added in targeted areas thereby benefiting regional development.

The Vision group recommends that the level of ambition as regards GI protection should be high. Being part of a CEPA, GI/ protection should go beyond TRIPS obligations for foodstuffs and provide for extension of the protection at least to TRIPS article 23 level (referred to as TRIPS +).

To support Indonesia on these issues, the EU is already providing capacity building on IPR in the ASEAN region through various programmes (ECAP I through to ECAP III). However, further capacity building and facilitation may be needed for Indonesia in order to accomplish effective implementation of such IPR provisions. This cooperation may include exchange of information and experience on issues such as best practice, promotion dissemination, streamlining, management, protection and effective application of intellectual property rights, the prevention of abuses of such rights, and the fight against counterfeiting and piracy.

Competition Policy



Competition policy is a necessary means to create equal, non-discriminatory, and level playing fields in the two economies. Fairness in business activities without distorting competition is welfare enhancing to consumers in the economy. Fair competition will induce greater efficiency and productivity, in turn resulting in higher income levels and higher growth trends in the medium run. Competition policy should be effective in addressing unfair business practices that distort competition.

Many countries have established competition policy based on widely agreed principles whilst adjusting its application on to local conditions and to the business climate in their own economy. The trading partners will therefore have distinctive ideas and approaches towards competition policy

To ensure that companies effectively have equal access to each other markets, the Vision Group argues that the CEPA between Indonesia and the EU should include some disciplines that both parties would agree to implement through their respective competition laws. They might, for instance, agree to prohibit and sanction certain restrictive practices and transactions involving goods or services which distort competition, trade and investment, such as cartels or monopolistic abuses by companies and anti-competitive mergers and/or acquisitions. This would imply that anti-competitive practices will not be tolerated by the parties and would be subject to effective enforcement action, when they lead to harming consumers and higher prices. However in a longer term perspective, some sectoral exemptions from competition could be reconsidered. Competition law

should also apply to state-controlled enterprises as this may help in fostering greater efficiency.

It would be important that the agreement would contain provisions that prohibit certain types of subsidies and state aids, which are considered to be particularly distorting thereby affecting trade and investment between the parties, in the letter and spirit of the WTO Agreement on Subsidies and Countervailing measures, and possibly go beyond it.

Recognizing that competition policy could contribute to creating a conducive, stable, and predictable development for trade, which is particularly important for small scale investors who decide on investing in Indonesia, it is important to establish closer cooperation in the field of competition policy, such as:

- Exchanging information concerning the relevant imposition of competition policy measures.
- Include provisions in the CEPA on consultations and dialogues on all matters relating to competition policy.
- Enhancing capacity building such as providing training, education, human resources development, and technical assistance, and possible exchange of staff or traineeships.
- Exploring the merits and scope of possible cooperation between the Competition Supervisory Commission of Indonesia and the European Commission.

Sustainability:

Environment as a Competitive advantage



Indonesia has long recognized the importance of improving the economic and social fabric of the Nation as a prerequisite for achieving environmental goals. It is best expressed by President Susilo Bambang Yudhoyono who has emphasized the importance of pro-poor, pro-job, pro-growth and pro-environment policy. For the Indonesian government, the objective of “Sustainable Trade in Indonesia” is initially associated with trade that should not harm the environment (the first pillar) and this has been extended to embrace social

concerns (the second pillar), and which finally includes the importance of economic growth (third pillar) as the basis to meet environmental and social goals.

The EU shares this same strategy of sustainable growth as embodied in the Treaty establishing the European Union as well as various policies and laws.

The Vision Group argues that sustainability is a political necessity but also an inevitability driven by consumer tastes

increasingly demanding “environmental friendly products and services”. It was identified that, if embraced and always put alongside growth objectives, this approach can also produce win-win solutions which combine sustainability and profitability. Namely, sustainability can be turned to profit and to advantage in our trade and investment relations.

The Vision Group identifies that a CEPA should include concrete measures to promote the greening of EU-Indonesia trade and direct investment while creating growth and jobs.

In the public sector, partners will be encouraged to work with the Government of Indonesia Ministry on Sustainable Trade by addressing the above three elements from the trade perspective.

A CEPA should, therefore, also include structures that ensure any sustainability policy neither accidentally impedes trade nor restricts growth or job creation. The recent example of laws against illegal logging is a good case in point where this environmental concern was jointly tackled by Indonesia and the EU but in a manner that actively increases and enhances Indonesia’s competitiveness and access to the EU timber and timber product market.

Both Indonesia and the EU passed laws against illegal logging. This was not enough: legal timber might find problems entering the EU if buyers and authorities were unsure if it was legal or not – threatening jobs and growth. For this reason, the EU and Indonesia have agreed a Voluntary Partnership Agreement, effectively a form of mutual recognition, through which local SVLK legality origin certificates will be accepted by EU authorities as proof of legal origin and will be allowed into the EU. This assumes the Indonesian authorities implement the new SVLK effectively. This is the type of action the Vision Group argues should be incorporated in the CEPA – acceptance of an environmental policy (combating illegal felling of Indonesia’s forests) but by designing actions that not only secure the €700 million of existing trade in wood products from Indonesia to EU but also gives Indonesia a chance to expand its market in the EU, taking market share from other countries who do not have a similar scheme and cannot offer the same level of “legality” assurance. Other sectors where such an innovative pro-environment, pro-growth, pro-jobs and pro-poor approach can be developed include palm oil and fisheries.

Consumers are increasingly demanding environmentally sustainable products and services across all areas. Industry is changing its operations to meet this market trend. European businesses already have high levels of compliance with the UN Corporate Social Responsibility definitions. A number of global leaders have integrated environmental concerns in corporate culture and responsibility. This has resulted in the use of cleaner production technologies, selected sourcing of raw materials with favourable carbon footprints and in general embracing a culture which is environmentally friendly by reducing energy consumption; and optimizing logistics etc. We recognize that the main driver behind this corporate change is market driven as consumers and corporate customers have increasingly shown a preference to source from environmentally friendly companies combined with growing awareness of shareholders to the global challenges faced.

Together Indonesia and the EU can drive this transformation enabling Indonesian manufacturing to move up the value chain in a sustainable manner, branding goods with higher value thanks to being sustainable and growing the business opportunities for both parties.

Capacity building and trade facilitation should be designed with these sustainability objectives in mind. Specifically there should be a framework of mutual understanding of the value of long-term sustainability overriding short-term economic gains; for example converting power plants to use more sustainable sources of fuel, transforming Crude Palm Oil production by reducing greenhouse gas emissions, implementing production methods and certification when relying on standards which enable goods to compete with quality and low carbon footprints.

In short, the Vision Group recommends that CEPA should include concrete measures to promote green elements in EU-Indonesia trade and investment, while creating growth, value and jobs. This must evolve to a competitive business model which benefits both parties. This can provide a platform for fighting climate change and protecting the environment.

Governance/Dialogue Structure



To secure the good functioning of a CEPA, effective institutions, institutionalised and continuous dialogues involving governments and business should be put in place. The strong dialogue that Indonesia and the EU currently have is proposed to be institutionalised under the Partnership and Cooperation Agreement. This would include annual ministerial meetings as well as a technical Working Group on Trade and Investment which would meet twice a year, fed by sectoral dialogues (currently investment, pharmaceuticals, food & beverages and industry & environment). These meetings should incorporate business and / or work with the recommendations of the institutionalised EU Indonesia Business Dialogue.

This combination of business and government dialogues, technical expert cooperation and financial cooperation is a **deliberate strategy** to ensure Indonesia sees and obtains advantages from the EU-Indonesia commercial alliance. This has been a feature of EU - Indonesia relations and will remain a cornerstone of future relations. Some examples in palm oil, timber and fisheries where this deliberate constructive strategy is being pursued today help to prove the point.

The Indonesian government has shown impressive commitments in each of the above areas and in promoting constructive dialogue with the EU. The successful EU Indonesia Business Dialogue in Jakarta in December 2010

has provided a good example. . Thanks to the joint work and leadership of Indonesia's Chamber of Commerce (KADIN) and the European chambers, supported by Ministers of Trade, Industry and Economic Cooperation, a concrete and workable set of recommendations on trade, investment and business were agreed and are currently being implemented and followed up.

The CEPA should have solid 'governance' based on trust, friendship and rules. The specific follow-up of the CEPA treaty in its various areas of policy and capacity building requires permanent cooperation and consultation. Nevertheless, no matter how 'deep' economic relations are or will become, differences of opinion will emerge under any agreement anywhere in the world. The Indonesia-EU CEPA will be no different. Differences of opinion should not be allowed to simmer, let alone, to turn into trade conflicts. The recent experience in timber shows that dialogue and concrete willingness to address the issues, possibly with technical cooperation, can work. The CEPA should explicitly incorporate this idea. Firm dispute settlement, based on recognized international practice of today, should be included. Without that option the CEPA would lose credibility. However, given and backed by a credible dispute settlement procedure, partners should nevertheless employ other mechanisms, including intense dialogue and technical cooperation, before resorting to the use of dispute settlement arrangements.

Communication strategy



The commercial ties between the EU and Indonesia are strong and relations are positive and constructive. But perceptions lag behind current realities. So consultation on and socialisation of the CEPA in Indonesia and the EU will be crucial – explaining the existing scale and complementary nature of relations, how CEPA is different from other recent economic agreements and how it will bring rewards to both sides. Some key elements of the Communications Strategy are as follows:

- **Communicate Early and consistently for Positive responses.** The most important lesson from Indonesia’s experiences is that meaningful and comprehensive communications and dialogue must begin at the earliest stages of building a new bilateral or regional relationship in order for all stakeholders to feel involved and make positive contributions. Governments risk negative reactions if there is little room for such contributions because decisions have effectively already been made.
- **Communicate the Innovations in CEPA:** The consultation must show the stakeholders the distinct and very largely positive features of CEPA. It should emphasize three fundamental positive outcomes:
 - » **A Dynamic Approach to Growth, development and Jobs,** showing how CEPA creates growth, jobs, development and capacity building in non-technical terms so people can see the clear value added of the CEPA.
 - » **Boosting competitiveness in the Wider Strategic Context of Integration,** showing how CEPA will strengthen Indonesia’s competitiveness in ASEAN and East Asia and help to avoid that EU agreements with other ASEAN neighbours result in a declining share of European trade and investment for Indonesia.
 - » **Turning Sustainability into a competitive advantage for Indonesia and EU.** Too often, sustainability is seen as a negative issue. Countries having embraced sustainability have found that it is becoming a source of growth and jobs. CEPA will help Indonesia and the EU to exploit sustainability as a source of growth and profit.
- **Communicate how capacity building under the CEPA will help ensure Indonesia obtains benefits:** CEPA’s comprehensive and dynamic structure of dialogues, technical committees and financial cooperation (detailed elsewhere in our report as “capacity building”) will help companies to deal with problems and realise opportunities.
- **Compensating for the costs of Adjustment:** the costs of adjustment for those companies which might have to restructure in the short run (somewhat negatively, named “losers”) are probably rather limited given the complementary nature of this CEPA. Nevertheless, be open about this possibility and identify such subsectors or companies as early as possible so that the necessary adjustment policies and compensation packages can be communicated at the outset. Early identification will help develop a more balanced debate and assessment among all stakeholders. It is also likely to induce such companies to anticipate the effects of CEPA and adapt their business before such costs might fall upon them. Indeed, given complementarity, “losers” might in fact often only see their growth affected somewhat, without having to cut capacity or fire workers. Capacity building as well as phased implementation and exemptions will assure this aspect is addressed to maintain positive returns from CEPA for both parties.
- **Stakeholder Dialogue and Engagement.** The communication strategy will target all stakeholders in EU and Indonesia, paying special attention to Parliament (and the European Council in the EU), specific Ministers and Government Officials in Agencies affected by the CEPA, chambers of commerce and the Business Community, the Academic Community, the Media, civil society (including Consumers and union groups). Direct dialogue, classical media (newspapers, radio etc), internet and social media will be used to provide information and promote dialogue with these stakeholder groups.



PRODUCT SECTORS OF SPECIAL IMPORTANCE



PRODUCT SECTORS OF SPECIAL IMPORTANCE



Reality of trade and investment policies differ between sectors for reasons related to the stage occupied by an industry its life cycle, the prominence of an industry in relation to the issues of sustainability, TBTs, SPSS, environment, illegal trade and some other issues. The Vision Group finds it appropriate to single out a few sectors of products in view of the prominence attached to them in the Indonesia-EU relations without intending to argue in favor of an active industrial policy.

Regarding market access (goods, services and investments) mentioned in the report, the Group proposes to consider a number of sectors of special importance. Some examples are provided below. Note that these are discussed also in chapter 9 on capacity building.

Palm oil employs workers from more than 3.5 million Indonesian households. Exports are surging. The EU is Indonesia's second largest palm oil market. However, there

are concerns in Indonesia over possible consumer boycotts and on assuring fair access to the trade preferences under the EU's Renewable Energy Directive. The EU and Indonesia have a strong dialogue on the issue, involving both industry and civil society, to:

- Re-assure Indonesia that the EU market remains open. There is no restriction on Indonesia's exports of palm oil. Growth in EU market demand for CPO has been strong.
- Facilitate discussion between industry and civil society to promote better mutual understanding so civil society is aware of CPO industry concerns and industry can adapt to changing consumer tastes in the EU where sustainability issues are increasingly important to consumers.
- Technical dialogues to ensure technical thresholds for obtaining EU trade preferences for palm oil as a renewable energy source are set fairly. Scientific data, findings and dialogue will then feed into future revision of thresholds.

Wood and paper products are another key export area for Indonesia to the EU. Indonesia has long wanted the EU to strengthen its controls against the import of illegal timber products into the EU. Indonesia was of the view that, as long as such trade continued into the EU, it effectively promoted illegal timbering in Indonesia. However Indonesia does not want any EU action to reduce the EU market for Indonesian timber and paper products. In response:

- The EU first passed a law requiring importers in the EU to guarantee the legality of the source of their timber and paper imports.
- The EU and Indonesia have signed a Voluntary Partnership Agreement (VPA) that will assure access for legal Indonesian exports. If Indonesia is able to credibly implement its national legality system (SVLK), such SVLK certificates will be sufficient to guarantee access into the EU markets.
- The EU has provided €40 million in financial cooperation to support the timber sector in Indonesia and will provide a further €10 million to help industry and civil society to implement the SVLK law.

In the area of fisheries, Indonesian exporters to the EU found it hard to comply and prove compliance with the

EU's tough food safety standards. A technical dialogue has been going on for the last three years to strengthen food safety testing and data collection in Indonesia so as to improve the safety of fishery exports. Financial support is being provided to help Indonesia strengthen its national system for testing. And the number of shipments that are rejected in the EU for food safety reasons has reduced as a result.

The pharmaceutical sector in Indonesia is particularly promising for EU business and the Vision Group would suggest removing the decree 1010 (obliging local manufacturing before selling products), increasing the FDI cap to 100% and ensuring better data exclusivity. These measures would greatly incentivize new EU direct investments coming to this sector in Indonesia, which have been stalled since the 75% cap was introduced in 2007.

In the Food & Beverages area, particularly beef, dairy and alcohol, EU business is experiencing a number of measures that restrict (potential) imports, such as pre-listing of establishments and recognition of EU food safety standards.

Moreover on courier services and EDS, the Indonesian Postal law is restricting door-to-door delivery and maintains restrictive treatment of foreign firms and investors; local content in telecom, (wireless broadband) also restricts EU business involvement in key sectors.

In general the Vision Group recommends linking Indonesian and EU business associations, to support business dialogues and to follow-up with financing to help materialise the potential.



POTENTIAL GAINS/ECONOMIC ANALYSIS



Estimating ex-ante the overall economic impact of a trade agreement is an important step in defining policy priorities. In this endeavour, computable general equilibrium (CGE) models are most suited in offering a sense of the likely economic results of an FTA. This section summarizes the main results of two separate simulations: (i) a short term, static assessment of a future EU-Indonesia trade agreement; (ii) a longer-term, dynamic analysis, taking into account the synergies that can be created between new trade and investment opportunities. While the static assessment yields the gains for Indonesia in the magnitude of 0.1% of its GDP, the dynamic analysis taking into account accumulation of international investment flows brings the gains to 1.3%.

I. EFFECTS OF THE EU-INDONESIA FTA: SHORT-TERM ASSESSMENT

One of the most widely used CGE models to estimate ex-ante the likely impact of a trade agreement is the standard static GTAP model. The underlying GTAP 7 database covers basically the entire world and contains detailed macroeconomic information for each country, thus allowing capturing inter-sectoral and inter-country effects a trade agreement is likely to induce. Before simulating the new trade agreement between Indonesia and the EU, a baseline against which results are benchmarked needs to be generated. The baseline takes

into account Indonesian and the EU's bilateral FTAs with third countries that have been implemented since 2004. The policy scenario assumes tariff only full liberalization, i.e. the elimination of all tariffs in trade in goods.

One of the most important conclusions of this analysis is that although trade agreements need time to fully deliver their economic impact, even in the short run such a trade agreement would increase both Indonesian and the EU overall welfare. Given the tariff-only liberalization assumptions and the short-term time span, the additional effect on the Indonesian GDP is relatively modest. Nevertheless, an additional 0.1% (524 million euro, based on the estimated 2010 GDP of Indonesia) could be generated annually. Given the much larger size of the EU economy and its diversified economic and trade structure, the overall positive impact on EU GDP growth will also be relatively small in percentage terms. Overall, Indonesian gains will originate primarily in more favourable terms of trade following the FTA.

The detailed CGE disaggregation into economic sectors in Indonesia also allows a breakdown of economic effects by sector. While several sectors will clearly benefit as a result of the FTA, a limited number of economic sectors will be subject to adjustment pressure in the short run. While the

nature of complex and fairly aggregate CGE models does not allow a more detailed sub-sectoral analysis, this suggests that possible short-term adverse impact on certain small and medium sized enterprises would require accompanying support measures. Among the likely source of this negative impact is the limited availability of technology, lack of capacity and inadequate infrastructure in Indonesia. Therefore, there is a case for supporting domestic policies in Indonesia and enhanced cooperation with the EU, including a reorientation of EU technical assistance in order to mitigate these adjustment costs. In the longer term, as the analysis described in the next section suggests, the new investment opportunities likely to be created by a comprehensive trade agreement, will also alleviate these costs and create new economic opportunities for most sectors.

The overall conclusion is that the FTA is expected to create better welfare and give an additional boost to economic growth in both partners. However, in the short-run, it is important to ensure that adjustment costs are adequately addressed by other domestic policies and through bilateral cooperation in key areas.

II. LONGER-TERM, DYNAMIC ASSESSMENT OF A BILATERAL TRADE AGREEMENT

While some effects are clearly visible in the short-term, trade policy also leads to significant economic transformations in the longer-term. To complement this short-term, static analysis described above, CGE simulations were also performed using a dynamic GTAP model. The dynamic model gives the possibility of introducing international capital flows and the time dimension into the existing static framework. In other words, the distribution of the effects over time in this dynamic CGE model is obtained through the accumulation of capital and through capital flows among countries being influenced by changes in profitability rates.¹⁰ This last feature seems to be particularly relevant for Indonesia, aiming at hosting more technologically-advanced foreign investment.

The underlying database on which the analysis is performed is, like in the static analysis, based on the same GTAP7

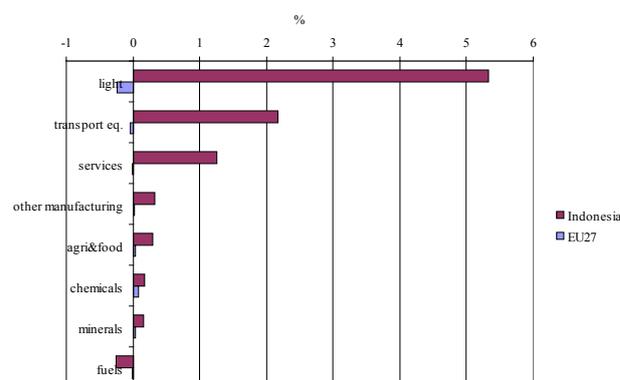
10 The model gives a choice in terms of various policy parameters underlying the allocation of investment and savings. For the purpose of this analysis it was assumed that capital (both savings and equity) is relatively mobile among developed countries, while for the developing countries these are savings, which are relatively unrestricted, while the sources of funding for the local firms are more limited and skewed towards acquisition of capital domestically.

database, which is benchmarked to year 2004.¹¹ For the purpose of this exercise it was assumed that the future EU-Indonesia trade agreement enters into force in 2015. The time horizon of the simulations was set to 2030, after which all or the vast majority of the effects of an FTA implemented by 2015, should take place. Several results point out the importance of a longer-term assessment of the economic effects of a future EU-Indonesia trade agreement.

Instead of static 0.1% additional GDP growth for Indonesia, long-term dynamic gains are in the range of 1.3% of Indonesian GDP in the long run. This translates roughly in the range of 6.8 billion of euro (based on estimated 2010 GDP of Indonesia estimate). Due to size and other economic asymmetries, the effect on the EU GDP remains in percentage terms much smaller.

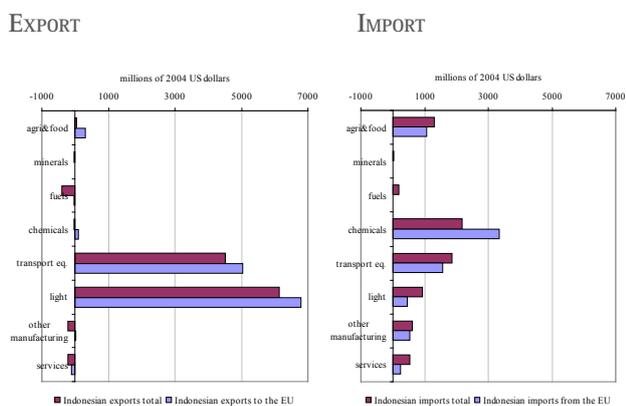
In terms of sectoral effects, the output of Indonesian light industries is going to be 5% higher, than in a situation without the FTA (see figure 1). The production of transport equipment and parts as well as the provision of services are also going to increase by 2% and 1%, respectively. The only economic sector which shows a slight output decline of 0.3% is fuels. However, overall these sectoral effects suggest that the Indonesia economy will become more diversified, relying more on manufactured rather than primary products and exports.

Figure 1: Effects on production in Indonesia and in the EU by sectors and countries, in %, cumulative changes in 2030 as compared to the baseline



11 In order to bring the database closer to the current year, a number of adjustments had to be made on the original 2004 data. Thus, the baseline scenario includes a number of implemented EU's, Indonesian and ASEAN FTAs, phasing out the Multi-Fibre Agreement etc. The policy scenario is, for comparability purposes, the same as the one performed under the short-term analysis, i.e. tariff only EU-Indonesia FTA.

Figure 2: Effects on Indonesian trade values by sectors, in millions of 2004 US dollars, cumulative changes in 2030 as compared to the baselin



In terms of effects on trade volumes, Indonesian export of light industries and transport equipment is estimated to increase considerably. And as these sectors constitute together a large share of total Indonesian exports, when measured in constant prices, Indonesian exports of goods and services in 2030 is going to be higher by USD 9.8 billion (as compared to a situation without the FTA). Imports of (in particular) chemicals, transport equipment and agricultural products and processed food are also set to expand by around USD 7.7 billions. Therefore, the overall Indonesian trade balance in the long run will improve by around USD 2 billion.

III. BEYOND A SHALLOW FTA

Moreover, there are grounds to believe that if a deep and comprehensive trade agreement is going beyond simple tariff dismantling, is implemented, the economic gains are going to be even more substantial. A typical EU FTA contains many provisions going beyond tariff liberalization, such as approximation/mutual recognition of standards, enhancing competition, liberalisation of barriers to trade in services, opening up procurement markets etc. These provisions usually lower non-tariff barriers to trade and enhance trade creation leading to bigger overall welfare gains.

For instance, the dynamic results of the simulated FTA point out an increase by 2% in new FDI inflows into Indonesia in the short and medium-run (2016-2020) and by over 4% of new FDI inflows into Indonesia by 2030 (as compared to the situation in 2030 simulated without the FTA).

Possible additional effects, which can be brought about by the liberalisation of barriers to trade in services are perhaps the most interesting in this case. Recent study exploring consequences of the removal of restrictions on services by developing countries (CIE, 2010) pointed out that the effects of such an action on Indonesia would be in the range of 0.1% of its GDP. Most likely, such move will stimulate substantial additional FDI flows, in particular to the financial intermediation sector.

IV. COSTS OF DOING NOTHING

One may think about other possible scenarios for the EU-Indonesia trade relations. In case no FTA is concluded while some bilateral agreements are taking place with other partners, trade diversion is most likely going to dominate any other effects with adverse consequences for Indonesia. On top of this, the GSP system undergoing changes is also going to impact upon existing trade flows. Stating how large welfare changes these might be is beyond the scope of this exercise. Nevertheless it is useful to remember that the changes simulated here show only one possible direction of events.

V. TRADE AND POVERTY REDUCTION

Since the possible FTA raises concerns about its impact on poverty, we turn now to the topic of how trade influences poverty and what kind of effects can be expected in the case of the FTA between the EU and Indonesia. The dynamic GTAP simulations described above suggest an overall rise in the Indonesian wages of 1.5% as a result of a trade agreement. This is a strong indication that income levels in Indonesia, including for the poorer segments of the population will be positively affected. Returns to land (important for the rural population) will increase in the long run as well, but the change is going to be smaller. It is also important to emphasize that other supporting policies will certainly have a strong impact on poverty reduction, alongside the impact of trade policy.

Economic literature on the link of trade and poverty suggests that contrary to the general perception that trade may harm the poor, trade is in general poverty alleviating (see Winters et al. for a survey of applied studies). Whether trade liberalisation has a positive impact on poverty depends therefore on the development of markets for unskilled labour and often complementary domestic reforms are needed to enhance the ability of poorer households

to exploit potentially beneficial changes (cf. Hertel and Reimer, 2005). Moreover, countries may need to strengthen social protection to mitigate adjustment effects of trade liberalisation (cf. Winters et al., 2004).

In the case of Indonesia ex-ante analysis has found trade liberalisation generally reduces poverty with more liberalisation entailing a stronger reduction in poverty. Robilliard and Robinson (2005), for example, find that full multilateral trade liberalisation would reduce the number of the poor by around 1.3 million people. Since the majority of the poor in Indonesia receive income from agriculture and transfers (Hertel et al., 2003), significant reductions in poverty will be driven by this strata. Henceforth for trade liberalisation to be poverty-reducing in Indonesia it should benefit these parts of society. Hartono et al. (2007)

examines the poverty implications of the EU-Indonesia FTA as opposed to some other FTAs. They find that an Indonesia–EU FTA would benefit Indonesia relative to other FTAs (i.e. FTAs with India or Singapore) in terms of real GDP growth, increases in household income, and welfare. Moreover, an Indonesia – EU FTA is supposed to reduce poverty with increases in average household income disproportionately benefitting unskilled labour and rural areas.

Taking all the above into account, one should expect the full EU-Indonesia FTA, with all the tariffs eliminated across-the-board, to have the effect of alleviating poverty. Nevertheless, the inclusion of additional provisions reducing NTBs seems desirable as well as other effectively targeted support measures.



INDONESIA – EU DEEPENING FRIENDSHIP



EU AND INDONESIA: LONG HISTORY, STRONG PRESENT AND GREAT FUTURE...

Deep economic integration over a very wide spectrum of policies and legal obligations, and with the political acceptance of centralized common institutions, has been the foundation for European growth and stability for more than 50 years. Today, EU citizens from 27 Member States can travel, work and live without any constraints inside a market of 500 million people. Business enjoys genuine free movement of goods, services, capital; (to some degree) workers and codified technology and can establish itself anywhere in the Union. The world benefits from European integration. Indonesia's government has a single counterpart for trade, not 27 individual states. Indonesian exporters to Europe meet one EU standard, not 27 different standards. Indonesian visitors to Europe's "Schengen-area" need one visa and can travel throughout the "Euro-zone" using one currency.

Indonesia has developed rapidly into a strong, stable democracy as well as an emerging global economic power. It is a G20 member showing leadership on issues of global importance such as climate change, financial stability and peace. In Indonesia, the EU has found an important strategic partner that shares its values of development, diversity and democracy. Today it is a friendship that includes co-operation on education, climate change, emergency response, justice, trade and investment - all based on the core values EU and Indonesia share.

BILATERAL EU AND INDONESIA ALLIANCE – EQUAL PARTNERS AND MUTUAL BENEFIT

The existing EU and Indonesia alliance is extensive and important for both where a thriving economic partnership is paving the way for closer political relationship to the benefit of future generations of Europeans and Indonesians.

In the **political cooperation area**, cooperation has been expanding for two decades. This has ranged from election observation during the late 1990's, through human rights and inter-faith dialogues and even to support on conflict resolution. The government of Indonesia requested support from the EU to assist in its conflict resolution strategy in Aceh. The EU provided the Aceh Monitoring Mission and facilitation of negotiations by President Ahtisaari.

In the area of diversity, people to people contact is growing every year. Students, businessmen and tourists are boosting these people to people flows towards the million per year level. In education, the EU provides about 1,000 grants to Indonesian students to study at European universities per year.

Thanks to the opportunities opened up by the **Partnership and Cooperation Agreement**, the EU and Indonesia have started cooperating in new areas such as on security issues like counter-terrorism, such as on research and technology, such as on human rights dialogue.

In the area of **development through trade and investment**, the EU and Indonesia mutually benefit from huge-scale commercial ties between the two economies:

1. The EU is Indonesia's second largest investor. Over 700 EU companies are operating in Indonesia, providing more than 500,000 jobs. This number will increase as Indonesia's economy continues on its path to rapid growth.
2. The EU is Indonesia's second largest export market. Indonesia's exports to EU currently stand at EUR 14 billion but are set to expand as Indonesian companies move up the value-chain.

In the **development through financial cooperation area**, the EU and its Member States provide over EUR 700 million annually to Indonesia across sectors vital for future prosperity such as education, health, trade and climate change:

1. The EU and its Member States are supporting Indonesia's climate change initiatives with US\$1.5 billion, including projects encouraging forestry conservation and sustainable management. EU specifically supports Indonesia's REDD+ strategy, MRV system, and resilience to climate change impacts. The

EU assists Indonesia's efforts to combat illegal logging and ensure credible legal verification through trade policies and co-operation with government agencies, the private sector and civil society and the EU promotes environment friendly consumption and production through projects in various economic sectors such as the batik industry

2. The EU and its member states have been leaders in supporting Indonesia after natural disasters. The EU was the largest donor to the Multi Donor Trust Fund for Aceh and Nias to support reconstruction efforts after the 2004 Indian Ocean tsunami. The EU has also provided significant financial support for humanitarian and long-term reconstruction assistance following the earthquake and tsunami in the Mentawai Islands, the Merapi volcanic eruption and in the aftermath of the Yogyakarta and Central Java earthquakes.
3. Since 2010, EU has provided funds directly to the Indonesian state budget to support Indonesia's own policies and priorities within education. EU co-funds with Australia a \$1 billion programme to increase knowledge, competitiveness and towards equal opportunities in the education sector. The EU is supporting implementation of minimum standards to improve the quality of basic education in Indonesia.

AN EMERGING GLOBAL ALLIANCE: INDONESIA AND EU TOGETHER MAKING A DIFFERENCE

Given that the EU and Indonesia share the same views and approaches to common global problems, EU and Indonesia are natural allies in the global domain and cooperation through bodies such as the UN or G20 is expanding rapidly.

1. In WTO, EU and Indonesia are working for fairer global trade and are engaged in negotiations to secure a fairer result in the WTO's Doha Development Round.
2. In the G20, EU and Indonesia worked to achieve a positive agreement on tackling the 2008 global financial crisis.
3. In climate change areas, EU and Indonesia have pledged to reduce greenhouse gas emissions: the EU by up to 30% by 2020 and Indonesia by 26% by 2020.

MAJOR SOURCE FOR INVESTMENTS IN INDONESIA ... BUT SO MUCH MORE POTENTIAL

The greatest strength of the commercial alliance between the EU and Indonesia lies in the greater tendency for EU companies to invest in Indonesia, rather than simply to trade with it. This assures Indonesia that its favourable trade balance with EU will continue (€7 billion in surplus in 2010) but also that the commercial alliance with the EU will produce far greater local value added for Indonesia:

1. Employment – existing EU investments generate over 500,000 jobs in Indonesia. However, the multiplier rate is much larger: one EU investor recently commissioned an independent study to see the additional indirect employment benefits of its investment in the Indonesia economy – in addition to having some 10,000 direct employees, the study identified that 150,000 Indonesian were employed in wholesale and retail sectors associated with that company's products.
2. Technology transfer. By expanding investment, European companies bring the technologies to the Indonesian market – adding further intellectual and capacity value locally. For example, a company in Bandung formed a partnership with Airbus and now produces locally in Indonesia the struts that bind the wings of the Airbus A380 to the fuselage.
3. Mutual prosperity: European investors are the second largest in Indonesia encompassing oil and gas; mining;

services; food products; metal and machinery; chemicals and manufacturing. EU Member States companies recognise the advantages of Indonesia for investment, which include: economic growth (soon predicted to reach 7%); a strong middle class; a stable political environment ; that Indonesia is the largest economy in a dynamic ASEAN and Asian region; its infrastructure opportunities; production networks and network of FTAs; also the availability of natural resources and its large labour force - and its increasingly competitive advantages that help position Indonesia positively in relation to China.

CONCLUSION – A FRIENDSHIP THAT COULD GROW EVEN FURTHER

EU and Indonesia relations are already strong and growing healthily across the board. Trade and investment ties have always underpinned this alliance, thanks largely to the fact that there is great complementarity between the two economies. The EU and Indonesia do not make the same products and do not compete with each other. EU companies tend to invest in Indonesia rather than sell to Indonesia. These ties continue to bring massive advantage to Indonesia – a healthy trade surplus and investments by EU companies in Indonesia creating jobs and transferring technology. These ties also bring advantage to the EU – with great products coming to the EU, while EU investing companies continue to build their activities. Trade and investment will continue to underpin this alliance in the future.





BACKGROUND NOTES





I INDONESIA – EU TRADE RELATIONS

This background note is to support the Vision Group and its discussions. It does not express official government views. This applies to all following Background Notes.

1. MAIN PRODUCTS TRADED

Trade flows between Indonesia and the EU complement each other. Indonesia's exports to the EU largely consist of agricultural products, fuel & minerals, textile & clothing; and (semi) manufactured goods.

EU exports to Indonesia mainly consist of high-tech machinery, transport equipment, manufacturing goods, chemicals, and processed foods. EU products are important for the development of the Indonesian infrastructure and upstream industry and for consumer demand.

| Indonesian exports to EU - 2010 | | % of total |
|---------------------------------|---|------------|
| 1 | Animal or vegetable fats and oils | 14.7% |
| 2 | Machinery, electronics, & electrical | 14.51% |
| 3 | Textiles and textile articles | 10.9% |
| 4 | Mineral Products | 9.2% |
| 5 | Footwear and headgear | 6.7% |
| 6 | Miscellaneous manufactured articles | 5.8% |
| 7 | Plastics; rubber | 8.9% |
| 8 | Prepared foodstuffs; beverages, tobacco | 3.6% |
| 9 | Products of the chemical | 6.6% |
| 10 | Wood and articles of wood | 4.0% |

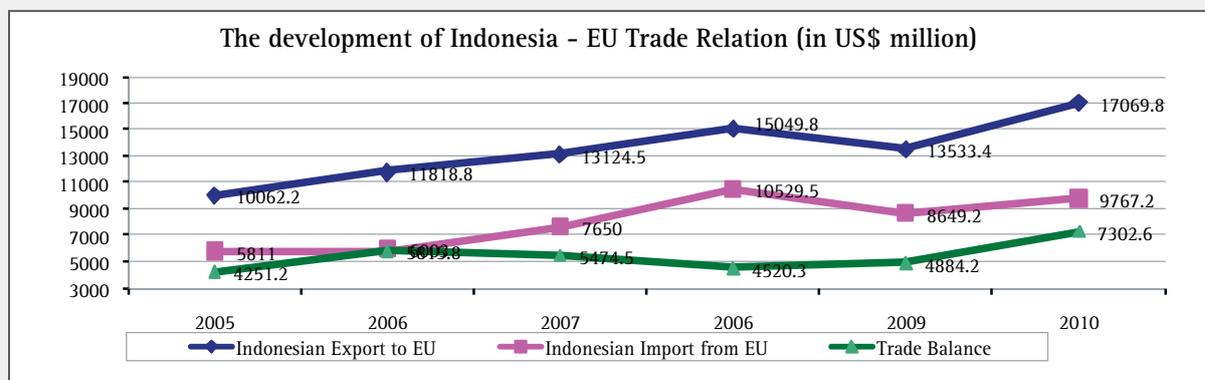
Trade complementarities between Indonesia and the EU are reflected in the list of top ten products traded between Indonesia and the EU. Out of ten groups, five are highly complementary. For Indonesia these are: animal/vegetable fats & oil, mineral products, footwear & headgear, miscellaneous manufactured goods, and wood & wood products. The five groups of the EU are: transport equipment, metals, paper, optical products, and animal products. The other five groups are similar at aggregated level but complementary when taking at a more disaggregated level. In machinery, electronics, and electrical products, Indonesia largely exports office equipment and household electronics, while the EU exports industrial machinery and high-tech components for the downstream industry.

| EU exports to Indonesia - 2010 | | % of total |
|--------------------------------|---|------------|
| 1 | Machinery, electronics, & electrical | 42.9% |
| 2 | Chemical products | 16.3% |
| 3 | Transport equipment, aircraft, ship | 10.6% |
| 4 | Base metals and articles of base metal | 7.6% |
| 5 | Paper or paperboard | 6.9% |
| 6 | Plastics; rubber | 4.4% |
| 7 | Live animals; animal products | 3.5% |
| 8 | Optical, photo cine precision instruments | 2.6% |
| 9 | Prepared foodstuffs; beverages, tobacco | 2.6% |
| 10 | Textiles and textile articles | 2.8% |

2. DEVELOPMENTS

Even though the trade value between Indonesia and the EU is growing in absolute terms, in relative terms it is reducing as Indonesia increasingly imports from China, India and Japan. The EU is Indonesia's second largest export destination (13% share) and the fourth largest source of imports. For the EU, Indonesia is the 19th largest import source (1% share) and the 35th largest export destination (0.5% share) for the EU. The share of the EU as an Indonesian export destination increased from 15% in 2006 to 18% in 2010 and the share of the EU as a source for Indonesian imports dropped from 14% in 2006 to 8% in 2010.

In absolute terms, trade between the EU and Indonesia increased over the period 2005 - 2010 – with a positive trade balance for Indonesia.



Source: BPS (The Indonesian Central Bureau of Statistics)

| EU's trade with Asia (2010, Eurostat) | | | |
|---------------------------------------|-------------|--------|------------|
| Rank | Country | M EUR | % of total |
| 2 | China | 394966 | 13.9% |
| 6 | Japan | 108558 | 3.8% |
| 8 | India | 67778 | 2.4% |
| 9 | South Korea | 66563 | 2.3% |
| 12 | Singapore | 42591 | 1.5% |
| 14 | Taiwan | 38850 | 1.4% |
| 16 | Hong Kong | 37877 | 1.3% |
| 17 | Australia | 36590 | 1.3% |
| 22 | Malaysia | 31926 | 1.1% |
| 24 | Thailand | 27168 | 1.0% |
| 31 | Kazakhstan | 20107 | 0.7% |
| 32 | Indonesia | 20043 | 0.7% |
| 36 | Vietnam | 14068 | 0.5% |
| 42 | Philippines | 9107 | 0.3% |
| 45 | Bangladesh | 8200 | 0.3% |
| 48 | Pakistan | 7456 | 0.3% |
| | ASEAN | 146693 | 5.2% |



II TRADE POLICY

1. INTRODUCTION

Indonesia is the largest economic power in South East Asia. The country has achieved remarkable success in its economic development over the last decade. Even though being hard hit by the Asian economic crisis in 1997, Indonesia managed to recover and demonstrate a positive economic growth record in the last decade. The Government of Indonesia envisions high and inclusive economic growth as a means of achieving sustained prosperity for its people and the protection of its natural resources and environment in its National Long-Term Development Plan 2005–2025. To achieve that objective, Indonesia will need to achieve high export and inward investment growth rates. Indonesia is highly competitive on primary products and some manufacturing commodities.

The EU is the largest trading bloc worldwide. It exported goods and services worth 2.5 trillion USD in 2010, equivalent to 16% of the EU's GDP. These exports include 1,814.6 billion USD exports in goods, 699.6 billion USD of exports in commercial services. Total EU imports amounted to 2.5 trillion USD in 2010, of which 1,974.1 billion USD in goods, 602.1 billion USD in commercial services.

On 9 November 2010, the EU adopted a paper “Trade, Growth and World Affairs”, proposing a strategy to reduce trade barriers, open global markets and get a fair deal for European businesses. The strategy also recognises that Europe is the largest source of foreign direct investment abroad and that it attracts 29% of global foreign direct investment. It is in the EU's interest to keep the world trading system open and fair. Trade helps Europe to keep its edge in innovative, high-value products and services that generate sustainable, quality jobs.

2. INDONESIA'S TRADE POLICY

In order to enhance and maintain the positive trade balance with its trade partners, Indonesia's main trade policies and strategies are as follows:

- (1) Enhancing the competitiveness of non-oil exports products to diversify its export markets and increase diversity, quality and image of export products. Currently, Indonesia has 10 main export commodities, namely textile products and textiles, electronic tools, rubber and its by-products, palm oil, timber and forest products, footwear, automotive tools, shrimps, cocoa, and coffee. Indonesia is also developing other potential export commodities, such as leather products, medical tools, herbal plants, fish and fishery products, spice, and jewellery. Among services, Indonesia is focused on construction, information technology, and labour-related services.
- (2) Improving the business climate for external trade by improving services in licensing and non-licensing related to external trade.
- (3) Increasing Indonesia's role and capacity in international trade diplomacy to minimise tariff and non-tariff barriers in exports markets by increasing participation at various international forums and negotiations.
- (4) Improving distribution networks to support the development of the national logistics system, strengthening the internal market and the effectiveness of the goods market, and improving the effectiveness on monitoring and business climate. This policy is embodied in the long term plan for developing the economic corridors, strengthening the national connectivity system, and accelerating human resource capacity development.

3. EU'S TRADE POLICY

The European Commission uses trade policy to help exit the current crisis and to create the right environment for a strong EU economy. Specifically, the Commission proposes:

1. to complete its ambitious negotiating agenda at the WTO by 2011 and with major trading partners such as India and Mercosur and launch new trade negotiations with several ASEAN countries. Completing this agenda would increase European GDP by more than one percent per year;
2. to deepen trade relations with other strategic partners, such as the US, China, Russia and Japan, where the main focus will be on tackling non-tariff barriers to trade;
3. to help European businesses, in particular SMEs, access global markets by setting up a mechanism to redress the balance between open markets in the EU (for example in public procurement) and more closed markets with our trading partners;
4. to start negotiating comprehensive investment provisions with some of EU key trading partners;
5. to make sure trade is fair, and EU rights are properly enforced, translating promise on paper into concrete benefits (i.e. improve market access, IPR etc.);
6. to ensure that trade remains inclusive so that the benefits go to the many, not the few. EU aims to set up a new framework of rules for trade preferences for developing countries.

4. FOR MORE INFORMATION

<http://www.kemendag.go.id>

http://trade.ec.europa.eu/doclib/docs/2010/november/tradoc_146955.pdf





III INDONESIA-EU INVESTMENTS

1. INDONESIA – AN IDEAL INVESTMENT LOCATION

The Investment Coordinating Board of The Republic of Indonesia (BKPM) encourages investment in ‘remarkable Indonesia’ - targeting total investments for 2011 of 26.4 billion USD. Indonesia is promoted for its democratic rule, economic potential, natural resources, large and growing domestic market and young and technically trained work force. Indonesia is the world’s fourth most populous country, a G-20 member and has a growing middle class and a strategic geographical position in the region, especially towards other ASEAN countries.

The UNCTAD ‘World Investment Prospects Survey’ identifies Indonesia as part of the top ten attractive destinations for foreign direct investment (2009-2011). Indonesia is close to reaching investment grade by the beginning of 2012, as indicated by two major rating agencies (S&P and Moody’s) that recently upgraded their ranking of Indonesia.

2. SUPPORTED BY INCREASED INTEREST AND FIGURES

According to BKPM, total realised investment (both domestic and foreign direct investment) amounted to 23.0 billion USD in 2010, a 54.2 percent increase from 2009. FDI in Indonesia is becoming increasingly geographically diversified, with investment realisation outside Java increasing by 174 percent from 2009 to 2010. The EU remains Indonesia’s second largest source of FDI (after Singapore) and this trend is expected to continue throughout 2011.

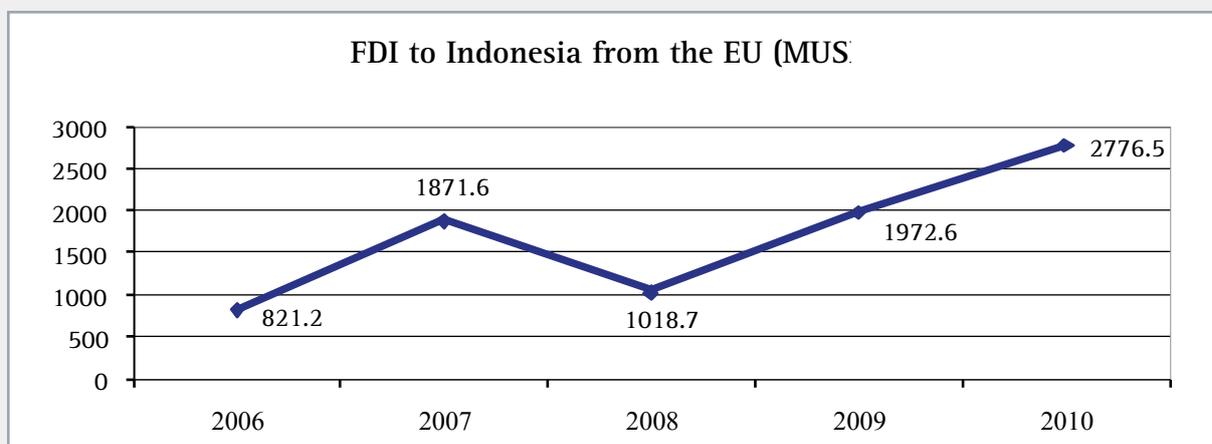
Share of FDI realisation in Indonesia by country of origin:

| Country | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|-------------|------|------|------|------|------|------|
| Singapore | 24% | 8% | 36% | 10% | 40% | 31% |
| EU | 9% | 31% | 10% | 13% | 18% | 17% |
| Japan | 13% | 15% | 6% | 9% | 6% | 4% |
| South Korea | 5% | 8% | 6% | 2% | 6% | 2% |

Source: BKPM.

3. INCLUDING FROM THE EU

It is estimated that EU’s total investment in Indonesia amounts to 66 billion USD, with over 700 EU companies present in Indonesia, employing over 500,000 people, but there is potential for much larger figures. EU investors focus on sustainable development, fair employment conditions and high quality products, services and technological solutions.

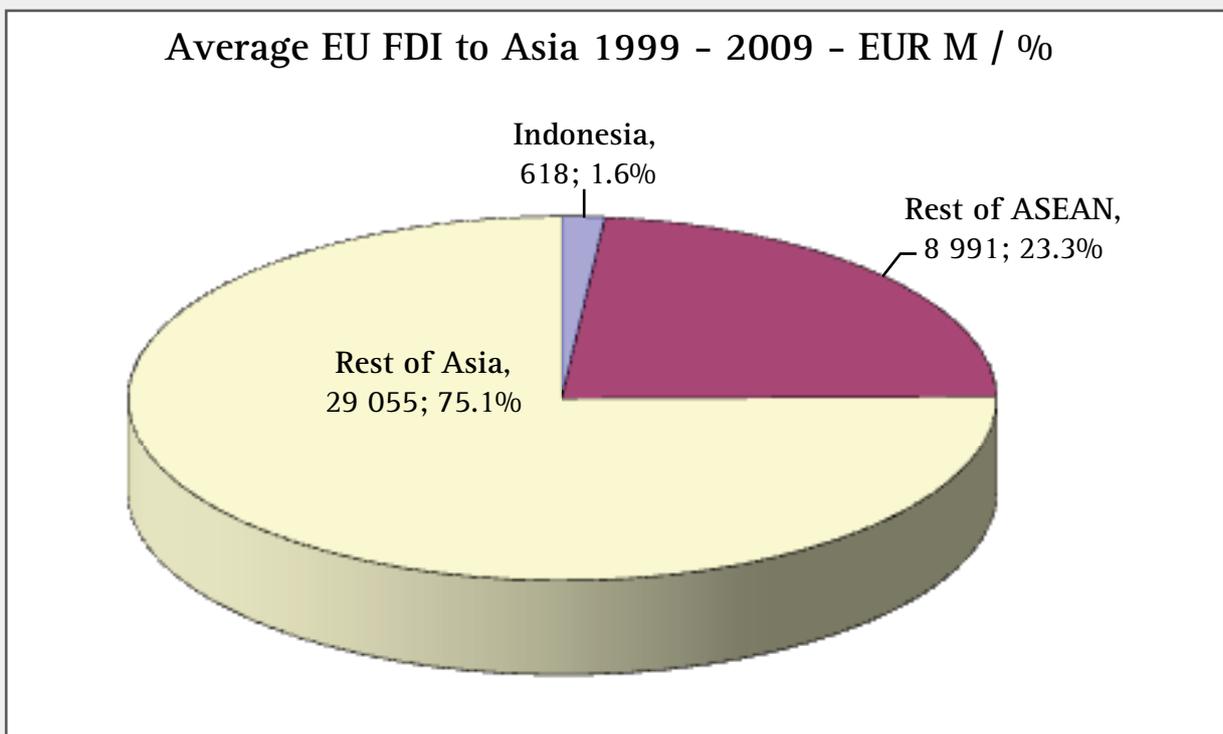


Source: BKPM.

Data collected from an investment survey conducted by the EU Delegation in Jakarta displays that the main sectors of EU investment include electronics, construction, chemical and pharmaceutical industry, power generation, mining and manufacturing of non-metallic mineral products.

4. ... BUT NOT ACCORDING TO ITS POTENTIAL

However, although EU is the world's largest source of investments, only 1.6% EU investment to Asia goes to Indonesia. Even though Indonesia's population represents 45% of all ASEAN countries, it only receives 10% of FDI designated to ASEAN and only 7% of EU investments to ASEAN go to Indonesia. EU companies prefer investments in other ASEAN countries mainly due to better trade and investment climate, fewer restrictions on foreign investment and even more rapid economic growth rates.



Source: Eurostat.



IV INVESTMENT POLICY

1. INDONESIA'S INVESTMENT POLICY

Since the 1998 Asian financial crisis, the quality of infrastructure in Indonesia has continued to deteriorate as a result of the decrease in public spending in real terms, as well as due to many private sector infrastructure projects being delayed or cancelled. This has already decreased the supply capacity of the Indonesian economy and reduced potential growth to pre-crisis levels.

The Indonesian government therefore prioritises developing physical infrastructure which can be integrated into the domestic economy including the construction of roads nationwide and inter-island transportation systems to integrate the domestic economy. Indonesia also seeks to ensure the development of domestic "soft" infrastructure, including improved bureaucracy, simplification of investment licensing, reduction of the cost of doing business, legal certainty, and simplification of regulations. Deregulation to eliminate institutional hurdles to domestic trade flows; actions against non-competitive behaviour within the domestic economy; and improvements in the domestic climate for doing business should be given the highest priority in economic policy. Several of those priorities have been implemented, including simplifying bureaucratic procedures in trade, simplifying documentation, operating ports on a 24-hour, seven days a week basis, and harmonising national, regional and international regulations

2. THE LATEST DEVELOPMENT OF INVESTMENT POLICY REFORM

Indonesia has estimated that its total infrastructure needs from 2010 to 2014 are around US\$ 21.3 billion. The strategy on infrastructure development in five-year national development plan 2010 – 2014 consists of:

1. Enhancing Public Private Partnerships:

- Shifting the role of the government to become a facilitator or promoter.
- Focus on service sustainability through efficient and effective investment.

2. Connectivity:

- Developing infrastructure which accelerates the flow of goods and information.

3. Economic Corridors:

- Encouraging industrialisation through regional the development of centres in six Priority Economic Corridors.

3. EU'S INVESTMENT POLICY

The EU is the world's biggest player in the field of Foreign Direct Investment (FDI). By the end of 2009 outward stocks of FDI amounted to 4.9 trillion USD while EU inward stocks accounted for 3.6 trillion USD.

The Lisbon Treaty's attribution of EU exclusive competence on FDI integrates FDI into the common commercial policy. Until now, the Union and the Member States have separately built around the common objective of providing investors with legal certainty and a stable, predictable, fair and properly regulated environment in which to conduct their business. Those investments are secured via Bilateral Investment Treaties (BITs). They establish the terms and conditions for investment by nationals and companies of one country in another and set up a legally binding level of protection in order to encourage investment flows between two countries. Amongst other things BITs grant investors fair, equitable and non-discriminatory treatment, protection from unlawful expropriation and

direct recourse to international arbitration. With a view to ensuring external competitiveness, uniform treatment for all EU investors and maximum leverage in negotiations, a common international investment policy should address all investment types and notably assimilate the area of investment protection. The Union should follow the available best practices to ensure that no EU investor would be worse off than they would be under Member States' BITs.

Through investment negotiations, which in principle would be conducted as part of broader trade negotiations, the EU should seek to obtain binding commitments from its partners that guarantee and protect the free flow of all forms of investment. Stand-alone investment negotiations would also remain an option. In the short term, the Commission will seek the adaptation of negotiating directives to enlarge the scope of negotiations for a number of countries with whom trade negotiations are ongoing, where strong interests exist and where requests have been formulated. While the principles and parameters for such negotiations will be inspired by 'best practices' that Member States have developed, this Communication already submits some broad contours of the scope and standards the Union should be setting through international investment negotiations.

EU investment policy is focused on providing EU investors and investments with legal certainty and a stable, predictable, fair and properly regulated environment in which to conduct their business. The EU-Korea Free Trade Agreement is the most recent example of an agreement that reflects EU investment policy negotiations. Its main principles are: i) focus on long-term investment, ii) improved market access, iii) fostering transparency by clarifying the regulatory framework; iv) it aims at freeing the flow of payments and investment-related capital movements, and v) it seeks to facilitate the movement of investment-related natural persons.

4. FOR MORE INFORMATION

www.bkpm.go.id

http://ec.europa.eu/development/icenter/repository/tradoc_118805_en.pdf

http://trade.ec.europa.eu/doclib/docs/2008/november/tradoc_141470.pdf



V AID FOR TRADE

1. WHAT IS AID FOR TRADE

“Aid for Trade” (AfT) is development assistance provided in support of the efforts of developing countries to develop the basic economic infrastructure and tools they need to expand their trade. The intention behind the AfT Initiative is not to create a new global development fund for trade, but rather to expand financial resources devoted to trade as part of existing development strategies. AfT has a broad scope, encompassing both aid directly helping beneficiaries formulate and implement trade policies and practice (“Trade Related Assistance”), and aid supporting developing beneficiaries’ wider economic capacity to trade, e.g. invest in infrastructure and productive sectors (“wider AfT”).

The EU is one of the leading providers of Aid for Trade. On 15 October 2007, the EU Council adopted the EU AfT Strategy aimed at supporting developing countries to further integrate into the global trading system. The strategy is a joint EU policy initiative, providing for a double and complementary focus on more resources to AfT and better impact on development objectives, especially with a view to poverty reduction. Total AfT commitments of the EU have constantly increased over the period 2004–2007, to reach €7.2 billion in 2007.

EU AfT is delivered as other EU aid, following agreed Aid Effectiveness principles. This means going through policy dialogue, needs assessments, inclusion of priorities into national and regional development strategies (such as Poverty Reduction Strategy Papers), and formulation of response strategies on this basis. This is the only way to ensure ownership, coherent programmes and sustainability.

2. SUPPORT TO INDONESIA

2.1. EU Delegation

EU cooperation with Indonesia is focused on trade policy issues and improvement of infrastructure for Indonesian exports, in sectors where needs have been identified by the Government of Indonesia. Future co-operation will also focus on export quality infrastructure issues and supporting improvement in regulatory issues affecting the trade and investment climate.

The EU Delegation support to improvement of trade and economic conditions has been a constant priority area of cooperation for the EU with Indonesia and total disbursements of assistance has amounted to EUR 20 million during the period 2006–2009. EUR 9.3 million is allocated to improve Indonesia’s public financial management systems and is implemented through a Multi-Donor Trust Fund. In addition, major cooperation initiatives, such as the EU-Indonesia Trade Support Programme II (EUR 15 million) address the need to strengthen the quality infrastructure that ensures compliance of Indonesian exports to international standards. Finally, the upcoming EU-Indonesia Trade Cooperation Facility (EUR 12.5 million) will support the reform programmes of the government to improve trade and investment climate, covering important topics such as trade and investment policy, technology transfer and intellectual property rights.

The EU has also supported the Indonesian business associations and chambers of commerce, which are key actors in the improvement of trade and investment climate in the country. This support has been channelled through grant programmes such as the Small Projects Facility, which will be continued in 2011 with a similar scheme directed to the civil society organisations involved in the trade and investment sector (EUR 2.5 million).

There is also an important EU-ASEAN cooperation programme that aims at supporting ASEAN Economic Integration. There are six on-going or about to start projects, amounting to EUR 38.7 million, covering areas such as customs, standards, IPR, single civil aviation market, statistics for trade and investment and other trade-related aspects. New programmes which will start in 2011 support ASEAN FTA negotiating process (EUR 2.5 million) and the ASEAN Economic Integration Support Programme (EUR 15 million).

2.2. EU Member States

EU Member States are also active in the field of trade and investment.

The Netherlands assists the Ministry of Marine Affairs and Fisheries to improve sanitary conditions for fisheries exports. The Netherlands contributes US\$ 10 million to the Multi Donor Facility for Trade and Investment Climate for the period 2008-2013. In addition, a facility for improving the investment climate in Indonesia's regions is implemented by the Benelux Chamber of Commerce in Indonesia (INA), amounting to IDR 8 billion.

Germany supports SME development, including improving export skills, together with multilateral and other bilateral donors. These programmes have disbursed over EUR 130 million during 2007-2009.

The Czech Republic financed a regional transport infrastructure project in Yogyakarta, totalling EUR 280,000 over the past three years.

Spain has a facility of supporting commercial projects, primarily in the infrastructure sector, implemented by Spanish companies. The facility has run since 2004 and amounts to EUR 210 million, whereof 50% is through a soft loan and 50% on commercial terms. In 2008 a regional programme commenced to enhance the livelihood of fishermen. The programme amounts to EUR 1.8 million for Indonesia during five years.

Sweden supports a number of trade organisations in Sweden and Indonesia in a textile trade promotion programme. An expanded programme for other sectors (furniture and food products) is being planned and expanded cooperation around policy issues affecting international trade is being discussed. Sweden finances an air transportation programme for eastern Indonesia. Corporate social responsibility is another prioritised area with discussions being initiated. The indicative budget for 2010 – 2012 is around SEK 3 million (around EUR 0.4 million).

3. FOR MORE INFORMATION

http://ec.europa.eu/development/icenter/repository/tradoc_118805_en.pdf

http://trade.ec.europa.eu/doclib/docs/2008/november/tradoc_141470.pdf



VI EDUCATION COOPERATION

1. INTRODUCTION

Investment in education is crucial for a country's economic development. Education is the main focal sector for EU cooperation with Indonesia. A number of programmes are in place to support the improvement of Indonesia's education system.

2. ERASMUS MUNDUS

The Erasmus Mundus (EM) scholarship programme, funded by the European Commission (EC), has awarded over 7,000 scholarships for students and scholars from all over the world since 2004. 266 Indonesians have received the Erasmus Mundus scholarships. Altogether, the EU and the EU Member States provide some 1,000 scholarships a year to Indonesian students. This is in addition to the number of Indonesian students graduating in the EU who finance their own studies. The Erasmus Mundus Master Course (EMMC) is open for graduate students to undertake EMMC in at least two or more universities in two or more EU countries; and scholars/ academicians/ researchers to conduct teaching and research periods of three months at two or more universities in two or more EU countries. Erasmus Mundus Joint Doctorate (EMJD) degree offers fellowships covering up to three years of doctoral activities.

Erasmus Mundus Action 2 – Partnerships among Higher Education Institutions (former Erasmus Mundus External Cooperation Window) is a funding opportunity to support the establishment of cooperation partnerships between Higher Education Institutions (HEIs) in Europe and other countries.

3. THE EDUCATION SECTOR SUPPORT PROGRAMME (ESSP)

The EU contributes over €200 million (+ an expected second phase of €144 million) to the education sector for the period of 2010–2015 with the objective of supporting key policies and strategies in the education Renstra 2010-14 to ensure nation-wide access to, quality of, and good governance in basic education services.

Activities under this programme include:

- An initial contribution of €180 million over 2010-12 will be channelled as sector budget support. Part of the EU budget support is a performance-based component used as an incentive measure against achieving agreed results related to increasing access to education, achieving education quality standards and school accreditation, and developing capacity of school principals, supervisors and key district officials in managing the delivery of basic education.
- A complementary technical cooperation component of € 20 million over 2010-15 provides the Government with technical expertise and access to international knowledge and best practices to implement necessary reforms to achieve its education objectives.

4. BASIC EDUCATION SECTOR CAPACITY SUPPORT PROGRAMME (BE-SCSP)

The EU contributed €20 million to improve the capacity of local authorities and schools to deliver quality basic education and to improve district and provincial plans and budgets for basic education. Activities included:

- Component 1 (implemented by the ADB) has assisted the Government with defining Minimum Service Standards for basic education which define the minimum conditions that need to be provided by districts and schools/ madrasah for quality teaching and learning to occur. These standards are now enacted into Ministerial Decree 15/2010.

- Component 2 (implemented by UNICEF) has assisted with the identification and dissemination of good practices in basic education that have proven to be effective, efficient and affordable in increasing the quality of basic education. The project has directly targeted 12 districts and 505 primary and junior secondary schools, but an additional 2,500 schools have replicated the good practices using district/schools own resources.

5. THE BASIC EDUCATION SECTOR CAPACITY SUPPORT PROGRAMME 2 (BE-SCSP2)

- The EU contributes €17.5 million (+ €22 million from the Netherlands government) in 2008-2012 to support the Government efforts to improve the delivery of basic education services in 50 districts of 9 provinces through targeted capacity building and strengthening of systems at local government level.

6. NON-STATE ACTORS AND LOCAL AUTHORITIES (NSA LA) IN DEVELOPMENT PROGRAMME - EDUCATION SECTOR

Complementing EU's bilateral assistance in the education sector, 8 projects are currently being implemented by non-state actors starting in the beginning of 2009 with a total amount of EU funding of EUR 1.4 million. These actions aim at improving access to quality basic education, fully in line with the Education Renstra. The main themes of the projects are capacity building of education stakeholders; advocacy to increase regional government's budget allocation for the education sector; promotion of budget management, reporting, monitoring and transparency of education budget at the regional and school levels; engagement of civil society in improving quality and access to education; improving the quality and increasing access to inclusive education; and the promotion of good teaching and learning practices.

7. FOR MORE INFORMATION (ON ERASMUS MUNDUS)

http://eacea.ec.europa.eu/erasmus_mundus/results_compensia/selected_projects_action_1_master_courses_en.php

http://eacea.ec.europa.eu/erasmus_mundus/results_compensia/selected_projects_action_1_joint_doctorates_en.php

http://eacea.ec.europa.eu/erasmus_mundus/funding/2011/call_eacea_41_10_en.php



VII EU-INDONESIA BUSINESS DIALOGUE

1. INTRODUCTION

The second EU-Indonesia Business Dialogue took place in November 2010 in Jakarta. It was an excellent example of an integrated dialogue where business and government discussed various opportunities between Indonesia and the EU. Eight recommendations were formulated at the end of the meeting which are given in the following paragraph. During the first Vision Group meeting, these recommendations were presented to the Vision Group members as some of the follow-up related specifically to the Vision Group work. Follow-up meetings took place with business and government, most recently with Vice Minister Mahendra Siregar, to look at ways of implementing the recommendations.

2. RECOMMENDATIONS

As presented by the Indonesian Chamber of Commerce (Kadin)

1. EU and Indonesia to focus more on opportunities
 - a. develop a vision to ensure our trade and investment relations reach the next level of growth
2. EU and Indonesia should pave the way towards a comprehensive partnership agreement
3. EU and Indonesia to put in place a mechanism to improve transparency and consultation on government regulations
4. EU and Indonesia to improve regulatory cooperation through improved communication and technical dialogues
 - a. business should be integrated in this dialogue
5. EU to support Indonesia through cooperation and technical assistance:
 - a. To make regular impact assessments on draft regulations
 - b. Capacity building for implementing regulations
 - c. To implement international standards in key sectors such as UNECE standards for the automotive sector
 - d. To develop better understanding of EU laws and regulations including SPS measures, REACH, FLEGT and RED
 - e. Capacity building to help meet EU regulatory requirements
 - f. To develop capacity building programs for new market opportunities in cosmetics and herbal products
6. Indonesia to cut red tape in areas such as mandatory certification and registration system for industrial and food products
 - a. Give specific attention to easing requirements on SNI
 - b. Facilitate registration and labelling of agro food products in Indonesian

7. Indonesia to improve the investment climate in key areas including infrastructure, medical and pharmaceuticals and ensure better protection of IPR
 - a. Review the negative list related to the pharmaceutical sector
 - b. Enforcing a stronger agenda on public-private partnerships (PPPs) and its regulatory framework
 - c. Implementation of land acquisition and government guarantee funds policies should be done dealt soon sand effectively.
8. Establish mechanisms and processes for business and government cooperation in Indonesia. To strengthen the communication on trade and investment challenges and opportunities between the GoI and the business sector, represented by Kadin and the European chambers in Indonesia, it is recommended that:
 - a. Specific focal points to be nominated in the MoT, BKPM and other relevant agencies and in the business sector to prepare and handle issues
 - b. A regular and structured mechanism for consultation to be established between business and government, facilitated by the focal points, which will provide a clear and constructive interface for consultation.

3. FOR MORE INFORMATION

www.eibd-conference.com/





VIII TIMBER EXPORTS AND FLEGT – FOREST LAW ENFORCEMENT, GOVERNANCE AND TRADE

1. INTRODUCTION

The European Commission published the Forest Law Enforcement, Governance and Trade (FLEGT) Action Plan in 2003, which sets out a range of measures available to the EU and its Member States to tackle illegal logging and related trade. Indonesia is a key partner of the EU in the context of the FLEGT Action Plan. In particular, Indonesia is the first Asian country to have concluded the negotiation of a Voluntary Partnership Agreement (VPA) with the EU. Actions in other consumer countries, such as the amendment to the Lacey Act by the USA in 2008 to prohibit commerce in illegally sourced plants reflect the fact that fundamental changes that will benefit producers and traders of legal and sustainable timber are taking place in consumer markets.

Timber is an important tradable good and crucial for the EU industry. Figures show an increase in the world trade of 27% in the last years, of which the bulk goes to the EU, which imports reached almost 100 billion Euros in 2010 (including trade between EU member states). Despite the impressive market growth, Indonesia's exports have remained relatively small – meaning opportunities are not fully grasped.

2. EU'S ILLEGAL TIMBER REGULATION

EU's "Illegal Timber Regulation" builds on a comprehensive public consultation and impact assessment process. It has benefited from inputs received from Indonesian stakeholders during this process and the regulation was adopted in October 2010. Its aim is to counter the trade in illegally harvested timber and timber products through three key obligations:

- (1) It prohibits the placing of illegally harvested timber and products derived from such timber on the EU market;
- (2) It requires EU traders who place timber products on the EU market for the first time to exercise 'due diligence'; Once on the market, the timber and timber products may be sold on and/or transformed before they reach the final consumer. Economic operators in this part of the supply chain have an obligation to:
- (3) Keep records of their suppliers and customers.

The Regulation covers a wide range of timber products including solid wood products, flooring, plywood, pulp and paper. Exceptions are recycled products. FLEGT timber is considered to meet the due diligence requirements. FLEGT timber (i.e. timber produced under a FLEGT Voluntary Partnership Agreement between the country concerned and the EU) is subject to independently verified legality controls which provide a good level of assurance as to the legality of the timber. This source of timber is therefore exempt from the administrative requirements of the Regulation. Indonesian exporters will therefore benefit from an advantage on the EU market once the VPA is effectively implemented. The application of the Regulation will start from 3 March 2013 to allow sufficient time for EU operators, timber producers and Member States, as well as trading partners, to prepare for its implementation.

3. EU-INDONESIA VPA NEGOTIATION

A VPA is a binding agreement between the EU and a Partner Country by which they undertake to implement a credible timber licensing scheme to eliminate illegally-produced timber from a Partner Country's international and domestic trade. The credibility of the VPA relies on the development of a Legality Assurance System (LAS). The purpose of the LAS is to provide a reliable means to distinguish between legal and illegally produced forest products. Issuance of licenses by Partner Countries requires a system for ensuring that only legally-produced timber is licensed for export. This must include checks of forest operations and also control of the supply chain from harvesting to export.

Indonesia is the largest timber exporter country to have concluded the negotiation of a VPA. The successful conclusion was announced in Jakarta on 4 May 2011 by EU Trade Commissioner Mr De Gucht and Indonesian Forestry Minister Mr. Hasan. There are currently five countries developing the systems agreed under a VPA (Indonesia, Ghana, Cameroon, Central African Republic, and Republic of Congo) and six countries that are negotiating with the EU.

The start of the EU-Indonesia VPA negotiation was officially announced in 2007. Negotiations started in 2009, following the adoption of Indonesia's new timber legality verification system (SVLK) and the release of the proposal on the illegal timber regulation by the European Commission. The agreed LAS will be subject to an independent technical evaluation to confirm that the licensing scheme is fully operational before the VPA is implemented.

Expected impact and benefits

- Enhanced reputation of Indonesian timber products as well as secured and easier access to the EU market in the context of the EU's illegal timber regulation.
- Contribution to improved forest governance and law enforcement in Indonesia
- Contribution to Indonesia's response to climate change in the land use and forestry sector. The importance of combating illegal logging to Indonesia's climate change response is acknowledged by the GoI in several climate change policy and program documents such as the Letter of Intent concluded with Norway as well as Bappenas "Yellow Book" and the Climate Change Program Loan matrix, all referring to measures related to combating illegal logging.
- Increased revenue collection from the timber sector.
- Supply of legal timber to EU buyers.

EU and member states (UK) are supporting the FLEGT implementation in Indonesia through a variety of cooperation programmes, worth EUR 15 million and are in the process of identifying new areas of support.

4. MORE INFORMATION

http://ec.europa.eu/environment/forests/illegal_logging.htm

http://ec.europa.eu/environment/forests/timber_regulation.htm



IX EU REACH REGULATION

1. INTRODUCTION

The EC Regulation no.1907/2006 established a single integrated system for the Registration, Evaluation and Authorisation of Chemicals (REACH). The purpose of the REACH Regulation is to ensure a high level of protection of health and the environment as well as the free circulation of substances on the internal market. The Regulation entered into force on 1 June 2007.

The features of REACH which is of most direct impact to business are those pertaining to the 'Registration' and 'Authorisation' process. 'Registration' concerns the process by which information on chemicals, produced or imported above a certain threshold, will need to be submitted for registration in a central database. 'Authorisation' relates to the procedure whereby substances that are deemed to cause great concern will need to be expressly authorised before they can be manufactured or imported into the EU, and would need to be progressively replaced, where they are found to cause unacceptable risks to human health and the environment.

The REACH Regulation does not apply to business entities which are not established in the EU. Regarding substances which are manufactured outside the EU but that are imported in the EU, the obligation to make sure that they are in compliance with REACH falls primarily upon their importers. Non-EU operators cannot directly access the registration system. Manufacturers of substances that are established outside the EU and export their substances to the EU may, on a voluntary basis, appoint an only representative to conduct the registration.

The obligation to register substances manufactured or imported in the EU will be implemented gradually:

- November 2010: Registration deadline for substances manufactured or imported in quantities of 1000 tonnes and above, as well as carcinogens, mutagens and substances toxic to reproduction above one tonne per year, and substances classified as very toxic to aquatic organisms above 100 tonnes.
- June 2013: Registration deadline for substances manufactured or imported in quantities of 100 tonnes and more.
- June 2018: Registration deadline for substances manufactured or imported in quantities of one tonne and more.

A study carried out by the Government of Indonesia in 2009 indicated that 522 Indonesian companies mainly from furniture, chemical, metal, textile, leather and paper industries would be affected by the regulation of REACH. The study showed that the average readiness of Indonesian industries to meet REACH requirements was 42.6%.

2. EXEMPTION OF PALM OIL DERIVATIVES

Interested parties have the possibility to comment at various stages of the process of identification of substances that will require an authorisation (all information about the consultation process is available at ECHA's website).

Annexes IV and V of the REACH legislation set out substances and groups of substances that are exempted from registration, evaluation and downstream user provisions of REACH. The Commission adopted a review of these Annexes in October 2008 to include a number of additional substances to be exempted from registration. The list of those substances that will not need to be registered was expanded to include certain vegetable and animal oils, fats and waxes, as well as certain types of glass and ceramic frits. The Asian, including Indonesian, Oleochemical Manufacturers were included in this process. EU Commissioner for Trade Mr. de Gucht informed the Minister of Trade of Indonesia Mrs. Mari Elka Pangestu of the exemption of palm oil derivatives such as fatty acids and glycerol under Annex V, REACH in his letter on June 7, 2010.

3. TECHNICAL COOPERATION

The REACH legislation is accompanied by guidance documents for domestic EU producers and importers to ensure smooth operation of the system. The European Union Delegation in Jakarta has also translated the most important brochures about REACH into Indonesian. Issues associated with the technical and practical implementation of the REACH Regulation are primarily a matter of the European Chemicals Agency, which has a helpdesk.

During the Third Working Group on Trade and Investment between Indonesia and the EU on December 1st 2010, Indonesia expressed its concerns regarding its laboratory capacity and the costs to companies, especially SMEs, who lack necessary tools as well as expertise to comply with the REACH regulation. Indonesia – EU trade and cooperation programmes started in 2011 under which compliance with REACH could be discussed as part of the cooperation programmes managed by the Ministry of Trade of Indonesia, but that would require better understanding of the concrete challenges Indonesian companies face related to the REACH regulation and that the issues relate to export quality infrastructure.

Regarding SMEs, the amount of information that is required in the context of registration is related to lower tonnage ranges. Additionally, significant reductions in fees and charges for SMEs (up to 90%), have been foreseen in the Regulation.

4. FOR MORE INFORMATION

http://ec.europa.eu/environment/chemicals/reach/reach_intro.htm

<http://echa.europa.eu/>



X TECHNICAL BARRIERS TO TRADE (TBT)

1. INTRODUCTION

The TBT Agreement, negotiated during the Uruguay Round, is an integral part of the WTO legal framework. Key principles underlying the TBT Agreement are (1) non discrimination; (2) proportionality – measures should not be more trade restrictive than necessary to achieve the objectives pursued; (3) harmonisation through the use of relevant international standards; and (4) transparency, notably through an obligation to notify draft technical regulations and conformity assessment procedures to the TBT Committee at an early stage and take account of comments from other WTO members.

This means that technical standards should be aligned with international standards and should not impose unnecessary burdens for traders. Technical standards should not be used as a barrier to trade. Legitimate use of technical standards include: national security requirements; the prevention of deceptive practices; protection of human health or safety, animal or plant life or health or the environment. In assessing such risks, relevant elements of consideration are, inter alia: available scientific and technical information related processing technology or intended end-uses of products.

2. EU'S POLICY

Technical requirements arise through all sectors of the economy. Their impact on trade arises through the costs of (1) adjusting products and production facilities to comply with differing requirements in different markets and (2) demonstrating compliance with these requirements. The impact on trade of technical requirements can be very significant and at times excessive.

The EU takes a risk-based approach to its procedures to assess conformity with its requirements. In many sectors deemed of low-risk, the EU offers the option of a Supplier's Declaration of conformity. The EU believes that mandating certification for low-risk products may lead to disproportionately burdensome obligations on economic operators. A central EU objective in the TBT field is to facilitate exports by EU manufacturers by reducing technical barriers which unnecessarily restrict trade in world markets. The EU also promotes greater harmonisation of technical regulations, standards and conformity assessment procedures.

In the EU, standardisation is a voluntary process of developing technical specifications based on consensus among all interested parties (industry including Small and Medium-sized Enterprises, consumers, trade unions, environmental Non Governmental Organisations, public authorities, etc). Overall, the EU strives to develop a better regulatory environment for businesses. This initiative aims at simplifying existing regulations, reducing administrative burdens and using impact assessments and public consultations when drafting new laws and regulations.

3. INDONESIA'S POLICY

Standardisation is a supporting element of TBT that has an important role in optimising the utilisation of resources in development activities in Indonesia. Government Regulation No. 102 of 2000 regarding National Standardisation sets out the National Standardisation System (SSN), which is coordinated by the National Standardisation Agency (BSN) assisted by the technical Ministries in implementation.

The implementation of National Indonesian Standards (SNI) is mostly voluntary, meaning that the activities and products that do not meet the provisions of the SNI are not prohibited for trade. Thus, to ensure the acceptance and widespread utilisation of SNI, the application of norms of openness to all stakeholders and consistent with the development of international standards is a very important factor. However, for the purposes of protecting the consumer health and safety, national security and environment conservation, the Government can impose certain mandatory SNI.

The enforcement of mandatory SNI is done through the issuance of technical regulations by government institutions or agencies which are authorised to regulate the activities and the circulation of products. In this case, the activities and products that do not meet the provisions of the SNI are prohibited from being traded. This provision is universally applied both to products manufactured domestically and imported products.

4. COOPERATION

The EU pursues a range of bilateral and regional initiatives aiming to reduce TBTs. These initiatives include regulatory cooperation (to make regulatory systems more compatible); mutual recognition agreements (to eliminate costs arising from unnecessary duplication of technical and / or certification requirements); and the provision of technical assistance for developing countries. The EU is continuously supporting Indonesia in upgrading its conformity assessment and testing framework with a view of upgrading the export quality infrastructure in selected sectors. This support has been ongoing since 2005 under the Trade Support Programmes I and II.

5. MORE INFORMATION

<http://ec.europa.eu/enterprise/tbt/>

http://www.wto.org/english/tratop_e/tbt_e/tbt_e.htm

<http://www.bsn.go.id>



XI INTELLECTUAL PROPERTY RIGHTS

1. INTRODUCTION

Strong intellectual property rights (IPR) protection is crucial to protecting and stimulating entrepreneurship and fostering creative economy. Counterfeit products are a threat to public health and good protection of IPR is a key to research and development. Furthermore, trade and investments are attracted by high standards of IPR protection which in return stimulate more innovation and thus national development. This all serves to achieve goals and benefits of integration into the global system. Countries with inadequate protection are often vulnerable to patent, copyright, and trade mark infringements that hinder trade flows, technological transfers and economic development. Improving the legal framework and strengthening enforcement are important cornerstones for investors as well as for new entrepreneurs stimulated by the economic policy aiming at encouraging creativity and innovation.

Protection and enforcement of intellectual property are crucial for the EU's ability to compete in the global economy as European competitiveness builds on the innovation and value added to products by high levels of creativity. Intellectual property rights such as patents, trade marks, designs, copyrights or geographical indications are becoming increasingly important for European inventors, creators and businesses. These rights enable them to prevent unauthorised exploitation of their creations and distinctive signs, or to allow such exploitation in return for compensation. One of EU's objectives is to see such standards respected by its trading partners. The EU works in the WTO to improve the protection and enforcement of IP rights and to continuously strengthen the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs). The EU negotiates IPR provisions in its bilateral trade agreements and was involved in the development of the Anti-Counterfeiting Trade Agreement (ACTA).

2. INDONESIAN FRAMEWORK

The Government's Medium Term National Development Plan includes culture, creativity and technological innovation as priorities. In the strategic plan of the Ministry of Trade, the main priority in the short term is to increase export performance through market and product diversification, including services such as design and information technology and as means to protect Indonesia's traditions and rich cultural heritage. IPR plays a crucial part to enhance and protect these sectors and its innovation potential. In particular, Indonesia supports the development of Geographical Indications (GIs) and the EU supported the process of registering Indonesia's first GI in 2008 (Kintamani coffee).

Following its 1994 ratification of the WTO Agreement, Indonesia has taken steps to develop and issue new intellectual property laws, create a better framework for protection of intellectual property rights and provide a better environment for the development of intellectual property and inventions. Still, less than 10% of all patents registered in Indonesia are domestic inventions, which is one reason for a need to focus on increasing awareness on the importance of intellectual property rights. Over the past decade there has been significant progress in the development of Indonesia's intellectual property (IP) laws and the implementation of those laws by the Directorate-General of Intellectual Property Rights (DG IPR). Right holders consider that Indonesia has an acceptable legal framework largely in line with WTO TRIPS agreement and containing strong penalties for infringements, although some issues of concern remain. Firstly, Indonesia has not in its legislation on patents implemented TRIPS Article 39.3 on data exclusivity. Secondly, a well known trademark has to be registered in Indonesia in order to enjoy protection.

Cooperation and coordination between government agencies needs improvements, particularly related to enforcement. The establishment and further strengthening of a National Task Force created in 2006 should help remedy this situation. Indonesia has an interest in improving these matters not only in order to enhance innovation and protect its own IPRs, but also as a response to demands from the international community as a way of fulfilling international commitments and thereby better integrating into the global trading system.

3. TECHNICAL COOPERATION

The regional EU-ASEAN programme on IPR, ECAP, started in 1993. The core objective of the ECAP programme has been to foster trade, investment and technology exchanges between Europe and ASEAN as well as to foster intra-ASEAN trade and investment. ECAP I assisted ASEAN in strengthening systems for the protection of industrial property rights, whereas ECAP II covered the entire spectrum of intellectual property rights, particularly enforcement. The third component, ECAP III, was launched in the first half of 2010. ECAP III aims at further harmonising and upgrading systems for intellectual property generation, protection, administration and enforcement in ASEAN, including in the ASEAN Secretariat, and builds on the previous two programmes. It will focus around five components, e.g. IPR enforcement, promotion of IP education, continued support to the implementation of geographical indication as well as awareness raising activities.

ECAP III will be complemented by a bilateral programme for Indonesia under the Trade Cooperation Facility set to commence in early 2012. This follows a strong wish from the Indonesian Government of a dedicated programme focusing on Indonesia specific issues. The purpose is to contribute to increasing legal certainty for investors and traders and enhancing the competitiveness of Indonesia's goods and services through benefitting from a strengthened protection of intellectual property rights. It is proposed that the project centres around three areas: i) Support the revision of the legal framework so as to further harmonise it with international treaties and best practices, ii) Strengthen enforcement and administration of legislation through better coordination between government agencies and more efficient administrative procedures, iii) Support the creation of an IP culture through awareness building activities.

There is also some bilateral co-operation between Indonesia and the EU Member States. The National Institute of Intellectual Property Rights of France has previously been engaged in a dialogue with DG IPR on geographical indications, formalised through a cooperation agreement. The Swedish IP office has through SIDA provided funding for basic IP training, implemented by WIPO (World Intellectual Property Office).

4. FOR MORE INFORMATION

<http://www.dgip.go.id/ebscript/publicportal.cgi>

<http://ec.europa.eu/trade/creating-opportunities/trade-topics/intellectual-property/>



XII RULES OF ORIGIN

1. INTRODUCTION

Rules of Origin are used to determine the criteria to decide whether goods were really produced or manufactured in the beneficiary country to which the preferential tariff treatment is granted. To be considered as originating in the beneficiary country concerned and thus to be able to benefit from the preferential treatment, goods must be wholly obtained (e.g. grown, mined) there or, where this is not the case, have undergone sufficient processing there. The rules of origin define “sufficient processing” by way of a list of origin criteria that vary from product to product.

2. RULES OF ORIGIN IN FREE TRADE AGREEMENTS

Free trade agreements (FTA) should include an agreement on ROO. ROO are used to determine whether goods traded between parties qualify for access to the tariff under the agreement. They are necessary to ensure that the benefits reciprocally negotiated under the agreement accrue principally to the parties to that agreement. Generally, to qualify for preferential tariff treatment under an FTA, a good must fall into one of three categories.

- The first category covers goods that are wholly obtained – that is, wholly sourced, produced or manufactured – in the territory of the FTA parties.
- The second category involves products manufactured in the territory of the FTA parties entirely from materials that themselves satisfy a ROO.
- The third category involves products using non-originating materials but produced in such a way as to satisfy a prescribed ROO.

To qualify for preferential tariff treatment as originating goods on the third category, goods must undergo substantial transformation.

- Change in tariff classification method requires a good, after production, to be classified under a sufficiently different tariff classification of the Harmonized Commodity Description and Coding System from the classification of the non-originating imported component materials.
- Value added method prescribes a threshold proportion of the value of a good that must be derived from materials and processing within the territory of an FTA party.
- Processing method requires specific manufacturing or processing operations to be undertaken in an FTA party’s territory, such as a chemical reaction.

3. REVISED RULES OF ORIGIN UNDER THE EU GSP REGIME

The European Commission on 18 November 2010 adopted a regulation revising rules of origin for products imported under the generalised system of preferences (GSP). This regulation relaxes and simplifies rules and procedures for developing countries wishing to access the EU’s preferential trade arrangements, while ensuring the necessary controls are in place to prevent fraud. The new rules of origin apply from 1 January 2011.

The Regulation adopted by the Commission today will considerably simplify the rules of origin so that they are easier for developing countries to understand and to comply with. The new rules take into account the specificities of different sectors of production and particular processing requirements, amongst other things.

The proposal also puts forward a new procedure for making out proofs of origin, which places more responsibility on the operators. From 2017, the current system of certification of origin carried out by the third country authorities will be replaced by statements of origin made out directly by exporters registered via an electronic system. This will allow the authorities of the exporting country to re-focus their resources on better controls against fraud and abuse, while reducing red-tape for businesses.

The underlying principles for the new regulation, namely, simplification and development-friendliness, were laid down in a Communication on the future of rules of origin in preferential trade arrangements adopted by the European Commission on 16 March 2005 following a wide-ranging debate initiated by a Green Paper of 18 December 2003. The Communication set out a new approach to rules of origin and envisaged that the first concrete application should be to the GSP.

4. FOR MORE INFORMATION

http://ec.europa.eu/taxation_customs/customs/customs_duties/rules_origin/index_en.htm



XIII CUSTOMS AND TRADE FACILITATION

1. INTRODUCTION

Today, customs are facing new challenges: they must ensure the smooth flow of trade whilst applying necessary controls, guaranteeing protecting the health and safety of citizens. To achieve the correct balance between these demands, customs procedures and control methods must be modernised and co-operation between different services must be reinforced. The modernisation of customs should rely on two pillars: a modern customs code and a comprehensive customs computerised system. Both are necessary in order to achieve trade facilitation correctly and efficiently control their international trade as well as to fight against illicit activities.

Trade Facilitation includes measures to simplify and modernise customs and other import and export procedures and requirements. As part of the ongoing round of multilateral trade negotiations, the Doha Development Agenda (DDA), WTO Members agreed in 2004 to launch negotiations on Trade Facilitation in order to improve WTO rules and technical assistance in this area.

For business, trade facilitation promotes transparency and cuts red tape. For governments, the benefits are also high. Trade Facilitation strengthens security through more effective controls, improves the investment climate and promotes higher customs revenues. Revenue loss from inefficient border procedures in some developing countries may exceed 5% of GDP. Inaction, in terms of not modernising can be very costly. Instead of gaining new opportunities, countries lose existing ones to more reform minded counterparts.

2. INDONESIA'S POLICY

One of Indonesia's main strategies in supporting its trade development is to promote trade facility by ways of energizing licensing service to public, debottlenecking barriers, securing foreign market access, and developing special economic zones.

Indonesia has launched its new online system called Indonesia NSW for its export-import activities. The main purpose for having a Single Window for a country or economy is to increase the efficiency through time and cost savings for traders in their dealings with various government authorities for obtaining the relevant clearance and permit(s) for moving cargoes across national or economic borders. The ASW-INSW (Asean Single Window – Indonesia Single Window) is Indonesia's national commitment within ASEAN cooperation and also to fulfil World Customs Organisation (WCO) recommendation.

A licensing permit system integrated with INSW is called Inatrade that is being developed under principles of transparency, single submission, integration, procedure streamlining and traceability.

In response to the challenge faced by Indonesian exporters, the Government of Indonesia formed a National Team to Promote Export and Investment (PEPI). The forum is expected to hold a constructive dialogue and to seek solutions among stakeholders.

3. EU'S POLICY

To effectively assume the expanded roles, EU customs pursue a continuous dialogue with stakeholders. In this context, consultation with the business sector has been enhanced. Trade associations are regularly invited to seminars and working groups to give their input to the development of new policy and legislative initiatives. For example, the Trade Contact Group, in which all major players in the international supply chain are represented, has been established.

The EU's objectives are to secure a framework of rules that would (1) increase the transparency of and ensure effective consultation on trade regulations; (2) simplify, standardise and modernise customs and other trade procedures; (3) improve the conditions for transit; and (4) make a significant contribution to the development dimension, including through enhancing technical assistance.

A new EU customs legislation was adopted at the end of 2006 concerning security of the supply chain, introducing a framework for better risk analysis of goods crossing EU borders. The regulation is aiming at increased security for shipments entering or leaving the EU and providing greater facilitation for compliant operators. From 1 January 2008, reliable traders (Authorised Economic Operators) respecting high standard security criteria benefitted from trade facilitation measures and from 1 January 2011, the electronic exchange of advance information between traders and customs authorities on all goods entering or leaving the EU was introduced. The regulation also requires customs authorities to exchange information electronically on exports in order to speed up export procedures. This legislation is consistent with the commitments taken by most Customs administrations throughout the world in relation with the adoption in 2005 of the WCO "SAFE framework of standards to Secure and Facilitate Global Trade".

4. COOPERATION

The EU is providing substantial support to ASEAN customs integration through its cooperation programme APRIS II. The project has developed an ASEAN Data Model as required for the ASEAN Single Window. A cargo customs clearance model has been developed and pilot tested in two countries. The protocol designing the ASEAN Customs Transit System and all technical appendices have been completed and endorsed.

Indonesia's Customs and Excise department has been offered to participate in capacity building and technical exchange under the umbrella of the Trade Cooperation Facility starting in 2012.

5. FOR MORE INFORMATION

<http://www.insw.go.id>

<http://inatrade.depdag.go.id/>

http://ec.europa.eu/taxation_customs/index_en.htm

<http://www.wcoomd.org/home.htm>

http://www.wto.org/english/tratop_e/tradfa_e/tradfa_e.htm



XIV BENEFITS OF TRADE

1. INTRODUCTION

1. More trade means more economic growth. External trade and investment boost economic growth. Trade policy can help this to happen.
2. Trade means more jobs. Trade also leads to higher salaries and improved living standards.
3. Increased trade offers a greater variety of goods, at lower prices, to consumers.
4. Trade helps to reduce poverty. A World Bank study, which used data from 80 countries over four decades, confirms that open trade boosts economic growth and that the incomes of the poor rise one-for-one with overall growth. All things being equal, countries with open economies tend to grow faster than those that trade less.
5. Trade allows countries to procure the best products and services for its citizens internationally. This means government and local authorities can spend less public money on the products and services they purchase.
6. Trade and investment flows spread new ideas and innovation, new technologies and the best research, leading to improvements in the products and services that people use.
7. Trade brings people together. It develops and secures economic ties between nations and contributes to political stability.
8. Trade and investment boosts competition as well as competitiveness. It allows businesses to access inputs at the lowest prices, allowing them to compete on the world market.
9. Trade agreements can make it easier to do business. For example encouraging the use of international standards for industrial products reduces the costs of doing business and promotes international trade.
10. Trade makes it easier to exchange innovative or high-technology products. For example, international rules on intellectual property protect knowledge and allow the transfer of technology to other countries.

2. THE BENEFITS OF TRADE FOR INDONESIA

- (1) Economic growth performance. Indonesia was able to survive the global financial crisis in 1997 and has maintained a remarkable record of economic growth ever since. Some international institutions have started grouping Indonesia together with the BRIC (Brazil-Russia-India-China), a club of emerging markets whose total GDP is projected to surpass US and UK by 2030.

3. THE BENEFITS OF TRADE FOR THE EU

- (1) Economic growth: Completing the ongoing free trade negotiations and making significant further progress in our relations with strategic partners would lead, by 2020, to a level of EU GDP more than 1% higher than it would otherwise be.
- (2) Consumer benefits: a wider variety of products and lower prices brings gains to the average European consumer in the range of 600 Euros per year.
- (3) Labour effects: More than 36 million jobs in Europe depend, directly or indirectly, on the EU's ability to trade with the rest of the world. Foreign investment is also an engine for job creation: in the EU, more than 4.6 million people work for US and Japan-majority owned companies alone.





XV INDONESIA – EU PARTNERSHIP AND COOPERATION AGREEMENT

1. INTRODUCTION

Indonesia and the EU signed a Partnership and Cooperation Agreement (PCA) in November 2009. The PCA was the first of its kind between the EU and ASEAN countries. It is now in the process of ratification by both the 27 EU Member States and Indonesia, which should be completed by the end of the year. It opened a new era in bilateral relations of Indonesia and the EU, based on shared principles such as equality, mutual respect, mutual benefit, democracy and rule of law.

The Agreement aims at strengthening political, economic and sectoral cooperation across a wide range of policy fields, including trade, environment, energy, science and technology, and good governance, as well as tourism and culture, migration, counter terrorism and the fight against corruption and organised crime. The Parties of the Agreement undertook to hold a comprehensive dialogue and promote further cooperation between them on all sectors of mutual interest. Their efforts will in particular be aimed at:

- a) establishing cooperation bilaterally and in all relevant regional and international fora and organisations;
- b) developing trade and investment between the Parties to their mutual advantage;
- c) establishing cooperation in all trade and investment-related areas of mutual interest, in order to facilitate trade and investment flows and to prevent and remove obstacles to trade and investment;
- d) establishing cooperation in other sectors of mutual interest, notably tourism, financial services; taxation and customs; macro-economic policy; industrial policy and SMEs; information society; science and technology; energy; transport and transport safety; education and culture; human rights; environment and natural resources, including marine environment; forestry; agriculture and rural development; cooperation on marine and fisheries; health; food safety; animal health; statistics; personal data protection; cooperation on the modernisation of the state and public administration; and intellectual property rights;
- e) establishing cooperation on migration issues, including legal and illegal migration, smuggling and trafficking in human beings,
- f) establishing cooperation on human rights and legal affairs;
- g) establishing cooperation on countering the proliferation of weapons of mass destruction;
- h) establishing cooperation on combating terrorism and transnational crimes, such as the manufacturing and trafficking of illicit drugs and their precursors and money laundering;
- i) enhance existing and encourage possible participation of both Parties within relevant sub-regional and regional cooperation programmes;
- j) raising the profiles of both Parties in each others' regions;
- k) promoting people-to-people understanding through cooperation of various non-governmental entities such as think-tanks, academics, civil society, and the media, in the form of seminars, conferences, youth interaction and other activities.

Through the establishment of a Joint Committee and a number of sectoral working groups, the PCA will steer cooperation and ensure a comprehensive and more intensive dialogue between Indonesia and the EU. Findings and recommendations from the Joint Committee will feed in the meetings at Ministerial level.

2. COOPERATION ON TRADE AND INVESTMENT

General principles of the cooperation on trade and investment between Indonesia and the EU, laid down in the Agreement include the following:

- The Parties shall engage in a dialogue on bilateral and multilateral trade and trade-related issues with a view to strengthening bilateral trade relations and advancing the multilateral trade system.
- The Parties undertake to promote the development and diversification of their reciprocal commercial exchanges to the highest possible level and to their mutual benefit. They undertake to achieve improved market access conditions by working towards the elimination of barriers to trade, in particular through the timely removal of non-tariff barriers and by taking measures to improve transparency, having regard to the work carried out by international organisations in this field.
- Recognizing that trade plays an indispensable role in development, and that assistance in the form of trade preferences schemes have proven beneficial to developing countries, the Parties endeavour to strengthen their consultation on such assistance in full WTO compliance.
- The Parties shall keep each other informed concerning the development of trade and trade-related policies such as agricultural policy, food safety policy, animal health policy, consumer policy, hazardous chemical substances, and waste management policy.
- The Parties shall encourage dialogue and cooperation to develop their trade and investment relations, including the provision of technical capacity.

3. LINK TO BILATERAL TRADE AGREEMENTS

The EU is of the view that any bilateral trade agreement forms part of the political relationship with third countries and should be integrated in a broader Partnership and Cooperation Agreement. Therefore an appropriate link to the PCA would need to be made in any future trade agreement.

4. FOR MORE INFORMATION

http://eeas.europa.eu/delegations/indonesia/documents/eu_indonesia/eu_idnpca_en.pdf



XVI FISHERIES

In the last decade, the expansion of international trade in fishery products has exceeded the growth in total fish production in the world. This rapid expansion reflects the large increase in consumption of marine products in the EU and US markets as well as many other regions in the world. Among these fast-growing markets, the European Union is not only the world's largest market (accounting for 25 percent of the world's total imports), but it is among the fastest growing markets for high-value imports like shrimp, tuna, bass and bream. The prospects for these markets continue to be favorable. Overall, the outlook for the global fishery market is robust, and EU fish imports are expected to grow by 8 percent annually in the medium-term.

There is considerable scope for Indonesia to increase the amount of fisheries that it exports to the EU market. Indonesia accounted for only 1.4 percent of total EU imports from third countries in 2010. If it were to expand its share of exports to the EU market to the same proportion as the European Union's share of world imports, Indonesia's foreign exchange revenue from its fishery exports would more than double.

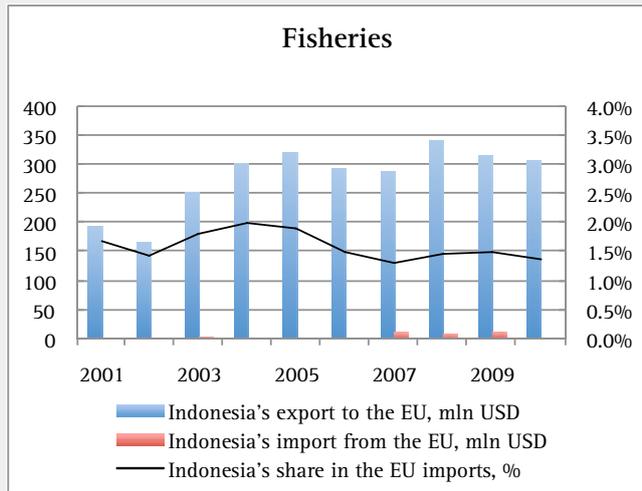
For Indonesia, the rapid expansion of the global fishery market and the European Union's strong market for high-value imports offers a number of excellent opportunities.

- Indonesia has a cost advantage in its proximity to large marine and fishery resources and its abundant labor supply, which helps to offset shipping costs to the EU market.
- Indonesia's fishery industry has the chance to reverse the EU market share losses it suffered in the last decade because of external competition from large exporters like Ecuador and China, as well as the internal inertia in addressing testing and accreditation hindrances and trade impediment.
- Secondly, Indonesia's exports could be increased in terms of traditional exports and diversified into various other fish species and processed products that are in high demand abroad, for example, the main exports from aquaculture are shrimp (unfrozen, frozen and canned), crabs (unfrozen, frozen and canned), frog legs (fresh or chilled), ornamental fish (freshwater and mariculture), mollusks (scallops and snails), including capture products like tuna, jelly fish and coral fish as well as fish fat and oil and shrimp crackers.
- A third opportunity lies in aquaculture growth and development, where opportunities exist for community-based economic activities and rural development, along with greater foreign exchange earnings from exported aquaculture products. Given that two-thirds of Indonesia's territory consists of marine and inland waters with an abundance of natural resources, the development of aquaculture and sustainable capture fisheries has the potential to make the fisheries industry a leading engines of growth and development for the country.

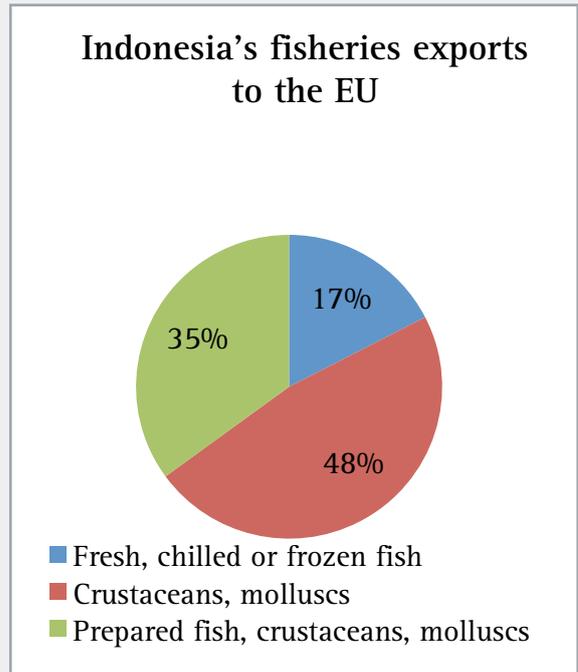
The fishery market is highly price competitive, and some countries have a competitive advantage because of preferential tariff rates under free trade arrangements (FTAs) with the European Union, like those under the unilateral instrument of GSP plus, or the Everything But Arms (EBA) arrangement that include duty-free and quota-free access for products originating in Least Developed Countries (LDCs). Indonesia is a GSP beneficiary with preferential duties on fisheries.

For EU fishery imports, the average MFN tariff rate is 10.8 percent, with a range of 0 to 23 percent; the average GSP rate is 7.1 percent, with a range from 0 to 19.5 in the case of some products like fresh, chilled or frozen sardines, some tunas like long-finned and yellow-fin tuna, and skipjack or stripe-bellied bonito. For crustaceans, an ad valorem tariff of 11.1 percent applies to third countries, with a range of 6 to 18 percent; the preferential tariff rate for GSP recipient countries is 5.1 percent, with a range of 2.1 to 14.6 percent. Between 2003 and 2008, Indonesia was the beneficiary of an annual tariff quota of 2,832.5 tons of canned tuna exports to the European Union. The duty applicable was 12 percent. Since 2009, the applicable tariff has reverted to that of the most-favored nation (MFN) at a rate of 20.5.

The Ministry of Marine Affairs and Fishery (MMAF) has been appointed by the European Union as the Competent Authority for fishery products in Indonesia. The efforts of the MMAF in recent years to improve the quality relevant elements have been very successful and have lead to a drastic reduction in the number of rapid alerts issued by the European Union.



Source: Eurostat.





XVII AUTOMOTIVES

Indonesia's automotives industry has potential to become a big player on the world market. During the last 5 years, Indonesia's market and production of cars and motorcycles has grown around 7-8% a year.

Indonesia is in a very strong position to become the largest car manufacturer in ASEAN because of its strong domestic demand, skilled labour, and growing component industry. The large size of the Indonesian population and the low level of car ownership in the country suggest there is a lot of potential for expansion for the automotive industry. For example, in 2007, only one in every thirty-five people in Indonesia owned a car, compared with one in fourteen in Thailand and one in seven in Malaysia.

Automotives industry in Indonesia consists of several assemblers of various types of cars and motorcycles and hundreds of component producers. Indonesia is a production base for multi-purpose vehicles and light commercial trucks. Domestic manufacturers serve as the assemblers for foreign, primarily Japanese, motor vehicle companies. In general, the main activity of Indonesian automotive companies is assembling, either intermediate goods (parts of motor vehicles) or final goods (cars and motorcycles).

Investment in production facilities, geared in part towards the export market, has become increasingly common. Vehicle export volumes, primarily to Malaysia, Thailand and Japan, are relatively low, but are beginning to rise, as Indonesia's importance as a production base within the Southeast Asian region increases. Toyota Astra, a subsidiary of Japan's largest carmaker Toyota, accounts for about 90 percent of the Indonesian car exports.

European carmakers are under-represented in Indonesia. Indonesian auto industry consists of mostly Japanese manufacturers. According to the Association of Indonesia Automotive Industries Gaikindo there was only one European car manufacturer in Indonesia, Mercedes-Benz, who belonged 100% to German Daimler AG and manufactured Mercedes-Benz cars in Indonesia (annual capacity 20,000 units). Japanese cars also dominate the domestic motor vehicles market. Out of the 750 000 cars sold in Indonesia in a year, only 5000 are European (mostly Mercedes Benz and BMW).

The future of cars lies in environmentally friendliness and energy saving. Indonesia plans to follow in the footsteps of Thailand by offering incentives for the production of fuel-efficient cars. European car manufacturers have the know-how and state-of-the-art technology for modern car production and they are willing to invest in Indonesia.

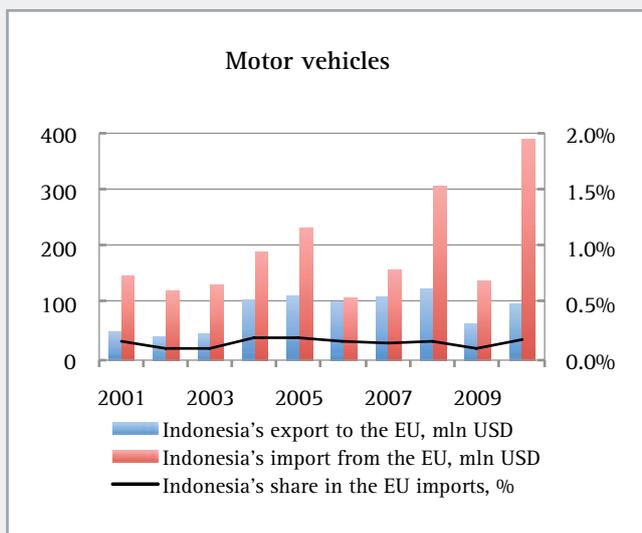
The European Automotive Industry is a leader in the global automotive market, with integrated automobile operations that combine research, design, development, production and sales. It has a dense worldwide network of joint ventures, production and assembly sites. Europe is the world's largest vehicle producer with an output of over 15 million passenger cars, vans, trucks and buses per year, or 25% of worldwide vehicle production (China produces 23%, NAFTA 14%, Japan 13%, South Korea 6%, and Indonesia 0.9% of the world's total). Leading in high-quality products, the industry sells and produces vehicles in all major world markets.

The automotive sector is Europe's largest private investor in R&D. According to the EU Industrial Investment Scoreboard, the sectors 'automobiles and parts' and 'commercial vehicles and trucks' represented R&D investment of 46 billion USD in 2008. In 2008, almost 6,300 patents were filed by the European automotive industry. They made up 55% of all automotive applications at the European Patent Office. 23% of automotive applications came from Japan, 16% from the US, 1% from China/Taiwan and 1% from South Korea.

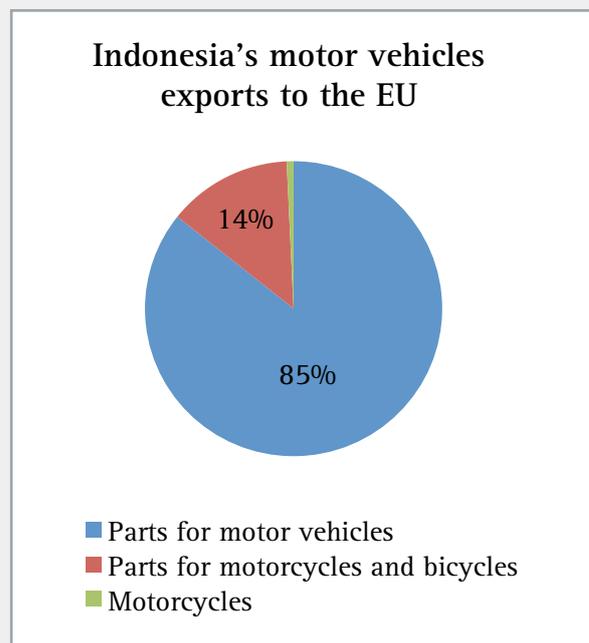
Volkswagen has expressed interest in making Indonesia its production base. Volkswagen officials have stated that they would build a factory in Indonesia in 2012 for a full car manufacturing, while in 2010 they already started assembling its MPV, Touran, in cooperation with Indomobil.

In addition, German premium brand Audi has chosen Indonesia as its next Asian production base, after China and India. Audi expects car sales in the country to grow by 15% in 2011, and the premium segment to double by 2015. Assembly of the A4 1.8-litre TFSI and A6 2.0-litre TFSI has already started, in cooperation with local firm Garuda Mataram Motor, a subsidiary of the Indomobil Group. Audi is aiming to achieve assembly of 2,700 units by 2015.

In 2010 the EU imported 58 billion USD of motor vehicles and vehicles parts. The EU mostly imported cars from Japan, Turkey, USA, and South Korea. Indonesia's share in the EU imports was only 0.2%.



Source: Eurostat.

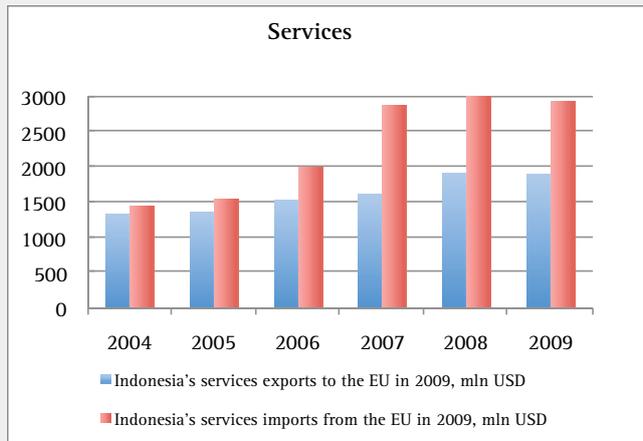




XVIII SERVICES

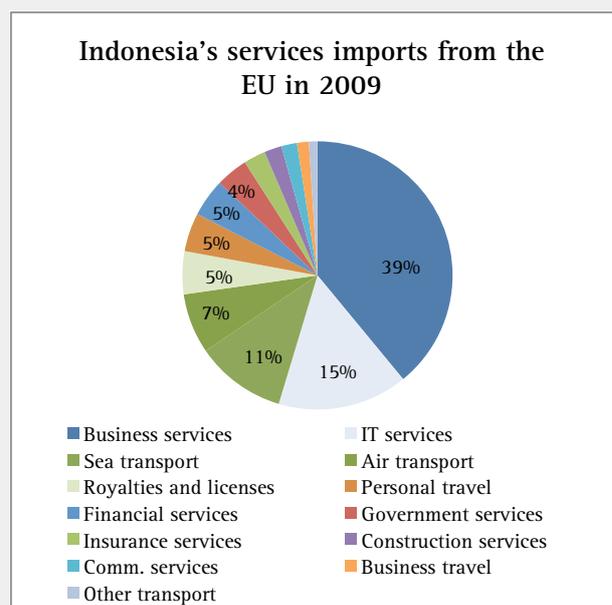
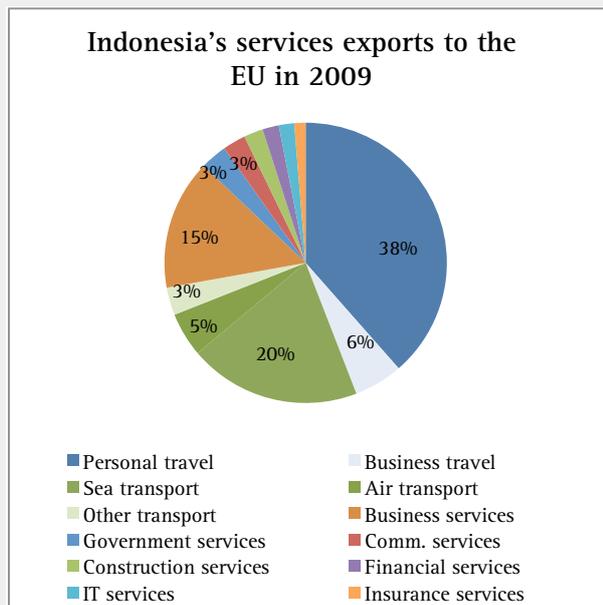
Rapidly expanding services sector is contributing more to economic growth and job-creation worldwide than any other sector. The services sector accounted for three-quarters of the gross domestic product for the European Union (EU) and 53% for Indonesia in 2010.

Indonesia's trade in services with the European Union has increased during the last 6 years, but the trade deficit has widened due to an increase in the imports of different business services from the EU. Indonesia's services' exports to the EU amounted to 2 billion USD and imports from the EU reached 3 billion USD in 2009. Indonesia has remarkable potential to increase its services exports to the European Union and convert the trade deficit into a trade surplus.



Source: Eurostat.

Indonesia has a comparative advantage vis-à-vis the European Union in labour-intensive services: tourism, transportation and construction. New potential export opportunities are also emerging in communication, IT and business services. In 2009 Indonesia mostly exported to the EU tourism and transport services, when the EU mainly offered to Indonesia business, transport and IT services.



Source: Eurostat.

Indonesia could increase its export revenues from tourism, both leisure and business travel. Indonesia attracted 7 million foreign tourists in 2010 that spent around \$1,000 each. Around 59% of all visitors travelled to Indonesia for holiday, while 38% for business purposes. Three quarters of Indonesia's visitors came from the Asia-Pacific region, with Singapore and Australia among the top countries of origin. Only less than 1 million Europeans visited Indonesia in 2010, spending around 1500 USD each.

Maximising export revenues from tourism is dependent on the necessary and efficient infrastructure being in place. Tourists rely on efficiently operating transport, telecommunications and financial services. Indonesia needs to develop these essential services for the benefit of tourism but also other sectors. European investors are interested in infrastructure development in Indonesia and Indonesia could benefit from their knowledge and financial resources. The archipelago of more than 17,500 islands has beaches, mountains and dive-spots among its diverse attractions, but tourism infrastructure outside Bali is often poor. Indonesia is also well behind its tiny neighbour Singapore, which attracts around 10 million tourists a year, and Malaysia, which sees around 20 million foreign tourist arrivals every year.

Air traffic between Indonesia and Europe is expected to increase. Garuda Indonesia has managed to re-establish its foothold in the European air cargo market in 2010 and plans to expand its network in Europe in the coming years.

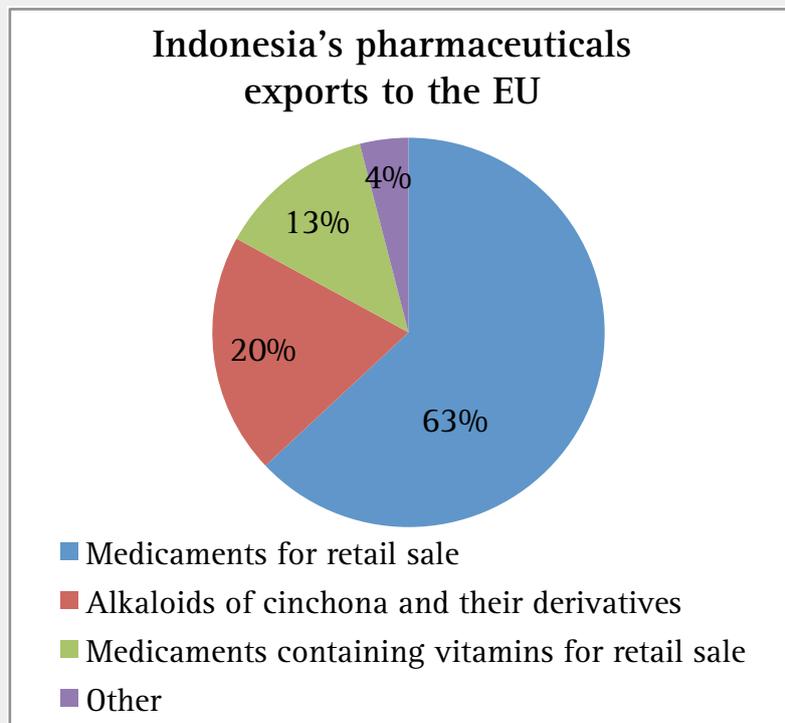
Transportation sector in Indonesia benefits from strong economic growth and trade flows. The EU is the most important foreign investor in the transportation sector in Indonesia, providing 50% of total FDI. During the last seven years, the EU has invested 3.2 billion USD (1.2 billion USD in 2010) in the transportation, storage, and communication sector of Indonesia.



XIX PHARMACEUTICALS

There is remarkable scope for cooperation between Indonesia and the EU in the pharmaceutical sector. Combining vast natural and human resources of Indonesia with the know-how and technology of European investors would result in an increase in the competitiveness of pharmaceutical companies in Indonesia.

The EU is a big and growing market for Indonesian pharmaceutical products. EU pharmaceuticals market is the world's second largest after the USA. Around 590 billion USD was spent on medicines in 2007 in Europe and this amount will likely continue to increase as the population ages. Overall, in 2007, the market for prescription and non-prescription medicines for human use in the EU was worth 189 billion USD at ex-factory and 293 billion USD at retail prices. The EU market (extra EU imports) has substantially grown, 2 times during the last 10 years. Around 80% of pharmaceuticals imports to the EU come from Switzerland and the USA. Indonesia only provided 0.02% of EU imports in 2010.



Source: Eurostat.

Herbal medicine is one area where Indonesia could create a competitive advantage in the EU market, following increased interest in 'alternative medicines' in the EU (and growing imports of related products), coupled with a well developed industry in Indonesia and availability of resources. Typical ingredients for common recipes include varieties of ginger; spices such as nutmeg, cardamom, cumin and cloves; certain chillies; and fruits like papaya and banana. The availability of raw materials to make traditional herbal medicine is relatively abundant in Indonesia. The results of studies conducted by the Indonesian Institute of Science showed that 30,000 of the 40,000 available species of world medicinal plants are found in Indonesia.

Many countries in Asia, like India, Singapore, and Thailand benefit from medical tourism. Indonesia could also become a medical tourism destination in the future, if it would invest in good quality medical service with the help of FDI.

The market size of pharmaceutical products in Indonesia is estimated to be around US\$ 3.9 billion in 2010, with an impressive average annual growth of 10% in the last five years. The country possesses huge manufacturing capabilities. The Indonesian pharmaceutical industry consists of chemical-pharmaceutical and non-chemical traditional (herbal) medicine manufacturers. The market consists of 170 local companies including four state owned companies and 32 foreign companies. Out of the estimated 32 multinational pharmaceuticals companies operating in Indonesia, there are around 20 European companies with an active presence.

Indonesia has exported pharmaceutical products for a long time. Indonesia mainly exports quinine and its derivatives as well as herbal medicines. Exports of quinine and its derivatives mainly go to Germany, USA, Singapore, UK, Vietnam, Spain, and Canada. Exports of herbal medicine mostly go to Pakistan, Iran, and Hong Kong.



XX AGRI-FOODS

In Indonesia the processed foods industry has steadily increased its contribution to the total output value of the Indonesian economy. Its share of the economy's total value added rose from 13 percent to more than 16 percent during the decade. Its impact on the growth and employment of other sectors has been large because of upstream and downstream linkages to primary sector and input activities and service-related industries. The commodity composition of exports is fairly evenly distributed among cereal, flour and starch preparations; vegetable and fruit preparations; and other types of food preparations.

The geographic composition of Indonesia's exports of agri-foods is highly concentrated on the ASEAN regional market. Around half of industry's exports are directed at neighboring countries, especially the Philippines, Malaysia, Singapore, Vietnam and Thailand. The EU and U.S. markets each absorb about 15 percent of Indonesia's agri-food exports. The share of exports destined for countries in Europe, the United States and Japan is small compared with the size and agri-food absorption of those markets. The European Union, for example is the world's largest market for these types of products.

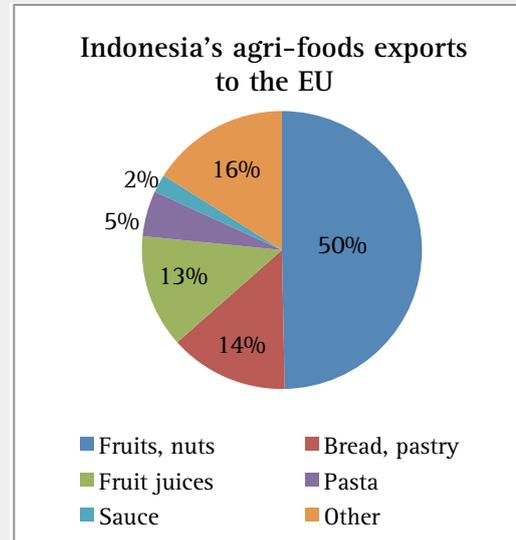
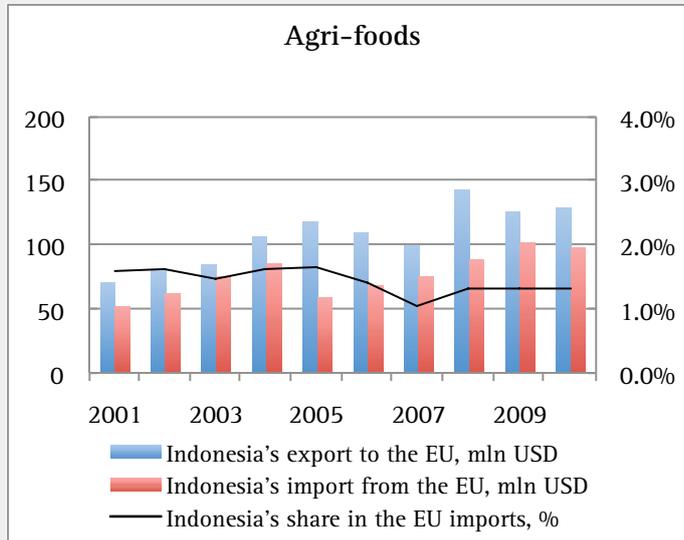
In Europe processed foods are becoming an increasingly important part of consumer expenditures as people look for more convenient ways to store and prepare food. Consumers spend 12 percent of their income on food consumption and domestic production supplies about 90 percent of the EU market. The main sub-sectors are processed fruits and vegetables, cereal-based products, processed meats and dairy products. EU demand for quality agri-food products is growing rapidly, and sourcing from non-EU producers is outpacing intra-EU sourcing.

The European Union's fruit subsector is the most dependent on foreign supplies (about one-fourth of domestic utilization). For that reason, imports of fruits tend to predominate in the EU imports of processed agri-foods. Fruit and vegetable juices are the largest processed agri-food imported into the European Union, accounting for over 18 percent of all agri-food imports. The fruit and vegetable juice subsector has one of the fastest growing markets in the European Union, and Indonesia has an abundance of tropical fruits and vegetables that places it in a privileged position. At present, Indonesia's exports are small compared to its potential.

Another potential export article from Indonesia to the EU is processed meat. Processed meat imports into the European Union have grown by an average annual rate of 13 percent a year, outpacing all other food groups by a significant margin.

An important growth area is organic food ingredients and food products. Europe has been unable to supply its population in this sub-sector.

Five countries dominate third country competition in the EU market for agri-foods: Brazil, Turkey, China, United States and Thailand. Together these countries account for one-half of the European Union's imports of food products from non-EU suppliers. As a country having a similar profile to that of Indonesia, Thailand has been highly successful in expanding its exports to the EU market because of its good infrastructure, favorable government policies towards foreign investment, tax incentives, and successful promotion of SME food processors. Indonesia's share of the EU market is modest and there is considerable room for growth. However, trade balance with the EU has been positive over the years.



Source: Eurostat.

Two-way trade of agri-foods between Indonesia and the European Union generally takes place in different types of products. Each trading partner is specializing in the types of products in which it has a comparative advantage.

Duty rates for Indonesian exporters shipping processed agri-food products to the EU markets vary across individual products within each category. For meat preparations, an ad valorem tariff of 16.9 percent applies to third countries, and a preferential tariff rate of 12.4 percent applies to Indonesia. For processed cereals and starches, an ad valorem tariff of 6.4 percent + 24.6 EUR/100 kg and a non-preferential tariff quota applies to third countries, and a preferential tariff rate of 7.4 percent applies to Indonesia. For preparations of vegetables, fruit, nuts or other parts of plants, an ad valorem tariff of 10.9 percent applies to third countries 14.4 percent (no preferential rate).



XXI ELECTRONICS

Electronics is Indonesia's largest contributor of foreign exchange earnings from manufactured exports. It accounts for nearly one-fifth of total manufacturing exports, with consumer electronics leading industrial electronics by a two-to-one ratio. The industry contributes around 6 percent to Indonesia's gross domestic product.

Development of the industry dates back to the 1970s when the Japanese established joint ventures with Indonesian firms to access the domestic market in the period of import-substitution policies. When Indonesia adopted an export-oriented industrialization strategy in the 1980s, foreign electronics companies used the country as one of their export bases, benefitting from low production costs in Indonesia.

Strengths of Indonesia's electronics industry include:

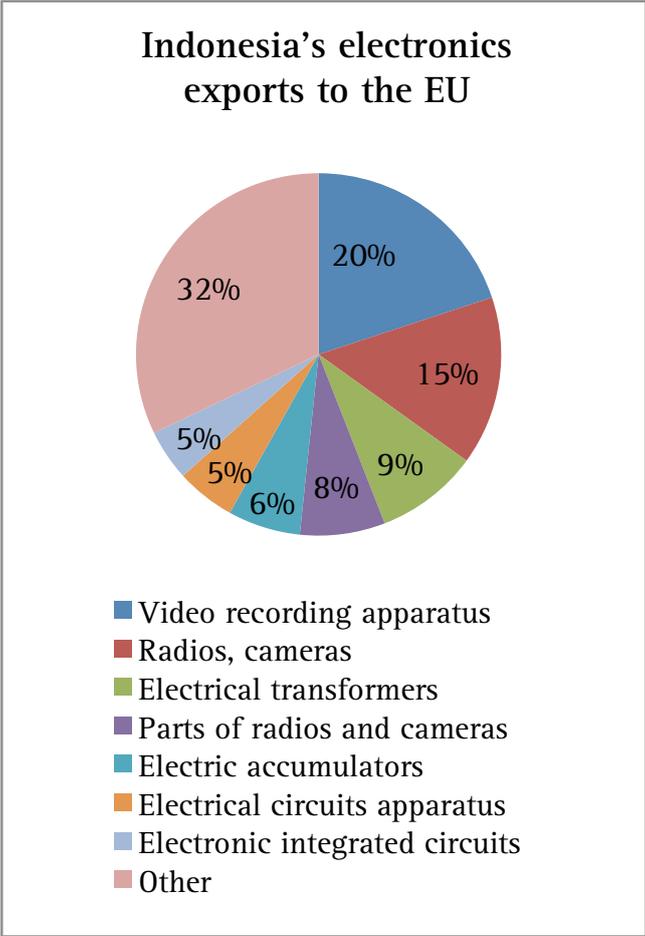
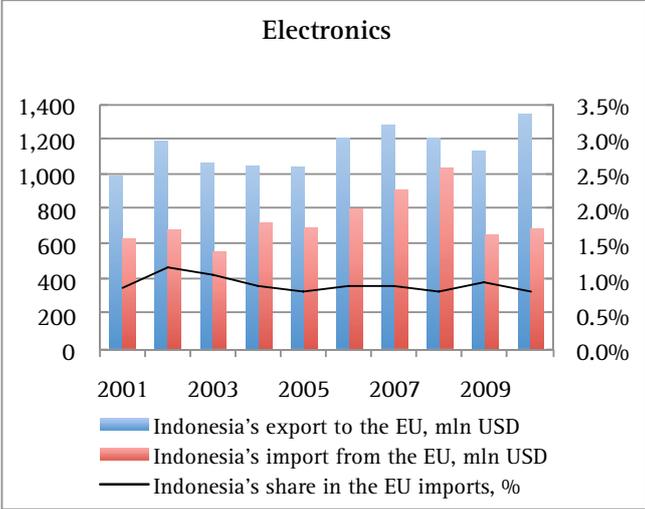
- Well functioning supply chains governed by international companies.
- Competitive cost structure relative to EU producers.
- Flexible production systems.
- Availability of several laboratories with increasing capabilities.

The EU market offers good opportunities for Indonesia's electronics as EU consumer demand for electronic products is strong and growing in all sub-sectors and there are relatively low market access requirements for third country products.

The European Union is a net importer of electronic components, with imports volume of US\$240 billion in 2010. The European Union is Indonesia's largest export market for consumer electronic products, followed by the US and ASEAN. Indonesia's exports of consumer electronics are concentrated on a few basic types of products. About 70 percent of exports are in the form of sound-recording and video-recording apparatus. Television and radios account for around 10 percent of exports each. There is a small amount of refrigerators and heating units exported. Other minor exports are electric shavers and dishwashers.

Indonesia's share of the EU consumer electronics market has been stable in recent years, and there is considerable scope for increasing Indonesia's market share. Recently, the industry's output has begun to surge again as multinational electronics enterprises relocate their production from China due to rising labour costs.

Chinese products dominate the EU market of consumer electronics. Almost 60 percent of all non-EU imports originate from China. Although Indonesia is the seventh largest non-EU supplier of consumer electronics in the EU, its market share is relatively small. Indonesia primarily supplies video recording equipment (25% of total EU imports), radio and television transmitters (18%), and radio and television parts (11%).



Source: Eurostat.

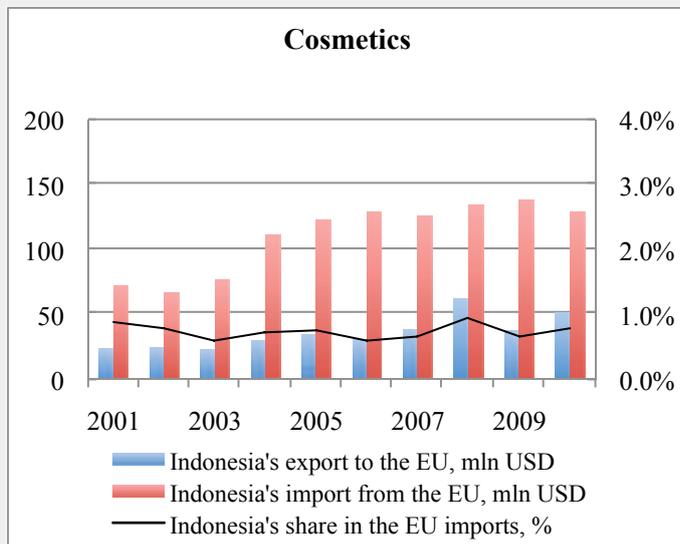


XXII COSMETICS

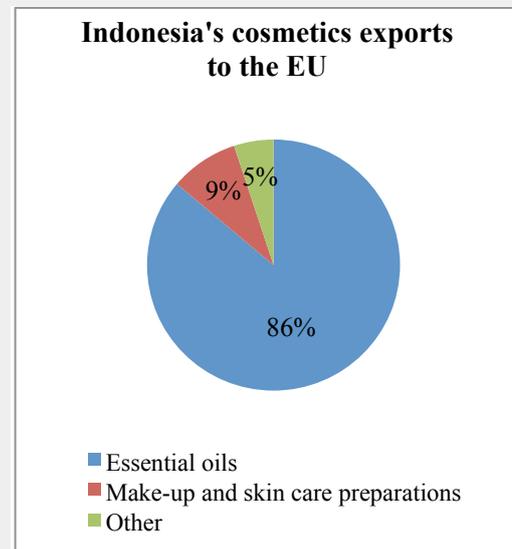
One of the fastest growing segments of the global cosmetic market is products with natural ingredients. Recent data suggests that EU and US consumption of cosmetics that use natural ingredients is growing by 8 percent a year, compared with a growth of 5 percent for all types of cosmetics. Indonesia has one of the most biodiverse environments in the world, with access to a large variety of natural cosmetic ingredients. The country has a long tradition of producing natural cosmetics using its vast plant resources. Approximately 700 companies produce a wide variety of cosmetics.

Exports of the industry in Indonesia are concentrated in the ASEAN region, and are mainly in the form of essential oils and beauty makeup preparations. In the area of end-use products, Indonesia exports beauty make-up preparations in the form of perfumes and toilet waters, and hair products. In the area of ingredients used in the production of natural cosmetics, Indonesia mainly exports essential oils of geranium, which accounts for over 70 percent of essential oils, resinoids and terpenic by-products, and essential oils of vetiver, which accounts for most of the remaining exports in this category.

Indonesia only exports 10 percent of its natural cosmetic products and ingredients to the European Union, even though the European Union is the world's largest market. The cosmetic market of the European Union is nearly as large as the combined markets of the United States and Japan. Common growth patterns are occurring throughout the European Union in sun care products to protect against rising concerns about skin cancer. In addition, the aging population of Europe is generating growing demand for anti-aging creams and anti-cellulite skin care products. There is also growing demand for natural and organic products across all age groups.



Source: Eurostat.



Because of strong and rising consumption of cosmetic products in the European Union, imports have grown rapidly in the last ten years, averaging nearly 10 percent a year. The largest product categories are make-up and skin care products. The European Union imports nearly US\$7 billion worth of cosmetics annually, three-fourths of which come from China, Switzerland and the United States. A mere 0.8 percent comes from Indonesia. Nonetheless, the growing concern of end-users about the presence of possible harmful 'synthetic' ingredients offers Indonesia a considerable opportunity to improve its presence in the EU market and elsewhere.

For Indonesian exporters shipping cosmetic products to the EU markets, the following are the specific market access requirements:

1. Tariffs: For cosmetics, an average MFN rate of 2.5, and an average preferential tariff rate of 0.2 percent apply to Indonesia.
2. Specific requirements on technical standards applicable to cosmetic products cover (a) health and marketing conditions for cosmetic products; (b) marketing requirements for dangerous chemicals, pesticides and biocides (when intended to be used in plant protection products and/or biocides), and prohibition of products containing fluorinated greenhouse gases (when used with aerosols for entertainment and decorative purposes containing hydrofluorocarbons); and (c) rules of origin.

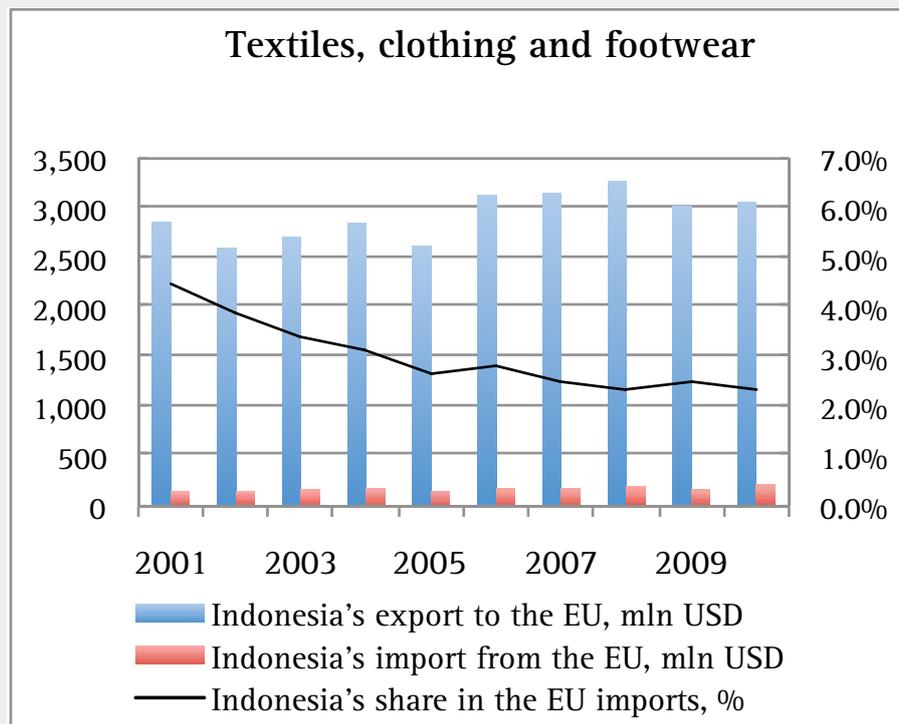


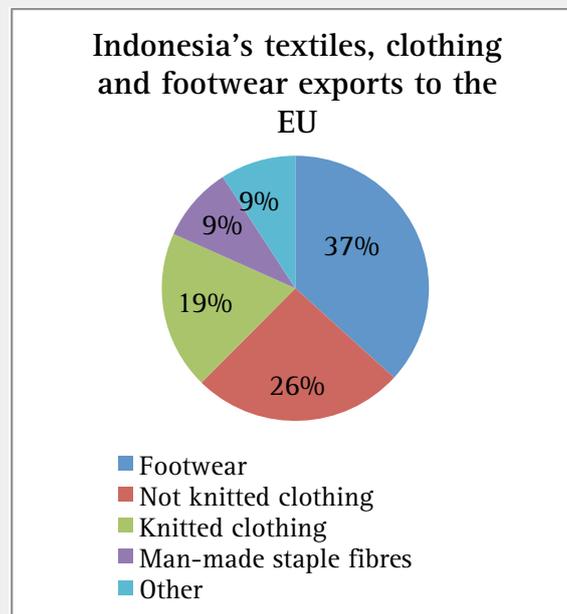
XXIII TEXTILES, CLOTHING AND FOOTWEAR

The textile, clothing and footwear industry is expected to remain a major contributor to Indonesia's economy. Indonesia still has a comparative advantage in labour-intensive industries. Some companies have already shifted their production from China to Indonesia due to rising labour costs. Indonesian Textile Association expects Indonesian share on the global textiles market to rise from 1.8 percent in 2011 to 2.5 percent in 2014. The competitiveness of certain textiles in Indonesia, such as fibre and yarn, has recently increased.

Indonesia's textile and clothing industry is vertically integrated and involved in almost every sector of the textile supply chain – from the production of man-made fibres, particularly polyester, nylon and rayon; man-made and cotton yarn spinning; and weaving and knitting; to dyeing, printing and finishing; and apparel manufacturing. Indonesia's textile and clothing industry consists of around 3000 companies. Indonesia is one of the world's largest synthetic fibre manufacturers.

Indonesia is among the TOP10 textiles and clothing importers in the EU but still, there is scope for increasing its textiles and clothing exports to the European Union market. In 2010 the EU imported 111 billion USD of textiles and clothing, and 19 billion USD of footwear. Each person in the EU is estimated to use an average of 34 kilograms of textiles a year (around 6 kilograms in Indonesia).





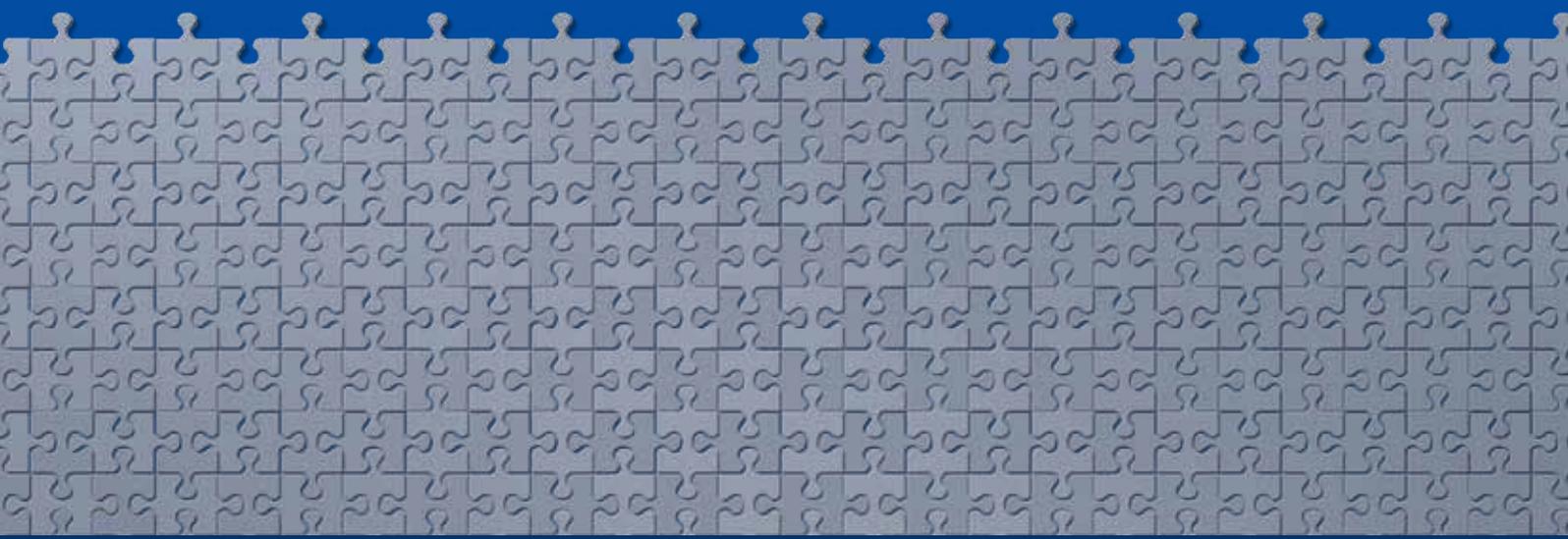
Source: Eurostat.

In 2010 exports to the EU represented 19 percent of Indonesia's total textile exports of around US\$11 billion. Trade liberalisation with the European Union would enable Indonesia's textile producers further expand their market share in the European Union. Potential export products include garments for men, women and children, but also industrial textiles for automotives industry, and special clothes for medical and construction workers. Indonesia could also benefit from specialisation on a certain segment of textiles and clothing. For example, clothes for Moslems or with ethnic design could help to increase its share on the global market.

Indonesian Footwear Association's (Aprisindo) official Binsar Marpaung said in Jakarta Post on March 18th, 2011 that the Indonesia's footwear industry could see its exports to the EU jump 20 percent if a FTA was implemented. The EU was the second-largest export destination for Indonesia's footwear products in 2010. Exports to the EU contributed to around 35 percent of Indonesia's total footwear exports of \$2.4 billion.

The European Union is also source of technology, know-how and chemicals for Indonesian textile companies. The EU continues to dominate global markets for up-market and high quality textiles, clothing and footwear. Technological upgrade would lead to higher competitiveness and market share in the world.





Delegation of the European Union

Intiland Tower, 16th Floor
Jl. Jend. Sudirman 32, Jakarta 10220
Indonesia
Tel. : (+62 21) 2554 6200
Fax : (+62 21) 2554 6201
E-mail : delegation-indonesia@ec.europa.eu
<http://delidn.ec.europa.eu>

Government of Indonesia Ministry of Trade

Jl. M. I. Ridwan Rais No. 5
Jakarta Pusat 10110