Using tariffs to incentivise sustainable palm oil

This briefing stems from a Fern commissioned study on lessons from the Indonesia and the European Free Trade Association (EFTA) Free Trade Agreement (FTA). It provides a brief summary of the Indonesia-EFTA FTA and details Fern’s position on it and makes recommendations for the EU-Indonesia Cooperative Economic Partnership Agreement (CEPA).

EU-INDONESIA FREE TRADE AGREEMENT NEGOTIATIONS – STATE OF PLAY

The European Union (EU) and Indonesia have been negotiating a Free Trade Agreement (FTA), known as the Comprehensive Economic Partnership Agreement (CEPA) since 2016. There have been eleven rounds of negotiations, but trade in ‘sustainable’ palm oil remains a stumbling block. Indonesia has asked for recognition of the mandatory Indonesian Sustainable Palm Oil (ISPO) Certification scheme and has also proposed a clause which would commit the EU to not discriminate against palm oil. EU text proposals focus on the promotion of sustainable forest management, but do not contain incentives for trade in sustainable palm oil nor include obligations to halt trade in any commodities that cause deforestation, forest degradation or violate human rights.

In parallel to the FTA negotiations with the EU, Indonesia concluded an FTA with the EFTA (Iceland, Lichtenstein, Norway and Switzerland) in December 2018, which came into force on 1 November 2021. This innovative agreement includes Article 8.10, which links preferential market access to sustainable production. Palm oil, and other vegetable oils “that have been produced protecting primary forests, peatlands, and related ecosystems... and respecting rights of local and indigenous communities and workers” will get preferential market access. This is the first time a bilateral FTA links ‘sustainable’ production with lower tariffs.

Of the four EFTA countries, Switzerland is by far the largest. Rather than establishing their own control system, the Swiss government decided to assess whether existing palm oil certification schemes were adequate to meet the criteria in Article 8.10. The State Secretariat for Economic Affairs (SECO) commissioned an evaluation of existing schemes and identified four schemes that could provide proof of compliance: (1) Roundtable on Sustainable Palm Oil (RSPO) but only if the sustainable palm oil is kept separate from ordinary palm oil through the supply chain (RSPO Identity Preserved); (2) RSPO Segregated; (3) RSPO Segregated; (4) RSPO Segregated.

1 - A false hope? An analysis of the new draft Indonesia Sustainable Palm Oil (ISPO) regulations, Environmental Investigation Agency, July 2020
2 - Consistent with the respective national treatment or most-favoured-nation obligations enshrined in the General Agreement on Tariffs and Trade (GATT)
3 - See leaked Indonesian proposal for a TSD chapter, June 2017
4 - See EU proposal for a TSD chapter, May 2017
5 - Article 8.10, on ‘Sustainable Management of the Vegetable Oils Sector and Associated Trade’. The Parties commit to: ‘effectively apply laws, policies and practices aiming at protecting primary forests, peatlands, and related ecosystems, halting deforestation, peat drainage and fire clearing in land preparation, reducing air and water pollution, and respecting rights of local and indigenous communities and workers’ (Article 8.10(2)(a)); and to ‘ensure that vegetable oils and their derivatives traded between the Parties are produced in accordance with the sustainability objectives referred to in subparagraph (a) (Article 8.10(2)(e)).
7 - This means that sustainable palm oil from a single identifiable certified source is kept separately from ordinary palm oil throughout supply chain. See: https://rspo.org/certification/supply-chains
8 - This means that sustainable palm oil from different certified sources is kept separate from ordinary palm oil throughout the supply chain. See: https://rspo.org/certification/supply-chains
RELYING ON PRIVATE CERTIFICATION SCHEMES TO ENFORCE SUSTAINABILITY COMMITMENTS IN TRADE AGREEMENTS IS DOOMED TO FAIL

The Swiss EFTA incentivises primarily private certification schemes which have not been very effective in tackling deforestation and human rights abuses. Several certified companies have been accused of breaching standards or being responsible for deforestation and human rights abuses.

Other concerns include:

- The provisions in the EFTA FTA include primary but not secondary forests, despite the fact that an estimated 8.6 million hectares (ha) of secondary forests are at risk of deforestation in Indonesia.13

- The preferential tariff regime has not been negotiated with relevant Indonesian civil society organisations. Palm oil smallholder organisations, Indigenous Peoples and local communities and palm oil workers’ organisations have not been consulted on the definition of sustainable palm oil and how these trade preferences could be beneficial.

- The lack of a third party monitoring system and a complaints mechanism.

LIMITED IMPACT FORESEEN

The impacts of this preferential tariff regime on trade in sustainable palm oil is expected to be minimal both in Indonesia and Switzerland because Swiss palm oil imports from Indonesia are limited;14 most palm oil intended for the Swiss food industry is already RSPO certified; and tariffs are already low.

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9 - This presumably means that sustainable palm oil is kept separate from other palm oil. But the website is not clear about this: https://www.iscc-system.org/
10 - http://poig.org/
11 - The Indonesian national palm oil sustainability standard, was not included in the assessment; as the study commented: “The Indonesian Sustainable Palm Oil Standard (ISPO) has currently no relevance in the Swiss market and is unlikely to gain a more prevalent position in its current form, as several studies have found it to compare poorly to other standards … The benchmark for ISPO was hence not included in this report, though we reference findings regarding ISPO from other studies and a short description. It is worth noting that ISPO is currently under review. The forthcoming version of ISPO may prove to be more relevant for the Swiss industry and could be included in a future evaluation”.
12 - For details see page three of the report ‘Trade Incentives for improving forest governance in relation to palm oil within CEPA negotiations’, November 2021, Duncan Brack
14 - From 2012 to 2019, only around 2.5 per cent of imported palm oil in Switzerland came from Indonesia; this volume fell to 0.1 per cent of total imports in 2019.
LESSONS LEARNED FOR THE EU INDONESIA FREE TRADE AGREEMENT

The EFTA FTA sets an interesting precedent for treating a commodity differently in trade agreements based on processes and methods of production, using reductions of tariffs to reward sustainable production.

Usually, Trade and Sustainable Development (TSD) chapters are limited to commitments to adopt and/or implement international core environment, climate and International Labour Organisation conventions, and compliance is not subject to sanctions. The EFTA CEPA, despite the limited impact foreseen, shows it is possible to discriminate commodities on sustainability grounds.

The EU has in November 2021 released a draft Regulation on deforestation-free products which prohibits the placing on the EU market of all palm oil (and five other forest risk commodities) linked to deforestation. A process - as part of CEPA – that incentivises truly sustainable palm oil production, notably from smallholders who farm and live on their own land, might be a good complementary initiative. Hence, building on the mechanisms set up by the Indonesia-EFTA agreement, the EU and Indonesia could agree to give preferential tariffs to truly sustainably and legally-produced forest risk commodities and derived products.

However, key issues remain including how to achieve an inclusive and deliberative participatory negotiation process, a compliance mechanism and a deliberative involvement of third parties in implementation and enforcement.

Even if done well, the impact will, however, remain limited as EU import tariffs for palm oil are already low. Crude palm oil and crude palm kernel oil (two-thirds of EU imports) already benefit from zero import duties although processed products have progressively higher tariffs.

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15 - Is the future of preferential trade in sustainable production only?
16 - “This is a typical example of ‘tariff escalation’ – higher import duties on semi-processed products than on raw materials, and higher still on finished products, designed to protect processing industries in the country of import and discourage the development of processing activity in the countries where the raw materials originate”. Duncan Brack, Trade incentives for improving forest governance in relation to palm oil within CEPA negotiations, Final report, November 2021.
FERN’S RECOMMENDATIONS

For trade to support the global transition to a greener and fairer economy, EU trade policy needs to start from the position that production and consumption have to respect planetary boundaries. As such, the EU-Indonesia FTA cannot be beneficial whilst it focuses on increasing trade instead of bringing it to levels compatible with tackling the climate and biodiversity crises. The following recommendations are based on the assumption that the EU-Indonesia FTA will go ahead and that it can therefore be improved by learning from the EFTA-Indonesia FTA.

1. The CEPA should include clear criteria for sustainably produced forest risk commodities, and these should be linked with tariff preferences. Market access should also be conditional on products being free from deforestation and human rights violations.
   a. Quota allocations and lower tariff rates should be tied to compliance with the social and environmental criteria agreed by the Parties bilaterally, in meaningful consultation with civil society organisations. These should be reciprocal and respect international environmental, labour, and human rights agreements. These criteria must be met before preferential tariffs are granted.

2. Commitments to improve social and environmental standards should be backed up by a roadmap. It should define and outline policy reforms, law enforcement actions and traceability norms needed from both trading partners. The roadmap should include indicators of progress, especially in relation to:
   a. the implementation of important Multilateral Environment Agreements, including the Paris Agreement and the Convention on Biological Diversity’s Aichi Targets, i.e. both EU and Indonesia’s National Biodiversity Strategy and Action Plans.
   b. the effective implementation of the EU Regulation on deforestation-free products and agreement on EU policy measures to support Indonesia to comply with the Regulation and CEPA requirements on sustainable palm oil.

3. Civil society participation in the negotiation and implementation of CEPA should be strengthened. This means:
   a. Civil society in Indonesia and the EU should have the right to participate in the trade negotiations, and debate with members of their national parliaments about the potential impacts.
   b. All information, including updated FTA’s negotiation texts, should be made accessible to those participating.
   c. The Commission should establish clear reporting and monitoring tools to track progress and ensure accountability, potentially via indicators or scorecards. This could help provide the information needed to properly enforce the above-mentioned commitments.

4. The CEPA should require that Parties establish or designate a competent and independent authority to deal with complaints from individuals and civil society organisations. The complaint mechanism should also be empowered to trigger the suspension of trade preferences.