

KEY MESSAGES

PALM OIL

- The EU is mindful of the environmental and social implications of palm oil production, as well as of the economic and social opportunities that palm oil presents. The Commission has a balanced approach on the matter, and believes that it is essential to cooperate and support the efforts of producing countries to minimise deforestation and achieve sustainable production of this commodity.
- The EU is supportive of the efforts by Indonesia to strengthen their national palm oil certification scheme (ISPO), and looks forward to continuing exchanging on on-going work on the matter and future implementation and enforcement of the scheme.
- The Commission is also contemplating the possibility of launching an EU initiative on deforestation, looking in particular at avenues for engaging more closely with producing countries on how to ensure sustainable production and consumption of agricultural commodities, including palm oil.

FLEGT

- We are very pleased about our long-standing cooperation on sustainable forest management and tackling illegal logging through the FLEGT VPA.
- The official start of FLEGT licensing to the EU on 15 November 2016 was a major milestone. We are pleased with the overall positive experience so far and the favourable reception by EU importers, but there is no room for complacency. We need to continue to work hard to ensure a smooth operation of the FLEGT licensing system bearing in mind that its success will depend ultimately on its robustness and

credibility. To this end, Indonesia's efforts to tackle corruption and ensuring adequate law enforcement remain a priority.

- Any major changes to the Indonesian timber legality assurance system (e.g. recent change to the legality verification system for timber imports) is made only after prior consultations with the EU and joint assessment of its implications. Unilateral decisions are not in line with the spirit or law of our bilateral **partnership** agreement and may lead to severe consequences.

1) INTRODUCTION

OBJECTIVES

PALM OIL AND DEFORESTATION

- Indicate the Commission's willingness to adopt a balanced approach regarding palm oil and to work jointly with producing countries on the matter. Highlight the need to address the environmental and social impacts of palm oil production, and ensure sustainable supply chains of this commodity.
- Reiterate the EU willingness to continue engaging in discussions with Indonesia on palm oil sustainability, including through the working group on Environment and Climate Change under our EU-Indonesia Partnership and Cooperation Agreement. Highlight EU interest in Indonesia's on-going work to strengthen the Indonesian Sustainable palm Oil (ISPO) certification scheme, and hope that the Ministry of Environment will be given the possibility to play an active role in the process.
- Reiterate that promoting sustainable forest management and combating deforestation remains a priority for the EU, including as part of the implementation of the 2030 Agenda for Sustainable Development and the SDGs, as well as the Paris Agreement. Inform about the Commission's on-going work on a potential EU initiative to better address deforestation. Highlight the Commission's broad approach to the issue, looking at all drivers of deforestation (including but not limited to palm oil) and policy instruments available to address the issue.

FLEGT

- Welcome the long-standing EU-Indonesia cooperation on sustainable management of Indonesia's forest resources. Stress the value of the FLEGT VPA as a concrete demonstration of our partnership and Indonesia's continued commitment to combat illegal logging and associated trade.
- Stress that the official start of FLEGT licensing to the EU on 15 November 2016 is a landmark development which brings to fruition many years of work on both sides. At the same time, reiterate that we need to continue to work hard to ensure a smooth operation of the future FLEGT licensing system bearing in mind that its success will depend ultimately on its robustness and credibility.
- Stress the absolute need to ensure that any major changes to the Indonesian timber legality assurance system (e.g. recent change to the legality verification system for timber imports) is made only after prior consultations with the EU and joint assessment of its implications. Unilateral decisions are not in line with the spirit or law of our bilateral agreement.

SPEAKING POINTS

PALM OIL

- The EU is mindful of the environmental and social implications of palm oil production, such as deforestation and biodiversity loss, greenhouse gas emissions, and indigenous rights issues. Addressing the challenges of deforestation remains indeed an important matter for the EU, including as part of the implementation of the 2030 Agenda and the SDGs, as well as the Paris Agreement. But we are also aware of the opportunities that palm oil presents in Indonesia as a significant development opportunity, including for rural communities and smallholders.
- As you may have seen from the Commission's response released last September to the European Parliament resolution on palm oil, we defend balanced positions on the matter. The Commission believes that it is essential to cooperate and support the efforts of producing countries to minimise deforestation and achieve sustainable production of this commodity.
- We are interested in the efforts made by the Indonesian government to strengthen your national palm oil

certification scheme, and we welcome your engagement to export 100 % sustainable palm oil by 2020. We look forward to continuing exchanges on avenues for your national scheme – ISPO, Indonesian Sustainable Palm Oil – becoming mandatory to all producers. We also look forward to the future Presidential Decree on ISPO, and hope that the Ministry of Environment will play an active role in implementing the Decree and ensuring robust enforcement of the scheme.

- I trust that the working group on Environment and Climate Change under our EU-Indonesia Partnership and Cooperation Agreement provides a valuable platform for exchanges on the matter. In addition, I am aware that palm oil is an important topic under the ongoing negotiations on the EU-Indonesia FTA (CEPA).
- At the same time, the EU is aware that deforestation has multiple causes, including but not limited to palm oil production. We are in this context contemplating the possibility of launching an EU initiative on deforestation, looking in particular at avenues for engaging more closely with producing countries on how to ensure sustainable production and consumption of agricultural commodities, including palm oil. I trust that, should such an initiative materialize, it would provide us with additional opportunities to collaborate with Indonesia on the matter.

FLEGT

- The start of FLEGT licencing on 15 November 2016 has coroneted several years of close partnership and hard work on both sides to set up a unique system to ensure legality of Indonesian timber exports. This was very special moment for all the colleagues in our respective administrations who have worked over many years to turn this vision into reality.
- The implementation and enforcement of the FLEGT Voluntary Partnership Agreement will not only protect vital forest resources from illegal logging, but also increase Indonesia's competitiveness in timber markets and showcase the country's efforts to improve the sustainable management of its natural resources.
- I am very pleased about the positive early experience with FLEGT licensing so far and favourable reception in the EU amongst the private sector.
- However, there is no room for complacency. We need to continue to work hard to ensure a smooth operation of the future FLEGT licensing system, including working on monitoring implementation and continuously strengthening the system in the long term in line with the agreed 2018 joint Action Plan recently agreed by the Joint Implementation Committee.

- Strong implementation and law enforcement remains particularly crucial, as well as continued support and close involvement of all relevant stakeholders, particularly civil society. Finally, we need to work together internationally to ensure that other major players (for instance China), take comparable commitments to those made by the EU and Indonesia.
- I would like to stress the absolute need to ensure that any major changes to the Indonesian timber legality assurance system is made only after prior consultations with the EU and joint assessment of its implications. Unilateral decisions are not in line with the spirit or law of our **partnership** agreement. The recent case of the change to the legality verification system for timber imports is not the first one (recall the unilateral decision to exclude furniture from the product scope which delayed the start of FLEGT licensing by almost 1 year). We cannot afford or tolerate similar cases in the future.
- As shown by our discussion on deforestation and palm oil, concerns over deforestation in Indonesia remains very high in the EU. While we do have a positive story to tell about how Indonesia has brought under control its forestry sector, this positive narrative will be increasingly undermined if Indonesia does not address concerns related to the loss of natural

forests for establishment of palm oil and timber plantations, often in violation of Indonesia own policy and legislation.

3) DEFENSIVE POINTS

The EP vote of January 2018 on the recast of the Renewable Energy Directive (RED) implies that the EU is planning to impose a ban on imports of palm oil. Such measures are deliberately in favour of European rapeseed producers.

- To be clear, the EP has not voted in favour of a ban of palm oil-based biodiesel. Instead it has voted in favour of excluding biofuels produced from palm oil from being accounted towards the EU Renewable Energy targets as of 2021. This would by no means limit the amount of biofuels from palm oil that can be produced or imported and consumed in the EU.
- The vote by the European Parliament does not mean that the EU has adopted a final decision. So far the EP has voted, but the position is now subject to discussions with the Council and the Commission (the so-called 'trilogue'), whereby the Commission has an important technical and brokering role.

What is the Commission aiming to achieve in the trilogue?

- EU support for biofuels as per the current RED has provided and continues to provide huge opportunities for the palm oil industry.
- The Commission will examine closely the proposals adopted by the European Parliament and the Council. The overall objectives pursued by the Commission remain those put forward in its proposal of November 2016.
- With specific regard to biofuels, the Commission's proposal foresees the introduction of a 7% cap (to be gradually reduced to 3,8% by 2030) on the contribution of all crop-based (i.e. including but not limited to palm-based) biofuels to reaching the EU renewable energy targets. This is because oil crops have by far the highest indirect land use change (ILUC) emissions, as recognised already under the ILUC Directive.
- However, MS would have the possibility to distinguish between different types of conventional biofuels taking into account indirect land use change, for instance by setting a lower limit for biodiesel produced from oil crops.

Will RED II be WTO compatible?

- The proposal for the REDII issued by the Commission in November 2016 is fully compatible with the EU WTO obligations as it does not include provisions discriminating imports or affecting trade. The Commission remains committed to ensure that EU law is consistent with the WTO rules.

Will the EU facilitate palm oil imports under the EU-Indonesia FTA? Or are you intending to restrict them based on sustainability criteria?

- The EU is committed to making trade contribute to sustainable development. In the negotiations with Indonesia, the EU is pursuing an ambitious and comprehensive chapter on Trade and Sustainable Development, addressing labour and environmental issues of relevance in a trade context.

- We want to have in the FTA a good framework to address the root causes of concerns on the sustainability impacts of palm oil production - e.g. ensure sustainable management of forests, protection of biodiversity, sound working conditions, responsible business practices.

The palm oil study recently released [to be updated depending on publication date] by the European Commission is too critical on ISPO and Indonesia's legislation and production system.

- The Commission carried out a study on the environmental impacts of palm oil production, as well as on certification schemes and legislation in place in producing countries, including Indonesia. We believe indeed that, considering on-going debates on palm oil in Europe, it was important to provide an objective assessment of the situation to inform discussions. Whilst this study provides a useful analysis, the report remains analytical and does not provide policy recommendations.
- At the same time, the study - recently released on the Commission's website - ago [to be checked based on final publication date] was carried out by an independent consultant and does not represent the official views of the Commission. The contributions provided by the Indonesian authorities to our consultants during the drafting of the report were very useful in that regard.
- We trust that the final report provides a robust analysis of the strengths and weaknesses of the main palm oil certification schemes, including ISPO, and that the study can now serve as a basis for future exchanges and consolidation of these schemes.

EU imports of palm oil are decreasing. This is due to campaigns criticising palm oil in the EU, as shown by declarations of the French Minister of Environment Nicolas Hulot last July. How will the EU address this situation?

- We acknowledge Indonesia's objective to ensure that palm oil is treated in a non-discriminatory manner. The latest statistics for the exports of palm oil from Indonesia towards the EU have seen a 45% increase in value between January and November 2017 over the same period in 2016. This illustrates well that the EU market remains open to your country's exports of this product. In addition, the EU import duties on palm oil are considerably lower than those of other major export markets for Indonesian palm oil (such as India).
- At the same time, trade (and thus potential import restriction) is an EU competence, which means in practice that individual EU Member States are not in a position to adopt national trade restrictions on palm oil.
- "Palm oil free" campaigns and labelling by various EU brands are fully voluntary, and there is no legislation in the EU barring a company or a consumer from labelling a product "palm oil free" for marketing purposes, if this claim is indeed accurate. The best means for producer countries to react to such campaigns is therefore to engage with the critics, which several companies have done by strengthening their supply chains and buying sustainable palm oil.

The European Parliament resolution on palm oil and deforestation is disproportionately negative against palm oil. Will it lead to import restrictions on the EU side?

- The resolution of the European Parliament on palm oil represents a useful contribution to the broader debate on palm oil and deforestation, which we believe should also fully involve producer countries. The resolution reflects the views and concerns put forward by various parts of the EU public opinion as part of our democratic process. This resolution is nonetheless not part of a legislative initiative and is not binding on the Commission.

The interest of partner countries in implementing the FLEGT agreements will diminish if they see that no action is taken on illegal timber imports under the EU Timber Regulation. What is the Commission doing to ensure that the EU Timber Regulation is effectively enforced?

EU competent authorities have been obliged to effectively enforce the EU Timber Regulation since March 2013. The European Commission has been taking all necessary measures to ensure that the both the EUTR and the FLEGT Regulation are correctly applied in all EU member states. As reported in our most recent meetings, EUTR application is consistently taking pace across the EU. The number of checks carried out is increasing constantly and so are the sanctions/penalties being applied. For imported timber alone, almost 3000 checks on operators were carried out leading to hundreds of penalties. The number of checks and penalties for operators failing to comply with due diligence obligations for domestic timber is much bigger.

There have also been several investigations/cases targeting specific countries/products (UK report on plywood from China; Brazil and DRC cases in Belgium, penalties to operators in many MS in relation to timber imported from Myanmar, in addition multiple cases dealing with timber harvested in the EU, e.g. Romania).

More importantly we believe that the regulation is achieving its intended objective to reduce illegal timber on the EU market and that there are clear indications that economic operators in the EU are adjusting their sourcing policy accordingly by using verified/certified timber or sourcing from low-risk countries.

4) BACKGROUND INFORMATION

1. PALM OIL

1.1. Palm oil and Indonesia

Palm oil is a key economic sector for Indonesia: it represents 14% of its total exports to the EU, is a key employment sector and the main source of income for millions of smallholders. Indonesia is the world's largest producer, accounting for more than 50% of the global output of palm oil (32.5 million tonnes, 2015). It is also a major exporter of crude palm oil (26.4 million tonnes, 2015) and its derivatives – as well as the second consumer of palm oil worldwide. The palm oil industry generates 4 million direct and 12 million indirect jobs in Indonesia. The EU is the second largest export market for palm oil (after India, ahead of China).

Indonesia has long expressed strong (and often disproportionate) concerns on the debate on palm oil in the EU, alleging that, under the cover of sustainability/health considerations, there is a deliberate attempt to spread a negative image of palm oil to the benefit of other (EU-produced) vegetable oils/fats. However, over the last months there has been a change of gears in the Indonesian attitude on the matter, triggered both by domestic politics (regional elections are scheduled in June 2018, and presidential elections in 2019, and palm oil is seen by the government as instrumental in gaining the votes of millions of smallholders) and by the increasing focus on the matter in the EP, with repeated calls for adoption of restrictive measures by the EU.

The adoption of the EP own-initiative (non-legislative) Resolution on palm oil and deforestation in April 2017 spurred very vocal reactions, which have further escalated in the context of the EP vote on the recast of the Renewable Energy Directive (RED II). The inclusion in the official EP position (adopted on 17 January 2018) of an amendment to the Commission's proposal in order to exclude biofuels produced from palm oil from being taken into account in the EU renewable energy targets - by 2021 (while, according to the same amendment, biofuels from other vegetable oils would continue to count until their phase-out in 2030) - triggered yet another wave of strong reactions by palm oil producing countries.

Indonesia has also generally expressed repeated concerns regarding other aspects of the EU policy, in particular regarding vegetable oils labelling, private sector "palm oil-free" labels (in particular in France and Belgium), health considerations (EFAS advice of May 2016 on glycerol-based process contaminants in palm oil), announcements by individual EU MS of possible import restrictions (cf. Nicolas Hulot's declarations of July 2017).

1.2. Measures by Indonesia to improve palm oil sustainability

In 2016, the Indonesian Government announced it would strengthen the Indonesian Sustainable Palm Oil (ISPO) certification scheme, given increasing global demand for sustainable, deforestation-free palm oil, and lack of market uptake for ISPO certification. The coordinating ministry of economic affairs (KEMENKO) of Indonesia recently shared with the EU Delegation a draft for a Presidential regulation on strengthening ISPO, which contains severe flaws in terms of clarity, ambition, level of details, governance, and feasibility of the ISPO standard certification.

Specifically, it appears that the Ministry of Environment and Forestry (MoEF) is not involved to the extent that it should in the drafting process. MoEF should lead on the operational definition, quantification and limitation of palm oil's environmental impacts (deforestation, forest degradation, forest fires, biodiversity, water quality, GHG emissions) which should be included in the regulation.

1.3. EU – Indonesia Comprehensive Economic Partnership Agreement

Negotiations for an EU-Indonesia Comprehensive Economic Partnership Agreement (CEPA) started in September 2016. In February 2018, Parties concluded the 4th round of negotiations, during which Indonesia presented its updated ISPO certification scheme.

The EU tabled rules on the sustainable management of forests, biodiversity and climate change in the draft Trade and Sustainable Development chapter (TSD) of CEPA. Though certain aspects of these proposals cover palm oil, there are no explicit rules covering it in TSD.

Market access, i.e. the level of duties applied in the EU to Indonesian palm oil will be covered in the Agriculture part of the Trade in Goods chapter.

1.4. Recast of the Renewable Energy Directive

The Renewable Energy Directive establishes an overall policy for the production and promotion of energy from renewable sources in the EU. It requires the EU to fulfil at least 20% of its total energy needs with renewables by 2020 – to be achieved through the attainment of individual national targets. All EU countries must also ensure that at least 10% of their transport fuels come from renewable sources by 2020.

On 30 November 2016, the Commission tabled a proposal for a revised Renewable Energy Directive (REDII) to make the EU a global leader in renewable energy and ensure that the target of at least 27% renewables in the final energy consumption in the EU by 2030 is met. The Commission proposed to introduce after 2020 an incorporation obligation requiring fuel suppliers to sell a gradually increasing share of renewable and low-emission fuels, including advanced biofuels and renewable electricity but not conventional biofuels. The exclusion of conventional biofuels reflects the growing evidence that these biofuels, such as palm oil, do not contribute towards achieving greenhouse gas emission savings due to the issue of indirect land use change such as deforestation.

Against this background the Commission further proposed that the share of crop-based biofuels that could account towards the EU renewable energy target would gradually decrease to 3.8% in 2030. Member States would be able to set a lower cap based and to distinguish between different types of biofuel based on ILUC. The proposal does not establish a differentiation between palm oil and other vegetable oils.

On 17 January, the EP adopted its initial position on the recast of the EU Renewable Energy Directive (RED II). With regard to provisions on biofuels and bioliquids produced from food or feed crops, the EP position includes the proposal for a total exclusion of biofuels and bioliquids produced from palm oil from being able to qualify towards the EU renewable energy target as of 2021.

The first trilogue took place on 27 February, and the next one is scheduled for 27 March. During the first trilogue, the ENVI rapporteur stressed the broad support in the EP for phasing

out palm oil from biofuels to be accounted against renewable energy targets. The Council recalled its position on 1st generation biofuels (7% cap) and stressed concerns on WTO-compatibility of the EP's position on phasing out palm oil. The Commission indicated that it was examining WTO consistency of the proposed amendment on palm oil.

1.4. EP Resolution on palm oil and deforestation

The European Parliament resolution on palm oil and deforestation of rainforests was adopted on 4 April 2017. The resolution reflects the EP critical approach to palm oil, focusing on the detrimental aspects of palm oil production on the environment and human rights in producer countries.

The Commission released on 7 September 2017 its response to the EP resolution, in particular concerning the several calls for action addressed to the Commission in the report. The resolution is not part of a legislative initiative. Therefore, while it has political value in expressing the orientation of the EP on the issues of deforestation/palm oil, the report will not in itself create binding rules.

1.5. Studies by DG ENV on deforestation and palm oil

DG ENV released a few days ago [publication date still to be confirmed] a study as a follow-up to the 7th EU Environment Action Programme and the 2013 study assessing the impact of EU consumption on deforestation in third countries. This study considers in particular the feasibility of options to step up EU action to combat deforestation and forest degradation. Its preliminary findings were presented to a stakeholder consultation last June, during which Indonesia was invited to present its policy and efforts to ensure sustainable palm oil production. This study is an important element underpinning a potential new EU initiative on deforestation (possibly a Communication to be adopted by May).

DG ENV also released a few days ago [publication date still to be confirmed] a study on the environmental impacts of palm oil production, and on certification schemes and legislation in place in producer countries. The preliminary results of the study were presented to an expert workshop on 2 October in Brussels, in which Malaysia participated. The study aims among other things at comparing the performances of the main four palm oil certification schemes in terms of verification, accreditation, supply chain certification and transparency. The study report overall ranks ISPO, the national Indonesian scheme, as the less robust of the 4 main palm oil certification schemes.

2. FLEGT

2.1 Forest Law Enforcement, Governance and Trade (FLEGT) Action Plan

The EU Action Plan on Forest Law Enforcement Governance and Trade ("FLEGT Action Plan") was proposed by the European Commission in May 2003¹ and endorsed by the Council² as a contribution to the international fight against **illegal logging** and associated trade. It focuses on building co-operation between producers (mainly developing countries) and consumers (EU and other major importers like USA, Australia, China etc.) through

¹ Communication from the Commission to the Council and the European Parliament - Forest Law Enforcement, Governance and Trade (FLEGT) - Proposal for an EU Action Plan, COM 251, 21.5.2003

<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=URISERV%3Ar12528>

² Council conclusions 268/2003 on Forest Law Enforcement, Governance and Trade (FLEGT)

interrelated efforts in **development cooperation, environment and trade policies**. The Action Plan sets out processes and measures to reduce the marketing of illegal timber into the EU, to improve the supply of legal timber and to increase the demand for timber sourced from responsibly managed forests in seven interrelated Action Areas (AA): support to timber-producing countries, trade in timber, public procurement, private sector initiatives, financing and investment, existing legislative instruments and conflict timber.

One of the main elements of the Forest Law Enforcement, Governance and Trade (FLEGT) Action Plan is the establishment of a FLEGT licensing scheme through which exporting countries develop systems to verify the legality of their timber exports to the EU and a licensing system to ensure that timber imported into the EU has complied with the legal requirements of the partner country. Regulation (EC) 2173/2005 (FLEGT Regulation) lays down EU procedures for the implementation of the FLEGT licensing scheme through the conclusion of Voluntary Partnership Agreements (VPAs) with timber producing countries.

Another key element of the Plan includes the **EU Timber Regulation (EUTR)**³ which prohibits the placing of illegal timber on the EU market and obliges operators to exercise due diligence to ensure that no illegal timber enters their supply chains. The "FLEGT licences" automatically meet the EUTR's requirements, thus saving companies the cost of due diligence. Indonesia will be the first partner to export FLEGT-licensed timber to EU (end 2016).

2.2 EU- Indonesia FLEGT Voluntary Partnership Agreement (VPA)

Indonesia has the largest area of tropical forest in South-East Asia and is rich in natural resources and biodiversity. High rates of deforestation and land conversion make Indonesia one of the largest contributors to global CO₂ emissions. Illegal logging contributes to this problem and threatens not only the environment but also the sustainability of the forest industry and timber exports.

Indonesia has been for many years at the forefront of the international community in combating illegal logging and avoiding deforestation. Indonesia was the first tropical country to raise the problem of illegal logging internationally through the Bali Declaration in 2001 and to call for cooperation between producer and consumer countries to tackle the issue.

The FLEGT Voluntary Partnership Agreement (VPA) with Indonesia is a bilateral agreement with a trade legal base which entered into force on 1 May 2014. The FLEGT licensing system established under the agreement became fully operational in Indonesia on **15 November 2016**. From this date only timber that has been verified as compliant with relevant Indonesian legislation through the Indonesian Timber Legality Assurance System (TLAS), which is known as SVLK (Sistem Verifikasi Legalitas Kayu), and been issued with a FLEGT licence will be able to enter the EU market. Indonesia is the first country in the world to reach this milestone and to have their system recognized by the EU. Preventing illegal timber from entering the EU market will assist the Indonesian government to tackle illegal logging by reducing demand, while at the same time European consumers can also be assured they are not fostering illegal logging in tropical forests. Besides clear legality verification procedures, the system also includes independent monitoring by civil society, transparency provisions and periodic independent system audits to help ensure the credibility of the scheme. Thanks to their involvement in its design and negotiation, the FLEGT VPA has good support from the Indonesian private sector and NGOs.

³ Regulation (EU) No 995/2010 laying down the obligations of operators who place timber and timber products on the market (the Timber Regulation), applicable since 2013

With the entry into application of the EU Timber Regulation (March 2013), FLEGT-licensed timber benefits from an advantage in the EU market as it is considered to be automatically compliant with that Regulation; thus EU importers do not need to take further measures to demonstrate “due diligence” under the terms of the EU Timber Regulation. This represents an important incentive for Indonesia's private sector.

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