

The Director General

Brussels,
C.2/SF/sst (2018) 1571060

**NOTE FOR THE ATTENTION OF DOMINIQUE RISTORI,
DIRECTOR-GENERAL, DG ENER**

Dominique,

**Subject: Your note on the treatment of palm oil in the EU Renewable Energy Directive
(Ares(2018)1130601)**

Thank you for your letter concerning the ongoing trilogue on the recast of the EU Renewable Energy Directive (RED II), which I am following closely, in particular with regard to the proposal put forward by the European Parliament (EP) to exclude as of 2021 from the scope of the RED II biofuels and bioliquids derived from palm oil, but not from other vegetable oils.

As you mention, this proposal has already raised concerns by a broad range of stakeholders, including not only palm oil producing countries, but also various EU constituencies – notably among Member States, as well as in the industry. These concerns cover several dimensions, ranging from trade policy to international relations (risk of creating a major political irritant in the EU relations with producing countries), to doubts on the effectiveness of this measure in meeting the stated objective of reducing deforestation (disruption of the incentives to engage in sustainable palm oil production provided by the sustainability criteria of the current RED).

I. Compatibility with WTO law

From a trade policy perspective, the EP proposal raises substantive concerns, in terms both of compatibility with the EU's obligations in the World Trade Organisation (WTO) and of trade relations with palm oil producing countries. Concerning compatibility with WTO law, the analysis carried out by DG TRADE legal team concludes that the EP proposal appears to violate the non-discrimination obligations under Art. I and Art. III:4 of the General Agreement on Tariffs and Trade (GATT), by establishing an unduly differential treatment between products which appear to be "like" (i.e. biofuels/bioliquids from palm oil and from other vegetable oils)¹.

¹ This analysis takes fully into account the fact that the EP proposal does not represent an import prohibition on palm oil for use in the biofuel sector, but would discourage it, notably by excluding palm-based biofuels from the incentives that public authorities could adopt under the RED II.

Such discriminatory treatment does not seem to be justifiable under the GATT general exceptions, not least because of a lack of sound scientific evidence warranting the suggested differential treatment to safeguard certain legitimate societal values, notably life or health (Art. XX(b)) or the conservation of exhaustible natural resources (Art. XX(g)). The annex to this note elaborates on some of the key elements of our preliminary legal analysis, in line with the information already shared at working level with your staff. Accordingly, the adoption of the EP (or an equivalent) proposal in the RED II would create serious risks of exposing the EU to WTO challenges with no solid defence.

It is therefore key to make sure that the outcome of the RED II legislative process is non-discriminatory and ensures its WTO compatibility. In this sense, the Commission's original proposal remains the safest option to avoid risks of incompatibility with the EU's obligations under the WTO. Therefore, and in line with the position already agreed in the GRI discussions so far, I wish once more to stress the need for the Commission to uphold its original proposal throughout the trilogue process. At this stage, I would request to keep our preliminary analysis within the Commission on a strict need-to-know basis. Going forward, I suggest that we jointly request the Commission's Legal Service to confirm our legal analysis.

II. Trade impacts

In your letter you also ask for an assessment of the trade impacts of the EP proposal, should it be included in the RED II. The EU is the third market for palm oil worldwide (and second importer, after India and before China), accounting for around 12% of global consumption. Over half of the EU imports of palm oil come from Indonesia (with palm oil representing around 15% of the total value of Indonesian exports to the EU in 2017), followed by Malaysia (accounting for over 20% of the EU total palm oil imports in 2017), Papua New Guinea (around 10% of the EU total palm oil imports in 2017) and Latin America. Palm oil imported into the EU is rather evenly distributed between the food sector on one hand and the non-food sectors (i.e. biofuels and bioliquids, energy, personal and home care items, oleo-chemicals) on the other.

However, it is not possible to quantify accurately the share of palm oil imports used in the biofuel/bioliquid sector based on trade data, as all imports of crude or partially refined palm oil for industrial use are clustered together, with no dedicated tariff codes for different non-food uses. Available estimates present significant discrepancies, ranging from the 46% of total EU palm oil imports reported by the well-known NGO "Transport&Environment" to the 23% calculated on the basis of the last Commission's progress report on the renewable energy targets². As for imports of processed palm-based biodiesel, these are clustered with other biodiesel, once again making it challenging to provide precise figures based on trade statistics. It can be assumed though that all imports of biodiesel from Indonesia and Malaysia are palm-based. These imports accounted for over 400 million euros in 2017. An increase can be expected in the future, as these countries invest more in refining facilities and in view of a possible termination or downward revision of the anti-dumping duties adopted by the EU on

² These figures refer to 2014, which is the latest year for which estimates from different sources are available.

biodiesel from Indonesia (prior to the adoption of which Indonesian exports of biodiesel to the EU were about 15 times larger)³.

Still, in all scenarios, it is clear that biofuels/bioliquids represent an important end-use for palm oil in the EU, and a measure that would disincentivise it would have a significant impact on trade flows, in particular with South-East Asian countries. Broader impacts on trade relations could also be expected, notably with regard to the possible adoption by palm oil producing countries of retaliatory measures against EU products or risk jeopardising the negotiations for Free Trade Agreements (FTAs) with Indonesia and Malaysia.

In order to proceed with a more detailed assessment of the potential trade impact of the EP proposal, I would like to reiterate the request made at working level for data on the actual use of palm-based biofuels/bioliquids in the EU, based on the reporting by Member States on the implementation of the targets under the current RED. Moreover, it would be important to have your assessment on the share of palm-based biofuels/bioliquids used in the EU which complies with the RED sustainability criteria. Anecdotal evidence suggests that, even if the current RED does not prohibit the use of crop-based biofuels/bioliquids not meeting the criteria, all palm oil imports in this sector do comply with such criteria, as they would not otherwise account towards the renewable energy targets and hence would not be viable. Should this be confirmed by your analysis, it would then seem likely that the EP proposal, while not setting a formal prohibition on the use of palm-oil biofuels/ bioliquids in the EU, would de facto crowd them out of the EU market. This would have an impact on palm oil imports of a value that, based on the above-mentioned estimate that the biofuel/bioliquid sector accounts for 23% to 46% of the EU palm oil imports and at 2017 prices, could be estimated to be between 1,12 and 2,25 billion euros globally (and between 3,5% and 7% of the total value of Indonesian exports to the EU).

III. Way forward

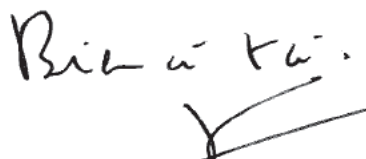
As the trilogue moves forward, interested stakeholders can be expected to keep raising their concerns on the treatment of palm oil in the RED II. Palm oil producing countries, in particular, are likely to continue voicing their opposition to discriminatory approaches, including by addressing the RED II in trade discussions. For instance, several palm oil producing countries have put this point on the agenda of the upcoming meeting of the WTO Committee on Technical Barriers to Trade and of recent or upcoming bilateral and regional trade dialogues (e.g. institutional bodies of our FTA with Andean countries, trade working groups with South-East Asian countries, ACP-EU Trade Cooperation Subcommittee).

I believe it is essential that we continue to engage with concerned stakeholders in a coordinated manner, addressing both the specifics of the RED II debate and the need to address the underlying concerns on the negative environmental and social impacts that palm oil production can have. On the latter, it will be important to highlight the Commission's openness to work with producing countries to enhance the sustainability of palm oil

³ Indonesia successfully challenged in the WTO the EU anti-dumping duties on biodiesel – again illustrating that Indonesia would have no restraint in taking the EU to WTO dispute settlement on the RED II.

production, on which credible progress is needed. On the RED II legislative process, it will be key to stress that the Commission remains committed to an outcome compliant with the EU's WTO obligations, as per its original proposal, and engages to this end with the co-legislators.

In this regard, I confirm DG TRADE's readiness to continue working closely with DG ENER, at all levels, throughout the trilogue to support a WTO-compliant outcome and look forward to our continued cooperation on this complex file.


[e-signed]

Jean-Luc DEMARTY

Annex: - Key elements of legal analysis

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