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Building a Sound Financial Architecture for Sustainable Forest Management: The Role of Forest Funds

Part of the Expert Meeting on Strengthening Financing for SFM through Forest Funds – 24-25 October 2013, Bogor, Indonesia

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2. Reforestation Fund: Case of Indonesia

Sudarsono Soedomo¹⁴

ABSTRACT

In order for the forestry fund to have substantial meaning, the fundamental factors that inhibit the forestry fund must be removed first. Although public investment of the reforestation fund (DR) is quite large, the overall productivity of the land developed for industrial plantation forest has failed to achieve a target price. Two internal factors that need to be addressed are (1) the property rights issue and (2) the price, which are very crucial for long-term investments. Only when forestry investment is profitable, then the funds will flow to the forestry sector. If forestry investment is not profitable, the forestry fund will only be wasted and there will be no sustainable production forests.

Keywords: Reboisasi (DR), Natural forest, Royalty, Incentive, Profitable, Sustainable

OVERVIEW BACKGROUND OF THE FUND

In accordance with the constitution, natural resources are used for the maximum benefit of the people in a sustainable manner. To ensure that such a use can be materialized, the productivity of the forest must be maintained; any degradation must be addressed, including by conducting reforestation. To ensure that reforestation can be implemented, the availability of funds dedicated to reforestation must be maintained. This is the background of Indonesia's forestry fund called DR. Although public investment of the fund is quite large, the overall productivity of the land developed for HTI has failed to achieve the target price. Two internal factors that need to be addressed are property rights issue and timber price.

In Government Regulation 6 of 2007, DR is defined as a fund collected from IUPHHK holders in natural production forests to reforest and rehabilitate forests¹⁵. There is a confusion in understanding of DR and Reboisasi Guarantee Fund (DJR, Dana Jaminan Reboisasi). From name point of view, both DR and DJR have similarity and it is understandable if one sees that the two terms have a close relation. It is true that the money of DR was from the money of DJR. DJR was money that belongs to holders of forest concession right that must be deposited in the government's account as a performance guarantee of reforestation of forest area under their concession. When we look at the substance contained in the DR and DJR has a much different meaning. DR is not a guarantee of performance, while DJR is a guarantee of performance. Act 41 of 1999 through Article 35 clearly mandates that every holder of IUPHHK is charged with a performance bond (DJK, dana jaminan kinerja). This mandate is not implemented by the Ministry of Forestry (MoFor). So, in terms of substance, DJR was altered to DJK, not DR.

Through the Presidential Decree No 35 of 1980 regarding DJR, the holders of forest concession were required to deposit money to the government as guarantee for performing reforestation on their logged over areas. As time went by, DJR at the hand of the government built up because very few holders of forest concession who performed reforestation. Furthermore, the government through the Presidential Decree No 31 of 1989 regarding DR cancelled the Presidential Decree No 35 of 1980 and DJR was changed to DR with the same consequences. The Presidential Decree No 31 of 1989 later, experiencing many changes, especially through the Presidential Decree No 29 of 1990, the Presidential

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¹⁵ Article 35 paragraph (1) of Law 41 of 1999 states " Each holder of forest utilization license as referred to in Article 27 and Article 29, subject to business license fees, fees, DRs, and performance bonds". In essence, DR is government revenue earmarked for reforestation.

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Decree No. 1991, the Presidential Decree No 40 of 1993, and finally the Presidential Decree No 24 of 1999.

The level of DR from 1989 to 1999 was not clear, whether or not it was the state revenue. Logically, DR revenues are grouped into two categories, namely in the form of tax revenue and non-tax revenue. The known non-tax revenues. During the period 1989 to 1999, DR was clearly not a tax revenue because inclusion of DR as a non-tax revenues lately occurred through Government Regulation No. 92 of 1999. Prior to 1999 the DR was off-budget, since 1999 the fund has been included in the budget. Large amounts of idle money certainly made many government bureaucrats tempt to use the characteristic of bureaucracy that tends to maximize the budget (Niskanen, 1968). While the DR which was large and growing rapidly, was contested by professional foresters who supported the sustainable forest management and political ally of Suharto, who sit in the Ministry of Forestry (Suharto, 2001).

RESOLUTION

DR is a form of royalties charged on timber harvested from natural forests. DR rate depends on the volume, size, and location (Table 1). Largest revenue comes from Meranti and mixed timber. While, revenues from logs of ebony, natural teak, fancy wood, and sandalwood are very minor. The production of those timbers is also very low. Revenue per year of DR is presented in Table 2.

Table 1: The rate of Reforestation fund (USD per cubic meter)

Species	Kalimantan-Maluku	Sumatera-Sulawesi	Papua-NT
Meranti	16.00	14.00	13.00
Mixed	13.00	12.00	10.50
Ebony	20.00	20.00	20.00
Natural	16.00	16.00	16.00
Fancy wood	18.00	18.00	18.00
Sandalwood	18.00	18.00	19.00

Source: Government Regulation No. 92/1999

Revenue from the lease of land is also included to generate ideas that there are other revenue sources, such as land lease that can be used for reforestation. Land lease is generally associated with mining operations. In other mining areas need to be rehabilitated in order to make it productive for agriculture. Whether or not the rate of land lease is already efficient still needs to be studied further.

Table 2: Revenue of reforestation fund (x1000 IDR)

Year	DR	Land Rent
2000	1 359 335 810.19	
2001	1 643 159 304.60	
2002	1 455 054 128.98	169 797 334.86
2003	1 721 221 417.26	162 231 506.40
2004	1 720 288 868.77	432 550 625.16
2005	1 516 134 718.31	403 865 794.15

Source: Directorate General of BUK

Annual revenue of DR tends to decline over time due to lower production of logs from natural forest. DR revenue on average is about 1.5 trillion IDR per year. The figures in Table 2 are not always consistent with the level of timber production in Figure 1 due to revenue of DR within a year does not always come from timber harvested during the year in question. Some DR received in a year may be as a payment against the outstanding DR in previous years.

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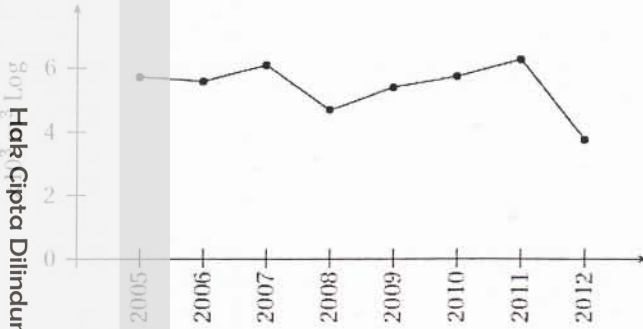


Figure 1: Log Production from Natural Forests

Other sources of income are limited to the discourse, such as REDD+ funds and funds from carbon trading. Practice of environmental services on a small scale has begun to occur, such as in Cidanau, Cirebon, and Kuningan local governments, and in Mataram NTB. Money paid by users of environmental services at least, can help producers of environmental services to conserve forests in the region. Actually, there is another important source, namely banking. For example, Bank Mandiri has shown its interest to help finance investments in forest plantations. But excessive regulation in the forestry industry makes the industry less attractive for investment (Kartodihardjo and Soedjadi, 2009).

FUND UTILIZATION

The use of DR during the New Order era was almost without clear criteria, except closeness to the power. Activities that supported the rehabilitation of land could also be financed by DR, but the definition of the supporting activities was not very clear. Oversight of the use of DR also practically non-existent. The central government controlled fully the revenue and the use of DR. The situation changed after the New Order regime collapsed.

According to the government regulation No. 35 of 2002, DR shall be divided as follows: a. 40% (forty percent) for the producing region and b. 60% (sixty percent) for the Central Government. The DR of central government is allocated to the Technical Department (MoFor) and the remaining is allocated to the Forest Development Account (RPH, Rekening Pembangunan Hutan).

Some of the DR has been placed on Public Service Board-Forest Development Funding Board (BLU-BPPH, Badan Layanan Umum-Badan Pembiayaan Pembangunan Hutan), a financial management agency designed to help finance the development of plantations. BLU-BPPH must report the implementation of its activities, including financial management, to the MoFor.

Under management of BLU-BPPH, DR is directed to assist the development of plantation, particularly private forest and HTR (forests planted by the people in the forest area). Loans to small-scale forest owners have started running and welcomed, as is the case in Wonosobo and Blora. Loans that have been given begins with application of a farmer group. After an investigation in the field, when the application is approved, the contract is for each farmer individually, not as a group. However, HTR development still face obstacles in the form of licensing procedures which are very complicated, especially for small-scale farmers who have a lot of resource limitations. Barriers to the HTR is also a barrier to forest funds.



FUND OVERSIGHT

Before the use of DR was practically not audited. Since 1999, the use of DR must have been audited by the Supreme Audit Board (BPK). A central feature of the DR during the Suharto period was that the DR was not flowing into the state treasury to be included in the annual budget of the government but was incorporated as a state off-budget funds managed directly by the MoFor (Ascher, 1999).

On 17 March 2007, the Minister of Forestry and the Ministry of Finance jointly issued a regulation that established the Forest Development Account (RPH) to support the use of DR in forest rehabilitation. RPH initial capital was granted in September 2007 amounting to 5.0 trillion Rupiah. The DR until then was administered by the Ministry of Finance.

Financial control over RPH is conducted by the Director General of the Treasury of the Ministry of Finance. He is obliged to submit monthly reports related to the position of account to the MoFor. The MoFor is allowed to withdraw funds from the account to support the activities of forest and land rehabilitation. To do this, the MoFor must submit a five-year work plan, along with a budget detailing the utilization of the fund. Once approved, the Ministry of Finance will send funds from RPH to a 'unit' of the MoFor who is responsible for the expenditure of the fund for forestry development.

'Units' of the MoFor in charge of managing DR as a 'revolving fund.' This unit is allowed to distribute a number of loans to a number of legal entities - state or privately owned - as well as to groups and cooperatives of farmers. To qualify for this loan, those legal entities and cooperatives are required to possess licenses in forest utilization (IUPHT, izin usaha pemanfaatan hasil hutan) and expertise in the field of forestry. The legal entities should have not been involved in any bad activities related to forestry. If a legal entity fails to pay back the loan, then the debtor is subject to a penalty of 2 percent of the principal each year along with its interest. For groups and cooperatives of farmers, if the debtor fails to pay back the loan, then the debtor may be sanctioned collectively, which is not specified.

On 17 March 2007, the Minister of Finance announced the creation of BLU-BPPH, which would serve as a 'work unit' of the Ministry of Forestry that is responsible for forestry development expenditure. Establishment of BLU-BPPH aims to create a more flexible financing institutions in disbursing funds but more role in financial management. Since BLU-BPPH is in early stage, we do not have enough information to make a fair evaluation of its performance.

KEY TAKEAWAYS

Some parties have influence and are influenced by forestry funds, particularly forestry fund in the form of DR, which is a state revenue. The fund management must be accountable to all the people, not only to those who contributed and who use it. As mentioned previously, the beneficiaries of DR in the past were mainly large-scale plantation companies, especially those who close to the center of power. Since the reform era, the target beneficiaries of the fund have changed slightly toward smaller scale owners of plantation forest.

Lately, there is a discourse to finance the rehabilitation of natural forests, particularly in relation to the application of intensive silviculture. According to existing rules, any investment in natural forests, the results of the investment belongs to the government. As a result, there are no private parties who are willing to make long-term investments in natural forest land. As a way out, several parties suggested that agents who implement intensive silviculture are exempted from the obligation to pay DR.

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CURRENT

What could be believed by DR was not much. Although public investment of DR was quite large, the overall productivity of the land developed for HTI has failed to achieve the targets set. Several years ago, the government gave the loan, which was sourced from the DR, to some companies of industrial plantations with zero percent interest, but the forests in question did not materialize and many loans have been returned. Worse, there is a suggestion to abolish the loan in default.

The number of companies that were willing to undertake rehabilitation was very little. They prefer to give up the land that has been handed over to the government than to rehabilitate the forests and get the land back. This suggests that the levy rate set by the government was too low. There are indications that the same thing happens in the case of post-mining reclamation funds.

Indonesia shows that transparency and accountability are critical components of good financial management. To a certain extent, DR abuses during the New Order were facilitated by non-standard accounting systems and weak supervision by the MoFor over DR account. So, it is important also to improve regulations that have the power of law in dealing with financial oversight, such as BPK and KPK (Commission on Corruption Eradication). The absence of effective oversight and accountability mechanisms has led to a large number of DR lost to fraud, diversion to other uses and wasted resources managed by HTI.

FUTURE

Without the support of financial institutions, private forest in Java Island has grown up to 2.8 million hectares. There are several factors that contribute to the development of private forest in Java: clarity of rights, timber prices, transportation infrastructure, and population demographics. What happens in Java would be a very valuable lesson learned that could be replicated outside Java where idle lands are still abundant.

Is it true that forest is experiencing a shortage of funds for investment? Is not a lack of applicants who want to invest? Is forest an attractive place for investment? I am afraid that the problem of the slow development of forests, especially outside Java, is not caused by a shortage of funds for investment, but by the lack of clarity about the rights, low timber prices, and limited transportation infrastructure. President Harry S. Truman said

“Give me one-handed economist! All my economists say: On the one hand, on the other.”

The same thing happened with the individuals working in forestry-related fields in Indonesia. On the one hand they try to keep forestry funds available for investment, but on the other hand they also make forestry funds attractive for investment. In the upstream, many barriers with respect to licensing that must be cleared by entrepreneurs. In the downstream, selling timber from a long investment is exposed to very low timber prices due to government policies that distort the market of logs. Forestry business in Indonesia can be summarized as “choked in the upstream and clogged in the downstream.” But it is expected to remain healthy.

Identifying the real problem is very important because with it we can design the use of forestry funds more effectively and efficiently. On land that is not forested there are certainly human activities, which often involve land conflicts. What is the better way to spend money from the forestry fund in a case like this? To resolve conflicts over tenure or to purchase seed? If there is no interference by humans, then the bare land will be covered quickly by vegetation through natural succession. We do not need to waste money for planting trees as a consequence. On the one hand we let the property rights remain unclear, but on the other hand we expect sustainability of forests is maintained. The intersection between the two is an empty set. Property rights offers incentives for long-term

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investor because it protects individual against expropriation by other agents, including the state. In a particular situation, making land rights more secure and transferable would promote incentive for investor efficient use of resources. There are three reasons supporting this conventional view. First, secure property rights are believed to provide a guarantee to farmers the benefits from their investments will be enjoyed by them and will not be appropriated by other agents. As a result, long-term investments will be encouraged (Besley, 1995; Deininger and Jin, 2006). Second, capitalization of asset with more secure property rights is more probable. According to Feder and Onchan (1987), security of ownership increases the chances of obtaining loans to finance agricultural investments. Secure property rights reduce the risk for the lender and provides the basis for using land as a collateral asset. Third, secure property rights would allow farmers to devote their productive resources to agriculture, rather than to other activities of their holdings against expropriation by other agents.

According to the data, natural forests in Indonesia, production forest that is allocated for large scale is 43.6 million hectares and small scale is 10.5 million hectares. Does this mean that maintaining forests is tantamount to maintaining the justice? Is justice not an important element of sustainability? So, forestry fund collected should be used to fix the injustice or to plant trees? There is no need to maintain sustainability if it does not deliver welfare to the people.

The most reliable and reliable source of forestry fund should be the forest itself. To achieve this, the forestry business must be profitable. Currently, the forestry business in Indonesia is generally less profitable. If any improvement in the business environment of the forest industry, it is difficult to expect them to invest their money in the forestry sector. Even the money that is available today will run out very quickly.

Sustainability is very difficult to maintain due to the decline in the ability of natural forests to produce timber. Besides the growth rate of natural forest is generally too slow. Other sources of funding must be found. In addition, the possibility of investing a part of DR in financial markets, which results in a higher rate of return with an acceptable risk, should be considered.

Export tax on timber make log price difference between the domestic market and international market so far. For example, the price difference can reach 220 USD per cubic meter. With prices at the international market, the entire allowable cut of natural forests (about 9 million cubic meters) will likely be utilized. Difference between allowable cut and actual production has the potential to generate additional production of 8 trillion IDR. If the government takes half of the additional benefits, via export tax for example, it can allocate the revenue to forestry fund then every year there is an additional

4 trillion IDR to the forestry fund. But there is a big risk, the destruction of natural forests. The reason is that property rights in natural forests are not clear.

Payment for environmental services can be considered as a source of forestry fund. It is still in early stage of development. We need to explore it further. A partnership between local water companies (PDAM, Perusahaan Daerah Air Minum) and farmers in protected forests in Mataram Lombok can be a good example (Soedomo and Nugroho, 2009). PDAM Menang Mataram has allocated 850 million IDR in 2011 to fund conservation and to provide assistance to communities and villages around the spring¹⁶

Let us take a look the economy of Indonesia, particularly its fiscal policy. So far, the importance of forest is still limited in a seminar room. Meanwhile, burning fossil fuel is much more important so that the government needs to support it by providing subsidy. Although it cannot be compared directly, the figures in table 3 say a lot about the real attitude of the society represented by the government. State budget allocated to subsidy for activities that add CO₂ in the air is much larger than the one allocated to activities or sectors that potentially support CO₂ reduction from the air. In 2006, the fuel subsidy was 64.2 trillion IDR, while the budget for environmental protection was only 2.7 trillion IDR.

¹⁶ <http://pdam.menangmataram.com/getberita.php?index=25>, Oct 14, 2013.

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Environment budget rose to 10.1 trillion rupiah in 2011, but at the same time fuel subsidy jumped to 129.7 trillion rupiah. In addition, two government institutions that are frequently associated with environmental protection, namely MoFor and Ministry of the Environment (MoE), received a total of 1.3 trillion IDR in 2006 and 7.0 trillion IDR in 2011. Reallocation of state budget from fuel subsidy to increase budget related to environment and forestry could be an important source of forestry fund.

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Table 1. Budget and contra (-) forces of CO₂ emission (trillions IDR)

Description	Year						
	2006	2007	2008	2009	2010	2011	2012
Fuel subsidy	+ 64.2	83.8	139.1	45.0	82.4	129.7	123.6
Env. protection	- 2.7	5.0	5.3	10.7	6.6	10.1	10.6
MoFor	- 1.5	1.8	3.2	2.1	3.3	5.9	6.1
MoE	- 0.3	0.4	0.4	0.4	0.4	1.0	0.9

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