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# Sustaining Indonesia's Forests

## Strategy for the World Bank

### 2006-2009



**BANK DUNIA** | THE WORLD BANK

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**SUSTAINING INDONESIA'S FORESTS:  
STRATEGY FOR THE WORLD BANK, 2006-2009**



**BANK DUNIA | THE WORLD BANK**



Forest and Karst Formation, Halmahera, North Maluku

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Forest flowers, Leuser Ecosystem, Aceh  
Forest Tree, Papua

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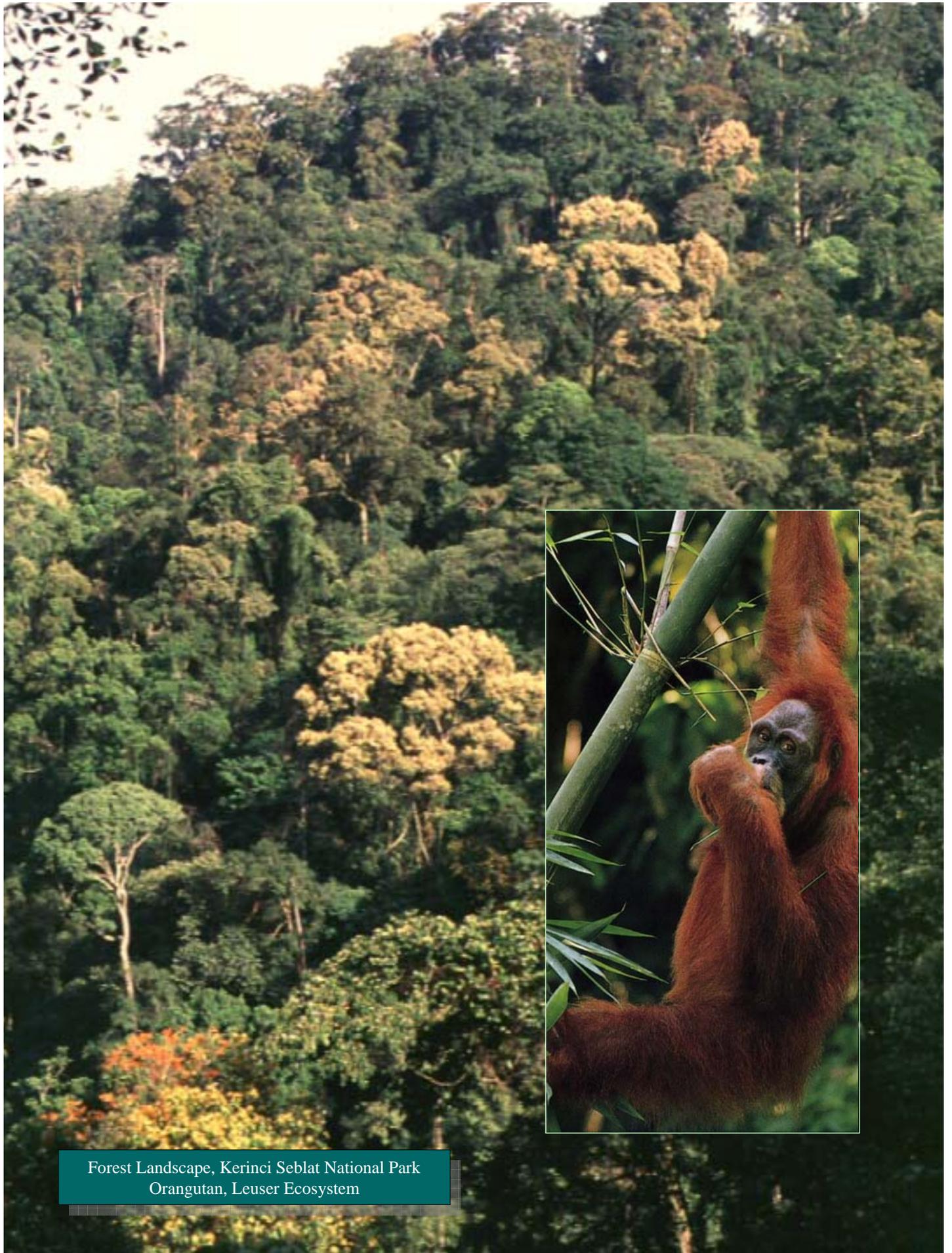
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## LIST OF ACRONYMS

Acronym	Description
AAA	Analytical and Advisory Assistance
ADB	Asian Development Bank
AMAN	Indigenous Peoples Alliance of Indonesia
AMDAL	Environmental Impact Assessment
AML	Anti Money Laundering
APHI	<i>Asosiasi Pengusahaan Hutan Indonesia</i> / Indonesian Forest Concessionaires Association
APKI	<i>Asosiasi Pulp dan Kertas Indonesia</i> / Indonesian Pulp and Paper Association
Apkindo	<i>Asosiasi Panel Kayu Indonesia</i> / Indonesian Wood Panel Association
BAPLAN	Department of Forestry Directorate General for Planning
BAPPEDA	Regional Development Planning Board
BAPPENAS	<i>Badan Perencanaan Pembangunan Nasional</i> / National Development Planning Agency
BPK	Dept of Forestry Directorate General for Forest Production Development & Management
BPN	<i>Badan Pertanahan Nasional</i> / National Land Agency
BPS	<i>Biro Pusat Statistik</i> / Central Statistics Board
CAS	Country Assistance Strategy
CBD	Convention on Biodiversity
CBFM	Community-Based Forest Management
CDD	Community-Driven Development
CDM	Clean Development Mechanism
CGI	Consultative Group on Indonesia
CGIF	Consultative Group on Indonesian Forestry
CI	Conservation International
CIDA	Canadian International Development Agency
CIFOR	Center for International Forestry Research
Concession	An area of natural forest designated for selective harvest under an HPH license
COREMAP	Coral Reef Rehabilitation and Management Project
CSO	Civil society organization
DFE	Donor Forum on Forestry
DFID	Department for International Development (UK)
DG	Directorate General / <i>Direktorat Jendral</i>
Dinas	Provincial or district agency reporting to governor, mayor or <i>bupati</i>
DirJen	<i>Direktorat Jendral</i> / Directorate General, DG
DPR	<i>Dewan Perwakilan Rakyat</i> / People's National Assembly
DR	<i>Dana Reboisasi</i> / Reforestation Funds
EC	European Commission
ECIFP	European Commission Indonesian Forest Programme
EIA	Environmental Investigation Agency
<i>Era Reformasi</i>	Era of policy reform since the end of New Order Government, mid-1998
Estate Crops	Agricultural crops and tree grown on plantations
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FEATI	Farmer Empowerment through Agricultural Technology and Information
FKKM	<i>Forum Komunikasi Kehutanan Masyarakat</i> / Communication Forum on People's Forestry
FLEG	Forest Law Enforcement and Governance
FLEGT	Forest Law Enforcement, Governance & Trade
FOMAS	Indonesia National Forest Monitoring and Assessment System
FWI	Forest Watch Indonesia
GDP	Gross domestic product
GEF	Global Environment Facility

## LIST OF ACRONYMS (CONT.)

Acronym	Description
GIS	Geographic Information System
GOI	Government of Indonesia
GTZ	<i>Deutsche Gesellschaft für Technische Zusammenarbeit, GmbH</i> / German Development Agency
HPH	<i>Hak Pengusahaan Hutan</i> / Forest Concession Right or license for natural production forest
HTI	<i>Hutan Tanaman Industri</i> / Industrial timber plantation
IBRA	Indonesia Bank Restructuring Agency
IBSAP	Indonesian Biodiversity Strategic Action Plan
ICDP	Integrated Conservation and Development Project
ICRAF	International Center for Research on Agroforestry, also known as World Agroforestry Center
IFC-PENSA	IFC Program for Eastern Indonesian SME Assistance
ILGRIP	Initiatives for Local Governance Reform Project
IMF	International Monetary Fund
IPB	<i>Institut Pertanian Bogor</i> / Bogor Agricultural Institute
IPK	<i>Izin Pemanfaatan Kayu</i> / Wood utilization permit
ITTO	International Tropical Timber Organization
JICA	Japanese International Cooperation Agency
<i>Kabupaten</i>	District, political subdivision within a province
KDP	Kecamatan Development Project
Kehati	<i>Yayasan Keanekaragaman Hayati</i> / National Biodiversity Foundation
LEI	<i>Lembaga Ekolabel Indonesia</i> / Indonesia Ecolabeling Institute
LMPDP	Land Management and Policy Development Project
m <sup>3</sup>	Cubic meters
MFP	Multistakeholder Forestry Programme
MLH	Ministry of Environment
MOU	Memorandum of Understanding
MPR	<i>Majelis Permusyawaratan Rakyat</i> / People's Consultative Assembly
NFP	National Forestry Program
NGO	Non-governmental Organization
NRM	Natural Resources Management
OECD	Organisation for Economic Cooperation and Development
PA	Protected Area
PEMDA	<i>Pemerintah Daerah</i> /Local Government
PERDA	Peraturan Daerah / Local Government Regulation
PP	<i>Peraturan Pemerintah</i> (Government Regulation)
PPATK	<i>Pusat Pelaporan dan Analisis Transaksi Keuangan</i> / Center for Analysis of Financial Transactions
PRSP	Poverty Reduction Strategy Paper
PSDH	<i>Provisi Sumber Daya Hutan</i> / Forestry Taxes
RePPProT	Regional Physical Planning Programme for Transmigration
Rp.	Rupiah (Indonesian currency)
SFM	Sustainable Forest Management
TGHK	<i>Tata Guna Hutan Kesepakatan</i> / Forest Land-Use Plan, 1982
TNC	The Nature Conservancy
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
WALHI	<i>Wahana Lingkungan Hidup Indonesia</i> / The Indonesian Environmental Forum
WCS	Wildlife Conservation Society
WISMP	Water Resources and Irrigation Sector Management Program
WRI	World Resources Institute
WWF	World Wide Fund for Nature



Forest Landscape, Kerinci Seblat National Park  
Orangutan, Leuser Ecosystem

## EXECUTIVE SUMMARY

Indonesia's forests are a concern of the World Bank because of their social, economic and environmental importance and the Bank's interest in promoting high quality economic growth and lasting poverty reduction. Indonesia has the world's third largest area of tropical forest and globally significant biodiversity. Forest governance is a tangible entry point for engagement on decentralization and democracy, conflict and injustice, poverty and vulnerability. Forest issues touch every segment of civil society, including communities, *adat* (customary) groups, women, religious groups, NGOs and watchdog groups, large and small business, unions, educational institutions, the media, local governments and parliaments, law enforcement agencies and the central government. Forest policy is an entry point for engagement on every key development theme: rural development, economic growth, poverty, anti-corruption, democracy, conflict, and decentralization.

Forests are a national asset, a global public good, and central to the livelihoods of many of the 36 million Indonesians living in poverty. Forest governance touches fundamental issues of asset management and democratic choice in nearly every district in Indonesia – 70% of the country's land. Forest 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 together.

Indonesia's forest resources are not contributing as they should to poverty reduction, economic and social development, and environmental sustainability. Instead, forest areas are threatened with degradation, fragmentation and destruction. A quarter of the "state forest area" lacks tree cover. In recent years, Indonesia has been losing up to 2 million hectares annually, mainly due to illegal cutting and land conversion fueled by excess processing capacity and a lack of effective management and law enforcement. Forest loss undermines rural livelihoods, ecosystem services and Indonesia's ability to meet poverty alleviation goals. Poor 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. 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, rural sector investment, jobs and growth.

**Why Now?** Indonesia's forest sector has been in crisis for some time, yet many observers and analysts believe the "continued donor support to forestry is essential and the likelihood of successful outcomes is higher now than at any time in the past" (EC 2006). This is because democratization and decentralization of government are creating positive political pressures. Indonesia's popularly elected President is committed to good governance and fighting corruption. Attitudes and roles among government, big business and civil society are changing. Central policy-making is more consultative and transparent. Local governments are becoming more responsive and accountable. Civil society and business are repositioning for more constructive relationships. In the Department of Forestry, a gradual process of evolution and reform is resulting in new opportunities for meaningful engagement.

**Forest Sector Objectives.** Indonesian legislation establishes clear goals for the forest sector: economic output, equitable distribution of benefits to improve people's welfare, watershed protection, and conservation. These goals are consistent with the Bank's policy on forest management, which is built on three interrelated objectives: harnessing the potential of forests to reduce poverty, integrating forests in sustainable economic development, and protecting global forest values. However, Indonesia is not succeeding in meeting these goals, especially in the areas of sustainability and equity. The Bank's objective is to assist the Government of Indonesia (GOI) to deliver on its own stated forest management goals and commitments and to promote wider policy dialogue among forest sector stakeholders.

This country forestry strategy draws on the Bank's *Country Assistance Strategy (CAS) (2004-7)*, the *East Asia Pacific Region Forestry Strategy (2005)*, the *Forests Strategy and Operational Policy (2004)* and the *Environment Strategy (2001)*. Both the country and forestry strategies emphasize the importance of improving governance in Indonesia. The *Environment Strategy* recognizes environmental resources as an essential foundation for growth, encourages stakeholder participation, and envisions distributing the gains of development more equitably and sustainably. In the forest sector, the Bank aims to improve management and governance to support governments and communities in sustainable forest management, conservation, development and dialogue. The Bank can best assist Indonesia in two main ways: first, supporting improved policies and management practices to help Indonesia deliver on its own goals and commitments; and second, promoting greater dialogue among stakeholders to ensure that the goals of forest management are clear, realistic, and widely agreed upon.

While Indonesia's legal framework is reasonable, its policies and management practices are often not consistent with that framework. Good management must be built on accountable institutions, rule of law, and sound policies. Steps toward more structured forest management will help to create the predictability, transparency, and accountability needed for improved governance. There are opportunities to focus on augmenting existing reforms, supporting champions, providing analytical support for new approaches, and clarifying the policy and regulatory environment. Reforms are needed to: make information transparently available; support GOI-led initiatives on illegal logging and industrial restructuring; protect existing conservation areas; clarify roles, responsibilities, and incentives under decentralization; and support dialogue and partnerships. At the

same time, there is a need to recognize that past approaches have not been effective and that new ways of doing business are needed to achieve a new level of engagement and effectiveness.

#### **Purpose of Strategy**

*Sustaining Indonesia's Forests: Strategy for the World Bank, 2006-2009* provides a framework for the Bank to clarify its goals in the sector, as well as the timing, resource implications, and risks of deepening engagement. The strategy also lays a foundation for mainstreaming forestry issues into the CAS and broader policy reform interventions. The strategy is a road map for internal discussion and decision-making, but also can offer some insights to the public on the Bank's views.

A companion technical 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 objectives and identifying potential options for policy and project interventions.

**Strategy.** The World Bank proposes to scale up and mainstream assistance in Indonesia's forestry sector. Scaling up means increasing engagement to catalyze action on key entry points of transparency, rule of law and industrial restructuring. Dialogue will also be scaled up on community-based resource management, land rights and access, and their contribution to growth and equity. Scaling up also means building on existing models and successes to develop more comprehensive programs, both in conservation and collaborative management at the community level. Mainstreaming means building environmental protection and forestry issues into activities with actors outside the forestry box, including enforcement authorities, customs, trade, local governments, communities, and into larger scale macro-policy interventions focusing on public revenue losses, corruption, and poverty alleviation.

This course of action is consistent with the directions in the CAS, as well as the forestry and environmental strategies. If there is reasonable progress in key areas, there is the potential in the medium term to increase the level of engagement with additional activities and financing instruments, including grant funding, development policy lending and other operations. To check progress on indicators, it would be appropriate to evaluate performance in the forestry sector in the context of the new CAS preparation in mid-2007. The document illustrates activities and funding instruments that could be employed for higher levels of engagement, if performance and commitment on reform initiatives are sustained.

During the remainder of 2006, the Bank will focus on building systems to improve transparency, accountability, rule of law and governance, and evaluating the feasibility of greater involvement in industrial restructuring – specifically on the supply side by promoting plantation development with community involvement. In May 2006, the Bank began implementation of a large scale forest conservation project in Aceh financed by the Multi Donor Fund for Aceh and Nias. The Bank will also initiate studies that will help to bring forestry and environmental issues into broader macro-economic and policy reform discussions, outside the forestry sector, including in finance and debt, poverty, and land policy. In FY07, the Bank will strive to mainstream environment and conservation issues into community-driven development efforts. The Bank will continue policy dialogue and analysis to contribute to efforts with donor and civil society partners to increase the space for discussion of forest land use and access issues, especially in the context of poverty alleviation and small business investment and diversification.

This strategic increase in the level of engagement is a natural progression from past steps, can be accommodated with resources already identified, and lays the foundation for deeper engagement, as progress is achieved. This path allows the Bank to build on current opportunities and validate progress, before committing to major investment. This strategy would also employ a wider range of Bank resources to work on cross-cutting governance and policy issues that affect the environment, natural resources, and forest lands.

Although the sector still faces many challenges and distortions, there is sufficient background information, understanding of the issues and objectives, and clear entry points to proceed with incremental actions to build systems to improve accountability and governance in the near term. However, there is still a need for the Bank to carefully consider its goals in the forestry sector, the timing and resource implications, and the risks of deepening engagement. This strategy document provides a framework for discussing and addressing these issues.



Forest Landscape, Halmahera, North Maluku

## RINGKASAN EKSEKUTIF

Hutan Indonesia menjadi perhatian Bank Dunia karena pentingnya hutan dilihat dari sisi sosial, ekonomi dan lingkungan hidup dan minat Bank Dunia untuk mendorong pertumbuhan ekonomi yang berkualitas tinggi dan menurunkan kemiskinan. Indonesia memiliki hutan tropis terluas ketiga di dunia dan secara global memiliki kekayaan keanekaragaman hayati yang tinggi. Tata pemerintahan kehutanan merupakan titik awal yang jelas bagi keterlibatan dan kerja sama kaitannya dengan desentralisasi dan demokrasi, konflik dan ketidak-adilan, kemiskinan dan kerentanan. Isu kehutanan menyentuh setiap lapisan dari masyarakat madani (*civil society*), termasuk komunitas, kelompok adat, kelompok perempuan, kelompok agama, LSM dan kelompok “*watchdog*”, usaha bisnis besar dan kecil, serikat kerja, lembaga pendidikan, media, pemerintah daerah dan parlemen (DPRD), lembaga penegak hukum dan pemerintah pusat. Kebijakan kehutanan merupakan titik awal bagi keterlibatan dan kerja sama pada setiap tema utama pembangunan: pembangunan pedesaan, pertumbuhan ekonomi, kemiskinan, anti-korupsi, demokrasi, konflik dan desentralisasi.

Hutan merupakan aset nasional, komoditi masyarakat global, dan sumber penghidupan utama bagi 36 juta masyarakat Indonesia yang hidup dalam kemiskinan. Tata pemerintahan kehutanan menyentuh isu dasar pengelolaan aset dan pilihan demokratis di hampir setiap wilayah kabupaten/kota di Indonesia- yang menempati 70% dari daratan Indonesia. Proses reformasi kebijakan kehutanan mengangkat isu nyata yang penting bagi ekonomi pedesaan dan rakyat miskin, membangun suara keterlibatan dan akuntabilitas, dan mempertemukan pemerintah dan masyarakat dalam membangun bersama praktek tata pemerintahan yang baik.

Sumberdaya hutan Indonesia saat ini belum memberikan kontribusi yang selayaknya bagi penurunan kemiskinan, pembangunan ekonomi dan sosial, dan keberlanjutan lingkungan hidup. Sebaliknya, wilayah hutan mendapatkan berbagai ancaman seperti degradasi, fragmentasi dan kerusakan. Seperempat wilayah hutan negara mengalami kekurangan tutupan pohon. Pada tahun belakangan ini, Indonesia telah kehilangan hutan sampai 2 juta hektar per tahun, terutama akibat pembalakan liar dan konversi lahan yang dipicu oleh kelebihan kapasitas pengolahan dan ketidak-efektifan dalam pengelolaan dan penegakan hukum. Hilangnya hutan merusak sumber penghidupan masyarakat desa, jasa lingkungan dan mengurangi kemampuan Indonesia dalam mencapai sasaran penurunan kemiskinan. Tata pemerintahan kehutanan yang lemah menghambat iklim investasi, ekonomi pedesaan yang potensial, kemampuan daya saing Indonesia dan reputasi internasional. Kejahatan hutan menambah permasalahan keseimbangan anggaran belanja dan fiskal, dan mengalihkan pendapatan publik yang secara lebih baik dapat digunakan untuk penurunan kemiskinan dan sasaran pembangunan. Sementara Indonesia bergerak dari masa transisi menuju stabilisasi dan pertumbuhan, ada kesempatan besar untuk membantu pemerintah dalam menemukan cara baru dalam mengelola wilayah hutan dengan cara bermitra dengan komunitas lokal, berkontribusi pada demokrasi, keadilan, kesetaraan, investasi sektor pedesaan, kesempatan kerja dan pertumbuhan.

**Mengapa Sekarang?** Sudah lama sektor kehutanan Indonesia mengalami krisis, sampai kini banyak pemerhati dan pakar percaya “kelanjutan dukungan donor untuk bidang kehutanan

merupakan hal yang penting dan dirasa bahwa kemungkinan kesuksesan hasil saat ini lebih tinggi dibandingkan masa lalu” (EC 2006). Hal ini karena adanya demokratisasi dan desentralisasi dari pemerintah yang telah menciptakan tekanan politik yang positif. Presiden Indonesia terpilih mendukung sepenuhnya tata pemerintahan yang baik dan pemberantasan korupsi. Ada perubahan sikap dan peran diantara aparat pemerintah, pengusaha besar dan masyarakat madani. Pembuatan kebijakan oleh pemerintah pusat lebih transparan dan berdasarkan konsultasi. Pemerintah daerah menjadi lebih responsif dan bertanggungjawab. Masyarakat madani dan para pelaku bisnis menata cara pandang mereka bagi hubungan yang lebih konstruktif. Di dalam Departemen Kehutanan, proses evolusi dan reformasi yang dilakukan berangsur-angsur menghasilkan kesempatan baru untuk keterlibatan dan kerja sama yang berarti.

**Tujuan Sektor Kehutanan.** Peraturan perundangan Indonesia memiliki sasaran yang jelas untuk sektor kehutanan: hasil ekonomi, distribusi keuntungan yang adil untuk meningkatkan kesejahteraan rakyat, perlindungan Daerah Aliran Sungai (DAS), dan konservasi. Sasaran-sasaran ini sejalan dengan kebijakan Bank Dunia pada pengelolaan hutan, yang dibangun berdasarkan tiga tujuan yang saling terkait: memanfaatkan potensi hutan untuk menurunkan kemiskinan, mengintegrasikan kehutanan pada pembangunan ekonomi yang berkelanjutan, dan melindungi nilai global hutan. Namun, Indonesia belum berhasil mencapai sasaran-sasaran ini, terutama dari sisi keberlanjutan dan keadilan. Tujuan Bank Dunia adalah membantu Pemerintah Indonesia untuk menghasilkan sasaran dan komitmen pengelolaan hutannya sendiri dan mempromosikan dialog kebijakan yang lebih luas diantara para pemangku kepentingan di sektor kehutanan.

Strategy kehutanan ini didasarkan pada *Country Assistance Strategy (CAS) (2004-7)*; *the East Asia Pacific Region Forestry Strategy (2005)*; *the Forests Strategy and Operational Policy (2004)* and the *Environment Strategy (2001)*. Kedua strategi, baik “country” maupun strategi kehutanan, menekankan pada pentingnya perbaikan tata pemerintahan di Indonesia. Strategy Lingkungan Hidup mengenal sumberdaya lingkungan sebagai dasar pokok untuk pertumbuhan, mendorong partisipasi pemangku kepentingan, dan melihat kedepan pada pembagian keuntungan pembangunan yang lebih adil dan lestari. Di sektor kehutanan, Bank Dunia bermaksud untuk meningkatkan pengelolaan dan tata pemerintahan dalam rangka mendukung pemerintah dan komunitas dalam pengelolaan hutan yang berkelanjutan, konservasi, pembangunan dan dialog. Bank Dunia dapat membantu Indonesia melalui dua cara: Pertama, mendukung perbaikan kebijakan dan pengelolaan untuk membantu Indonesia menentukan sasaran dan komitmennya sendiri; dan kedua, mempromosikan adanya dialog yang lebih luas diantara para pemangku kepentingan untuk menjamin sasaran dari pengelolaan kehutanan yang jelas, realistis, dan disepakati secara luas.

Walaupun kerangka kerja hukum di Indonesia layak dan realistis, kebijakan dan praktek pengelolaannya sering kali tidak konsisten dengan kerangka kerja. Pengelolaan yang baik harus dibangun dari lembaga yang terpercaya, aturan hukum dan kebijakan yang rasional. Langkah menuju pengelolaan hutan yang lebih terstruktur akan membantu menciptakan sesuatu kebutuhan yang dapat diprediksi, transparan dan akuntabel untuk memperbaiki tata pemerintahan. Ada peluang untuk memfokuskan pada peningkatan reformasi yang ada, mendukung para pemimpin, menyediakan dukungan analitik untuk suatu pendekatan baru, dan klarifikasi kebijakan dan peraturan. Reformasi dibutuhkan untuk: membuat informasi tersedia secara transparan, mendukung inisiatif-inisiatif yang dipimpin pemerintah dalam menanggulangi pembalakan liar dan restrukturisasi industri (kehutanan); melindungi wilayah konservasi yang ada saat ini; mengklarifikasi peran, tanggung jawab dan inisiatif dalam hubungannya dengan desentralisasi; dan mendukung dialog dan kemitraan. Pada saat yang bersamaan, ada kebutuhan untuk mengakui

bahwa pendekatan-pendekatan masa lalu belum efektif, oleh karena itu cara-cara baru untuk berbisnis dibutuhkan dalam rangka mencapai suatu tingkat keterlibatan dan efektifitas baru.

**Strategi.** Bank Dunia mengusulkan untuk meningkatkan dan mengutamakan bantuannya di sektor kehutanan Indonesia. Peningkatan bantuan berarti meningkatkan keterlibatan dan kerjasama untuk mempercepat aksi pada titik awal utama dari transparansi, aturan hukum dan restrukturisasi industri. Dialog juga akan ditingkatkan pada pengelolaan sumberdaya berbasis masyarakat, hak dan akses atas lahan, dan kontribusinya pada pertumbuhan dan keadilan. Peningkatan juga berarti membangun berdasarkan model saat ini dan sukses mengembangkan program yang lebih komprehensif, baik pada konservasi maupun pengelolaan bersama di tingkat masyarakat. Pengutamaan berarti memasukkan isu perlindungan lingkungan dan kehutanan kedalam kegiatan dengan pemeran/aktor diluar “kotak kehutanan” termasuk otoritas penataan, bea dan cukai, perdagangan, pemerintah daerah, komunitas, dan pada skala yang lebih luas intervensi kebijakan-makro yang difokuskan pada kehilangan pendapatan negara, korupsi dan pengentasan kemiskinan.

Langkah aksi ini konsisten dengan arahan yang ada di CAS, dan juga strategi lingkungan dan kehutanan. Jika ada

kemajuan yang layak di bidang utama, ada potensi pada jangka menengah untuk meningkatkan tingkat keterlibatan dan kerjasama dengan aktifitas tambahan dan perangkat keuangan, termasuk dana hibah, pengembangan kebijakan pinjaman dan operasi lainnya. Sebagai indikator kemajuan maka dapat dilakukan pengecekan melalui evaluasi kinerja di sektor kehutanan di dalam konteks persiapan CAS baru di pertengahan tahun 2007. Dokumen ini memberikan ilustrasi aktivitas dan perangkat keuangan yang dapat dimanfaatkan untuk tingkat keterlibatan dan kerjasama yang lebih tinggi, jika kinerja dan komitmen pada inisiatif reformasi terus berlanjut..

Dalam sisa kurun waktu tahun 2006, Bank Dunia akan memfokuskan pada pembangunan sistem untuk memperbaiki transparansi, akuntabilitas, aturan hukum dan tata pemerintahan, dan mengevaluasi kelayakan atas keterlibatan dan kerjasama yang lebih besar pada restukturisasi industri – secara spesifik di sisi suplai melalui promosi pengembangan hutan tanaman bersama masyarakat. Pada bulan May 2006, Bank Dunia mulai mengimplementasikan proyek konservasi kehutanan skala besar di Aceh dengan pendanaan dari *Multi Donor Fund* untuk Aceh dan Nias. Bank Dunia juga akan mempelopori studi-studi yang akan membantu membawa isu kehutanan dan lingkungan hidup ke dalam diskusi di lingkup ekonomi-makro yang lebih luas dan reformasi

#### **Usulan Strategi**

*Sustaining Indonesia's Forests: Strategy for the World Bank, 2006-2009* memberikan kerangka-kerja bagi Bank Dunia untuk mengklarifikasi sasaran di sektor kehutanan, begitu juga rentang waktu, implikasi sumberdaya dan resiko-resiko dalam memperdalam keterlibatan. Strategi ini juga memberikan landasan untuk mengutamakan sektor kehutanan ke dalam CAS (*Country Assistance Strategy*) dan intervensi reformasi kebijakan secara luas. Strategi ini merupakan suatu “road map” untuk bahan diskusi internal dan pengambilan keputusan, selain juga dapat memberikan wawasan bagi publik tentang pendapat ataupun pandangan Bank Dunia.

Dokumen teknis pelengkap berjudul *Sustaining Economic Growth, Rural Livelihoods, and Environmental Benefits: Strategic Options for Forest Assistance in Indonesia*, memberikan pandangan dan sintesis dari isu kehutanan di Indonesia dan kerangkakerja untuk memahami tujuan dan mengidentifikasi pilihan yang potensial untuk kebijakan dan intervensi proyek.

kebijakan, diluar sektor kehutanan, termasuk keuangan dan hutang, kemiskinan dan kebijakan lahan. Pada tahun 2007, Bank Dunia akan berusaha mengutamakan isu lingkungan hidup dan konservasi kedalam upaya-upaya pembangunan yang digerakkan oleh masyarakat.

Bank Dunia akan meneruskan dialog dan analisa kebijakan dalam rangka kontribusi terhadap upaya-upaya yang dilakukan dengan mitra donor dan masyarakat madani dalam rangka memperluas ruang bagi keperluan berdiskusi tentang isu tata guna lahan dan akses, terutama dalam konteks pengentasan kemiskinan dan investasi usaha skala kecil dan diverfisikasi.

Peningkatan secara strategis pada tingkat keterlibatan dan kerjasama adalah suatu kemajuan secara alamiah dari langkah-langkah masa lampau, dan dapat diakomodasikan dengan sumberdaya yang sudah diidentifikasi, dan meletakkan pondasi untuk keterlibatan dan kerjasama yang lebih dalam, sejalan dengan kemajuan yang diperoleh. Cara ini membuat Bank Dunia bergerak diatas peluang-peluang terkini dan dapat melakukan validasi kemajuan, sebelum memberikan komitmen pada investasi yang besar. Strategi ini juga akan menggunakan berbagai sumberdaya Bank Dunia yang lebih luas untuk bekerja pada isu tata pemerintahan dan kebijakan “*cross-cutting*” yang mempengaruhi lingkungan hidup, sumberdaya alam dan lahan hutan.

Walaupun sektor ini masih menghadapi banyak tantangan dan distorsi, ada cukup informasi tentang latar belakang, pemahaman atas isu dan tujuan-tujuan, dan titik awal yang jelas untuk dilanjutkan dengan aksi-aksi tambahan untuk membangun sistem dalam rangka memperbaiki akuntabilitas dan tata pemerintahan dalam waktu dekat. Namun, masih ada kebutuhan bagi Bank Dunia untuk secara hati-hati mempertimbangkan tujuan dan sasarannya di sektor kehutanan ini, implikasi waktu dan sumberdaya, serta resiko-resiko atas keterlibatannya yang mendalam. Dokumen strategi ini merupakan kerangka kerja untuk bahan diskusi dan pembahasan isu terkait.

## INTRODUCTION

This *Strategy for the World Bank* aims to clarify the Bank's objectives in the forestry sector, as well as the timing, resource implications, and risks of deepening engagement. The strategy also provides a foundation for mainstreaming forestry issues into the Country Assistance Strategy and broader policy reform interventions. This strategy is a road map for internal discussion and decision-making, but also provides the public with an understanding of the Bank's views at this time. Priorities and opportunities have been selected from more detailed analysis and options developed in a technical background document, *Sustaining Economic Growth, Rural Livelihoods, and Environmental Benefits: Strategic Options for Forest Assistance in Indonesia*. The background document provides an overview and synthesis of issues and an analytical framework for understanding objectives and identifying potential options for policy and project interventions, rather than a single set of recommendations. Based on a vision of forest resource governance and management for economic, social and environmental goals, the technical document identifies potential entry points that may be useful for donor governments and development assistance programs.

**Why Now?** Indonesia's forest sector has been in crisis for some time. Recommendations for reforms of policy and practice have made little headway for well over a decade. Despite this, the Bank – together with many observers and analysts – believes the prospects for positive change now are significantly better than in the recent past.

**Democratization and decentralization of government are creating positive political pressures at different levels.** Indonesia's popularly elected President is committed to good governance and fighting corruption. He has made specific commitments to fighting forest crime. A strong and active civil society, increasing media attention, and greater public recognition of environmental issues and resource degradation are creating broader constituencies for reform. International markets are increasing pressure for businesses to supply legally and sustainably-produced wood products.

**Attitudes and roles among government, big 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 marginalized groups, such as women and *adat* societies, are engaging in constructive dialogue with local governments, building trust and reducing conflict. The vulnerability of the poor is being reduced, their livelihoods are becoming 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 community partnerships; and civil society groups are more engaged in development processes, government operations, and resource allocation decisions. All these institutions are gaining skills in running democratic governance processes.

**The Department of Forestry is also becoming more open and responsive.** Change has been evolutionary, not revolutionary. Yet, changes in attitudes, senior management, and behavior have created more openness and gradually overcome the rigid approaches of the past. At some levels, there is still reluctance to embrace reform and participatory governance processes. Still, significant changes can develop over just a year or two and new opportunities for meaningful engagement appear regularly. The Minister of Forestry has a priority action agenda and multi-year window of opportunity for making progress. The Department of Forestry has a strong senior management team with champions of reform in increasingly influential positions. Key rules and regulations are under revision with multi-stakeholder consultative processes. There is measurable progress on forest law enforcement and governance, backed by Presidential commitment and recognized in the regional FLEG process and the developing transparency initiative, as well as the efforts of the Coordinating Minister for Security Affairs to establish inter-agency coordination. Advances in conservation are appearing with designation of new protected areas, improved national policies, and local government conservation initiatives and partnerships.

The Bank is well aware of negative media reports that appear from time to time on ill-advised proposals for roads or land clearing activities that threaten forests. These proposals represent continuing conflicts between private and public interest and a narrow view of development for short-term ends in the context of Indonesia's decentralization and democratization. The improving trend in governance, however, increasingly allows poor performance in the field and rent-seeking proposals that damage forests to be identified and evaluated by a range of stakeholders. In several notable cases, increased transparency and public participation have empowered progressive forces in Government to intervene before potentially damaging proposals have been implemented.

# 1. INDONESIAN FORESTRY: CONTEXT AND CHALLENGES

Indonesia's forests are a concern of the Bank because of their social, economic and environmental importance and the Bank's interest in promoting high quality economic growth and lasting poverty reduction in Indonesia. The Bank's objective is to assist the GOI to deliver on its own stated forest management goals and commitments and to promote wider policy dialogue among forest sector stakeholders by scaling up engagement and mainstreaming. This document outlines the recent history of Bank engagement in the sector, discusses ongoing issues and recent developments, and lays out an incremental strategy for the near future.

## 1.1 Country and Sector Context

Indonesia is in transition from an autocratic, centralized state to a democratic, decentralized one. The Bank's Country Assistance Strategy (2004-7) recognizes that in recent years macroeconomic stability has been restored and poverty has been reduced to near pre-crisis levels. Despite these achievements, poverty reduction remains a critical challenge. Governance and corruption are also key issues. Indonesia has started on a path toward more transparent and accountable government, with policymakers at all levels becoming directly beholden to voters. The results of the mid-2004 national elections showed that the people can make reasonable choices through peaceful direct elections. Indonesia has produced a rights-based poverty reduction strategy (2004) that emphasizes creating opportunities, empowerment, human capital and capacity development, and social protection. Due to weak implementation, though, there remains a large gap between the promise and the reality of governance reform. Indonesia is not yet free from risks to political and social stability, against which democracy, growth and poverty reduction remain the best weapons.

Indonesia's forests are among the most extensive, diverse and valuable in the world. The forest sector supports economic development and contributes to livelihoods of the rural poor. Forested lands also provide environmental services and habitat for biodiversity. Indonesia's forest sector is in crisis with rapid deforestation, rampant illegal logging, and industrial decline. Indonesian policy makers and civil society recognize that forestry is at a transition point from a past period of abundance to a future period of relative scarcity. There is increasing concern, recognition and positive steps toward policy reform and improved management. As with overall governance, however, a gap remains between the ideal and reality on the ground where forest and habitat degradation continue.

The Bank adopted a *Forests Strategy and Operational Policy* in 2002 and published *Sustaining Forests: A Development Strategy* in 2004 to help chart a course for countries to manage forests effectively and sustainably. The Forests Strategy is built on three equally important and interrelated objectives: harnessing the potential of forests to reduce poverty, integrating forests in sustainable economic development, and protecting global forest values. Building on this base, the Bank's East Asia Pacific Forestry Strategy was developed in 2005 to support governments and communities in the introduction and expansion of sustainable forest management, conservation, and development; and to use dialogue and investment as levers to reform underlying distortions in

policy, tenure, and governance. The Bank's *Environment Strategy* (2001) recognizes environmental resources and ecosystems as an essential element of countries' wealth and a foundation for economic growth and livelihoods. Countries' environmental choices may differ, but should be backed by good analysis, understanding and participation of affected stakeholders. It acknowledges the challenge of distributing the gains of development more equitably, preserving the interests of future generations, and managing environmental assets sustainably. The objectives of the environment strategy – improving the quality of life, improving the quality of growth, and protecting the quality of environmental commons – are in harmony with forest sector objectives.

In January 2005, the Department of Forestry issued a five year strategic plan (see Annex 1 for an overview) with five key objectives for policy reform and management improvement:

- Eradication of illegal logging from state forest areas and illegal timber trade.
- Revitalization of the forest sector, especially the forestry industry.
- Rehabilitation and conservation of natural forest resources.
- People's economic empowerment inside and outside the forest area.
- Determination of the forest area.

In May 2005, the Minister of Forestry requested Bank assistance in the forest sector, with a particular focus on forest law enforcement, monitoring, industrial restructuring and plantation development. In response, the Bank formed a mission in June 2005 to identify opportunities and risks for the Bank to assist the GOI to manage its forests more sustainably and equitably. This Indonesia Forest Strategy for the Bank is built upon these prior reviews, strategy and policy statements, as well as recent analytical work and political developments in Indonesia.

## **1.2 Brief History of Bank and Donor Engagement**

**Donor Assistance and Opportunity.** 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. A recent workshop convened by the European Commission and the Department of Forestry was designed to learn from this experience (EC 2006). The workshop found that, while donor investments were unsuccessful in achieving short term objectives, they contributed to a process of capacity building in both the Government and civil society organizations (CSOs). 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 noted that donor interest in forestry issues appears to be declining, just when the opportunity to capitalize on these past investments is high and the hardest work has been done. 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 conservation and more sustainable management of forests. A wide range of aid delivery mechanisms has been developed and tested with good results. 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 issues as mainly

about trees. A concern was also expressed that Indonesians might not be able to reap the benefits of past investments without some continued donor support. Engagement in the sector should go beyond empowering the Department of Forestry, and encourage links with other sectors, balance support for decentralized structures, promote the role of civil society, and involve legislatures, at national and regional levels.

**World Bank Engagement.** Over the past two decades, there have been three main stages of Bank engagement in Indonesia's forestry sector. Before 1994, the Bank engaged in lending operations and worked directly (and unsuccessfully) with the GOI to achieve policy reforms. After 1994, the Bank withdrew from lending operations in the commercial forestry sector, but tried to remain engaged in conservation and development operations. By 2000, large project-based interventions had stopped and the Bank worked to remain engaged through higher level dialogue processes, such as the Consultative Group on Indonesia. In the last five years, there have been increasing opportunities to engage in analytical and advisory services, which have begun to bear fruit.

In the early 1990s, the Bank was more actively engaged in the forestry sector. At that time, as now, governance and policy issues were paramount in improving forest management, but there was little agreement on how to resolve these issues. The Bank left the forestry sector over the course of the 1990s because of slow movement reflecting weak commitment and disagreement over the need for basic reforms. The first Forest Institutions and Conservation Project (FICP I) closed and the FICP II was canceled in 1994 at government request, reflecting the GOI's rejection of conditions imposed through the lending process. Later, the National Watershed Management and Conservation Project loan was reduced when key reform milestones in the Re-greening and Reforestation Program were not met. The large-scale Kerinci Seblat Integrated Conservation and Development Project, financed by the Global Environment Facility (GEF) and World Bank, ended in 2002 with allegations of corruption and poor management, some of which can be attributed to the design.

In 1998, the economic crisis provided an opportunity to introduce some policy changes and improve transparency. However, most attention was focused on crisis management, social safety net issues, and political transition – not on forest management. The Bank worked through the First and Second Policy Reform Support Loans in 1998 and 1999 to obtain the government's agreement to improve efficiency, transparency, and environmental sustainability in forest management. The government raised forestry royalties moderately (to collect a larger share of economic rent); reduced export taxes on logs, sawn timber, and rattan; and issued new forest management regulations intended to make forestry management more market-oriented. The government allowed the sale of forest concession licenses and eliminated the link between concessions and large-scale processing facilities. Many of these reforms were weakly implemented or later modified with different policies, which contributed to an unstable and uncertain policy environment during this period.

From 1999 to 2002, the political transition continued and the decentralization era was launched making it more difficult to engage the GOI on specific forest policy and governance issues. The devolution of power from the center to the districts created some new opportunities but may also have contributed to greater rates of forest exploitation in some areas. During this period, the GOI also passed a new Forestry Law (No. 41 of 1999), which improved upon some features of the earlier law from 1967, but also created some inconsistencies with the decentralization laws passed in the same year. In this period, Bank efforts shifted to increasing dialogue and raising awareness

about forest degradation issues through the Consultative Group on Indonesia and other venues, including engagement and partnership with civil society organizations. During this time, the GEF and other vehicles continued efforts to promote and advance the conservation agenda, through NGOs and the national park system. Indeed, GEF was the main way that the Bank engaged with the forestry sector. Even in this constrained operational mode, the Bank was able to support biodiversity conservation and achieve significant conservation outcomes.

Throughout this period, the GOI made many high-level commitments to forest sector reform, but was not able to deliver results in terms of policy reform, industrial restructuring, and curbing of destructive forest practices. While many mitigating factors and constraints can be mentioned – lack of coordination among relevant ministries, weak governance and rule of law, and the instability and frequent change associated with the political transition – this period still provides evidence of the gap between promise and reality. It also demonstrates that an approach based on donor-imposed priorities and conditions may not be as effective as approaches based on wider constituencies and common objectives among Indonesian institutions and stakeholders.

In 2001, the Bank's Operations Evaluation Department (OED, 2001) conducted a comprehensive study that concluded that many of the Bank's past policy prescriptions in the sector had been appropriate. However, they had little impact because the Bank did not focus enough on building a constituency for change in government – and more broadly in society. The review noted that there was insufficient commitment to long-term partnership with government and other stakeholders. Also, the OED review noted that the Bank had not used its resources to full advantage in engaging the GOI on issues in other sectors that influence forest management and policy, such as forest sector finance and mining.

**Effectiveness and Perceptions of Donors.** Other donors have also experienced a transition in their assistance programs over this period. The recent EC Workshop reviewing 20 years of programs (EC 2006) and a review commissioned by the Donor Forum on Forestry (DFF, March 2004) provide additional perspectives on donor assistance. During the period 1985 to 2004, the World Bank, Japan and the European Community were the largest donors to the forestry sector. In 1993, there were at least 40 donors, including international NGOs, supporting more than 74 projects. By 2003, only a small number of foreign-funded projects continued to operate within the Department of Forestry. This change resulted from the perceived weaknesses of past project approaches, the economic crisis and political transition, the rapid decentralization process, and perceived opening of opportunities to work directly on governance issues, both inside and outside of government. Many donors are now channeling assistance to forestry governance issues through a variety of CSOs and NGOs. Some donors are also addressing forestry issues through cross-sectoral approaches focused on decentralization, improved governance, rule of law, and more sustainable or participatory natural resources management. Donors also now support various forms of community-based or decentralized natural resources management and deal with forest issues alongside agriculture, rural development and governance. Much rethinking and lesson learning occurred during this period, but adoption of new approaches has been slow due to donor funding cycles and the need for negotiations with the Government.

The EC workshop also provided an evaluation of official development assistance to the forestry sector. Many donor efforts were judged to be top down rather than participatory; not fully responsive to stakeholder expectations and concerns; too technically-oriented rather than situated in the political economy of incentives and disincentives faced by institutions and individuals; and output-oriented, rather than focusing on progress toward major objectives (outcomes). Donor

interventions achieved many small successes – they improved capacity, transferred global best practices, enriched policy discourse, and heightened political awareness – but against an overall negative trend in the status of forest resources.

The DFF Review raised similar issues and noted that there was a broad political-economic flux during the reform era, with changing roles and responsibilities of actors at every level, which impeded progress on comprehensive, integrated and participatory approaches. During that period, also, the government and the donors (as well as NGOs) had very different interpretations of the basic priorities for forest policy reform. Consensus and collaboration among donors is important, but that consensus must also be shared by key Indonesian stakeholders. The review suggested that new communication strategies and constructive cooperation approaches with different partners were needed. The review also suggested that donors recognize their limited financial leverage and work through more progressive Indonesian actors to build long-term commitment and trust, while minimizing non-productive confrontation. The DFF review also recognized the benefits of mainstreaming forestry issues into broader development agendas and frameworks, rather than focusing sectorally.

**The Bank's Process of Re-engagement.** From 2000 to 2005, the Bank supported analytical and advisory activities to stay engaged in forest sector dialogue and to assist in building constituency for improvement. This engagement had three main components: structured dialogue processes, policy briefs and advice, and deeper technical analysis documents. Specifically, the Bank supported a range of donor and stakeholder dialogue processes, most clearly reflected in the Donor Forum on Forestry, which supported the Consultative Group on Indonesia (CGI). The CGI process provided a formal venue where donors and GOI could review and comment on progress on forest sector reform commitments. This process was also supported by brief policy and position papers issued in response to current events, such as the actions of the Indonesian Bank Restructuring Agency on forestry debt. The Bank also supported analytical work during this period, including special studies of issues, such as the log export ban, decentralization, and poverty-forestry links. These studies were often developed with academic and NGO partners.

In 2004, the Bank commissioned a report from CIFOR, intending to summarize major issues and trends in the forestry sector and serve as a base for more coordination among donors and the GOI. This document was also used to provide brief policy inputs to the new government in October 2004. Stakeholder consultations were also held during the same period. Additional analysis was conducted and incorporated in 2005 and 2006, culminating in the companion volume to this strategy, entitled: *Sustaining Economic Growth, Rural Livelihoods and Environmental Benefits: Strategic Options for Indonesia's Forest Lands*. This strategy document draws on the analysis and findings in the technical document.

From 2003 to 2006 there has been an increase in the seriousness of forestry policy reform dialogue processes, supported by rising champions of reform within the Department of Forestry and enhanced with substantial analytical work and field activities, sponsored by the Bank, other donors, NGOs, and international research organizations. Multi-stakeholder efforts to build constituency and increase political pressure have borne fruit in increased public scrutiny, press attention, and action by the legislature and executive on important issues of corruption, rule of law, and the economic and environmental importance of the forests. The challenge at this point is to convert increased awareness and understanding, reformist champions, and political will into concrete actions that improve conditions on the ground – meaning performance in achieving economic, social and environmental service delivery objectives.

In Indonesia, the Bank also plays an important role in offering a constructive response to challenges to good practices in the sector, through both informal and formal channels. A recent example is the proposed oil palm plantation development along the Kalimantan border, a zone of protected areas and high biodiversity and environmental service values. Working with key ministries and NGO partners, the Bank has stimulated high level debate and technical reconsideration of the project's design. In the past, the Bank has also helped to raise concerns about a road through the Leuser Ecosystem in Sumatra through the CGI process and facilitated dialogue with potential pulp sector investments on overcapacity and performance issues.

In June 2005, the Bank forestry mission reviewed key issues, increased dialogue at the working and policy level, and heard a wide range of opinion on what the Bank could do – and should not do (e.g., lending). There were different views within the mission team about how to proceed. Some saw signs of optimism and reasons to engage with the Department of Forestry, while others saw examples of business as usual and continuing cause for concern. At this point, nearly a year later, there is sufficient background information, understanding of the issues and objectives, and clear entry points to begin increasing engagement to improve accountability and governance in the near term. However, there is still a need for the Bank to carefully consider its goals in the forestry sector, the timing and resource implications, and the risks of deepening engagement. This strategy document provides a framework for discussing and addressing these issues.

### **1.3 Key Issues and Trends**

Indonesia's forestry sector still faces challenges. Major restructuring and alternative resource creation will be needed to bridge the growing gap between demand for forest products and services and the sustainable supply. Positive innovations in collaborative conservation management and decentralized forest management partnerships must be recognized, along with continuing threats to protected areas from road building, conversion, and other development schemes. The Bank's strategy must be built on full awareness of ongoing governance issues, forest degradation and loss. This section outlines the range of issues in the context of Indonesia's objectives for forest management, which are quite similar to the Bank's forest strategy goals. Tables on the following page provide a quantitative overview of Indonesia's forestry sector.

**Economic Issues.** Forestry and the forest products industry played an important part in Indonesia's economy over the last 20 years. In the last ten years, forestry represented 3 to 4% of national gross domestic product (or 20 to 24% of the industrial sector) and was an important source of export earnings. In rural areas, forestry and forest industries are even more important contributors to the regional economy. Tempering these economic benefits, forest exploitation has also engendered forest destruction, loss of environmental services, concentration of wealth, and conflict with traditional community land uses and non-commercial ways of life. The high economic values (billions of dollars/year) being extracted from the sector must be recognized as a constraint on how much policy reform or small incentives can be expected to achieve. Indonesia faces a choice between a continuation of the status quo – with bleak implications for the future – and a concerted effort to manage toward a different future state – with balanced supply and demand and a revitalized industrial sector (Dept. Forestry, CIFOR, DFID-MFP, 2005).

- **Forest Loss and Forest Crime Dominate the Sector.** Forest destruction and illegal logging, the leading factor in the loss of forests and the degradation of the remaining resource, have been discussed for more than a decade. Up to two-thirds of Indonesia's forest sector

production (requiring inputs of about 60 million cubic meters per year) is based on suspect or undocumented timber sources, representing an annual loss of \$3 billion in economic value to the country and its citizens. Forest crime is enabled not only by the lack of effective management systems (and clear responsibility for them), but also by the lack of effective prevention, detection and suppression programs. On the positive side, the President has issued a decree instructing relevant agencies to fight against illegal logging, led by the Coordinating Minister for Security Affairs. This, coupled with increasing action by the Department of Forestry, has resulted in increasing numbers of illegal logging cases of increasingly high profile. This initiative has been accompanied by much greater press attention to the issue (with donor, NGO and GEF project support), which increases political pressure for follow through on cases that are developed.

**Indonesia: Overview of Forest Land and Population**

Land Areas & Status	Total Area (Million Ha)	% of Area
<b>Total Land Area</b>	<b>185.7</b>	<b>100%</b>
Forest Estate	132.3	71%
- With Forest Cover (2000)	94.9	51%
- No Forest Cover (2000)	37.3	20%
Non Forest Estate	53.4	29%

Source: www.dephut.go.id, Dept Forestry Website

Population Categories	Pop'n 2003 (Millions)	% of Pop'n
<b>Total Population</b>	<b>214.4</b>	<b>100%</b>
Forest Estate	60.0	28%
- With Forest Cover (2000)	12.9	6%
- No Forest Cover (2000)	47.2	22%
Non Forest Estate	154.4	72%
Pop'n in Poverty	36.4	17%

Source: www.bps.go.id, Central Statistics Bureau, processed

**Indonesia: Overview of GDP and Trade**

Gross Domestic Product	GDP Values 2003 (\$ B)	% of GDP
<b>Total GDP</b>	<b>184.2</b>	<b>100.0%</b>
GDP Oil and Gas Products	18.2	9.9%
GDP Non-Oil and Gas	166.1	90.1%
Forestry (Agric)	2.1	1.1%
Wood Products (Manuf)	2.4	1.3%
Paper & Printing (Manuf)	2.5	1.4%

Source: www.bps.go.id; BPS Website

Trade Category	Export Value 2003 (\$ B)	% of \$ Exp
<b>Total Exports</b>	<b>61.06</b>	<b>100.0%</b>
Oil and Gas Products	13.65	22.4%
Non-Oil and Gas Products	47.41	77.6%
Timber and Wood Products	2.72	4.5%
Paper, Cartons & Products	1.97	3.2%
Pulp and Paper	0.79	1.3%

Source: www.dprin.go.id; Dept Industry Website

- Industrial Timber Demand Exceeds Sustainable Supply.** There is wide agreement that “too much” timber is being harvested from Indonesia’s natural production forest. While industrial demand is about 60 million m3 round wood equivalent per year, sustainable yield from existing natural production forests is estimated at 8-9 million m3 per year and from timber plantations at 3-4 million m3 per year (increasing in recent years, perhaps to nearly double those levels, according to some industry sources). This enormous timber gap is being filled both from excessive harvesting and from the conversion (clearing) of forested land to other uses. The Department of Forestry reports that more than a quarter of the production forest has been damaged to the point that it can no longer be considered forest. Forest conversion – an unsustainable harvest method – has been the fastest growing source of timber supply in recent years and is a major source of supply for pulp mills. As timber supplies in Sumatra and Kalimantan are depleted, harvesting pressure is moving from west to east, with Papua increasingly a target for commercial exploitation. On the positive side, the Minister of Forestry has recently adopted a science-based, three-phased plan for forest industry restructuring and revitalization, which includes actions to address both supply side and demand side issues (Dept Forestry, CIFOR, DFID-MFP, 2005).

- **The Processing Sector is not Prepared for Global Competition.** Indonesia's wood processing industry has been primarily export-oriented, serving mainly Asian countries in the region. On average, Indonesia's wood processing industries export two-thirds of plywood, 45 percent of pulp and 35 percent of paper production. Indonesia's producers face the same market challenges and threats as other regional players. Global and regional markets, including China's rapid growth, will put continuing pressure on Indonesia's forest management system and processing firms. Environmentally sensitive end-use markets may increase demand for quality forest management and assurance of sustainable timber production methods (EAP Forest Strategy, 2005). Due to old processing technology, especially at plywood mills, the productivity of Indonesia's forest industry is low and waste is high. This leads to declining output and international competitiveness. The high level of illegal harvesting artificially lowers timber prices, which distorts incentives for efficiency, market adjustment and re-investment. Undervaluing timber mainly subsidizes foreign consumers of wood-based products, including China, a major regional importer. Market trends will reward firms (and countries) that can add value in downstream wood processing and more diversified products (Dept Forestry, CIFOR, DFID-MFP, 2005).
- **Timber Plantations Are Insufficient and Performing Poorly.** Timber supply from plantation forests cannot meet current levels of demand because planting rates and areas are insufficient to produce enough timber in the right time frame. While a few large firms have made great strides in establishing timber plantations with high productivity, other areas allocated for plantations have been poorly managed or abandoned. Only a third of the lands allocated for plantations have been planted, and only a portion of these lands are yielding timber at industry-recognized levels of performance. The structure of the industry will need to evolve/retool over the next 10 to 15 years to make use of newly maturing grown-timber supplies (Dept Forestry, CIFOR, DFID-MFP, 2005). The medium-term outlook will depend very much on actions taken in the next few years.
- **Forest Sector Financing Creates Inappropriate Incentives.** Indonesia, like many EAP countries, lacks sufficient due diligence in private-sector financing of the forest industry. This has contributed to the industry's over-capitalization, which creates an unsustainable demand on the forest resource base, as well as the same kind of debt, risk and overexposure that contributed to the financial crisis of the late 1990s. Due diligence processes need to be improved to realistically evaluate raw material supplies, plantation development prospects, and the likelihood of increasing illegal logging. Forest sector analysts have made only limited progress in getting this issue onto the agenda of major financing agencies and donors advising financial sector institutions and donor agencies in Indonesia. On the positive side, innovative financing mechanisms for carbon sequestration or environmental service delivery have some potential to improve the level of replanting and responsible local level forest management (EAP Forest Strategy, 2005).
- **Forest Sector Debt Still Hampers the Banking Sector.** Large debts among forestry firms, particularly in pulp and paper, hinder the sector's revitalization and impose a financial burden on the banking sector. The Indonesian Bank Restructuring Agency's (IBRA) heavily discounted sale of forestry debts in 2002 and 2003 did not resolve or remove the debt issue, but transferred it to government-backed banks such as Bank Mandiri, Bank Negara Indonesia, and Bank Central Asia. These debts continue to undermine the full recovery of Indonesia's banking sector, which is plagued by high levels of non-performing loans (Tempo, 2006). The

GOI (Coordinating Ministry for Economics and Ministry of Finance) is now trying to resolve this banking issue, as well as potential corruption in the transfers of forest industry assets (Supreme Audit Agency and Attorney General's Office). These agencies may benefit from technical assistance and advice in these endeavors. In particular, there is a need to proceed with caution because debt write offs or suspension of interest payments for uncooperative debtors, would further subsidize these profitable firms, which have already benefited from policy and preferences in the past (Kaimowitz, 2006).

- **Reinvestment and Revitalization.** Indonesia is now seeking new investment in the forestry sector. Investments that aim to retool, increase efficiency, and diversify value-added processing would help to improve the competitiveness of Indonesia's industry, in line with the Minister's plan for restructuring and revitalization. However, investments that expand processing capacity would put additional pressure on Indonesia's forests, unless accompanied by sustainably managed timber plantations. As this next round of investment goes forward, it will be important that proactive steps (laws, institutions) are taken to improve due diligence, corporate accountability and transparency, and environmental and social safeguards (Kaimowitz, 2006; EAP Forest Strategy).

**Poverty and Rural Development Issues.** Most poor Indonesians live in rural areas. Forestry sector and land use issues are intertwined with rural development and poverty alleviation issues. In the rural sector generally, and in the forestry, agroforestry, and small scale plantation sector in particular, poorer households suffer from uncertain property rights, pressure to move to marginalized land and often resort to unsustainable resource management practices. They have limited access to capital and justice. Forest sector discussions often focus only on products or rights, not the other enabling conditions needed to produce community livelihood improvements, such as credit, markets, access and infrastructure. (Section 2.3 provides more information about the Bank's rural development approaches and the relationship with forestry issues.) In forest sector or land use discussions, communities are often viewed as instruments for attaining certain goals (e.g., watershed rehabilitation), rather than as market actors and competent partners engaged in forest and ecosystem use and management. In conservation discussions, communities are increasingly seen as partners in achieving protection objectives, but they are often also viewed as threats, not legitimate users of forest resources.

- **Efforts to Address Rural Poverty Must Recognize Issues of Forest Land Use and Control.** State-claimed "forest lands" account for more than 70% of Indonesia's land area. Recent GIS and population analyses confirm that 50-60 million Indonesians (about a quarter) live in this mostly rural, state-claimed area. More significantly, 80% of these people live in areas with no tree cover. Of the people living in the forest zone, about 20% are poor, slightly higher than the national average of 17%. In areas with forest cover, the numbers of poor are relatively low (3-6 million people), but poverty incidence is relatively high (22% in poverty vs. 17% for the country as a whole) (Boccucci, Muliastira, and Dore, 2005; Brown, 2004). These large numbers of people have uncertain and insecure rights of access to forest resources, even in areas that no longer support tree cover.
- **Disagreement Over Who Should Control Forest Lands Causes Uncertainty and Conflict.** Significant areas of the state claimed "forest zone" are non-forested (32 million ha or 24% of total). Some of these areas, and other forested areas, are in fact community-managed agroforests, agricultural lands or grasslands. These areas are currently regulated as if they still are natural forests or lands to be reforested for timber production (Contreras-

Hermosilla and Fay, 2005). Many argue for a wider rationalization of forest land uses, control, and ownership. Others note that improved tenure security is a key element in alleviating rural poverty. Various initiatives are being promoted for addressing these issues and boundary demarcation of forest lands is a ministerial priority. Access and tenure are increasing issues of discussion between the Department of Forestry and stakeholders.

- **Women's Roles and Rights Need More Active Consideration in Forest Sector Decisions.** Women use forest resources differently than men. These differences may be especially important in poorer areas more dependent on traditional practices, such as collection and processing of non-timber forest products and fuelwood. Poverty also has differential gender impacts, and many argue the more women and children are among the poor. Improvements in forest management, access and rights would help to address this imbalance. There are efforts to raise awareness and action within the Department of Forestry and its regional branches through training programs and coordination with other key GOI agencies to include gender issues into forest development and make the agency more gender responsive.

**Environmental Issues.** Fifty million hectares of Indonesia's land area is allocated for watershed protection and conservation of biodiversity. This is an area the size of Spain or Thailand. Thirty million hectares of protection forests (23% of total forest zone) have been nominally transferred to local government control under the decentralization framework. This presents an opportunity for improving decentralized forest management through capacity building and partnership at the local level. However, due to the lacking management framework and uncertain legal authorities, these areas have become open access lands managed weakly, if at all. In areas allocated to conservation and biodiversity protection (about 19 million ha, the size of Senegal or Syria), analysis of forest cover change shows that nearly 80% of this land still has good forest cover. Relative to other land use designations, then, 'protected forest' and 'conservation forest' status offers better prospects for preserving the forest cover and its associated environmental services (watershed services, carbon storage). It must be noted, however, that the lowland forests harbor the most plant and animal biodiversity. Because they are the most accessible, these vital areas are often the first to be exploited and degraded. There are also still specific concerns about logging in protected areas, proposals for roads through sensitive areas, and periodic forest and land fires.

- **Deforestation and Land Degradation are Increasing Public Concerns.** Indonesia is losing forests at a remarkable rate, one of the fastest in the world. There is widening public recognition and press attention to these issues. Illegal logging and forest conversion (clearing) for other uses are associated in the public eye with increased flooding and landslides. This link may not be scientifically valid, but it creates political pressure on government for action and highlights the opportunity and challenge of using public awareness as an entry point and catalyst for change. Improvements in land allocation policy and administration are needed to ensure that conversions are restricted to suitable areas, though this becomes an issue of center-region politics over control of land use decisions. The Department of Forestry has launched a large and expensive national movement for forest and land rehabilitation (known in Indonesian as GNRHL, or GERHAN), which aims to restore about 3 million hectares over 5 years, 60% inside and 40% outside the state forest area.

**Conservation and Biodiversity Protection Need Greater Emphasis.** Indonesia is a recognized mega-diversity country, spanning three bio-geographical regions and a diverse range of habitats, altitudes and climate zones. It includes the most extensive and species-rich forests in Asia and is recognized as a global hotspot for marine and freshwater diversity. Although Indonesia maintains

a substantial protected area network, forest conservation and management have not generally been well-resourced and are not often priorities of local government under the decentralization framework. In addition to forest loss, the illegal wildlife trade is an increasing threat to biodiversity in many places across the archipelago. To address the concern that it is easier to declare national parks than to manage and protect them, in March 2006 the Forestry Minister established management units for 16 new parks that had been established in 2004 and 2005. This provides a management structure and resources for implementation of protection programs. Innovative partnerships are providing more resources for conservation initiatives. Examples include the GEF-supported Critical Ecosystem Partnership Fund managed by Conservation International and the GEF and IFC-supported initiative in Komodo National Park managed by The Nature Conservancy.

- **Decentralized Conservation Initiatives Are Showing Promise.** Many conservation practitioners today are also capitalizing on the decentralization process by encouraging better stewardship at the local level. Purnomo (2005) documents recent local initiatives and success stories from many conservation NGOs, including the Indonesian Biodiversity Foundation (Kehati), WCS, and WWF, and many other Indonesian NGOs. Similarly, GEF MSPs have managed to enhance conservation in local sites where commercial logging is a lesser threat and less significant to the local economy. Another important innovation is the development of public awareness campaigns and environmental education programs. All of these provide reasons for optimism that local initiatives and awareness-raising efforts can, under certain conditions, overcome downward national trends in conservation management.

**Governance and Management Issues.** Improving governance and management in the forest sector is needed to achieve goals for poverty alleviation, economic growth and the provision of environmental services. Good forest management is the purposeful, planned, and accountable use of forest resources to pursue socially endorsed goals and objectives. Genuinely sustainable management must be built on good governance, accountable institutions, and sound policies. Indonesia's poor forest management framework is constraining its ability to meet its own goals for the forest sector. Institutional issues and constraints are also part of the challenge of improving management (Kartodihardjo, 2004).

- **Improving Forest Governance is a Major Opportunity.** The Bank's CAS and EAP Forest Strategy place governance at the center of needed improvements. Indonesia has improved its governance framework in recent years with new legislation and regulations, developed with wider stakeholder consultations. Higher-level political declarations, including a Presidential decree, have added to pressures to improve forest sector performance. Institutional changes have been implemented to increase the focus on illegal logging and forest crime. Press reports indicate that this is having some effect on the rate and level of enforcement actions. Results on the ground, however, are still heavily influenced by the actions or proposals of regional governments in this era of decentralization, including roads through protected areas, small scale timber harvesting licenses, and resistance to management edicts from the center. At the national level, too, GOI departments are considering several risky or ill-advised initiatives that will further threaten forest resources. Thus, there is still uncertainty about the GOI's ability to address these governance and management issues.
- **Corruption Remains a Concern.** The CAS and the regional forestry strategy both acknowledge the special problem of corruption in Indonesia. In the forest sector, this is manifested by substantial off-budget flows of revenues and taxes, as well as lack of

transparency in the allocation of land and forest use rights. On forest crime, the GOI has made some progress with high-level political pronouncements and prosecution of some high-profile cases. In the past, the Department of Forestry has had low credibility among civil society advocates, and even district governments. Although improvements at the center are clear, community level interactions with local forestry agency officials are still plagued by mutual mistrust.

- **Decentralization Opened New Roles and Responsibilities in Forestry.** Democratization and decentralization after the end of the 'New Order' regime in 1998, led to a decline in central authority and rapid transfer of political and financial authority to the district level governments by 2000. Democratization of the electoral process also made local parliaments and district leaders more responsive to local citizens, though political parties retain a strong role. The decentralization of authority was marked by disorder and a lack of transparency due to weak planning and institutional capacity in all sectors, but perhaps especially in forestry. Regions, encouraged by weakened central governance and a legal framework in flux, asserted jurisdiction and authorities over forest lands and licenses. These years saw a protracted tug of war between the center and the districts over control of forest resources, with some localities adopting short-term forest exploitation practices to raise revenue (Resosudarmo, 2004). More recent legislation has clarified these authorities and laid the foundation for more rational and sustainable management in the future, with participation of stakeholders. The process of stakeholder consultations and legal clarification continues, representing an opportunity for engagement with different levels of government and new institutions, such as the associations of regional governments and legislatures (see Annex 2).
- **Regional Capacity Building and Community Empowerment are Opportunities.** Many agree that local governments need improved capacity for working with the public, identifying and responding to their needs, and running public consultation processes, as well as technical and institutional capacity to manage and protect forests. NGOs and universities (with donor and foundation funding) have been instrumental in opening the processes of governance at the local level, building capacity, holding public hearings, using the media to highlight issues, and creating constituencies for improvements in policies and practices. Decentralization also creates opportunities and demand for resolution of land access and rights issues – both from existing rights holders (private concessionaires) and aspirants for more secure access (communities). Competing claims and confused governmental responsibilities have opened and widened the debate over forest access and land use rights. There is an opportunity to build more effective and transparent institutions to support these kinds of negotiations in a process of forest land rationalization. Despite some environmental concerns about more rapid forest conversion, the decentralization process has created important opportunities to improve governance at the local level. Also, some studies show that the decentralization process has provided opportunities and direct benefits to rural households, smallholders and forest dwellers. Some communities have greater access to land and resources or in a better position to negotiate benefits from companies seeking harvesting permits (Engel and Palmer 2006).

**Risks.** Risks and difficulties in proposing increased engagement by the Bank in Indonesia's forest sector are significant. In the near term, the GOI has not expressed interest in borrowing for routine forestry operations. Also, as is often discussed at CGI meetings, some elements of government and civil society object to debt financing or involvement of foreign institutions, or both. This can create some risks for the Bank, but not more so than in other sectors where the Bank is active. This issue must be considered in the longer term to determine where and how the

Bank can engage and what it can reasonably seek to accomplish. This presents an opportunity for going “outside the forestry box” to engage on a wider set of environmental and natural resource issues. The Bank needs to continue efforts to increase the level and momentum of forestry dialogue, as well as its own engagement with other agencies of the GOI. This also means engaging with provincial and district governments and communities, as has been done through GEF-funded medium-sized projects (MSPs) and a proposed deeper engagement with the Kecamatan Development Program. An “out of the box” approach must recognize that forestry is not unique as a natural resource sector. Similar issues of governance, corruption and illegality appear in other natural resource and environmental issues: mining, fishing, and land management. The Bank needs to be circumspect about buying into initiatives that do not have a compelling rationale in terms of environmental protection or poverty alleviation. Like the country as a whole, the forestry sector continues to illustrate the wide gap between promise and reality in forest sector governance, management, and reform. Although statements, strategies, and systems appear to be improving under the current political regime, there is a sufficient history of lack of follow through, continuing deterioration in the field, and risks of reengagement, that the Bank must adopt a step-wise approach, with attention to performance indicators. In summary, it appears that the risks and uncertainties are becoming better understood and smaller, while the opportunities for success are increasing.

#### **1.4 Recent Developments**

Despite the foregoing, there are signs of progress and potential for major improvement. The process of dialogue, analysis, and constituency-building in recent years has created some of the conditions and opportunities – as well as political pressure – for changes that are being seen now. The prospects for positive change in the sector are significantly better than in the recent past due to both general democratization of governance and specific changes within the sector. Also, an active, stronger civil society is emerging; media attention to forestry and environment issues is increasing; public recognition of resource limits and the implications of forest degradation is improving; and market pressures on issues such as legality and sustainability are emerging.

Within the sector, the Department of Forestry has focused on five priority areas: fighting illegal logging, rehabilitation of forest land, revitalization of forest industry, increasing welfare of communities around forests, and stabilization of the forest area. The Department’s Strategic Plan for 2005-2009 (see Annex 1) lays out specific goals for the forestry sector in line with the mission and vision established in the Forestry Law, including increasing support for watershed services, promoting the role of the people, and guaranteeing just and sustainable distribution of benefits. The strategy provides quantitative objectives that can be used as one measure of performance and results achieved.

In November 2005, the President of Indonesia reaffirmed his commitment to the Minister of Forestry, while reshuffling his economic team. On this basis, the Minister reorganized his senior management team, giving new responsibilities to existing and new champions of reform. A previous reorganization among the second tier of officials brought reformist champions into key positions. These organizational changes have the potential to solidify and accelerate ongoing reform processes.

On forest crime and governance, Indonesia has become one of the better performers in the regional FLEG process, with advances in both transparency and law enforcement. The Department of Forestry is developing a forestry transparency initiative (with a “Forest Monitoring

and Assessment System” (FOMAS) as a key component) and a “10 Step Program to Combat Illegal Logging,” with support from the Bank and other donors. Positive media reports on the rate and level of enforcement actions are common. There has also been progress in the revision of key implementing regulations (PP No. 34/2001) and development of new law enforcement legislation, both with wider multi-stakeholder consultative processes. An interagency working group on forest crime under the direction of the Coordinating Minister for Law, Politics, and Security is now working to develop operational guidelines for implementation of the Presidential Decree on Illegal Logging.

The Department of Forestry (with CIFOR, DfID, and Bank support) recently completed and adopted a synthesis report and three phase strategy for industry restructuring and rationalization. In September 2005, the Minister instructed the Director General of the Production Forestry Service (*Bina Produksi Kehutanan*, BPK) to follow up on implementing the recommendations. In December, the Minister and the Director General for Forest Research and Development Agency presented the synthesis results and the strategy to a wide audience of industry and NGO representatives. Follow on work is focusing both the supply side (raw material) and the demand side (timber industry), organization of data on industry capacity and use of (legal or illegal) raw materials, development of plans for increased forest plantations with communities, as well as incentives and enabling conditions that can accelerate this process.

Regarding land and livelihoods, the Minister has placed priority on community empowerment and promoted social forestry as a cross-cutting theme. The Department of Forestry’s largest activity (GERHAN) involves rehabilitation of degraded lands and watersheds. Important recent legal and economic analyses have provided new insights that have the potential to increase level of dialogue on land and tenure issues (Contreras-Hermosilla and Fay, 2005; DfID-MFP 2006) as one element of a strategy to improve community livelihoods.

Several new conservation initiatives are worthy of mention and continued development, including: designation of new national parks and protected areas, a decree on ecosystem restoration in production forests, creating the opportunity for conservation innovations in forest concessions, a decree on collaborative management for protected areas, and new regional conservation initiatives and innovations.

At the same time, however, reports of negative actions or ill-advised proposals often overshadow the relative good news, and serve as a reminder that short sighted commercial interests and closed decisions continue to threaten Indonesia’s remaining forests. In the context of Indonesia’s decentralization and democratization, these represent continuing conflicts between a narrow view of ‘development as exploitation’ and a balanced vision of sustainable development with conservation and environmental protection. Some regional governments are still generating ill-considered proposals that would encroach on protected areas or undermine forest management rules. Regional governments also resist policy changes initiated in the center. There are substantial off-budget flows of revenues and taxes and a lack of transparency in the allocation of land and forest use rights. Examples already noted above include oil palm development along the Kalimantan border, proposed roads through Kerinci Seblat and Leuser National Parks, and potential investments to further expand unsustainable industrial capacity. However, misguided proposals are often redirected with positive results after issues are raised in more open and transparent governance discussions with multiple stakeholders.

## **1.5 Partnerships and Constituencies**

The democratization and decentralization process in Indonesia has created many opportunities for engaging new partners and constituencies to improve forest governance and management. In addition to working more closely with the Department of Forestry in recent years, the Bank has made efforts to work with a broader range of GOI agencies and civil society organizations. This approach was recommended by the reviewers of the Donor Forum on Forestry (DFE 2004) and endorsed by participants at the recent EC-Department of Forestry Workshop (EC 2006). The workshop also identified a number of constructive approaches that donor governments can take in engaging more partners and new constituencies. Interventions should be: flexible and responsive; more holistic and integrated (not based on fads or slogans, such as ICDPs or SFM); supportive of GOI priorities (through program support), only if linked to needed human resource and institutional development needs; transparent regarding the underlying agenda; based on deeper and more enduring partnerships; more programmatic, rather than project-based; and include innovative ways of supporting promising local and civil society initiatives (e.g., through grants). This section reviews some of the potential partners and constituencies that the Bank has engaged and will continue to develop through implementation of this strategy.

**Broader Donor Engagement.** Within the traditional forestry sector, the DfID Multi-stakeholder Forestry Project, the European Commission series of projects (notably the Illegal Logging Response Center and the new Forest Law Enforcement, Governance, and Trade Project), GTZ, USAID and Japan remain engaged in donor dialogue processes and provide support for analytical efforts. Currently, several Northern European countries are seeking to expand involvement in environmental and governance issues, with an interest in touching also on forestry. Cross-sectoral donor coordination efforts in the Aceh reconstruction process have led to increased awareness of illegal logging and timber sourcing issues for all donors, with both UNDP and FAO sponsoring programs based with the Aceh Reconstruction and Rehabilitation Agency. Through this strategy, the World Bank will also be reaching out to donors engaged in decentralization, governance, poverty alleviation and law enforcement. Several donors are exploring the role of the Decentralization Support Facility in addressing key issues of decentralized land and forest management that affect livelihoods. This coordination could lead to a broader initiative for sustainable natural resources management.

**Law Enforcement and Financial Investigation Agencies.** Through a range of forest law enforcement and governance initiatives, the Bank and a coalition of partners including CIFOR, DFID-MFP, WRI and the Indonesian Working Group on Forest Finance, are engaging a range of law enforcement and financial agencies that have important roles to play in combating forest crime. The Bank and other partners are already working with the Coordinating Ministry for Political, Legal and Security Affairs (Menko Polhukam) who is bringing the Police, the Attorney General's office, and other concerned agencies together in the fight against illegal logging and trade. The Indonesian Financial Transaction Report and Analysis Center (or *Pusat Pelaporan dan Analisis Transaksi Keuangan, PPATK*) is firmly engaged with partners in developing and implementing the money laundering law enforcement approach. Following the money targets the financial backers of forest crime, not the field workers, often poor. This approach also opens doors for working with Banks and other financial service providers, who must become more active and prudent in relation to their customers' financial transactions (Setiono and Husein, 2005). The World Bank is already pursuing efforts to build capacity, strengthen policy and guidance, and improve coordination in this important area.

**Regional Governments and Decentralized Initiatives.** Many local governments are experimenting with innovative forest, watershed, and community-based natural resource management approaches, often with the help of NGO networks and universities. The Ford Foundation and the DFID Multi-stakeholder Forestry Programme support a wide range of efforts of this type using grants and technical assistance. World Bank managed GEF-MSPs have also been successful in achieving conservation objectives working at the provincial and district level. These initiatives need continued nurturing with flexible aid delivery mechanisms and technical assistance. It has been suggested that the Decentralization Support Facility should be interested in forest and land governance initiatives that include government and civil society partnerships.

**Land and Access Institutions.** There are increasing opportunities to engage on land use and access issues with central and local government, NGOs, farmer and adat groups, academics and business interests. The Department of Forestry established the Tenure Working Group in November 2001 to develop a discourse on forest management that is more just and sustainable. The Working Group aims to develop mechanisms for resolving conflicts and building understanding among multiple stakeholders about land use conflicts (as mandated by a legislative decree in 2001). This group has sponsored or participated in workshops and field visits to raise awareness and contributed to publications that aim to clarify the issues and recommend a course of action (e.g., Contreras-Hermosilla, A. and Fay, C. 2005). The Bank's rural development and social development units will continue to be actively engaged in land policy dialogue through the National Land Agency and other agencies and civil society networks.

**Environment and Conservation NGOs.** The environmental and conservation NGOs have been key partners of the Bank and other donors in developing analyses of key commercial forestry issues and contributing to ongoing dialogue processes (e.g., Forest Watch Indonesia, TNC, and WWF Indonesia). Several NGOs have developed constructive partnerships with the Department of Forestry on critical governance issues (e.g., Indonesian Corruption Watch and Greenomics). The Department is also embracing some positions and initiatives that NGOs have long advocated (e.g., industrial restructuring and social forestry). The Department is also loaning staff to conservation NGOs as part of a long term capacity-building program. Environmental and conservation NGOs, however, have not always worked in unison to provide a compelling alternative vision of the forestry sector. During discussions with the forest mission, some NGOs recommended that the Bank could be more usefully and broadly engaged in policy reform efforts, not strictly focused on forestry.

**International Research Institutions and Foundations.** CIFOR, ICRAF and the Ford Foundation are important partners in conducting analysis and supporting civil society organizations and wider dialogue processes. These organizations and the CSOs they support have contributed to technical analyses and promoted dialogue processes that have contributed to the current opportunities seen in the sector.

**Religious Leaders.** Indonesia's Muslim leaders are increasingly supporting conservation efforts, with active encouragement from the Forestry Minister, leader of an Islamic political party. In April, the Minister signed a five-year agreement on forest conservation with Nahdlatul Ulama, the country's largest Muslim group. Efforts to increase awareness and teaching of forestry and conservation issues through religious institutions are also supported by the World Bank's "Faith and Conservation Initiative" in partnership with Conservation International.

**Carbon Financing.** There are potentials for employing new market mechanisms to provide incentives to reduce deforestation, including expansion of carbon credits for reforestation, and even the potential to include “Avoided Deforestation” for the second implementation phase of the Kyoto Protocol. The Ministry of Environment, the Department of Forestry and Indonesian universities are engaged in this process.

**The Evolving Private Sector.** During the development of Indonesia’s forest sector, many private sector forestry firms and trade associations benefited from political connections and rent seeking, while adopting practices that did not benefit the forests or the people who live in them. Improvements in governance, rule of law and management and outcomes in the forest will depend on participation of corporate interests, which generate billions of dollars in economic output each year. Once, the forest industry was more monolithic and controlled by a few powerful trade associations, where crony capitalists decided timber allocations and export licensing rules. Now, though, it seems that furniture makers, pulp producers, plywood and sawn wood manufacturers, all face different market forces and see their opportunities for the future differently. There are signs that at least some parts of the corporate sector are adapting in ways that will contribute to solving forest sector problems. Progressive firms are already making investments in plantations and retooling that will allow them to demonstrate sustainability and efficiency in global markets. The trade associations have also evolved from the days of Apkindo: many are under new management, better represent the needs of their members – firms trying to do business in the global economy – and are more open to public consultation and transparency. The industry no longer speaks with one voice. Progressive forces denounce illegal logging because they recognize that international perceptions of Indonesia influence their ability to access lucrative foreign markets.

**International Buyers and Markets.** The rise of China and India as both competitors and markets for forest products has led to new realizations about the need to improve the competitiveness of Indonesia’s forest industry, which has been protected and subsidized at times in the past, leading to inefficiencies and waste in production methods. As well, the certification movement, environmental networks and greater scrutiny by civil society organizations (e.g., the Global Forest and Trade Network) are swaying market forces by influencing major buyers in developed countries to demand greater sustainability and proof of proper forest and land management approaches among timber, furniture and paper suppliers.

**Private Partnership Potential.** Some NGOs (WWF and TNC) and the IFC have developed partnerships with more progressive elements of the private sector to work on issues such as certification or high conservation value forest. Most of the early partnership opportunities have already been found. However, additional opportunities will arise as market forces and opportunism continue to differentiate various groups within the industry. Donors can (and have) influence this process through policy initiatives that favor access to their domestic markets for legally-sourced forest products, through support to NGO networks and civil society watchdogs, and through private sector partnerships. Optimism must be tempered, however. Efforts to increase financing in the forest sector or to work with individual firms would have to recognize that firms may misjudge costs, underestimate environmental impacts, and use overly optimistic future projections. As noted in the previous section, there is a need for better due diligence practices and to learn lessons from past private sector entanglements, especially in the pulp sector (CIFOR, 2006).



Forest Canopy  
Kerinci Seblat National Park

## 2. COUNTRY AND SECTOR: EXPERIENCE AND LESSONS

The Indonesia Forestry Strategy was developed in the context of the Indonesia Country Assistance Strategy, the East Asia Pacific Forest Strategy, and the Bank's Environment Strategy. These documents are reviewed here for relevant background and strategic insight into forestry sector issues that must be addressed at the country level.

### 2.1 Linkage with Country Assistance Strategy

The World Bank Group's Country Assistance Strategy (2004 – 2007) is based on the assessment that restoring macroeconomic stability has brought poverty down, but further progress is needed. Indonesia has successfully regained macroeconomic and political stability, but poverty reduction remains a challenge, and governance concerns cloud its achievements. Indonesia continues to under-perform its neighbors in access to quality health, education and other basic services, important indicators of the Millennium Development Goals (MDGs). Indonesia's progress toward the MDG on "ensuring environmental sustainability" is worsening in terms of the proportion of land covered by forest. As noted above, nearly a quarter of Indonesia's people live on state-claimed forest lands, a quarter of which lack trees. On average, these rural people are poorer than the majority of Indonesians. Further progress in reducing poverty is prevented by two major factors—low investment and weak service provision—which in turn are caused primarily by problems of governance.

The Bank's country strategy is focused on addressing these problems through three main thematic areas:

#### **Opportunities for Forestry Initiatives in CAS Objectives**

##### **"Improving the Investment Climate for Poverty Reduction"**

###### **Stronger, diverse financial sector; more equitable access**

- Improved access of SMEs and the rural poor to resources, markets and services from natural environments and increased capacity to reap benefits through enterprises

###### **Supportive environment for competitive private sector**

- Improved corporate governance and competition through greater transparency, int'l standards of performance, and investments for efficiency and competitiveness
- Improved opportunities for investment in SMEs and community-managed enterprises to use forest resources and land productively and sustainably
- FLEG efforts reduce forest crime which distorts local economies and undermines the investment climate

###### **Sustainable income opportunities for poorer households**

- Land rights policies meaningfully implemented on forest lands through decentralized mechanisms that encourage community participation and poverty targeting
- Titling efforts linked to communities seeking access/reform of land rights in non-forested areas (with partners)
- Augmented CDD programs to include village level stewardship of environmental resources (forests, watersheds, coasts, etc) for local livelihoods
- Increased in tenure and policy security for small holders and agroforesters to increase investment and productivity of agricultural and forest land

improving the climate for high quality investment, making service delivery responsive to the needs of the poor, and the core issue of governance. The strategy is being implemented through four platforms, focused on community-driven development, local services, public utilities, and national lending. The Bank leverages the projects it finances with analytical work, policy advice, technical assistance, strategic partnerships and capacity building to systematically increase standards of governance at each level of government. The Bank also engages intensively with Indonesian society and provides increased analysis and advice on how to help local governments and communities provide opportunities and services, especially to the poor.

Forestry issues are being addressed mainly through activities related to “improving the investment climate” and “governance.” Opportunities for forestry initiatives in the context of these two CAS objectives are identified according to desired outcomes identified in the strategy in the text boxes in this section.

## **2.2 Linkage with East Asia Pacific Forestry Strategy**

The World Bank’s EAP Forestry Strategy seeks to support governments and communities in the introduction and expansion of sustainable forest management, conservation, and development;

**Opportunities for Forestry Initiatives in CAS Objectives**

**“The Core Issue of Governance”**

**Development planning more responsive to constituents**

- Local government planning processes and natural resource management frameworks explicitly address the use, management, and community control of forested areas balancing demands for protection, economic development, and livelihood improvement
- Strengthened regional participatory planning initiatives for forest conservation and environmental protection
- Forest sector transparency improved through implementation of FOMAS, including information about flows of forest sector resources and revenues

**More effective implementation of decentralization**

- Revisions to Law 41/99 on Forestry revised to ensure greater consistency with decentralization laws
- Expansion of decentralized conservation forest management initiatives with community and CSO partners

**Establishment of a credible, impartial justice sector**

- Improved law enforcement approaches and improved forest sector compliance through FLEG initiatives

and to use dialogue and investment as levers to reform underlying distortions in policy, tenure, and governance. The EAP Forestry strategy views management as the main entry point because it permits a focus on observable and measurable inputs and outcomes. The Regional strategy emphasizes iterative processes of policy and institutional engagement and dialogue, coupled with investments in analytical work and technical assistance in the medium term. It proposes that levels of engagement be guided by evidence of positive progress in management and commitment. The strategy also notes that

the Bank should also communicate its objectives, perspective and motivations behind this approach to external stakeholders. Where reforms take hold and progress is measurable, the Bank can deepen its engagement.

In Indonesia, the Bank is re-engaging in forestry through increasing and deeper policy dialogue and information exchange. The Bank will take a measured approach in light of concerns about government commitment and capacity. The Bank will opportunistically pursue areas of interest proposed by government as ways of expanding and exploiting entrée into a richer dialogue on the underlying policy problems and distortions that inhibit the forestry sector. In particular, the Bank is focusing on bringing other non-forestry agencies into the dialogue, as well as other donor agencies and civil society, as much as possible to develop constituencies for change.

### **Opportunities for Indonesia Forestry Program in Context of Regional Strategy**

#### **Forest law enforcement and governance**

- Continue to develop, support, and expand FOMAS and 10 Step Program
- Use donor-funded projects to show case regional enforcement initiatives (e.g., Aceh Forestry)
- Engage in regional policy dialogue processes, including FLEG, promoting Indonesian progress, as able

#### **Investments in natural forest management and biodiversity conservation**

- Use analytical work to support GOI industry restructuring and rationalization efforts
- Support FOMAS to publicize results of resource assessments and protected area encroachment
- Mainstream forestry/ biodiversity/ conservation concerns into the Bank's CDD program
- Continue/expand use of GEF grants and MSPs to promote improved conservation management

#### **Investment in plantation area expansion**

- Evaluate options for accelerating plantation investment, with community participation.
- Support Dept of Forestry analytical efforts to define industrial needs, establish appropriate incentives
- Consider innovative financing sources including carbon offset mechanisms, environmental service payments/compensation, and private sector investment/stimulation.

#### **Maintenance of environmental and social safeguards**

- Increase cross sectoral dialogue toward mainstreaming forestry issues in wider AAA and policy work

#### **Maintenance of rural development and agriculture portfolio**

- Link to rural development and CDD efforts to increase productivity of agroforestry plantations
- Increase analytical work to improve, clarify, rationalize land use access in favor of SME and community use of forest lands, especially those non-forested areas outside of conservation areas.

The EAP strategy places special emphasis on forest law enforcement and governance as the most pressing need and best opportunity for demonstration of political will for improving management. The strategy notes that one way forward in Indonesia is based on recent expressions of interest

from the government, and the possibility of engagement on the key issues of law enforcement, information transparency, and plantation acceleration with greater community involvement. The regional strategy notes that there have been tremendous changes in Indonesia and in its forestry sector in the last decade, but the issues of corruption, rent seeking, and distorted incentives still remain, together with poorly implemented decentralization and illegal logging. Following up on recent requests, the Bank is using the GOI's focus on forest finance and plantation acceleration as an opening to wider discussion of forest tenure, land use, environmental and legal issues. Related opportunities and options are identified in the following text box.

### **2.3 Relationship with Rural and Agricultural Development Programs**

The forestry sector improvements and approaches outlined in this strategy – resource governance improvements, industry restructuring and revitalization, policy dialogue on tenure and access for small holders, support for small and medium enterprises for diversification and growth, and community-based plantation initiatives – are fully consistent with the Bank's rural development objectives and priorities, as well as the GOI's revitalization program for the natural resource sectors. Broadly, forestry is part of the Agriculture and Natural Resources primary economic sector, which employs 45 percent of Indonesians and contributes 17.5 percent to GDP. While this sector provides a relatively stable base of employment and contributes vital raw materials to the manufacturing sector, growth is stagnating. The Bank's Rural Development Unit recognizes that revitalizing the rural economy will require an emphasis on new directions and renewed attention to the fundamentals. There is a need to focus on high value commodities and diversification. Smallholder tree/industrial crops, horticulture, fisheries, and livestock, will need to make up most of the growth of agricultural output.

#### **The Bank's Rural Development Portfolio**

The Bank's rural development approach focuses on raising agricultural productivity, supporting local governance reforms, improving land titling and administration policy, and strengthening coastal resource management. The Initiatives for Local Governance Reform Project (ILGRP) supports select district governments in improving transparency, accountability, financial management and participatory practices. The proposed Farmer Empowerment through Agricultural Technology and Information (FEATI) project will improve delivery of technical services to the farming community for increased incomes and agriculture modernization and promote public-private partnerships. In water and watersheds, the Bank has also supported a new water resources law, strategic institutional and capacity building program, creation of new river basin and management organizations, including autonomous water user associations. The Land Administration Project (recently ended) helped to improve tenure security, strengthen land administration capacity, address accountability issues, and encourage the development of a comprehensive land policy framework. The ongoing Land Management and Policy Development Project (LMPDP) aims to deepen this agenda and secure a further 2.5 million land titles. The Multi-Donor Fund for Aceh and Nias is supporting the Reconstruction of Aceh Land Administration (RALAS) Project which aims to improve land tenure security in Aceh, partly through the issuance of 600,000 land titles. The second phase Coral Reef Rehabilitation and Management Program aims to improve sustainable coastal and marine resource management by placing 4,725 square kilometers of coral reefs under sustainable community-driven collaborative management. A proposed Marginal Fishers Project will broaden support to participatory planning and development in very poor coastal fishing communities.

The Bank understands that productivity gains are key to smallholder income growth. Broad-based growth in rural productivity will need solid systems for generating, adapting, disseminating technology to smallholders, through research and extension. Also, sustainable natural resources management is key to rural development. The growing water scarcity, increasing costs of developing new sources, neglect of irrigation schemes maintenance, soil degradation, groundwater depletion, water pollution, and wasteful water usage, are posing sustainability concerns. In both forest and coastal areas, weak governance/institutions and common property mismanagement are putting at risk important products that contribute enormously to both GDP and employment. Land conflicts/disputes, concentrated ownership and tenure of land, high cost of title transfer, and lack of legal protection over land rights affect investments and income.

The agenda for the future needs to focus on agricultural services in a decentralized context and effective natural resource management. Indonesia's President has taken a leadership role in developing an agenda for the revitalization of agriculture, fisheries, and forestry that was formally launched in June 2005. In natural resources management, while the government has undertaken measures to strengthen institutional arrangements and develop updated policy, regulatory and administrative frameworks, the Bank recognizes a number of key issues that still need to be addressed (see text box).

#### **2.4 Relationship with International Finance Corporation Programs**

The International Finance Corporation (IFC) has been gradually re-engaging in Indonesia since 2003, after a slower period of investment and legal complications due to the Asian financial crisis. To address corruption and transparency issues that were highlighted in court cases dealing with problem loans, the IFC convened businessmen and government officials in the Private Sector Forum, which has now evolved into the CGI's Investment Climate Working Group. IFC has learned that a sponsor's reputation is a primary consideration in a business relationship, that credible international sponsors can be valuable partners in times of crisis, and that local currency lending is an important priority.

In 2003, IFC launched a three year growth phase to enhance its impact in achieving the GOI's key economic goals for job creation, infrastructure, and investment climate improvement. IFC expects to invest in financial markets, infrastructure, pro-export sectors (primarily commodities); and SMEs and micro-enterprises. IFC expects to provide advisory services on the investment law, municipal

##### **IFC Program for Eastern Indonesian SME Assistance**

IFC-PENSA is a technical assistance facility supporting small and medium enterprise development in Eastern Indonesia. IFC-PENSA's Sustainable Wood program creates business opportunities in the forestry/furniture sector by improving environmental management and encouraging sustainability, especially through sourcing good wood and making links to markets seeking environmentally-friendly products. The facility has funding from multiple donors. IFC-PENSA believes that the best way to combat illegal logging is to encourage the trade in sustainable wood. The program has demonstrated that it makes good business sense for furniture manufacturers to use fast growing plantation species, in preference to traditional and increasingly scarce species, such as teak which costs 40% more. Large and small furniture makers are now purchasing this competitive alternative and meeting orders from the environmentally conscious markets of Europe and North America.

simplification (one stop shops), SMEs and micro-credit solutions and Aceh. Indonesia is an ideal market for collaboration throughout the World Bank Group toward making a significant impact on infrastructure and sub-sovereign finance, working with government, state owned enterprises, municipalities, and the private sector.

IFC has enhanced its advisory presence to help address the issue of weak investment climate, one of the GOI's priority efforts. IFC works in four key areas: national level policy reform, sub-national level policy reform, gender and business, and business information, with emphasis on the first two. Policy reform challenges include bureaucrats with little incentive to weaken their authority, perceptions that Indonesian businesses must be protected from foreign competition, and uncertainty over decentralized authorities granted to sub-national governments. IFC is working with five municipalities on reducing red tape associated with licensing. In January, the Minister of Trade called for national legislation requiring district governments to establish One Stop Shops and asked the IFC to help in drafting guidelines on how they would operate at the district level.

The IFC has made investment in small and medium enterprises (SMEs) a core part of its program because of their important role in economic growth and job creation. In 2003, the IFC established a \$25 million technical assistance facility to support SMEs with assistance from Japanese, Dutch, Canadian and Swiss governments. The IFC Program for Eastern Indonesian SME Assistance (see text box) is one of the largest providers of advisory support to SMEs in Indonesia. The IFC also sees an opportunity for creating a facility to assist banks to analyze and manage the risks of SME investments in the forestry sector.

## **2.5 Lessons**

Based on the CAS and the Regional Forestry Strategy, the most relevant lessons have been integrated into this strategy, including:

- Calling attention to poor governance and corruption.
- Supporting improved transparency, oversight and voice.
- Channeling funds through decentralized CDD programs, while following forestry management rules and broader environmental protection objectives.
- Using development policy lending in a limited way to support government-driven reform efforts (and incorporating environmental sustainability objectives to the extent possible in later stages). Dialogue and consensus are more important than conditionality, though it remains useful.
- Developing partnerships with donors and civil society to enhance effectiveness and collaboration.
- Addressing decentralization directly and realistically.
- Building on analysis to better inform the design of operational interventions and affect policy change.
- Using national level reforms (e.g., of industrial concession systems, agro-industrial policies and other macro-economic policies and incentive systems) to create physical and policy space for small-scale community-based management alternatives. Focusing on the larger scale may still be necessary and important to address deep-seated distortions.
- Making forestry goals and objectives explicit and specific.

### **3. INDONESIA'S FOREST GOALS AND BANK ASSISTANCE OPTIONS**

This section describes the relationship and compatibility between Indonesia's and the Bank's forest sector goals. This is a basis for a discussion of different assistance options and instruments, as well as different levels of engagement that could be pursued to address these objectives.

#### **3.1 Indonesia's Forest Sector Objectives**

Indonesia's legal framework establishes certain goals for the forest sector, including economic output, equitable distribution of benefits to improve people's welfare, watershed protection, and conservation. These goals are consistent with the Bank's policy on forest management that supports the three broad goals of promoting economic growth, providing widespread and equitable benefits to society (livelihoods and poverty reduction), and sustaining environmental services and benefits. However, Indonesia is not meeting all of these goals, especially in the areas of sustainability and equity. In addition, some forest sector stakeholders question whether specific objectives and policies are established with sufficient participation and consultation. There is an issue of management performance in meeting the objectives laid out by the legislature and at the Ministerial level. The Bank's strategic options need to consider the incentives, management structures and interventions that can improve performance.

#### **Indonesian Law 41 Year 1999 on Forestry**

"Forest is a blessing controlled by the State to provide multiple uses. It should be managed, utilized, and maintained for people's maximum welfare in a good, fair, wise, transparent, professional and accountable manner. Sustainable forest management should accommodate community aspirations and participation, customary and cultural, and social values" (paraphrased). Also, forestry administration "shall be based on benefit and sustainability, democracy, equity, togetherness, transparency and integration" and "shall be oriented for people's maximum welfare based on equity and sustainability principles."

The Bank can best assist Indonesia in two main ways: first, supporting improved policies and management practices to help Indonesia deliver on its own stated goals and commitments; and second, promoting greater dialogue among stakeholders to ensure that the goals of forest management are clear, realistic, and widely agreed upon. The first path involves familiar Bank instruments including policy analysis and technical assistance. The second path involves supporting institutions, mechanisms, and processes for engaging in policy dialogue with the public, especially among affected stakeholder groups. The Bank's strategy for engagement in forestry in Indonesia and the current portfolio of activities are designed around these two approaches. The strategy focuses on governance, management, and FLEG, and considers incremental steps that can demonstrate the GOI's increasing commitment and action on the ground. At a later stage, after demonstrated success with some of the governance and policy aspects of forest management, there may be mutually agreeable areas where lending would be appropriate.

### **3.2 Strategic Assistance Options**

Steps toward more structured forest management will help to create the predictability, transparency, and accountability needed for improved governance. Good management must be built on accountable institutions, rule of law and sound policies. While Indonesia's legal framework is reasonable, the policies it pursues are often not consistent with that framework. Reforms are needed to: make information transparently available; support GOI led initiatives on illegal logging and industrial restructuring; protect existing conservation areas; clarify roles, responsibilities, and incentives under decentralization; and support dialogue and partnerships. In order to justify new funding, especially from GEF, there will have to be clear and convincing progress in performance and impact.

Based on the findings above, review of the CAS, and Regional Forestry Strategy, the Forestry Mission in June 2005, as well as stakeholder consultations, options for several possible levels of engagement have been examined. The first level is the proposed starting point, or base level of engagement, which calls for scaling up and mainstreaming of successful initiatives and approaches. The medium level of engagement would involve deeper and more focused analytical work, possibly including development policy lending conditions. The high level of engagement would build on prior efforts and potentially include lending operations that help to resolve prior issues. This sequenced engagement approach calls for flexible Bank responses over a relatively long and dynamic period of institutional reforms, which will require adaptability, participation and commitment to overall goals, not a rigid blueprint. Non-lending operations provide the means for meaningful, country-driven engagement. Each is developed in more detail below.

In the base case of engagement, the Bank would continue and deepen its analysis and advice activities using internal resources and grant funding. The focus would be on existing portfolio activities, including FLEG and transparency, industry restructuring and plantation acceleration (as an entry point for community-based initiatives and land use reallocation), CDD pilot projects, and conservation initiatives. The Bank's current activities reflect this increased level of engagement. If progress and performance on forest management and policy reform continue, the Bank could move into a moderate level of engagement. This would involve deeper and broader analysis and advice activities with more focus on operational aspects of FLEG, including forest monitoring and interagency collaboration on law enforcement. Deeper engagement would also be expected on industry restructuring to better balance supply and demand, including efforts to promote community-based timber growing efforts by improving the enabling conditions. Further, the Bank could consider linking forest governance reforms into the Development Policy Lending (DPL) process, especially in the areas of transparency and forest industry revitalization. Additional analysis and advice would be pursued on land use, resource access and rights issues. The Bank would also expect to scale up proven approaches in CDD and conservation, building on results of existing activities.

Again assuming continued progress, as well as positive experience with analytical activities and policy lending, the Bank could consider a higher level of engagement. At this level, lending operations could be added to the analytical and grant-funded activities, after some experience is gained and there is interest on the part of GOI and stakeholders. Lending operations would be considered to resolve problems that have been thoroughly analyzed and agreed upon through earlier stages of engagement. This could include forest monitoring, training and technology for law enforcement and information systems, plantation development or small- and medium-

enterprise promotion. Larger investments in rural livelihood development could be considered, if there is considerable progress on issues of tenure and interest in forest land use rationalization.

**Alternative Approaches.** There is also an option of lowering the level engagement from the current state. However, this is not regarded as realistic or justified in the context of current signs of progress, as well as the increasing level of interest by the GOI, the Department of Forestry, the Bank and other donors, over the last year especially. As well, this strategy argues that the Bank should be engaging, not ignoring, a country and a sector with such great importance and potential in terms of global biodiversity, carbon, trade and poverty alleviation. Also, without increasing cross-sectoral engagement, there is some risk that actions by other Bank programs could contribute to forest loss or further muddy the policy framework affecting forest lands. If progress at current levels of engagement is not sustained, the Bank could reduce efforts to low key analytical work and dialogue with GOI and the donor community, as was the case in 2000-2003.

There is also the option of considering more rapid and deep engagement on fundamental issues, rather than an incremental approach – for example, pressing immediately for fundamental changes in industry structure or the distribution access rights to forest resources. Land rights and tenure security are fundamental issues for rural development and community livelihoods and these are already important elements in ongoing dialogue processes and analytical work, in partnership with other donors and institutions. The GOI's Poverty Reduction Strategy offers some openings in this area. There is some progress in special cases and continuing experimentation with alternative models of community based forest management, serving as demonstrations and confidence-building models. The GOI is expressing increasing willingness to discuss alternative approaches for allowing access to and use of state forest areas. The strategy recognizes this as an important area for continuing dialogue, partner support, and analytical work to document the economic and other benefits of wider access to state-claimed forest lands. However, there are still risks that any opening of access to communities could be derailed by burdensome regulations, hidden agendas, lack of trust or approaches that use communities as instruments to achieve objectives established elsewhere. For these reasons, land rights should be only one of several entry points for re-engagement in forestry issues in Indonesia.

In contrast, however, law enforcement and transparency are also fundamental issues where the entry points are more immediately clear and the potential for progress is illustrated in a broad portfolio of activities with the GOI and in the region. These entry points were not available even a few years ago and good progress and partnership are already apparent. Strategically, it makes some sense to focus on these areas where active progress is possible, while building the case and identifying the entry points for more focused work on land and rights in future phases of engagement. The possibility of rapid and deep engagement also faces practical and operational difficulties. Practically, it would be difficult to engage in a large or conditionality-based program, if the GOI is not actively considering major borrowing for forestry. Operationally, the Bank has insufficient confidence or trust for large portfolio expansion in an area where the potential for progress remains uncertain. Incremental engagement is seen as one way to build confidence toward deeper engagement in the future.

### **3.3 Levels of Engagement: Activities and Risks**

The Bank envisions employing different assistance instruments at different levels of engagement. The kinds of activities that could be undertaken at each level of engagement are outlined briefly

and presented in a table in the next section. Indicators of the conditions that would allow moving from lower to higher levels of engagement are also organized into a table in the next section.

**Base Level: Scaling Up and Mainstreaming.** In this current level of engagement, the main entry point is governance foundations – transparency and rule of law – that are required preconditions for any other intervention. Under this option, the Bank would use analytical and advisory activities (AAA) and other non-lending operations (e.g., trust funds, grants) – as well as convening power – to catalyze action on forest information management and monitoring, as well as forest law enforcement policy and capacity building. The Bank is currently engaged in the following activities:

- Develop, finance (through trust funds and grants), and help to implement the Forest Monitoring and Assessment System (FOMAS), which would take steps to improve monitoring and aggressive follow-up of offenders and case tracking.
- Support institutionalization of the “10 Step Program to Tackle Illegal Logging,” to support policy reform and action on illegal cutting, transport, processing, and export.
- Supervise implementation of the Aceh Forest and Environment Project, which will help to provide a provincial-level demonstration case for forest governance initiatives.

Scaled up engagement also entails increased analytical and advisory activities to stimulate action and progress on industrial restructuring and balancing supply and demand. In addition to support for working groups and partners, the Bank is currently studying options for accelerating development of timber plantations with community involvement. This is an entry point for continuing discussion of the roles and rights of communities in forest land, as well as issues of conflict and investment climate. This effort is also congruent with the IFC's strategy to support small and medium-scale enterprises in timber sourcing, processing and accessing export markets.

#### **Cross Sectoral and Mainstreaming Opportunities from CAS**

**Creating Income Opportunities for Poorer Households and Farmers.** The Bank forestry program will benefit by integrating or coordinating with Bank programs addressing the challenges faced by the 65 percent of Indonesia's poor who rely on agriculture, land and forest resources for their livelihoods. Synergies and partnerships can be sought with: The Poverty AAA activities, the proposed FEATI project, the IFC's PENSA program, the CDD platforms, and efforts to accelerate land titling, and improve water/irrigation infrastructure, and strengthen local government capacity.

**The Issue of Governance.** Forestry certainly exhibits the gap between gains in transparency and democratic competition and genuine government accountability for demonstrable results. The forestry program will benefit by integrating or coordinating with Bank programs addressing the challenges related to land use and local governance. Specific opportunities may arise from coordination with local level CDD efforts; participatory mechanisms in WISMP, COREMAP, Catchment Protection, and FEATI; legal system improvement activities, including Justice for the Poor.

In biodiversity conservation, the Bank would continue to support small-scale, convincing forest initiatives and pilot projects (through NGOs and medium-sized projects in supportive districts) to improve conservation and sustainability of the protected area network. The Bank will continue to investigate ways to scale up this positive experience through larger, more coordinated efforts with the Department of Forestry. The Bank would also step up and focus efforts to convene a dialogue with donors and civil society toward a joint position, which could later form the basis for joint intervention strategies with interested donors, as has been done in Brazil and Cambodia.

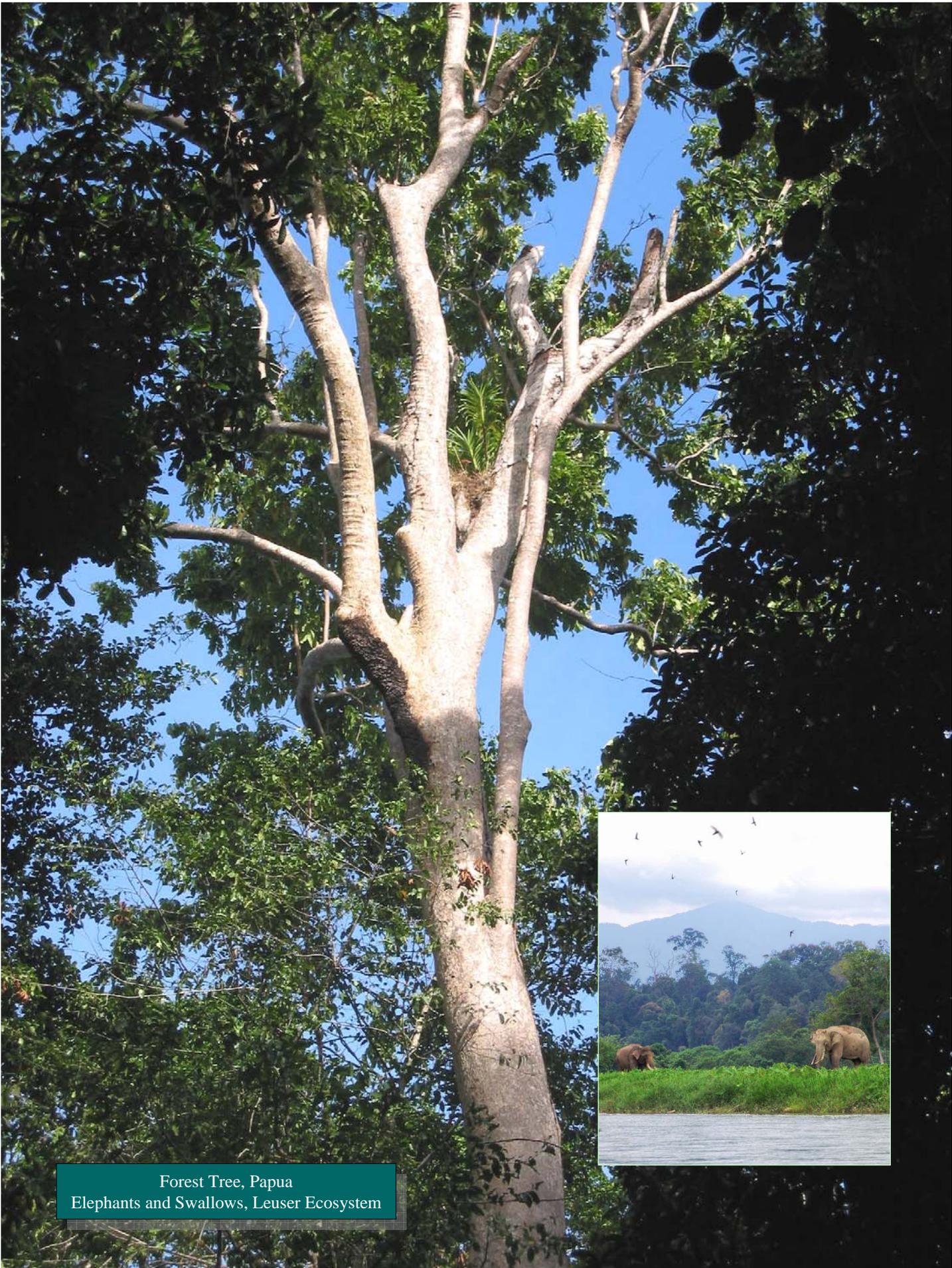
Mainstreaming would build environmental protection and forestry issues into activities that involve actors beyond the Department of Forestry, including work with other departments on customs, trade and forest crime; local governments in the ILGRP and USDRP projects; and with communities in KDP (with proposed GEF funding). Through economic and sector work, public expenditure reviews, and poverty and environment studies, the Bank would aim to mainstream forestry concerns into the larger policy context, especially with regard to public revenue losses, corruption, and poverty alleviation. Some opportunities for mainstreaming forestry and environmental issues into the Bank's current CAS portfolio are summarized in the text box.

There are some risks to this approach. The Bank would face political resistance from some factions within the GOI, the Department of Forestry, and the industry, especially those connected with the powerful financial interests profiting from forest crime. On mainstreaming, there would be a challenge in establishing 'buy in' from a wider range of powerful ministries (Finance, Industry, etc) on the appropriate sustainable natural resource development path. At the same time, there is some risk of not being involved in such an important sector in such a large country.

**Moderate Level of Engagement.** This level of engagement represents approaches and activities that are logical as follow on to current activities, but have more far-reaching implications for reform of the sector. While still largely driven by analytical work and grant funding, this level of engagement would begin to develop the vision and components for real investments that could be considered in the future, depending on progress on the indicators mentioned above. In this moderate level, forest industry restructuring and land use rationalization could be entry points, as well as planning for broader protected areas initiatives, with other donors. Analytical work being initiated now could provide the background needed to engage in broader level policy and governance reforms initiated through the DPL process, if there is sufficient interest. In addition to the risks mentioned above, progress at this level of engagement will likely face resistance from some elements of the GOI and NGOs, opposed to conditionality in borrowing, as well as the entrenched private sector, opposed to industrial restructuring.

**High Level of Engagement.** This option envisions continuation of analysis and assistance activities, but also includes possible lending operations to address high priority issues of mutual interest. Lending operations could be envisaged to scale up operational components of FLEG, transparency and forest monitoring initiatives. Lending could also be considered to assist the GOI and the forest sector with the costly transition to a new forest industry organizational structure, with many more small and medium enterprises and processing oriented toward newer, more diversified products based on planted timber resources. In addition, the nature of analytical and advisory activities would shift to take on more sensitive topics, including forest land rationalization, focusing on deforested, degraded lands. Step-wise progress could be made in promoting mainstream political interest, based on the need for economic opportunity for the rural poor. More windows of opportunity would be explored for engaging in dialogue outside the Dept.of Forestry, including the legislature, the national land agency, and local governments.

The main risk at this level of engagement relates to lending operations. All the risks of corruption and poor management will become more sharply pointed in a lending relationship. Some elements of the GOI and civil society will not react favorably to this possibility, as is noted regularly at CGI meetings. To reach this level of engagement, of course, there would have to be major progress on prior technical, analytical, dialogue, and constituency efforts; GOI interest in borrowing; and clear demonstration of major benefit from borrowing.



Forest Tree, Papua  
Elephants and Swallows, Leuser Ecosystem

## **4. WORLD BANK INDONESIA FOREST STRATEGY**

### **4.1 Increased Engagement and Mainstreaming**

The World Bank proposes to scale up and mainstream assistance in Indonesia's forestry sector, in line with the base case option outlined above. Scaling up means increasing engagement to catalyze action within the main entry points of governance (transparency and rule of law) and industrial restructuring, through accelerating community-based plantations. Dialogue and analytical and advisory activities will continue on issues of community rights and access. Scaling up also means building on existing models and successes to develop more comprehensive programs, both in conservation and collaborative management at community level. Mainstreaming will entail building environmental protection and forestry issues into activities with multiple actors in and out of government, including customs, trade, local governments, communities, and into larger scale macro-policy interventions focusing on public revenue losses, corruption, and poverty alleviation.

This is a reasonable course of action consistent with the directions in the current CAS, as well as the pillars of the regional forestry strategy. If there is reasonable progress in key areas, there is the potential in the medium term to increase the level of engagement with additional activities and financing instruments, including DPL and lending. It would be appropriate to evaluate performance in the forestry sector in the context of the new CAS preparation in mid 2007. The table on the following page shows how the activities and funding instruments could evolve to higher levels of engagement, if performance and commitment on existing activities and reform initiatives are sustained. Another table illustrates the kinds of indicators that will be used to assess readiness to take on a deeper level of engagement. It is important to recognize that progress on indicators may be more rapid in some areas (e.g., enforcement and transparency) than in others (e.g., industrial restructuring).

In the remainder of 2006, the focus will be on building systems to improve transparency, accountability, rule of law and governance, and evaluating the feasibility of greater involvement in industrial restructuring – specifically on the supply side by improving the enabling conditions for community plantation development. At the same time, the Bank will also begin implementation of a large scale forest conservation project in Aceh under the Multi Donor Fund for Aceh and Nias. The Bank will also initiate studies to help to bring forestry and environmental issues into broader macro-economic and policy reform discussions, outside the forestry sector, including in finance, poverty, and land policy. In FY07, the Bank will also begin implementation of an environment window for KDP, with GEF and bilateral donor funding. The Bank will continue policy dialogue and analysis to contribute to dialogue among GOI, donors and CSOs on forest land use and access issues and community-based initiatives.

This moderate, but strategic, increase in the level of engagement is a natural progression from past steps, can be accommodated with trust funds and resources already identified, and lays the foundation for deeper engagement, if indicators of progress are achieved. The Bank is proposing a balanced approach, strengthening positive incentives where possible, and increasing negative feedback where necessary. On the positive side, the Bank is co-funding initiatives within the

Department of Forestry that will help to build the base for improved transparency and forest governance. On the negative side, for example, the Bank is using cross-sectoral policy dialogue and media and stakeholder awareness to focus attention on misguided development projects that would contribute to forest degradation. This path allows the Bank to build on current opportunities within the government and validate commitment and progress, without yet committing to major investment. This step-wise approach is also consistent with Indonesia's political calendar. This strategy would also draw on a wider range of Bank resources to engage on cross-cutting governance and policy issues that affect the environment, natural resources, and forest lands in the context of the CAS. The next section discusses how the current portfolio of activities will support and advance the forestry strategy for Indonesia.

Forest Strategy: Instruments and Progressive Levels of Engagement		
Base Case	Medium Engagement	High Engagement
<b>Governance and Law Enforcement</b>		
<p><b>AAA</b></p> <ul style="list-style-type: none"> <li>Forest Law Enforcement Initiative (10 Steps) and Forest Transparency Initiative (FOMAS)</li> <li>Donor &amp; NGO Partner Engagement and Dialogue</li> <li>Regional FLEG Engagement</li> </ul> <p><b>Grant Funding</b></p> <ul style="list-style-type: none"> <li>Forest Governance Initiative</li> </ul> <p><b>Dialogue/Convening</b></p> <ul style="list-style-type: none"> <li>Inter Agency WG with Menko Polhukam</li> </ul>	<p><b>AAA</b></p> <ul style="list-style-type: none"> <li>Forest monitoring, law enforcement policy studies &amp; capacity building</li> <li>Promote interagency collaboration on integrated forest crime, trade and AML</li> <li>Donor dialogue, regional FLEG &amp; engagement with industry groups</li> </ul> <p><b>DPL</b></p> <ul style="list-style-type: none"> <li>Rule of Law improvements for transparency of forest sector info, interagency enforcement coordination, strategically prioritized investigation support</li> </ul>	<p><b>AAA</b></p> <ul style="list-style-type: none"> <li>Dissemination of results from analysis of FOMAS databases (e.g., forest concessions, forest cover, and conservation financing)</li> <li>Increasingly harmonized donor work on enforcement efficiency &amp; targeting</li> <li>Regional FLEG Strategy Alignment</li> </ul> <p><b>Investment Lending</b></p> <ul style="list-style-type: none"> <li>Forest monitoring, GIS and Remote Sensing technology and training</li> <li>Forest law enforcement technology, training, database management services</li> </ul>
<b>Forest Industry Restructuring and Financing</b>		
<p><b>AAA</b></p> <ul style="list-style-type: none"> <li>Forest Industry Restructuring Dialogue &amp; Analysis</li> <li>Collaboration with IFC on SMEs and value added processing</li> </ul> <p><b>Grant Funding</b></p> <ul style="list-style-type: none"> <li>Alternatives for accelerating community based Plantations (WWF-WB Alliance)</li> </ul> <p><b>Dialogue/Convening</b></p> <ul style="list-style-type: none"> <li>Ministry coordination on community plantations, land access, CBFM</li> </ul>	<p><b>AAA</b></p> <ul style="list-style-type: none"> <li>Forest industry restructuring: impact analysis, employment mitigation strategy</li> <li>Improving the incentive basis for forest fiscal systems and revenue sharing mechanisms</li> <li>Improving business climate for investments in retooling, SMEs, plantations</li> </ul> <p><b>DPL</b></p> <ul style="list-style-type: none"> <li>Improvements in enabling conditions for forest industry investment with community partnerships</li> </ul>	<p><b>AAA</b></p> <ul style="list-style-type: none"> <li>Industry restructuring approaches to capitalize on SMEs and future market potentials</li> <li>Support for Chain Of Custody and Certification Efforts</li> </ul> <p><b>Investment Lending</b></p> <ul style="list-style-type: none"> <li>Plantation development &amp; community involvement</li> <li>SMEs or community-based enterprises</li> </ul>
<b>Livelihoods</b>		
<p><b>AAA</b></p> <ul style="list-style-type: none"> <li>Analysis of accelerating plantation development through community participation</li> <li>Internal integration: local governance and rural development projects</li> </ul> <p><b>Grant Funding</b></p> <ul style="list-style-type: none"> <li>CDD Pilot Projects with environmental components(CIDA, GEF)</li> </ul> <p><b>Dialogue/Convening</b></p> <ul style="list-style-type: none"> <li>Land policy, role of smallholders, rural investment climate, CBFM</li> </ul>	<p><b>AAA</b></p> <ul style="list-style-type: none"> <li>Improvements in policy enabling conditions for CBFM and community plantations</li> <li>Poverty &amp; land use studies: Depth &amp; distribution relative to different forest types; targeting approaches</li> <li>Engagement on land and resource access &amp; rights issues</li> </ul> <p><b>Grant Funding</b></p> <ul style="list-style-type: none"> <li>Scaled up CDD Projects with Environmental Components (CIDA, GEF)</li> </ul>	<p><b>AAA</b></p> <ul style="list-style-type: none"> <li>Timber plantation approaches that benefit communities and the poor.</li> <li>Forest industry restructuring/ retooling to capitalize on SMEs, future mkt potential</li> <li>Forest land rationalization studies</li> </ul> <p><b>Investment Lending</b></p> <ul style="list-style-type: none"> <li>Investment in rural livelihoods on reallocated lands</li> <li>Support to selected regions based on performance and/or degree of threat</li> <li>Investment in accelerated rural-urban migration in key areas</li> </ul>
<b>Conservation and Environmental Protection</b>		
<p><b>AAA</b></p> <ul style="list-style-type: none"> <li>Development and Environment Study (CSIRO) &amp; analysis for DPL process</li> <li>PROFOR involvement in CSIRO study</li> </ul> <p><b>Grant Funding</b></p> <ul style="list-style-type: none"> <li>MSP Biodiversity Projects (GEF)</li> <li>Aceh Forest and Environment Project (MDF Aceh &amp; Nias)</li> </ul> <p><b>Safeguards</b></p> <ul style="list-style-type: none"> <li>Manage environmental safeguards process</li> <li>Engage with other sectors; improve project design</li> </ul>	<p><b>AAA</b></p> <ul style="list-style-type: none"> <li>Development and Environment Study (CSIRO) inputs for DPL, CAS, and RKP</li> <li>Environmental awareness &amp; education needs assessment and recommendations for coordination</li> </ul> <p><b>Grant Funding</b></p> <ul style="list-style-type: none"> <li>Full size multi-site project (GEF)</li> <li>Continue MSPs plus AFEP</li> </ul> <p><b>Safeguards</b></p> <ul style="list-style-type: none"> <li>Manage environmental safeguards process</li> <li>More mainstreaming in other sectors</li> </ul>	<p><b>AAA</b></p> <ul style="list-style-type: none"> <li>Cross-sectoral linkages: land and forest impacts</li> <li>Environmental awareness &amp; education coordination for scaling up</li> </ul> <p><b>DPL</b></p> <ul style="list-style-type: none"> <li>Conditions for policy reform to improve environmental services for economy and poverty: Growth with Quality and Equity</li> </ul> <p><b>Safeguards</b></p> <ul style="list-style-type: none"> <li>Manage environmental safeguards</li> <li>More mainstreaming</li> </ul>

Forest Strategy: Indicators/Triggers For Increased Levels of Engagement		
Base Case	Medium Engagement	High Engagement
<b>Governance and Law Enforcement</b>		
<ul style="list-style-type: none"> <li>▪ Continued development &amp; implementation of FOMAS and "10 Step Program to Tackle Illegal Logging"</li> <li>▪ Establish interagency law enforcement task force on illegal logging, under Polhukam (PPATK, Customs, Trade, &amp; Menko Polhukam).</li> <li>▪ Issue guidelines for financial investigation and anti-money laundering regime for combating forest crime.</li> <li>▪ Report on progress toward goals from Forest Transparency Workshop (Feb 2006) by end 2006, incl. disclosure policy &amp; public release of data &amp; maps.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Coordination on int'l trade in illegal timber, more effective coordination among customs &amp; trade agencies on export controls &amp; legality verification.</li> <li>▪ Continuing engagement of local gov'ts in resolving forest policy issues (as demonstrated in follow on to April 2006 national coordination meeting).</li> <li>▪ Increased processing of forest crime cases, as demonstrated through regular publication of reports and media monitoring (transparency initiative).</li> <li>▪ Prepare academic draft of new law on forest crime with wide consultations.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Major progress on transparency &amp; governance initiative with apparently improved access &amp; engagement of stakeholders.</li> <li>▪ Substantial steps to reduce illegal international timber trade, through coordinated action by multiple countries &amp; government agencies.</li> <li>▪ Continued progress on processing of forest crime cases, as demonstrated through regular publication of reports and media monitoring (transparency initiative).</li> </ul>
<b>Forest Industry Restructuring and Financing</b>		
<ul style="list-style-type: none"> <li>▪ Complete revisions of key regulations (PP No. 34/2001) with multi-stakeholder consultative processes and support for CBFM initiatives.</li> <li>▪ Increasing action to curb industrial timber demand, building on the three phase industrial restructuring strategy promulgated in December 2005.</li> <li>▪ Establish working group on industrial revitalization with multi stakeholder inputs and direct access to Minister of Forestry.</li> <li>▪ Progress on learning from &amp; scaling up efforts to promote and diversify SMEs in wood processing &amp; value adding activities (in line with IFC's efforts to support SMEs in timber sourcing, processing &amp; accessing export markets.)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Actions to curb industrial timber demand by addressing indebted firms and illegal sourcing of timber.</li> <li>▪ Actions to increase industrial timber supply, including greater planting rates &amp; efforts to hold plantation firms accountable for performance targets.</li> <li>▪ Efforts to remove obstacles &amp; build enabling policy conditions for plantation establishment &amp; land rehab.</li> <li>▪ Efforts to engage communities in more productive uses of forest land, with appropriate access &amp; security of rights.</li> <li>▪ Efforts to create enabling policy conditions to improve competitiveness in the wood processing sector through investment in retooling, efficiency &amp; market responsiveness</li> </ul>	<ul style="list-style-type: none"> <li>▪ Positive results from GOI action to curb industrial timber demand</li> <li>▪ Efforts to improve policy incentives for firms engaged in legal &amp; effective forest management.</li> <li>▪ Positive results from GOI action to increase industrial timber supply, including greater planting rates &amp; efforts to hold plantation firms accountable for performance targets.</li> <li>▪ Positive results from efforts to engage communities in more productive uses of forest land, with appropriate access &amp; security of rights.</li> </ul>
<b>Livelihoods</b>		
<ul style="list-style-type: none"> <li>▪ Develop strategy paper accelerating community based plantation development for community livelihoods.</li> <li>▪ Successful development of a Community-Driven Conservation Project in association with KDP, indicated by endorsement &amp; uptake by key ministries, including Bappenas &amp; Home Affairs.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Increased discussion of environment &amp; NR sector issues in context of Rural Investment Climate and the Poverty Reduction Strategy (which expresses a right of access to resources).</li> <li>▪ Increasing discussion of land tenure and access issues in the context of forest sector investment and rural livelihoods improvement.</li> <li>▪ Successful experience with Community-Driven Conservation Project in association with KDP.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Demand for analytical &amp; advisory activities in previously sensitive areas, including forest land rationalization, focusing on deforested, degraded lands</li> <li>▪ Positive results from GOI efforts to establish timber plantations with meaningful engagement of communities using forest land productively.</li> <li>▪ Accelerated efforts to rationalize forest land use &amp; tenure claims through participatory boundary demarcation</li> </ul>

Forest Strategy: Indicators/Triggers For Increased Levels of Engagement (continued)		
Base Case	Medium Engagement	High Engagement
<b>Conservation and Environmental Protection</b>		
<ul style="list-style-type: none"> <li>▪ Progress in coordinated, successful implementation of the Aceh Forest and Environment Project funded by the Multi Donor Fund for Aceh &amp; Nias.</li> <li>▪ Linkage and uptake of AFEP actions and lessons with national level enforcement policies and practices through FOMAS.</li> <li>▪ Coordinated response to conservation threats (e.g., roads and conversion) as in Heart of Borneo.</li> <li>▪ Successful implementation of existing GEF-funded MSPs</li> </ul>	<ul style="list-style-type: none"> <li>▪ Strengthening of monitoring &amp; enforcement in key National Parks, as evidenced in media reports.</li> <li>▪ Improved efforts to combat wildlife crime, as evidenced in media reports.</li> <li>▪ Efforts to improve the institutional base &amp; enabling conditions that allow environmental service payment schemes (e.g., carbon finance, etc) to play a larger role in creating incentives for appropriate forest stewardship.</li> <li>▪ Successful development of new GEF-funded biodiversity and forestry projects.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Positive results enforcement efforts in key National Parks, as evidenced in forest cover monitoring.</li> <li>▪ Positive results on coordinated efforts to halt threats to conservation areas, such as roads and agricultural conversion.</li> <li>▪ Increased use and adoption of carbon financing and other environmental service payment approaches that can provide incentives for forest rehabilitation &amp; stewardship.</li> </ul>

## 4.2 Drawing on the Current Forest/Biodiversity Portfolio

In recent years in the Indonesian forestry sector, the World Bank has focused its attention on analytical work, policy dialogue, donor coordination, data collection, as well as GEF operations, rather than large projects and lending operations. This process has led to the development of a number of important initiatives with increasing buy-in and engagement by both the GOI and CSO partners. This current forest and biodiversity portfolio, summarized below, provides the building blocks for the strategy. Activities are grouped according to the major themes of the Bank's forest sector policy.

### Governance and Law Enforcement

- **Forest Law Enforcement Initiative:** This initiative aims to implement and support a systematic, comprehensive framework of prevention, detection and suppression measures designed to combat forest crime in Indonesia. The framework, known as the “10 Step Program to Curb Illegal Logging and Improve Law Enforcement,” has resulted from a series of multi-stakeholder consultations on illegal logging. This initiative has been developed and supported by the WWF/WB Alliance and subsequently lead by the Department of Forestry. This effort is mandated by Presidential Decree No. 4/2005, which instructs the Coordinating Ministry of Political, Legal and Security Affairs to bring concerned agencies together in the fight against illegal logging. Collaboration among the Department of Forestry, the enforcement agencies (Police, AGO, Coordinating Ministry for Security (Polhukam)) and the Financial Transaction Analysis Agency (PPATK), other donors and NGOs has created an interagency working group. This group is now developing implementing guidance for this presidential instruction, with assistance from the Bank and partners engaged in the law enforcement initiative. These efforts are addressing not just illegal logging, but also anti-money laundering training and actions, as well as recovery of stolen assets. There are plans to road-test financial intelligence and investigation approaches as well as on-the-job development of the required interagency coordination. This will open the way for more ‘just’ enforcement: by following the money and not the chainsaws, penalties will land on the masterminds not on the poorer operators at the bottom of the supply chain. Recovery of assets sitting overseas can also create an immediate political incentive for action, as well as more resources for forest management and protection. The Coordinating Minister for

Polhukam requested assistance from the World Bank in further developing and implementing these initiatives. The Department of Forestry is also making progress and is developing a new Act on Forest Crimes which will strengthen the legal provisions for effective forest law enforcement including asset forfeiture.

- **Forest Transparency Initiative:** Collaboration with the Department of Forestry and other stakeholders has resulted in the opportunity to promote forest sector transparency and accountability through an initiative known as FOMAS (Forest Monitoring and Assessment System). This initiative aims to establish a dynamic decision-making environment where reliable, accurate and up-to-date information on forest and timber resources and related decisions are continuously and publicly available. The core components of this initiative are an information management system, a comprehensive disclosure policy, effective disclosure mechanisms, and a decision support system designed to use accurate forest sector information in daily operations. The Department of Forestry hosted a major transparency workshop in February 2006 and committed to reporting on progress on key action items at another event to be scheduled for October 2006.
- **Facilitation of Asia Regional FLEG Initiative:** As the country with the largest forested area participating in the Asia FLEG process, Indonesia's progress with these initiatives can set a constructive pace for efforts in the region, creating momentum and serving as a model for other countries seeking to improve forest governance. The Bank's Indonesia office is supporting the EAP Regional initiative through facilitation and promoting Indonesian examples and successes in the wider forum. FLEG has contributed to a number of national, bilateral and regional agreements, initiatives and actions. The EAP-FLEG Task Force Advisory Group met in Manila in early 2006 and a Ministerial meeting may be convened later to review the status of implementation and to reaffirm high-level commitments. All of these efforts are helping Indonesia move from commitments to results on governance. The transparency and law enforcement work has developed into a collaboration with the trade and customs agencies to reduce trade of illegal timber, an international dialogue among timber consuming and producing countries, and a growing constituency among GOI, NGOs, Donors and increasingly from the Private Sector.

### **Forest Industry Restructuring and Community Involvement**

- **Forest Industry Restructuring:** The Bank has supported policy analysis and engagement in forest industry restructuring in partnership with other donors, particularly DFID-MFP, and research organizations, especially CIFOR. This ongoing policy dialogue has recently resulted in Ministerial decisions and delegation of responsibility to implement a three-phased restructuring strategy, which recognizes the need both to reduce industrial demand and to augment available supply through an accelerated plantation program. The Minister's program also recognizes the need for greater involvement of communities in timber plantations and greater involvement of small and medium enterprises in production of processed wood products for export. The Bank is continuing to support analysis, policy dialogue, and inter-sectoral coordination that support the industry restructuring and revitalization process. In June 2006, representatives from Indonesia's government, private sector, and NGOs participated in the Forest Investment Forum in South Africa, supported by the Bank, the IFC, WWF, and other partners.

- **Alternatives for Accelerating Community Plantations:** Maintaining the forest sector's performance and allowing for future growth will depend on a much-expanded plantation program. There is good potential to involve the rural poor in plantation production on both community and individually-owned land, using innovative partnerships and improved extension and market information services to ensure equitable outcomes. Building on interest from the Department of Forestry, the Bank is conducting a feasibility study for alternative means to accelerating timber plantation development with the active participation of communities. This study will assist the GOI in analyzing a range of priority enabling conditions and operational issues involved in plantation development and financing in ways that appeal to communities. The objective is to develop mechanisms that would mobilize resources and direct them toward high quality opportunities for enhancing timber supply, with a priority on poverty-reducing, community-managed schemes.

There is also an opportunity to assist the IFC with private sector support in forestry. The IFC is working on pilot projects with SMEs that demonstrate the social, environmental and economic benefits of sustainable forest management, as noted in Section 2.4. The IFC's PENSA program recognizes that millions of SMEs account for the vast majority of employment in Indonesia, yet they operate in an uncertain and often unhelpful environment. Those that can gain access to appropriate materials and markets – and maintain quality and cost – have high potential for growth and export earnings. This approach is consistent with the emerging Department of Forestry industrial restructuring strategy, aiming to improve sustainability and market access – including diversification of products and focus on SMEs for flexibility and employment – for the long term future health of the industry. This provides a firm basis for partnership in analytical efforts and policy advice to the GOI.

### **Conservation and Environmental Protection**

- **GEF Biodiversity Portfolio:** The Global Environment Facility is currently financing several large and medium-sized projects to conserve biodiversity, though the largest ones are not focused on forestry.<sup>1</sup> Two medium-sized projects focus on terrestrial biodiversity conservation through habitat protection, stakeholder participation and awareness-raising in the Sangihe-Talaud islands and the Lambusango forest of Sulawesi. A medium-sized project for conservation of the newly designated Aketajawe-Lolobata National Park on Halmahera Island of North Maluku is also under preparation.
- **Community-Driven Conservation.** The first large-size terrestrial biodiversity GEF project for Indonesia since the Kerinci-Seblat experience is now in the pipeline. It is a community-driven conservation and environment project linked to the Kecamatan Development Program. The project will train KDP facilitators to identify and develop environmental management projects in kecamatan that are located in and around areas of critical biodiversity, and will provide financing for an initial set of community investments. CIDA is providing grant funding for a sister project aimed solely at Sulawesi. This project will be partly Bank executed and partly GOI executed. The Bank will assist in preparing the project for implementation.

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<sup>1</sup> The large-scale GEF projects currently focus on marine biodiversity through the Coral Reef Rehabilitation and Management Project II, a Marine Aquarium Market Transformation Initiative, and the Komodo Island Tourism Project. Another large-size GEF project is being developed for sea turtle conservation in conjunction with a World Bank loan to marginal fishing communities.

- **Multi-Site Conservation Concept.** The Department of Forestry has requested assistance on developing a “model parks” initiative working to strengthen capacity in 10 National Parks. In addition, the Ministry of Environment’s Lake Management Unit is interested in biodiversity protection in Indonesia’s unique ancient tropical lakes. The Bank intends to develop a project concept for working in multiple sites with multiple funding sources, potentially including GEF.
- **Aceh Forest and Environment Project:** After near a decade’s absence from investment in the forest sector, the World Bank has launched its first forest project in Indonesia with a grant from the Multi-Donor Fund for Aceh and Nias. The \$17.5 million grant, entitled the Aceh Forest and Environment Project, will work with two NGOs (Flora Fauna International and the Leuser International Foundation) to protect the key watersheds that provide drinking water to the people of Aceh and create the largest ecological corridor (3.2 million ha) in Southeast Asia. The project became effective in April 2006. This project will provide a venue for regional demonstration of the themes and approaches being pursued under the transparency and law enforcement initiatives at the national level.

### **Dialogue, Donor Coordination and Analyses**

- **Donor Dialogue Process:** Following the demise of the Donor Forest Forum, there has been relatively irregular and informal communication among donors in the Indonesian forestry sector. The Department of Forestry has convened the Technical Group on Indonesian Forestry on several occasions to bring together technical staff from donor-supported projects to share information. The companion technical discussion paper, entitled *Sustaining Economic Growth, Rural Livelihoods, and Environmental Benefits: Strategic Options for Forest Assistance in Indonesia*, will serve as a vehicle to stimulate dialogue and coordination among donors. Several donors have already expressed interest in focusing on new ways for the donors to re-engage in a wider range of joint activities. In addition, the World Bank actively participates in meetings of the Aceh Environment Donors Forum, which addresses forestry issues in a productive and progressive climate for exchange.
- **Forestry and Poverty Study:** The Bank has completed a study about the links between forestry and poverty in Indonesia using BPS data, recently completed poverty maps, and the forestry database for Indonesia compiled during the FOMAS dialogue. It includes results from the spatial analysis of the relationship between poverty and forestry in key forest zones (conservation; protection; production; conversion; and non-forest). This is an important piece of information that increase understanding of the pattern of use of forest lands and the potential for an improved utilization of these lands for livelihoods and poverty reduction. This work is summarized in the companion technical paper (referenced above) and is contributing to the Bank’s Poverty Assessment to be released in 2006.
- **Development and Environment Study:** A new study is currently being planned on “Government Policies, Natural Resources and the Environment: Analyzing Paths to Sustainability in Indonesia.” This collaboration between the Bank, AusAID and CSIRO will assess the likely economic, ecological and social consequences of policies and policy reforms in key sectors. This work is being coordinated by BAPPENAS with good

support from sectoral departments. Forestry is likely to be a key sector of analysis, especially in terms of impacts on land use changes attributable to macro-economic changes. Some related analytical work will be supported through PROFOR. This study could provide useful inputs to the long term discussion of programmatic lending and the next country assistance strategy.

From other sectors and units, the Bank is supporting dialogue and analysis on land, forestry, and tenure policies. The Bank supported a recently published study of forest land use and tenure in Indonesia through the World Agroforestry Center and Forest Trends (Contreras-Hermosilla, A. and Fay, C. 2005). The Bank also produced a series of policy briefs for the new GOI in October 2004, focused on forest, land and poverty, among other things. This strategy envisions further collaborative work among the rural, environment, and social units within the Jakarta office to build on these initiatives and create opportunities to promote analysis and policy debate toward long term rationalization of forest sector land use.

### **4.3 Internal Requirements to Implement the Strategy**

Resources to support each of the main activities in the current portfolio have been identified, covering priority elements of the strategy (see table below). AAA resources are used to maintain dialogue and develop analysis and advice on emerging initiatives. Trust funds and bi-lateral support are used to develop and implement specific projects after agreement with GOI counterparts. As the portfolio expands and engagement deepens, some additional resources will be needed for special studies, partner support, and coordination on mainstreaming in other sectors. Resources are limited for developing new analytical products or to capitalize on opportunities and issues that emerge from ongoing or expanded dialogue processes.

The activities implied by this strategy indicate that the work program of the World Bank's Environment Team in Jakarta is increasing dramatically. Current human resources within the Jakarta-based Environment Team include an Environmental Coordinator/Lead Environment Specialist, a Forest Governance Advisor, a Natural Resources Management Advisor and some assistance from the Safeguards Team. In particular, the Safeguards team is active on donor coordination and dialogue on timber supply and safeguards issues for the reconstruction process in Aceh. The team also has administrative support and access to consultants on the forest transparency and forest crime initiatives. Washington-based teams provide additional backstopping and analytical support. In particular the forest law enforcement and governance work is done in coordination with EASRD, the Financial Market Integrity unit, the Forest Team and the Financial and Private Sector Unit of PREM in Jakarta.

<b>Assessment of Resource Availability by Main Activity</b>	
<b>Portfolio Activity</b>	<b>Resource Support</b>
<b>Governance and Law Enforcement</b>	
▪ Forest Law Enforcement Initiative	Dutch TF Grant resources adequate for year one only
▪ Forest Transparency Initiative	Dutch TF Grant resources adequate for year one only
▪ Facilitation of Asia Regional FLEG Initiative	AAA resources for coordination, participation
<b>Forest Industry Restructuring and Financing</b>	
▪ Forest Industry Restructuring	AAA resources for coordination, participation
▪ Alternative Financing for Plantations	AAA for phase 1, WWF-WB Alliance grant for phase 2
<b>Conservation and Environmental Protection</b>	
▪ GEF Biodiversity Portfolio	GEF resources for development/oversight of MSPs
▪ Aceh Forest and Environment Project	MDF Aceh-Nias Grant resources adequate
▪ Community-Driven Conservation	Possible GEF PDF B for preparation in 2007 Grant resources from CIDA for preparation
▪ Multi-Site Conservation Concept.	AAA resources for coordination and dialogue
<b>Dialogue, Donor Coordination and Analyses</b>	
▪ Donor Dialogue Process	AAA resources adequate
▪ Forestry and Poverty Study	AAA resources adequate. Needs uptake by PREM
▪ Development and Environment Study	AUSAID funds CSIRO; Bank inputs funded by PROFOR

As natural resource-related work develops and the Bank's partnership with Indonesia deepens, additional analyses and project development work will be needed. The Jakarta team is currently seeking to recruit an Environment Specialist, primarily focused on safeguards work, an NRM Specialist to support forestry and biodiversity programs, and a Junior Professional Associate to provide general support.

The EAP Regional Strategy also notes some additional areas for management attention and cross sectoral coordination that would improve the effectiveness of forestry strategy implementation in the region. In the Indonesia context, the following could be recommended:

- Deployment of existing staff and TA resources to cover FLEG, forest sector and carbon financing issues in Indonesia and to facilitate transfer of lessons among countries.
- Improved dialogue and coordination among groups, possibly facilitated by an internal working group with representatives from Rural, Environment and Social Units, as well as the IFC to cover forestry and SME issues in the sector.
- Better coordination on regional timber trade issues.
- Better outreach and constituency building, including more possible cross sectoral consideration of broader public awareness and education needs on environment and natural resource issues.

**Operational Issues.** The Bank's approach in forestry draws on lessons of experience in Indonesia: that success depends on transparency and accountability in implementation. Most of

the planned activities are funded from trust funds and bilateral donors, as well as internal resources. As engagement in the forestry sector increases and the program expands, the team will have to consider and build in controls for transparency and corruption issues. The forestry effort will work with the Country Office's well-established anti-corruption program, including a Senior Governance Adviser, strong field-based Operations Services Unit team, and in-house Anti-Corruption Committee to integrate mechanisms in design and review implementation and operations. This kind of coordination has already been successful in the context of the Multi Donor Fund's Aceh Forest and Environment Project.



Mountain Landscape  
Kerinci Seblat National Park

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## **ANNEX 1: KEY ELEMENTS OF THE STRATEGIC PLAN OF THE DEPARTMENT OF FORESTRY, 2005-2009<sup>2</sup>**

The Department's vision is "forest management that guarantees sustainability and improves the people's welfare." The Minister has determined five priority targets for medium term development:

- Eradication of illegal logging from state forest areas and illegal timber trade
- Revitalization of the forest sector, especially the forestry industry
- Rehabilitation and conservation of natural forest resources
- People's economic empowerment inside and outside the forest area
- Determination of the forest area

Based on analysis of the condition of the forest relative to the desired state, the Department identified two key problems that the strategic plan aims to address: forest management is not yet optimal and the distribution of benefits is not yet just. The strategic plan (which is currently being improved) lays out objectives, targets, policies and programs consistent with the vision and mission of the Department. The programs for each of the key target areas are outlined here. Progress toward those goals was outlined by the Director General for Nature Conservation at a seminar in Pekanbaru in March 2006 (and must be regarded as a snapshot from that point in time).

### **Eradication of Illegal Logging from State Forest Areas and Illegal Timber Trade**

#### Programs

- Providing information on locations prone to forest crime
- Mobilizing people that care about the eradication of forest crime
- Reducing the forest disturbance
- Intensifying coordination measures with the National Police, Attorney General and related parties in overcoming illegal logging and for operations to settle forest crimes
- Carrying out operations in eradicating illegal logging and trade

#### Progress

- Sustainable Forest Operation I in E. Kalimantan (106 cases, 134 suspects, 101,000 m<sup>3</sup> evidence)
- Sustainable Forest Operation II in Papua (173 suspects, evidence: 72,000 logs, 20,000 m<sup>3</sup>, 361 false documents and 1,269 unit of equipment).
- Wanalaga Operation II in W. Kalimantan & Operation on Handling Concession Permit Falsification
- Forest Security Operation in Betung Kerihun National Park and Gunung Palung NP
- Completion of forest product management business (Revision of Ministry Decree No. 126/Kpts-II/2003 into Permenhut No. P18/Menhut-II/2005 and replacement concession permit document)
- Socialization and Consolidation of implementation of Presidential Instruction No. 4/2005
- Working out cooperation with PPATK and Establishing Fast Reaction Forest Police Unit
- Working out cooperation with timber consumer countries, NGOs

### **Revitalization of the Forest Sector, Especially the Forestry Industry**

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<sup>2</sup> With progress summarized from a presentation, entitled "Sustainable Forest Policy in Indonesia" by the Director General of the Directorate for Forest and Nature Conservation, delivered at a workshop on High Conservation Value Forest, sponsored by WWF in Pekanbaru on March 1-2, 2006.

Programs

- Facilitating improvements in industry performance
- Implementing sustainable forest management on 200 unit natural and plantation forest concessions
- Improving production of NTFPs
- Optimizing forest harvesting fees and reforestation levies
- Facilitating establishment of 5 million ha industrial timber plantations
- Facilitating development of 2 million ha community forests

Progress

- Comprehensive study on forest industry (ITTO, CIFOR, WB, USAID)
- Inventory of Primary Industry Wood Forest Product (1,670 units with input needs of 66.3 M m<sup>3</sup>/yr)
- Re-register primary industry business permits (Ministerial Decree No. 300/kpts-II/2003) for sawmills, veneer mills, wood and laminated veneer, and chip mills
- Improve efficiency and competitiveness by replacing old technology and relocating chippers and lathe mills closer to sources of raw material
- Revise rules to encourage the industrial timber plantation investments
- Settle cases of 130 small scale natural timber concessions (of which 20 have handed over the business permit to Department of Forestry and 9 others have settled)
- Assess performance of 24 industrial timber plantations in 2005, and another 39 in 2004
- Cancel 23 District Regulations and 1 Provincial Regulation to improve competitiveness and reduce nuisance taxes
- Evaluate small scale concession licenses issued by District Governments
- Increase the effectiveness of collection of Forestry levies (PSDH and DR)

**Rehabilitation and Conservation of Natural Forest Resources**

Programs

- Supporting the effectiveness of implementation of forest and land rehabilitation programs on 5 million hectares (60% forest area, 40% outside the forest area)
- Management and beneficial use of conservation area in 200 unit KSA/KPA
- Establishing and operating 20 model National Parks
- Prevention of forest fires
- Ensuring that 282 priority watersheds (DAS) function optimally
- Improving the management of environmental services through recreation forest management.

Progress

- Continuing the National Forest and Land Rehabilitation Program (GERHAN) in 372 districts
- Take initial steps for rehabilitating 10 priority watersheds in Java, Sumatera and Sulawesi)
- Handling the critical areas by using model pattern of "Pot" in 2 Districts in Java
- Establishing a plan for post-tsunami disaster during 2006-2010 (preliminary study, master plan arrangement, planting trial in the protection area 500 ha, and rehabilitation of coastal forest)
- Promotion of "Planting when small, Harvest when tall" program of cooperation with Education Department, district/town government and the parents of the students
- Developing participative model for forest and land rehabilitation
- Deciding new conservancy area in 9 new national parks (Batimurung-Bulusaraung, Togeang Islands, Sebangau, Ciremai Mountain, Merbabu Mountain, Merapi Mountain, Tesso Nilo and Batang Gadis)
- Developing Wild Animal Center cooperating with several NGOs
- Rehabilitating wild animal to their original habitat

### **People's Economic Empowerment Inside and Outside the Forest Area**

#### Programs

- Promoting people's economic development inside and outside the forest area
- Improving the small medium business climate and access to the forest
- Giving guarantee on the availability of the raw material for forestry SMEs
- Continuing the development of "Social Forestry"

#### Progress

- Education for villagers in 552 villages around natural forest concessions and 2,619 villages around planted forest concessions
- PHBM in 5,699 village in around area Perum Perhutani teak management areas
- People's forest development in several provinces for 50,644 Ha
- Social forestry development in 17 places in several provinces inside and outside Java, cooperating with 8 related departments

### **Determination of the Forest Area**

#### Programs

- Facilitating the establishment of forest management units KPHP, KPHL and KPHK
- Making efforts to finish the demarcation of forest area (kawasan hutan)
- Promoting forest area settlement decision on 30% of forest area that has been mark for the boundaries
- Carrying out coordination, synchronization with other sectors in the process of forest area use
- Maintaining the existing forest area
- Providing complete information on forest resources, including land cover, commercial and non commercial potential, the potential of non timber, wild life, environmental service and recreation
- Providing spatial and non-spatial data and information on forests

#### Progress

- Determination of 35 forest units with area 1.1 million ha
- Issuing the Ministerial Decree regarding the designation of forest and water areas in all provinces
- Evaluating the release of forest area for agricultural cultivation in Sumatera, Kalimantan, Sulawesi, Maluku and Papua
- Establishing a permanent organizing committee of the Ministry of Forestry for overcoming dispute about usage of forest area
- Issuing circular regarding the location permit approval / recommendation for back up of forest area released for plantation cultivation

## **ANNEX 2: INDONESIA'S DECENTRALIZATION PROCESS<sup>3</sup>**

After the Asian financial crisis and the end of the 'New Order' regime in 1998, there was a decline in central authority and widespread calls for democratization and decentralization. A rapid transfer of political and financial authority to the district level governments was legislated in 1999 and implemented in 2000. Within only a few years, with little preparation, about two-thirds of the central government staff was transferred to the regional level and hundreds of district and municipal governments became responsible for providing a large share of government services (around 40 percent of budget responsibility) (Hofman and Kaiser 2004). The provincial governments (now 32) were by-passed in this process, retaining mainly coordination and planning responsibilities. Ongoing decentralization and democratization of the electoral process means that the President is directly elected by the people and local parliaments and district leaders must become more responsive to local citizens, though political parties retain a strong role.

The decentralization of authority was marked by disorder and a lack of transparency due to weak planning and institutional capacity in all sectors, but perhaps especially in forestry. Contradictions in the legal framework between the decentralization laws and the Forestry Law of 1999 created legal uncertainty and conflict between central and regional authorities. Regions, encouraged by weakened central governance, asserted jurisdiction and authorities over activities and licensing, even when those authorities were subsequently limited or constrained by newer implementing regulations. The uncertain legal framework encouraged a protracted tug of war between the center and the districts over control of forest resources and revenues.

Unclear allocation of authority over forest resources during this period led some local governments to adopt short-term forest exploitation practices, partly as a source of revenue and partly as an assertion of control. More recent legislation has clarified these authorities and laid the foundation for more rational and sustainable management in the future, with participation of stakeholders. In particular, provincial governments have acquired a larger role in handling natural resource management issues that cross administrative boundaries, such as watersheds. The process of stakeholder consultations and legal clarification continues, representing an opportunity for engagement with different levels of government and new institutions, such as the associations of regional governments and regional legislatures.

The newly decentralized electoral process provides the means for governments to become more responsive to citizens, but local governments need improved capacity for working with the public, identifying and responding to their needs, and running public consultation processes. District officials are often far removed, both physically and functionally, from communities most affected by forest management policies. NGOs and universities have been instrumental in opening the processes of governance at the local level, holding public hearings, using the media to highlight issues, and creating constituencies for improvements in policies and practices. These sorts of activities have been supported by donor agencies with the flexibility to provide small grants or programmatic resources to civil society organizations, notably USAID/NRM, DFID-MFP, and the Ford Foundation.

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<sup>3</sup> Draws on 'Reflections on Indonesia's Experience on Decentralization of Forest Management.' Boccucci, Jurgens, and Schulze. In *The Forest Sourcebook*. The World Bank. In progress. 2006.

Most agree that district governments also need more technical and institutional capacity to manage and protect forests. Working at with district governments is an important opportunity because they control more resources for forest management and rehabilitation, as well as 30 million ha of watershed protection forests. Many NGOs, with support from GEF and other sources, are already engaging with local governments in collaborative forest and park management activities.

Decentralization also creates opportunities and demand for resolution of land access and rights issues – both from existing rights holders (private concessionaires) and aspirants for more secure access (communities). Competing claims and confused governmental responsibilities have opened and widened the debate over forest access and land use rights. This process has impeded forest sector concessionaires from negotiating the right to use large areas and made their existing forest harvesting rights less secure. In addition, district and provincial governments have developed permit, concession, and taxation proposals that burden businesses and impede investment. Forest concessionaires have found that only a fraction of their allocated area is in fact available for forest harvesting or planting activities. Some firms would willingly negotiate away a tenuous claim to a large area for a secure claim to a smaller area. More effective and transparent institutions need to be developed to support these kinds of negotiations in a process of forest land rationalization.

Some blame decentralization (and the political transition of the reformasi era) for an apparent increase in logging and forest degradation, at least partly due to small scale concession licenses issued by districts. However, others note that forest crimes also occurred in centrally-issued concession areas and centrally-controlled national parks. CIFOR (2004) points out that the total areas logged under small-scale concessions was far less than the area logged under officially-sanctioned forest concessions during this period.

The decentralization process has also provided opportunities and direct benefits to rural households, smallholders and forest dwellers. A study of the impacts of decentralization in East Kalimantan found that companies wishing to receive harvesting permits from the district government had to negotiate directly with affected communities. After decentralization an average of 94% of households surveyed received payments from companies, compared to only 1% before decentralization, and villagers were also able to negotiate better non-cash benefits (Engel and Palmer 2006). Decentralization also opened the door to new perceptions and community empowerment: a much larger portion of households (80%) thought forests belonged entirely to communities, compared to only 20% before decentralization. Many communities reported that logging was bad for hunting and the quality of river water, but felt that logging caused fewer problems for farming and forest product collection after decentralization compared to before. Nearly two-thirds of community agreements with companies included environmental provisions, such as replanting logged forests, respecting minimum diameters, and only logging certain species. When companies didn't follow these agreements or were late with payments, communities felt empowered to take direct action with the companies, often with success (Engel and Palmer 2006).

The dynamics of forest decentralization in Indonesia are still evolving and the ultimate impacts cannot be seen. The process has had some promising results, but also demonstrates that such rapid change should be accompanied by proper monitoring and controls, improved management capacity, and wide agreement on roles and responsibilities at each level of government. Improvements are still being developed and implemented, representing an area of opportunity for the World Bank and other donors to provide technical assistance, capacity building and policy analysis.