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The Impact of the European Union's Palm Oil Resolution Policy on the Indonesian Economy Sector

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ABSTRACT: Indonesia as the world's largest producer and consumer of palm oil is experiencing considerable challenges due to the enactment of the The European Union (EU) Parliament Resolution on the use of palm oil and on overcoming the issue of deforestation. The Union issued a RED policy aiming at directing the European community to use energy-efficient and emission-free fuels. The regulation comprises a rejection of palm oil and its derivative products. The ban on importing such products imposed by the European Union has caused a decrease in Indonesia's GDP by 1155.28 million Euros. In addition, this impacted the employment sector, particularly the oil palm farmers who experience a decrease in income. Despite the issuance of the European Union policy that prohibit or restrict palm oil import, the EU has dependence on Indonesia's palm oil since they can not produce the oils on a large scale in order to meet their needs. This is a qualitative study and the data collection technique is the heritage study methods obtained from journal, scientific journals on similar topics. As for the theoretical analyses, the mercantilism approach with the aim to use economic policies to maximize the state's wealth as a means of political power is implemented.

Keywords: Palm Oil, European Union, Biofuels

INTRODUCTION

Indonesia is the world's largest producer and consumer of palm oil (Alliance, 2022). Nevertheless, the industry is currently facing major challenges that begin with the approval of a resolution by the European Union Parliament for reforestation of Palm Oil and Rainforest. Later, the European Union Commission issued Delegated Regulation No. C(2019) final 2055 on high and low ILUC risk criteria for biofuels (Suwarno, 2019). This is seen as a discrimination that involves policy motives and competition considering that the products of Indonesian palm oil meet the international regulations and the continuity of development goals. Therefore, to combat such discrimination, efforts must be made in the form of a palm oil diplomacy strategy . In this regard

to diplomacy, Indonesia should provide explanations to the parties involved in the European Union and practice regional and multilateral economic diplomacy (Maiwan, 2015).

On December 6, 2022, the European Union passed a law which banned the import of deforestation-related goods. The law prohibits products, such as coffee, soybeans, milk, and palm oil, generated from deforested land to enter the European Union region (Arif, 2022). This is not the first policy, since similar other policies in a smaller scope have also existed in 2013 and 2017, when products are restricted to palm oil and its derivative items. The first policy is the Renewable Energy Directive (RED) policy made by the European Union to support the use of biofuels. This RED policy initially benefited Indonesia's palm oil sales as demand for palm oil increased. However, in 2018 the European Union updated its policy and removed palm oil as a biofuel material since a surge in demand for palm oil resulted in an increased land clearing and air pollution(Sinaga & R, 2021). Second, the Oil and Deforestation of Rainforest resolution assesses that palm oil produced by Indonesia is not in line with the principles of environmental sustainability due to the fact that palm oil land causes large-scale forest fires, rivers drought, soil erosion, waterway pollution and biodiversity loss. Therefore, since 2019, palm oil will gradually be discontinued (Pradhana, 2020).

The policies implemented by the European Union have an impact on the opinion of Indonesian palm oil so that the country's income has decreased. The data from BPS (Biro Pusat Statistik or Statistics Central Bureau) in 2021 revealed that Indonesian experienced a decrease in palm oil purchases. It was recorded that since 2017, the sales of Indonesia's palm oil to European Union reached 3.8 million tons, but in 2021 the sales decreased to only 2.1 million tons (O'reilly et al., 2020; Santika et al., 2019). Indonesia will certainly not remain silent with such policies that discriminate its products, therefore, these issues are frequently raised as a topic of discussion in every meeting held between Indonesia and the European Union (B.P.S., 2021).

The aim of the paper is to investigate the following:

Is the Palm Oil Policy implemented by European Union truly shows concerns to the environment? and What is the impact of the policies to the economy sector in Indonesia?

In a research entitled "EU Palm Oil Policy and Challenges for Indonesian Economic Diplomacy" by Suwarno, it is stated that the palm oil resolution passed by the European Union is an act of discrimination against Indonesia as the Union blames the nation for deforestation regardless the international and sustainable development standards Indonesia has set up (Abram et al., 2017; Nurfatriani et al., 2019).

Furthermore in his manuscript, Pradhana (2020) analyzed the change in attitude of the European Union towards its policy of banning Indonesian palm oil imports. It was argued that Indonesia and Europe have conducted fruitful diplomacy in the form of postponing the deadline for banning palm oil imports, starting from 2021 to 2030 (Zahir, 2020). This raised questions on EU stance, whether or not the withdrawing of the import ban deadline is a mere EU-vested interest (Drajat & Hadi, 1996; Dugis, 2016).

Furthermore, an article entitled "The influence of European Union policy on Indonesian palm oil exports" by Hendra Maujana Saragih analyzed the influence of EU policies on Indonesia's palm oil exports (Pahlevi, 2022). The author uses green theory as his analytical tool (Naylor et al., 2019; Putri et al., 2022). The results of the analysis are similar to the previous article, stating that Indonesia experienced a discrimination by the European Union over its policies. The fact is that such discrimination is only to protect the European market and to raise environmental issues as if that palm oil business were harmful, hence the European community will stop using palm oil and substituted with vegetable oil (Saragih, 2018).

This paper implements mercantilism method, aiming to use economic policies in order to maximize the country's wealth as a means of political power and to strengthen national power (Mas'oed, 2008). Mercantilism sees traders and governments as collaborating to minimize trade deficits and create trade surpluses. The theory requires the state to take an important role in the sustainability of economic activity (Jackson & Sorensen, 2013). The roles are as follows:

1. The state should worry about the advantages gained by other countries since they can be used to increase military power.
2. The state should maintain its national economy.
3. The state needs to protect local goods by increasing export and reducing import.

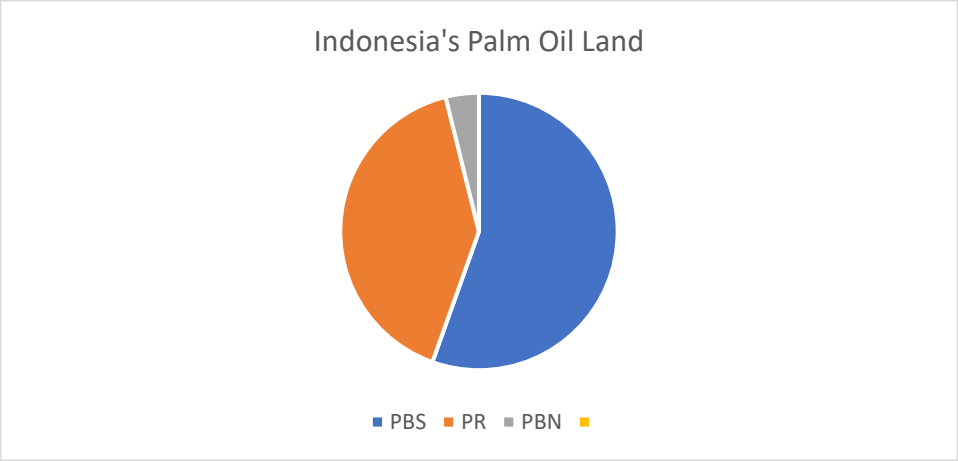
METHOD

This is a qualitative research with naturalistic method where the analyses are carried out in *natural settings*; it is also known as the ethnography method, since it is more widely used for a research in cultural anthropology; it is referred to as a qualitative method, because the data collected and the analysis are interpreted by texts (Sugiyono, 2019).

The data collection technique used in this paper is a literature study obtained from scientific journals with similar topics, international relations books, and electronic print media. The data are analyzed scientifically to obtain newness in knowledge in order to make them useful as a complement to the information previously collected. Ultimately, these data reinforce the existing discoveries or knowledge.

RESULTS AND DISCUSSIONS

Palm Oil Competitiveness

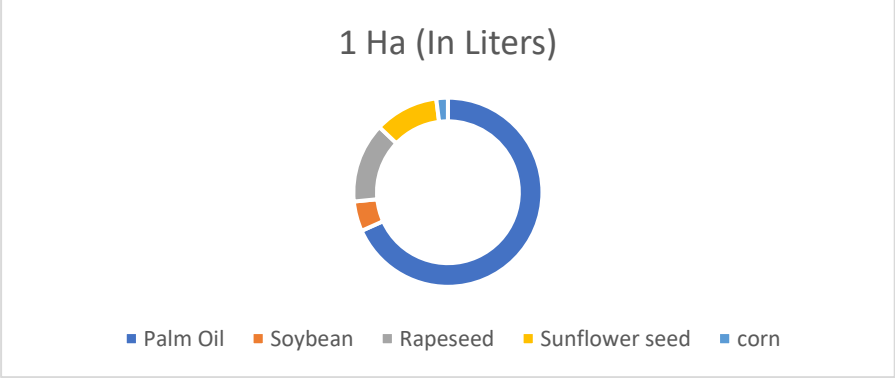


Source: 1. Dewani, A. Rizaldi, B. Nurul, J. (2014). Analysis Footprint Carbon Agribusiness Palm to Pile up Referral Corporate Social Responsibility (CSR) Strategies and Programs. Bogor: School Postgraduate, IPB. Pg 100

Indonesia is the world's largest palm oil producer, producing 46.88 million tons of palm oil in 2021. The massive production, however, requires sufficient land for the plants to grow.

Based on the data carried out by katadata.comit, it is recorded that Indonesia's palm oil land reached 15.08 million hectares where 8.42 million ha (55.8%) is owned by Large Private Plantations (PBS or Perusahaan Besar Swasta); 6.08 million ha (40.34%) by Smallholder Plantations (PR or Perkebunan Rakyat); and 579.6 thousand ha (3.84%) by the State Large Plantations (PBN or Perkebunan Besar Negara).

The existence of this palm oil plantation is able to absorb a large number of workers, so that the unemployment rate can be reduced. Nevertheless, Indonesia's palm oil plantations are not dominated by the private sector, since the ownership is balanced (private 55.8% and people-owned by 40.34%). Such balanced distribution of public and private land ownership benefits local farmers since they can use it productively.



Furthermore, the initial purpose of the establishment of RED (Renewable Energy Directive) was to respond to environmental pollution caused by the massive use of fossil energy cars. Along with

that, the amount of food production has increased, so that the foodstuffs are processed into biofuel energy (fuels generated from plants, such as corn, sunflower seeds, soybeans, and palm oil). Of these materials, palm oil has a higher level of productivity. One hectare of palm oil is capable of producing 5,950 liters of palm oil, much larger than 446 liters of soybeans, 1190 liters of rapeseed, 952 sunflower seeds, and 172 liters of corn. In addition to the greater palm oil production power, the crop absorbs carbon relatively well, where a hectare of palm oil trees is able to absorb 64.5 tons of CO_2 /ha/year. Therefore, palm trees are more suitable to be utilized as biofuels based on their production level and a fairly good carbon absorption capacity, making them superior to other biofuel-producing crops (Dewani et al., 2014).

The issue of deforestation triggered the European Union Commission who stated that Indonesia has recently become the third highest CO2 polluter in the world and is experiencing a decline in biodiversity, with several endangered wildlife species on the verge of extinction. From the results of a 2013 European Union Commission study, the highest cause of deforestation was the agricultural sector which reached 58 million hectares, while palm oil only caused 6 million hectares out of a total of 239 million hectares of deforestation. The impact is that palm oil is considered the fourth factor causing deforestation after soybeans and corn, which contribute around 2.5% of global deforestation (Santosa & Haryadi., 2021). This proves false allegations made by the European Union about Indonesia's palm oil being the world's largest contributor to deforestation. In fact, Indonesia has a mandatory on ISPO (Indonesia Sustainable Palm Oil). This policy focuses on both environmental protection and management so that the country can produce palm oil which is considered safe for the environment. The varying speculation is that the oil discrimination by the European Union parliament bears political importance (Giplin, 2001).

Moreover, palm oil land is considered water-consuming, although this is refuted in the PASPI (PalmOil Agribusiness Strategic Policy Institute) journal. It is stated that Palm oil only needs 1,104 mm / year, while pine, acacia, and sengon plants often used as forest plants have almost the same absorption capacity and even larger than the palm oil itself (PASPI, 2020). In addition, it is proven that the palm oil water footprint is only 1,097 m^3 / ton consisting of 96% from rainwater and the rest from *gray water* (water needs needed to assimilate pollutants). Compared to rapeseed of 2,270 m^3 / ton consisting of 75% rainwater, 10% from groundwater, and 15% from *grey water,* this indicates that rapeseed water consumption is not only greater and but also absorbs groundwater (Ermawati & Saptia, 2013).

The Analysis of the European Union policies that discriminate Indonesia's palm oil

In 2009, the European Union issued a RED (Renewable Energy Directive) policy. The purpose of this policy is to direct the European Union community as well as the world to use biofuel fuels. However, the RED rearranged its regulations into the RED II agreed in 2018. This regulation contains provisions or requirements for biofuel products (The European Union Parliament, 2017):

"It sets limits on high ILUC-risk biofuels, bioliquids and biomass fuels with a significant expansion in land with high carbon stock."

This means that the European Union restricts biofuel products with a high risk of ILUC (Indirect Land Use Change). The gradually high demands on biofuels force the producers to increase the

production output. The increase in production resulted in the increase of the plantation land so that green land (forest and peat) is converted into agricultural land which is indirectly considered environmentally harmful. As a consequence, Indonesian-owned CPO (Crude Palm Oil) is threatened because of the land expansion.

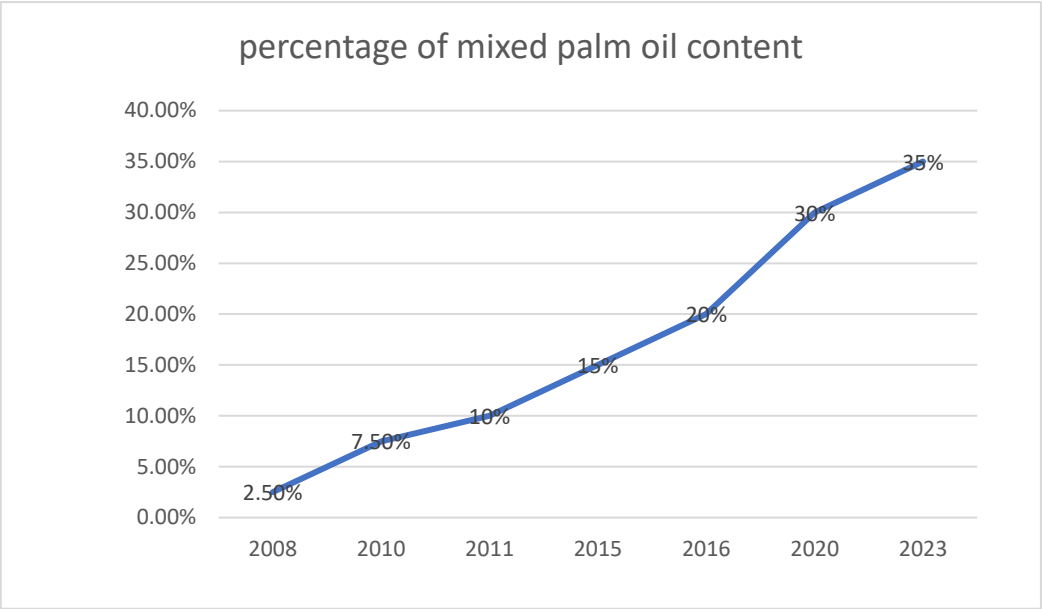
However, the purpose of RED II is for the European Union community to use energy-efficient and emission-free fuels. If the environmentally friendly fuel is processed and produced in a way that is not environmentally friendly, such as emissions and waste production, and the green land damage, it can be emphasized that environmentally friendly fuel is similar to fossil fuels even though the fuel is labeled "environmentally friendly".

Further on is the Palm Oil and Deforestation of the Rainforests resolution in 2017. The regulation includes a rejection of palm oil and its derivative products as the growing demand for palm oil causes forest conversion and increased carbon emissions, making palm oil unfit for use as a biofuel staple (The European Union Parliament, 2017).

Then In December 2022, the European Union inaugurated a new law related to deforestation. The law prohibits deforested goods or goods produced from deforested land, such as coffee, soybeans, milk, and also palm oil, from entering the European Union region. This affirms environmental issues so that both individuals and countries will pay more attention to the environment in their economic growth (Republikacoid, 2022).

In addition, the policies have the same purpose: to prevent environmental damage. However, there is another intention behind this policy, in which the European Union acts to safeguard their vegetable oil products. However, before the policies were present, the European Union had issued Directive 2003/30/EC on the introduction of biofuel products then reaffirmed with the implementation of the RED policy in 2009 on the European Union's target to replace fossil fuels. Such policy does not discriminate Indonesia's palm products, even the first-generation RED has encouraged the export of Indonesia's palm oil in large quantities (Jevon, 2019). In addition, the existence of these policies encourages Indonesian's researchers to create biodiesel products (one part of biofuels) made from palm oil, and this has been started since 1990.

With considerable encouragement towards the development of biodiesel products, in 2008 Indonesia had the ambition to build biofuel products from palm oil as stated in the Regulation of the Minister of Energy and Mineral Resources No. 32 of 2008. The regulations resulted in the development of palm oil-based biodiesel to be implemented. Additionally, the data from the Ministry of Energy and Mineral Resources confirmed that the progress made by Indonesia in the development of biodiesel products from 2008 to 2023 is considered very satisfactory.



Source: ESDM (2019)

The data showed that from 2008 to 2023 the development of biodiesel in Indonesia has been increasing with satisfactory results. The peak of biodiesel development in Indonesia began in 2015, with a vegetable oil content of 20% (B20) and it continues to grow until it reaches a vegetable oil content of 35% (B35) in 2023 (E.S.D.M., 2019). This B35 product is the first in the world with the highest vegetables oil content and the B35 staple product is palm oil. The sale of this B35 product was also implemented on February 1, 2023 in Indonesia. In fact, the development of biodiesel does not stop here, as Indonesia has targeted to produce biodiesel fuel based on 100% vegetable oil and palm oil as the staple product.

Nevertheless, after 2013 the European Union's attitude towards palm products began to change. The European Union imposed an Anti-Dumping Import Duty (BMAD or Bea Masuk Anti Dumping) on palm oil refined products, namely biodiesel (biofuel) products. This is due to Indonesia's success in developing biodiesel products so that it is considered interfering biofuel products owned by the European Union. Indonesia, however, addressed its reservations by suing the European Union at the WTO (World Trade Organization). As a result, Indonesia won the lawsuit in 2018 and the European Union had to accept the biodiesel products. Further investigation revealed that the European Union in the BMAD policy is a set up-trap for Indonesia so that crude palm oil products can enter the European Union, without the processed products. By such doing, the European Union can protect its biofuel products without having to compete with Indonesian biodiesel products.

Furthermore, in 2017 and 2018 the European Union changed its strategy by questioning the environmental issues of these products and carried out a complete cessation of Indonesian palm oil products gradually. This resulted from the failure of the European Union to take Indonesia's biodiesel products plus Indonesia's increasing success in developing its biodiesel products with palm oil content of 20% to 30% forced the European Union to stop all palm oil products and derivatives. Consequently, European Union biofuel products were less competitive, compared to Indonesia's biodiesel products.

On Tuesday 6 December 2022, the European Union approved a new law to prevent the import of deforestation-related products into the EU market. The European Union requires companies to make due diligence statements proving that their supply chains do not cause forest destruction. This means that any products closely related to plantations or livestock must have a certificate to assure that the products do not come from deforested land.

Considering the policy will threaten Indonesia's palm oil exports, the country took a quick action by revamping the existing Indonesia Sustainable Palm Oil (ISPO) policy. It aimed at complying with the European Union's RED program and the SDGs set by the United Nations to bring order to palm oil lands in Indonesia in accordance with sustainability principles. Indonesia's ISPO certification test is based on European Union "*sustainable*" criteria, therefore the feasibility of palm oil land determined by ISPO and European Union sustainability criteria is of the same standard. This certification is based on "*sustainable*" criteria, namely: Business legality; Plantation management; Protection from the use of natural forests and peatlands; Environmental management and monitoring; Responsibility towards workers; Social and economic empowerment responsibilities; and Continuous improvement of efforts (T S EGroup, 2021).

Although Indonesia's own policy has been built and adjusted by European Union criteria, the certification has not been recognized by the European Union, since the certification will allow Indonesia's palm oil to enter freely and the products are threatened with reduced revenue. The European Union's failure to break away from imports of palm oil and its derivative products has in fact been detected, nevertheless, it is impact-less for the Indonesia's ISPO certification to be recognized.

With the European Union's policy to slowly stop Indonesia's palm oil imports, the impact will affect the environment in the future. Preventing the most productive raw materials from biofuels can open up new plantation land from palm oil substitutes, such as soybeans, sunflower seeds, rapeseed, and corn. With a reference to the RED II target, about 32% renewable energy is used by 2030, thus, the demand for biofuels will increase. As a consequence, biofuel raw materials, such as sunflower seeds, rapeseed, soybeans, and corn, will be massively planted in order to meet the needs. The products mentioned require an increasingly large area of land, particularly since the amount of raw material productivity is far below the productivity of palm oil crops, therefore, such policy will damage the environment in the long run .

The impact on the Indonesian Economy

The policies implemented by the European Union have an impact on a decrease income from Indonesia's palm oil. According to data taken from BPS in 2021, the country experienced a decrease in palm oil purchases, and it was recorded that since 2017 Indonesia's palm oil sales to Europe reached 3.8 million tons, but in 2021 they decreased to only 2.1 million tons. Indonesia has filed some criticism on policies that discriminate its products, so these issues are frequently raised as a topic of discussion when Indonesia and the European Union hold meetings.

The European Union's ban on direct imports of Indonesian palm oil cuts by 1.19 billion European Union in direct exports. This led to a decrease in Indonesia's GDP *(Gross Domestic Product)* by 1155.28 million Euro, which was reduced by -0.2% from the initial GDP value (Rum

et al., 2022). The import ban scenario has different implications at the regional level. When viewed through Indonesia's GDP data, the areas most affected by the loss of this policy are the Sumatra region with the decrease of -0.72% and Kalimantan region with the decline of -0.24%. In addition, if the condition is reviewed more specifically through the provincial level, Riau is the province mostly affected by the largest loss, with a total decrease of -1.87%, the second position is North Sumatera with a total decrease of -0.98%, and the third is Kalimantan Tengah with a total decrease of -0.89%. As for the job losses, most of them occurred outside Java, amounting to 96.26% of the total palm oil seed sector, which is 75.21%.

Furthermore, Riau experienced a decline in *output* due to intra-regional effects of 1.02 billion Euro (-1.87% of Indonesia's GDP baseline). When compared to other provinces, the decline is the highest, twice of what North Sumatra experienced (-0.98% or equivalent to 497.9 million Euro) and 6 times of Lampung which is 149.2 million Euro. This indicated that the economy in Riau relies on the vegetable oil sector. Nevertheless, the vegetable oil sector experienced a decrease in *output* of 664.2 million Euro (-8.11%) and the oilseed sector decreased by 271.3 million Euro (-5.65%) as the impacts of the policies.

Moreover, from the interregional impact, a number of provinces and sectors have experienced a decline due to the *spillover effect*. This is caused by changes in the demand for vegetable oils from other provinces as the effects of import restrictions. Almost all provinces in Sumatra and Kalimantan experienced a decline in palm oil seed production. As previously described, Riau province, experienced a decrease in vegetable oil *output* by 4.03 million Euro (-0.05% of the initial value).

Hence, the total multiplier effect of reduced production on Riau's vegetable oil sector by adding the intra-regional and inter-regional production multipliers can be calculated: €668.19 million (66422 + 4.03) or -8.15% of initial value. Due to cross-regional impacts, provinces such as Jambi and South Sumatra recorded larger production decline in the oilseeds sector. This means a decrease of €23.71 million (-3%) and €18.96 million (-2.75%) respectively. Similarly, other industries, especially the service sectors, are affected. It can be concluded that almost all provinces of Java, Sumatra and Kalimantan are experiencing production declines. The capital city, Jakarta, is experiencing the steepest contraction in the services sector.

European Union Dependence on Indonesian Palm Oil Production

Based on the data, about 50% of the total European Union vegetable oil imports come from Indonesia. This dependence occurs because the European Union has not been able to produce palm oil products in large enough quantities to meet domestic needs (Zahir, 2020). In addition, the competitive palm oil prices and the supply stability are the major factors in the European Union's dependence on Indonesian palm products. However, the European Union is currently under pressure to reduce its dependence on palm products that are considered environmentally unfriendly.

To meet its vegetable oil needs, the European Union mostly imports from other countries. This is due to the limited production of vegetable oils that can be produced by the European Union. The total import comprises more than 80% of soybean seeds, more than 60% of soybean flour, and

50% of sunflower. As for palm oil, the European Union imports 74% of palm oil products from third countries such as Indonesia, Malaysia and Thailand. Even higher for non-CPO, the total import reaches 95%. The 2016 European Union data confirmed the import of 5 million tons of vegetable oil which is derived from tropical crops or 4.1 billion Euro in 2015.

Another reason why the European Union relies on palm oil is that the crop is able to produce the highest oil in each hectare compared to other vegetable oil crops. The Oil World (2007) reports highlight the capability of palm oil to produce around 3.74 tons/ha/year. Meanwhile, other vegetable oil crops such as rapeseed oil (0.67 tons / ha / year), sunflower oil (0.48 / ha / year) and soybean oil (0.38 / ha / year) products contribute to 10-15% of palm oil production. Thus, it can be concluded that palm oil is the most effective and efficient crop compared to other types.

The capabilities Indonesia has to meet the world needs should strengthen its position. By continuing to demonstrate the extraordinary amount of palm oil crops and researching whether or not the environmental damage is justified, Indonesia could present some evidence that oil palm crops are not harming the environment, thus, it is easier to fight for justice at the WTO. In addition, tightening ISPO certification and supervising the land of 17 illegal palm oils provide support for the processed palm products. With the capacity of 35% palm-based biodiesel products, the development should be intensified . Given the urgent need for palm oil technology, the profits generated from the business should be allocated and it is recommended that the government subsidize properly, in order to quote such products more competitively.

CONCLUSIONS

The European Union has three policies related to environmental issues, namely the Renewable Energy Directive (RED), a resolution on Palm Oil and Deforestation of Rainforests, and a law banning deforestation products. The policies aimed not only at the environment but also at other intentions, one of which is to save the domestic products, such as palm oil and biodiesel from foreign products, biofuels. This proved to be true as the European Union had imposed Anti-Dumping Import Duties (BMAD) on Indonesian-owned biodiesel products for no apparent reason since 2013. The European Union' concerns that the success of Indonesia in developing biodiesel products from palm oil, coupled with the considerable European consumption of Indonesian-owned palm oil, will make the European Union dependent. Thus, the biofuel products owned by the European Union will be less competitive. Therefore, the European Union made the Anti-Dumping Import Duty (BMAD) regulations. Fortunately, in 2018 Indonesia won against the European Union after filing some reservations to the WTO.

Another piece of evidence exists when the European Union implemented the regulations of the Oil and Deforestation resolution in 2017 and RED II in 2018 that directly rejected palm oil products and palm biodiesel since they had damaged the environment and cleared the rainforest land. In fact, this policy is aimed at completely stopping the import of palm oil and its derivatives. This is once again triggered by Indonesia's success in developing palm oil products into biodiesel with a content of 20% equivalent to biofuel products owned by other countries.

Furthermore, in a new resolution at the end of 2022 , Indonesia's success in developing biodiesel products with a content of 30%-35%, the highest biofuel content in the world, was proven, even products with a content of 100% is in the stage of jobs testing and its development supported by ISPO certificate. It is obvious that the three policies made by the European Union are not solely for the sake of the environment, it is rather to dispel Indonesia's palm oil products, especially biodiesel, from entering Europe so that their domestic products are safe.

It is obvious that the European Union's ban on direct imports of Indonesia's palm oil led to a decrease in Indonesia's GDP by 1155.28 million Euro, or a reduction by -0.2% from the initial GDP value. Riau Province is the province mostly affected by the establishment of this policy. The province experienced a decline in output due to intra-regional effects of 1.02 billion Euro, if compared to the other two provinces, North Sumatera and Lampung. In addition, some other provinces and sectors have experienced a decrease due to the spillover effect caused by changes in the demand for vegetable oils from other provinces as import restrictions persist.

As for the data from European Union, about 50% of the total European Union vegetable oil imports come from Indonesia. The dependence is triggered by the regions not having sufficient land capacity for palm oil products in large enough quantities to meet domestic needs. Around 5 million tons of vegetable oil derived from tropical crops or 4.1 billion Euro in 2015. Another reason why the European Union still relies on palm oil is that it is the good quality crop having the potential to produce the highest oil in each hectare, compared to other vegetable oil crops.

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