

Community Based Forest Management in Indonesia: a review of current practice and regulatory frameworks

Background paper for The Forest Dialogue on Investing in Locally Controlled Forestry (ILCF), Yogyakarta, Indonesia 6 – 9 February 2012.

30 January 2012

Nonette Royo and Adrian Wells

***Summary** Community Based Forestry Management (CBFM) in Indonesia has significant potential for revenue generation and employment. Yet it remains on the margins of forest policy and economic development planning. This paper describes current practice and constraints in CBFM, as well as the blend of regulatory reform, 'soft investment' and financing needed for the sector to succeed and scale.*

Key messages

- CBFM has the potential to meet industrial demand for timber and to generate valuable jobs and revenue in rural areas. Between 1 and 1.5 million hectares of private woodlots on Java alone produce up to 8 million m³ a year of timber and up to USD360million a year in income for farmers.
- Yet, despite a raw material supply gap in the industrial wood processing sector, CBFM continues to get scant attention from policy makers. Implementation of legal arrangements for CBFM has been slow, falling far short of targets established in forestry-sector development plans.
- The implications are serious if more effort is not made to support CBFM. The supply of natural forest timber will not be enough to sustain forest industries. Indonesia will lose out on a major rural development opportunity.
- Key constraints include the incomplete delineation of state and private/customary claims in forest land and resources; the gap between formal CBFM arrangements and existing best practice; complex and costly administrative procedures; not enough government support; and the inability of CBFM SMEs to access finance.
- Site-based learning and dialogue remains central to addressing these constraints, and in particular to sustain efforts to implement recommendations emerging from the recent International Conference on Forest Tenure, Governance and Enterprise in Lombok 11 -15 July 2011, including steps to finally resolve the delineation of state and private/customary rights.
- Assess the efforts to *decentralise* CBFM arrangements to better fit with local contexts. The devolution of forest management authority to watershed-based Forest Management Units or *Kesatuan Pengelolaan Hutan* (KPH) offers a possible framework to explore this.
- Immediate steps can be taken to address regulatory complexity and high transaction costs, in particular over rights and procedures relating to timber; granting local communities a much stronger incentive to invest in replanting. It may also be possible to financially reward local government for efforts to establish CBFM.
- CBFM succeeds on institution building and organizational capacity development ('soft investment'), giving forest managers the means to engage with capital and markets on their own terms. This requires dedicated enterprise support to help CBFM SMEs make the leap from informal micro-finance to formal banking and investment.
- As CBFM groups make the transition to fully fledged SMEs, it is also necessary to anticipate their changing requirements for finance ('hard investment'). Where communities are planting on bare land, this may require an initial injection of public equity to build the asset base, after which it can attract lending or private equity.

1. Background

This paper has been commissioned by The Forests Dialogue as background for the latest in a series of meetings on Locally Controlled Forestry (ICBFM) to be held in Yogyakarta, Indonesia, 6 – 9 February 2012.

The paper revisits analysis originally produced in 2006 by the first phase of DFID Multi-Stakeholder Forestry Programme in Indonesia (MFP1). It provides a snapshot of the state of play with locally controlled forestry (CBFM) in Indonesia, the constraints it faces, and possible steps to unlock its potential for inclusive and sustainable economic development.

2. Overview of Indonesia's forests

Indonesia's forests span around 88.5 million hectares by 2005 estimates, representing around 48% of the country's land area. Of this, 48.7 million hectares constitutes primary forest, 36.4 million hectares semi-natural forest, and 3.4 million hectares productive plantation.¹

Yet around 120 million hectares of land are categorised as National Forest Estate under state control – suggesting that around 31.5 million hectares of the Estate has no forest cover at all. The total Estate breaks down into 33.5 million hectares of protection forest, 20.5 million hectares of conservation forest, 58.25 million hectares of production forest and around 8 million hectares of forest designated for conversion to other uses.²

Within the Forest Estate, just 0.23 million hectares is allocated for use by communities and indigenous groups according to 2008 estimates. Just 1.7 million hectares of forest constitute registered private property, owned by individual or firms, outside of the Forest Estate.³

Rates of deforestation in Indonesia are far lower now than they were at peak forest loss of 3.51 million hectares a year in 1997. However, they still averaged 0.71 million hectares a year for the period 2000 – 2005, second behind Brazil.⁴

Future forest loss could be as much as 28 million hectares by 2030, assuming:⁵

- a) Government plans for increasing pulp and palm oil production will require 11-15 million hectares of currently forest covered areas to be converted, equivalent to 6 - 8 million hectares for pulp and 5 - 7 million hectares for oil palm.
- b) That another 10 – 13 million hectares will be needed to feed and support Indonesia's growing population.

Emissions from LULUCF comprise up to 85% of total emissions, mainly from forest and peat land fires, peat land drainage and decomposition, deforestation and degradation. And emissions of LULUCF are predicted to continue to rise over the next 20 years, even if they decline in relative importance to emissions from other sectors such as energy and transport.⁶

Some of the principal drivers of forest loss are:

- a) Low agricultural and estate-crop productivity. For example, yields in palm oil have leveled off in recent years at an average of 2.7 tons of CPO per hectare. This is lower than the Malaysian average of 3.63 t/ha. If Indonesia's palm oil sector continues to expand at 5% per annum and average yields are not improved, then the estate will require an additional 12 million hectares of land by 2030 placing further pressure on forest. But if yields are improved to match industry best practice, then only 5 million hectares of additional land may be needed – well within the amount of degraded land estimated by to be available for oil palm expansion.⁷
- b) Historical underinvestment in plantations to match industrial processing capacity. Between 1989 and 2006, 10 million hectares of industrial timber plantation licenses (HTI) were issued, but only 30% were actually realised – leaving natural forest to fill the supply gap. So in 2005 up to 65% of the timber feeding the largest pulp mills in Sumatra came from clear-cutting of natural forest.⁸
- c) Structural over-dependency on natural resource extraction. Analysis by the Harvard Kennedy School (2010) shows that Indonesia's manufactured exports have grown very slowly since 1997 compared to other emerging economies, due to increasing reliance on unprocessed or part-processed raw material exports; just 6.4% per year between 2003 and 2007, compared to 21% per year in Vietnam, and 16.3% in Brazil. The report notes that Indonesia's economic model *'relies too heavily on over-exploitation of natural resources, does not invest sufficiently in people and fails to make the most of the opportunities presented by globalisation.'*⁹

3. Forest-sector development in Indonesia

According to 2010 data from National Statistic Agency (BPS), the land-use sectors currently represent around one fifth of the economy (Table 1).

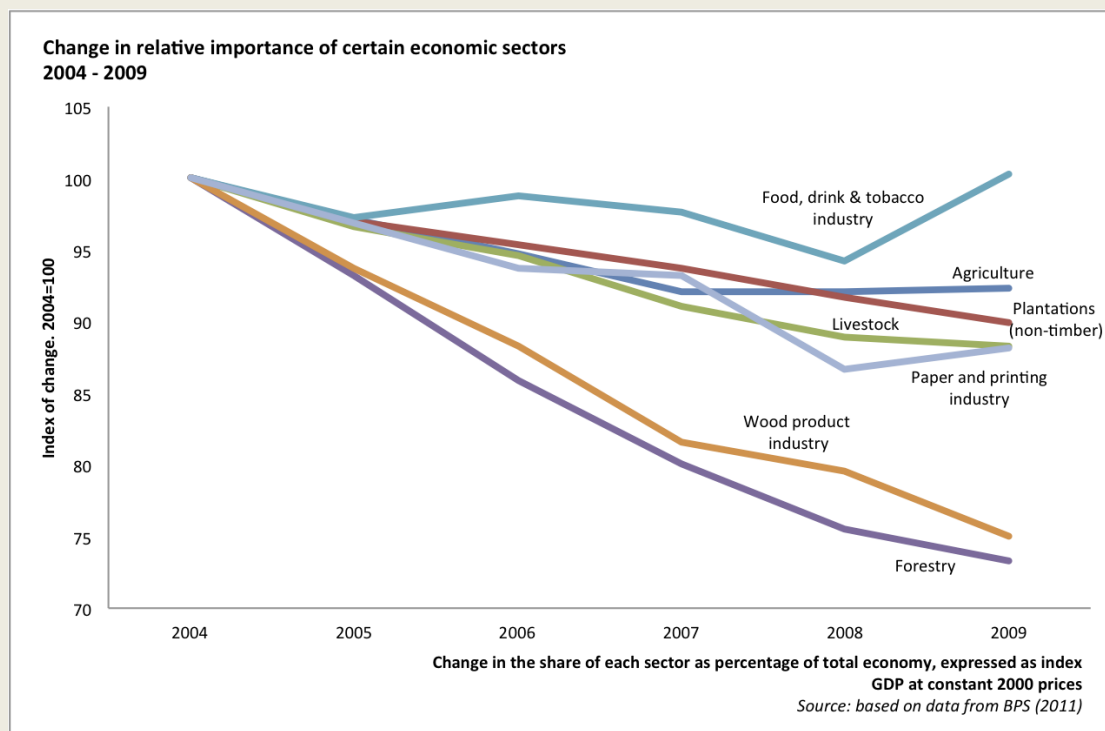
Table 1: Share of economy & size of sector in 2009

Sector	Share of GDP (2009)	USD billions
Agriculture (food crops)	7.46%	46.6
Plantations (non timber estate crops)	2.00%	12.5
Livestock	1.85%	11.6
Forestry	0.80%	5.0
Food, drink & tobacco	7.49%	46.7
Wood product industry	1.43%	8.9
Paper and printing industry	1.09%	6.8

Source: BPS (2010) 2009 GDP at current prices

But Figure 1 below also shows how a number of land-use sectors have declined as a proportion of the economy since 2004. Only the food, drink and tobacco industries have sustained their position. Forestry and wood product industries rate the worst performers – at only 0.8 and 1.43 % of the national economy in 2009.

Figure 1: Value of the land use sector to the economy 2004 – 2009 (change in GDP share)



Source: Elson D. (2011) *Cost-Benefit Analysis of a Shift to a Low Carbon Economy in the Land Use Sector in Indonesia*, UK Climate Change Unit, British Embassy, Jakarta.

Inadequate competition in the supply chain is one of many possible reasons for this loss of competitiveness. So, for example, Indonesian smallholders are paid less than half the price for pulp wood than their peers in China. This means that, while China's area of plantation forestry increased by over 40 % in 10 years, largely as a result of investments by smallholders, it actually shrank in Indonesia.¹⁰

Logically, a declining forest industry would slow the rate of deforestation. But a decline in the timber processing sector could also mean proportionally more raw material being exported. So although economic value falls, the volume of extraction from natural forest remains the same or even rises – especially if there has been insufficient investment in a sustainable plantation base.

It is this context – declining productivity in the industrial wood processing sector combined with sustained pressure on natural forest to fill a raw material supply gap – that makes support to CBFM so relevant and so urgent.

4. The practice of community based forest management (CBFM) in Indonesia

4.1 How much CBFM is there and what does it consist of?

Extensive research by MFP1 estimated that there are around 6 million hectares of recorded community and family management spanning both state and non-state forest areas. This is equivalent to around 5% of the National Forest Estate.¹¹ But its true extent may be much greater than this: data generated by the Ministry of Forestry and the National Statistics Agency Data (BPS) identifies 31,957 villages in forest areas, of which 71% of which are directly dependent on forest resources. Furthermore, the 6 million hectare estimate does not yet take into account the extensive, and mostly unrecorded, customary land management systems in Papua.¹²

In defining CBFM in Indonesia, MFP1's review of literature and policy statements suggest a number of common features including: the role of communities themselves in determining management systems; the clear allocation of rights and responsibilities within these systems; production limits that respect principles of conservation and sustainability; significant benefits for equity and local welfare; and a role for government in facilitating and monitoring arrangements.¹³

4.2 Regulatory arrangements for CBFM

There are three main forms of CBFM in Indonesia spanning customary and formal arrangements within the Forest Estate, and private titled arrangements outside the Forest Estate.

(a) Customary CBFM arrangements within the National Forest Estate

Customary or *adat* CBFM refers to communal forestry and agro-forestry managed by indigenous people, and that vary widely across regions and cultures. As self-regulating and environmental sustainable systems, they only require documentation, formal recognition to benefit from capital and markets.¹⁴

Where these are not already subject to a land title (see section c below), customary forest or *Hutan Adat* is taken to constitute state forest or *Hutan Negara* under Article 1(6) of the Forestry Law 41/1999. Indigenous groups may enjoy usufruct in these areas in accordance with customary law where these do not contradict government law (Article 67). Timber use rights are restricted to production forest and are conditional on an indigenous group constituting a cooperative to obtain a business license (Articles 26 – 29) under the formal arrangements for CBFM described below.

(b) Formal CBFM arrangements within the National Forest Estate

'Formal' CBFM arrangements within the Forest Estate refer to state-sanctioned agreements for community involvement. There are currently four main types, as mandated by Government Regulation PP6/2007 under the Forestry Law 44/1999:

- a. Group or cooperative rights under Community Forestry (*Hutan Kemasyarakatan* or HKM).
- b. Cooperative and individual rights in timber production under Peoples' Timber Plantations (*Hutan Tanaman Rakyat* or HTR).

- c. The delegation of forest management rights to village administrations within the framework of Village Forests (*Hutan Desa* or HD).
- d. Company – community partnership arrangements (*Kemitraan*), under which local communities may gain access to forest resources based on an agreement with the holders of business licenses. Terms of access will vary between agreements.

Table 2 below summarises the scope of each.

(c) Private arrangements outside the National Forest Estate

There are also significant areas of individual/family agro-forestry plots and woodlots outside the registered Forest Estate – at least 1.5 million hectares on Java alone – known as peoples' forest or *Hutan Rakyat*.

The presumption rests on private title as the principle determinant for exclusion of *Hutan Rakyat* from the Forest Estate. *Hutan Rakyat* is, however, a problematic land category.

First, customary, communal arrangements do not qualify as *Hutan Rakyat* until such time as the National Land Agency (BPN) is able to issue titles over *private collective* (as opposed to private individual) rights. No clear legal mandate yet exists for this.

Second, based on 2005 estimates, only 10% of the 120-million hectare Forest Estate has been legally delineated. This leaves 108 million uncertain as to the nature of rights attached – including areas which might otherwise qualify as *Hutan Rakyat* under current rules.¹⁵

Third, although areas currently presumed to constitute *Hutan Rakyat* lie outside the Forest Estate and therefore under the domain of BPN, not all it has been titled. BPN itself has yet to define what *Hutan Rakyat* actually constitutes.

Without better cadastral information, the dividing line between state, customary and private individual rights is inevitably blurred.

Table 2: Formal Arrangements for Locally Controlled Forestry under Government Regulation PP6/2007¹⁶

	Scope	Conditionality	Period	Decision-making authority
Community Forestry or Hutan Kemasyarakatan (HkM)	Group or cooperative use rights over: <ul style="list-style-type: none"> ➤ Timber from <i>planted trees</i> only, in Production Forest areas. ➤ Non-timber forest products. ➤ Environmental services. 	Use subject to separate business license. Not alienable, cannot be collateralized.	35 years	<ul style="list-style-type: none"> ➤ Minister for timber ➤ Governor¹⁷ or Bupati¹⁸ for non-timber
Village Forest or Hutan Desa (HkM)	Village imangement rights over: <ul style="list-style-type: none"> ➤ Timber from both natural and planted forest, in Production Forest areas. ➤ Non-timber forest products. ➤ Environmental services. 	Use subject to separate business license.	Unspecified	<ul style="list-style-type: none"> ➤ Minister for timber ➤ Governor or Bupati for non-timber
People's Forestry Plantation or Hutan Tanaman Rakyat (HTR)	Individual or cooperative use rights in Production Forest, under three different models: <ul style="list-style-type: none"> ➤ Independent, established at own initiative and cost (<i>pola mandiri</i>). ➤ Partnership or joint venture with plantation company (<i>pola kemitraan</i>). ➤ Led by a company under an outgrower scheme (<i>pola developer</i>). 	Use rights granted at outset. Not alienable, only planted trees can use be used for collateral.	60 years	<ul style="list-style-type: none"> ➤ Bupati
Kemitraan	Subject to contractual negotiation with license holder		Unspecified	Subject to contractual negotiation with license holder

4.3 CBFM's potential for sustainable and inclusive economic development

CBFM has traditionally supported the basic subsistence and income generating needs of rural households across Indonesia. It has also proved highly versatile in engaging markets. It now supplies most of the raw material required by the furniture industry (see Box 1 below).

Box 1: Smallholder private woodlots (*Hutan Rakyat*)– already generating USD360 million per year

In Java, 70% of the timber used by Indonesia's furniture industry is supplied by private, smallholder woodlots (*Hutan Rakyat*). A good portion of the *segon* filler for plywood is also supplied by smallholders.

There are between 1 million - 1.5 million hectares of private woodlots on Java alone, which provide people with savings for further education and a pension. In 2005 these woodlots were producing at least 6million m³ of timber per year (Ministry of Forestry¹⁹); more than what large-scale concessions were producing across Indonesia's entire area of Production Forest (25 million hectares). Other sources (IFC 2007) suggest that 8 million m³ a year is a more accurate estimate of what private woodlots are producing.

Depending on species and price, production at 8 million m³ per year can generate at least USD 360 million per year in income for farmers. But because a lot of this income is informal, it may well be missing from GDP figures.

This underpins the economic argument to grant forest farmers legal access to the Forest Estate where at least 25% lacks tree cover for want of clear tenure and management rights. Analysis generated by MFP1 in 2006 suggested that transferring 20% more land (or 10% of existing non-forested land) to small-holder tree crops could generate around USD1.4billion in benefits and 1.6 million jobs.²⁰

As a small- and medium-scale enterprise (SME) sector, CBFM has the potential to generate strong multipliers. This includes both the horizontal links (business clusters), as well as the vertical links (integration into supply chains), that an economy needs to boost productivity. Experience with CBFM SMEs in Nepal suggests a multiplier effect of USD10 for every USD1 invested.²¹ In China, SMEs have led China's expansion in planted forests, and now meet most of the raw material needs of China's pulp and paper industry.

Yet, in spite of its potential to underpin inclusive and sustainable economy development, CBFM gets scant attention. Industrial forest production continues to dominate policy.

4.4 Grasping CBFM as a policy priority

(a) Struggles to enshrine CBFM in law

Current formal arrangements for CBFM within the National Forest Estate are the result of over 20 years' of advocacy by civil society groups in Indonesia – a process that started with efforts to document the many customary systems for land and forest management across Indonesia, and to address often violent conflict between license holders and local communities.

Community Forestry or HKm was the first formal arrangement granting communities the right to sustainably use forest resources for subsistence and income generation under Ministerial Decision (SK Menhutbun) No. 622/Kpts-II/1995, as revised by SK Menhutbun No. 677/Kpts-II/1998 and then SK Menhutbun No. 865/1999.

With the passage of the new Forestry Law 41/1999, this was further modified under SK Menhut No. 31/Kpts-II/2001 to grant community cooperatives 25 – year use rights in areas designated by the Minister, and under a license issued by District Heads (*Bupati*). It also included the possibility of a 3 – 5 year interim permit where cooperatives were not already incorporated.

But the period 1999 through 2005 also witnessed vigorous contestation between central and local government over the authority to issue forest licenses, and over the rights of customary communities in forest resources. New CBFM arrangements were signed into law, including *Izin Pemungutan Hasil Hutan Masyarakat Adat* (IPHH-MA) under Ministerial Decree SK 317/99 for timber harvesting by traditional (*adat*) law communities, as well as *Izin Pemungutan Kayu Masyarakat Adat* (IPKMA) granting equivalent rights under Law 21/2001 on Special Autonomy in Papua Province. But they were then withdrawn under a new implementing regulation PP34/2002 partly on the pretext that they were being abused to facilitate illegal logging.²²

Then in 2004 a Social Forestry policy was introduced under Ministerial Regulation (Permen) No. P.1/2004, but which was unspecific and did not address the status of existing arrangements. It was in this context that an alliance of actors, supported by MFP1, came together to lobby for greater clarity rights in CBFM. This effort drew on site-based learning and facilitated dialogue to influence the development of a new Government Regulation PP6/2007. This replaced PP 34/2002 as the principal implementing regulation under the Forestry Law 41/1999.

PP6/2007 introduced the current set of formal CBFM arrangement including three new schemes in addition to HKm: (i) Village Forests (or Hutan Desa); (ii) People's Timber Plantations (or *Hutan Tanaman Rakyat* – HTR); and, (iii) community – community Partnerships (or *Kemitraan*) (see Table 2 above). Crucially, Hutan Desa included rights to harvest natural forest timber which previous decisions under PP34/2002 appeared to have rescinded. But PP6/2007 did not address the more specific question of the rights of Special Autonomy regions to regulate their own CBFM arrangements.

A number of Ministerial Regulations have since been issued for HKm, Hutan Desa and HTR, under PP6/2007: Permenhut No. P.37/Menhut- II/2007 and Permenhut No. P.18 /Menhut-II/2008 on HKm; Permenhut No. P.49/Menhut-II/2008 on Hutan Desa; as well as Permenhut No. P.23/Menhut-II/2007, Permenhut No. P.5/Menhut-II/2008 and P.55/Menhut-II/2011 on HTR. These establish the scope, conditions and licensing

procedures for each of these CBFM arrangements, including processes for prior determination of suitable sites.

(b) And still going nowhere fast

Notwithstanding the clear legal mandate for CBFM under PP6/2006, progress in implementing any of these arrangements has been slow.

According to analysis presented at the International Conference on Forest Tenure, Governance and Enterprise in Lombok 11 -15 July 2011, the official development target for HKM and Hutan Desa is 500/000 hectares per year. Of this, just 92,252 hectares has been designated by the Ministry of Forest, and just 30,021 hectares has been licensed to community groups or cooperatives. This is equivalent to 0.0008% of the area licensed to large-scale logging and industrial timber plantation concession which span 35.75 million hectares.²³

HTR has made better progress but still falls short of targets. By December 2010 less than 45,000 hectares of HTR plantations had actually been approved, although local district governments have identified almost 640,000 hectares of suitable plots of land. At this rate of progress the scheme will achieve only 120,000 hectares of community-managed plantation by 2016.²⁴ The Ministry had originally planned to establish 5.4 million hectares of HTR under its 2006 – 2025 Long Term Development Plan²⁵ to fill a chronic shortage of raw material for forest industries.²⁶

The implications are serious if more effort is not made to support CBFM. First, the supply of natural forest timber will not be enough to sustain forest industries; deforestation will continue just to supply them. Second, Indonesia is losing out on a major source of job creation and rural development. Third, up to 20 million hectares of degraded land will continue to lie idle, making no productive contribution to the economy.

This is not, however, simply a case of accelerating licensing. Current constraints on CBFM need to be properly understood if more rapid progress is to be made in future.

5. Constraints facing CBFM

5.1 Tenurial uncertainty

As described in section 4.2 above, there are substantial overlaps between state, customary and private individual forms of CBFM across all forest types. This reflects ambiguities in the legal and administrative framework governing rights in forest. The State agrees that forests with rights attached constitute *Hutan Rakyat* (i.e. private forests outside the National Forest Estate). But the lack of comprehensive cadastral data means that *Hutan Rakyat* is hard to determine and just as vulnerable to the State issuing overlapping industrial licenses as land within the Forest Estate.

The Forestry Law 41/1999 also treats areas under the control of traditional law communities (*Hutan Adat*) as merely one category of state forest²⁷ - despite recognition of traditional law in the Basic Agrarian Law (1960) and the fact that the land registration system does not explicitly exclude titling of *private collective* rights. This arguably contradicts the definition of state forest or *Hutan Negara* as that without rights attached.²⁸

The continued survival of customary/private forms of CBFM and the success of formal arrangements under regulation PP6/2007 both rely on resolution of these ambiguities, for two reasons:

- a. First, without transparent processes to map and register rights in line with the legal Forest Delineation Process or *Berita Acara Tata Batas* (BATB), CBFM remains highly vulnerable to land and resource conflict – undermining the incentive for local people to make long-term investments in trees.
- b. Second, if CBFM arrangements are not properly aligned with pre-existing private/customary ownership and decision-making structures, then they run significant risk of instability; possibly even outright rejection by existing community forest managers (see also Section 5.2 below).

5.2 The need to reflect existing best practice

Analysis of sites supported by MFP1 found that the forms of state-sanctioned CBFM take little account of, pre-existing customary practice. Yet customary systems demonstrated better tree cover and forest management because communities remained the main actors and decision makers in determining institutions and systems of management, with clear rights and responsibilities. The analysis concluded that imposed regulatory instruments have proved cumbersome and inappropriate in customary contexts, even weakening pre-existing forms of community organization and excluding the poorest (often landless) households and the informal forest use off which they most depend.²⁹

5.3 High transaction costs

The regulatory framework governing CBFM has evolved into a confusing array of instruments, which vary in terms of their scope, conditionalities and likely economic benefits. Challenges arise at every step - from the point a community makes an application to use an area, right through to point of harvesting. This includes:

- a. Technically demanding application processes which require the support of local NGOs and local government that may not be equipped with the necessary resources to deliver at scale.
- b. The time taken for applications to be processed by local government and by the Ministry of Forestry depending on whether or not CBFM is afforded political priority, and on available budgets.

The case of the *Hutan Jaya Lestari Cooperative* (KHJL) in Southeast Sulawesi (Box 2 below) is illustrative. KHJL's experience highlights the extent to which licensing relies on the political cycle, and on the presence of strong civil society or SME groups capable of maintaining pressure on politicians to deliver.

Box 2: The unpredictability of CBFM licensing - the case of *Koperasi Hutan Jaya Lestari* (KHJL)

The case of Konawe Selatan in Southeast Sulawesi illustrates the extraordinary transactions costs of securing an CBFM license, even after designation of the land by the Ministry of Forestry.

On 10 December 2008 the Ministry of Forestry delineated 9,835 ha of degraded land

within National Forest Estate in Konawe Selatan as eligible for HTR licensing. Once the HTR-eligible area was designated, a local cooperative with a strong track record in certified-sustainable teak production - *Koperasi Hutan Jaya Lestari (KHJL)* - formally applied for the license to manage the HTR area.

KHJL's application for a license had to be approved by the District Head. First, all farmer groups in villages bordering the 9,835 ha area were identified, representing 1,252 families. Next, the cooperative worked to gather all the necessary maps and paperwork required to apply for the HTR license. This included signed letters of support from the Village Heads of all 39 villages. On 1 June 2009 the official application for the license was submitted.

In the first instance the Head of the District issued a license for only 1,000 hectares out of the total 9,835. Only after intense lobbying by the communities involved did the District Head relent and grant 4,639.95 ha to the KHJL cooperative – about half of the area approved by the Ministry of Forestry. The license also covers 14 different parcels spread over 60 kilometres, which makes managing the area very challenging for KHJL

Based on: *Prantio, S. and R. Barr (2010) Community cooperative granted license to manage state teak forest area, in Konawe Selatan District, Indonesia, Tropical Forest Trust.*

Communities under HKm and Hutan Desa arrangements are also weighed down by the requirement to secure business licenses in order to make use of timber, non-timber forest products and environmental services for income generation - in addition to the permits granting them rights in an area; a process that may require the establishment of a separate business entity.

The exception is HTR, where the right to timber is bundled with the principal permit – but even here Ministerial Regulation P.55/Menhut-II/2011 has limited the maximum HTR plot size to 900ha, meaning that communities seeking to manage larger areas will need to apply for multiple permits.

Other constraints include rights to only planted timber under HKm, a low limit to the volume of natural forest timber that communities can harvest under Hutan Desa, and the imposition of local government taxes, over and above the collection of license fees, taxes and levies by central government.³⁰ This does not yet take into account the potential additional transaction costs of mandatory Timber Legality Assurance.

5.4 Not enough government support

In 2011 just USD5.7 million (IDR 51.2 billion) had been allocated for HKm and Hutan Desa in 2011 to establish 500,000 hectares whereas the actual cost may be in the region of USD 27.8 million (IDR 250 billion).³¹

At the same time, up to USD234million³² has been allocated out of the USD2.5 billion Reforestation Fund³³ for the development of 9 million ha of timber plantations including HTR by 2016, under the Forest Development Invest Body or *Pusat Pembiayaan and Pembangunan Hutan (P3H)* - a government financial institution or *Badan Layanan Umum (BLU)* established by the Ministry of Finance in 2007.³⁴

Yet less than 10% of licensed HTR has so far been capitalized by the P3H BLU. The reasons possibly relate to: (a) the terms of financing, and whether these are enough to

meet the true cost of set-up and maintenance; and, (b) the absence of an intermediary institution with the capacity to nurture and aggregate HTR groups at a scale capable of absorbing P3H financing.

5.5 Conservative lending practices and the high cost of capital

CBFMs, like any SMEs in Indonesia, face significant barriers to financial access. Outside of government schemes such as P3H, banks remains reluctant to lend to SMEs for some of the reasons summarized below:

Table 3: Typical barriers to financial access facing SMEs in Indonesia

Transaction costs	<ul style="list-style-type: none"> a) It is expensive to perform due diligence on a large number of small businesses; their records will be less organised and comparable than larger companies. b) Monitoring performance of SMEs is more expensive
Difficulty pricing risk	<ul style="list-style-type: none"> c) The absence of credit risk information on small businesses, some of which may be in specialist areas. Benchmarking and pricing risk becomes difficult. d) Collateral may be hard to value
Lack of deal flow	<ul style="list-style-type: none"> e) A large number of SMEs is needed in specific sectors to allow bank officials to build expertise; it is often hard to build this kind of pipeline.
Weak contract enforcement	<ul style="list-style-type: none"> f) Collateral may be hard to access in the event of default.

Barriers to financial access are compounded by the high cost of capital. Indonesian banks have the highest Net Interest Margins (NIMs) in the region (6% in 2010). This reflects high lending rates, typically of between 12% and 15% a year. The reasons for this include Indonesia's relatively high risk premium given volatile historical inflation, and the relative lack of non-bank financial institutions leaving banks with little competition.³⁵

6. Tackling the constraints facing CBFM

Historically, support to site-based learning and dialogue between civil society and government has nurtured important examples of policy innovation and best practice in tackling legal and institutional constraints. They include the delineation of community-managed areas, community institutional strengthening and efforts to divest management authority to the local level. Just as such support was crucial in driving through CBFM arrangements under PP6/2007 so it remains crucial to tackling the constraints still facing CBFM today.

6.1 Addressing tenurial uncertainty

The recent International Conference on Forest Tenure, Governance and Enterprise in Lombok 11 -15 July 2011 is seen by many as a watershed in terms of the preparedness of Government to resolve one of the most intractable constraints on CBFM in Indonesia.

Crucial here is the emergence of an alliance of up to 18 civil society and research organisations in proposing and engaging the Ministry of Forestry on a roadmap for Tenure Certainty and Justice - *Menuju Kepastian dan Keadilan Tenurial*.³⁶

The Land Tenure Roadmap builds on the following legal precedents as its basis for action:

- a) The implicit recognition of customary rights under the 1945 Constitution.
- b) The Act of People's Assembly TAP/MPR IX/2001 mandating government to address conflicts of law relating to land and resource tenure.³⁷
- c) Provisions under the Basic Agrarian Law 1960 on customary rights, on the equitable distribution of land and forests, and on other social and environmental prerogatives.
- d) The overriding mandate of the Forestry Law 41/1999 to deliver welfare, justice and sustainability.

The Roadmap also draws on previous, successful experiences with community mapping and advocacy for CBFM to propose a number of measures. Amongst others it prioritizes:

- Regulatory reforms to enhance participation, transparency and resourcing in processes to complete delineation of the Forest Estate - the 90% that has not been through the full gazette process.
- Work to resolve the legal status of the over 30,000 villages inside the Forest Estate, through participatory mapping, joint work by the Ministry of Forestry and BPN to then release them from the Forest Estate, and land registration.
- Action to accelerate rights recognition of local and customary communities by local government, including the development of a new law where existing legal frameworks are considered insufficient.
- The development of dedicated, independent institutions for conflict resolution.

These recommendations are not new to the policy debate. But in so far as the Roadmap is owned by a broad coalition and provides the basis for a dialogue hosted by the Ministry of Forestry, it holds some prospect for change.

6.2 Aligning CBFM with existing best practice

Analysis by MFP1 highlighted *Koperasi Hutan Jaya Lestari* in Southeast Sulawesi (see also Box 2) as an example of the importance of institution building, as opposed to simply replicating organizational structures between sites. There, MFP1 found that '*an inclusive and transparent cooperative structure succeeded for two reasons. First, it built on existing community management groups and their efforts to organize at sub-district and district levels. Second, support to community institutional strengthening went hand in hand with credit support and efforts to broker market linkages, creating a strong incentive to collaborate*'.³⁸

Flexibility to adapt to existing structures is especially important under customary arrangements. Yet none of the existing formal arrangements for CBFM – HKM, Hutan Desa, HTR or *Kemitraan* presume recourse to customary institutions. Attempts to adapt these arrangements to better fit with local contexts need to be reviewed. Efforts by the Ministry of Forestry to devolve management authority to watershed-based Forest

Management Units or *Kesatuan Pengelolaan Hutan* (KPH) offer a possible framework to pursue this.

6.3 Simplifying rules, reducing transaction costs

The Land Tenure Roadmap highlights cross-sectoral support and resourcing to meet targets for licensing of HKm, Hutan Desa and HTR, including action to simplify licensing procedures.

Pending a comprehensive review of transaction costs under current CBFM arrangements, one immediate step could be a one-stop licensing procedure, bundling timber rights with the principal license for HKM and Hutan Desa. This would do away with the need to apply again to the Minister for a separate business license.³⁹

It may also be possible to develop an incentive system for local government to accelerate licensing – where this is often slow and unpredictable. The possibilities include performance-based payments by central government, upon delivery of HTR, HKm and Hutan Desa targets for specific regions.

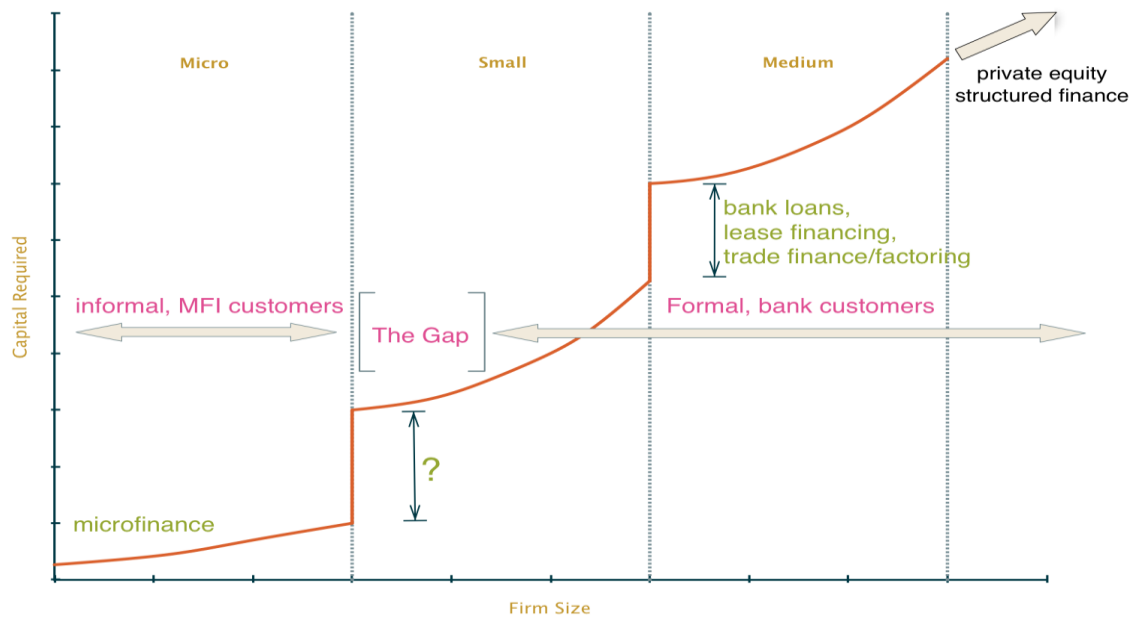
6.4 More effective support networks for CBFM – ‘soft investment’

A step change is needed in the way support is delivered to CBFM to meet even the targets currently set of HKm, Hutan Desa and HTR. Existing NGO networks capable of facilitating community forestry initiatives still lack the critical mass to support that level of expansion.

Also, while NGOs have an important role to play in institutional development and capacity building, many do not themselves have the skills to bring CBFM enterprises up to the required standard of commercial professionalism to engage with capital and markets on their own terms.

Dedicated enterprise support is crucial because scalable CBFM requires more than micro-finance. It also needs finance to flourish as a productive SME sector. Yet in many developing countries nascent SMEs face a critical gap between no longer qualifying for microfinance, and not yet qualifying for support by the formal banking sector. This gap prevents talented and energetic communities and entrepreneurs from getting a foothold, and many slide back into informality and petty trading. This is depicted in Figure 1 below.

Figure 1: The transition from micro-enterprise to SMEs



Making that step change requires the capacity to: meet the needs of supply chains (downstream linkages); organise (communication, delivery times, quality assurance); and capitalise (ability to incur costs of production before payment by customer).

How then do SMEs become bankable? This requires dedicated support, including 'soft' investment by government, donors or other 'angel' investors in (amongst others):

- The capacity of CBFM SMEs to: (a) supply information to banks that is transparent, professional, timely and accurate; (b) offer suitable collateral; and (c) organise with other SMEs in similar or complementary sectors to form clusters.
- Enabling mechanisms for the negotiation of fair and equitable partnerships with financial or product investors (those seeking to build secure supply chains), as well as for third-party monitoring and arbitration.
- Enabling rural infrastructure, including energy, warehousing and transport geared to the needs of SMEs.

All this calls for the role of NGOs to be augmented by specialised Business Development Service Providers (BDSPs) – see Box 4 below – the services of which could be factored into the start-up costs of a CBFM enterprise, without significantly reducing expected rates of return – perhaps by less than 1%.⁴⁰

Box 4: Business Development Service requirements for CBFM

Small-enterprise support is a crucial component of any project designed to scale up CBFM. This is a combination of the conventional Business Development Service Provider (BDSP), but with some additional services and objectives, including work to:

- Identify and prepare cooperatives that wish to start an CBFM business
- Facilitate applications for CBFMs permits (mapping, lobbying local government)
- Deliver organisational development and business planning.
- Mentoring CBFM managers
- Facilitate the formation of clusters and associations, to introduce scale into the CBFM supply chain.
- Introduce CBFMs to investors and lenders, and to assist with the negotiation of financing deal.
- Design benefit sharing and arbitration processes with financial and product investors.
- Facilitate the implementation of the business plan.
- Monitor performance and advise on improvements.

5.5 Structuring the right type of finance for CBFM – ‘hard investment’

Just as community and individual CBFM entrepreneurs have to make the leap from informal micro-enterprise to fully fledged SMEs, so their requirements for finance (or ‘hard investment’) will change; and so will the type of investors they need to seek.

At present, CBFM license holders are unable to collateralise anything other than the trees they have. So, unless a license comes with reasonable standing stock, a CBFM enterprise is unlikely to succeed without initial investment to develop its forest assets. And, unless lending schemes such as the P3H BLU raise their ceilings to better reflect the actual costs of establishment and maintenance,⁴¹ this will require a first injection of public equity in return for a share in future returns.

With that in place, and a growing timber asset base, it may then be possible to attract ‘angel investors’ or ‘venture capitalists’ interested in taking a private equity stake. But where venture capitalists will often want a quick exit (often after just 3-4 years), timber buyers or associations may be willing to provide a long-term equity stake to secure future supplies of raw material. Alternatively, the standing plantation is a more bankable candidate for loans from domestic banks; the standing stock would provide collateral.

If CBFM in Indonesia is to scale to the level expected, then this sequence of investment needs to be anticipated and planned for.

6. The way forward

Failure to address these challenges means that: more and more CBFM sites will fall apart; the nation will lose a potentially significant source of job creation; deforestation will continue apace to fill the current supply gap in timber, fibre and fuel; and, the Ministry of Forestry will lose key local partners in sustainable forest management.

CBFM arrangements under PP6/2007 constitute a major step forward, but as MFP1 concluded of the situation in 2006, any progress remains fragile and requires affirmation: implementing regulations are still cumbersome and more support is needed.

So it remains essential to: address the legal and regulatory constraints on CBFM; to make the ‘soft investments’ necessary for CBFM enterprise to succeed; and to broker the

right types of finance for CBFM to scale. And it remains vital to continue to invest in site-based learning and innovation, in particular to test ways of working with the customary, while simplifying, enabling and devolving the formal.⁴²

In the wake of the Lombok conference and the preparedness of civil society to engage, it is now contingent on the Ministry of Forestry to provide the vision and the leadership to make all this possible.

It is also important that processes such as the EU – Indonesia Voluntary Partnership Agreement on Forest Law Enforcement, Governance and Trade (FLEGT), and related legality assurance procedures, reinforce CBFM by affirming and protecting community rights, and by ensuring that they generate minimum additional transaction costs for small-scale forest managers.

Endnotes

¹ FAOa

² FAOb

³ Right and Resources Initiative.

⁴ World Resources Institute (2010)

⁵ Elson (2011b)

⁶ DNPI (2010)

⁷ Elson (2011b)

⁸ Elson (2011a)

⁹ Harvard (2010)

¹⁰ Elson (2011a)

¹¹ Multi-stakeholder Forestry Programme (2006a)

¹² Ibid.

¹³ Ibid.

¹⁴ Ibid.

¹⁵ Contreras-Hermosilla and Fay (2005)

¹⁶ Based on civil-society analysis prepared for the International Conference on Forest Tenure, Governance and Enterprise in Lombok 11 -15 July 2011

¹⁷ Provincial Head

¹⁸ Kabupaten (District) Head

¹⁹ Ministry of Forestry Press Release (Siaran Pers) S259, 11 May 2006

²⁰ Brown et al (2006)

²¹ DFID-funded Livelihoods and Forestry Programme, Nepal

²² Multi-stakeholder Forestry Programme (2006b)

²³ Muhshi et al (2011)

²⁴ Elson (2011a)

²⁵ Ministry of Forestry (2006)

²⁶ At least 5 million m3 (CIFOR, various reports)

²⁷ Article 5, Law No. 41/99. This is defined by law as state land inside traditional (*adat*) law community areas (Article 1 (6), Law 41/99)

²⁸ Article 1 (4), Law No 41/99

²⁹ Multi-stakeholder Forestry Programme (2006a)

³⁰ Ibid.

³¹ Muhshi et al (2011)

³² IDR 2 trillion

³³ Accrued as a charge on forestry concessions

³⁴ Surat Keputusan Menteri Keuangan No.137/KMK.05/2007 (1 Maret 2007)

³⁵ NIMs are a measure of banks' profitability, calculated as the ratio of net interest income (the difference between interest earned and interest expenses (World Bank, 2010)

³⁶ Safitri et al (2011)

³⁷ TAP/MPR IX/2001 enjoys renewed legal strength as the second most powerful form of legal instrument under the Constitution, with the passage of the new Law 12/ 2011 on the Formulation of Laws and Regulations (Safitri, M. et al 2011)

³⁸ Brown et al (2006)

³⁹ Muhshi et al (2011)

⁴⁰ Elson (2010)

⁴¹ Around USD 30 - 40 per hectare for licensing, training and organization development based on existing best-practice models such as *Koperasi Hutan Jaya Lestari* in Southeast Sulawesi

⁴² Multi-stakeholder Forestry Programme (2006a)

References

Brown et al (2006) *Returning Forest Areas to Community Management: What are the Welfare Gains?* Paper presented to the International Association for the Study of Commons.

Contreras-Hermosilla, A. and C. Fay (2005) *Strengthening Forest Management in Indonesia through Land Tenure Reform: Issues and Framework for Action*. Forest Trends.

DNPI (2010), *Indonesia's greenhouse gas abatement cost curve*, Dewan Nasional Perubuhan Iklim, Jakarta.

Elson, D. (2010) 'Investing in Locally Controlled Forestry: Reviewing the Issues from a Financial Investment Perspective' Background Paper for the Forests Dialogue, Yale University, New Haven.

Elson, D. (2011a) *An Economic Case for Tenure Reform in Indonesia's Forests*, Rights and Resource Institute.

Elson, D. (2011b) *Cost-Benefit Analysis of a Shift to a Low Carbon Economy in the Land Use Sector in Indonesia*, UK Climate Change Unit, British Embassy, Jakarta.

FAO(a) Forest Areas Statistics 2005

<http://www.fao.org/countryprofiles/index.asp?lang=en&iso3=IDN&subj=5>

FAO(b) *Overview of National Forest Product Statistics in South and Southeast Asia*, FAO Corporate Document Repository

<http://www.fao.org/docrep/005/ac778e/AC778E11.htm>

Harvard (2010), Harvard Kennedy School Indonesia Program. *From Reformasi to Institutional Transformation: A Strategic Assessment of Indonesia's Prospects for Growth, Equity and Democratic Governance*

<http://ash.harvard.edu/extension/ash/docs/indonesia.pdf>

IFC (2007) *Market Assessment of SME Sustainable Timber Potential in Indonesia*, PT Mitra Lingkungan, Dataconsult / International Finance Corporation - Program for Eastern Indonesia Assistance (IFC-PENSA), Jakarta

Ministry of Forestry (2006) *Rencana pembangunan jangka panjang kehutanan tahun 2006–2025*, MoF, Jakarta, Indonesia.

Muhshi, M. A., M. Siscawati, M., dan H. Santoso (2011) *The Challenge of Community Based Forest Management after a decade of forestry reform in Indonesia*, International Conference on Forest Tenure, Governance and Enterprise in Lombok 11 -15 July 2011,

Session D: The Role and Perspective of Forest Communities in the Indonesian Reform Process – 12 July, 2011, Lombok.

Multi-stakeholder Forestry Programme (2006a) *Community-based forest management in Indonesia. What is it and how can its potential be harnessed for economic growth and poverty reduction?* A briefing paper for the UK Department for International Development (DFID).

Multi-stakeholder Forestry Programme (2006b) *Whose rule of law? Forest Law Enforcement and Community Logging Rights in Indonesian Papua.* A briefing paper for the UK Department for International Development (DFID).

Rights and Resources Institute, *Data on Statutory Forest Tenure in Forty Countries*, http://www.rightsandresources.org/documents/country_data.php

Safitri, M., M. A. Muhshi, M. Muhajir, M. Shohibuddin, Y. Arizona, M. Sirait, G. Nagara, Andiko, S. Moniaga, H. Berliani, E. Widawati, S. Rakhma Mary, G. Galudra, Suwito, A. Santosa, H. Santoso (2011) *Menuju Kepastian and Keadilan Tenurial*, Civil Society Coalition for Forest Tenure Reform, Jakarta.

World Bank, *Indonesian Economic Quarterly*, June 2010, Jakarta.

World Resources Institute (2010) *Forest Cover Loss in Indonesia, 2000-2005: The Starting Point for the Norwegian Billion to Reduce Deforestation*, <http://www.wri.org/map/forest-cover-loss-indonesia-2000-2005-starting-point-norwegian-billion-reduce-deforestation>