



# Mandatory legality licensing for exports of Indonesian timber products: Balancing the goals of forest governance and timber industries

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## ABSTRACT

The government of Indonesia implements a Timber Legality Verification System (*Sistem Verifikasi Legalitas Kayu/SVLK*) as an instrument to improve forest governance and secure better trade linkages to foreign markets. It obliges all exports to be legally verified. Nonetheless, legality licensing has become increasingly controversial in the past decade because export policies keep changing whether to require the licensing for all types of products and scales of manufacturing. This paper discusses the pros and cons of mandatory legality licensing for exports. While overall there is a compelling argument that Indonesian exports have tended to increase in aggregate terms, different types and scales of forest industries have had different experiences with legality licensing. More specifically, small and medium-sized enterprises (SMEs) are experiencing with significant technical and financial burdens in contrast with the consummate ease with which larger manufacturers engage in legality. However, a complete termination of legality licensing for all exports, as was promoted and ruled on in early 2020, might not be the best viable solution. We argue that the termination will not necessarily result in a boost for SMEs, nor will such a decision solve challenges faced by small operators in engaging in global markets. Such a measure could also be viewed as a violation of the country's Voluntary Partnership Agreement with the European Union (EU). Instead, we recommend revisions to the legality systems and its policies, addressing the key issues and challenges that SMEs face and identifying support mechanisms for SMEs to navigate adverse impacts. In deregulating the legality policy, the Government of Indonesia will also need to establish communication and dialogues with the EU to explore the potential of opening new negotiations on any recommended amendments.

## 1. Introduction

The Indonesian timber legality assurance system (*Sistem Verifikasi Legalitas Kayu/SVLK*) is implemented by the Ministry of Environment and Forestry (MoEF) and is envisioned as a governance reform that serves as an instrument to tackle illegal logging (Hasyim et al., 2020; Tacconi et al., 2019; Laraswati et al., 2020). The policy was also anticipated to help improve the reputation of Indonesian timber products with the far-reaching aim of securing better trade linkages that helped to access markets and boost exports (Winkel et al., 2018). To further support these goals, Indonesia signed and ratified a Voluntary Partnership Agreement (VPA) with the European Union (EU), which obligated all the country's timber exports (both to EU and non-EU markets) to provide legality licensing.

Mandatory legality licensing for exports has nonetheless been an increasing source of controversy, centering on are centered on the issue of its accessibility by different types of manufacturers and the implications for markets and trades. Since it began implementation in 2012, a series of regulatory changes governing exports of forest products began to revisit issues of scope, types of products covered, operations, and timeline to enforce compulsory requirements of legality licensing (Section 2). Export legality licensing was recently reinforced through Regulation P.45/2020 after being briefly overruled in early 2020. It however continues to spark the negative feedback. A network of industry and trade observers has since penned an open letter to the President of Indonesia to reconsider mandatory legality licensing on downstream industries (see *Gramedia Post*, 2020), signaling further contentious policy developments.

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This commentary paper discusses the pros and cons of mandatory legality licensing for exports. Centering around analyses of lessons learned from the serial regulatory changes, this paper observes the potential implications of a termination of legality licensing policy (if implemented) from a governance and trade perspective. The paper also explores policy options and recommendations for relevant legality-related policymakers to help guide them in exercising better policies to achieve the dual goals of maintaining commitments on improving forest governance while fostering improvements in national timber industries.

## 2. Legality licensing for exports: the storyline

Formally legislated in 2009, MoEF's SVLK regulations oblige forest/timber production operations (upstream) and processing industries (downstream) to obtain a legality certificate demonstrating that their operations are conducted legally. Nevertheless, it took three years for the Ministry of Trade (MoT) to start legality licensing for exports. The provisions of these legality licenses (V-Legal) are a custom document for exports of timber products (processed and finished products, including rattan), and was first regulated in Regulation 64/2012. This regulation authorized legally verified manufacturers to use the legality licenses for conducting exports. However, exports of non-legally verified products were still allowed with inspections conducted prior to shipments (See Table 1).

Phased implementation schedule was introduced at the end of 2013, and delays were introduced until January 2015 for full-fledged legality licensing of exports on furniture and handicrafts by small- and medium-sized enterprises (SMEs) and artisans. The legality licensing was then further relaxed, culminating in an October 2015 policy that no longer required SMEs to submit legality stipulations for exports on several products (notably furniture and handicrafts). Administrative, technical, and financial burdens experienced by SMEs and artisans in engaging in legality licensing were behind the relaxation of the export policy.

The legality licensing regulation went through another change in the following year. As stipulated in Regulation No. 25/2016, the licensing policy was reinforced for all exports, including furniture and handicrafts. This was driven by the preparation of FLEGT (Forest Law Enforcement, Governance and Trade) Licensing, with which Indonesian timber products would be able to freely enter EU markets (Maryudi et al., 2015). The mandatory legality licensing for all exports was further sanctioned in Regulation 84 in December 2016 following the first shipment of FLEGT-Licensed Indonesian timber products. The fact that Indonesian products were granted with "green lane" access to EU markets appeared enough to persuade the reinforcement of mandatory legality licensing. Legality licensing for SMEs was to be subsidized to address concerns about their financial burdens.

In February 2020, as stipulated in Regulation 15/2020, the legality license was removed from the requirements of exports of timber products. The regulation only required verification and technical checks of the administrative information on exports. Regulation 15 aimed at simplifying procedures on exports of timber-based products and fostered investments on the national timber-based industries and exports. It was issued as a part of the government stimulus packages to navigate the potential adverse impacts of COVID-19. The origin of Regulation 15/2020 dated back to the MoEF-MoT "contract" in late 2018, which aimed to revise Regulation 84/2016 by "splitting" it into two complementary regulations, i.e., P15/2020 (focusing on verification/technical checks prior to shipments) and a new (revised) MoEF regulation on legality licensing.

Regulation 15/2020 came after extended policy advocacy conducted chiefly by the Indonesian Furniture and Craft Industry Association (*Himpunan Industri Mebel dan Kerajinan Indonesia, HIMKI*). Other forest/timber-related industry associations have formally expressed their confidence on the previous regulations (provisions of mandatory legality licensing for exports). Nevertheless, the regulation was later revoked,

**Table 1**  
Key regulations regarding mandatory legality licensing for exports.

Trade regulation	Date	Key features	Mandatory degree	Motives/Reasons
64/2012	October 22, 2012	Mandatory legality licensing for exports of processed and finished products (e.g. furniture) & rattan, but inspection still allowed for primary products (non-furniture)	Partial	Supporting enforcement of MoEF legality regulations and promises of better access to EU markets
81/2013	December 27, 2013	Phased implementation schedules of mandatory legality licensing, furniture products starting a year after regulation issuance	Partial	Allowing SMEs & artisans (mostly furniture) getting ready for mandatory V-Legal
97/2014	December 24, 2014	Legality Self Declaration replacing legality licensing for exports of furniture and crafts (by small and medium registered exporters)	Partial	Easing administrative & financial burdens on SMEs and artisans
89/2015	October 19, 2015	Exports of several products (mostly furniture) not required to use legality license, only statement raw materials from legally verified suppliers	Partial	Easing administrative & financial burdens on SMEs and artisans
25/2016	April 15, 2016	Mandatory legality licensing for all exports, including for furniture and handicrafts	Full mandatory	Observing trends of trade of legal products
84/2016	December 27, 2016	Mandatory legality licensing for all exports, legality verification of small industries subsidized	Full mandatory	Observing trends of trade of legal products; easing financial burdens on SMEs
15/2020	February 18, 2020	No references towards MoEF Regulation on legality, all exports only require technical inspection	Non mandatory	Simplifying export procedures & fostering investments on timber-based industries
45/2020	May 11, 2020	Revocation of P. 15/2020, mandatory legality licensing for all exports, including for furniture and handicrafts	Full mandatory	Responding protests from civil society groups

following intensive pressure from civil society groups and some factions of private sector. As of December 2020, legality licensing for all exports is still reinforced.

### 3. Differing levels of confidence on legality: effects on Indonesian exports

The Indonesian forest/timber sector is highly fragmented and diverse, from vertically integrated operations (such as pulp and paper industry, woodworking/plywood) to the labor-intensive SMEs and home industries of furniture (Maryudi and Myers, 2018). As previously mentioned, the debates on mandatory legality licensing in Indonesia are centered on the issue of accessibility of the legality systems by different types of forest operations and the implications for their operations, markets and trades.

On the one hand, the main legality advocates usually use the aggregate term (the national level) to point out the positive impacts of legality on the exports. The Indonesian exports of timber products have markedly increased in terms of value and quantity over the period between 2014 and 2018 (SILK, 2020). The major rise was recorded by pulp and paper products, with slight increases also recorded for woodworking, furniture, and handicrafts. A recent report from the [International Tropical Timber Organization \(2020\)](#) mentions that Indonesia has started to benefit from legality licensing.

On the other hand, critics point out challenges facing small-scale forestry sector and artisanal operations, particularly in terms of the extra costs and efforts involved in legality verification and mandatory licensing. HIMKI is at the forefront of this, particularly in the face of unclear -if non-existent- incentives offsetting the associated costs that would have instead persuaded them to engage in legality (Erbaugh et al., 2017). Several studies (Obidzinski et al., 2014; Setyowati and McDermott, 2017; Acheampong and Maryudi, 2020; Maryudi et al., 2020) have also reported that many small businesses have faltered during legality implementation. In some cases, they were ironically forced to conduct illegal practices to sustain their business, in contrast to the consummate ease with which larger manufacturers engaged in legality (Maryudi and Myers, 2018).

Drawing clear links between legality implementation and sale/export levels is challenging because it involves many other factors, including market situations, competition, consumer preferences, designs of products, and influencing trade of timber products. What has become clearer is that there are diverse conditions that are experienced in different ways by different types and scales of industries. Overall, legality licensing is more accessible for larger manufacturers and operators than for SMEs as only a small fraction of SMEs in Indonesia is legally verified (Maryudi and Myers, 2018). This was identified as a pressing governance challenge that the legality policy initially sought to address.

However, removing legality licensing altogether for export requirements does not necessarily mean that SME exports will be boosted, nor does it solve the challenges facing small operators in engaging in global markets. In EU markets, for example, without FLEGT Licenses, Indonesian products will have to follow due diligence procedures, which can be complex and costly. An analysis from the Global Timber Forum (2015) reveals the costs of due diligence, which could outstrip those of legality verification (Maryudi, 2020). Due diligence may also open the possibility for voluntary chain of custody certification, which many Indonesian timber manufacturers already participate in. For example, as of December 2019, nearly 300 companies (mostly woodworking/panel and furniture) have been CoC-certified by the Forest Stewardship Council (FSC, 2020). However, voluntary certification does not necessarily solve the overall issues of accessibility by different types of forest operations, thereby proving the issues will remain present from those experienced during mandatory legality licensing.

One may also consider other markets other than the EU, which have not explicitly required SVLK-styled legality license for Indonesian products to enter. Those markets have not explicitly required SVLK-styled legality license for Indonesian products to enter. In fact, Asian countries, notably China, Japan, and Republic of Korea (India, Malaysia, and Taiwan to a lesser extent) remain the main export destinations for Indonesian timber products (SILK, 2020). However, Indonesia is

contractually tied by its VPA with the EU and cannot unilaterally choose to make legality optional for non-EU markets. It may seek to do so, but this step needs to be done through bilateral consultations, negotiations, and eventual revisions of the VPA and relevant annexes. Furthermore, legality licensing may later offer competitive advantages for Indonesian products, especially when the recent trends on legality policies in main export destinations are strongly enforced.

### 4. Mandatory legality licensing: looking ahead

There are intensive ongoing discussions and consultations taking place between MoEF, MoT, and related stakeholders on the future of legality licensing for exports, which seek to consider how legality licensing can best serve and balance the goals of forest governance and timber industries. A complete termination of legality licensing, as was stipulated in the eventually annulled Regulation 15/2020, might not be the best viable solution given its potential adverse political consequences. It might be viewed as a violation of EU-Indonesia's VPA. Although the bilateral agreement was made on a voluntary basis, it is legally binding after ratification. Following the issuance of Regulation 15/2020, an EU delegation sent a *Note Verbale*, requesting an emergency meeting of the Joint Implementation Committee. It highlighted the function that the Indonesia-EU VPA will be "unilaterally and unacceptably affected". The delegate further indicated that grounds exist for the invocation on the suspension of the VPA, in line with Article 21 of the VPA.

Indonesia indeed has the option to exit the agreement at any stage but doing so would be a diplomatic blunder and may politically harm its standing in international relations and other cooperation initiatives. Instead, the Government of Indonesia may need to establish communication and dialogues with the EU and explore the potential of opening new negotiations on the potential amendments on the VPA, including the potential relaxation of legality licensing as a safeguard measure to address concerns about the ability of SMEs to engage in legality.

There is a valid argument that relaxation of the export policy might be problematic itself as a robust legality system needs the verification of timber movements along its supply chains (Meridian et al., 2018). Partly, this is because the Indonesian legality policy only applies to production forests (in the case of state forests) and does not cover protection and conservation forests on which logging is prohibited. Logging is prohibited in both forest types. When legality policy is implemented in the upstream (forests) only, timber from unclear sources (illegal timber), including timber from protected and conservation forests and imported timber cannot be verified. Hence, as some legality advocates argue, it creates loopholes in the legality system and poses further questions about country commitments in tackling illegal logging (Suradiredja, 2020).

Nonetheless, there are several types of forest operations that could be excluded from legality licensing (e.g. private smallholder forests and planted trees), especially the species (e.g. teak) that are increasingly considered under a "low risk" category. Although not legally verified, this does mean that they are illegal (see Nurrochmat et al., 2016). Over the past 15 years, numerous furniture manufacturers in Indonesia have heavily relied on timber sourced from private smallholder planted forests (see Maryudi et al., 2015). In fact, legality verification for private smallholder timber production has been relaxed in legality regulations and replaced with a legality declaration instead. Hence, similar deregulation for downstream processing industries, particularly SMEs, manufacturing timber originated from smallholder timber producers is a potential option to address concerns about their ability to engage in legality.

### 5. Conclusions and policy recommendations

In this paper, we discuss the ongoing controversies regarding mandatory legality licensing for exports of all types of timber products

to all export destinations. The Indonesian timber legality system was introduced to address illegal logging, improve forest governance, to help improve the reputation of timber products and ensure continued access to key foreign markets. While there is a strong argument that Indonesian exports increased, there is also increasing evidence of varying effects across different types and scales of forest industries engaging in legality licensing. More specifically, the challenges and difficulties facing small manufacturers, in contrast with larger operators, highlights the way that legality licensing is increasingly burdening SMEs.

Nonetheless, we do not advocate the termination of legality licensing for exports. First, doing so could be viewed as a violation of an international agreement, and termination would thereafter result in a series of cascading impacts. Such a decision would be a diplomatic blunder and risks Indonesia's political standing if the country decides to exit the VPA. In addition, implementation trends are heading towards more stringent legality regulations, not only in the EU, but also in other key target export destinations of Indonesia's timber products, and foregoing legality licensing will only weaken Indonesia's broader export potential. We instead promote revisions on the legality systems and policies, addressing the key issues and challenges, such as how to navigate the potential adverse impacts on legality policy experienced by specific industries, especially for SMEs. We promote the legality policy being deregulated in ways that entail more simplified processes and reduce cost burdens for engaging in verification processes. The process should be improved to be more accessible for SMEs, and this should be done through streamlined mechanisms and procedures for low-risk timber species (timber from private lands and plantations) and simplifying requirements for certain industries whose timber supplies originate from low-risk sources.

In deregulating the legality policy, the Government of Indonesia first needs to establish communication and dialogue with the EU to explore the potential of opening new negotiations on the potential amendments on the VPA. The success of such a dialogue requires a mutual understanding between both parties on the various key aspects of timber trade governance in ways that help to gain mutual benefits. More specifically, the dialogues need to be focused on the definition and scope of legality as well as coverage of mandatory legality licensing to reflect the existing situation.

Domestically, synergies and communication approaches need to be established. The series of regulatory changes regarding mandatory legality licensing for exports also indicates differing priorities and policy goals between different ministries. To address these differences, the legality policy should be orchestrated under high-level regulatory frameworks, e.g. presidential decrees/regulations. This measure will take time, so we recommend the MoEF to swiftly proceed with the formulation of complementary measures to ensure the credibility and sustainability of the Indonesian legality system if the MoT eventually decides not to require legality licenses for exports of timber products. Credible law enforcement measures must also be strengthened to ensure legality.

At a broader context, to improve access to foreign markets, future policy discussions should not be relegated to whether legality licensing is required. The government and timber industries should therefore also need to begin pondering other factors, such as ways to improve marketing strategies and product designs, which are also fundamental issues shaping the markets.

#### Declaration of Competing Interest

The authors declare that they have no known competing financial

interests or personal relationships that could have appeared to influence the work reported in this paper.

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