KPK
Komisi Pemberantasan Korupsi

Preventing State Losses in Indonesia's Forestry Sector

An Analysis of Non-tax Forest Revenue Collection and Timber Product Administration

EXECUTIVE SUMMARY

DIREKTORAT PENELITIAN DAN PENGEMBANGAN
KEDEPUTIAN BIDANG PENCEGAHAN
KOMISI PEMBERANTASAN KORUPSI
REPUBLIK INDONESIA

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Executive Summary

Indonesia is home to one of the largest tropical forests in the world, and the vast majority of this forest is administered by the Government through a forest estate that covers over 70 percent of the nation's land area. Based on Article 33 of the Constitution, the Government is responsible for managing Indonesia's natural resources for the maximum benefit of the country and its citizens. When forests within the state-administered forest estate are harvested for commercial timber production, the Government collects various royalties, levies, and fees based on reported timber production, collectively known as PNBP non-tax revenues. If timber is not reported and/or royalty fees are not paid, then the economic value from these forests is captured by private interests and not harnessed for the benefit of the Government and, by extension, the people of Indonesia.

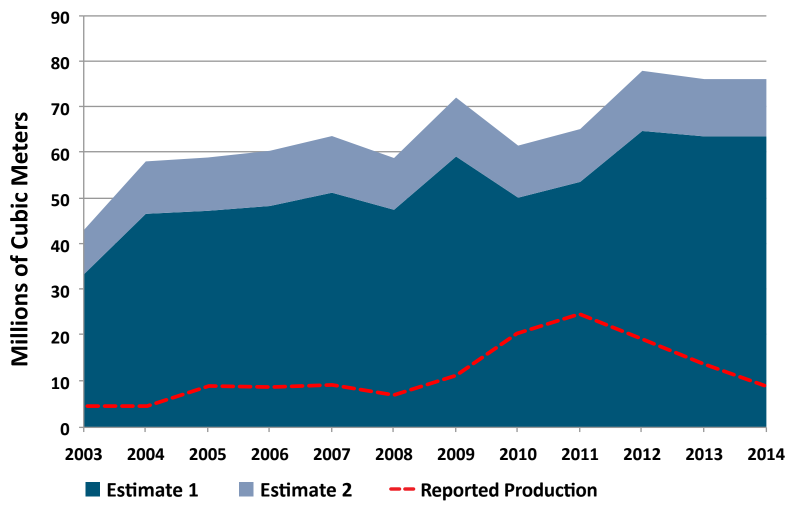
The President has encouraged KPK to calculate state losses in the forestry sector, examine the systems that allow such losses to occur, and coordinate efforts to fix these systems and improve revenue collection. This study estimates the loss of state assets from unreported timber production and the under-collection of non-tax forestry revenues during the period 2003–2014. The study analyzes the weaknesses in the Government's administrative systems for overseeing timber production and for collecting non-tax forest revenues, and then provides recommendations for how these systems should be strengthened and revenue collection improved. This study will provide the basis for KPK to coordinate an inter-ministerial reform initiative to improve state administration of Indonesia's forests for the benefit of the country.

Estimating the volume of unreported timber production

According to official statistics, commercial wood production from Indonesia's natural forests during 2003–2014 totaled **143.7 million cubic meters** (m^3). Of this, 60.7 million m^3 was harvested through selective logging by HPH concession-holders; and 83.0 million m^3 was produced through land-clearing for the development of industrial forestry plantations, oil palm and rubber estates, and mining.

The study finds that the reported production is far less than the volumes of timber that are actually harvested from Indonesia's natural forests. Results from the study's quantitative model indicate that actual timber production during 2003–2014 totaled between **630.1 million m³** and **772.8 million m³**. These figures suggest that Ministry statistics captured only 19–23% of total timber production during the study period, while 77–81% was unreported.

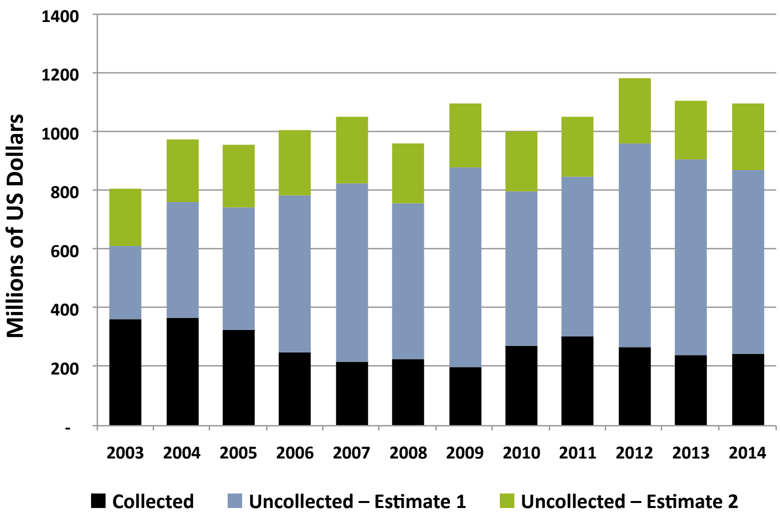
Estimates of actual timber production from natural forests in Indonesia, 2003–2014



State losses from uncollected PNBP forest revenues

The Government collected **US$ 3.26 billion** (Rp. 31.0 trillion) in combined receipts from the Reforestation Fund *(Dana Reboisasi, DR)* and the natural forest component of the Forest Resource Provision *(Provisi Sumber Daya Hutan, PSDH)* between 2003 and 2014. However, the study's model calculates the Government should have collected aggregate revenues of between **US$ 9.73 billion and US$ 12.25 billion** (Rp. 93,9 and 118,0 trillion) from the DR and PSDH during 2003–2014. These figures indicate that state losses from under-collection of DR and PSDH revenues totaled between **US$ 6.47 billion and US$ 8.98 billion** (Rp. 62,8 and 86,9 trillion) – or, on average, between **US$ 539 million and US$ 749 million** per year – during the 12-year study period.

Estimates of state losses from under-collection of DR and PSDH revenues, 2003–2014

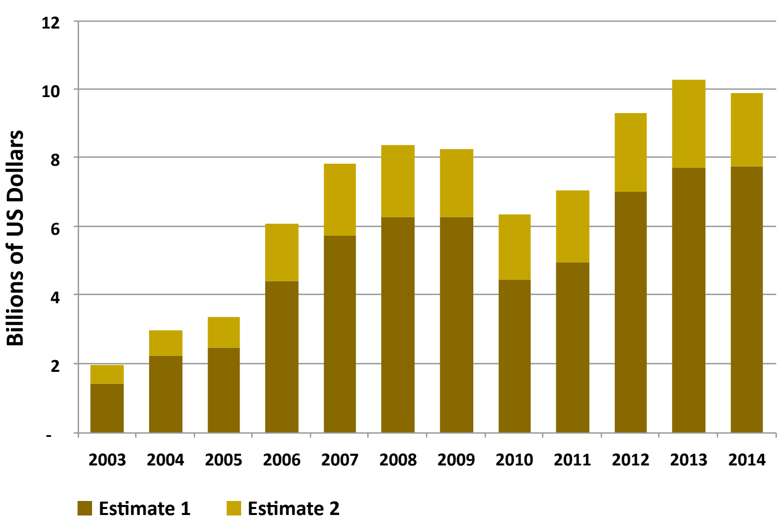


State losses from the commercial value of unreported timber

The study also calculates the commercial value of unreported timber production, since the trees in the Government-administered forest estate are a state asset. When licensed timber production is reported and the DR and PSDH are paid according to the production report, the timber then becomes a private asset. Under Indonesian law, timber that is not reported becomes a stolen state asset, and money generated through the sale of this timber can be considered both state losses and proceeds of a crime.

Aggregate state losses from the domestic commercial value of unreported timber production during this period amount to between **$60.7 billion and US$ 81.4 billion (Rp. 598,0 and 799,3 trillion),** or between **US$ 5.0 billion and US$ 6.8 billion** per year. The value of annual losses climbed sharply through the study period, rising from a low of US$ 1.4–1.9 billion in 2003 to a high of US$ 7.7–9.9 billion in 2013. This dramatic increase was driven by the rapid expansion of commercial land-clearing and a significant rise in both domestic and international log prices. According to ITTO data, Indonesia's domestic prices for *Meranti* rose from US$ 77 per m^3 in 2003 to US$ 244 per m^3 in 2013.

Commercial value of unreported timber production in Indonesia, 2003–2014



Weaknesses in the administration of timber production and PNBP collection

Such large volumes of unreported timber production and state loss have resulted from significant weaknesses in the Government's timber production administration and revenue collection systems. Major weaknesses identified by the study include:

1. Management of data on reported timber production and non-tax revenue collection is insufficient for holding companies accountable to meet fiscal obligations to the state.
2. Existing internal controls are inadequate for ensuring the integrity of systems for timber administration and collection of non-tax revenues.
3. External accountability mechanism are inadequate for preventing state losses from the manipulation of information on timber production and non-tax revenue collection.
4. Ineffective law enforcement in the forestry sector has resulted in a 'shadow economy' for illegally harvested timber.
5. Forest royalty rates have been set at levels that facilitate only limited capture of economic rents by the Government and provide implicit incentives for unsustainable forest management.
6. Non-tax revenue collection and timber product administration is not directed at the broader public interest.

Roadmap for fixing the system

Within the context of Indonesia's National Movement for the Protection of Natural Resources, KPK will be working together with the Ministry of Environment and Forestry (KLHK), the Ministry of Finance, the Supreme Audit Agency (BPK) and other institutions to address the weaknesses identified by this study. KPK now calls on these institutions to formulate a joint action plan aimed at strengthening the administration of timber production and increasing non-tax revenue in the forestry sector. These efforts are critically needed to ensure that Indonesia's forests are managed more accountably and the benefits they generate are shared more equitably.

At minimum, this action plan must include:

1. A comprehensive audit of non-tax forest revenues conducted by BPK.
2. All timber production from state-administered forests reported on KLHK's online and publicly-accessible SI-PUHH system, including official inventory, planning, production, non-tax revenue payment, and mill timber consumption reports.
3. Spatial monitoring tools used to verify forest inventory for all land-clearing areas prior to harvest.
4. Routine coordination between KLHK and Ministry of Finance to plan empirically-based and accountable non-tax revenue targets.
5. Enhanced law enforcement actions, including use of anti-money laundering laws, against all actors identified to be underreporting timber production and/or evading payments of forest royalties.
6. High-level review of the structure and rates of royalty fees to determine how the Government will collect full economic rent on timber production.
7. KPK along with counterparts from KLHK and Ministry of Finance publishes publicly-available annual performance reports of non-tax forest revenue collection.