

# Commodifying Legality? Who and What Counts as Legal in the Indonesian Wood Trade

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## Abstract

This paper examines how legality verification in Indonesia, as developed under the EU's Law Enforcement, Governance and Trade (FLEGT) Voluntary Partnership Agreement (VPA), shapes who and what counts as legal. A review of Indonesia's evolving legality verification system, and in-depth stakeholder interviews, reveal a process of commodification driven by international demand for an interchangeable label of 'legality'. This interchangeability is produced through a reduction of forest governance to a narrow set of legal standards and third party, private auditing, which risks obscuring key governance challenges such as corruption and unclear tenure, and excluding most domestic and small-scale operators from economic and legal recognition. Given the market logic of legality licensing, it is more likely to 'ratchet down' than 'ratchet up' local access to, and benefit from, wood production, unless there is greater support and investment in legal and tenure reforms and improved local benefit-capture.

## 1. Introduction

The 2003 EU Forest Law Enforcement, Governance and Trade (FLEGT) Action Plan (EC 2003) represents one among a growing number of governmental and intergovernmental trade-based initiatives aimed at eliminating trade in illegal timber (e.g. Hoare 2015). A core hypothesis underlying such initiatives is that removing illegal wood from global supply chains will reduce deforestation and forest degradation and promote more environmentally and socially responsible forest management (e.g. EC 2003). Common among these trade-based strategies is the requirement for producers and buyers along the supply chain to take measures to ensure or verify that the wood they trade is legal.

The FLEGT Action Plan calls for Voluntary Partnership Agreements (VPAs) as one of its key mechanisms to provide such legality verification. VPAs entail partnerships with developing countries to create "legality licensing schemes" built upon systems of independent verification and monitoring. Once these schemes are in place, wood products coming from VPA countries will only be allowed into EU markets if they bear a FLEGT license. To date, six countries have signed a VPA with the EU, and nine countries are in various phases of VPA negotiation (EFI 2016). As of April 2016, five years after agreement on Indonesia's VPA was reached, the EC has confirmed that Indonesia is the first country to meet the EU's requirements for FLEGT licensing and that the EU will now take the necessary procedural steps to make Indonesia's FLEGT licenses fully operational (EFI 2016).

The focus of FLEGT on legality has been seen as a response to the limitations of non-state, market-based schemes such as sustainability certification (Wiersum et al. 2013). It has been argued that non-state certification lacks authority to address core governance challenges in the global South, such as corruption and lack of clarity in local land and resource rights (Ebeling and Yasué 2009). At the same time, certification's market-based logic has been criticized for commodifying production processes (Daviron and Vagneron 2011) in ways that favor large-scale, high capacity firms supplying green markets in the global North (Ebeling and Yasué 2009).

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The re-assertion of government authority through legality verification is therefore purported to offer various advantages. In particular, it appeals to governments as a means to strengthen state sovereignty, while at the same time harnessing the unique capacity of the state to institutionalize basic governance reform, including the recognition of community land and resource rights (Bartley 2014). Legality verification has also gained support from the private sector as a means to ‘level the playing field’ by removing market competition from illegal wood (van Heeswijk and Turnhout 2013). Finally, the involvement of civil society in the design of legality verification systems has been viewed as evidence of an ‘experimentalist regime’ that ‘democratizes’ forest governance (Overdevest and Zeitlin 2014). Building on this, Cashore and Stone (2012) predict that state and private actor support for FLEGT will enable widespread uptake, while the involvement of civil society will foster a “ratcheting up of forest standards and authoritative governance” over time.

But how are state-based legality verification schemes actually implemented, and to what extent does this draw on state and civil society versus market logics? How, in turn, does this impact their equity and ability to tackle underlying governance challenges? In particular, how do processes of legal formalization, standardization, auditing and labeling (the building blocks of certification and commodification) affect who can “play” on the playing field and which rules of the game are, or aren’t, enforced? In order to answer these questions, it is necessary to look more closely at how these VPA processes are actually being designed and enacted.

To do so, this paper draws on a case study of Indonesia, as one of the first countries to engage in a FLEGT VPA process, and as the first country to meet EU requirements for legality licensing. The Government of Indonesia first established its timber legality verification system in 2009, known by its Indonesian acronym as SVLK (*Sistem Verifikasi Legalitas Kayu*). Since that time a series of regulations and policies have been stipulated to support SVLK implementation, and there have been modifications and changes to these over time. These developments allow for a detailed investigation of how legality verification is being enacted in practice, and the tensions its enactment has entailed.

The paper is organized as follows. The next section covers the research methodology. This is followed by an overview of our analytical framework and the situation of the SVLK within this framework. This sets the stage for two sections considering 1) how the SVLK standards shape who and what is considered legal and 2) how auditing and labeling under the SVLK further impacts who benefits from legal recognition. The paper then concludes with reflections on the broader relevance of our findings.

## 2. Methods

The research presented in this paper is based primarily on data collected from March to December 2015. The sources of data include, firstly, a literature review and document analysis of relevant laws and policies examining the evolution of stakeholder engagement in the Indonesian FLEGT VPA, changes in the policies of the timber legality assurance system, and evidence regarding SVLK implementation.

The second category of data includes in-depth interviews conducted with thirty-four key informants representing multiple interests at multiple scales. At the national level these included government officers, NGO activists, certifiers, researchers, and

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industry representatives, and at the international level, international NGOs, donor agencies and UK and EU government officials involved in FLEGT. The interviews were designed to examine these stakeholders' perspectives on Indonesia's FLEGT VPA and SVLK and how they have impacted the content of forest law, the content of the SVLK standards and auditing processes, and large and small timber producers for domestic and export markets.

The authors also conducted interviews with 2 heads of smallholder associations from Java (with a combined total of 3,500 members); 2 representatives of smallholder associations on Sumatra, including one who has obtained and one who has not obtained *Verifikasi Legalitas Kayu*/VLK certification (with a combined total of 268 members); and small-scale wood processors, comprising of two representatives of associations of small and medium furniture enterprises (with a combined total of 2,836 members). We asked these associations and enterprises about their perspectives toward SVLK, their rationale to apply (or not) for SVLK certification, and the impacts of SVLK on their forest management or business practices.

While our field research addressed a range of FLEGT interventions, including donor-based projects and other non-regulatory or "soft" support for governance reform (Colchester et al. 2006), the core focus of this paper is on the impacts of SVLK as a legal mechanism to produce FLEGT licensed timber. This enables a focused investigation of the ways in which the particular policy instrument of legality verification shapes who and what counts as legal.

### 3. Legality, certification and the SVLK: An analytical framework

Our analysis of the SVLK builds upon two key streams of literature. The first is a growing body of work on legality verification as a type of legal 'formalization'. Formalization involves "the codification of the rights to own, access, or trade land and resources in a written legal or regulatory canon that is accepted by the state" (Putzel et al. 2015, p. 457). In developing countries, local and traditional systems of land and resource governance often co-exist 'informally' along with state-based legal frameworks. Attempts to further formalize, codify and enforce state-based legal frameworks put local actors at risk of criminalization, arrests and imprisonments (Putzel et al. 2015). In theory formalization can strengthen the rights of less powerful actors by more clearly articulating and integrating those rights into formal law. However, in practice such actors may lack the needed social and economic capital to assert their rights (Putzel et al. 2015; Putzel et al. 2014). Laws governing timber harvest are particularly complex in many developing countries (McDermott et al. 2010), and small-scale and community-based operators often lack the capacity and influence needed to obtain required permits (Obidzinski et al. 2014). Meanwhile the focus of legality verification on state law risks undermining existing local rules governing resource use (Pacheco et al. 2008).

Legality verification involves more than simply reinforcing state rules, however. Indonesia's SVLK emerged in response to international market demand for legally verified timber. As a market-driven instrument, it bears many features in common with certification (Cashore and Stone 2012; Maryudi 2015). Hence our analysis also draws on the literature on certification to better understand how markets influence the scope of issues addressed, and the distribution of costs and benefits.

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Certification was first adopted by commercial actors as a means to facilitate trade in ‘commodities’, i.e. products considered fully interchangeable or substitutable. Certification contributes to commodification through two key processes: *standardization* and *auditing* (Mutersbaugh 2005; Daviron and Vagniron 2011). *Standards* render certain common attributes of products visible, while obscuring other ‘contextual’ factors that make them unique. *Auditing* involves the assessment of conformity to standards by an interchangeable pool of third party auditors. Both of these processes work together to simplify and dis-embed products or processes from their local context, and thus make them fully fungible (Dauvion and Vagniron 2011).

Certification has its roots in the late nineteenth century, when industry standards were proliferating as a means to facilitate long distance trade (e.g. Daviron and Vagniron 2011). By the 1980s and 90s, rising international concern over the environmental and social impacts of this trade led NGOs and other actors to expand certification’s scope to address the ‘sustainability’ of production processes. (Ibid). This expansion of actors and issues spurred widespread debate over the content of certification standards, and catalyzed the adoption of multi-stakeholder processes as a means to gain broad support (e.g. Cashore et al 2004). The result has been a proliferation of sustainability certification schemes, each reflecting a different balance of stakeholder influence (e.g. Bartley 2007).

Indonesia’s SVLK contains key similarities and differences to these non-state certification schemes. Like sustainability certification, the SVLK drew on multi-stakeholder processes to establish a set of legality standards (EU et al. 2011). However, unlike these other schemes, the state carries final authority in the SVLK system. Specifically, the Ministry of Forestry (MoF) Decree on SVLK regulates the requirements, standards and guidelines for the certification of timber legality (VLK) and the certification of sustainable forest management (*Pengelolaan Hutan Produksi Lestari/PHPL*).<sup>3</sup>

Section 4 of this paper explores the issue of scope in the SVLK standards. Here we examine whether and how these government standards have functioned like commodity standards, i.e. have served to simplify Indonesian forest governance into an auditable list of regulatory requirements. In fact, given the multitude and complexity of Indonesia’s laws, norms and regulations across national, provincial, district and municipal levels (Obidzinski and Kusters 2015), it would be well beyond the remit of this paper to conduct a comprehensive analysis of which laws are, or aren’t, covered by the SVLK legality standards. Rather, we provide a general overview of the content of those standards, and then focus on the implications of this content for addressing two key governance issues: corruption and forest tenure. Both of these issues are critical in determining the impacts of legal formalization on local communities (Putzel et al. 2015). While our primary concern is with the verification of legality (VLK), we also consider the scope of the SVLK standards for sustainability (PHPL).

The processes of auditing and labeling are also critical in shaping certification’s

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<sup>3</sup> (MoF) Decree 38/2009. It has been revised several times to date.

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impacts, as these are the steps that communicate compliance with standards to the international marketplace. Past literature on sustainability certification reveals how third party auditing tends to favor large-scale operators due to economies of scale (Wiersum et al. 2013). Yet the market rewards of certification are limited to producers who can access international green markets (McDermott 2013). Such rewards are not available to producers selling to other markets, including domestic producers who generate the largest quantities of timber in many developing countries (Kishor and Lescuyer 2012).

Despite these known challenges, the SVLK has mirrored sustainability certification by adopting private third party auditors (LP&VI) accredited under Indonesia's accreditation agency (KAN). This use of private auditors was initially disputed, but encouraged by EU negotiators (Cashore and Stone 2012). It was argued that privatizing the auditing process would "bypass corruption or uncertainties about implementation" (ibid). Reinforcing this focus on external auditing, a civil society group (*Jaringan Pemantau Independen Kehutanan/JPIK*) was established to monitor the auditors, and further guard against corruption of the auditing process.

The decision was made, furthermore, that all timber harvesters and processors, regardless of size or domestic or export orientation, must undergo an audit to assess whether or not they conform to timber legality standards, requirements and guidelines. If they pass the audit, they obtain an SVLK (TLAS) license to operate. In addition, holders of concession licenses (IUPHHK HA/natural forest, IUPHHK HTI/Industrial plantation forests, and IUHHK RA/ecosystem restoration) must undergo certification to the supplementary sustainable forest management standard (PHPL).

Finally, the Ministry of Trade has issued another regulation which applies specifically to exports. Those entities exporting products covered under the SVLK are required to present a valid V-legal document. Failure to do so could result in the rejection of export licensing and prosecution (Ministry of Trade Decree, Art. 21). It is these V-legal licenses, in turn, that Indonesia aims to have recognized by the EU as FLEGT licenses, signifying that all licensed Indonesian timber can be legally imported into the EU. In other words, the potential market incentives for SVLK verification lie solely in the issuance of V-Legal documents, and associated V-Legal label, for export.

In light of this strong emphasis on private auditing and export licensing, Section 5 of this paper analyzes private third-party auditing and V-Legal labeling under the SVLK. In particular, we focus on the distribution of market incentives this entails, with particular emphasis on its economic costs and benefits for domestic, smallholder and community-based producers.

### **4. The SVLK standards: What is included and excluded?**

The focus of the SVLK legality standards, as outlined in the Indonesian FLEGT VPA (EU and Indonesia 2011), is on the presence of appropriate documentation affirming legal rights to harvest. The type and number of required documents to achieve this affirmation varies by operator category, from simply ownership papers and property maps (for private forest owners) to approved impact assessments, harvest plans, and permits for public forestland concessionaires. The following subsections draw on interviewee perspectives and available written literature to explore the implications of

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this narrowed definition of legality, and this exclusive focus on formal documentation, for addressing the key governance challenges of corruption and forest tenure.

### **Corruption**

Corruption has become a central focus of Indonesian politics over the past few decades (Gellert 2005). A study from the Indonesian Corruption Commission (KPK 2014) estimates that state revenues lost from forest sector corruption reach around IDR 22 billion (over \$1.5 million USD) per year. Some reports suggest that much of this corruption comes from irregularities in the issuance of permits and associated documents for log transports (KPK 2014; Rasad and Febismanto 2015), involving the bribing of government officials. Situmorang et al. (2014) suggest that bribery contributed to 30 percent of the entire production cost in the forest sector. The signing of a VPA agreement with the European Union and the establishment of SVLK hence form part of the Indonesian government's efforts to curb corruption in the forest sector, and especially corruption embedded in the permitting systems (Obidzinski and Kusters 2015).

Despite this widespread recognition of the role of corruption, this issue is not addressed by SVLK legality certification (Obidzinski and Kusters 2015). Instead, the focus of VLK standards on the production of documents does not require or enable auditors to evaluate irregularities in how those documents are obtained. This leaves ample opportunity for bribery, and has led one key informant to note that SVLK had been reduced to a system of administrative checklists, and to state that this hampers its potential to support broader efforts to improve forest governance.<sup>4</sup> Meanwhile a study carried out by the Anti Forest-Mafia Coalition (2014) has identified 12 companies in Riau province, which had received VLK and sustainable forest management (PHPL) certification despite obtaining their licenses and/or annual work plan (RKT) through corrupt practices.

Another recent study suggests that several loopholes in SVLK have enabled companies to misuse their export declaration documents to be used by other enterprises (JPIK 2016). The study found strong indication of illegality in which active wood exports continue to be carried out by companies that have not operated for more than a year and those that are not registered in the Trade and Industry Agency, as well as companies forging signatures for export documents (JPIK 2016).

A key informant working for an association of logging companies suggested that corruption remains deeply entrenched in Indonesia's forest sector. Even when the company has obtained the permits and V-legal documents to transport the logs legally, there is no guarantee that they will not be stopped by the '*oknum*', the government officers who demand bribes, when they transport the logs. According to this respondent:

We often need to spend 'non-budget' cost even though we have obtained Vlegal documents. We spend a lot of money for formal costs

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<sup>4</sup> Interview #3, NGO, April 8, 2015.

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with the hope that we do not have to spend more on the ‘informal’ costs, but the *oknum* often asked for other costs. As a result, the total could reach 40 percent of production costs.<sup>5</sup>

In response to the criticisms from civil society respondents on the weakness of SVLK with regards to corruption, requirements for sustainable forest management certificates (PHPL) were revised in 2014; these revisions include a provision in which the certificate could be revoked by the auditors if a company’s operational permits are influenced by criminal activities, which could include human rights violations, illegal activities (i.e. illegally buying and selling timber), carrying out logging activities outside concession areas, among others.<sup>6</sup> Some argue that although corruption is not specifically stated in the provision for revoking the PHPL certificate, the term ‘illegal activities’ could be interpreted to include corrupt practices in obtaining permits (RAN 2015). Nevertheless, it has been argued that this measure is insufficient because it would address only corruption on the part of companies rather than individuals. This would not cover issues such as bribery, since legal cases against bribery are commonly focused on individuals, but rather would be limited to issues for which companies are considered liable. Furthermore, the probability of a company being prosecuted for corruption in Indonesia is very low (RAN 2015).

The Independent Forest Monitoring Network (JPIK), the civil society group charged with monitoring SVLK certification, is intended to provide another layer of protection against corruption. However a recent JPIK report raises concerns over a lack of transparency and difficulties accessing relevant information, which is crucial to enable an effective monitoring system.<sup>7</sup> As a result, the monitoring network has only been able to carry out oversight on thirty out of the thousands of SVLK audits already conducted (JPIK 2014). Moreover, there is a lack of civil society members with sufficient expertise and capacity to monitor field compliance on the complex technical requirements contained in Indonesian forest-related laws, as well as on social issues such as land rights and benefit sharing mechanisms (Ibid).

### **Forest Tenure**

The European Council Conclusions on FLEGT (2003/C 268/01) articulate goals to “strengthen land tenure and access rights especially for marginalized, rural communities and indigenous peoples... strengthen effective participation of all stakeholders, notably of non-state actors and indigenous peoples, in policymaking and implementation... increase transparency...[and] reduce corruption”.

Relevant to this mandate, in Indonesia there have been ongoing debates on the extent to which forest tenure clarification needs to be addressed in the timber legality assurance system, especially considering widespread overlapping tenure claims over forest areas. Nearly 33,000 villages are located in areas classified as state forest (Rachman 2014). Many communities still struggle to have their rights over customary forests recognized by the state (Hall et al. 2011). In addition, many smallholder forest

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<sup>5</sup> Interview with key informant #8, logging industry, April 13, 2015

<sup>6</sup> Government Regulation (Perdirjen BUK 14/2014) Annex 3.1, 3c for PHPL Annex 3.2.2

<sup>7</sup> Interview with key informant #1, NGO, April 2, 2015



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owners do not hold formal land title, hence hindering their ability to obtain timber legality certification (Obidzinski et al. 2012). Currently the VLK standards merely require documentation showing clarity on the origin of the timber, permits for timber harvesting (if on state forests), proof of land ownership (if on privately owned forest), transport permits and any other legal documentation required.

In contrast, key informants argue that the SVLK needs to cover not only procedural legality by checking document compliance but also include measures to ensure forest tenure clarification and mitigate forest-based conflicts.<sup>8</sup> Yet most respondents were pessimistic that SVLK can fulfill this role. One key informant mentioned that during the policy debates on SVLK, little attention had been paid to the possible contribution of the system to address forest tenure issues, especially over *adat* (customary) forest.<sup>9</sup>

The one exception is a recent change to the SVLK regulatory framework addressing sustainable forest management (PHPL) certification. Based on inputs from various stakeholders, this latest revision of the PHPL standard<sup>10</sup> includes criteria and indicators on the need for free, prior and informed consent (FPIC), for a conflict resolution mechanism, and for measures to engage communities in forest area delineation. However, it remains to be seen how these requirements are checked and verified. Past research has highlighted that the application of FPIC in the context of certification is often highly constrained, due in part to the limited capacity, authority and incentive for private auditors to become enmeshed in lengthy and complex disputes over land and resource rights (Mahanty and McDermott 2013). In any case, the FPIC requirements apply only to those operators that undergo PHPL certification. VLK legality certification does not include criteria or verifiers that provide protection against licenses issued on indigenous lands or lands with overlapping claims (RAN 2015).

## 5. Third party auditing and legality labeling: Where lie the market rewards?

As discussed above, the decision to delegate the verification of legality to private, third party auditors was supported by the EU and other stakeholders, based on the argument that it would reduce the risk of corruption in the auditing process (Cashore and Stone 2012). Likewise, many key informants interviewed for this research expressed the view that third party verification would help enhance the credibility of Indonesia in the eyes of the international community. It was argued that Indonesia has suffered for decades from a rather negative reputation of widespread corruption and mismanagement of forest resources. Therefore third party verification was deemed necessary to restore the credibility of Indonesia's forest industry to the rest of the world.

Once the decision was made to incorporate third party auditing into the VPA, it then became a binding requirement and prerequisite for obtaining V-legal documents for export. This effectively shifted the costs of international credibility on to Indonesian

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<sup>8</sup> Interview with Key Informant #3, NGO, April 8, 2015 and Key Informant #10, NGO, April 14, 2015

<sup>9</sup> Interview with Key Informant #10, NGO, April 14, 2015.

<sup>10</sup> MoF Decree 14/VI-BPHHH/2014 on Standard, Criteria, Indicators and Guideline to implement SVLK and PHPL

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producers. At the same time it linked market rewards, if there are any, to those producers with both the interest and ability to access EU markets.

Two key informants, working for an Indonesian NGO and a certifying body respectively, highlighted significant flaws in this focus on EU market signals.<sup>11</sup> They point out that the European market comprises less than 5 percent of the market share of the total export of timber products from Indonesia (see Table 1). Most timber products exports are destined to other countries in Asia (around 85 percent), particularly China.

**Table 1. Destination Countries of Indonesian Timber Products<sup>12</sup>**

*[Insert Table 1 here]*

The lack of market incentive is perhaps even more pronounced for the majority of small and medium producers and processors who supply domestic markets. For example, smallholders who plant trees on private land (*hutan rakyat*) are important domestic timber suppliers, particularly in Java and Madura Island. While the exact figure of smallholder tree planting is unclear, a report suggests that the extent of smallholder private forests in Java is around 1.7 to 2.6 million ha (BPKH XI 2012) with potential timber production that could reach up to 72 million m<sup>3</sup> (Suprpto 2010). Obidzinski et al. (2014) estimates that there are approximately 6.8 to 10.8 million households planting trees in Java alone. Timber from smallholders' private lands contributed to more than 75% of the wood for the major timber industries within Jepara, Central Java (Hadiyati 2011 cited in Nurrochmat 2016).

In terms of small-scale timber enterprises, which are defined as wood processing industries with capacity of 6,000 m<sup>3</sup> or less, the record from MoF and the Forestry Industry Revitalization Agency (BRIK) suggest that there are 4,000 small-scale timber enterprises (Obidzinski et al. 2014). However, the actual figure is likely to be much higher because many of them are unregistered (ibid). Furthermore, and as articulated by one key informant, small-scale enterprises often source from a diverse and changing array of small producers, many of which have yet to verify their legality, while the enterprises themselves lack capacity to produce the detailed, long-term transaction records that certification requires.<sup>13</sup>

These smallholders and small-scale enterprises face not only limited market incentive to achieve legality verification, but third party auditing is disproportionately costly and challenging for them. In recognition of these challenges, the Indonesian government has been making a series of changes to the SVLK legislation. For instance, legality certificates were initially valid for 5 years for all certification applicants regardless of the size of their business and nature of forest ownership. However, this was later revised to grant small-scale industries and smallholders a longer certification period (10 years in comparison to 5 years for big industries and

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<sup>11</sup> Interview with key informant #2, NGO/donor agency, April 16, 2015 and key informant #16, certifier, May 8, 2015

<sup>12</sup> Data retrieved from [www.silk.dephut.or.id](http://www.silk.dephut.or.id). All data were updated as December 31, 2015

<sup>13</sup> Interview with key informant #21, NGO, April 1, 2015.

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concession holders) and a longer rotation period for surveillance (every 24 months compared to 12 months for big industries).

A more fundamental revision was then made by the government at the end of 2014 to 'relax' SVLK requirements. Through the issuance of the Ministry of Environment and Forestry (MoEF) Decree No 95/2014, small-scale, legally recognized private forest plantation owners (most of whom are on Java), are excluded from the requirement to obtain legality certification and V-legal documents. Instead, they can issue a self-declaration document declaring that the timber is harvested from private forests. Similarly, small processing and distributing enterprises can also issue a conformity declaration (*Deklarasi Kesesuaian Pemasok/DKP*), which declares that they obtain legal raw materials from smallholders. Furthermore, small and medium enterprises (SMEs) can issue export declarations for products in Group B (outlined in Trade Ministry Decree 97/2014 includes furniture and woodworking). The deadlines for obtaining legality were also extended. Initially, the Indonesian government stipulated that all timber producers must comply with SVLK requirements by the end of 2014. However, due to slow progress to integrating small and medium scale enterprises into the system, the full implementation of the SVLK was at first postponed until the end of 2015.

Then at the end of 2015, and in response to the demand from a small and medium furniture enterprise association to remove SMEs from the requirements to obtain export documents related to VLK, the Trade Minister issued a decree that exempts 15 HS Codes of the furniture and handicraft group from the SVLK system and removes the time limit to obtain VLK certification for those uncertified wood products.<sup>14</sup>

These changes have generated substantial controversy. In particular, the majority of stakeholders interviewed opposed the relaxing of third party verification requirements for small and medium enterprises (processors and traders) in particular. Quite significantly, this opinion was voiced at the EU level. An EC official stated that the EU will not accept self-verification for V-legal documents of any kind as proof of legality.<sup>15</sup> Presumably, such self-declarations would not be viewed as credible proof of legality and hence might appear to allow the leakage of illegal timber into the EU. The exemption for small-scale processors has since been removed, prior to the EU confirming that Indonesia had met its requirements for FLEGT licensing (Ika 2016).

In contrast to this hard line regarding small enterprise, key informants had divided views with regards to requirements for small-scale private forest plantation owners. Those who opposed a relaxing of requirements for even this one limited category of small producer, argued that the SVLK system should be 'non-discriminatory', i.e. it should be applied equally to all players in the timber industry regardless of the size of their business. It was suggested that providing an exception for smallholders would be "unfair". Rather, it was argued that the government should provide financial and technical assistance to enable smallholders to meet certification requirements. Moreover, some expressed the opinion that including smallholders in the SVLK system would bring them benefits, in that it would increase their access to markets

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<sup>14</sup> See Supplementary Online Material for a summary of these changes.

<sup>15</sup> Interview with key informant #22, European Commission, Sept. 7, 2015

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and reduce their dependence on intermediary traders.

On the other hand, other key informants suggested that obtaining third party certification and V-legal documents is not economically feasible for smallholders, even if they are allowed to certify as a group.<sup>16</sup> The VLK certification costs approximately IDR 30-40 million (\$2,000 – 3,000 USD) and IDR 25-30 million for the start-up verification (Maryudi, et al., 2014). Smallholders also need to spend around IDR 25 million for surveillance audits every two years. The total cost that smallholders need to cover during the validity period could reach up to IDR 100 million (\$7,300 USD) (Maryudi, et al., 2014). To date, only a few smallholders have obtained legality verification, and all with financial support from donors. The SVLK requirement to pay for certification would result in smallholders receiving an even smaller fraction of commercial benefits from their timber plantations.

Those in support of relaxing requirements for smallholders also argued that small-scale private plantation owners are not a significant source of illegal logging. Likewise, some key informants suggested that many smallholders are at risk of being criminalized since they do not possess land titles. In support of this, one key informant cited two recent criminalization cases against smallholders by the state-owned forest company in Java.<sup>17</sup> Similar to other stakeholders, the smallholders interviewed for this research also had mixed reactions to SVLK. In general, they argued that SVLK has increased their costs and administrative burdens; hence they generally welcomed the recent decision to exclude smallholders from third party SVLK requirements. Likewise, one smallholder key informant that had not obtained VLK certification explained that his farmer association could not afford the certification fee.<sup>18</sup>

On the other hand, an informant from a smallholder association on Java that has obtained third party SVLK certification, expressed a different view. He reported that applying for group SVLK certification was what motivated him and other farmers to establish their forest farmers association (*kelompok tani hutan* /KTH) and develop a long term forest management plan that applied to their collective forest area. This, he claimed, has enabled them to better manage their forest sustainably and access various government services, such as a credit scheme to postpone timber harvesting/ *kredit tunda tebang*.<sup>19</sup> After obtaining VLK certification, this respondent also suggested that they have been able to gain better access to markets by securing agreements with furniture companies seeking VLK certified raw materials, thereby removing the need for intermediate traders in the local timber trade. This respondent did not support the recent policy decision to remove the requirement for third-party verification, and viewed it as proof that the government has underappreciated the time and energy they have spent to apply for certification.

This reward of better markets on Java contrasts with the experiences reported in Jambi, Sumatra. A Sumatran respondent interviewed stated that his farmers

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<sup>16</sup> Interview with key informant #2, donor agency, April 16, 2015

<sup>17</sup> Interview with key informant #6, NGO, April 10, 2015

<sup>18</sup> Interview with key informant #18, smallholder, June 22, 2015

<sup>19</sup> Interview with key informant #7, smallholder, April 10, 2015

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association has not received any tangible benefits from VLK certification (e.g. increasing access to market and higher timber price). He further reported that many farmers in the area, including those who have obtained VLK certification, have since converted their privately owned forests to oil palm plantation.

## 6. Conclusion

To date, much of the literature on FLEGT and other illegal logging initiatives has focused on their role in bringing the state back into international forest governance, and the promise this holds for institutionalizing improved forest governance (e.g. Bartley 2014). For example, some scholars have argued that FLEGT VPAs have created new coalitions of stakeholders that contribute to the democratizing of decision-making (Overdevest & Zeitlin 2014) and the ‘ratcheting up’ of forest standards over time (Cashore and Stone 2012). Yet others have cautioned that a re-focus on state laws can create disproportionate burdens for domestic and small-scale producers, but argue that this may be overcome if increased law enforcement is accompanied by the formalization of local rights (Obidzinski and Kusters 2015).

This paper departs somewhat from this past literature, by questioning to what extent FLEGT VPAs signal a return to the state versus the marketization or commodification of the state and its associated legalities. We draw on the literature on certification, to observe how legality verification, like certification, relies on processes of standardization and auditing to create interchangeable labels of ‘sustainability’ or ‘legality’ in the international marketplace. In this way, they inherently redefine that which they aim to verify in ways that reflect a particular balance of interests and authority. As is clear from the Indonesian case, legality verification does not simply “reinforce state authority”. Nor does it certify ‘legality’ in any complete sense. Rather, it involves a unique blend of public and private authority that has narrowed the scope of who and what is considered legal. Under the Indonesian SVLK, ‘the state’ (the Ministries of Forestry and Trade, respectively) has set the official boundaries of what laws and regulations are included in legality standards, and has delegated the task of auditing compliance to private, third party auditors.

We found that the VLK legality standards consist of an easily auditable document checklist, and examined the implications of this approach for addressing the key issues of corruption and land and resource tenure. This revealed how the focus on documentation ignored the issue of whether concessions, plan approvals, harvest or transport permits were issued through corrupt practices. This is perhaps not surprising, given the limited authority, capacity and incentive for private auditors, hired by private companies, to uncover either government or private sector corruption. Regardless of the justification, verifying operations as ‘legal’ that have engaged in corruption obscures its significance relative to the issues that are covered in the standards, and risks further entrenching and legitimating that corruption.

The findings on land and resource tenure suggest that SVLK may have limited reach in this area as well. Again, the focus on official documentation of ownership, harvest and transport rights is ill suited to address tenure-related corruption and conflicting resource rights. Furthermore, the Indonesian stakeholders interviewed did not view SVLK certification as a promising tool to address these issues in the future either, belying predictions that legality verification is likely to ‘ratchet up’ forest standards

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(Cashore and Stone 2012) in ways that enhance community rights (Bartley 2014), or contribute to the formalization of local rights as advocated by Obidzinski and Kusters (2015).

The SVLK's reliance on third party auditors was consistent with the wishes of EU negotiators, as well as some civil society groups, and was viewed as a means to reduce corruption and uncertainties regarding the auditing process. Whatever the rationale, our analysis reveals a number of other effects this decision has had on the distribution of costs and benefits and the ways in which legal issues are addressed.

Firstly, the default costs of private third-party verification are borne by the producers. Despite some state subsidies, economies of scale have put smallholders, as well as small-scale enterprises (processors and traders), at a disadvantage in achieving certification. These costs involve more than the costs of the audit. Verification requires legal proof of land and resource rights and other types of formal forest planning for which many smallholders lack capacity. Likewise, small-scale enterprises often source from smallholders and themselves lack capacity for producing detailed formal records of their transactions. Since only a very small fraction of wood is destined for an EU market which rewards verified legality, there is little chance of market benefits.

These market inequalities are similar to those of non-state certification, but are more acute due to their mandatory, legal nature. Some stakeholders claim that legality verification should be subsidized for smallholders, but to date subsidies have covered only a minute fraction of what would be required to verify all wood producers. While our research found that third party legality verification has sometimes been a positive experience for smallholder associations, this appears the exception rather than the rule.

The Indonesian government has attempted to reduce the burden for small operators by allowing self-verification. This decision is supported by some stakeholders for the very limited case of smallholders who can verify ownership of tree plantations. However the EU has successfully pushed back on the easing of requirements for small-scale enterprises.

So, given these findings, what is the way forward? Firstly, there is a need to recognize the limitations of both certification and legality verification, in terms of their scope, as well as their discrimination against domestic and small-scale operations. Instead of requiring that all producers in Indonesia or other developing countries be subsumed into certification-like systems of standardization and auditing to 'prove' legality, such approaches might better be restricted to large-scale wood exporters and re-framed as evidence of due diligence or risk mitigation rather than legality. Meanwhile improving governance of domestic and small-scale producers could be better achieved through legal reform combined with other non-regulatory or "softer" approaches that prioritize *de jure* and *de facto* recognition of community rights to access and benefit from their local forest resource.

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