

EXECUTIVE SUMMARY

“Starting now, the Indonesian Nation is determined to make every effort to manage forests sustainably, prioritizing in the short term the protection and rehabilitation of forest resources for the greatest possible prosperity and justice for the people.” This National Forest Statement, developed through four years of consultation, is the perfect starting point for this report. Through this statement, the Government of Indonesia recognizes a gap between vision and achievement, between potential and performance – and resolves to address the gap through positive action to sustain Indonesia’s forests for the good of all.

Today, Indonesia is striving to make progress on a wide range of development challenges: growth, vulnerability to poverty, decentralization, democratization, equity, conflict and justice. Forest management issues touch on each of these major challenges, as well as every segment of Indonesian civil society. Improved forest management must be based on improved governance generally, including transparency, accountability, and equity. Improved sustainability means more attention to the balance between economic growth, poverty alleviation and environmental benefits generated from forests. The principles of good governance and sustainability, in fact, are embedded in Indonesia’s legal framework for forest management and serve as the organizing framework for this report. Yet, there is a gap between written law and rule of law -- and a gap between benefit and equitable distribution. Indonesia’s Biodiversity Strategic Action Plan of 2003 recognizes that “so far, only a minority of Indonesians enjoy the benefits from the use of forests and biodiversity, while the costs of degradation are borne by the majority.”

The Government of Indonesia (GOI) is striving to bridge these gaps in increasing collaboration with forest sector stakeholders. This report is about how donors and development agencies can assist the Government, civil society, the private sector, as well as the poor and disadvantaged, to take steps toward more sustainable and equitable forest governance and management.

Purpose of Strategic Options Paper

This document, *Sustaining Economic Growth, Rural Livelihoods, and Environmental Benefits: Strategic Options for Forest Assistance in Indonesia*, provides an overview and synthesis of issues in Indonesia’s forestry sector and a framework for understanding and identifying potential options for policy and project interventions. It is intended as a reference and guide for analysts and stakeholders of forestry issues in Indonesia. It is particularly directed at donor governments, research organizations, and development assistance agencies that may be planning programs or activities in economic development, poverty reduction, forestry, rural development, land, and governance.

A companion document, *Sustaining Indonesia’s Forests: Strategy for the World Bank, 2006-2009* provides a framework for the Bank to clarify its objectives, as well as the timing, resource implications, and risks of deepening engagement with the Indonesian Government and stakeholders. The strategy also lays a foundation for mainstreaming forestry issues into the Country Assistance Strategy and broader policy reform interventions. The strategy is a road map for internal discussion and decision-making, but also offers the public some insights on the World Bank’s views.

Forest Management Issues are Development Issues

Forests are a national asset, a global public good, and central to the livelihoods of 10 million of the poorest 36 million Indonesians. Forest governance touches fundamental issues of asset management and democratic choice in nearly every district in Indonesia – two-thirds of the country’s land. Forestry policy reform processes address real issues that are central to the rural economy and the poor, build voice and accountability, and engage governments and people in building good governance practices.

Forest loss undermines rural livelihoods, ecosystem services and Indonesia’s ability to meet poverty alleviation goals. Weak forest governance damages the investment climate, rural economic potential, and Indonesia’s competitiveness and international reputation. Forest crime exacerbates problems of budget and fiscal balance, and diverts public revenues that could be better spent on poverty reduction and development goals. Fires used for forest and land clearing cause health and transport problems both in Indonesia and neighboring countries, release greenhouse gases into the atmosphere, and undermine Indonesia’s regional standing.

As Indonesia moves from transition to stabilization and growth, there is a tremendous opportunity to help the government find new ways of managing forest areas in partnership with local communities, contributing to democracy, justice, equity, and ultimately, rural sector investment, jobs and growth.

Opportunities for Improvement are Growing

Indonesia is in a dynamic governance transition. Attitudes and roles among government, business and civil society are changing. Central government is re-orienting basic natural resource policies; local governments are becoming more responsive and accountable; and civil society and business are repositioning for more constructive relationships. More empowered poor communities and local governments are engaging in constructive dialogue, building trust and reducing conflict. The vulnerability of the poor is being reduced, their livelihoods are more diversified, and women’s voices are being empowered.

The rules of the game are changing, too. Policy-making is more consultative and transparent; local governments and parliaments are better informed about forest and land issues; companies are more aware of the importance of partnerships and community engagement; and civil society groups are more engaged in development processes, government operations, and resource allocation decisions. All these institutions are building skills in managing democratic processes.

In the Ministry of Forestry, change has been evolutionary, not revolutionary. Yet, changes in attitudes, senior management, and behavior have gradually overcome the rigid approaches of the past. At some levels, there is still reluctance to embrace reform and participatory governance processes. Still, new opportunities for significant engagement appear regularly. There have been such rapid changes in the last year or two that it is difficult to remain current in a document such as this. In the past year, the GOI has finalized the National Forest Statement, providing a multi-stakeholder vision for the future of forest management. The Ministry of Forestry has also developed both a medium term planning document and a long term plan for the future. These plans include frank assessments of the issues in the forestry sector and concrete plans for addressing them through actions within the Ministry’s sphere of influence. The Ministry and the many forest sector stakeholders have also convened the 4th National Forestry Congress, which

agreed to create and elect a National Forestry Council, creating new pathways for more democratic and accountable forest management.

Forest issues are also being addressed by key agencies beyond the Ministry of Forestry. The President has issued a decree demanding cooperation among law enforcement and customs agencies to combat illegal logging. The Coordinating Minister for Politics, Law and Security has convened inter-departmental groups to work on issues of forest law enforcement, forest crime and trade. Indonesia's Financial Intelligence Unit has taken steps to track and report on suspicious forest sector financial transactions and the banking sector has taken steps to improve accountability and environmental due diligence among forest sector lenders.

Much Work Remains, Donors Can Help

Over one billion dollars has been invested in development assistance to Indonesian forestry in the past two decades by more than 40 donors. Yet, management and governance continue to be weak and forests continue to be lost. The European Commission and the Ministry of Forestry convened a workshop in March 2006 to learn from this experience. The participants concluded that donor efforts over the long-term contributed to a process of capacity building in both the Government and civil society organizations, although specific investments were sometimes unsuccessful in achieving short term objectives. Based partly on donor assistance efforts, laws, policies, institutions and, above all, motivated and competent people are now in place and the opportunities for progress are considerable. The major conclusion of the workshop was that "continued donor support to forestry is essential and the likelihood of successful outcomes is higher now than at any time in the past."

Participants agreed that measures to improve forest governance can lead to improved governance generally, that more needs to be done to build decentralized forest management capacity, that rights and access issues need to be addressed in the long term, and that the corporate sector will be important and influential. Regarding forest loss and degradation and the forest land transition, the group agreed that it is more important to improve management of existing protected forest areas, rather than to strive to protect all remaining forests. Donor engagement should assist in achieving an orderly and rational pattern of forest cover, rather than resisting change.

Donors have helped build the understanding, commitment, human resources, legal framework and institutions that are now poised to yield improvements in practice and management. There are now major opportunities for achieving improved management and a wide range of tested and successful aid delivery mechanisms. Donor governments now have the opportunity to sustain and expand on these past achievements, by focusing on an entire landscape of entry points in governance, decentralization, poverty alleviation, and institution building, rather than thinking of forestry as only a sectoral issue. Engagement should go beyond the forestry sector and encourage cross-sectoral links, balance support for decentralized structures, promote the role of civil society, and involve legislatures, at national and regional levels.

Entry Points for Forest Assistance in Indonesia

This section provides a summary of key options that donors and development agencies can pursue with the Government of Indonesia and forest sector stakeholders to improve forest governance and management, promote economic growth with greater equity, improve livelihoods of the poor and marginalized, and protect environmental services and biodiversity values. These should be viewed as entry points for engagement on issues of poverty, democratization, decentralization,

investment climate, public finance, justice, transparency and accountability. While broad governance and democratization reforms continue to create new opportunities, these options recognize that practical progress can still be made in many areas, even within the usual forest and land classification framework in place today. Equally, there are opportunities to work “outside the forestry box,” with a wide range of Government agencies that influence forest sector incentives and management, as well as civil society organizations.

Options for Improving Governance and Management (See Chapter 3). To close the gap between governance rhetoric and results, there are opportunities to work on dialogue processes, transparency, rule of law, decentralization and conflict resolution. Development agencies could consider activities in the following areas.

- **Dialogue.** It is important to continue support for ongoing efforts to build and extend national dialogue processes on forestry sector rights, rules, roles, and responsibilities. New institutions, such as networks of civil society organizations and the new National Forestry Council (with representatives from government, business, communities, NGOs and universities), provide important entry points for expanding and deepening dialogue, while also increasing trust and transparency. Dialogue toward improved governance will have to be built upon good representation of the voices of the poorest and most marginalized groups, including women and ethnic minorities.
- **Transparency.** Assistance efforts could support the Ministry of Forestry and other key agencies in implementing an action agenda on transparency in data and decision-making, initiated at a national event in February 2006. This program will include development, implementation, and widespread use of the Forest Monitoring and Assessment System (FOMAS); a comprehensive disclosure policy; and effective disclosure mechanisms so that the public and affected stakeholders can access information effectively.
- **Law Enforcement.** Assistance efforts could support inter-agency coordination efforts to combat forest crime under the Coordinating Minister for Politics, Law and Security. These efforts could include building capacity, strengthening national laws, and setting precedents through prosecution of high profile forest crimes, including financial crimes and money laundering. The Ministry of Forestry’s “11 Step Program to Combat Illegal Logging” provides a framework and activities that can be supported. Civil society organizations’ efforts to use media and investigation to expose corruption and crime are also important contributions to governance improvement. There is also a need to enforce rules that help to reduce the negative impacts of *legal* logging, reduce land clearing by fire, and improve the payment and collection of fees and taxes. Also, increased efforts to curb the illegal wildlife trade could be recommended.
- **Decentralization.** There is a great need to strengthen district and provincial forestry agencies in concert with the central government. Options could begin with institutional development support to facilitate implementation and interpretation of roles and responsibilities for district and provincial governments in management, implementation, licensing, and monitoring activities on forest lands in line with the legislative changes of 2004. Opportunities to work at the regional level must be tempered with the need to have reasonably consistent approaches and overall conformance with national laws. Institutional and structural changes at the center may also be needed to increase responsiveness to the decentralization of some responsibilities to regional governments.

- **Conflict Resolution.** There is a great need to develop mechanisms to prevent and resolve forest and land use conflicts. This will need to be a national and broad-based effort, similar to that envisioned under the process and framework established in MPR Decree No. 9 of 2001. Although there are many local and civil society-led conflict resolution initiatives that could be supported, it may also be useful to study the recent experience with the MPR Decree process. Lessons learned could usefully inform new legislative initiatives, such as the proposed Law on Natural Resources Management or proposed revisions to the Basic Agrarian Law.

As part of the governance dialogue, one recurrent theme will be land use, allocation and access. On the areas of the state forest zone lacking trees, there are good economic arguments for allowing wider use and management rights to a more diverse set of user groups. Some reallocation could encourage investment in land and forest resources, increase productivity and earnings, improve rural welfare and relieve poverty, and contribute to reducing conflict.

Options for Increasing Sustainable Economic Development (See Chapter 4). To bridge the gap between immediate benefit and longer term sustainability and to achieve more equitable sharing of benefits, there are opportunities to support industry restructuring initiatives, policy harmonization, and greater investment in community access for livelihood security. Indonesia's 55 million hectares of forested lands allocated for economic uses (i.e., production and conversion) are a high priority because of the large area of forested land and because of their importance both for community livelihoods and commercial forestry.

- **Industry Restructuring.** Among the highest priorities is support for the Ministry of Forestry's industrial restructuring and revitalization strategy, which includes acceleration of plantation development, retooling of existing mills, and greater sharing of benefits through promotion of small and medium enterprises and community involvement. Possible interventions could support planting more trees for production/timber uses; improving productivity of existing and new plantations; and promoting community-company partnerships to open new kinds of benefit sharing, as well as new lands, for timber production. Efforts to promote timber planting and production should be wary of approaches that rely on excessive regulation, subsidies, soft loans or unbalanced power relations, rather than markets.
- **Financial Due Diligence and Forestry Debt Settlement.** Industry restructuring requires financing. In the financial sector, improved institutions and practices are needed to increase due diligence and transparency and to learn lessons from past debt management experience during Indonesia's financial crisis. Settling the issue of forestry debt remains a critical piece of the sectoral restructuring process. Greater harmonization of policies across sectors will be necessary to prevent mixed signals or inappropriate incentives for timber growers, wood processors, and exporters. Financing decisions should be based not only on financial viability, but also on responsible assessment of potential environmental and social costs.
- **Positive and Negative Incentives.** Greater competitiveness and market responsiveness will only be achieved if better incentives (improved policy enabling conditions) are provided for long term investment in and stewardship of forests and production facilities. More positive incentives for private sector forest managers (e.g., regulatory relief for law-abiding and certified firms) are needed along with greater disincentives for poor

management as law enforcement activities increase. Positive incentives must go hand-in-hand with forest law enforcement and governance initiatives to increase the costs of non-compliance. For example, more costly consequences are needed to reduce the use of fire for land conversion and to encourage existing plantation companies (mostly linked to pulp mills) to comply with existing timber self-sufficiency requirements.

- **Downstream Processing.** Appropriate value-adding activities with future potential include furniture, moldings, building components, and more labor intensive downstream processing into finished products for consumer markets, including non-timber forest products and handicrafts made from them. In the rattan industry, donors and NGOs have supported small enterprise development and provided marketing assistance, and business management skills for producers' cooperatives. Success in this direction will require work on underlying enabling conditions to allow access arrangements that benefit the poor and encourage investment by communities and small enterprises.
- **Benefit Sharing.** To improve communities' ability to share in the benefits of commercial forestry, development agencies could continue to promote innovative licensing arrangements, local land use agreements, small enterprises, partnerships and a more pro-poor policy environment. There are opportunities to support legislative and regulatory changes that allow greater access to forest resources for communities and marginalized groups. As noted below, there are also important opportunities to support community based enterprises, agroforestry, and traditional livelihood activities.

Options for Improving Livelihoods and Alleviating Poverty (See Chapter 5). To narrow the gap between rich forests and poor people, progress can be made by recognizing that forest lands are part of the rural economy and people's livelihoods. Policies could better address the linkages among community livelihoods, investments, markets and infrastructure, rather than viewing forests as raw material for export-oriented processing. Indonesia's large areas of non-forested and degraded lands (28 million hectares are deforested within Production and Conversion Forest Areas) are a high priority for intervention because of the vast area involved, the rapid rate of degradation, and the relatively unmanaged status of much of this land. This is also one of the most logical and cost-effective places to begin to think about rationalizing the forest estate and allowing more equitable and pro-poor access and activities.

- **Forests for People.** Progress can be made by recognizing that communities, *adat* groups, smallholders and the forest-dependent poor are legitimate forest sector actors and stakeholders who should have rights, roles, responsibilities and returns in balance with other users of forest land. To make economic development of forested lands more equitable and oriented toward producing livelihood benefits and alleviating poverty, some options could be considered for focusing on smallholder needs and investments. Development agencies could support and encourage community forestry and small and medium sized enterprises, perhaps including aspects of the Ministry of Forestry's Social Forestry program. This could involve providing incentives, clearer rights and technical assistance to community groups or cooperatives. Community-based and small enterprises have the advantage of creating more jobs than large, capital-intensive firms.
- **More Options on Degraded Lands.** Community forestry, social forestry, agroforestry, non-timber forest products, cooperatives and small and medium enterprises can be promoted in areas where the forest is degraded, but still has productive potential.

Degraded and deforested conversion lands are a logical entry point to a broader discussion about access and tenure arrangements, beginning with the least forestry-important lands. With good demonstrations and appropriate management policies and practices, ultimately, these lands could be moved into more productive uses, with some targeting to benefit the poor and vulnerable groups. This approach must proceed with caution to avoid perverse incentives, such as the incentive to clear forested land to establish an ownership claim.

- **Multiple Uses, Multiple Benefits.** Non-forested Conservation and Protection lands account for less than 10 million ha of land. Since it is not possible to return these lands to a fully natural state, options could be considered for managing these lands for production of environmental services and watershed protection functions in a mixed mosaic of cropping and cover patterns with community involvement. Rehabilitation efforts could be focused on steep slopes and riparian zones. While these activities are primarily aimed at preserving or restoring environmental functions, they also can produce economic opportunities for smallholders and the poor, if properly designed.
- **Extension and Services for the Poor.** Beyond access to forests and land, communities and poor people need skills, credit, infrastructure and markets. Communities may need technical assistance and capacity building to improve their ability to take advantage of emerging opportunities for utilizing forest land. Intermediate service providing organizations could help people to understand rules of access, develop appropriate organizational structures, improve business skills and identify opportunities. These services would lower the transactions costs for communities to engage in forest management and utilization activities at smaller scale with greater flexibility.

Options for Protecting Environmental Services and Biodiversity (See Chapter 6). To bridge the gap between current benefit and future stewardship, there are opportunities for improvements in local collaborative management of watershed protection forests, preservation of critical habitats, and improvements in financing of both protected areas and environmental service delivery. Forested Conservation and Protection areas represent nearly 40 million hectares, so it is a high priority to ensure that these lands can produce the services for which they are allocated (assuming that they are allocated properly for high conservation value or steep, vulnerable slopes). Environmental services and biodiversity benefits are not generally highly valued in land use decisions. The economic consequences of inadequate care are beginning to be recognized, however: the costs of replacement of forests and natural resources are vastly higher than the costs of stewardship and prevention, as Indonesia has seen in the cases of forest fires, landslides and drought. Options for engagement and support include the following.

- **Collaborative Land Use Plans and Agreements.** Activities in forested watershed protection areas could include establishing rules and partnerships (within the decentralization framework) for managing larger forest landscapes for environmental service protection and production. Land use plans developed at local level in collaboration with local users are often able to identify and allow compatible economic activities, such as community based agroforestry, on selected land that is not too steep or fragile. Community based negotiations and agreements are creating important opportunities for maintaining environmental service functions, while allowing multiple uses and traditional uses of watershed areas. Environmental service payments based on water supply values or carbon storage can offer partial compensation for better

stewardship practices in upland areas. These initiatives need institutional development and policy support at both national and regional level.

- **Protected Landscapes.** Efforts to preserve watershed and protection forests will also protect habitat for Indonesia's rich biodiversity, especially if integrated with the Protected Areas system. Efforts to protect "high conservation value forests" within production forest areas are also important, especially where these are part of critical wildlife corridors or within the range of endangered or endemic species. Initiatives are needed to protect remaining valuable and threatened lowland forest areas.
- **Protected Areas Management and Financing.** Biodiversity conservation also requires a focused and sustained effort to strengthen both management effectiveness and resources for Indonesia's protected areas system. On management effectiveness, there are increasing opportunities to build on local collaborative management approaches, through partnerships with local governments and communities to sustain and protect the essential functions and values of protected areas. On financing – both for conservation and for watershed protection – there are increasing opportunities to develop sustainable financing options at the national level through fiscal mechanisms, at the protected area level through user fees, and at the local level through environmental service payments, where possible, based on water or carbon storage values. Some improvements in management of conservation and protection areas can be achieved by evaluating the fiscal and policy incentives for local governments under the decentralization framework. The three GOI departments most responsible for Protected Areas and biodiversity conservation – Ministries of Forestry, Marine Affairs and Fisheries, and Environment – have recently proposed a coordinated effort to improve financing for conservation.
- **Public Awareness and Education.** There is increasing awareness of environmental and conservation needs in the Indonesian media and the general public. More innovative outreach, environmental education and awareness programs can be supported, including through schools and religious institutions. Many examples and partners exist for supporting this work, but more comprehensive and long term investments are needed to change attitudes and practices.

Next Steps. The final chapter of this report develops a framework and provides a more detailed range of options for creating an intervention strategy over the medium term. Development agencies can promote dialogue toward agreement on directions for the forestry sector, indeed for all natural resource management concerns. New institutions are emerging as useful partners in such engagement. Development assistance agencies can also readily support ongoing initiatives that have solid support from both the GOI and civil society organizations, including the transparency initiative and the growing campaign against forest crime. The Ministry of Forestry's medium-term and long-term planning documents are good starting points for discussion of actions and possible partnerships. The priorities and options mentioned in this report are already largely consistent with the Government's plans.