

## **Indonesia will issue first FLEGT Licenses in November**

The Indonesian government and European Commission (EC) have announced that the first FLEGT licenses will be issued in November 2016. After 13 years of effort to develop a framework to license the legality of all wood exported from Indonesia to the EU, this is a major achievement. The key issue now is whether the licensing system will deliver in terms of improved export market access, sales and profitability. The jury is still out on that and there are downside risks in the short term, but long-term prospects are good.

In the last step of the FLEGT licensing process, on 18 August the EC amended the FLEGT Regulation to include Indonesia and its Licensing Information Unit under the list of “Partner countries and their designated licensing authorities”. The regulation was also amended to include Indonesian products in the list of “Timber products to which the FLEGT licensing scheme applies.”

The FLEGT regulation will enter into application on 15 November, making this the earliest date that Indonesia may issue FLEGT licences. The actual date for issue of the first licenses – whether on or shortly after 15 November - will be agreed at a meeting of the FLEGT Joint Implementation Committee on 15 September 2016. After the agreed date, the EU will only accept FLEGT licensed imports of regulated products from Indonesia. The V-legal documents, issued since 2013 through Indonesia’s SVLK national certification system, will be recognised and accepted as FLEGT Licenses for exports to the EU from that date.

Indonesian products requiring FLEGT licenses in the EU are essentially all those wood-based products that can be legally exported from Indonesia in Chapters 44 (wood), 47 (pulp), 48 (paper) and 94 (furniture) of the Harmonised System (HS) for international product nomenclature. There are some exclusions, mainly products that cannot be legally exported from Indonesia, such as logs and large dimension sawn timber which cannot be FLEGT licensed. The list of products requiring licenses differs in some ways from the list of products covered by the EU Timber Regulation (EUTR), for example wood seating from Indonesia will require a license despite not being regulated under EUTR.

Products made from rattan, bamboo and other non-wooden materials, and paper made from recycled material, will also be excluded and won’t need a FLEGT-license. However, paper products originating from non-wooden or recycled material must be accompanied by a formal letter from the Indonesian Ministry of Industry validating the use of non-wooden or recycled materials.

### **FLEGT licensing follows concerted effort to rollout SVLK**

The announcement follows a concerted effort to rollout the SVLK system throughout Indonesia’s forest products sector. The latest report by the EU-Indonesia VPA Joint Implementation Committee (JIC) in May shows the SVLK system had certified 23 million hectares of forest. All large-scale primary and 82% of secondary processors were audited and over a million SVLK 'supplier's declaration of conformity documents' had been issued to Indonesia's small-scale mills and producers. Exporter SVLK certification was at 95%, with the remainder in process. Consequently, since V-Legal documents' introduction under the SVLK in 2013, they had been issued for 194 product types. Sales of these – to 200 countries, including all EU member states – totalled US\$23bn.

An update on sales value is not available, but it has clearly risen significantly since, as the number of V-Legal licences issued rose from 354,000 to end May 2016 to 462,000 to end August 2016. The SVLK’s underlying structures have developed too, with 15,000 central and local government, forestry personnel and community leaders and 700 auditors now trained. The independent forest monitoring

network (JPIK), which brings together civil society organisations to regularly assess the system, has also grown to 407 individuals and 51 organisations.

With the vast majority of Indonesia's timber product export categories to the EU covered by the FLEGT VPA and the scale of the SVLK structure and licensing operation, FLEGT national policing bodies in the EU, or Competent Authorities (CAs), expect to be processing significant volumes of FLEGT licensed shipments soon after the first arrive before the end of the year.

### **High expectations of market advantage**

The Indonesian government and industry are looking to the FLEGT licenses to deliver significant market advantages. Expectations are high as the license gives Indonesian suppliers a green lane through the due diligence procedures of the EU Timber Regulation so there will be no risk of any EU importer being prosecuted under the regulation when buying from Indonesia. Minimising such risks is increasingly important to the private sector in the EU, not only to avoid direct EUTR sanctions - confiscation of timber, fines and possible prison terms - but also for brand protection and to reassure shareholders and lenders. Some governments in the EU also explicitly recognise FLEGT Licenses as sufficient to satisfy minimum criteria for public sector procurement of forest products.

The EU private sector is clearly enthusiastic, and rather relieved, at the imminent arrival of the first licensed timber. Since the EUTR was introduced in March 2013, EU importers have reported significant challenges in gathering together the necessary evidence of low legality risk in many tropical countries. The license means this will no longer be an issue for Indonesian timber.

According to Andreas von Möller, President of the European Timber Trade Federation (ETTF), "the lack of results [on FLEGT licencing] after so much time and energy spent by the EU was disappointing for many and I'd almost lost hope it could work out. But now enthusiasm for the arrival of the first licensed timber is growing the closer it gets. It's big news and will spread quickly, once it's here, going far beyond trade insiders. It's one of the best adverts for the EU timber import trade generally and their commitment to legality, and the tropical trade in particular. It has potential to open new trading value and volumes and impact on timber production".

Andre de Boer, ETTF Secretary General, observed that the FLEGT license "should save time and costs, simplify logistics and reduce corporate risk". However, Mr de Boer also stressed that Indonesia's success was just the "start of the FLEGT licensing journey" and the onus was now on the EU trade to communicate its benefits to the market, adding that ETTF's member federations are already doing this increasingly vigorously. "We must also maintain pressure for strict, uniform enforcement of the EUTR EU-wide. Any weakness here is a disincentive to supply and buy FLEGT-licensed timber," he said. "We need a virtuous trading circle with rigorous EUTR enforcement driving demand for FLEGT-licensed timber."

### **FLEGT licensing challenges for SMEs**

So there are challenges remaining to ensure full market recognition of FLEGT licensing within the EU. There are also challenges on the supply side. A key issue is to ensure that any extra red tape and cost resulting from licensing in Indonesia does not overwhelm market advantages. This is particularly critical in a sector with very high dependence on small and medium sized enterprises. CIFOR has estimated that Indonesia may have over 700,000 such enterprises, employing up to 1.5 million people (CIFOR Info Brief on timber legality verification and small-scale forestry enterprises in Indonesia, September 2014)

Like all certification systems, the unit costs of implementing FLEGT licensing tend to fall more heavily on smaller operators. These operators are also difficult to reach in terms of communication and education and certification bodies often lack capacity to provide adequate coverage.

Local press reports in Indonesia have highlighted these challenges in recent months. In August, the Jakarta Post reported that the costs of SVLK certification to individual operators ranged from Rp 48 million (US\$3,600) to Rp 200 million depending on business category. Tempo, the Indonesia Weekly magazine reported comments by Suryanto Sadiyo, deputy director of non-governmental organization Java Learning Center (Javlec Indonesia), that many smaller furniture companies still do not understand the SVLK system and are very reluctant to pursue certification. Suryanto added, that constant changes made to the SVLK standard – which has been revised three times in 2009, 2014 and 2015 - had confused business owners when applying for a certificate.

More positively, there are also reports that the Indonesian central and regional governments are working together to overcome obstacles for smaller enterprises. In a report in the Jakarta Post in August, the DG of Foreign Trade at the Trade Ministry, Dody Edward, is quoted to say that he met with the Bali regional trade head to discuss provision of subsidies for SVLK certification of SMEs. He also recommended that regional governments work with SMEs to develop cooperatives for group certification so that the Rp 48 million cost burden of certification can be shared.

### **Positive implications of FLEGT licensing**

These reports, combined with the data on the extent and pace of SVLK uptake in recent months provide reassurance that FLEGT licensing will not be a significant obstacle to smaller Indonesian operators selling into the EU market. Longer term, there are reasons to believe that licensing may actually play an important role to facilitate trade for smaller operators. Participation by communities and small business groups has been an important feature of the FLEGT VPA process from the start, and this is reflected in strong support for the licensing process by industry groups like ASMINDO, the largest furniture trade association in Indonesia.

There are also likely to be economic advantages resulting from implementing a single unified Licensing System across all suppliers, rather than relying a range of different private sector initiatives not necessarily well aligned to national forestry regulations and practices and which don't mutually recognise procedures and standards. Having a single framework directly linked to national legislation may be simpler and reduce costs in the long run.

And of course the system is not only about export competitiveness, but also about increasing participation in regulatory processes and preventing illegal logging. This in itself has important business benefits, such as increased supply continuity and reduced price volatility, greater direct industry engagement in regulatory reform, and potential for enhanced industry communication and co-operation to improve marketing and encourage investment and innovation.