

The Swiss referendum on the FTA between the EFTA States and Indonesia

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In December 2018, the EFTA States – Iceland, Liechtenstein, Norway and Switzerland – signed a Comprehensive Economic Partnership Agreement (CEPA) with Indonesia. In Switzerland, however, in order for the CEPA to be ratified, it had to be approved in a referendum. On 7 March of this year, the Swiss voters approved the CEPA by a narrow margin of 51.7%. It will therefore enter into force in all four EFTA States. This is the first time a free trade agreement (FTA) has been challenged through a referendum, the consequences of which this blog post will look at for future FTAs in the EFTA context.

Introduction

On the one hand, the Comprehensive Economic Partnership Agreement (CEPA) between the EFTA States and Indonesia is a conventional third-generation free trade agreement (FTA). On the other hand, however, two novelties are worth looking at a bit more closely: First, the CEPA deals in a particular way with palm oil. Given the widely criticised production methods of palm oil, parties to FTAs have been under pressure, essentially from environmentalist groups, to enhance sustainable production methods. This is the first time that issue has been addressed in a CEPA.

Second, directly linked to the first novelty, Switzerland's ratification of the CEPA was challenged by a referendum. This of course raises three initial questions:

- Could the CEPA have entered into force without Switzerland ratifying it?
- Could Liechtenstein have remained a Party to the CEPA if Switzerland did not ratify?
- What are the implications of an increased use of such referenda for similar FTAs in the future?

The questions above may be seen as primarily relevant to Switzerland (and Liechtenstein). Indeed, Switzerland is the EFTA State with the biggest investment in Indonesia and also the EFTA country with the highest share of trade in goods with FTA partners. The third question raised above is therefore also of some relevance to the future of EFTA's third-country trade policy.

Indonesia as an interesting trading partner

With an area of around 1.9 million square kilometres and a population of 265 million, Indonesia is the largest state in Southeast Asia. It is the only Southeast Asian country represented in the G20 forum and plays a leading role within the Association of Southeast Asian Nations (ASEAN). With an estimated

average income per capita of USD 4 000 a year, Indonesia is one of the emerging economies. Its service sector is the most important pillar of the economy, with a GDP share of 59%. The manufacturing sector contributes about 28% and the agricultural sector 13%. However, about 31% of the population still make a living from agriculture. Indonesia's GDP grew by around 5% in both 2017 and 2018. The country thus ranks 16th among the world's largest economies and accounts for about 40% of ASEAN's GDP. According to various forecasts, Indonesia could become the fourth largest economy in the world by 2050. It should also be mentioned that the situation with regard to human rights and respect for democratic principles has improved considerably over the past decade and more.

Trade policy context: strike together, march separately

The CEPA concluded with Indonesia expands the network of FTAs that the EFTA States – Iceland, Liechtenstein, Norway and Switzerland – have been building up with third countries outside the European Union (EU) since the early 1990s. However, while such an FTA is negotiated jointly, it is concluded individually by each EFTA State and the respective partner country. This is due to the fact that EFTA – contrary to the EU – is neither a supranational organisation, nor does it have a customs union between its members. There normally is a standard main text, but an FTA may also contain different solutions in certain areas, usually found in country-specific annexes. For all of these reasons the other EFTA States are not affected if, for example, one state does not join the negotiations or is subsequently unable to ratify the FTA. Reversing a well-known proverb, the EFTA States strike together, but then march separately.

The Swiss decide for Liechtenstein, or do they?

A particular case is Liechtenstein: In accordance with the Treaty of 29 March 1923 between Switzerland and Liechtenstein on the annexation of Liechtenstein to the Swiss customs territory (Customs Treaty (CT)), Switzerland acts for Liechtenstein in the areas covered by the CT and to the extent provided for therein. However, in 1991 Liechtenstein joined EFTA in its own right, around which time EFTA started negotiating FTAs beyond Europe. Liechtenstein thus practically participates in these negotiations on its own, while being legally bound by Swiss decisions on content and ratification, at least regarding the areas covered by the CT. Conversely, Liechtenstein is not only covered by the FTA of 22 July 1972 concluded between Switzerland and the EU, but also participates in the 29 FTAs concluded within the framework of EFTA, and Switzerland's three bilateral agreements with the Faroe Islands, Japan and China.

As a member of EFTA, Liechtenstein is a contracting Party to the CEPA. It is represented in the negotiations and also has a voice. However, as mentioned before, Switzerland acts for Liechtenstein in the areas covered by the CT and to the extent provided for therein. This means that, in those areas, Liechtenstein is largely bound by the Swiss strategy and interests with regard to negotiations, and cannot have its own position if it diverges from that of Switzerland. Hence, Article 1.4(2) CEPA states that Switzerland represents Liechtenstein in the areas covered by the CT, i.e. essentially trade in goods. However, Liechtenstein has its own schedules on exemptions and commitments in the annexes, such as for services, investments or movement of persons. In the event of a Swiss refusal to ratify the CEPA, Liechtenstein could thus have theoretically ratified a version of the agreement that excludes all CT-relevant areas. Negotiating an exception to the CT – as was done for Liechtenstein to be able to join

the European Economic Area (EEA) – was not really an option and would have meant opening a Pandora’s box in other regards.

The road to the CEPA

The first steps undertaken by the EFTA States and Indonesia in view of strengthening economic ties took place in as early as 2004. Formal negotiations were launched after the completion of exploratory work in 2011, and were concluded at the beginning of November 2018 after 15 rounds of negotiations and several intermediate rounds and expert meetings. The CEPA was signed in Jakarta on 16 December 2018.

The agreement, with its 17 annexes and two records of understanding as well as a memorandum of understanding, largely corresponds to the EFTA States’ more recent FTAs. Like these, it has a comprehensive scope and contains provisions on trade in goods, technical barriers to trade, sanitary and phytosanitary measures, rules of origin, trade facilitation, trade in services, investment, protection of intellectual property, competition, technical cooperation and capacity building, dispute settlement, and trade and sustainable development. In the area of government procurement, it contains a development clause. The CEPA is complemented by a Memorandum of Understanding on economic cooperation and capacity building.

As a preferential agreement, the CEPA goes beyond the existing level of market access and legal certainty in the WTO agreements in various areas. To take the Swiss example, at the end of the maximum 12-year transitional period, the CEPA removes tariffs for over 98% of today’s Swiss exports to Indonesia. This indeed makes a difference, as Indonesian tariffs are relatively high. Based on today’s bilateral trade, companies can save up to CHF 25 million annually in customs duties when importing into Indonesia.

Palm oil in particular

Of all the EFTA States, Switzerland was the most sensitive to agricultural policy with regard to concessions for palm oil. The problem is twofold: On the one hand, the Swiss Government had to reckon with a strong environmentalist opposition to the importation of palm oil altogether. On the other, there were the interests of the farming sector to be kept in mind, as Swiss farmers did not want palm oil to become a cheap alternative to domestic oilseeds.

In a first for an FTA with EFTA, Indonesia has committed to rules on trade and sustainable development. These are intended to ensure coherence between the EFTA States’ commitments in the areas of economy and sustainable development. In particular, a specific provision on the production and trade of vegetable oils takes into account Swiss concerns about the social and environmental consequences of palm oil production. In order to address concerns about the conditions of production, the Parties developed a specific article on sustainable management of the vegetable oil sector. To this end, they included a reference to the objectives of Article 8.10 CEPA in the Schedule of Concessions. In order to support the implementation of these obligations, additional technical conditions apply which ensure the traceability of palm oil along the supply chain. The CEPA also creates an institutionalised framework for cooperation between authorities to monitor and further develop the agreement, and to solve any problems that may arise.

In addition, specific Swiss tariff and quota provisions are regulated bilaterally in an annex. Five partial quotas were agreed for various palm oil products: crude palm oil, palm stearin and palm kernel oil. The size of the quotas will be increased by 5% of the initial size each year for the first five years. The restriction for all of these sub-quotas is that they can only be used if the palm oil is imported in 22-tonne tanks. This mode of transport makes it possible to ensure traceability from the Swiss buyer of the goods, back to the producers of the palm oil. In addition, palm oil imported under the CEPA must comply with the provisions of Article 8.10 mentioned above, in order to ensure that these tariff preferences can only be used for sustainably produced goods. The tariff concessions for palm oil, which can substitute domestic oils such as rapeseed or sunflower oil due to its properties, are designed in accordance with the circumstances of Swiss oilseed production. The granting of concessions within tariff quotas also ensures that palm oil imports are limited in terms of quantity. Article 2.17 CEPA contains a safeguard mechanism that allows Switzerland to react appropriately to imports of Indonesian palm oil if, contrary to expectations, the Swiss oilseed market comes under pressure.

Why a referendum against an FTA?

First, a short excursion to the Swiss system of referenda: Certain laws passed by Parliament, including amendments to the Federal Constitution, must be put to the vote of the People and the cantons (mandatory referendum). In other cases, where citizens, parties, civil society groups, etc. disagree with a decision of Parliament and they gather 50 000 valid signatures within 100 days of the official publication of the act, or eight cantons submit a request, the act is submitted to a vote of the People (an optional referendum). The act only comes into force if it is accepted by the majority of the People.

Until now, FTAs have never been the subject of a referendum. The only exception was the FTA between Switzerland and the EU in 1972. But that was of a different nature and must be seen in the light of Switzerland's integration policy at that time.

However, in June 2016 the Federal Council decided to make all future FTAs the subject of an optional referendum. In the meantime, and in order to produce a proper legal basis to revert to former practice, the Swiss Government has drafted a law codifying the practice of standard agreements, so that not every FTA must be subject to an optional referendum if it does not contain any new elements.

Given the very detailed and specific result of the negotiations on the CEPA, in particular with regard to palm oil, it was assumed that its ratification would be straightforward. However, 61 184 signatures were gathered; sufficient to set the referendum machinery in motion. The main reason given for opposing the CEPA's ratification was that sustainability, above all with regard to palm oil production for import, was still insufficient.

From a merely quantitative perspective, the problem seems rather exaggerated: in 2019 Switzerland only imported 35 tonnes, i.e. 0.0001% of Indonesia's palm oil exports or 0.16% of Switzerland's global imports of palm oil. And it seems paradoxical that precisely an agreement that for the first time contains rules addressing sustainable development in a very specific manner should be insufficient in that regard. The suspicion thus arises that the fight against palm oil imports stands for a wider resistance against free trade as such.

Takeaways

More “modern” FTAs contain rules on sustainable development, social rights, etc. At the same time, civil society groups are becoming increasingly involved in the negotiation and conclusion of FTAs, putting pressure on governments to include exactly those specific chapters in FTAs if they are not to be refused altogether.

In Switzerland, contrary to former practice, the CEPA was opened to an optional referendum. This opportunity was seized by political parties and interest groups of the left and the greens, as well as by some agricultural lobby groups. The CEPA, nevertheless, obtained the Swiss voters’ blessing, albeit by a very narrow margin. Now to return to our three questions:

- Could the CEPA have entered into force without Switzerland ratifying it?
- Could Liechtenstein have remained a Party to the CEPA if Switzerland did not ratify?
- What are the implications of an increased use of such referenda for similar FTAs in the future?

The first two can be answered in a straightforward manner: First, the CEPA as such would not have been prevented from entering into force in Iceland and Norway if the Swiss had declined to ratify the agreement. This is due to the fact that EFTA is merely an intergovernmental organisation. Under the EFTA Convention there is no “speaking with one voice” as with the EEA Agreement. While the EFTA States negotiate together, the ensuing agreements are concluded between every country individually and the partner country. Switzerland’s two EFTA partners, Iceland and Norway, could therefore not have been taken hostage by the Swiss voters.

Second, Liechtenstein is not free to negotiate and conclude an FTA on the areas and subjects covered by its CT with Switzerland. It could, however and theoretically, sign and ratify the other parts of such an FTA. Hence, had the Swiss voters rejected the CEPA, Liechtenstein most probably would have had to follow suit and not ratify it either, at least its major and commercially most interesting parts.

The third question was on the consequences of an increased use of referenda in Switzerland regarding the ratification of FTAs. There are various reasons for this: Undeniably, there is great concern about sustainable development in general. But there are also concerns from rather protectionist sectors, first and foremost the agricultural sector. And, more generally, there are clear signs of a political climate that is increasingly unfavourable towards free trade. This does not bode well in view of the upcoming ratification of the EFTA-Mercosur FTA. With regard to the latter, the sustainability problems are probably far bigger if we look at Brazil’s deforestation policy in the Amazonas region. And opposition from agricultural protectionist lobby groups is even more substantial given the Mercosur countries’ agricultural potential, especially for meat exports.

All of this needs addressing in the EFTA Council, if not EFTA Ministerial meetings, to avoid EFTA’s third-country policy taking a blow in the foreseeable future.

Final remark: after this text was finalised, Charlotte Sieber-Gasser published a blog post on the same subject, though with a different focus: <https://www.humanrightsincontext.be/post/the-efta-indonesia-template-for-sustainable-palm-oil-and-for-human-rights>.

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