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AGRICULTURE, FOOD AND BEVERAGE

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Introduction



Agriculture plays a pivotal role in the various challenges and opportunities which are facing Indonesia. Based on data issued by the BPS in Q2 – 2017, the agricultural sector made a positive contribution which amounted to 13.92% of national GDP, while in Q1 – 2017, the sector made a 13.59% contribution to GDP. Under the current president's leadership and administration, Indonesia's national agricultural policy has been focused on the achieving of food security and self-sufficiency by aiming at the target of the 2045 World Food Barns.

The food and beverage industry also plays a hugely important role in Indonesia and remains one of the country's most important sectors in terms of the contribution that it makes to national GDP. Based on figures issued by the Ministry of Industry, Indonesia's food and beverage industries made a 7.19% contribution to national GDP in Q2-2017, although this meant that the sector had actually contracted since Q1-2017, when it made an overall contribution of 8.15%. Considering Indonesia's large population and expanding middle class, the population will naturally consume more and will also become more selective when choosing products. Therefore, the food-and-beverage industry is one of the most popular areas of investment (both foreign and domestic) within Indonesia.

Having said that, the government's various economic policy packages and tendency towards deregulation, which are aiming to improve the country's investment climate, are highly crucial in this context. EuroCham welcomes the significant efforts which are being made by the government in order to deal with several initiatives which are currently hampering the food and beverages sector, such as the Excise Implementation on Plastic Packaging and Soft Drinks and the Regulation on Sugar Bidding Procedure.

The government has also initiated various efforts designed at increasing the welfare of the country's farmers through programs which include insurance aimed at covering losses which are sustained through agricultural activities. Agricultural insurance currently only applies to cows and agricultural fields which suffer from floods or outbreaks of pests. Another program involves the issuance of farmers' cards which will help farmers to obtain subsidized fertilizer, seeds and pesticides at affordable prices. Through these initiatives and programs, the government hopes that the country's farmers will be able to increase their incomes and thus ultimately improve their welfare.

For more comprehensive and meaningful development throughout these vital sectors, strong cooperation and coordination amongst all of the relevant stakeholders will be necessary—be they public entities, private actors or domestic and foreign companies. Representing European companies investing in the sector, EuroCham is aiming to encourage constructive and proactive dialogue, which is essential to the development of a joint approach to the achieving of various goals which encompass food security, economic opportunities and environmental sustainability.

The agriculture, food and beverage working group is one of the priority sectors in the EU-Indonesia Comprehensive Economic Partnership Agreement (CEPA) negotiations. A successful outcome to these negotiations will open up market access for both the EU and Indonesia. Reflecting the EU's "From the Farm to the Fork" approach, Indonesia should consider working to develop higher levels of safety for foodstuffs and food products at all stages of the production and distribution chains. This should protect legitimate objectives and ultimately safeguard human, animal and plant health. Furthermore, the prevention and elimination of barriers to trade by each side should also be regarded as an essential element of the ultimate success of these negotiations.

Key Issues - Agriculture

Horticulture

Under Law No. 13/2010 on Horticulture (Horticulture Law), the foreign shareholding composition of any company operating a horticultural business is limited to a maximum of 30%. This law also broadly defines the various horticultural businesses and products which are allowed under such foreign-ownership schemes. With such restrictions in place, the law may ultimately limit the ability of a company's local partner to meet the demand for horticultural products made by farmers or consumers, as the foreign partner will be unable to fully participate.

Most horticultural businesses which are operated by foreign-investment companies within Indonesia focus upon the production of horticultural seeds, as opposed to finished consumer products. However, foreign investment is advantageous to both the government and farmers, as it provides a channel through which high-quality horticultural seeds can be obtained. This, in turn, helps to produce decent harvests for export or which can be used to meet the demands of the local market. Foreign investment also addresses concerns which relate to government capacity and readiness as regards the production of high-quality horticultural seeds.



The prices of horticultural seeds are relatively higher than those for non-horticultural seeds, as a result of the complexity and diversity of the business itself, as well as the necessity for substantial investments in research and development. Therefore, limiting foreign ownership to just 30% would make Indonesia even less attractive in the eyes of foreign investors.

Furthermore, this law required existing foreign investors to retroactively divest their ownership down to a maximum level of 30% within four years of its enactment, meaning that this provision has been in full force since 2014. This could raise concerns as to whether existing foreign investors - who have already invested in Indonesia – will decide to remain in such a discouraging business and investment environment. Moreover, despite the fact that this law states that technical details as regards this issue will be further addressed through the issuance of a ministerial regulation, to date, no draft regulation has yet been issued by the Ministry.

Recommendations:

1. The Horticulture Law needs to be amended so that it includes an overall evaluation of the types of horticultural businesses which will have the foreign-ownership limitation imposed upon them.
2. In view of the significant contributions which have been made by foreign investors to Indonesia's horticultural and agricultural sectors thus far, legal certainty (grandfathering) is well-deserved by those who made investments prior to the enactment of this law, in order to give such parties a chance to continue with their investments.
3. The law would benefit from clear and effective implementing regulations.

Roadmap for Biotechnology Adoption in Indonesia

Plant science makes a vital contribution to Indonesia's economic development, agricultural growth and food security. Greater access to the field of technologically advanced agriculture for farmers - including biotechnology seeds - would lead to increased yields of crucial food crops such as rice and corn. Since the EU is a pioneer in this field, the ongoing CEPA negotiations could help Indonesia to:

- Achieve the goal of curtailing food imports with an eye on ultimately ending them altogether.
- Achieve food stability, security and sustainability.
- Encourage new agricultural investment within Indonesia
- Help improve the lives of farmers and workers within the agricultural sector.

However, within the last 17 years - since transgenic cotton was first introduced back in 1998 - Indonesia has failed to set up a biotechnology plant. This technology has benefited millions of farmers across the Philippines and is about to be introduced to farmers in Vietnam.

However, Indonesia has no clear guidelines on variety release and post-cultivation monitoring, which prevents technology proponents from launching their products in this country.

Recommendations:

1. A roadmap is needed for the commercialization of biotechnology crops within Indonesia. This roadmap should encompass mapping and the identification of regulatory loopholes. Input from the relevant ministries, such as the Ministry of Agriculture, the Ministry of Health, Indonesian National Agency of Drug and Food Control (*Badan Pengawas Obat dan Makanan/BPOM*), the Ministry of Environment and Forestry, and the Coordinating Ministry for Economic Affairs, will be crucial as regards the drafting of any roadmap.
2. The country's biotechnology industry requires public support from the government in order to promote further growth and development.
3. The government needs to encourage investment and development in the field of biotechnological research by offering strong patent protections to technology proponents and by allowing investment within this growing field.

Pesticide Registration

Minister of Agriculture Regulation (MoA Regulation) No. 39/2015 on Pesticide Registration has been long awaited by the industry. This regulation sets out a roadmap for improved enforcement, as well as offering a clearer focus on making "better quality" pesticides available to farmers across Indonesia — thus minimizing the hazards of counterfeit and/or substandard products being sold in the marketplace.

However, some provisions set out under this regulation are considered counterproductive to Indonesia's goal of food security and self-sufficiency. Indeed, when the regulation was originally issued on 14 July 2015 it sparked concern within the industry in relation to the following:

- Article 6 removes critical decision-making power from authorities in Indonesia and transfers it to the IARC (International Agency for Research on Cancer) — a WHO agency. Ceding this power to a single international organization and potentially basing a decision to forbid the national use of a safe and effective agricultural technology could have a devastating impact on Indonesian farmers. Additionally, it could chart a course for less sound, science-based regulatory processes.
- Article 23 limits the number of active ingredients within any formulas/products which are produced by a given company to three. This could ultimately hamper agricultural investment in Indonesia and thus result in weaker competitiveness at the regional level. This provision could also lead to the unintended consequence of increasing the use of non-recommended pesticides.
- The regulation contains a clause which requires 90 days for pesticide concentrations to decrease to 50% of the initial concentration used for the purpose of crop protection (DT50), where there is no scientific research which backs up this technical stipulation. Furthermore, the criteria for oral and acute dermal still refer to the 2004 WHO criteria and are thus in need of an update. This issue can be considered one of the current non-tariff barriers to investment and is likely to become the subject of CEPA negotiation



Recommendations:

In order to address the abovementioned concerns, MoA Regulation No. 39/2015 could be amended to:

1. Include the Joint FAO/WHO Meeting on Pesticide Residues (JMPR) or other international references and, instead of a hazard-based analysis, a risk-based analysis could be introduced.
2. Remove the limitation on active Ingredients for registration purposes.
3. Use or refer to the Stockholm Convention, which suggests 180 days for DT50.
4. Update the regulation with the 2009 WHO criteria, which refers to the implementation of the Globally Harmonized System.

Limitation on Imports of Hybrid Rice Seeds

The Indonesian Government has been aiming to increase rice productivity with an eye on achieving self-sufficiency in the crop by 2017. With its fertile soils and favourable climate, Indonesia has plenty of potential as regards the achieving of these goals. One of the low-hanging fruits in this regard is to utilize the most advanced seedling technology available in the global marketplace.

While most of Indonesia's farmers cultivate superior, non-hybrid varieties of rice, in some areas there has been a turn towards the use of hybrid rice seeds. When planted in the right locations, hybrid rice can increase productivity by up to 30% (20% on average). In addition, some varieties offer greater resistance to drought.

However, in the face of increasing demand, the willingness of farmers to adopt this new seedling technology is still likely to prove insufficient in terms of boosting local production. As a result, Indonesia still needs to import a high quantity of hybrid rice seeds.



As the country seeks to maintain adequate infrastructure and production capacities, limiting the import span of hybrid rice seed to just three years may constitute a non-tariff and non-technical barrier to trade. Indeed, this prohibition, as stipulated under Minister of Agriculture Regulation No. 127/2014, discourages transfers of technologies, which is one of many objectives that will be discussed during the CEPA negotiations.

Recommendations:

1. Taking into account current productivity and capacity, this is not the best time to impose restrictions on the importation of hybrid rice seeds, as stated in article 9 (3) of Minister of Agriculture Regulation No. 127/2014.
2. Initiating a consultative dialogue with the Indonesia Seed Association offers a great opportunity to build and enhance production capacities as regards local hybrid rice seeds. Such a dialogue can also open up opportunities for investment within the seed industry.

Key Issues - Food and Beverage

Halal Product Assurance

Law No. 13/2014 on Halal Product Assurance (Halal Law) was issued on the 17 October 2014. Based on this law, an implementing regulation should have been issued within two years, while an implementing agency for halal product certification should also have been established within three years of the enactment of this law. Moreover, the obligation for products which are traded/distributed within Indonesia to obtain halal certification becomes effective five years after the introduction of the Halal Law.

The Halal Law aims to offer protection for consumers of beverage and cosmetic products, and can be seen as an extension of the Consumer Protection Law. This new law requires mandatory halal certification and labelling for food and beverages, cosmetics, pharmaceuticals, as well as biological, chemical and genetically engineered products and other products which are manufactured, imported, distributed and/or traded within the Indonesian customs area. Despite the extensive range of products which are available in the marketplace, the regulation, in essence, divides the Indonesian market into two only categories: halal and non-halal products.

The Ministry of Religious Affairs is currently drafting an implementing regulation for the Halal Law. Based on the latest information regarding the draft, the law will be implemented in two stages: year one - three (2019 – 2022) for food and beverages products; and year one - five (2019 – 2024) for biological products, chemicals, cosmetics, genetically engineered products, pharmaceuticals and used or worn (i.e. in contact with the skin) products.



It has also been hinted that halal certification will only apply to parties who wish to become halal certified – in contrast with the mandatory requirement set out under the Halal Law. Non-halal products have also been discussed in order to make the implementation of the new law easier, and the clear printing of any non-halal ingredients on the relevant packaging has been mandated (while non-halal labelling will not be required).

There are a number of reasons why this may not be the right time to implement this new law though. Within the pharmaceutical sector, for example, only 34 products (0.015%) out of a total of approximately 300 drugs manufactured by around 200 companies across Indonesia had managed to obtain halal certification nearing the issuance of the law. Furthermore, Indonesia and other ASEAN countries are in the middle of building the ASEAN Economic Community – a fully functioning internal market which would allow these countries to freely import and export products to and from Indonesia. Thus, implementing the Halal Law at this stage would limit the contribution that Indonesia is ultimately able to make to the ASEAN Economic Community.

Recommendations:

In principle, we are supportive of the implementation of the Halal Law; however, in order to ensure that the new law will not disrupt business and the investment climate within Indonesia, the following suggestions are worth taking into consideration:

1. We hope the government will be able to clarify the issuance of the implementing regulation. In this case, voluntary halal certification would work better for businesses, especially those businesses which are intending to use such halal certification as part of their business strategies.
2. We encourage the government to undertake consultations with both local and international companies and commercial associations as regards the drafting of the relevant regulations and policies.

> Next Recommendations

3. Simplified processes and requirements are always the best options for halal certification.
4. It is important that all of the relevant supporting infrastructure, institutions and agencies, including human resources, are adequately prepared for the implementation of the Halal Law.

Draft Bill on Water Resources

On 18 February 2015, the Indonesian Constitutional Court annulled Law No. 7/2004 on Water Resources, thus upholding the claim that this law encouraged the privatization and commercialization of water resources at the expense of the public's right to water. In the absence of an adequate replacement legal framework, however, the court ultimately re-enacted the old Law No. 11/1974 on Irrigation as the controlling regulation until the time that a new law can be put into place.

The background to the judicial review and annulment of Law No. 7/2004 concerned the fact that many areas of Indonesia still do not have adequate access to clean water and the fact that the government, by turning over the management of the country's water resources to the private sector, was seen as not fully fulfilling its role in observing the right of Indonesian people to be able to access clean water. In its decision, Indonesia's Constitutional Court issued six principles which should be used as basic guidelines for the utilization of water:

1. Any use of water must not disturb the right of Indonesian citizens to access water.
2. The state must provide access to water to citizens, as this is a human right.
3. Any use of water must take environmental factors into consideration.
4. The state must have absolute control over water usage.
5. The first priority, as regards water use, is to be the country's state-owned enterprises (BUMN), both national and local.
6. Only if the above guidelines have first been fulfilled is the government then allowed to offer water utilization licenses to the private sector, with strict terms and conditions being applied.

Following the re-enactment of Law No. 11/1974 due to the revocation of Law No. 7/2004, the government issued two implementing regulations for this law:

1. PP No. 121/2015 on Water-Resource Utilization (*Pengusahaan Sumber Daya Air*).
2. PP No. 122/2015 on the Drinking-Water Supply System (*Sistem Penyediaan Air Minum/SPAM*).

These two regulations were issued in order to protect existing businesses working in these two industries (water-resource utilization and drinking-water supply systems).

However, the Law No. 11/1974 was ultimately considered to be old and obsolete and not applicable to the current climate across Indonesia. As a result, the Indonesian Parliament decided to draft a bill in order to replace Law No. 11/1974 and to attempt to manage and utilize the country's water resources for the welfare of its citizens.

Some important articles contained within the draft bill have become objects of concern for businesses, particularly bottled mineral water (*Air Minum Dalam Kemasan/AMDK*) and SPAM companies, as follows:

- The draft bill regulates for two types of water utilization license, specifically the Utilization License for Noncommercial Activities (*Ijin Penggunaan Sumber Daya Air untuk Kebutuhan Bukan Usaha*) and the Utilization License for Commercial Activities (*Ijin Penggunaan Sumber Daya Air untuk Kebutuhan Usaha*). One article of the draft bill states that private companies will be allowed to obtain utilization licenses. However, a different article states that licenses for drinking-water products for daily are to be held by state-owned enterprises (BUMN/BUMD). The elucidation of this article explains that the products included under the definition of drinking water are drinking water held by SPAM and bottled water. The regulation thus considers the SPAM and bottled-water industries to be part of the same sector, whereas, in reality, these two sectors are very different.
- In regard to obligations, the draft bill states that the community has the right to enter, take and utilize any water resources currently in possession of companies. This ultimately means that companies cannot erect any physical or non-physical signage demarcating their water resources.

Recommendations:

1. EuroCham recommends that a clear distinction is made between SPAM and bottled-water industries.
2. In its decision, the Constitutional Court never forbade the private sector from undertaking business within the water sector. The Constitutional Court only forbade the private sector from exercising authority over water resources. Therefore, we recommend that the draft bill is revised in order to give private companies the opportunity to engage in business within the water sector.
3. Furthermore, EuroCham would like to encourage a clear explanation of each of the relevant articles in order to avoid any misinterpretations arising.
4. As in current practice, the industry is required to open up access to water for communities by laying pipelines through residential areas, so that communities have the right to enjoy clean water. However, it is hoped that the government will ultimately decide to omit the article that sets out a prohibition upon companies protecting their water resources.

Regulation of Milk

The Government of Indonesia issued Minister of Agriculture Regulation No. 26/2017 on the Supply and Distribution of Milk in July 2017. This regulation is intended to increase local milk production and increase the welfare of farmers. The regulation addresses following areas

- Milk supply.
- Distribution.
- Partnerships.
- Reporting schedules and to which government officials businesses need to report.
- Development and supervision.
Provision on sanctions if businesses do not wish to engage in any partnerships.

The regulation recognizes two types of companies:

- Companies that utilize fresh milk as a raw material and which are required to engage in partnerships with local farmers and to utilize local milk.
- Companies which use milk derivative products as a raw material and which are required to undertake promotional activities. In addition to the utilization of local milk and promotional activities, other types of allowed partnership encompass partnerships for the provision of production facilities, production sites and financing.

Data released by the Indonesian Central Bureau of Statistics (BPS) in 2016 revealed that Indonesia's cattle population stood at 533,860 milk cows, which were only able to satisfy 23% (around 3.7 million tons) of national milk consumption.



This amount is far from sufficient in terms of fulfilling the demands of Indonesia's 250 million-strong population. Indeed, these numbers reveal a significant imbalance between growth in milk production capacity and the amount of milk needed in order to meet local public demand.

Moreover, some 90% of locally produced fresh milk is currently being absorbed by the industry, whereas the remaining 10% cannot be absorbed due to quality issues. Specifically, this remainder does not meet the quality requirements which it needs to in order to be utilized for public consumption. In light of increasing national milk consumption and the capacity of local milk producers, importing milk from other countries remains necessary.

In reality, though, the price of fresh milk depends on the market price and agreement between industry and farmers or industry and cooperatives. This is due to the fact that fresh milk from each region is different, hence prices can differ. Intervention from the government will ultimately disrupt this state of affairs.

Completing the regulatory framework for this sector, Minister of Agriculture Regulation No. 13/2017 on Partnerships explains the various types of farming business which are eligible to engage in partnerships; as well as the various kinds of players, patterns and business partnership schemes. Specifically, the types of partnerships that companies can engage in with farmers are:

- Core plasma
- Profit sharing
- Lease
- General trading
- Subcontract.

The current regulation, however, does not offer any details on implementation as regards the establishment of partnerships and only provides general information. Without clear guidelines, companies will thus be looking for local farmers all by themselves and will also have to undertake their own mapping. Indeed, it is likely that most such partnerships will be centred in Java and will not reach far beyond as a result. Moreover, each partnership will also be required to undertake imports, as all of the existing milk produced by local farmers is already spoken for and there are no available partners in the marketplace, it will be difficult to conduct partnership with local farmers which its location is far from the company's manufacturing which will cause higher cost in transportation activity. Therefore, it is important to realize that this regulation cannot be applied immediately.

The Ministry of Agriculture is also currently drafting regulations on the Import and Export of Food Products Originating from Animals; as well as the Import and Export of Non-Food Products Originating from Animals. These two draft regulations will address milk products and their derivatives, as well as eggs, honey, gelatin, collagen, tallow and animal fat, animal skins, beeswax and animal feathers. Both regulations will focus more on Sanitary and Phytosanitary/SPS issues and on the procedures which have to be followed in order to obtain import recommendations from the Ministry of Agriculture prior to importers being able to apply for specific import approvals from the relevant related Ministry.

The draft regulation also stipulates that any companies wishing to obtain import recommendations need to demonstrate evidence of partnerships in their supporting documents. However, some of the requirements which are set out under the draft regulation have the potential to overlap with requirements set by other ministries. Moreover, the timeframe for the provision of data surveillance, as requested under the regulation, is too short and it will, therefore, prove difficult to provide complete information.

Recommendations:

1. EuroCham recommends that government encourages businesses to engage in partnerships with local farmers, not in the form of an obligation but more in terms of offering incentives for businesses that decide to establish partnerships with local farmers.
2. EuroCham recommends that the government offers industry the opportunity to propose prices to the government after a process of self-calculation based on the fresh milk capacity and geography of the relevant region, as well as the capabilities of the industry, among other factors.
3. EuroCham members are also encouraging the government to speed up the introduction of regulation on imported milk products.
4. EuroCham recommends that the government sets out more details and offers technical guidance on how to engage in partnerships.
5. EuroCham members support the government's idea of increasing the welfare of local farmers; however, it would be better if the contributions made by the relevant stakeholders were implemented over the longer term.

Regulation on Recommendations for the Import of Horticultural Products

Minister of Agriculture Regulation No. 16/2017 on Recommendations for the Import of Horticultural Products has been in force since 18 May 2017 and became effective immediately. This regulation stipulates the following provisions and consequences:

- API-U holders must obtain a recommendation from the BPOM in advance, prior to applying for import approval from the Minister of Trade. This creates a redundancy in process.
- The regulation does not define any products/volumes of products which can be defined as official research-and-development products, which may lead to the possibility of officials offering their own interpretations.
- Importers are obliged to acquire certificates of Good Agricultural Practice (GAP), which not all origin countries can provide. This situation may create challenges as regards the importation of various products.
- API-P holders can only obtain one license within the space of a single year. Given that certain horticultural products are actually used as raw materials within the food and beverage industry, and that materials such as garlic powder, chilli powder and paprika powder are currently not available in Indonesia, this restriction could potentially hinder any product innovations which require horticultural commodities as raw materials.

Furthermore, in November 2017, Minister of Agriculture Regulation No. 38/2017 was introduced, revoking MoA Regulation No. 16/2017 in the process. The new regulation removed the obligation to obtain import recommendations for processed horticultural products, and also added a number of additional provisions:

- Import recommendations are only needed by companies who are looking to import fresh horticultural products.
- Applications for import recommendations do not require any import recommendation letter from the BPOM.
- Companies are required to draw up import realization reports for the Ministry of Agriculture as an additional requirement when applying for import recommendations.



Recommendations:

1. EuroCham recommends that the government allow enough of a grace period for companies to be able to inform their suppliers to complete the requested documents and to prepare necessary mitigation plans in order to ensure a smooth transition and thus avoid any disruption to business.
2. Any restrictions which are put in place should also consider local capacity as regards supporting the needs of industry, otherwise, this regulation will ultimately prove counterproductive in terms of the Indonesian Government's effort to boost investment in the country.
3. In order to ensure common understanding as regards the technical implementation of the regulation and to raise awareness of the new policy, Eurocham is encouraging the Ministry of Agriculture to engage in the further socialization of Regulation No. 38/2017



Imports of Forestry Products

EuroCham acknowledges that the Government of Indonesia is aiming to preserve a sustainable environment, particularly as regards the protection of the country's forests. This goal is to be realized through the following regulations:

- Minister of Trade Regulation No. 78/2014, which was revised through the issuance of Minister of Trade Regulation No. 97/2015 on Import Provisions for Forestry Products, which stipulate that any importers holding licenses for traders/general importers (*Angka Pengenal Importer Umum/API-U*) or licenses for producers/manufacturers (*Angka Pengenal Importer Produsen/API-P*) must first obtain approval from the Minister of Trade as regards the importation of forestry products.
- In order to be granted such import approval, an importer must obtain a recommendation letter from the Minister of Environment and Forestry after first completing a process of due diligence.

The recommendation letter is an additional requirement set out under the current regulatory framework. This compares with previous practice, whereby only import approval was needed in order to import forestry products. Thus, requirements are becoming a burden in terms of administrative processing and procedures.

Moreover, the regulation applies not only to upstream but also downstream industries, such as food and beverage businesses (such as packaging materials). This regulation may thus ultimately lead to non-tariff and non-technical barriers to trade, which could eventually increase costs and reduce national competitiveness.

Recommendations:

1. EuroCham supports ongoing efforts by the Ministry of Environment and Forestry, together with the Ministry of Trade and other technical ministries, which are aimed at improving the current regulatory framework. As a result, we hope that we will be able to participate in this process and make a useful contribution to the discussion of this issue.
2. EuroCham would like to recommend that government simplify the administrative regime for the import of products in order to create a more effective process.
3. We believe that the current regulatory framework would prove more effective if it addressed industries dealing directly with the importation of forestry products (upstream industries), instead of those which utilize forestry products (for packaging materials, for example).

Excise on Alcoholic Beverages

In clear *prima facie* violation of its WTO commitments, the Indonesian excise regime applies higher tax rates to imported Category B (mostly wines and liqueurs) and Category C (most spirits) products than it does to its own domestically produced beverages.

Based on previous WTO rulings and market dynamics in Indonesia, it is clear that the products are either “like” or at least “directly competitive or substitutable” and should, therefore, be subject to either identical or similar levels of taxation. This clear discrimination provides protection to the domestic industry in clear contravention of Indonesia’s obligations under GATT Article III: National Treatment on Internal Taxation and Regulation.

The enforcement of such excessive excise on alcoholic beverages has led to the following complications:

- Excessive taxes have left a significant retail-price gap between Indonesia and other countries. This gap, in turn, has led to parallel/smuggled products entering Indonesia via the black market.

- Different excise rates for each alcoholic-beverage category mean that similar products are treated unfairly. This practice is considered discriminatory and runs contrary to the prospect of increasing trade and investment across Indonesia.
- This measure is not in line with the aim of the ongoing CEPA negotiations, which are seeking to reduce all discriminative measures within the trade-and-investment sector.



Recommendations:

1. Indonesia should make a clear commitment to bringing its discriminatory excise-tax system into line with its existing WTO obligations, as a precondition for the conclusion of the EU-Indonesia Comprehensive Economic Partnership Agreement (CEPA).
2. We recommend that Indonesia adopts a specific tax system in line with its WTO obligations.
3. In line international best practice, we hope that the government will consider imposing the same rate of excise on all alcoholic beverages.
4. The industry is confident that a reduction in the current rates of excise will generate more government revenue and lead to a reduction in the smuggling of alcohol beverages.

Sustainable and Sensible Taxation of Imported Alcoholic Beverages

International alcohol producers have to rely on imports in order to meet domestic demand for alcoholic beverages in Indonesia, as expansion is prohibited under the Negative Investment List issued by the Indonesia Investment Coordinating Board (*Badan Koordinasi Penanaman Modal/ BKPM*). Moreover, Minister of Finance Regulation No. 132/2015 on the Stipulation of Classifications for Imported Goods and the Imposition of Import-Duty Tariffs imposes an import-duty tariff of 150% upon alcoholic beverages – which is a very high rate in comparison with elsewhere in the world.

These regulations mean that companies have no option other than to increase their sales prices, which in turn makes it more difficult to compete with illegal alcoholic beverages. Under these circumstances, an estimated 90% of imported alcoholic beverages will enter the market as contraband. Moreover, these excessively high import duties create incentives for illicit trade and activities which ultimately result in revenue loss for the government, loss of employment within the hospitality sector and the consumption of illegal products which can prove injurious to health.

Excessively high import-duty tariffs and discriminatory excise taxation have had a major impact on trade and investment within Indonesia. Given the importance of the European wine and spirits industry, this issue is likely to harm the objectives of the CEPA negotiations, which are aiming to expand trade and investment volumes between the EU and Indonesia.



Recommendations:

1. As part of the upcoming EU-Indonesia Comprehensive Economic Partnership Agreement (CEPA), European imports need to be exempted from tariffs. A full elimination of import tariffs upon the entry into force of the agreement is the key priority for the wine, spirits and beer industries. This should include any EU products which are trans-shipped through regional hubs, which is consistent with the modern rules of origin provisions.
2. Reducing or removing tariffs will ensure that customers choose to purchase legal products over illicit or contraband products. This, in turn, should boost state revenue and lead to the elimination of the illicit market.

Quotas for Alcohol Products

In contradiction with GATT Article XI, Indonesia applies strict import quotas to all alcoholic beverages. Despite a significant demand for imported spirits, the Ministry of Trade has been reducing quotas for imported beverages year by year. Moreover, in 2017, it only released the import quota after a five-month delay, leading importers to rely on their pre-existing stock, which became significantly depleted.

In practice, these quotas are ineffective, as excessive duties and discriminatory excise-tax structures, especially as regards distilled spirits, create a high “barrier to entry” for legitimate imports versus non-tax paid and illicit products.

Within the framework of the ASEAN Economic Community, the ASEAN Economic Officials Meeting included alcoholic beverages on the list of goods which are subject to low import duties. In spite of these arrangements, Indonesia continues to impose the highest possible import duty on alcoholic beverages.



Contrary to the country’s intentions, the current restriction may, in fact, lead to more cases of smuggling/illegal production/illegal distribution, which would consequently pose an even higher health risk to consumers.

The government’s current direction of quota limitation will result in stagnant or even declining growth within the industry. Thus, in the light of the CEPA negotiations, this issue needs to be addressed in order to produce an increase in trade and investment volumes. Nevertheless, consumer safety should also remain a crucial objective of the negotiation process.

Recommendations:

1. The Indonesian government should eliminate its quantitative import limitations and bring its system into line with its WTO commitments.
2. In the meantime, the Ministry of Trade should standardize its assessments when deciding alcoholic-beverage import quotas for each year in order to avoid the depletion of stocks. Moreover, once the relevant import quota has been decided, the Ministry should clearly communicate it to all stakeholders.

Draft Bill on the Prohibition of Alcoholic Beverages

The Draft Bill on the Prohibition of Alcoholic Beverages is currently under discussion at the Indonesian Parliament. This bill is aiming to prohibit the production, importation, distribution, sale and consumption of alcoholic beverages within Indonesia. However, the draft provides an exemption for so-called, “consumption for limited interest,” which means that alcohol is allowed to be used for customary practices, religious practices, consumption within tourist areas and pharmaceutical uses.

It is well-known that Indonesia faces a serious problem, largely due to the sale of unregulated alcoholic beverages. Methanol poisoning resulting from the consumption of tainted alcohol AKA *oplosan* has resulted in a high number of deaths across Indonesia in recent years.

A total ban on legal alcohol products, which are safely produced in compliance with the approved international quality standards and which have verified safe ingredients and alcohol contents, would surely exacerbate this problem. The ban would encourage trade in more illicit alcohol products which frequently contain a homemade and often deadly methanol base, creating a highly profitable illegal industry in the process.

Furthermore, a ban on the consumption of alcohol would threaten Indonesia’s tourism industry and risk the country’s reputation as a tourist destination. Declining sales of alcohol in restaurants, hotels and retail outlets could also potentially lead to a general slowdown in Indonesia’s consumer-driven economy and thus eventually cost the country thousands of existing and new jobs.

Recommendations:

1. Prohibiting the sale and consumption of alcohol has been widely shown to be ineffective in reducing alcohol-related harm and is often counterproductive. Prohibition deprives governments of legitimate tax revenue, shifts production to the illicit market and also encourages the illegal consumption of unregulated alcoholic products, which can pose a serious risk to public health. It also criminalizes responsible drinkers. Addressing harm in a targeted and culturally appropriate manner is more effective in reducing harmful drinking.
2. We recommend that the government modify its approach from prohibition to supervision in order to avoid harming Indonesia's reputation as a moderate, culturally diverse, tolerant and tourist-friendly country.

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