

# REVENUE COLLECTION IN NON-EXTRACTIVE NATURAL RESOURCE SECTORS IN INDONESIA

## BRIEF: POTENTIAL STATE REVENUE FROM THE REGIONAL FORESTRY SECTOR AND ITS PROBLEMS

### BRIEF FACTS

Amount of forested area (ha, hectare)

Conservation Land Areas:

22,108,630.99

Protected Areas: 29,673,382.37

Limited Production Areas:

26,798,382.01

Fixed Production: 29,250,783.1

Production that could be converted:

12,942,295.24

Total Forested Area: 120,773,441.7

Source: SK Menteri Kehutanan (Ministry of Forestry Decree, SK76/MenLHK/2015)

Issued forestry licenses (HPH): 277 companies (2015)

Total Size of licensed forests:

20,374,317 ha (2015)

Production: 5,879,380 m<sup>3</sup> of wood logs (2015)

Critical land: 24,196,000 ha (2013)

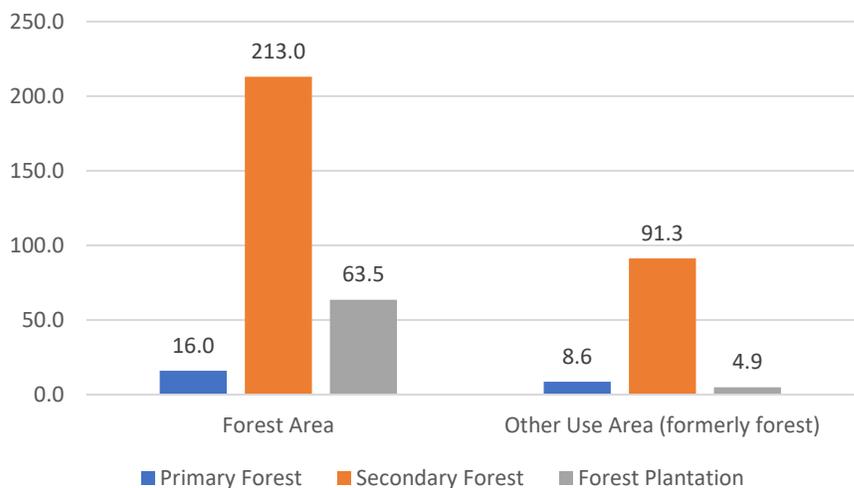
Reforestation: 105,656 ha (2013)

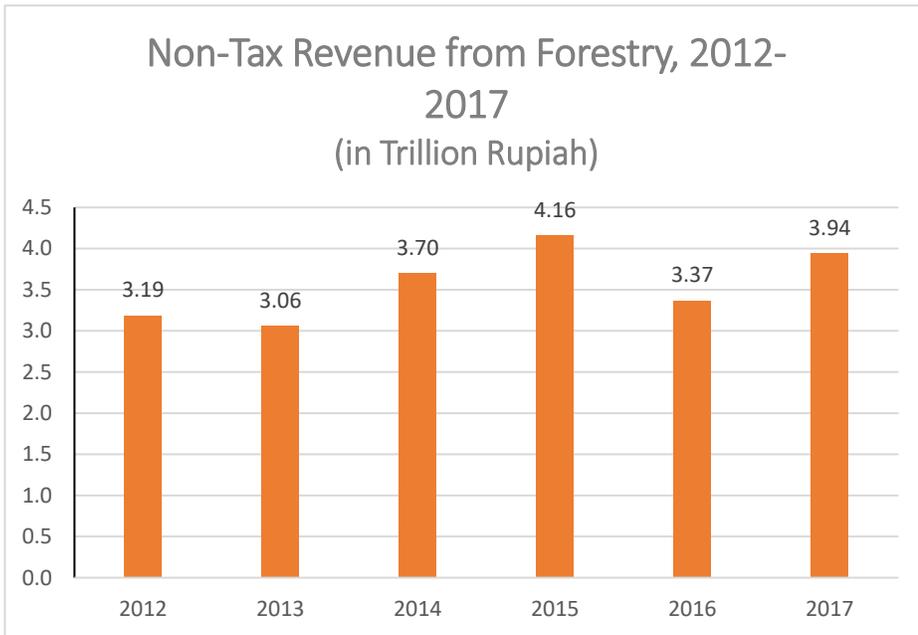
### FORESTRY SECTOR IN INDONESIA

Indonesia's tropical rain forest is the third largest in the world after Brazil and the Congo. In 2015, forested areas reached 120 million hectares, consisting of conservation forests, protected forests, limited production forests, permanent production forests, and conversionable production forests. Approximately 60 million Indonesians depend on forests for their livelihoods. With such large forests, Indonesia should be able to maximize the benefits of its existing resources. Forests not only have economic value, but also have ecological and biological value and provide a source of food.

Unfortunately, this wealth is being rapidly exploited. Deforestation rates in Indonesia are the highest in the world. By 2015, the rate of deforestation was recorded at 727,981.2 hectares (ha) per year, or roughly 2,793 football fields per day. In the same year, the highest rate of deforestation was reported in Riau Province, covering 201,939.40 ha; in Central Kalimantan covering an area of 58,835.60 ha; and in East Kalimantan with an area 38,339.40 ha. Deforestation occurs due to illegal logging, expansion of plantations, mining, encroachment and occupation of land, and forest fires.

Average Annual Deforestation (000 hectares)





Data: Seknas FITRA from the Ministry of Finance

Despite the high rate of deforestation, the forestry sector provides only a modest contribution to state revenue collections and the forestry sector’s contribution to the national Gross Domestic Product (GDP) remains small. In 2014, the forestry sector accounted for just 74.8 trillion of the total GDP of IDR 10542.7 trillion (at current prices).

The forestry sector also contributes tax and non-tax revenues. In 2015, forestry property tax collections based on the Government Performance Report (Laporan Kinerja Pemerintahan/LKP) only amounted to IDR 1.5 trillion. The Provision of Forest Resources (Provisi Sumber Daya Hutan/PSDH) and the

Reforestation Fund (Dana Reboisasi/DR) generate significant non-tax state revenues (PNBP), with other PNBP sources producing only small amounts of revenue. The non-tax revenue contribution is low and fluctuates. In 2015, the amount of PNBP obtained was only 4.2 trillion. The disparity between the level of deforestation and the limited amount of revenue collected leads us to ask why this discrepancy exists.

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## FINDINGS

The findings of this study: 1) describe the management of regional forest sector state revenues; 2) estimate potential state revenue collections; 3) identify possible causes of revenue leakage; and 4) examine other forestry sector management issues, such as the practice of illegal retributions or payments. This research identifies a number of state revenue governance issues affecting the forestry sector, ranging from data inconsistencies among agencies to inconsistent licensing practices to lack of supervision of implementation in the field.

The prevalence of inconsistent data among various agencies is a significant problem that has yet to be resolved by the government. Inconsistencies are found in data documenting production, licensure, company, location, and other aspects of the forestry sector. In the case of timber production, data reported by the National Bureau of Statistic (BPS) and Ministry of Forestry and Environment (Kementrian Lingkungan Hidup dan Kehutanan/KLHK) are not the same. Even data from the KLHK related to 2015 Forestry Production and 2015 KLHK statistics on the amount of wood production are not the same. Based on the 2015 Forestry Production Statistics, wood log production was 43.87 m<sup>3</sup>. Meanwhile, wood log production reported by the KLHK 2015 Statistics for natural forest yields was reported at 5,843,179.25 m<sup>3</sup> and wood logs production from plantation forests was 29,447,109 m<sup>3</sup>.

Another issue is a disparity in the reported number of permit holders and their land areas. Based on data from the Ministry of Forestry and Environment in West Kalimantan, there are 25 companies holding a IUPHHK-HA permit corresponding to a managed

land area of 1,221,880 m<sup>2</sup>. Meanwhile, based on 2016 data from the Directorate General of Forestry Company, there were 76 companies with a total concession area of 1,973,846 m<sup>3</sup> in West Kalimantan. It is not clear which source is correct.

Licensing-related data issues result from unreliable information on the number of permits, the extent of land permitted, and the location of the permits. Based on the report by Ditjenbun, 768 IUPs were issued between 2007 and 2015 covering a land area of 6.08 million hectares spread over 24 provinces. Ninety-five percent of the IUPs are for oil palm commodities. The largest number of permits are attributable to West Kalimantan and East Kalimantan with 1,158,333.47 ha and 1,063,967.92 ha, respectively. Sites that intersect with forests are logged and cleared. The timber is not reported, the profits from the timber are taken by the plantation company and are shared with the license holders.

There are several practices that threaten state revenue. The first is losses due to illegal logging. Based on a 2010 State Supreme Audit (Badan Pemeriksa Keuangan/BPK), state losses due to illegal logging amounted to IDR 83 billion per day or IDR 3.29 trillion per year. Meanwhile, calculations conducted by our researchers, revealed that about 40,000,000 m<sup>3</sup> was lost due to illegal logging. Using an estimated price for mixed jungle wood of approximately US\$500/m<sup>3</sup> (based on the benchmark price of wood exports), state losses reach IDR 262 trillion, assuming that all of the wood is exported. However, if calculated based on the value of compensation owed for logged trees with an average price for the Kalimantan and Sumatra areas of IDR 385,000/m<sup>3</sup>, state losses total IDR 15.4 trillion. The calculated value of state losses is much greater than the estimate of the BPK. Malaysia is suspected to be the largest benefactor of illegal timber logging from Indonesia. Many reports document that Malaysia processes as much as 58.2 million/ m<sup>3</sup> of wood, while the country's legal timber production is only 25.4 million/ m<sup>3</sup>.

The most recent study of the Corruption Eradication Commission (KPK) estimates state losses from the forestry sector to be around US\$9.0 billion, or between IDR 8.45 trillion and IDR 11.7 trillion over the period of 2002-2014. These losses stem from a lack of consistency in the recording of the volume of logged timber production which, in turn, contributes to underpayment of non-tax state revenues due to reforestation and provision of forest resources funds.

Forest fires are another cause of revenue loss. The government's 2014 budget reports that the cost of extinguishing hotspots in six provinces reached IDR 385 billion. The World Bank estimates that in 2015 forest fires in Indonesia cost the state IDR 221 trillion, equal to 1.9 percent of GDP. In contrast, the forestry sector only contributed 0.71 percent of the country's 2014 GDP.

The production of timber logs in natural forests is regulated by the Timber Forest Product Utilization Permits in Natural Forest (IUPHHK-HA) and Timber Utilization Permits (IPK), while timber production from plantation forests is regulated by Timber Utilization Business Permit in Plantation Forests (IUPHHK-HT) and Public Forest State Enterprises (Perhutani). Based on 2015 Quarterly Forestry Data (Data Kehutanan 2015) reports, the total production of wood logs in Indonesia amounted to 43.87 million m<sup>3</sup>. This would generate an estimated total Provision of Forest Resources (Provisi Sumber Daya Hutan/PSDH) of IDR 47,731,130 million if tariffs are imposed. However, the actual 2015 PSDH reported on the website Sipuhh online was just IDR 444,958,624,741.

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*“If the PSDH tariff is imposed, the total PSDH obtained from national wood production should reach IDR 47,731,130 million. But in reality, data listed on PSDH 2015 on the website Sipuhh online, revealed that it only generated a value of IDR 444,958,624,741.”*

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Other inconsistencies can be found in Reforestation Funds (Dana Reboisasi/DR). For example, Reforestation Fund collections in two districts in a province totaled IDR 36,533,474,770. This amount is not appropriate based on calculations using the basic forestry production statistics for 2015. Using production statistics, Reforestation Fund collections should have totaled IDR 44,798,128,363.12. However, these two figures are much smaller than the amount reported by the Sipuhh Online system of IDR 168,168,753,870. These disparities complicate efforts to validate the data on the sector and determine the amount of revenue produced by the sector.

There are many other problems in the forestry sector that reflect poor governance and lead to low state revenue collections. One of the most common problems is the lack of a transparent licensing process. The main function of permits is to control forestry operations, rather than serve as a revenue source. The permitting procedures are often designed in a manner that is complex and "troublesome." However, the complexity and difficulty of the licensing process fails to prevent people from breaking the rules.

In the forestry sector, one of the most common practices identified by the research was businesses' payment of gratuities to bureaucrats and local governments to shortcut licensing processes. One example of this would be a payment made in exchange for the issuance of a permit before the necessary requirements are fulfilled. Another example is when a company requesting permission to log fails to meet stated requirements, but still receives a permit. Another frequent problem occurs when companies obtain a Plantation operating license (HTI), but operate in a natural forest area to avoid payments to the PNBP Reforestation Fund. Another mode for controlling forests is to manipulate the status of the land. For example, a company applies for permit to establish a plantation. The actual use of the land on the plantation site is as a forest. By manipulating the status, the company extract logs on the pretext of preparing land for plantations as stated in the permits been obtained from the government. By doing this, the company can extract logs without having to pay the Restoration Funds (DR), the PSDH, and other non-tax revenues to the state.

Other issues arise when natural forests are partially or completely cleared and/or converted into a plantation. In these situations, government officials, with the encouragement of the suspected company, act to "white-wash" the status of the land by making changes in spatial planning documents and/or avoid paying fines for past violations.

Other problems occur when forestry companies target traditional forests or community-controlled forest areas. Abuse occurs when the companies recruit local community members to form fake cooperatives that, in turn, exploit the forest for the benefit of the companies.

The complicated and expensive nature of the licensing process encourages abuse. One factor contributing to the cost is the large number of illegal contributions or bribes that are needed to speed up various steps in the licensing process. This investigation revealed that entrepreneurs were forcibly asked to make illegal payments of IDR 30-50 thousand per hectare in order to obtain an operating permit. These payments are not part of the legal-formal non-tax state revenue (PNBP). These charges can happen at every step in the process from the level of the licensing office (the licensing officer and the party that provides the security guarantees) to the officials around the location (such as the village head, tribal chief, or related officials). The total extortion for each hectare of land covered by a permit can amount to 2.5 million rupiah. If, for example, a permit covers 30,000 hectares, at an overall licensing cost of IDR 2.5 million per hectare, the cost of bribes and extortion can reach IDR 75 billion or more for a permit.

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*With long and complex bureaucracies, from the level of the licensing office (the licensing officer and the party that provides the security guarantees) to the officials around the location (village head, tribal chief, or related officials), the total extortion for each hectare of land requested in the permit can reach 2.5 million rupiah per hectare.*

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Other highly visible illegal costs occur in the transportation process. Typically, logs are transported past 13-15 posts prior to reaching their destination. Local thugs - corrupt state and non-state actors - often extract a charge of IDR 50-100 thousand at each post along the way.

## IMPLICATIONS

Indonesia's vast forests are a national treasure that are too easily exploited. Evidence of corruption in the forestry sector is common. Corruption occurs due to weak supervision, lack of integrity on the part of government officials, and untested systems. These weaknesses in governance, in turn, reduce the amount of revenue that is collected.

Licensing can and should be an effective tool for managing the use of Indonesia's natural forest resources. Instead, it becomes a part of the problem due to the length, complexity and lack of transparency that encourages businesses to engage in illegal activity to obtain permits and influence public policymaking processes. For corrupt individuals, the high profits promised from the forestry sector justifies the risk of engaging in illegality.



Photo: Wulandari

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The licensing process also provides an opportunity for corrupt officials to request illegal payments from businesses by promising to ease licensing and investing in order to make personal gains. This research found that companies could easily obtain permits for large amounts of land, while local residents found it very difficult to get a permit. In fact, it is common for forest land occupied by local communities to be taken over by companies that have obtained the requisite permit.

Problems with the permit process don't stop here. Long, complicated, expensive, and non-transparent licensing procedures hamper both entrepreneurs and individuals who want to work in the forestry sector. Forestry businesses often take risks by "operating while waiting for permits." When operating without permits, no income is paid to the state as the operation is deemed illegal.

Entrepreneurs who "operate while waiting for permits" engage in a number of abusive practices, including deliberately working with communities to exploit forests under community management as a plantation. Once forest, mining, and HTI or other permits are obtained, villagers often experience difficulty in accessing the forest and are at risk for damage to their livelihoods.

Lastly, a number of businesses engage in problematic practices while engaging in illegal logging. Often times forestry officials will ignore these violations in exchange for a bribe.

## CONCLUSION

Overall, most of the problems in Indonesia's forest sector stem from the long, complex, expensive and non-transparent licensing process which encourages corruption on the part of local officials. Other significant problems include the conversion of land status through the adjustment of local regulations that result in areas that originally classified as forests to be changed into plantations and mining sites. Furthermore, there are payments outside of those that are statutorily required taken by corruption individuals or diverted from the state treasury. In brief, the failure to realize the potential of the forestry sector results not only from corruption, extortion, or tax evasion but also from the weakness in the governance regimes that trigger conflicts at the lower levels.

***Jean Ross prepared this brief as a consultant to the International Budget Partnership in October 2018***