



A Review of Ministry of Trade Regulation No. 15/2020

SAFEGUARDING INDONESIA'S FOREST PRODUCT EXPORTS

Prof. Dr. Ahmad Maryudi
Prof. Dr. Hariadi Kartodihardjo, MS
Ir. Haryanto R. Putro, MS

EXECUTIVE SUMMARY

The Ministry of Trade of the Republic of Indonesia recently issued Minister of Trade Regulation (*Permendag*) No. 15/2020, regarding provisions for forest product exports. This new regulation stipulates that V-Legal checks, which verify the legality of all timber products, are no longer required for exports. By removing timber legality verification requirements, the regulation aims to streamline the export process for forest products and thereby boost trade. However, there is considerable risk that this change would instead lead to the opposite of the desired impact. *Permendag* 15/2020 risks diminishing Indonesian timber export performance, which has benefited from consistent growth since V-Legal requirements were put in place. *Permendag* 15/2020 will likely be considered a breach of the Voluntary Partnership Agreement for Forest Law Enforcement, Governance and Trade (FLEGT-VPA) that Indonesia has signed with the European Union (EU). This brings the risk of trade suspensions or costly due diligence processes because timber products from Indonesia will no longer be eligible for FLEGT Licenses. In Article 10 of the FLEGT-VPA, Indonesia and the EU agreed on the implementation of a timber legality assurance system

covering both Indonesia's domestic timber market and all international exports. By violating this internationally-recognised agreement, negative perceptions of Indonesia will likely emerge across many key markets for tropical timber, where demands for legality verification have become increasingly important: the United States, South Korea, Australia, Japan and, soon, China. Indonesia is at risk of losing its export markets for tropical timber, and lagging even further behind its competitors.

Therefore, the Ministry of Trade should postpone and revise *Permendag* 15/2020. The revised regulation should be reissued alongside a complementary Regulation of the Minister of Environment and Forestry, which would maintain V-Legal requirements for forest product exports. At the same time, the mechanisms and procedures of the Timber Legality Assurance System (SVLK) should be improved, by streamlining processes for low-risk timber sourced from community forests and timber plantations, as well as for certain industries procuring supplies from such low-risk sources.

PREFACE

Indonesia has committed to eliminating illegal logging and producing solely legally-verified forest products, thanks to the creation of the SVLK system and V-Legal checks on timber exports. This commitment has gained support from the EU, through the FLEGT Voluntary Partnership Agreement with Indonesia. In addition to the EU market, Article 10 of the VPA describes Indonesia's commitment to guarantee timber legality assurance for products traded on both domestic and non-EU export markets. The FLEGT-VPA has been ratified by the Government of Indonesia through Presidential Regulation No. 21/2014.

The newly issued Minister of Trade Regulation No. 15/2020, which will be effective as of 27 May 2020, no longer specifies that forest product exports will require V-Legal documentation, despite this being enshrined in the current regulation: *Permendag* No. 84/M-DAG/PER/12/2016. The 'Considerations' (*Menimbang*) section of the new regulation states that the *Permendag* has been issued to provide businesses with greater certainty in order to streamline forest product exports. This is presented as a follow up action after a series of ministerial coordination meetings regarding economic affairs. It concludes that licensing for forest product exports must be simplified.

"Considering: that to provide business certainty in order to achieve effective forest product exports and to follow up on the decisions of the coordinating meetings for economic affairs, it is necessary to simplify the forest product export licensing process" (Permendag 15/2020)

The exclusion of V-Legal documentation from forest product export requirements and the lack of reference to Indonesia's timber legality assurance system in this Permendag has triggered a series of negative reactions from both national and international audiences. These include statements of concern from the timber trade associations in Indonesia's key tropical timber market countries (the EU, UK, US and Australia), from friendly country governments (the EU, UK, US and Japan), many domestic timber associations, and civil society networks in Indonesia and abroad. Considering these reactions and evidence available, this brief describes a number of risks that will emerge should Permendag 15/2020 enter into force.

RISK OF DECLINING EXPORT PERFORMANCE FOR INDONESIAN FOREST PRODUCTS

Permendag No. 15/2020 could potentially repeat the mistakes made five years ago through Permendag No. 89/2015, which also attempted to exclude timber legality assurance and V-Legal requirements for several timber products. At the time, Permendag No.89/2015 was strongly rejected by several stakeholder communities² and resulted in reputational damage that hampered Indonesia's timber export performance³. Data from the Indonesian Statistics Office (BPS) and the Timber Legality Information System (SILK) recorded a drop in Indonesian timber exports of USD 600 million, or 5.8%, during the period of January to June 2016 – immediately after the enactment of Permendag No.89/2015. The stipulations of Permendag 15/2020 will potentially repeat this same experience, and could well undermine forest product exports again by creating uncertainty in key markets, undermining the credibility of Indonesia's legal timber products and damaging its reputation in tackling illegal logging.

The EU has raised concerns that the issuance of Permendag 15/2020 could lead to a trade dispute. The potential outcomes range from trade suspension to the termination of the FLEGT-VPA. This loss of trust from one of Indonesia's biggest timber product markets contrasts sharply with the stated objective of improving the effectiveness of forest product exports in Permendag 15/2020 (as stated in the 'Considerations' section). This move also contradicts statements made by the Ministry of Trade, through its Directorate General of National Export Development,

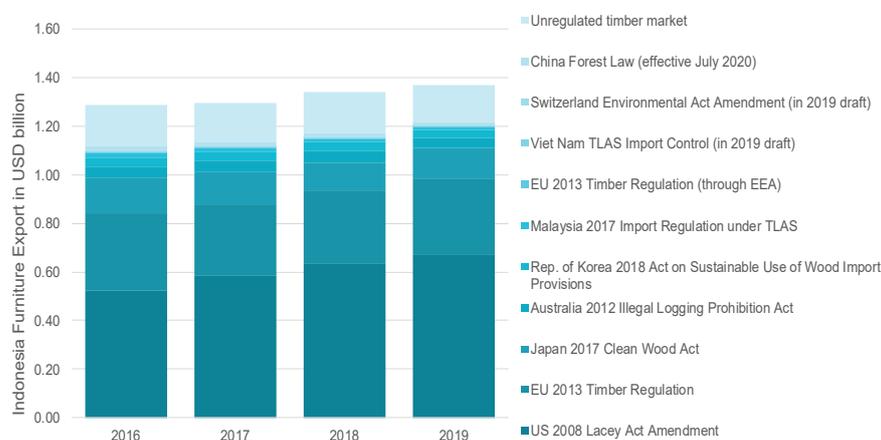
during the 2017 Interzum Exhibition in Koln, Germany - one of the world's most reputable exhibitions for furniture and interior design. At that time, Directorate General Arlinda stated that he looked forward to the success of Indonesian timber products in Europe and stated that, "Judging from market characteristics that care profoundly about environmental sustainability, FLEGT licensing will boost the competitiveness of our timber products, especially in European markets."⁴

The implementation of both SVLK and V-Legal has been effective in securing the trust of global markets for Indonesian timber products. SILK data in 2019 showed that Indonesian timber product exports increased from USD 6.05 billion in 2013 to USD 11.6 billion by the end of 2019. Additionally, the number of export destination countries grew from 155 in 2013 to 190 by 2019. If Permendag No. 15/2020 is adopted, Indonesia will face the risk of not only losing its export markets in the EU - which in 2019 alone amounted to USD 1.179 billion⁵ – but also in other key markets, including the USA, South Korea, Japan and Australia, which are known as well-regulated markets requiring legality proof for all imported timber products. China, a key market for Indonesian timber products, has recently amended its Forestry Law to incorporate a ban on the purchasing, processing and transportation of illegally sourced timber (Article 65). This regulation will be put into effect by mid-2020.

RISK OF LOSING ACCESS TO INTERNATIONAL TIMBER MARKETS

Today, the world's timber market is increasingly requiring legality assurance. As many as 70% of Indonesia's timber export markets require evidence of timber legality assurance, while 80% of the country's furniture products are exported to these regulated markets (see graphic). The issuance of Permendag 15/2020 poses the risk of drastically shrinking Indonesia's market share, and forcing a shift to rely more on markets which accommodate illegally sourced timber. It could also weaken the bargaining position of Indonesian businesses, as their timber products would be considered high-risk.

More than 80% of Indonesian furniture export markets require legality verification



2. <https://www.greeners.co/berita/penolakan-permendag-nomor-89-tahun-2015-kemendag-akan-kaji-berbagai-masukan/>

3. <https://www.beritasatu.com/ekonomi/353500/ganggu-kinerja-ekspor-permendag-89-tahun-2015-perlu-direvisi>

4. http://dipen.kemendag.go.id/app_frontend/AcceptedRsses/view/591bc4f4-2560-4f62-ac66-0435c0a83502

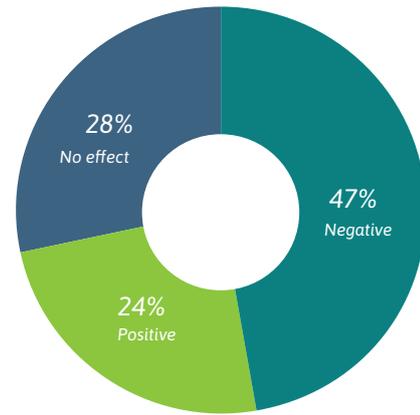
5. <https://www.flegtim.eu/index.php/vpa-countries/indonesia>

THE END OF INDONESIA'S GREEN LANE TO THE EU TIMBER MARKET

Another economic implication of Permendag 15/2020 and the failure to comply with FLEGT-VPA commitments would be the termination of the EU Customs Green Lane for Indonesian timber products. Businesses will be required to pass due diligence verification as regulated by the EU Timber Regulation (EUTR). It is true that the cost of due diligence is charged to importers, but this will indirectly affect the pricing of timber products from Indonesian exporters. The Global Timber Forum⁶ estimated that the average cost of due diligence could reach €33,083, or approximately IDR 540 million per exporting company per year. This high expense will be a burden for Indonesian business operators, compared to the expense of current SVLK certification for SMEs, which totals between IDR 15 million and IDR 25 million over an effective period of six years, subject to an assessment every two years.

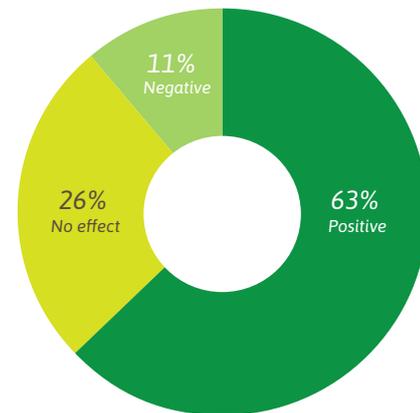
A quick online survey conducted by Sebijak Institute, with 151 respondents from forest product exporters from primary and secondary industries and non-producing exporters, showed that only 24% of the respondents believe Permendag 15/2020 will generate a positive impact on their export performance. On the other hand, 63% stated that SVLK and V-Legal documentation has positively benefited their sale performance since 2013. The results of this survey reveal that Permendag No.15/2020 has led to uncertainties among business operators along with genuine concerns that they may lose their export markets. Once more, this runs counter to the purpose of Permendag 15/2020, which aims to increase business certainty and boost forest product exports.

THE IMPACT OF PERMENDAG 15/2020 ON TIMBER EXPORT SALES



Graphic 1. THE IMPACT OF PERMENDAG 15/2020 ON TIMBER EXPORT SALES

THE IMPACT OF SVLK AND V-LEGAL ON TIMBER EXPORT SALES



Graphic 2. THE IMPACT OF SVLK AND V-LEGAL ON TIMBER EXPORT SALES

JEOPARDISING THE COMPETITIVE ADVANTAGE OF INDONESIA TIMBER PRODUCTS

Competition among legal timber exporting countries is becoming increasingly intense. There are 14 other countries currently working towards FLEGT licencing status⁷, including Vietnam: Indonesia's biggest competitor for wooden furniture. Vietnam is rapidly approaching the final stages of implementing its own VPA and is currently preparing to adopt FLEGT licensing across its timber exports. Indonesia, which has enjoyed global recognition as a pioneer in setting high standards for timber trade, as the first FLEGT-licensed tropical timber country in the world, now faces the risk of losing its global reputation. Should it be promulgated, Permendag 15/2020 will indirectly enable our competitors, such as Vietnam, to take advantage of the situation. Indonesia currently holds approximately 36% of the tropical timber global market, ranking as the second biggest tropical timber product exporter after Vietnam⁸.

Furthermore, Permendag No.15/2020 will potentially squander the competitive advantage of Indonesian timber products amidst a period of contracting tropical timber markets, due to the global recession triggered by the Covid-19 pandemic. Instead of boosting Indonesian trade and forest product exports, Permendag 15/2020 has the potential to reduce the country's income due to the difficulties that Indonesian timber products will face in competing in markets that require legality assurance. In turn, this could make business operators' revenues suffer and have a negative impact on the welfare of forest industry workers, including SME/MSMEs and craftsmen in furniture industry – all of which are currently significant sources of employment. Thus, the Permendag issued to mitigate the impacts of the Covid-19 pandemic may instead exacerbate the damage done during this period, particularly among the communities that rely most on the timber sector in Indonesia.

6. Global Timber Forum. 2015. *Supplier and Consumer Due Diligence Analysis*.

7. <http://www.euflegt.efi.int/es/vpa>

8. FLEGT-VPA Partners in EU Timber Trade 2018. *Report by Independent Market Monitoring (IMM)*, November 2019



RECOMMENDATION: SEEK AN ALTERNATIVE POLICY OPTION

Permendag 15/2020 aims to increase business certainty in order to boost the effectiveness of forest product exports, as well as streamlining licensing for timber exports. The Instagram account of the Trade Ministry, @kemendag, stated on 20 March 2020 that this change forms part of an export regulation relaxation strategy, following a directive from the President during a closed meeting session on 10 September 2019. However, in view of the risk of multi-dimensional negative impacts - reputational, political, economic, legal and technical - we recommend that the Government should reconsider the promulgation of Permendag 15/2020 and review the following options:

1. It is recommended that the Government does not breach the FLEGT-VPA or opt out of the Agreement as a consequence of Permendag 15/2020, which is intended only a short-term measure for dealing with the Covid-19 pandemic. The Government should formulate policy measures in order to re-assert the Nation's commitment to the bilateral agreement, which was established on a voluntary basis. Communication, consultation and dialogue with the EU should be maintained regarding trade policies between the two parties. Possibilities could be explored for negotiations regarding amendments to the FLEGT-VPA to facilitate new trade opportunities for Indonesian timber products in the EU and to support the simplification of SVLK process in order to generate more benefits for small-scale industries and community forests.
2. It is advised that the Trade Ministry postpones the pronouncement of Permendag 15/2020 until complementary measures for ensuring the credibility and continuation of the SVLK are agreed. In this case, the Ministry of Environment and Forestry is recommended to immediately establish a Ministerial Regulation (PermenLHK) that ensures V-Legal documentation and proof of timber legality as a requirement for all forest product exports. This PermenLHK will serve as a complementary regulation and, together with Permendag 15/2020, will form a complete set of legal measures that address forest product export issues.
3. Regarding the economic turbulence that Indonesia finds itself in in the wake of the Covid-19 pandemic, it is advised that the Government explores other policy incentives instead of abandoning V-Legal documentation, which has been widely accepted among domestic parties as well as both international communities and global timber markets. The Government needs to identify existing problems and establish a policy plan and instruments to resolve the negative impacts of SVLK implementation on certain industries, through streamlining the process, improving capacity and reducing certification costs.
4. While maintaining the integrity of the system, SVLK stakeholders should further develop simplified procedures for raw materials sourced from low-risk timber species, such as wood from community forests, and simplified requirements for certain industries whose timber supplies come from such low-risk sources. This will support the growth of timber product processing industries, particularly SMEs, and sustain the growth of community forests - which generate sustainable economic, social and environmental benefits. ***

Main Reference

The Regulatory Change of Legality Verification Requirements for Exports of Wood Products - A Rapid Impact Assessment.
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SEBIJAK Institute, the Faculty of Forestry,
Gadjah Mada University
Jalan Agro No.1 Bulaksumur, Yogyakarta
Email : sebijak-institute.fkt@ugm.ac.id
Website : <https://sebijak.fkt.ugm.ac.id>



SEBIJAK INSTITUTE
Faculty of Forestry
University of Gadjah Mada