

## Explanatory note

### Call for a reset of the negotiating agenda

The IEU CEPA negotiations – launched in 2016 and entering their 6<sup>th</sup> round of negotiations in October 2016 - continue to focus on the liberalisation and deregulation of trade and investment flows as their main objective. Meanwhile, a growing body of evidence demonstrates the failure of these neoliberal policies of corporate-led globalisation that contribute to climate change, environmental degradation and widening inequality across the globe. The architecture of trade and investment agreements continues to ignore these immense associated social and environmental costs.

The sustainable development chapters in EU trade agreements only pay lip service to inclusive and sustainable development. They are phrased in the softest of terms, and lack monitoring and enforcement. This stands in stark contrast to the highly enforceable protections for transnational corporations enshrined in trade agreements like the IEU CEPA.

If trade and investment agreements are to be understood as a means to achieve the objective of sustainable development, they should follow the definition of the UN Agenda 2030, which calls for the promotion of sustainable economic growth that is socially inclusive, respects ecological boundaries and promotes peace and democracy.

Ensuring that trade and investment contribute to the overriding objective of sustainable development requires *trade regulation*, rather than trade expansion through liberalization and deregulation.

The current agenda for the IEU CEPA negotiations, which largely reflects the interests of transnational corporations, must be turned around to genuinely put inclusive growth and sustainable development first. This will require a fundamental “reset”.

### Civil society concerns

Civil society from Indonesia and Europe share concerns about the potential social costs and human rights impacts of an IEU CEPA agreement, as well as about its impact on the environment and climate change.

**Irreversible liberalisation and negative impacts on Indonesian domestic development** – A key concern is that the CEPA will commit the signatory parties to irreversibly liberalise their economies. It is standard practice in trade agreements to maintain the level of liberalisation that exists at the time of signing the agreement. In addition, parties commit to lock in any further liberalisations of their economies. This means there can be no going back on liberalisations and parties can only move in the

direction of more liberalisation. Flawed liberalisations that do not bring the desired results, or even have negative effects – for example when the market is opened up prematurely – cannot be reversed. For Indonesia in particular, there is a real risk that small domestic producers and businesses in Indonesia will be crowded out by incoming European products and goods and service providers and force domestic retailers and farmers out of their livelihoods.

Large-scale infrastructure projects, the development of the tourism sector and commercial agriculture will attract European corporations and investors, but are associated with land- and ocean-grabbing, environmental destruction, biodegradation, and displacement of local communities.<sup>1</sup>

Concerns are compounded by the EU's drive to include in the IEU CEPA a ban on so-called performance requirements. Performance requirements demand that foreign investors meet certain obligations and can be an important tool to ensure that incoming investments contribute to the national development objectives of the host country. They can take the form of limits on foreign ownership; requirements to enter into joint ventures with local companies; local content requirements demanding that foreign investors use local materials in their production processes and employ local workers; research & development and technology transfer requirements. Indonesia's 2014 mining act, aimed at improving the added value of Indonesia's raw materials for the domestic economy by capping foreign ownership in the mining sector and stipulating that mining corporations must process raw materials domestically or pay higher export taxes, was immediately and successfully challenged by foreign mining companies under bilateral investment agreements (BITs). The EU should respect Indonesia's subsequent decision to terminate such BITs, and not bring back similar extensive investment protection enforceable through investor-state dispute settlement in the investment chapter of an IEU CEPA.

**Energy, raw materials and palm oil** - In the IEU CEPA negotiations, the offensive interests of the EU in the field of the exploration and production of energy goods and raw materials, as well as Indonesia's interest in enhancing palm oil exports require special consideration, because of the associated ecological impacts (deforestation; (marine) wildlife and biodiversity degradation; pollution) and human rights/social costs (land- and ocean-grabbing; forceful displacement of local populations/indigenous peoples; exploitation of labour).<sup>2</sup> From a sustainable development perspective, Indonesia's recent announcement of a three-year moratorium on new licences for oil palm plantations<sup>3</sup>, as well as the European

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<sup>1</sup> See for example, Social Justice at Bay, BothEnds/SOMO/TNI, 2017. At: <https://www.somo.nl/ncicd/>

<sup>2</sup> See, for example, Palming off responsibility - Labour rights violations in the Indonesian palm oil sector, CNV Internationaal, 2017. At: <https://www.cnvinternationaal.nl/Resources/Persistent/494a6d41ea4525468b46072a02e31f21e85a59c6/CNVI-0118%20Palmolie%20Indonesie-rapport-Low%20Res.pdf>

<sup>3</sup> 'Jokowi imposes moratorium on palm oil plantations', The Jakarta Post, 20 September 2018. At: <http://www.thejakartapost.com/news/2018/09/20/jokowi-imposes-moratorium-on-palm-oil-plantations.html>

Parliament's decision to cap crop-based biofuels<sup>4</sup> are welcome developments. However, to address the many associated social and ecological concerns, (trade and investments in) energy goods and palm oil must be dealt with outside the IEU CEPA negotiations, in a separate, coherent and tailored approach that engages all stakeholders.

**Access to medicine** - Civil society shares major concerns over the impact of an IEU CEPA agreement on the availability of affordable medicines. In the CEPA negotiations, the EU is demanding extended patent protection for its big pharmaceutical companies. This will interfere with Indonesia's policies to boost public health by ensuring availability of cheaper generic medicines. An IEU CEPA must regulate the pharmaceutical sector so that the commercial interests of 'big pharma' take second place to the human right to health.

**IPR protection, seed monopolies and the right to food** - Private plant breeders claiming intellectual property rights (IPR) over (genetically modified) plant varieties poses a threat to the livelihoods of farmers and the human right to food. (Extended) IPR creates temporary monopolies, which limit access to the protected good and services and almost always increase their price. A small number of agribusinesses like Monsanto, DuPont, Syngenta, Dow, BASF and Bayer have dominated the seed market, and the process of further market concentration is ongoing. IPR in agriculture makes farmers more vulnerable to market fluctuations. Monopolies on seeds and agrichemicals (fertilisers, pesticides) are associated with monocultural farming, environmental degradation and loss of biodiversity. (Extended) IPR in agriculture conflicts with human rights and ecological sustainability. An IEU CEPA must not contribute to a further concentration of the seeds market. Seeds must be approached as a public good. The commercial seed system must be strictly regulated from the premise of the overarching right to food and decent livelihoods for small producers and vulnerable farming communities.

**Market access and establishment in services** - Market access provisions in an IEU CEPA must protect against "cherry-picking" practices, whereby incoming service providers are allowed to focus exclusively on more affluent consumers in populated areas. The services chapter should guarantee regulatory discretion to ensure universal and affordable access to essential public services, such as health, education, water and public transport, for urban and rural populations in populated and remote areas alike.

Civil society is concerned about the EU's push to abolish performance requirements. An IEU CEPA should allow governments to (continue to) make use of performance requirements that are aimed at addressing inequitable growth and climate change and at protecting the environment. This should include placing limitations on the number and size of incoming service providers to avoid overexploitation. An example

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<sup>4</sup> 'EU Parliament ends palm oil and caps crop-based biofuels at 2017 levels', Euractiv, 17 January 2018. At: <https://www.euractiv.com/section/agriculture-food/news/eu-parliament-ends-palm-oil-and-caps-crop-based-biofuels-at-2017-levels/>

is the tourist industry, where under-regulation is associated with limited spill-overs for the local economy, unlawful displacement of local communities, and environmental destruction.

**Financial services** - In relation to trade liberalisation, there is the tendency towards cherry-picking by European banks and financial service providers. Trade liberalisation in financial services is associated with declining rural and agricultural credit; a bias towards urban consumer credit; a decline in services to poor clients and a bias towards rich clients; a rise in lending towards stock markets, commercial real estate, derivatives trading and other 'sensitive' sectors; and a decline in lending to SMEs, with associated adverse implications on economic growth and employment. In the IEU CEPA negotiations, the EU's push for a ban on performance requirements is a particular concern. In the absence of performance requirements, foreign banks cannot be required to open offices in un-banked and underbanked rural areas that are less profitable than urban and metropolitan areas. Experience with the EU-India FTA learns that after liberalisation of the Indian banking sector, top EU banks have largely ignored rural and social banking in India.<sup>5</sup>

An IEU CEPA should steer clear of liberalisation of speculative and risky financial instruments; easy authorisation of new financial services and risks associated with their lack of supervision and regulation; and a lack of restrictions on the size and number of financial operators and the value of their financial transactions, which carries the risk of their becoming 'too big to fail' and exposing host countries to potential financial instability.

**Investor protection, enforceable through investor-state dispute settlement** remains a main concern, as it allows foreign investors do directly challenge almost any kind of government regulation before an international tribunal. Through the investor to state dispute settlement mechanisms included in trade and investment agreements, foreign investors can and do exert undue influence over democratic decision-making processes and public interest policies.

It is important to note that

- 1) Investment protection/ISDS does not necessarily attract FDI. One of the most common rationales for investment protection/ISDS is that it can encourage FDI. However, evidence to support this claim remains inconclusive.<sup>6</sup>

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<sup>5</sup> Rethinking Liberalisation of Banking Services under the India-EU Free Trade Agreement, SOMO Paper, September 2009, <https://www.somo.nl/wp-content/uploads/2009/09/Rethinking-Liberalisation-of-Banking-Services-under-the-India-EU-Free-Trade-Agreement.pdf>

<sup>6</sup> Pohl, J. (2018), 'Societal benefits and costs of International Investment Agreements: A critical review of aspects and available empirical evidence', OECD Working Paper on International Investment, 2018/01, OECD Publishing, Paris, [https://www.oecd-ilibrary.org/finance-and-investment/societal-benefits-and-costs-of-international-investment-agreements\\_e5f85c3d-en](https://www.oecd-ilibrary.org/finance-and-investment/societal-benefits-and-costs-of-international-investment-agreements_e5f85c3d-en); See also Jonathan Bonnitcho (2017), "Assessing the Impacts of Investment Treaties: Overview of the evidence", IISD Report, September 2017. <https://iisd.org/sites/default/files/publications/assessing-impacts-investment-treaties.pdf>; UNCTAD (2014), "The impact of international investment agreements on foreign direct investment: an overview of empirical studies 1998-2014", IIA Issues Note, September 2014. <http://investmentpolicyhub.unctad.org/Upload/Documents/unctad-web-diae-pcb-2014-Sep%2016.pdf>.

Numerous studies indicate that investment protection/ISDS is hardly the determining factor for investors when making the decision to invest; other factors such as market size and growth potential, a skilled workforce, availability of natural resources and adequate infrastructure appear to be more important determinants of FDI.<sup>7</sup> In fact, a recent study shows no decrease and in some cases even an increase in FDI after countries terminated their bilateral investment treaties (including Indonesia).<sup>8</sup>

- 2) FDI does not necessarily contribute to sustainable development. Not all FDI is the same. FDI can produce wide-ranging benefits in host economies by generating employment, transferring skills and disseminating technology, generating fiscal revenues, supporting industrial diversification and productive capacities as well as contributing to local enterprise development through linkages with suppliers. But these benefits do not always materialize automatically. Research indicates that FDI can also have negative spill-over effects and crowd out domestic companies, create precarious jobs or reduce employment, increase income inequality, facilitate tax evasion and avoidance, and contribute to environmental degradation and pollution.<sup>9</sup> This shows that it is crucial to provide for the adequate mechanisms and regulations to harness FDI for sustainable development. Current trade and investment agreements tend to protect all kinds of FDI irrespective of the nature of the investment, the behaviour of the investor or the social, economic or environmental impact of the investment. Moreover, trade and investment agreements generally go beyond the traditional notion of FDI and typically include also portfolio investment and other financial and short-term speculative capital flows that are less likely to contribute tangible benefits for the host economy.

**Special Economic Zones** – In relation to the IEU CEPA, civil society is concerned that the agreement will enable foreign direct investors and service providers to take advantage of conditions in Special Economic Zones, where rules and regulations on labour rights and standards, health and safety rules and environmental requirements are often lowered or waived. It is in relation to such zones in particular that trade and

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<sup>7</sup> Liesbeth Colen, Miet Maertens and Johan Swinnen (2014), “Determinants of foreign direct investment flows to developing countries: The role of international investment agreements”, in O. De Schutter, J. Swinnen and J. Wouters (Eds.), *Foreign Direct Investment and Human Development. The Law and Economics of International Investment Agreements*. Routledge; Lisa E. Sachs and Karl P. Sauvant (2009), “BITs, DTTs, and FDI flows: An overview”, in Sauvant and Sachs (Eds.), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows*. Oxford University Press.

<sup>8</sup> Public Citizen (2018), “Termination of Bilateral Investment Treaties has not Negatively Affected Countries’ Foreign Direct Investment Flows”, Public Citizen Research Brief, April 2018. [https://www.citizen.org/sites/default/files/pcgtw\\_fdi-inflows-from-bit-termination\\_0.pdf](https://www.citizen.org/sites/default/files/pcgtw_fdi-inflows-from-bit-termination_0.pdf)

<sup>9</sup> For an overview of the different positive and negative effects of FDI, see: Liesbeth Colen, Miet Maertens and Johan Swinnen (2014), “Foreign direct investment as an engine for economic growth and human development: a review of the arguments and empirical evidence”, in O. De Schutter, J. Swinnen and J. Wouters (Eds.), *Foreign Direct Investment and Human Development. The Law and Economics of International Investment Agreements*. Routledge; UNCTAD (2015), “Investment Policy Framework for Sustainable Development”. [http://unctad.org/en/PublicationsLibrary/diaepcb2015d5\\_en.pdf](http://unctad.org/en/PublicationsLibrary/diaepcb2015d5_en.pdf).

investment agreements like an IEU CEPA must firmly and enforceably bind foreign investors to adhere to international corporate social responsibility standards. Foreign investors that flaunt these basic norms must be accountable in the jurisdictions of all the signatory parties to the agreement.

## **Towards a new architecture**

Statistical economic growth cannot be the yardstick by which to measure the benefits of trade agreements. The architecture of trade agreements must be fundamentally altered. Trade and investment flows must be regulated to support sustainable production.

An IEU CEPA should ensure that only products and services produced according to the highest international or national standards – whichever is the more stringent – on environmental protection, human rights, labour standards and climate change mitigation qualify for treaty treatment.

An IEU CEPA should not include expansive investor rights that enable foreign investors to stake multimillion dollar claims in compensation for public policies aimed at improving public welfare and environmental protection. Instead, an IEU CEPA should provide an architecture to improve governance and accountability of transnational trade and investments and binding obligations in relation to the corporate conduct of transnational businesses and their chains of supply.

**Ambitious trade and sustainable development chapter** - A comprehensive trade and sustainable development chapter should govern the agreement, containing strong commitments in the area of human rights, environmental protection and the protection of labour standards. Such a chapter must comprise an effective complaints mechanism for affected communities in case (the activities of) transnational corporations violate human rights or cause environmental damage, and an obligation for the parties to the agreement to follow up on such complaints.

**Supremacy clause** - In order to ensure that an IEU CEPA trade and investment agreement supports inclusive, sustainable growth and does not negatively impact on climate objectives and obligations, the IEU CEPA should include a 'supremacy clause' to ensure that in case of conflict, human rights law, environmental standards and climate agreements take precedence over trade and investment rules.

An IEU CEPA should clearly recognize the responsibility regarding the protection of human rights, environmental protection and climate change mitigation that both parties bear towards one another. It should require both Indonesia and the EU to ensure that transnational corporations and investors abide by the most rigorous human rights, labour, environmental and climate standards and objectives maintained by either of the parties to the agreement.

The authorities in Indonesia, the EU and the EU member states must be free to ensure that transnational business or investment activities in their territory are

undertaken in a manner sensitive to social, environmental and climate concerns. Transnational corporations and investors must not be enabled to use IEU CEPA investment protection and investor-state dispute mechanisms to challenge interventions by the authorities to ensure better compliance with international human rights, environmental protection or climate obligations.

**Freedom to regulate** - Liberalisation aimed at enhancing market access opportunities for transnational investors and service providers creates tension with domestic regulatory frameworks. The logic of trade agreements like the IEU CEPA demands that domestic regulatory frameworks are amended to ensure they are least burdensome to trade.

But regulations marked as an impediment to trade generally serve legitimate public policy purposes and are often designed to protect consumers and the environment. In the IEU CEPA negotiations, the EU and Indonesia must take into account the benefits of such regulations and the potential costs of their reduction or elimination.

Elimination of so called non-tariff barriers to trade should not be the primary objective. The IEU CEPA negotiations should be used to develop ambitious joint standards for both the protection and enforcement of international climate, environmental, labour and human rights obligations, as well as the governance of transnational corporate industry, from the express objective of furthering inclusive growth and sustainable development.

**No investment protection without investor obligations** - Modern free trade agreements provide extensive and enforceable protection for foreign investors, without corresponding binding obligations.

Current practice shows that corporate industry cannot be trusted to take corporate social responsibility. Inter alia, in Indonesia, foreign investors are implicit in illegal forest clearings for palm oil plantations and labour rights violations in the palm oil sector. Foreign mining corporations also engage in destruction of virgin rainforests, causing irreparable damage to the environment. In Europe, European industry lobby groups seek to actively oppose and obstruct urgent climate change mitigation policies.<sup>10</sup>

Corporate industry's track record shows that the protection of people and planet cannot be left to voluntary CSR standards and corporate self-regulation. Strong governance of transnational corporate actors is required. Indonesia and the EU should therefore positively engage with initiatives to enhance accountability of transnational corporations complicit in human rights violations and environmental destruction, such as the UN process to arrive at a Binding Treaty on Business and Human Rights.<sup>11</sup>

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<sup>10</sup> 'Trade group including Facebook, Google to 'oppose' EU climate efforts', Greenpeace, 18 September 2018. At: <https://unearthed.greenpeace.org/2018/09/19/businessseurope-cbi-eu-climate-paris-agreement/>

<sup>11</sup> See <https://www.business-humanrights.org/en/binding-treaty>

### An IEU CEPA should

- Reflect efforts to make foreign corporations and investors more accountable, by imposing direct and binding obligations on investors to respect human rights in the workplace and the wider community, comply with fundamental ILO labour standards, observe environmental law standards and comply with climate goals, upon the penalty of denial of benefits of the agreement; foreign investors must be held accountable for any violations in both home and host states and an IEU CEPA should include an effective complaints mechanism for affected communities and stakeholders, with an obligation for all state parties to the agreement to act on such complaints;
- Make incoming investments conditional on independent human rights, social and environmental impact assessments to a) identify adverse human rights, social and environmental impacts, b) determine (mandatory) measures for prevention, mitigation and remediation, c) and enhance corporate accountability; and make clear that in all decisions relating to the investment, the precautionary principle will apply;
- Ideally investor-state dispute settlement should not be included in the IEU CEPA at all: the mechanism enables foreign investors to challenge almost any government regulation and sue for compensation that can run into many hundreds of millions of dollars. Using the threat of claims, foreign investors exert undue influence over public decision-making and public interest policies. Should the negotiating parties to include a form of investor-state dispute settlement after all, parties should:
  - Make clear that investors can expect that Indonesia and the EU and its member states as parties to the agreement will continuously strive to improve laws and regulations to improve the protection of human rights, labour standards and the protection of the environment, and to mitigate climate change. An IEU CEPA should stipulate that regulatory changes towards these ends, and government interventions to improve compliance with international frameworks and agreements in these areas will be exempt from challenges under any investor-state dispute settlement included in the agreement;
  - Make treaty-based investment protection conditional on investors' compliance with international frameworks for responsible corporate conduct, international human rights law and international environmental and climate agreements and the applicable national laws and regulations, whereby the highest standard should apply;
  - Include a clause that allows for (periodic) evaluation and revision of the investment chapter and its dispute settlement mechanism, at the request of either party.



**Sustainability and human rights impact assessments** - To ensure that an IEU CEPA supports inclusive, sustainable development, both negotiating partners should commission independent impact assessments. These should comprise a dedicated Human Rights Impact Assessment (HRIA) and an Environmental Impact Assessment (EIA). These assessments must inform the negotiations, assess the final outcome and monitor the impacts of a CEPA beyond its implementation.

Instead of looking at statistical economic growth and taking continued trade liberalisation as a given, such assessments should take socially and ecologically inclusive and sustainable development as their starting point.

Civil society urges policy-makers not to turn a blind eye. Beware of one-sided modelling: Policy-makers must recognise the limitations of the current dominant (GCE) models used to assess the potential impacts of trade agreements. The GCE approach tends to insufficiently measure the macroeconomic adjustment costs such as loss in tariff revenues, destabilizing changes in the trade balance, displacement of workers and other social costs of regulatory change, and investor-state dispute settlement. Assessments of trade agreements using the UN Global Policy Model, for example, produce very different and less positive projected impacts. Impact assessments should therefore use and compare the outcome of alternative models.

Indonesia would be wise not to rely solely on the outcomes of the sustainability impact assessment of the IEU-CEPA commissioned by the EU. Its scope is Europe-oriented, and it is being carried out 'in support of' the IEU-CEPA negotiations. Indonesia would be advised to commission its own, independent impact assessments to complement the one commissioned by the EU.