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Editor's Note: For the report and supplementary materials, please go to http://forest-trends.org/indonesia_timber_supply.php. Username: embargoed; password: timber

New Report: More Than 30 Percent of Wood Used by Indonesia's Industrial Forestry Sector Comes from Illegal, Unsustainable Sources

*Current paper processing capacity exceeds reported supply of legally sourced wood;
If planned pulp and paper mills open, this "supply gap" could spike to 59 percent*

WASHINGTON, DC (17 February 2015)—More than 30 percent of wood used by Indonesia's industrial forest sector¹ stems from the unreported clear-cutting of natural forests and other illegal sources instead of legal tree plantations and well-managed logging concessions,² according to a new study analyzing Indonesian Ministry of Forestry and timber industry data to assess the sustainability of the country's booming pulp and paper industry. The report also finds that if the country's pulp and paper mills were to operate at full capacity, and if companies were to go forward with plans for a multi-billion dollar investment in new mills, the industry would need to double its legal supply of wood to meet demand.

Furthermore, the report found that the primary source of legal wood in Indonesia, industrial forestry plantations, which produce fast-growing species of trees like acacia, are currently unsustainable. The study, *Indonesia's Legal Timber Supply Gap and Implications for Expansion of Milling Capacity*, by the Anti Forest-Mafia Coalition, an alliance of Indonesian civil society organizations, and Forest Trends, a Washington-based non-governmental organization, found that the plantation sector is dramatically underperforming. In 2007, the Ministry of Forestry predicted that by 2014, plantations would be producing at almost twice the rate reportedly achieved.

"The timber industry's own numbers show that Indonesia's wood supply is unsustainable," said Michael Jenkins, President and CEO of Forest Trends. "If all companies implemented environmental

¹ As defined by the Ministry of Forestry's annual reports, this includes sawnwood, plywood, veneer, pulp, and other "processed" items produced in mills that use more than 6,000 m³ of wood per year. This analysis focuses on the pulp and paper sector, which comprises 80 percent of Indonesia's wood use.

² **Illegal logging** is generally defined as the harvesting, transporting, processing, buying or selling of wood in violation of national laws. This definition also applies to harvesting wood from protected areas and from threatened tree species, as well as falsifying documents. **Illegal wood**, in the context of Indonesia's Ministry of Forestry *Road Map* (and thus the Eyes on the Forest and Forest Trends analyses) refers more specifically to wood used by the industrial forest-sector in excess of the supply reported as legal. Unfortunately Ministry of Forestry does not report the level of illegal logging in Indonesia.

commitments, such as 'zero deforestation' pledges, it would be impossible to meet current demand for timber. Instead of allowing for new mills to be built, it would be advisable for Indonesia to hold future expansion of the pulp and paper industry until they successfully increase the number of tree plantations."

The study compared the supply of wood, as reported by the Ministry of Forestry, with the volume of production reported by the industrial forestry sector. The report found that the raw material used by these mills exceeded the legal supply by the equivalent of 20 million cubic meters, enough wood to fill more than 1.5 million logging trucks—all from illegal sources.

The source of this illegal wood is unclear, but it is unlikely to be from licensed plantations or from the harvesting of wood from forest concessions. Instead, the report suggests, the demand for illegal wood is likely fed by trees harvested during the clear-cutting of natural forests for new oil palm and pulp plantations. Given the area reportedly planted in oil palm and pulp, the gap could easily be met by this "conversion timber." (Indonesia has licensed an area for plantations almost as large as England and Scotland, combined.)

While the Indonesian government does not report the source of the illegal wood, its own data demonstrates the growing importance of "conversion timber." In 2013, the Ministry of Forestry reported that 53 percent of wood harvested from natural forests was from this "conversion timber." This is 4,000 percent more than the ministry predicted in 2007. In fact, given the scale of deforestation, the amount of wood now coming from land clearing may even be 15 times as much, according to the study.

"The core of the Anti-Forest-Mafia Coalition's research is to evaluate the adequacy of the legal timber supply for the growing Indonesian forestry industry," said Grahat Nagara of the Anti-Forest-Mafia Coalition. "We conducted research for the report that indicates that large-scale enterprises consume more wood than available legal timber supply for production."

"There are indications that the government is losing funds as a result of this. Assuming no payments were made to government on any of the wood in the 'illegal' gap, for 2014 about \$250 million was lost in reforestation fees and some \$153 million lost in stumpage, a total of \$403 million in losses."

"The Anti-Forest-Mafia Coalition therefore recommends that the Ministry of Environment and Forestry revise their forestry development strategy by incorporating some very important elements: not allowing a capacity increase in processing, not adding new licenses for forestry industry and industrial plantation forest (HTI) concessions, and improving HTI productivity. A performance audit on the HTI is a must, in addition to the continuation of the implementation of improvements in governance to prevent corruption in the forestry sector," Nagara added.

Implications for Asia Pulp and Paper (APP)

The new report comes as industry leaders push ahead with plans to build new pulp mills—even though current processing capacity in Indonesia already exceeds the legal supply of pulpwood. For example, Asia Pulp and Paper (APP) plans to build a US\$2.6-billion pulp mill in South Sumatra by 2016. This mill—the largest in Indonesia—is financed in part by a US\$1.8 billion loan from China Development Bank, and is expected to produce two million tonnes of pulp and 500,000 tonnes of tissue annually. If the sector were to operate at full capacity and mills planned for Sumatra, Kalimantan and Papua were built, then the existing gap would increase by more 44 million cubic meters. In this scenario, more than 59 percent of all the timber used by large mills would be from illegal sources.

In 2013, APP issued a forest conservation policy that contained a zero-deforestation pledge. Such a commitment would be impossible for all of Indonesia's pulp mills to meet. The pulp sector does not have sufficient supply from plantations to meet current industrial capacity. In fact, the report indicates that the situation may be even worse than the data suggests because plantations appear to be operating unsustainably. While the planting of pulp trees reportedly declined during the Asian financial crisis in the 1990s, the Ministry of Forestry reported that instead of a resultant decline, there was a ten-fold increase in the use of wood from pulp plantations between 1999 and 2008. If these claims are correct, then it suggests that the industry is not harvesting trees on a regular rotation, but at an unsustainable rate.

More Processing Capacity Heightens Deforestation Pressures and Investor Risk

Deforestation and land-use change that uses fire for clearing forests is Indonesia's largest source of greenhouse gas emissions, and is responsible for making the country the world's fourth-largest producer of carbon dioxide. The forest nation, which has the third-largest amount of tropical forest cover, lost 840,000 hectares of tropical forest in 2012—more than any other country lost that year. The primary cause of this forest loss is the expansion of the country's palm oil and pulp and paper sectors, which supply the globe with inexpensive cooking oil, paper products and more.

According to the study, even if no new pulp and paper mills were to be built, the pulp and paper sector would face steep challenges in meeting its environmental sustainability targets. At present, industry data examined in the report indicate that the sector is operating at less than 80 percent of capacity. If it were to operate at full capacity, the gap in legal supply would grow by at least 10 million cubic meters of wood. And then, if the new pulp mills were to be built, this gap would jump to over 44 million. Unless legal supplies are increased, more than half (over 59 percent) of all wood used would invariably be illegal.

In addition to sustainability concerns, the gap has implications on government revenue. If at least 30 percent of supply is illegal, then Indonesia is undoubtedly losing billions in uncollected taxes and royalties from the forest sector.

"Indonesia should expand its moratorium on new concessions to prevent any increase in processing capacity until the gap is closed," concluded Jenkins. "Before any new mills are built, the sector needs to provide timely, independent, public reporting to confirm that sufficient legal supply from plantations exist.

"Ultimately, Indonesia's forest sector cannot remain viable and attractive to investment if it cannot operate within the law—a risk that foreign investors are already starting to realize."

The Forest Sector Needs a Faster Road to Reform

In 2007, the Ministry of Forestry embarked on a "road map" for forest sector reform. It identified two obstacles to the sector's sustainability: insufficient supply of raw material and the overcapacity of mills. Based on data from 2005, the ministry estimated that the "supply gap" was as much as 45 percent of the total. This analysis shows that by reducing this gap by 15 percent, the government and industry has shown incremental progress in stemming the use of illegal wood. However, as the study suggests, if the industry operated at capacity, the supply would be 41 percent illegal, and if the new mills were also operating, the supply would be 59 percent illegal.

"This report clearly underlines the extent to which the government of President Joko Widodo, who took office last October, and has since merged the Ministry of Forestry with the Ministry of

Environment as part of his efforts to tackle deforestation in the country, will face major obstacles in putting Indonesia on a path to sustainability,” Jenkins said.

The study, which also assessed the veracity of government and industry data, suggests the sector could make improvements to its reporting. For example, the report found that the Ministry of Forestry data underreports timber use by small operators and also does not estimate losses due to smuggling, which are likely to be large. Pulp companies themselves do not publicly report in detail where they source their timber and in what volumes, further clouding the picture. Indeed, since 2010, Indonesian Pulp and Paper Association (APKI) has stopped their public reporting altogether.

These results come when Indonesia’s own forestry regulations now require all exports to be certified as legal—exports worth more than US\$10 billion per year (as of 2013) in forest products, according to UN trade statistics. The report by The Anti Forest-Mafia Coalition and Forest Trends suggests that industry will have difficulty in transparently demonstrating legality in timber bound for global markets. This would severely undermine initiatives such as Indonesia’s recently signed Voluntary Partnership Agreement (VPA), a bilateral trade agreement with the European Union, meant to fast-track exports of wood certified as legal under the EU Timber Regulation, which came into force in 2013.

“Due diligence will be crucial to ensure that the VPA does not provide a veneer of legality on new shipments of what is otherwise illegal wood,” noted Jenkins.

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[Forest Trends](#) is a Washington D.C.-based international non-profit organization that was created in 1999 by leaders from conservation organizations, forest products firms, research groups, multilateral development banks, private investment funds and philanthropic foundations. Its mission is four-fold: to expand the value of forests to society; to promote sustainable forest management and conservation by creating and capturing market values for ecosystem services; to support innovative projects and companies that are developing these markets; and to enhance the livelihoods of local communities living in and around those forests. It does this by analyzing strategic market and policy issues, catalyzing connections between forward-looking producers, communities and investors, and developing new financial tools to help markets work for conservation and people. Forest Trends’ approach integrates the fundamental dimensions of ecology, economy, and equity because our goal is to have an impact on a scale that is meaningful globally and for a diverse set of stakeholders.

The Anti Forest-Mafia Coalition is a group of Indonesian NGOs dedicated to improving forest governance.