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# ANALYSIS OF POLICY CONSTRAINTS ON THE FURNITURE INDUSTRY

CASE STUDY IN EAST JAVA AND CENTRAL JAVA

**AUGUST 2007 – REGIONAL ECONOMIC DEVELOPMENT INSTITUTE (REDI)**

THIS PUBLICATION WAS PRODUCED FOR REVIEW BY THE UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT. IT WAS PREPARED BY **DAI**

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## **DISCLAIMER**

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# LIST OF ABBREVIATIONS

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ASMINDO	Furniture and Handicraft Association
BBM	Fuel
BPS	Indonesian Bureau of Statistic
BU	Buku Ukur
DHH	List of Forestry Produce
DHHBK	List of Forestry Produce other than Wood
DKB	List of Unprocessed Timber
DKBK	List of Unprocessed Small Size
DKO	List of Processed Timber
DLAHH	List of Forestry Produce Transportation
DLHP	List of Felling Trees
DP	List of Transportation
DPP	List of Replacement Transportation
DPPHH	List of Forestry Inspection and Measurement
FGD	Focus Group Discussion
HHBK	Forest Product Non Logging
HHK	Wood Forestry Product
HPH	Exertion Authority of Forest
HPHT	Exertion Authority of Plant Forest
HPHTI	Exertion Authority of Industry Plan Forest
HS	Harmonized System
IPHHBK	Harvest Regulation of Forest Product Non Logging
IPHHK	Harvest Regulation of Wood Forest Product
IPK	Regulation of Wood Exploitation
IPKL	Secondary Process Forest Product
ISPM	International Standards for phytosanitary measures
KADIN	Indonesian Trade of Commerce
KB	Unprocessed Timber
KBK	Small Size Timber
KBS	Medium Size Timber
KO	Processed Timber
MDF	Medium Density Fiberboard
NTB	West Nusa Tenggara
NTT	East Nusa Tenggara
PPh	Income Tax
PPN	Added Value Tax
PPnBM	Tax of Luxury Item
UKM	Indonesian abbreviation for non-governmental organization (NGO).

# PREFACE

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The study was carried out by Regional Economic Development Institute (REDI) with the support of SENADA-USAID. The aim of the study was to develop a clearer understanding through in-depth analysis of the obstacles faced by the furniture industry, both regulatory and non-regulatory obstacles.

The study was carried out through in-depth interviews with select furniture entrepreneurs in East Java and Central Java. In addition, focus group discussions (FGD) were held in both locations. The results of the initial study were delivered in workshops in Semarang and Surabaya.

The REDI research team would like to express our deepest gratitude to various parties who have helped make this study possible, including representatives of: East Java ASMINDO, Jepara ASMINDO, Solo Raya ASMINDO, furniture enterprises, UKM in furniture industry, governmental agencies, and some donor agencies.

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# EXECUTIVE SUMMARY

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Indonesia is one of the biggest furniture exporters in the world. In 2006 Indonesian export of furniture products ranked eighth behind China, Canada, Mexico, Italy, Vietnam, Malaysia, and Taiwan. Based on Indonesian export value data, exports of wooden furniture products for use in dining, living, shop and others (outdoor) (HS 940360) are the most successful. The value of these exports is constantly increasing. For instance, 2006 showed an increase of US\$ 816 million with a total of 316.6 products. The second most important export product in the international market is bedroom furniture (HS 940350), which earned US\$ 190.65 million in 2006.

The furniture industry plays a very important role in the economy, especially in terms of job opportunities and improving social welfare. The existence of the furniture industry possesses a very long value chain and is connected with other sectors. Meaning, the multiplier effect that results from this industry is huge, from craftsmen who supply half-finished goods to entrepreneurs, wood sellers, and supporting sectors (such as food sellers, kiosks, public phone businessmen, and hotels) which cluster around the industry.

Important as it is, though, the furniture industry still faces some obstacles which negatively influence the competitiveness of this sector. This conclusion was arrived at in discussion between SENADA and ASMINDO in Surabaya. The result of the discussion showed the presence of obstacles in the path of furniture industry players, whether due to governmental policy or other. ASMINDO found that obstacles cause their enterprises' growth to be less satisfactory and to be less competitive, whether in domestic or international markets. ASMINDO identified those obstacles as follows: (1) the import of sample goods is treated similarly to the import of general goods; (2) raw materials are quarantined even though they have been processed; (3) fuel minimum order policy; (4) obstacles in the inter-territory trade of wood and wood products; and (5) obstacles created by the implementation of regional regulations and taxes.

Along with the initial identification, the results of our study show some deeper findings. The findings have a direct connection with problems of policy and its implementation. The current policy of importing sample goods, based on the decision of Ministry of Finance No. 140/1997, has contributed to decreasing the competitiveness of furniture industry. This decreasing of competitiveness is due to the treatment of sample goods as general imported goods. The import duties and taxes that have to be paid for importing sample goods is more than 60 percent, in addition to the very complicated procedure needed to eliminate the import duties. This policy causes Indonesia to lose export orders estimated at as much as Rp 485 billion. We recommend policy review of KMK 140/1997 to make the procedure in importing goods simpler and much less expensive.

The quarantine procedure of raw materials needed by the furniture industry, particularly MDF, is complicated as well, despite the elimination of the phytosanitary certificate. Furniture entrepreneurs who import MDF still have to report to Quarantine Head Office. This process, despite being simpler, is still inefficient – both in cost and time. MDF import procedures can be much simpler once a coordination between the Customs Office and the Quarantine Head Office is established. We recommend a decision of the Ministry of Agriculture on abolition of phytosanitary certificate<sup>1</sup> as well

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<sup>1</sup> International Standards for phytosanitary measures (ISPMs) are prepared by the Secretariat of the International Plant Protection Convention (IPPC) as part of the United Nations Food and Agriculture Organizations global program of policy and technical assistance in plant quarantine. The IPPC is an international treaty relating to plant health to which approximately 124 governments currently adhere. The purpose of the IPPC is to secure common and effective action to prevent the spread and introduction of pests of plants and plant products, and to promote appropriate measures for their control.

as the task of reporting to Quarantine Head Office, and reporting this to the Ministry of Finance to make the tax procedures for MDF simpler.

Related to fuel supply for the furniture industry, the obstacle is the lack of fuel supply to meet industry needs. If we give attention to the current fuel supply policy, the problems are shown to be related to the “gap” between industry needs and the minimum supply that Pertamina is able to fulfill. Besides the limited number of fuel agents for industry, some entrepreneurs reveal a lack of knowledge of the location (service point) of fuel agents for industry. A primary solution would be for Pertamina to add fuel agents for industry supply, particularly in high industry concentration areas. An alternative solution to be considered is to optimize the number of gas stations as fuel service points for industry supply.

Obstacles in the inter-regional trade, especially for wood and wood products, are still present. Furniture entrepreneurs still have to pay additional fees while distributing wood and wood products. Simplification in wood regulations through the existence of the Ministry of Forestry Regulation P. 55/Menhut-II/2006, which replaces the SKSHH as an official document of the log transportation using FAKB and FAKO, is still not powerful enough to eliminate the obstacles of wood and wood product distribution. More education about the new regulation will play an important role. To speed up the number of experts in each company with the right to issue FAKO, more training sessions must be held, while at the same time the training fees should be reviewed. The study found obstacles caused by central and regional policies, especially regarding taxes. Most businesses complain about the background reasons for implementing taxes and the lack of consistency in implementing them.

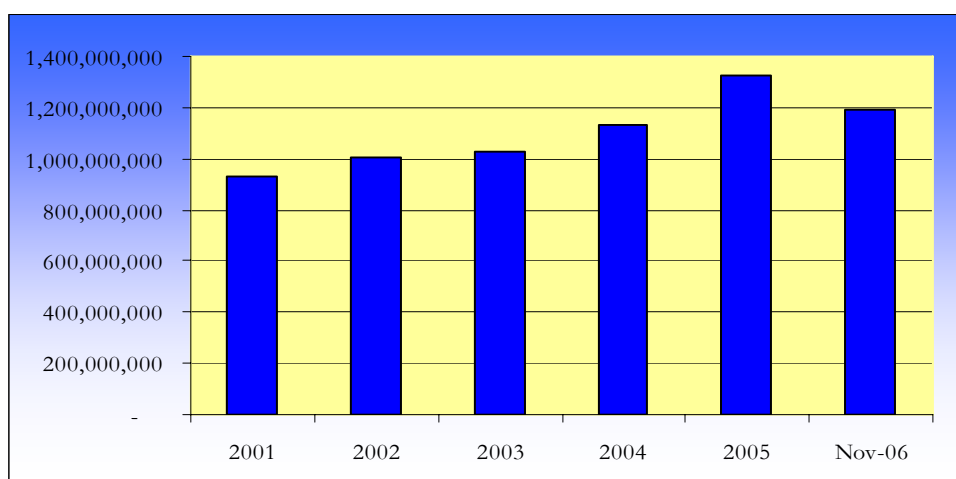
# CHAPTER I – INTRODUCTION

## 1.1. BACKGROUND

Indonesia is widely known as one of the biggest furniture exporting countries in the world. In early 2000, Indonesia was number 15 among all furniture exporters in the world. Data from Kamar Dagang dan Industri Indonesia (KADIN) shows that in 2006, furniture product exports held position number 8 below China, Canada, Mexico, Italy, Vietnam, Malaysia, and Taiwan.

The furniture industry plays significant role in the national economy. Data from 2001 to 2006 show an increasing trend of Indonesian furniture exports. In 2004, Indonesian furniture exports reached US\$ 1,129,502,649 and increased to US\$ 1,326,300,209 in 2005. That is a 6.14 percent growth of Indonesian furniture export value from 2004 to 2005; the average growth of export value for 6 years is 7.37 percent.

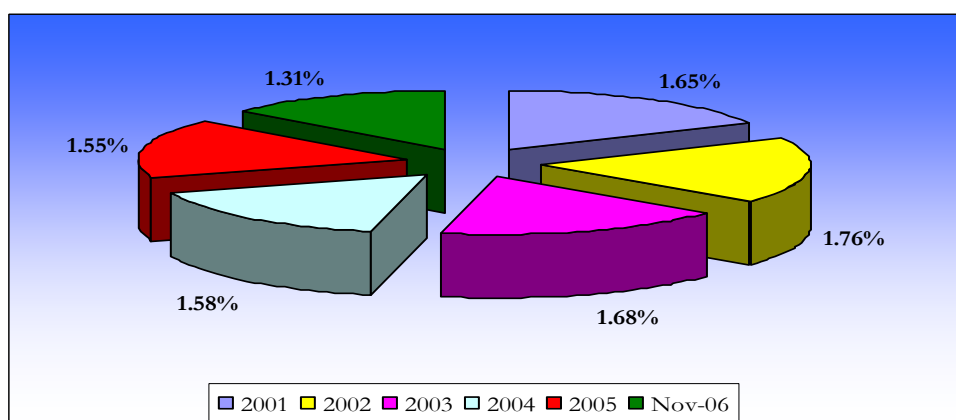
**FIGURE 1.1 – GROWTH OF INDONESIA FURNITURE EXPORT VALUE FROM 2001–2006 (US\$)**



Source: BPS (reprocessed)

Furniture export value compared to total export value shows the furniture export market share. The biggest furniture export market share was in 2002, at 1.76 percent. A year later furniture export market share decreased to 1.68 percent. It decreased again in 2003 and 2004. The average furniture export market share from 2001 through 2005 was 1.64 percent.

**FIGURE 1.2 – INDONESIA FURNITURE EXPORT MARKET FROM 2001–2006**



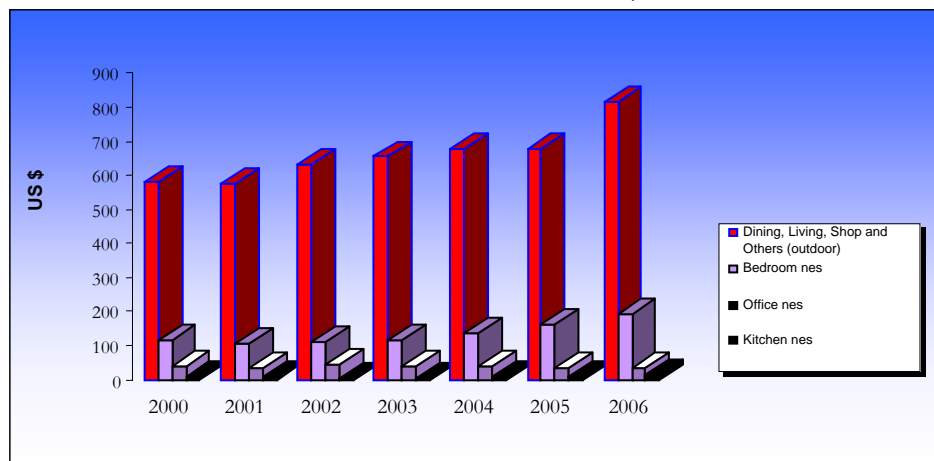
Source: BPS (reprocessed)



Based on the harmonized system code, wood furniture products (HS 94.03) consist of wood furniture (HS 94.03.30), kitchen furniture (HS 94.03.40), bedroom furniture (HS 94.03.50), and outdoor furniture (dining, living, shop, and other wooden furniture) (HS 94.03.60). Based on Indonesian export value growth (FIGURE 1.3), wood product export HS 940360 is the most successful. The average outdoor furniture product market compared to Indonesia's total furniture exports is 79 percent. Data shows that this outdoor product value tended to increase from 2000 to 2006. In 2005 Indonesian outdoor furniture product export value was US\$ 677.82 million and in 2006 product exports increased to US\$ 816 million.

The second most successful Indonesian furniture export is bedroom furniture, with an average market share – compared to total furniture exports – of 16 percent. In 2006, this line of furniture product contributed to the highest national income, 190.65 percent. There was a rise of 17.3 percent compared to the previous year.

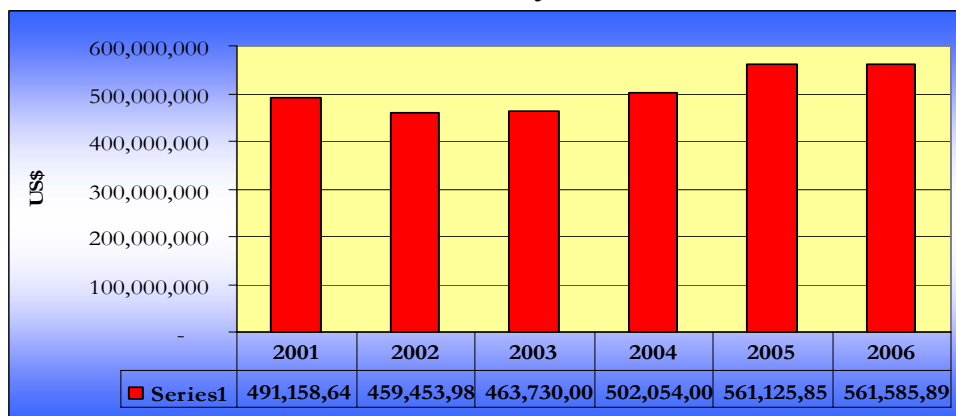
**FIGURE 1.3 – INDONESIA FURNITURE EXPORT (BASED ON THE CODE HS)**



Source: BPS (reprocessed)

The main market for Indonesian furniture is America. Total market share of furniture product exports to America (based on the fourth code of HS) is 35–37 percent. Outdoor furniture exports to America are 34 percent of total outdoor furniture exports. Bedroom furniture exports to America are 49 percent of total bedroom furniture exports.

**FIGURE 1.4 – GROWTH OF EAST JAVA FURNITURE EXPORTS**

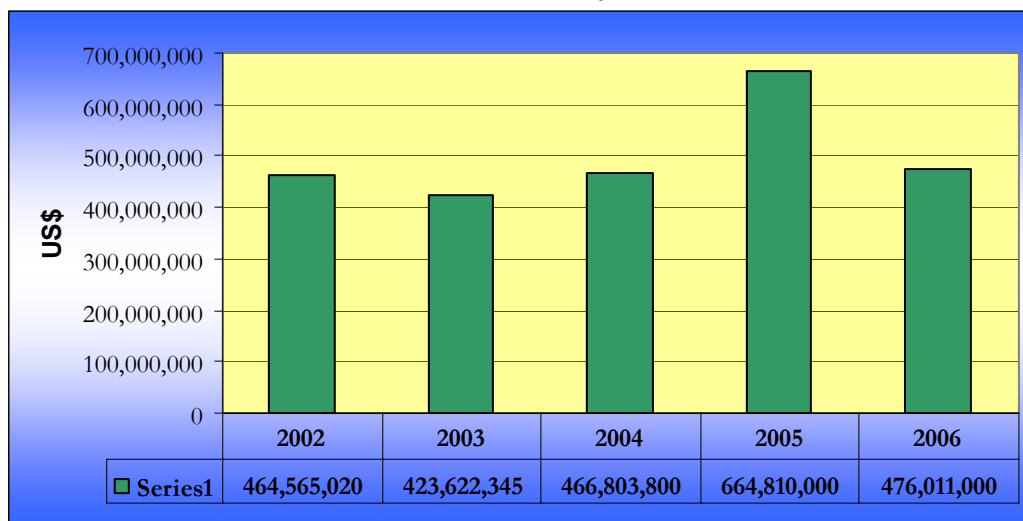


Source: BPS (reprocessed)

East Java constituted around 46–50 percent of the furniture industry on national scale. Based on the East Java furniture export growth data, there was a significant increase from 2002 to 2005. In 2002 furniture export value reached US\$ 459,453,980 and in 2005 it reached US\$ 561,125,851. On average East Java export growth from 2001 to 2005 was 4 percent.

The Central Java furniture export market share is 31–35 percent of the national total. The growth of Central Java furniture exports over five years tends to fluctuate yet increase steadily. The most significant increase happened in 2005, when export value reached US\$ 664,810,000. That then declined in 2006 to US\$ 476,011,000. On average, the growth of Central Java furniture export value is similar to industry growth in East Java, which is 4 percent.

**FIGURE 1.5 — GROWTH OF CENTRAL JAVA FURNITURE EXPORTS**



Source: Central Java Disperindag and Central Java Komda ASMINDO

The furniture industry plays an important role in the overall economy, particularly in creating job opportunities and increasing social welfare. The furniture industry is well-established and is closely connected to other sectors. As previously stated, the multiplier effect it creates is significant – from craftsmen who supply intermediate goods to entrepreneurs, wood sellers, and businesses in supporting sectors all of which cluster around the industry. Another factor that makes the furniture industry important in moving the economy forward is its contribution to exports. The greater the volume and value of Indonesian exports, the more the country earns in the form of foreign exchange, which, in the long run, has a stabilizing effect on the Indonesian economy.

Despite its importance, the furniture industry still faces obstacles that negatively influence its competitiveness. This issue came up in a series of discussions between SENADA and ASMINDO in Surabaya. The discussion showed that some of these obstacles are related to governmental policy and others are not. ASMINDO identified obstacles that prevent their businesses from growing rapidly and interfere with their competitiveness in international and domestic markets. The obstacles are: (1) the import of sample goods is treated similarly to the import of general goods; (2) raw materials are quarantined even though they have been processed; (3) fuel minimum order policy; (4) obstacles in the inter-territory trade of wood and wood products; and (5) obstacles created by the implementation of regional regulations and taxes. The study hopes to give a deeper understanding of these obstacles and provide strategic recommendations to SENADA-USAID and related parties.

## **1.2. RESEARCH OBJECTIVES**

The objective of the study was to better understand policy obstacles in the path of the furniture industry, including:

1. Obstacles on importing sample goods.
2. Obstacles created by the quarantine process for raw materials.
3. Obstacles created by the policy of fuel minimum order.
4. Obstacles in the inter-territory trade of wood and wood products.
5. Obstacles due to the implementation of regulations (regional and central) as well as the implementation of regional taxes.

# CHAPTER II – METHODOLOGY

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## 2.1 STAGES OF STUDY

Stages of the methodology included:

1. **Initial focus group discussion.** This study originated from FGD between SENADA and East Java ASMINDO held on 10 January, 2007 about factors that obstruct and weaken the competitiveness of the furniture industry.
2. **Coordination meeting with SENADA and ASMINDO.** The meeting with SENADA was a coordination meeting to discuss study realization techniques related to survey methods; review of the previous study; the respondents targeted; and the interview schedule. The meeting with ASMINDO in East Java and Central Java was aimed at getting in touch with and getting information from the selected respondent.
3. **Review of the previous study.** This step was undertaken as a way to get an initial picture of the issues, as well as to provide a reference based on case and research objective similarities. It was also aimed at avoiding research duplication.
4. **Design of study instrument.** Study instrument design was a preliminary step undertaken before survey implementation that involved selecting the respondents and compiling questions for them.
5. **Determining respondents.** The respondents chosen are furniture entrepreneurs in East Java (Surabaya and Pasuruan) and Central Java (Jepara and Solo Raya), both members and non-members of ASMINDO, chosen purposive sampling, that is, respondents who have close relationship to the five issues being studied by SENADA and ASMINDO.
6. **Finalization of study instrument.** Instrument finalization was the last step before executing the study. The trial/simulation was conducted with shadow respondents to give all parties involved in the study a clear picture of the information to be gained. From the trial we derived additional information to complete study instrument.
7. **In-depth interviews.** The in-depth interviews were aimed at getting thorough information about the five issues that are the focus of this study. This method was used due to its proven effectiveness to reveal facts.
8. **Focus group discussions.** FGDs were performed as a confirmation step following the in-depth interviews. They were also aimed at getting additional supportive information for the study. FGD were done by running limited discussions with a group of respondents chosen in the two study areas, East Java and Central Java.
9. **Writing of draft report.** The draft report was prepared next. The draft report was an initial plan of the report based on compilation of secondary data and matrix finding based on problems grouping and study locations.
10. **Review of draft report.** Review of the draft report was done by way of presentation and discussion with SENADA, entrepreneurs, and government agencies. From the discussion, we received some advice which was very supportive in writing the final study report.
11. **Finalization of report.** The last step was to finalize the study report, detailing all information that was collected from in-depth interviews, FGDs and workshop results in Semarang and Surabaya.

## 2.2. METHOD IN DETERMINING THE RESPONDENTS

To determine the respondents, the method used in this study is ‘purposive sampling’ because it is an effective way to filter important information by interviewing key respondents over research problems. Selected respondents are those with information about issues that are the focus of the study; they represent other furniture entrepreneurs. The composition of respondents is as follows:

- **Central Java:** Seven entrepreneurs who are members of ASMINDO and three entrepreneurs who are not ASMINDO members.
- **East Java:** Two entrepreneurs who are members of ASMINDO and five entrepreneurs who are not ASMINDO members.

### **2.3 TECHNIQUES OF ANALYSIS**

We chose quantitative descriptive analysis for the study. Descriptively by gathering qualitative data based on the information gained from the survey to reveal real conditions to reveal facts. Quantitatively the study focuses on measurement of data processing results gathered from interviews and secondary data.

### **2.4. DATA**

This study uses secondary and primary data. Secondary data used is the data related to the growth of East Java and Central Java exports and imports, while primary data is gathered by in-depth interviews of the selected respondents and follow-up FGD.

# CHAPTER III – STUDY FINDING 1: OBSTACLES IN SAMPLE PRODUCTS IMPORT POLICY

## 3.1. ANALYSIS ON THE SAMPLE PRODUCT IMPORT POLICY

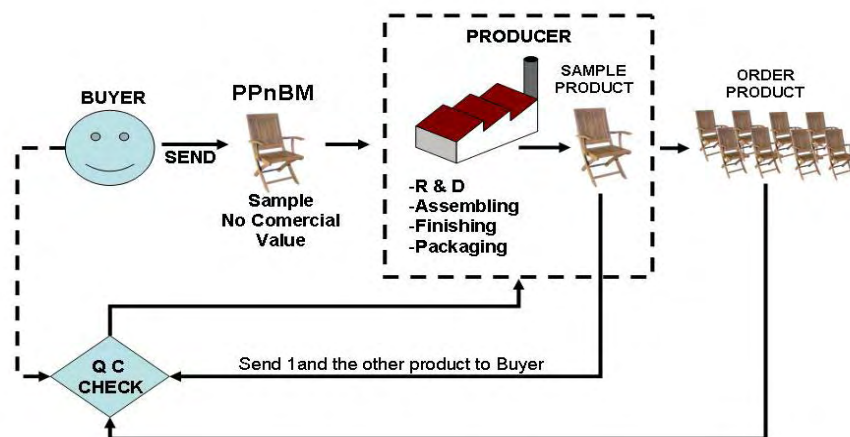
The exchange of furniture products between entrepreneurs and overseas buyers can occur in several ways. The furniture entrepreneurs in East Java and Central Java usually get their orders from abroad as follows:

- The entrepreneurs promote their product catalogues at exhibitions or on the internet.
- The entrepreneurs send product samples to their buyers, or the buyers directly come to the manufacturer’s showrooms to see those samples.
- The overseas buyers make specific requests to the entrepreneurs, and, based on those, the entrepreneurs produce sample products.

Each company has a different pattern in getting orders from buyers. The furniture entrepreneurs in Central Java, especially exporters in Jepara, Klaten, Surakarta, Sukoharjo and Boyolali, often use design and technique specifications sent by their overseas buyers. On average, it takes 2–3 exchanges of sample products and updated specifications to satisfy the needs of overseas buyers.

**FIGURE 3.1**

**ORDER PROCESS USING SAMPLE PRODUCT**



For the furniture companies in East Java, especially the large scale factories, the process is rather different. First, the entrepreneurs receive the sample products sent by the overseas buyers. They reproduce those and send their sample product to the buyers. If the buyers are satisfied by those samples and the price offered, they then send the purchase order to the entrepreneurs. In general, buyers send sample products to be replicated because of demands for accuracy of size, material and other technical specifications.

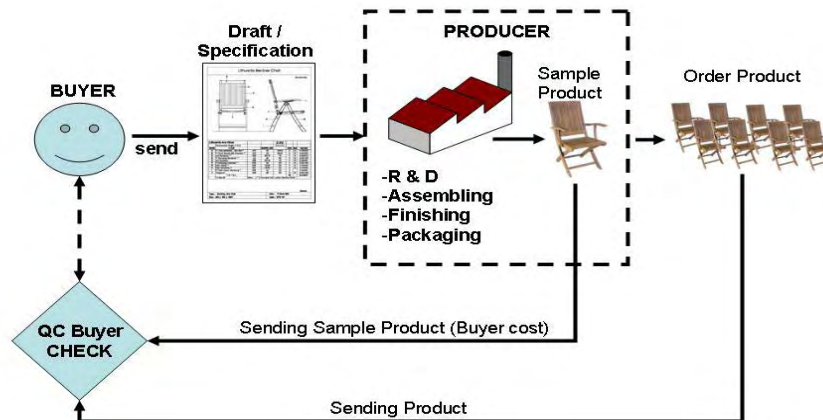
The differences of order process characteristics between furniture exporters in Central Java and East Java are caused by differences of company size and market segmentation<sup>2</sup>. Company scale: most of

<sup>2</sup> Information is given by several ASMINDO managers in the location of study on product characteristics and their customers.

the furniture entrepreneurs in Central Java are non-factory companies that receive half-finished goods from suppliers and they only finish the product; most furniture entrepreneurs in East Java are factories that perform most of the production process themselves – few of the product components come from sub-contractors. Market segmentation: the furniture entrepreneurs in Central Java often serve individual overseas buyers; East Java entrepreneurs often serve modern retail networks and high-end product line suppliers.

**FIGURE 3.2**

**ORDER PROCESS USING FAX / EMAIL**



As for the furniture entrepreneurs that receive sample products, one of the problems is the high cost of each sample product sent by the buyers. High costs happens because when entering Indonesia, those incoming sample products are treated similarly to imported products. Of course, the entrepreneurs are obliged to pay import duties and other kinds of taxes. Furniture entrepreneurs often complain about import duties and other taxes charged to import sample products, primarily because the taxes are high and are charged on non-traded products. The import duties and other sample product taxes are detailed below:

- |  |              |
|--|--------------|
| 1. Import duties                                 | :10 percent  |
| 2. Value Added Tax (PPN)                         | :10 percent  |
| 3. Sales Tax on Luxury Product (PPnBM)           | :40 percent  |
| 4. Income Tax (PPh) Import Regulation article 22 | :2.5 percent |

Import duties and taxes charged on sample products have actually been discontinued since 1997, according to the Ministry of Finance Regulation No. 140/KMK.05/1997. That regulation states the import duty is discharged if the import is:

- Only for the introduction of new products;
- Includes only three items for one brand/model/type;
- Not going to undergo further production process, unless that production process is meant to be experimental and related to quality development.
- Not to be exchanged, sold, or consumed overseas.
- Not for use in motor vehicles or heavy instruments of any type and/or condition;
- Should be kept well in two years since the import realization date.

Nonetheless, the furniture entrepreneurs often still complain about treatment of sample products as imported products, because:

1. The regulation only discharges import duties, while other taxes, equal to and higher than import duties, are charged.
2. In order to avoid import duties, the entrepreneurs must send a proposal to the General Director of Custom Office or to the associated officer in charge, along with (a) the details of product, including import value, quantity and type, that is to be imported; and (b) the recommendation letter issued by the associated technical department.

The entrepreneurs think that the process of getting import duties discharged under the regulation – 140/KMK.05/1997 – is unreasonably complicated and costs them even more than the duties themselves.

This regulation is inefficient because the entrepreneurs have to make the proposal through the associated technical institution / department in the capital city. There are direct costs associated with this and there is opportunity cost as well. The proposal process can take up to 10 business days.

Because of the complicated, time consuming, and costly nature of the proposal process of receiving sample products import-duty free, some entrepreneurs sometimes reject sample products sent by their overseas buyers; this, of course, means they are losing business.

#### **IMPORT PROCEDURE OF SAMPLE PRODUCTS IN CHINA AND VIETNAM TAKES ONLY 1 DAY:**

One of the furniture entrepreneurs in East Java informed the study team that in China and Vietnam it takes only one day to get the import duties and sample product taxes discharged. The regulation was designed for manufacturing exporters, so that they can compete internationally.

Entrepreneurs in Indonesia often receive complaints from their overseas buyers because they do not face such problems sending sample products to other countries, especially to China and Vietnam.

Compared to the regulation in those countries, the regulation on imported sample products in Indonesia is rather uncompetitive. Buyers likely will choose to order from countries with easier processes and lower costs. In importing the sample products, the cost is usually charged to the buyers. If the import duties and sample product taxes are too high, the buyers will decide to order from other countries where the procedures are easier.

### **3.2. COST-BENEFIT ANALYSIS OF SAMPLE PRODUCT IMPORT POLICY**

Treating imported sample products the same as other imported products increases costs by up to 68 percent of the original product price, plus the freight cost. The assumptions used to calculate the benefits and the cost are:<sup>3</sup>

1. The destination country that most often requires sample products in its orders is the U.S.
2. A full 50 percent of total orders placed by companies in the USA involve the use of sample products.
3. The import of sample products costs 0.3 percent – 4 percent of total order value, therefore median cost is set at 1.5 percent of the order value.

Using those assumptions above and the data on Indonesia furniture exports to the USA, we can calculate the cost and benefits of the regulation on sample products import. The benefit gained from the regulation is the national income on sample product imports from several income posts:

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<sup>3</sup> As the result of an interview with ASMINDO and in-depth interviews of several respondents.



1. Import duties : 10 percent
2. Value Added Tax (PPN) : 10 percent
3. Sales Tax on Luxury Products (PPnBM) : 40 percent
4. Income Tax (PPh) Import Regulation article 22 : 2.5 percent

**TABLE 3.1 — VALUE OF INDONESIAN FURNITURE PRODUCT EXPORTS TO THE USA IN 2006**

HS Code	Product	Trade Value
940330	Office furniture, wooden, nes	\$4,535,920
940340	Kitchen furniture, wooden, nes	\$3,835,206
940350	Bedroom furniture, wooden, nes	\$105,713,186
940360	Furniture, wooden, nes	\$267,932,214
<b>Total Trade Value of Furniture Products</b>		<b>\$382,016,526</b>

Source : Comtrade, www.comtrade.un.org

Based on the assumptions above and the data of Indonesian furniture products export value to the USA in 2006, we can conclude that the benefit to the national income from the regulation – consisting of import duties, value added taxes, sales taxes on luxury products, and income taxes – is a total of Rp. 26,072,627,900 (at an exchange rate of US\$ 1 = Rp 9,100).

That Rp 26 billion of government income is the direct cost charged to furniture entrepreneurs. The other cost caused by the import regulation on sample products is the probability of losing orders from overseas buyers because those buyers do not want to be burdened by problems with importing the sample products – such as the import duties and other taxes – which do not occur in other countries.

Potential lost order estimation on national furniture exports reaches Rp 485 billion. Lost orders are a particular problem in East Java, where the lost order estimates reach as much as Rp 412 billion. Those values are calculated based on interview results aggregated with the secondary data. Related to the regulation on sample product imports, we can identify some strategic issues, such as:

**EXAMPLES OF LOST ORDERS AND ACTUAL COST OF THE SAMPLE PRODUCTS POLICY**

A furniture entrepreneur in East Java lost an order from a Japanese buyer for US\$ 2 million, because he refused to pay the cost required to take the samples from the shipping dock. It would have cost him Rp 70 million for 14 items. Also in East Java, a different furniture manufacturer was obliged to pay import duties and various other taxes totaling Rp 40 million for 1 item, a bed. A furniture manufacturer in East Java had to pay import duties and other taxes of Rp 410,000 for 2 items valued at Rp 1.8 million, which were sent by his potential customer. The biggest cost consisted of the value added and sales taxes, which totaled 50 percent of the product price. These taxes were calculated not only on the product value but also on the freight cost. The samples actually had no commercial value.

- The smaller the company scale, the bigger the proportion of the sample products cost charged.
- There is a high probability of order loss, because overseas buyers will choose suppliers in countries where the sample products import procedure is easier, the cost is lower, the product quality is better, and the price is more competitive.
- The furniture export market into the USA is huge, but Indonesian furniture exports account for only 3.1 percent of that country's total imports. Some changes to the regulation on sample products import can be one way to improve the export market, especially for exports going to the USA.

# CHAPTER IV – STUDY FINDING 2: OBSTACLES IN RAW MATERIAL QUARANTINE PROCEDURE

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## 4.1 ANALYSIS OF RAW MATERIAL QUARANTINE PROCEDURE POLICY

Based on the results of FGDs organized by SENADA and ASMINDO, along with the in-depth interview results, one of the problems that decreases the competitiveness of the Indonesian furniture industry is related to the process of importing raw material. For big entrepreneurs in East Java these problems are associated with the quarantine of wood and wood products. The result of in-depth interviews with entrepreneurs in East Java shows that ISPM 15<sup>4</sup> guidelines on imported medium density fiberboard (MDF) products have not been implemented, or are rejected – meaning that the MDF products arriving in Indonesia are subjected to quarantine. MDF products are exempt from quarantine under the provisions of ISPM 15, to which Indonesia is a signatory.<sup>5</sup>

ISPM No. 15 is the international standard for plant quarantine procedures. World Trade Organization–Sanitary and Phytosanitary (WTO-SPS) Agreement Article 3 explains that standards for harmonizing sanitary and phytosanitary measures must be based on the international standard with few exceptions. The International Plant Protection Convention (IPPC) Article 1 explains the purpose and responsibility of members to the Convention, and Article 4 of the Convention lays out the requirements for a national organization for plant protection. Indonesia is a member of the WTO and a signatory to the IPPC/ISPM15. Members of the WTO and IPPC are obligated to abide by the guidelines set forth in ISPM 15 in implementing the quarantine of wood packaging.

In Indonesia, the function of plant protection is executed by the Farm Quarantine Head Office. Nationally it is accommodated by the law: Government Law (*Undang-Undang*) No. 16/1992 article 9 and 10 contents the free-quarantine for product out of Indonesian territory except there are any conditions ruled by destination country. Other policies related to the international agreement is mentioned too on the Government Regulation (*Peraturan Pemerintah*) No. 14/2002 article 72 and the Ministry of Agriculture Regulation (*Surat Keputusan Menteri Pertanian*) No. 38/90 article 17.

The Food and Agriculture Organization (FAO) of the United Nations (UN) ratified ISPM 15 in March 2002. ISPM 15 specifically regulates the treatment and certification (branding) of the wood packaging used in international trade. The plant quarantine standards, including treatment and labeling of wood packaging, is under the authority of plant quarantine officer. The implementation of ISPM 15 can be delegated by the plant quarantine officer to others who fulfill the terms and conditions of the agreement, provided their duties are executed under the supervision of the plant quarantine officer.

ISPM 15 is needed to regulate wood packaging made of low quality raw wood. This low quality raw wood is at risk for wood borers' nematodo fungi. ISPM 15 regulates the quarantine of wood packaging made of materials recycled more than once, as well, which can lead to products of which the original material is hardly recognizable. ISPM 15 is also needed to prevent one-sided regulations that can cause serious obstacles to international trade. Included in the category “wood packaging” are palette, dunnage, crafting, drum, skids, and other packaging made of unprocessed raw wood. Exceptions to the standard are processed wood packaging that has been created using heat, glue, or pressure such as plywood, particle board, and veneer; other exceptions are wood materials that are too small or thin to be reasonably expected to host pests, such as: sawdust, shavings, and wood layers thinner than 6 mm.

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<sup>4</sup> International Standards for Phytosanitary Measures Publication No. 15: Guidelines for Regulating Wood Packaging Material in International Trade

<sup>5</sup> See, [www.agriculture.gov.id](http://www.agriculture.gov.id)

Because of the manufacturing process, MDF products are exempted from the requirements of ISPM 15. As noted, ISPM 15 does not regulate packaging material made of processed wood such as plywood, chipboard, oriented strand board (OSB) and any other wood that is stacked using glue, heating and pressure process as well as the combination of those methods. However, furniture entrepreneurs still complain about the regulation.

- **The average costs of ISPM 15 is Rp 124,000 – each 40' container.** Although there has been an international agreement stating that the MDF products do not require the ISPM 15 process; in Indonesia it is required when MDF is imported. If the ISPM 15 requirements are disregarded, the imported MDF will be detained in the shipping dock. This costs the company even more. In-depth interviews with some furniture manufacturers shows that the average cost of ISPM 15 is Rp 124,000 each 40' container and it takes 1–2 days to get the license from the Quarantine Head Office.

The entrepreneurs have to pay demurrage costs of US\$ 65 – 100 due to the regulation on the MDF products quarantine. If they decline to pay, the release of the imported raw material (MDF) is postponed even longer. In the end, entrepreneurs are compelled to obey “the jungle rule” and pay the ISPM 15 cost rather than face getting their products late from the shipping dock, which also can charge them demurrage fees of US\$ 65 – 100 each day for the additional container rent.

Related to the MDF import regulation, in April 2007 the Chief of Farm Quarantine Head Office sent a letter to one of the wood companies in East Java, stating that: “...MDF coded HS 4411 is not [an] organism carrier, therefore the commodity entrance does not require Phytosanitary Certificate from its original country...” Nonetheless, in importing MDF into the Republic of Indonesia, the owner is still obliged to report it to the plant quarantine officer in the plant quarantine technical unit at the point of entrance. Therefore, the exemption of imported MDF products from ISPM 15 requirements is still questioned by other government institutions, especially the Customs Office.

- **Associated institutions have not been strictly implementing the policy of exempting MDF from ISPM 15.** The Tanjung Perak Plant Quarantine Head Office stated that KT-14 regulation – the regulation associated with MDF – exempts MDF from ISPM 15, but a manufacturer must report his MDF import to the Quarantine Head Office. With the KT-14 form, he can release his MDF products from import duties.

Unfortunately, this regulation compels entrepreneurs to go back and forth from the Customs Office to the Quarantine Head Office in order to fill out and present the KT-14 form. As a result, the opportunity cost, including the cost of time spent and lost production opportunity, will be high. Although there has been a change in the procedure for MDF – it has been released from phytosanitary standards – there has not been an improvement on the time taken to complete the process. One entrepreneur who experienced the MDF product quarantine, said: “I demanded clarification from the import duties office, whether the MDF should have been examined or not. They always said that MDF was the product deposited by the Quarantine. If it should be examined, then the Quarantine will examine it.”

The testimony above shows that although there has been national and international recognition that MDF products are exempt from examinations, the associated institutions – in this case, the Quarantine Head Office and the Customs Office – have not consistently implemented that regulation.

## 4.2. COST-BENEFIT ANALYSIS OF MDF PRODUCTS QUARANTINE POLICY

The study found several entrepreneurs who are discouraged by the regulation on phytosanitary standards (ISPM 15). In the analysis on the benefit caused by applying the regulation to MDF products, it was found that in this case no benefit resulted from the regulation. This is the case because it is internationally agreed that MDF is safe: it is not a plant disease carrier.

Regarding cost, the regulation has increased the cost the importer is required to pay. Some sources informed the study group that the average phytosanitary regulation cost Rp 124,000 per each 40' container. The cost paid by those industries that use imported MDF is calculated from total Indonesia MDF import value. Some basic assumptions used to calculate the cost are: (a) the imported MDF costs US\$ 260 m<sup>3</sup>; and (b) the 40' container capacity is 18 m<sup>3</sup> per container.

**TABLE 3.2 — IMPORT VALUE OF MDF PRODUCTS TO INDONESIA IN 2006**

HS Code	Product	Trade Value
4411	Fiberboard of wood or other ligneous materials	\$20,791,621

Source: Comtrade, [www.comtrade.un.org](http://www.comtrade.un.org)

Based on the assumptions above, MDF import volume reaches 79,967 m<sup>3</sup> – equal to 4,443 containers annually. the total phytosanitary cost obliged to the industry that uses imported MDF is:

$$4,443 \text{ containers} \times \text{Rp } 124,000 = \text{Rp } 550,932,000 \text{ annually}$$

Besides the direct cost, the fee to be paid can also be higher if the examination or phytosanitary-exempt letter comes so late that the entrepreneurs is compelled to pay demurrage charge. Based on the interview, the demurrage charge is US\$ 65 – US\$ 100 each day. If 40 percent of total containers containing MDF get the phytosanitary-exempt letter so late that the demurrage is charged, the cost is at least Rp 1.05 billion. That demurrage charge is so high that the entrepreneurs choose to pay extra fees in order to get the phytosanitary-exempt letter as soon as possible.

## CHAPTER V – STUDY FINDING 3: OBSTACLES IN FUEL MINIMUM ORDER POLICY

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The field study findings show that the regulation on the fuel minimum order does not affect the furniture entrepreneurs in East Java and Central Java. Furniture entrepreneurs use the fuel as a color mixing agent, genset fuel for electricity reserves, and to power chainsaws.

- **The officer in charge of regulating uses of funded fuel excludes most of the small-scale furniture industry centers.** The policy of minimum fuel order is at first identified as an obstacle that is commonly felt by small-scale entrepreneurs. In fact, the policy is not an obstacle, especially in the furniture industry centers. Generally, the relevant parties, especially the fuel officer and Pertamina, tolerate their need of fuel. Some cases of furniture entrepreneurs who use funded fuel to advance their businesses are:
  1. A furniture entrepreneur in Pasuruan needs 40 liters of kerosene each month for a color mixing agent. The kerosene can be purchased retail and, so far, he never has not had any trouble, especially with the police.
  2. A furniture entrepreneur in Solo Raya needs 100 liters of diesel fuel each month for his genset fuel. The fuel comes from the supplier, sold at a similar price as in the gas station. Once, he was visited by a Pertamina officer, but there was no problem because he needed so little fuel.
  3. An entrepreneur in Jepara buys diesel fuel at the gas station for his genset, yet the police and the Pertamina officers tolerate him and never inspect him.

Few furniture entrepreneurs get into trouble with the fuel regulation. When small-scale furniture entrepreneurs or craftsmen in some furniture industry centers need fuel (kerosene or diesel fuel), they can get it from the kerosene retailer or the gas station. The mid- and large-scale furniture entrepreneurs usually get their industrial fuel by purchase order from Pertamina or the appointed industry fuel agents.

- **Fuel regulation: There is a gap between demand and supply.** According to Presidential Regulation 09/2006, the procedure of getting the funded fuel for large-scale business is quite complicated because of the requirement for verification from the associated institution. On the other hand, the minimum order that can be delivered directly by Pertamina is too much for small-scale businesses: 8-kiloliters each month for each unit. Pertamina declines to fill orders below the minimum.

Therefore, there is a gap between the small-scale business needs of funded fuel with the Pertamina minimum supply policy. Pertamina offers a “fuel pool” system for groups of small businesses in certain areas that need funded fuel in amounts below the minimum order requirements. Small businesses that are interested in this system should present proposals to Pertamina in line with the terms and conditions mentioned in Presidential Regulation No. 09/2006.

As for the mid and large-scale furniture entrepreneurs, they need the industrial fuel. Most of the fuel is used for genset, used only when the electricity is off, and the need of fuel is relatively small: 50–100 liters each month. However, the industrial fuel minimum order is 5 kiloliters. In fact, one of the respondents made his last purchase two years ago, yet there is still plenty today. So far, the supply of industrial fuel comes from Pertamina or appointed industrial fuel agents. In East Java alone there are 17 appointed industrial fuel agents. Geographically those agents are scattered in these locations:

- |             |             |                |            |
|-------------|-------------|----------------|------------|
| 1. Surabaya | : 10 agents | 4. Tulungagung | : 1 agent  |
| 2. Sidoarjo | : 1 agent   | 5. Bangkalan   | : 1 agent  |
| 3. Gresik   | : 1 agent   | 6. Banyuwangi  | : 3 agents |

The data above shows that the distribution of the industrial fuel agents is limited; they are not located on every point of East Java. This becomes problem for entrepreneurs in other areas who need industrial fuel. While industrial fuel is hard to find, the entrepreneurs do not want to get into trouble with the police; meaning they cannot use funded fuel. Of course, in this case, the production process in their companies is obstructed.

# CHAPTER VI – STUDY FINDING 4: OBSTACLES IN THE INTER-TERRITORY WOOD TRADE POLICY

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## 6.1. OBSTACLES IN THE INTER-TERRITORY TRADE OF WOOD AND WOOD PRODUCTS

### 6.1.1 PUBLIC POLICY ON FORESTRY PRODUCTS ADMINISTRATION

Ministry of Forestry Regulation No. P.55/Menhut-II/2006, issued on 29 August, 2006, is the latest basic rule on the forestry products policy. It regulates the Governmental Forestry Products Administration and replaces Ministry of Forestry Decree No. 126/KPTS-II/2003. The Ministry of Forestry Decree No. 126/KPTS-II/2003 gave a very dominant role to the government and caused some problems, such as high costs and a time consuming process that discouraged sector growth. The PUHH system confused forestry products that were governmental assets with those that were private assets. According to the Ministry of Forestry Decree No. 126/KPTS-II/2003, the whole process and mechanism of taking wood from the forests and putting it into the customers' hands falls under the statutes of SKSHH documents and all wood and wood products are officially assessed.<sup>6</sup>

To resolve the legal uncertainty, the government deregulated the forestry products administration by issuing Ministry of Forestry Regulation No. P.55/Menhut-II/2006. That new PUHH regulation is meant to:

- Simplify (deregulate) the forestry products administration.
- Focus more on the health and sustainability of the harvesting of governmental assets (logs taken from the governmental natural forest as industrial raw materials).
- Clearly delineate between governmental assets and private assets, and provide legal certainty of the status of forestry products that are company or individual assets.
- Reposition the rangers outside the forest into the upper part to keep the forest safe, by controlling the forestry products removed.

It's goals are to:

- Sharpen the focus of the PUHH object.
- Provide legal certainty for consumers/businesses.
- Decrease the high costs of inter-territory trade.
- Improve public services.
- Reinforce the watch in the upper part of the forest by repositioning the rangers previously concentrated outside the forest.

Hopefully the PUHH revision will shorten the process and mechanism of issuing SKSHH documents. That simplification is done by giving the wood forestry products a primary industry role and responsibility (*self-assessment* documents provision<sup>7</sup>) and by auditing the forestry products administration in the forest as well as in the forestry products industry. Some basic changes of the Ministry of Forestry Decree No. 126/2003, implemented in the Ministry of Forestry Regulation No. P.55/Menhut-II/2006, are:

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<sup>6</sup> The legal examination and the forestry products legal document provision are done by the government (the Ministry of Forestry).

<sup>7</sup> The forestry products legal document is issued by an individual representing the certified company.

1. Redefining legal document of forestry products (SKSHH) as “the general term.” Now, that document can be every document stating that the forestry products are legal on each action segment (LHC, RKT, LHP, Log Legal Document/SKSKB, and transportation Invoice).
2. Implementing the mandatory illicit timber industry investigation.
3. Conducting the SKSKB document for the logs from the forest into the destination or industry.
4. As for the wood taken out of the man-made forest, its transportation should be legalized by the Log Transportation Invoice (FAKB).
5. While the transportation of the forestry products produced by the industry, or processed wood, is legalized by the Processed Wood Transportation Invoice (FAKO).
6. The SKSKB Replacement Document (advanced) uses FAKB.
7. The SKSKB document is issued by the government, including the form supplying (the IUPHHK that is considered able to manage the forest well will be given incentive: the SKSKB can be issued by the company).
8. The transportation invoice for whether the log or the processed wood is issued by the wood company, including the form supplying.
9. In order to control and ensure uniformity, the format of transportation invoice form is set by the Department of Forestry; the color palette is: (a) *white* form for the provinces in Java, Madura, Bali, NTB and NTT; (b) *yellow* form for the provinces in Sumatera; (c) *red* form for the provinces in Kalimantan; (d) *blue* form for the provinces in Sulawesi; and (e) *green* form for the provinces in Maluku, West Irian Jaya and Papua.

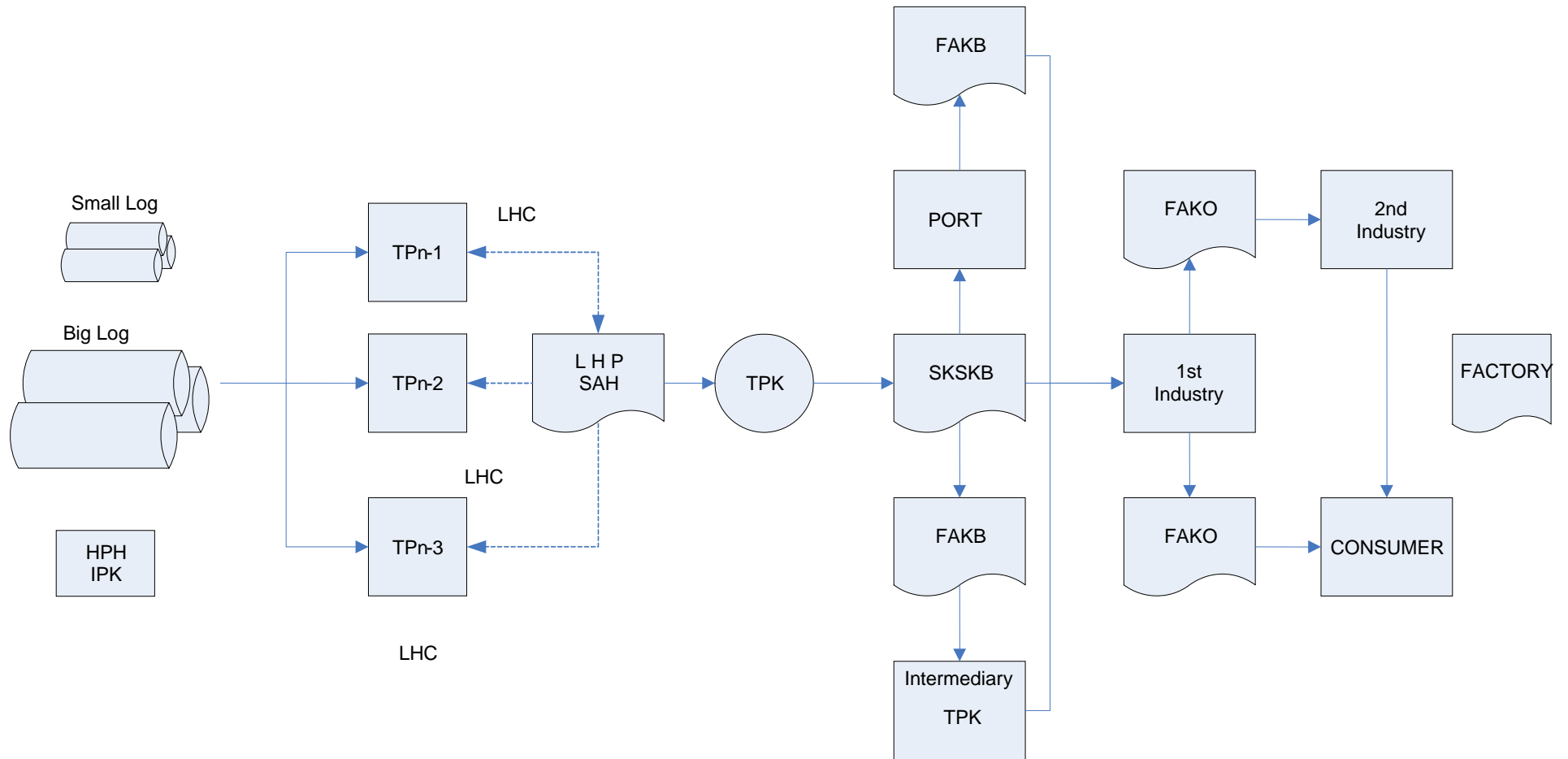
### 6.1.2 LOG TRADE ADMINISTRATION

According to the Ministry of Forestry Regulation No.P.55/Menhut-II/2006 regulating the Forestry Products Administration, the trade administration requires the following:

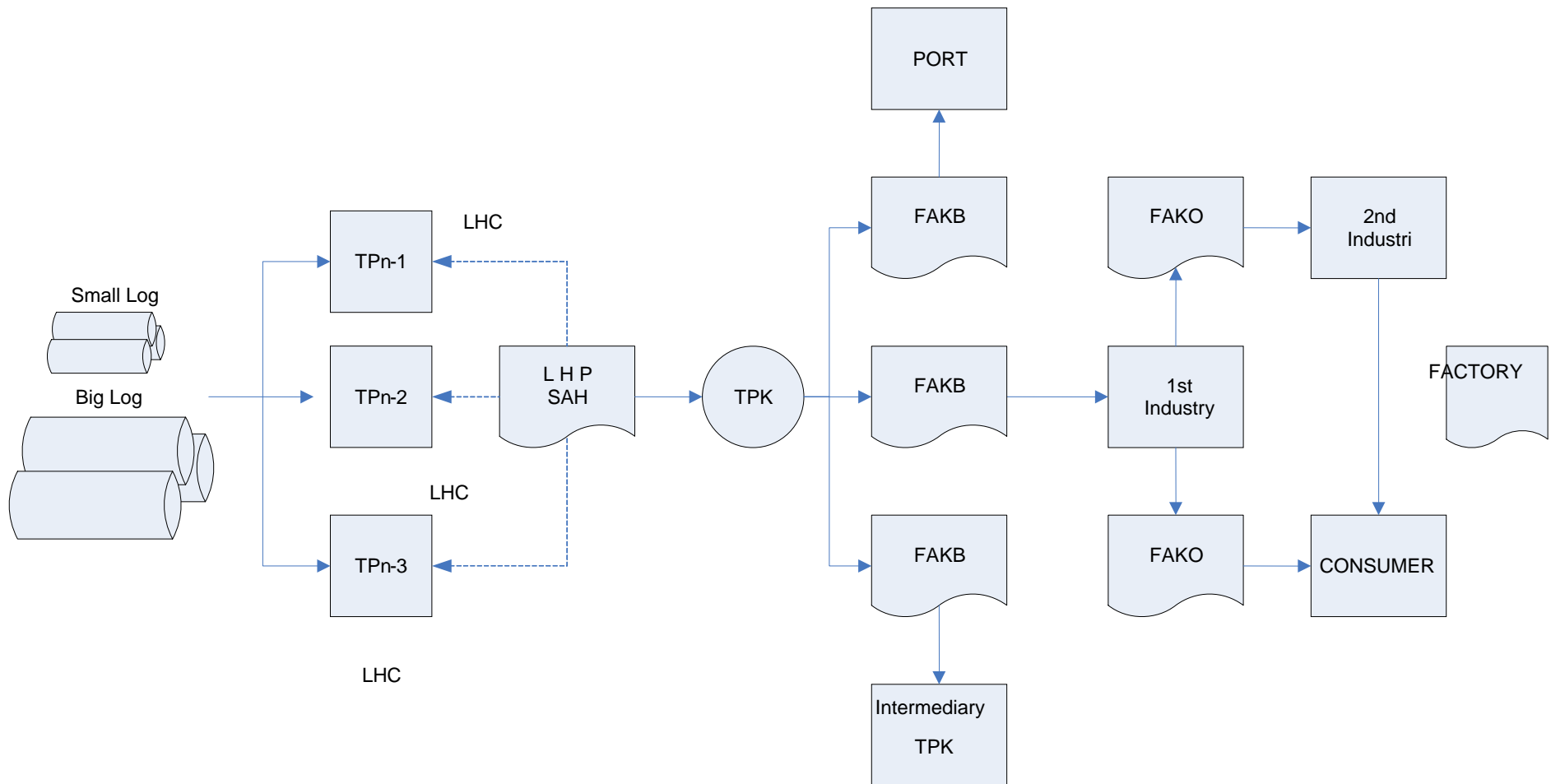
- **The natural forestry products.** At this first level, every log, regardless of size, undergoes the same chain of process. It needs the License of Forestry Exertion (HPH) and the License of Wood Processing (IPK). To get those licenses, there should be the Crusing Result Report (LHC), the measuring book set on the wood collecting area (TPn), and the Production Result Report (LHP) in the wood warehouse (TPK). LHP is legalized by the ranger appointed by the Regional Head of the Department of Forestry. To transport the wood from TPn to TPK in one location, there should be HPH, IPK and HPHH, along with legalization given by the Bureau of Forestry. From TPK to the Upper Industry of Wood Processing (IPKH)/Consolidated Industry of Wood Processing (IPKT), or from TPK outside HPH, IPK and HPHH, or from TPK to another IPKH, or from the warehouse to IPKH, there should be Log Legal Document (SKSKB) and Log List (DKB). As for the small-sized logs, the Small-sized Log (KBK) seal has to be stamped on the SKSKB.
- **Rights of people forestry products.** Wood that comes from the rights/people forestry products is that harvested from people’s or agricultural field owner’s property. The species of people’s plant is managed under the statutes of Origin Invoice (SKAU) document in its distribution path. SKAU is used to transport the logs and the processed wood originated in the rights forest, such as sengon (*Paraserianthes falcaferia*) and coconut wood (*Cocos nucifera*). SKAU is used in order to keep forestry products originating in the rights/people’s forest in order, so that the people’s rights are protected. That cultivated wood transported from the cutting point to IPKH/warehouse/be sold has to be sent along with the Origin Invoice (SKAU). SKAU is issued by the Village Chief or other officer at the same rank from the originating destination. The officer who issues SKAU is appointed by the Regent/Mayor, based on the nomination of the Head of Regency/City Bureau of Forestry. There has to be SKAU for the two rights forestry commodities mentioned above, while for the others there have to be FAKB, sent from TPK to the processing industry.



**FIGURE 6.1 THE FLOWCHART OF NATURAL FOREST LEGAL DOCUMENTATION  
(The Ministry of Forestry Regulation No.P.55/Menhut-II/2006)**



**FIGURE 6.2 THE FLOWCHART OF RIGHTS FOREST LEGAL DOCUMENTATION  
(The Ministry of Forestry Regulation No.P.51/Menhut-II/2006)**



### **6.1.3 PROCESSED WOOD ADMINISTRATION**

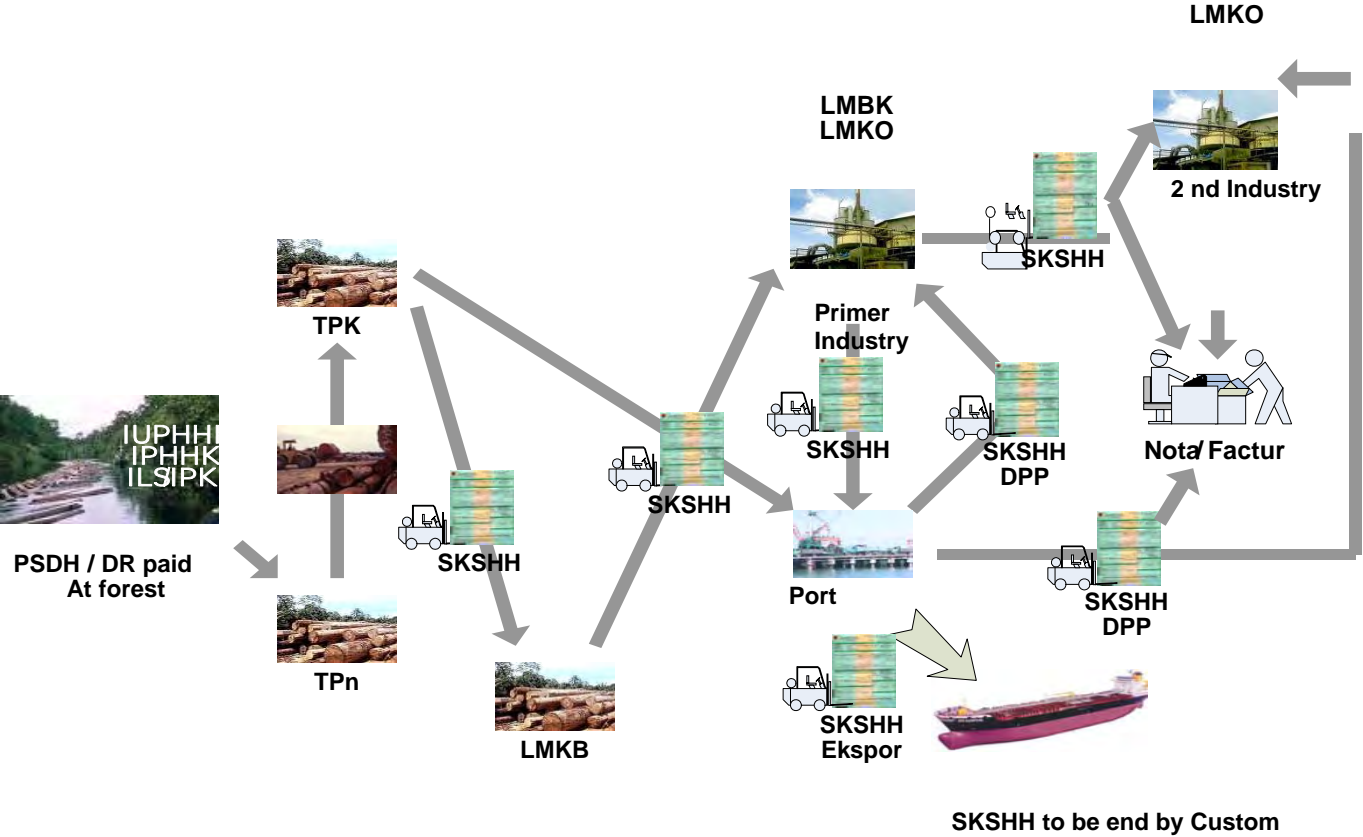
The transportation document that must be reported from Upper/Inter-TPK and the shipping dock distribution to the consolidated wood processing industry (IPKT) needs a log invoice (FAKB). After that, in order to distribute it to the customers or the line industry, the IPKT holder is obliged to attach the processed wood invoice (FAKO). The log invoice and processed wood invoice are issued by the forestry business company's employer who is certified as the forestry products examiner and appointed to issue the invoice.

### **6.2 ANALYSIS OF THE WOOD ADMINISTRATION REGULATION**

Ministry of Forestry Decree No 126/KPTS-II/2003 regulating the implementation of SKSHH as the official document of the log transportation is considered inefficient. That document is conducted when the wood is distributed out of TPK to Inter-TPK until the shipping dock. The obstacles found by the entrepreneurs caused by the SKSHH implementation are:

1. The SKSHH process is complicated, both in terms of the process and problems such as officials running out of the SKSHH forms,
2. SKSHH issued by the Bureau of Forestry tends to be comparatively expensive,
3. There are too few provision experts on duty, which causes entrepreneurs to have to wait longer,
4. The SKSHH conduct period is so short that it is sometimes questioned by officers in the middle of the distribution path. This causes extra costs in the transportation of raw materials.

**FIGURE 6.3 THE FLOWCHART OF NATURAL FOREST LEGAL DOCUMENT  
(THE MINISTRY OF FORESTRY DECREE No 126/KPTS-II/2003)**



**TABLE 6.1. ANALYSIS OF THE REGULATION ON WOOD ADMINISTRATION WITH SKSHH  
MINISTRY OF FORESTRY DECREE NO 126/KPTS-II/2003**

NO	REGULATION PROBLEMS	IMPLEMENTATION PROBLEMS
1	The SKSHH process is involved and bureaucratically complicated.	SKSHH often causes increased costs.
2	There is too few provision experts on duty causing long wait times .	The conduct period is so short that it causes problems with officers in the middle of the distribution path.

Therefore, implementation of SKSKB, FAKB and FAKO as the legal documents in raw material distribution, as intended under Ministry of Forestry Regulation P. 55/MENHUT-II/2006, is considered to be useful in decreasing the raw material administration inefficiency.

Both SKSKB and FAKB in natural wood distribution improve the legal certainty that the raw material is gained from the governmental asset, and the statute reinforces the watch in the upper part of the forest by repositioning the rangers concentrated outside the forest.

The entrepreneurs are charged Rp 7,000,000 if they want to get the FAKO expertise certificate. According to the regulation, the processed wood invoice is issued by an official issuer the legal wood processing industry and an approved warehouse. Therefore, the wood company can issue the FAKO document as long as the entrepreneurs have a certified officer issue the self-assessment document.

Issuing the processed wood invoice for wood products produced by the Perum Perhutani industry does not cause any problems, because it can be done by the Perum Perhutani officer. However, for the people's wood industry, the regulation states that the wood entrepreneurs can issue FAKO only if they send their staff to be trained. The problem is that most of these entrepreneurs are small-scale and find the cost prohibitive.

The regulation began to be implemented on 1 January, 2007, but the Forest Provincial Office gave entrepreneurs until 30 June, 2007. The additional six months prior to implementation was to give the entrepreneurs a chance to participate in FAKO issue training. This training was held by association of wood industries, that is Indonesia Sawmill Woodworking Association (ISWA) and The Forest Production Utilization and Supervision Bureau.

The implementation of the Ministry of Forestry Regulation regulating SKAU usage in transporting the forestry products then benefits the limitation of rights forestry products. This is meant to keep the rights forestry products distribution in order, and also to provide legal certainty for the individual asset forestry products. SKAU is easier to be attain than FAKO – it can be issued with the permit given by the Village Chief where the wood originates.

Entrepreneurs are burdened by the extra cost caused by the unclear and inconsistent implementation of illicit timber industry investigation documents. The obstacles in wood and furniture trade are still a problem for entrepreneurs both in Central Java and in East Java. The FGD result supports the in-depth interview done in Jepara. Even with the new regulation, Jepara entrepreneurs have to pay extra costs in transporting raw material into Jepara.

**TABLE 6.2. THE EXTRA COSTS IN DISTRIBUTING THE RAW MATERIAL INTO JEPARA**

NO	LOCATION	COST
1	From West Java into Jepara	Rp 200,000
2	From East Java into Central Java	Rp 25,000
	- passing Rembang – Jepara	Rp 250,000
	- passing Pati – Jepara	Rp 25,000–75,000

These extra costs are caused by the unclear and inconsistent implementation of illicit timber industry investigation documents. The regulation change replacing SKSHH with SKSKB, FAKB and FAKO (Ministry of Forestry Regulation 55/Menhut II/2006), is actually quite insignificant; it does not eliminate the extra costs. Nonetheless, other entrepreneurs in Solo and East Java do not complain much about this situation; they feel it has improved.

**TABLE 6.3. ANALYSIS ON THE REGULATION ON WOOD ADMINISTRATION WITH FAKO THE MINISTRY OF FORESTRY REGULATION P. 55/MENHUT-II/2006**

NO	REGULATION PROBLEMS	IMPLEMENTATION PROBLEMS
1	The people's wood industry is obliged to join the training. The cost is Rp 7 million	At the time this study was completed, wood entrepreneurs are still paying high costs, in spite of the new regulation.
2	The training is not always available.	Entrepreneurs, especially those who sell wood, still consider the new document the same as SKHH. Therefore, they choose to pay the extra costs; they think it is better than being stopped by the officers.

### 6.3. OBSTACLES IN THE INTER-TERRITORY WOOD PRODUCTS TRADE

The export tax charged to entrepreneurs is not so clear. In addition to raw materials, transportation of furniture products is also difficult. Entrepreneurs in East Java claim that the export tax is not transparent enough, so that it is not provisioned strictly. Some entrepreneurs try to get around this by inviting the customs officer to watch the loading process. They do this to avoid inspection problems at the shipping dock, which may cause even higher costs. They are compelled to pay Rp 500,000 for each container loaded in this manner.

The entrepreneurs have to allocate the extra cost for inter-territory wood trade distribution. In-depth interview with a furniture entrepreneur in Solo Raya revealed that every time containers are transported from Solo to the Tanjung Mas shipping dock in Semarang, the transportation service hired by the furniture company must pay not less than Rp 500,000 per container. It is used to pay various costs – both en route and at the shipping dock.

The following example is from East Java. A manufacturer sent his product to Bali. He had to allocate about Rp 100,000 for miscellaneous transportation costs on the way, while the transportation itself cost him Rp 2.5 million. In-depth interviews with several entrepreneurs in Jepara revealed that some points of distribution are more likely to raise additional costs. Those are as follows: from Jepara to Surabaya costs Rp 5–10,000; from Jepara to Tanjung Mas costs Rp 200,000; when passing Welahan, the cost is Rp 10–15,000. From Jepara to Semarang there are roadblocks, which leaves a choice

between Welahan and Kudus. The extra costs are about the same, so most entrepreneurs choose to transport through Welahan because the journey is shorter, creating a fuel savings.

**TABLE 6.4. THE EXTRA COSTS FOR THE PRODUCT DISTRIBUTION FROM JEPARA**

NO	LOCATION	COST
1	From Jepara to Semarang (Tanjung Mas)	Rp 200,000
	- passing Welahan (shorter distance)	Rp 10,000–15,000
	- passing Kudus	Rp 10,000–15,000
2	From Jepara to Jakarta	Rp 150,000
3	From Jepara to Surabaya (situational, depends on the officer)	Rp 5,000–10,000

Another problem experienced is the decrease of the terminal handling cost. Most of the furniture entrepreneurs think it is not useful, because the cost decrease is actually followed by other cost increases, such as the document fee and the commission fee.

#### 6.4. COST-BENEFIT ANALYSIS OF THE OBSTACLES IN THE INTER-TERRITORY WOOD AND FURNITURE TRADE

The extra cost charged to the exporters transporting goods from Solo to the Tanjung Mas shipping dock in Semarang, both en route and at the shipping dock, is Rp 125–300 million each month. As stated previously, in-depth interviews with furniture entrepreneurs in Solo Raya revealed that every time the containers are transported from Solo Raya to Tanjung Mas, the transportation service hired by the furniture company must allocate Rp 500,000 for each container; this money is used for various costs, both on the way and at the shipping dock.

**TABLE 6.5. AGGREGATE COST OF TRANSPORTING WOOD PRODUCTS FROM SOLO RAYA TO TANJUNG MAS**

COST (THOUSAND)	PEAK SEASON			LOW SEASON			Total Cost in 1 Year (million)
	Container	Period of Time (month)	Subtotal (million)	Container	Period of Time (month)	Subtotal (million)	
Rp 500	600	6	Rp 300	250	6	Rp 750	Rp 2.55

The extra cost charged to the exporters transporting products from Jepara to Tanjung Mas is not less than Rp 210,000 per container. As stated above, the in-depth interviews found some points of distribution that are more likely to involve additional costs. The most significant is from Jepara to Surabaya, which can cost up to Rp 1 million. From Jepara to Tanjung Mas, the entrepreneurs have to pay Rp 200,000 and the cost charged when they pass Welahan is around Rp 10.000 to 15,000. From Jepara to Semarang they can choose to go either through Welahan or Kudus. Although the extra cost is about the same, they prefer Welahan because the path is shorter, allowing them to save fuel.

The entrepreneurs in Jepara pay extra cost for their wood products at Rp 3,903,601,528. Using the Disperindag data of the export volume per year, we can estimate the cost charged to the furniture entrepreneurs for a trip from Jepara to the Tanjung Mas shipping dock. It is assumed that the cost has stayed the same for the last 3 years and that each 40' container contains 3–3.5 tons. In 2006 entrepreneurs in Jepara had to pay transportation costs of Rp 3,903,601,528 for 18,589 containers (40').

**TABLE 6.6. AGGREGATE COST OF TRANSPORTING WOOD PRODUCTS FROM JEPARA TO TANJUNG MAS**

YEAR	EXPORT VOLUME	CONTAINER (40')	COST (RUPIAH)
2004	61,817,687.75	20,606	4,327,238,142
2005	57,490,449.61	19,163	4,024,331,472
2006	55,765,736.12	18,589	3,903,601,528

As stated previously, the Terminal Handling Cost (THC) decrease actually causes additional costs for the exporters. Most furniture entrepreneurs think it is not useful, because the cost decrease is actually followed by other cost increases, such as the document fee and the commission fee.<sup>8</sup> The in-depth interviews reveal that for each 20' container the THC has decreased, from US\$ 150 to US\$ 95; however, extra costs have been added, such as the document fee at US\$ 10 – US\$ 25.

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<sup>8</sup> The extra cost must be paid by exporter to shipping companies, and has been implemented after the reduction of the THC.



# CHAPTER VII – STUDY FINDING 5: OBSTACLES ASSOCIATED WITH THE CENTRAL AND REGIONAL REGULATIONS

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## 7.1. THE REGIONAL REGULATIONS AND TAXES ON THE FURNITURE INDUSTRY

Based on result of in-depth interviews regarding the regional regulations and the regional taxes, most of the entrepreneurs claim that neither is over-burdensome. This is because the costs charged are relatively low. Some furniture entrepreneurs stated that they usually figure the costs into their production cost structure at about 2 percent. One of the other costs allocated is for when there are unpredictable costs, such as the donation and the tax or the regional fee that had not been previously estimated.

- **The furniture entrepreneurs question the rationale of the regional tax more than the taxation itself.** One of the problems associated with the regional regulation, especially the regional tax, complained of by the furniture entrepreneurs, is not the cost itself, but rather the fact that they have to pay it. The tax itself is quite low and insignificant to the production cost, but the legal basis for it is questionable. Associated with regional regulations on the regional tax, the furniture entrepreneurs often complain about the following:
  1. The legal basis for the regional tax/fee is not clear; the stipulation of tax object issued by the regional government is not supported by any valid data.
  2. Where the regional government has a legal basis in stipulating the regional tax/fee, the officers often estimate the amount to be charged without consistent data; resulting in confusion even among items that should be taxed at the same rate.

### THE BASIC CASES OF THE UNCLEAR AND IRRATIONAL REGIONAL TAX AND FEE

The furniture entrepreneurs in East Java were obliged to pay an advertising tax. The amount was relatively small – Rp 54,375 – and they were not unwilling to pay it. The problem was that none of them had ever had advertising media around their factories; some of them had not even installed signs with their company names. When they discussed the situation with the regional government officer, he simply suggested that they install the advertising board around their factories since they had paid the advertising tax.

A furniture businessman in Central Java had to pay a construction license fee (IMB) of Rp 6 million. He felt it was too high, considering the IMB taxation legal base considers the building width only, while the building type is not considered. It was an enormous burden for him because the IMB tax estimation impacts the land and building tax charged afterwards.

In another case, a furniture businessman in East Java was assessed road lighting taxation, at Rp 50,625 each month. According to the notification sent by the local tax office, the taxation amount was based on electricity usage by the customer, categorized at 14 – 200 KVA. In fact, his company used electricity at 700 KVA. He believed that the regional government stipulation was not supported by valid data, and was done only for redistributing PAD.

## 7.2. THE REGULATION ON THE LAND AND BUILDING TAX INCREASE

In addition to the problems with regional regulations on regional taxes, there are also central regulations effecting all entrepreneurs, including furniture entrepreneurs. One serious problem is that the land and building tax (PBB) increases by 30 percent each year. The PBB increase is achieved by raising the object

trade value tax (NJOP) at a rate of approximately 30 percent each year. The annual NJOP raise is considered irrational because it is in fact already above market price. The increase is considered to be a shrewd attempt by the central tax office to raise the PBB. This raise has happened in almost every region, including study locations: East Java and Central Java.

Such problems are commonly experienced by the entrepreneurs in East Java. Although the PBB/NJOP regulation is issued by the central tax office, the regional government gets the majority of the profit from it, because 90 percent of the taxation is returned to them.

### **7.3 ANALYSIS ON THE IMPACT OF THE REGIONAL REGULATIONS AND THE REGIONAL TAXES ON THE FURNITURE INDUSTRY**

The in-depth interviews in East Java and Central Java reveal the regional regulation problems associated with the regional taxes charged to the furniture companies. Analysis of the regional regulation on these regional taxes shows that the extra costs are actually very low, only 0.3 percent. As stated, the entrepreneurs figure these costs at less than 2 percent. Therefore, the new burden of regional taxes and fees is not significant to the furniture manufacturing industry.

For the entrepreneurs, this problem will not unduly impact their companies. The problem is that it causes negative perceptions about the regional governments – the belief is that the effort is PAD-oriented rather than trying to create better business conditions.

# CHAPTER VIII – CONCLUSIONS AND RECOMMENDATIONS

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## 8.1 CONCLUSIONS

1. The deregulation in place in Ministry of Finance Regulation 140/KMK.05/1997 only impacts import duties, while the other taxes (PPn, PPnBM and PPh import regulation article 22) are still charged. Another problem caused by the regulation is the procedure for exempting import duties for sample products; the exemption has to be proposed to the General Director of the Customs Office along with a recommendation from the associated technical department (the General Director of Agrochemicals of the Department of Industry). This procedure is very complicated and takes quite a long time. It also burdens the company for the extra cost for the container (demurrage charge) at a progressive fee until the products are taken out of the shipping dock..
2. The sample products import problems are more likely to be experienced by large-scale furniture companies (factories) rather than small- and mid-scale businesses. The import duties and other taxes charged on sample products are the main issue. The taxation is also estimated based on the value of the freight, increasing the fees charged to the businesses.
3. The regulation to replace the phytosanitary certificate for imported MDF with a report to the Quarantine Head Office – which is supposed to simplify the policy – is unclear and the process is still inefficient. The entrepreneurs who import MDF still have to produce the phytosanitari-free letter, so potential additional costs remain.
4. This study does not find any obstacles caused by the fuel minimum order, because of the furniture industry's cluster characteristic and the funded gas stations' sufficient supply and service. There are problems for the industry, however. Fuel service is still limited and this regulation is not transparent enough. Entrepreneurs are upset because they need the fuel but it is difficult to find legally; consuming the funded fuel will put them in a situation where their actions are illegal, even though local officers are not penalizing them.
5. The regulation that simplifies the wood administration, regulated by the Ministry of Forestry Regulation 55/Menhut II/2006, is insignificant and does not alleviate problems with the inter-territory distribution of wood and wood products. The deregulation has not decreased the extra costs charged to the wood/furniture entrepreneurs during the raw material and products transportation.
6. The regional regulations that burden furniture entrepreneurs today are actually better than prior to decentralization. Yet, the tax stipulations are sometimes unclear and inconsistent.

## 8.2 RECOMMENDATIONS

### 8.2.1 RECOMMENDATIONS ON THE POLICY REVIEW

1. The Ministry of Finance Decree No. 140/KMK.05/1997 should be changed in order to comprehensively deregulate the import of sample products, especially abolishing the associated taxes. This will allow Indonesian furniture entrepreneurs to compete with those in competitor countries, with simpler regulations on the import of sample products.

2. The procedure of getting the exemption from import duties and other taxes should be simplified, by decentralizing it to the regional office and the province bureau. This would mean that the process can be done faster and allow companies to avoid the extra costs charged at the shipping dock.
3. The Ministry of Agriculture should decree that the phytosanitary certificate for imported MDF and other wood products can be used to hasten the import procedure for MDF and other raw materials needed by the furniture industry. The regulation on reporting the imported MDF to the Quarantine Head Office should be discarded; it has not given any benefit, and costs even more than the previous system.

#### **8.2.2. RECOMMENDATION ON POLICY IMPLEMENTATION**

1. Pertamina should provide more industrial fuel agents in areas that have not been served by existing agents so that the industry can buy fuel more easily.
2. The gas stations should be considered service points of industrial fuel sales so that small-scale purchasing can be done.
3. The Ministry of Forestry Regulations PP 51 and 55/Menhut II/2006 (that replace SKSHH with SKSKB, FAKB and FAKO) should be more widely communicated. The lack of information on these regulations definitely encourages illegal extra costs being charged to entrepreneurs who are distributing and transporting their wood and wood products.
4. The cost for training certified experts to issue the FAKO should be reconsidered. Those experts replace the Bureau of Forestry officers' role in issuing the SKSHH, therefore the training cost should be paid by the government.
5. The Department of Forestry should increase the frequency of training sessions for certification to issue the FAKO. Training also should be held in locations closer to the wood industry center so that the wood or furniture entrepreneurs are able to join the training more easily.
6. Synchronization between regional institutions is definitely needed, especially between the regional governments, shipping dock authorities, and the police. This way the extra charged assessed to the furniture industry will decrease. The Bureau of Industry and the Organization of Investment can be the leading institutions in the effort taken to overcome the furniture industry high cost economy.

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