Projecting Potential Impact of European Union Deforestation Regulation on Indonesian Palm Oil Industry

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Abstract

As a commitment to realizing the Green Deal which aims to reduce greenhouse gas emissions, the European Union has issued new regulations, namely the European Union Deforestation Regulation (EUDR) which focuses on eradicating products related to deforestation and forest degradation. Several provisions are implemented ranging from due diligence requirements to state assessments based on a three-level system. Based on the international trade conflict that occurred previously between the European Union and Indonesia regarding palm oil commodities, the author uses a qualitative approach to analyze tendencies in the EUDR as a continuation of the European Union's new protectionism against Indonesian palm oil commodities through administrative barriers. Several potential impacts are also visible, ranging from disputes at the WTO to losses in the Indonesian economy and development.

Keywords: *European Union, New Protectionism, Palm Oil, Indonesia.*

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A. INTRODUCTION

Indonesia has produced the largest amount of palm oil in the world with the latest data in 2022 contributing around 59% of total global palm oil production, which means this is 45.5 million metric tons (Nurhanisah, 2023). This is an industry that contributes greatly to the Indonesian economy, which even continued to grow positively during the Covid-19 pandemic and has become a labor-intensive industry that directly employs 4.2 million people and around 12 million workers indirectly from upstream to downstream industrial sectors (Gabungan Pengusaha Kelapa Sawit Indonesia, 2021). Being Indonesia's 3rd largest trading partner, European Union countries are a valuable market for Indonesia. Spain is even included in the top seven importing countries for Indonesia's largest palm oil production with around 630 thousand tons in 2022 (Syaharani, 2023). The European Union is still unable to produce palm oil on a scale sufficient to meet the needs of its countries.

However, in recent years challenges have begun to emerge for Indonesia regarding exports to European Union countries with the issuance of a number of policies that limit and inhibit palm oil imports by Indonesia. This started with the emergence of Germany in 1991, which introduced feed-in-tariffs which became popular and was followed in its footsteps by other countries to produce renewable energy in Europe (Leiren & Reimer, 2018). This renewable energy then became a pillar of the environmentally friendly energy transition until in 2009 the European Union began to have nationally binding targets through the Renewable Energy Directive

(RED) and RED II in 2010. The price is very low and it is domestically produced, making this mission developed to reduce Europe's dependence on external suppliers (European Commission, 2022).

Since this regulation was implemented, the impact has begun to be felt by Indonesia and has given rise to a number of polemics. The consequence of RED is that European Union member countries as users of biofuel whose basic ingredient is palm oil are not allowed to access it again as the contribution of biofuel as a renewable energy source has been removed (Palm Oil Plantation Fund Management Agency of the Republic of Indonesia, 2018). This is proven by competition in the European Union market, Indonesian palm oil has experienced a significant decline which previously ranged from 49.8167 to 19.9838 in 2010 since the implementation of RED II (Ramadhani, Fahriyah, & Asmara, 2022). It is clear that Indonesia, as a third exporting country, has become the party disadvantaged by the policies implemented by the European Union in fulfilling its own national interests, which can be categorized as an act of protectionism.

Protectionism has the potential to make the world weaker, more vulnerable to conflict and increase inequality (Goldberg & Reed, 2023). Therefore, Indonesia has intensified a number of efforts to face this challenge, through diplomacy for example. In 2018, Indonesia carried out diplomacy by explaining the importance of the palm oil industry for Indonesia, especially regarding poverty alleviation, to the EU Parliament. The ban previously intended to be implemented in 2021 on the use of palm oil products in the form of biofuel has been postponed until at least 2030, which was announced by the European Union in a trilogue in June, is said to be the result of the diplomacy that has been carried out (Pablo, 2018). However, in fact the European Union has again launched a similar regulation regarding protectionist actions that have the potential to harm the Indonesian palm oil industry, namely the European Union Deforestation Regulation (EUDR) in 2023.

The EUDR was issued to stop the import of products that in the industry are linked to destructive deforestation activities occurring throughout the world. This is in order to realize the Green Deal proposed by the European Commission since 2019 which aims to achieve greenhouse gas emissions of at least 55% with the European Union's seven-year budget in the form of a series of legislative and non-proposal agreements ranging from climate, energy and transport policies. and taxation with success targets in 2030 and 2050 (European Commission, 2023a). This is in line with previous regulations which also raised environmental issues to regulate international trade between European Union countries and third countries. The author sees that EUDR also creates patterns and impacts that lead to acts of administrative protectionism which are interesting to research and discuss in depth.

B. METHOD

The method used is qualitative research. Researchers conducted an extensive literature review using content analysis by Krippendorff (2018) as a basis for carrying

out in-depth research on the latest regulations issued by the European Union, namely EUDR as a form of New Protectionism and its impact on Indonesian palm oil industry.

The strategy used in collecting data is to collect writings including in the form of academic books, journal articles, reports and government policy drafts collected as the latest data regarding the EUDR, new protectionism by the European Union, and its impact on Indonesian crude palm oil imports with similar topics and which are related to the subjects used in the research. Looking at the general characteristics of research subjects and excluding subjects that do not meet the inclusion criteria, are applied in selecting data sources obtained from several academic databases. The suitability and quality of the methodology, focus and analysis are taken into consideration when literature samples are selected for review, identification and categorization using thematic analysis. Thus, the most relevant sources will be used.

The data that has been collected and compiled will be analyzed scientifically so that it can be developed as a new understanding that can also strengthen existing discoveries or knowledge by providing a comprehensive picture of the topics discussed in the research starting from the results of historical analysis to economic and political impacts. Data analysis is carried out starting from determining the unit of analysis and then processing the data so that it can be useful in formulating answers to research questions that have been implemented.

C. RESULTS AND DISCUSSION

1. EUDR as New Protectionism

Based on what has been stated in article 1 of the new rules for deforestation-free products by the European Commission, the EUDR exists because as a country that imports and consumes a third of globally traded commodities ranging from agricultural grains as soybeans, animal products as beef, plantation commodities as chocolate, coffee, rubber, palm oil and derivative products as oil, tires or furniture are the main driver of the process of expanding agricultural land, some of which in large quantities are not environmentally friendly and are directly related to deforestation and forest degradation (European Commission, 2023b). At least the consequences of these activities produce anthropogenic greenhouse gas emissions of around 23% of the total. (European Commission, 2021). Even between 1990 and 2008, for those production of goods and services, 10% of all deforestation events throughout the world have been recognized as one of the responsibilities imposed on the European Union. It is estimated that even in 2030, just calculating consumption of the six main commodities of concern, namely coffee, cocoa, soybeans, palm oil and wood, as well as livestock, will result in deforestation covering an area of approximately 248,000 hectares (European Union, 2023). For this reason, appropriate regulatory intervention that can have a large impact globally is considered a necessity, EU regulations were finally formed to not only regulate the EU's domestic supply chains but are aimed at influencing markets in all parts of the world including through fundamental international cooperation with the countries both consumers and producers of commodities in free trade agreements. Thus, the scope resulting from the EUDR

covers two-way trade in commodities and products both within the meaning of those produced by and to be exported, and outside those imported into the European Union.

It is interesting how the EUDR is discussed in Regulation (EU) 2023/1115 Of The European Parliament And Of The Council Of 31 May 2023 On The Making Available On The Union Market And The Export From The Union Of Certain Commodities And Products Associated With Deforestation And Forest Degradation And Repealing Regulation (Eu) No 995/2010, also discussed the EU's commitment as a member of the World Trade Organization (WTO) in realizing inclusiveness and fairness by not discriminating in the multilateral trading system under the WTO. Meanwhile, the EUDR at the same time also maintains the discriminatory resolution by the European Union against palm oil in regulations previously issued to date against Indonesia by blaming the country for deforestation without paying attention to international demands and sustainable development standards that have been set by Indonesia (Nurfatriani, Ramawati, Sari, & Komarudin, 2019). Thus, it would be fact that Indonesia has experienced discrimination, especially against palm oil products, due to market protection policies from the European Union itself, which is also a vegetable oil producer using environmental issues (Saragih & Rahayu, 2022).

Through the EUDR, protectionism has been carried out in the form of discrimination involving countries unilaterally. With the application of article 29 related to country assessment in Chapter 5 which regulates Country Benchmarking System And Cooperation With Third Countries, assesses to classify both member countries and third countries into one of the risk categories of a three-level system, namely the first countries which in producing commodities do not comply with the rules stipulated in Article 3, point (a) or are deforestation-free are identified as 'high risk' countries, secondly countries in which there is adequate assurance that these countries produce the relevant commodities which are not deforestation-free as 'low risk' countries, and finally countries or territories that do not fall into the previous two categories as 'standard risk' countries. Standard risk levels will be set for all countries at an initial stage as of 29 June 2023. After that a list of countries, or parts thereof, will be published as assessments have been carried out which will determine whether they are at low or high risk by at least 30 December 2024 and will be reviewed and updated as when strong evidence is obtained to support the update.

This is a threat and constitutes discrimination, especially for developing countries. In the EUDR it is actually stated whether the countries concerned have attention and contribution to the Paris Agreement in the form of their national or sub-national legislation. However, the state assessment article actually excludes demands for standards based on the capabilities of third countries. In the case of Indonesia, it is stated in Law (UU) Number 16 of 2016 concerning Ratification of the Paris Agreement To The United Nations Framework Convention On Climate Change, that on the part of developing countries, consider the principles of justice and shared responsibility based on the different capabilities and national situations of each country resulting in special needs and circumstances in achieving the objectives of the Convention, emphasizing the close interconnection that caused by the action, handling and impact

of climate change on equal access to sustainable development and poverty alleviation (Central Government of the Republic of Indonesia, 2016).

It would be non-inclusive if developing countries that really need to utilize forest land for development purposes would actually be labeled as risky countries which would have a negative impact on them, especially in international trade. Indonesia itself is carrying out crucial development, namely the new National Capital which requires at least 30% of the 256 thousand hectares of forest for infrastructure development and so on (Sucahyo, 2023). Of course, this will touch on what is stated in Article 10 EUDR concerning Risk Assessment, regarding the prevalence or proportion of deforestation or forest degradation in certain populations and time periods in commodity producing countries as well as the risk of ignoring this Regulation and other fraud such as mixing products. -products produced in areas that have or are experiencing deforestation or forest degradation.



Figure 1. Annual Tree Cover Loss by Dominant Driver in Indonesia (2001-2022)

Source: Global Forest Watch, 2023

In fact, as can be seen in the data above, Indonesia itself has experienced a significant decline in Indonesia's deforestation rate in the last few years (2016-2021), which is largely due to the decline in commodity-driven expansion (The Sustainability Consortium, World Resources Institute, and University of Maryland, 2023). Issues outside of deforestation are also raised as concerns in point (H), some of which are issues that developing countries are vulnerable to, starting from an assessment of the high level of corruption, weak law enforcement powers, the amount of data falsification, human rights violations, and other violations imposed by either the UN Security Council or the Council of the European Union.

The risk assessment is carried out as every operator or trader placing a commodity on the EU market, must ensure that the product is deforestation-free with legal clarity, can be measured and recognized internationally with data obtained quantitatively and ensured to be objective which according to Article 2 means that after 31 December 2020, all products or commodities are guaranteed not to be involved in any form of connection with deforestation and degradation, whether produced using the results or originating from the land. So in proving this, requirements related to information, risk assessment, and steps that must be taken to mitigate risks are mandatory to be included in the due diligence statement on

reporting obligations. What is also important in the due diligence system includes identification which contains information and is in accordance with the time and position of earth observations on the geolocation coordinates of land in countries carrying out production as this system is intended to present information on commodities and products being marketed including their origin or source. If a risk is identified, the operator must mitigate the risk so that it does not exist or is only a negligible risk. Thus, in a series, this can be categorized as an act of disguised protectionism with the application of administrative and technical barriers. The European Union is trying to implement administrative barriers to products that want to be imported so that it is not easy to comply, especially for palm oil producers from developing countries such as Indonesia.

2. Potential Impact of EUDR on Indonesian Palm Oil Industry

The first potential impact that will occur as a result of the implementation of EUDR is Indonesia's involvement as a third exporting country with the EU in WTO dispute cases. Indonesia can file a lawsuit with the World Trade Organization (WTO) over the potential discriminatory nature of the EUDR. This is because these regulations are inconsistent with the WTO exception clause, Article XX GATT. Basically, the multilateral trading system with the World Trade Organization (WTO) is intended to provide stability and predictability with two principles of non-discrimination which are institutionalized in two main clauses, namely the first is to treat all countries of origin or exporters equally and fairly regarding imports with the exception of regional integration and preferential trade agreements, and the second is the absence of both fiscal and administrative barriers by countries that could burden imported goods. Thus, these principles are also applied to prevent cases of implementing trade policies that become tools of national protectionism like this. Negotiations related to transparency and flexibility are matters that will be discussed when a lawsuit occurs and there are indeed trade distortions over potential WTO disputes (Capuzzi, 2023).

The Indonesian Palm Oil Farmers Association (Apkasindo) supports the Indonesian government in filing a lawsuit regarding EUDR at the WTO. The association believes that the government must immediately file a lawsuit and if not, then they are ready to file a lawsuit independently because EUDR is considered to have a big impact on palm oil farmers (Indonesian Palm Oil Entrepreneurs Association, 2023). It is possible that the impacts that will arise will touch and be a major problem for small farmers. With the EUDR, these small farmers are disadvantaged because they have limited capital and capacity so it will be difficult to comply with these regulations and even to compete and participate in the palm oil supply chain which is also filled by large companies. This is certainly a threat because small farmers in the palm oil industry have a crucial role in Indonesia with total production amounting to 34% of Indonesia's total production in 2021 (Iswara, Nurshadrina, & Suryahadi, 2023).

Furthermore, the impact that will certainly occur is hampering Indonesia's efforts to improve the economy and development as palm oil is a very important commodity for Indonesia. The first is that the new administrative requirements require exporters or companies from Indonesia to incur additional environmental detection costs which will affect product prices. This will expand and have a further impact in at least two ways, the first is that it will lead to the company's decision to carry out other expenditure effectiveness which can also threaten the welfare of workers when dealing with a reduction in wages and the number of workers, then the second will affect the amount of market demand that is likely to decline as the price of palm oil products, which were previously used as an alternative because they were cheap, becomes less affordable. This EUDR policy with all the assessments given also indirectly complicates Indonesia's image which can influence investors from the European Union to be more careful or even less interested in investing in the palm plantation sector with the resulting risk assessment for Indonesia. Thus, state income will decrease significantly and slow down the pace of development.

Table 1 Estimated Increase in Selling Expenses of The Two Largest Palm Oil Companies in Indonesia

Company	Selling Expenses in 2022 (Rp Trillion)	Estimated in Low Risk Conditions (Rp Trillion)	Percentage (%)	Estimated in Standard Risk Conditions (Rp Trillion)	Percentage (%)	Estimated in High Risk Conditions (Rp Trillion)	Percentage (%)
Sinar Mas Agro Resources and Technology Tbk	61.73	64.23	4	80.48	30	101.73	64
Salim Ivomas Pratama	13.15	15.65	19	31.9	143	53.15	304

Source: Data is processed, 2023

In the first option, it can be calculated based on the estimated costs that have been weighed by the European Union in the Impact Assessment Report on proposals related to the EUDR, that building a due diligence system one time will cost between EUR 5,000-90,000 or IDR 85 million-1.5 billion per operator or per company that exports, which means it will amount to IDR 2.5-40 Trillion per year (European Commission, 2021). This range was created because the amount of due diligence costs will depend on complexity, including the risk value of the company's supply chain against deforestation and forest degradation. In operations, these costs mean an addition to selling expenses related to export sales administration and are quite a nominal addition for even large companies. Although according to the European Commission the impact of these due diligence costs can be borne by reducing the profits of EU member countries as final consumers in the value chain. Estimated increase in expenses for the two largest palm oil companies in Indonesia using the total selling expenses in 2022 if it is categorized into each risk classification within the cost ranges presented.

D. CONCLUSIONS

Indonesia has established quite good cooperation with the European Union, the palm oil industry will be affected by protectionist measures through administrative obstacles carried out by the European Union by implementing due diligence and risk assessments so it is very unfortunate as this has a big impact on the Indonesian economy. This seems to override the capabilities and priorities of each third exporting country which should be taken into account so that there is no discrimination in implementing the EUDR.

On the other hand, Indonesia must be more responsive in dealing with cases of protectionism which are a structural administrative challenge in the palm oil industry. Several key cooperation steps in the region, such as the formation of a Joint Task Force with Malaysia, need to continue to be maximized and even expanded relations with countries that have common interests in dealing with concerns over the impacts caused by the implementation of the EUDR. Collaboration can take the form of coordinating the provision of guidance to fulfill the EUDR as well as access to resources, both knowledge and other technical needs, to support production by small farmers. Apart from internationally, domestic cooperation by related and competent parties is also needed to realize sustainable agriculture.

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