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SENADA
INDONESIA COMPETITIVENESS PROGRAM

END MARKET ANALYSIS

FURNITURE INDUSTRY VALUE CHAIN

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ACRONYMS AND ABBREVIATIONS

AFLEG	Southeast Asia and Africa FLEG
ASMINDO	Asosiasi Industri Permebelan dan Kerajinan Indonesia (the Indonesian Furniture Producers Association)
C8-Global	a market-oriented forest management consulting firm
CB	Certification Body
CITES	Convention on International Trade in Endangered Species
CPET	UK Central Point of Expertise on Timber
CSA	Canada's National Sustainable Forest Management Standard
ENAFLEG	Europe and North Asia FLEG
FLEG	Forest Law Enforcement and Governance
FLEGT	Forest Law Enforcement, Governance, and Trade
FSC	Forest Stewardship Council
FWI	Forest Watch Indonesia
ICW	Indonesian Corruption Watch
IFC	International Finance Corporation
INDRI	Indonesian (Natural) Resources Institute
FAO	UN Food and Agriculture Organization
G8	The group of eight most industrialized nations in the world
GFS	Global Forest Services
GFTN	WWF's Global Forest & Trade Network
GTZ	German Technical Cooperation agency
LEI	Lembaga Ekolabel Indonesia (the Indonesian Eco-labeling Institute)
MTCC	Malaysian Timber Certification Council
NGO	Non-Government Organization
NWG	Vietnam National Working Group on Sustainable Forest Management
PEFC	Program for the Endorsement of Forest Certification
PENSA	IFC's Program for Eastern Indonesia SME Assistance
REFAS	Rural Development Reform of the Forestry Administration Structure
SA	Social Accountability
SA8000	Social Accountability International certification requirements
SFE	State Forest Enterprise
SFI	Sustainable Forestry Initiative
SME	Small and Medium Enterprise
SGS	A leading international forest certification body
SIPPO	Swiss Import Promotion Program
SPWP	Secondary Processed Wood Products
TFT	Tropical Forest Trust
TNC	The Nature Conservancy
TTF	Tropical Forest Foundation
TTAP	Timber Trade Action Plan
TUV	A global leader in independent testing and assessment services
VLO	Verification of Legal Origin
VPA	Voluntary Partnership Agreement
WRAP	Worldwide Responsible Accredited Production
WSSD	World Summit on Sustainable Development
WWF	World Wildlife Fund

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EXECUTIVE SUMMARY

The purpose of this work was to assist SENADA in developing an understanding of the needs and opportunities for increasing competitiveness of the Indonesian wooden furniture industry. The forty-day length of engagement included meetings with furniture companies, industry trade associations, and related organizations and institutions throughout Java. Throughout the mission the consultant provided the SENADA team briefings on topics important responsible purchasing to the supply of sustainable timber to the industry and various resources that would be important for the project. These are not included in the report due to length but the topics are listed in Chapter V.

SENADA has a great opportunity to provide meaningful and needed assistance to the Indonesian wooden furniture industry by supporting the sector to improve its procurement of raw material through legal verification of origin. There is every reason to believe that a knowledgeable and professional approach can greatly increase the competitiveness of the industry, provide substantial opportunities for individual companies, increase the quantity and quality of industry employment, and be a beneficial use of the USAID funds.

A responsible purchasing program for forest products should aim to improve the environmental and social performance of the supply base by ending the purchase of products that contain timber from illegal or controversial sources and by continuously increasing the proportion of forest products purchased that contain timber from credibly certified forests.

To achieve this transition, from whatever starting point, SENADA has developed a program of activities that will seek to assist the Indonesian wood furniture sector to maintain and develop international market share. This shall be done by pursuing the practice of responsible timber procurement and thus ensuring that all supplies of raw material are verified as legal at the point of origin. SENADA will then disseminate successes to the rest of the sector as part of a broader advocacy campaign on the importance of responsible procurement and verification of such through third party verification.

Detailed recommendations are provided at the end of this report.

1. DEMAND SIDE TRENDS FOR WOOD FURNITURE MANUFACTURING PRODUCERS IN INDONESIA

The concept of market competitiveness through improved timber procurement policies stems from the growing demand for certified or legally verified products on the international market. The European Union is currently seeking to develop Voluntary Partnership Agreements (VPA) under its Forest, Law Enforcement, Governance and Trade (FLEGT) program with wood exporting countries to prevent the export of wood-based products manufactured from illegal wood to the EU.

These VPA agreements are due to come in to effect in 2008 and are likely to result in stepwise market closure over a defined timeframe. There are also numerous bilateral agreements between the Republic of Indonesia and countries concerned about preventing illegal logging including: the United Kingdom (UK), Japan, Norway, and China. The Republic of Indonesia is also in discussions to develop a similar bilateral agreement with the USA. These bilateral agreements have provided a basis to develop both national and international solutions to Indonesia's illegal logging problems. They will also put pressure on the secondary manufacturing sector, such as the furniture sector, to implement responsible purchasing policies to stay in certain markets.

The work of SENADA in the furniture sector will focus on preparing the industry for the current shift in International procurement policies too that of a more corporate social responsibility ethos. This report looks at the current situation within the Indonesian furniture and forestry sectors and examines the burgeoning procurement policies that will impact the Indonesian furniture sector.

1.1. INDONESIAN FURNITURE SECTOR

The international furniture market was estimated to be worth US\$66 billion in 2006 of which Indonesia controls only 2 percent. In 2007 demand was expected to grow by between 5 and 7 percent. China and Italy are currently the leading global market suppliers with combined exports of US\$9.3 billion. It is evident that even in Southeast Asia, Indonesia trails behind neighboring countries Malaysia and Vietnam. Many blame this on the rising operating constraints that are eroding Indonesian competitiveness as compared to other producer countries. The last fuel price hikes, which averaged 126 percent, pushed operating costs up 25 percent, with a proposed increase in industrial electricity prices likely to increase costs by another 20 percent.

The rise in operation costs has pushed up end-product prices this has meant that Indonesia is at risk of losing further global market share. It is estimated that the market place will tolerate a raise in process costs of a maximum 6 percent. On the domestic front, furniture manufacturers were increasingly losing out to Chinese goods. According to ASMINDO figures, total furniture imports increased by 78 percent last year.

Wooden furniture production in 2004 reached 2,483,067 cubic meters but in 2005 it dropped to 2,330,389 cubic meters and in 2006 to 2,258,882 cubic meters. An important issue to be considered is that the drop in the production utility rate and volume from 2,483,067 cubic meters in 2004 to 2,258,882 cubic meters in 2006 has been blamed on a shortage of wood and rattan supply as a result of illegal harvesting and illegal exports of timber.

However the nominal value of exports of the products rose, growing from US\$1.58 billion in 2004 to US\$1.65 billion in 2005, and in 2006 rising to US\$2.38 billion. Exports grew by 3.5 percent in 2006 after growing at about four percent a year during the past five years. A higher growth of 5-7 percent is expected in the coming years. Wooden furniture accounts for three-quarters of the total furniture exports, followed by rattan (21 percent), metal (2 percent) and bamboo (1 percent) furniture. The major markets for Indonesian wooden furniture are the USA (24 percent of total exports), Japan (7 percent), the Netherlands and France (5 percent each). The USA is the main export destination for rattan furniture.

Wooden furniture makes the largest contribution to national exports reaching 672,311 tons worth US\$1.32 billion while export of furniture components reached 907,158 tons worth US\$746.08 million. Thus in Indonesian it is still a sizable manufacturing sector. Statistics state that the Indonesian furniture sector comprises more than 3,500 companies with over two million workers. Wooden furniture dominates the furniture sector, accounting for two-thirds of the total furniture exports. The furniture industry is mainly concentrated in Java (notably Jepara, Semarang, Solo and Surabaya), where furniture accounts for about 40 percent of Java's total exports. Jepara is particularly known for its crafted wooden furniture. Small firms market their products through a network of furniture shops that sell locally. Exports are carried out through sub-contracting arrangements and small enterprises play an active role in export.

The Indonesian furniture industry relies heavily on timber as its raw material with an annual requirement of 4.5 million cubic meters. Although Indonesia is the world's second largest timber producer, the industry faces shortages of raw materials. The main timber species for wood carving are teak, mahogany, and sonokeling (*Dalbergia latifolia*). Almost half of total national rattan production is based in Cirebon.

1.1.1. CHALLENGES FACED BY THE FURNITURE INDUSTRY

Indonesia faces several challenges in expanding its furniture exports. Firstly, despite its vast forest resources, illegal timber logging and trade have affected the supply of timber to the furniture sector. This was aggravated by the government's reduction of the logging quota for natural forests to 5.7 cubic meters in 2004 and 5.4 million cubic meters in 2005. Indonesia's Minister of Forestry announced that the harvest quota for natural timber for 2007 would be increased to 9.1 million cubic meters, up almost twelve percent from 2006. The harvest quota was reduced between 2001 and 2005 to achieve sustained yield and reduce over-capacity in lumber and plywood mills, which, the government believes, has been achieved to a certain extent.

The Indonesian wood industry has shrunk in the last years through the declining availability of logs. The number and production capacity of lumber and plywood mills have plummeted over the period. The declining supply of Indonesian plywood contributed, in fact, to the sharp increase of plywood prices in 2006. According to some analysts, the logging quota in 2006 was not fully used by local mills due to the reduced production capacity and financial difficulties. Some analysts thus believe that the increased logging quota for 2007 would not necessarily lead to the revival of the Indonesian wood industry.

1.1.2. INDONESIAN WOOD INDUSTRY AND LEGALITY

Indonesia's tropical rainforests, the largest and richest in Asia, are being lost at the alarming rate of over 3.5 million hectares (almost nine million acres) per year - the equivalent of more than 500 soccer fields per hour. Much of this loss is driven by demand within Asia for timber and pulp. Around two-thirds of the logging in Indonesia is illegal. Estimates suggest that 300,000 cubic meters of timber are smuggled

from Indonesia every month, much of which is destined for Asian (China and Japan) and European markets. Some projections anticipate the global rates of wood consumption may nearly double by 2050. There is an emerging momentum for change in wood markets due to shifts in business practices and government policies. In North America and Europe, markets already favor environmentally friendly forest products. This has a major impact on suppliers. To increase competitiveness, forest products companies are making voluntary investments to improve forest management.

Illegal logging and the international trade in illegally logged timber is a major problem for many timber-producing countries in the developing world. It causes environmental damage, costs governments billions of dollars in lost revenue, promotes corruption, undermines the rule of law and good governance, and funds armed conflict. It retards sustainable development in some of the poorest countries of the world. In a world market of timber and timber products worth around US\$270 billion the value of tropical woods exported from producer countries as logs, sawn timber, veneer and plywood in 2003 was US\$7.3 billion. The export of secondary processed wood products (SPWP) from tropical timber producing countries was worth US\$8.3 billion. The value of timber and timber products exported from Russia and the Baltic States, where there are significant concerns regarding illegality, was US\$8.3 billion according to FAO figures.

By definition, the scale of illegal logging is difficult to estimate, but it is believed that more than half of all logging activities in the most vulnerable forest regions – Southeast Asia, central Africa, South America and Russia – may be conducted illegally. Worldwide, estimates suggest that illegal activities may account for over a tenth of the total global timber trade, representing products worth at least US\$15 billion a year. Of which the EU (including the UK), the US and Japan are the main markets.

In many timbers producing countries decades of large scale industrial logging have failed to deliver ecologically and socially responsible forest management, poverty alleviation or sustainable development. Indonesia is such a country and a country where these problems are exacerbated due to the level of institutional capacity, weak regulatory systems and high levels of corruption. The impacts of illegal logging on an industrial scale can be disastrous for people, for the environment and the economy of Indonesia. In addition to the internal civil impacts cheap timber from destructive and illegal sources on the world market results in unfair competition for those companies and countries that are behaving responsible and are ready to play by the rules of a responsible market place. Today through these illegal activities the impact that Indonesian is experiencing are many:

- **Environmental.** Illegal logging depletes forests, destroys the habitats of endangered species and impairs the ability of land to absorb carbon dioxide emissions, with impact on climate change.
- **Physical.** The destruction of forest cover often has knock-on effects such as flash floods, landslides, species extinctions etc.
- **Budgetary.** Illegal logging loses governments revenue. Estimates from Indonesia suggest that the government is losing more than US\$4 billion a year in lost revenue.
- **Social.** Illegal logging undermines respect for the rule of law and of government, and is frequently associated with corruption, particularly in the allocation of timber concessions. Protected by powerful patrons, timber companies may evade national regulations with relative impunity.
- **Trade-related.** As illegally logged timber is invariably cheaper than legitimate products, it distorts global markets and undermines incentives for sustainable forest management. A study published by the American Forest & Paper Association in 2004 estimated that world prices were depressed by between seven percent and sixteen percent (depending on product) due to illegal activities.

Consumer countries contribute to these problems by importing timber and wood products without ensuring that they are legally sourced. In recent years, however, producer and consumer countries alike have paid increasing attention to illegal logging, with many of their activities being triggered by the G8 Action Program on Forests of 1998–2002. The main initiatives include:

- A series of discussions and declarations, including the Forest Law Enforcement and Governance (FLEG) conferences in East Asia, Africa and (in 2005) Europe and North Asia.
- Bilateral agreements between individual consumer and producer countries to improve enforcement and keep illegal products out of international trade.
- Measures to exclude illegal timber from international markets – mainly the EU’s Forest Law Enforcement, Governance and Trade (FLEGT) Action Plan, which centers on a licensing system for legal timber exported from partner countries.
- The use of government procurement policy to ensure that only legal (and sustainable) timber products are bought by government purchasers.
- Efforts to ensure that investments in the timber and related industries, whether channeled through private banks or public agencies, do not contribute to illegal activity.
- Assistance with improved law enforcement in producer countries, and the establishment of systems to track the movement of legal products.
- Industry initiatives to work with suppliers to source legal timber.

1.2. REGULATIONS, POLICY AND NEW TRENDS THAT WILL MANDATE THE NEED FOR LEGAL VERIFICATION

The above sections have shown that although the Indonesian wooden furniture industry international is small player nationally it is an important manufacturing sector. However due to its limited international market share Indonesia has a great potential to increase its sales in the future. Although in order to do this Indonesia must work within the changing market place. The market is changing to one with socially responsible procurement policies, be this private or public organizations and thus the Indonesia furniture must be proactive in its strategies to accommodate this shift. The ability to meet the new market demands is more important for Indonesia because it is the second biggest producer globally of tropical raw material.

The next section will investigate in more detail some of the market driven tools and legislation that are being put in place that will affect the Indonesian forest product industries and thus wooden furniture sector. The growing demand for certified products will require in the future that at the very least exporters of wooden furniture to the EU will be able to prove legal origin of raw material. It should be noted that the main driving force behind the increased demand is policy, legislation and regulatory changes being implemented by governments and major retailers. The demand from the end consumer is at best small and thus unfortunately not the driving force behind the shift in timber procurement.

1.2.1. LICENSING: THE EU FLEGT SCHEME

Governments seeking to exclude imports of illegal timber products from their countries are faced with an immediate problem: how can legal goods be distinguished from illegal ones? This lies at the heart of the EU’s Action Plan on Forest Law Enforcement, Governance and Trade (FLEGT), published originally in May 2003.

The Action Plan rests primarily on the negotiation of FLEGT voluntary partnership agreements (VPAs) with producer countries. These agreements will put in place in each country a licensing system designed to identify legal products and license them for import to the EU; unlicensed – and

therefore possibly illegal – products will be denied entry at the EU border. The agreements will include the provision of capacity-building assistance to partner countries to set up the licensing scheme, improve enforcement and, if necessary, reform their laws – and, where appropriate, provisions for independent scrutiny of the validity of the issue of the licenses, verifying legal behavior at every stage of the chain of custody of the timber.

As of May 2006, negotiations on a VPA are currently under way between the EU and Indonesia. The EU has already amended its own legal system by agreeing (in December 2005) a new regulation which requires its customs authorities to refuse entry to unlicensed products from partner countries. Initially the licensing scheme will only cover a limited range of products – raw timber, sawn wood, plywood, and veneer – but the intention is to extend it to other products categories as quickly as feasible and this is expected to include furniture. Licensing systems designed to exclude products are familiar mechanisms in international trade. The FLEGT timber licensing system is similar in effect to systems already in place in several international agreements, including the Convention on International Trade in Endangered Species (CITES), the Montreal Protocol on ozone-depleting substances and the Kimberley Process on conflict diamonds. Unlike those systems, however, there is no equivalent global agreement under which to develop a timber licensing scheme, and the FLEGT system is therefore being built up through a series of bilateral agreements.

1.2.2. LEGISLATION TO STOP ILLEGAL PRODUCTS

In addition to the FLEGT licensing scheme interest has been displayed in the possibility of using existing, or new, domestic legislation in the EU to target illegal timber being imported from non-VPA countries, or from VPA countries in ways which evade the controls. Studies of legislation of potential relevance were conducted in a series of EU member states in 2005–06. The most progressive of the EU states is the UK and currently the UK government is looking at four areas of existing legislation, and has concluded that:

1. Laws dealing with theft and handling stolen property could apply to products stolen overseas and imported into the UK. However, to be applied it would have to be shown that those importing the products knew that they were stolen – which is generally not the case. This law would also only apply to stolen timber, and not to other categories of ‘illegal’ timber – for example, products exported without payment of export duties.
2. There might be a possibility of the original owners of the timber (from the producer country) taking a civil case against those who had imported it into the UK, or had subsequently bought it. To be successful, it would have to be shown that the timber that had been stolen from the original owners was the same as that finally imported into the UK (not always an easy task), but it would not have to be shown that the importers or purchasers knew that it had been stolen.
3. If the illegal products had been incorrectly described in some way for the purposes of import, a case could be brought under customs regulations. However, it seems unlikely that this would be of much relevance in practice.
4. Money laundering legislation could be used if the proceeds of the illegal logging (the products themselves or the money or other assets deriving from their sale) were disposed of in the UK. This is likely to be of most relevance where there is good evidence of the original criminal behavior available from the original producer country. For example, from a criminal conviction or at least an ongoing court case – and the flow of products and money can be traced. In the absence of such evidence, it is likely to be difficult to bring a successful case.

The difficulty of cooperation between enforcement agencies in different countries, the problems of obtaining evidence from foreign countries, and the complexities of tracking the movement of products across thousands of miles all combine to make cases brought under any of these options difficult – though not always impossible – to prove.

Given these conclusions, the EU is examining whether there is any need for additional legislation, either at EU or at member state level. The main option appears to be legislation modeled on the US Legal Timber Protection Act which makes the import and illegal harvested fauna a flora including timber illegal. This was originally the US Lacey Act and was revised in March 2007 to include timber¹. Legislation in the EU, or in its member states (both are possible) would avoid some of the problems associated with the domestic legislation outlined above. The Legal Timber Protection Act, for example, covers all illegal products (not just ‘stolen’ ones) and can apply even when the importers did not know the goods they were handling were illegal. Prosecutors would still, however, have to show some evidence of the original illegal activity, which is not always straightforward.

The main problem that any of these approaches have to wrestle with is the difficulty of showing that the products in question have actually been illegally produced. This is why the licensing scheme, which provides a means of distinguishing between legal and illegal products, is likely to be so much more effective – as long as the system can be developed to avoid the loopholes outlined above in section 4.1. Legislation modeled on the US Legal Timber Protection Act, however, could well be a useful reinforcement to the scheme, and an added disincentive to those trying to bring illegal timber into the EU. The European Commission is due to announce its conclusions on the need for any additional legislation later this year [2007].

1.2.3. PUBLIC PROCUREMENT POLICY

In all developed countries, government (central, regional and local) is a major consumer of timber and timber products in its own right. Though precise figures are difficult to come by, spending by public authorities in the EU, for example, is estimated to account for 16–18 percent of GDP, and it is generally assumed that they account for a similar proportion of purchases of timber and timber products. Governments have greater latitude in imposing requirements for their own purchases than in setting rules for their countries as a whole, and a number have introduced procurement policies which specify that all timber products bought by government must be legally (and often sustainably) produced. In some countries this was explicitly a response to the general rise in concern over illegal logging, whilst in others it was a development of a pre-existing concern with environmental issues more broadly.

The development of public procurement policy for timber has proceeded furthest in the EU, where encouragement for its use was included in the FLEGT Action Plan:

All the four governments which have reasonably comprehensive timber procurement policies (Denmark, France, Netherlands, UK) have developed them in slightly different ways. Denmark’s is voluntary, for example, while the others’ are mandatory; Denmark’s only covers tropical timber, while the others’ extend to all sources; and the acceptable level of proof of meeting the criteria also differs between the countries.

¹ On March 13th U.S. Representative Jerry Weller (R-Morris) joined Congressman Earl Blumenauer (D-OR), Congressman Robert Wexler (D-FL), and a broad coalition of supporters from environmental, industry, and labor groups to announce the introduction of the Legal Timber Protection Act, which bans the use of illegally-harvested timber and wood products. The bipartisan legislation will amend the long-standing US Lacey Act, extending its protections to plants to catch trafficking in timber and wood products.

More importantly, they also differ in their criteria and definitions. The French and Dutch policies are aimed primarily at sourcing sustainable timber; such timber should of course be legal, but this is a side-effect rather than the main aim. The Danish and British systems have both been designed to procure legal and sustainable timber, recognizing that while sustainable timber is desirable, it may not always be available in sufficient quantities, and therefore a minimum standard of proof of legality should be required for all purchases. 'Legality' is generally defined as being in accordance with the laws of the producer country.

However, all four countries use different definitions of 'sustainably produced'. One particular area of disagreement is the question of whether social criteria over and above those legislated for in the producer country itself – for example, international health and safety standards amongst the logging workforce, or land tenure rights of indigenous communities – can be included. Whatever the criteria they choose, all these countries have to face the question of how to operationalize their policies – i.e. how in practice can they make sure that government purchasers are buying products that meet the criteria? This is partly what the UK CPET was established to do, and the first phase of its work consisted of an evaluation of the extent to which the main certification systems met UK criteria. (All five met the legality criteria, but only FSC and CSA met the sustainability criteria, whereas PEFC, SFI and MTCC did not. A later evaluation, after PEFC and SFI had been modified, concluded that they too now met the sustainability criteria.)

CPET also has to evaluate alternative documentation which might show legality and sustainability, where products are not covered by any of the certification schemes (EU procurement rules do not permit member states to specify simply products covered by particular schemes; they have to rest on criteria), and also carries out training and awareness-raising exercises and monitors the implementation of the policy amongst government departments. Although the other EU governments with timber procurement policies may not possess bodies like CPET, the nevertheless have to find some way of carrying out the same functions.) Finally, it should be noted that these procurement policies apply only to central government. Many regional and local governments, however, are showing an interest in this area. Some have modeled their own policies on central governments, whilst others have adopted different policies, often based on FSC as a standard, where it is available. In most of these countries, the procurement policy is too new for its impacts yet to be measurable.

Outside the EU fewer countries have developed timber procurement policies specifically in response to the debates around the control of illegal logging. However central, regional and local governments throughout the developed world often possess or are developing a variety of 'green' procurement policies. Many local authorities encourage the use of sustainably produced timber in building projects, and authorities at all levels often promote the use of recycled paper – both of which have some impact in reducing the demand for potentially illegally-logged timber. In the US, for example, a number of states, including Michigan, Vermont and Massachusetts, and several local authorities, possess procurement policies aimed at sourcing sustainable timber and timber products, usually defined as those covered by a variety of certification schemes. In Canada, the federal government promotes (though does not require) the use of sustainable and recycled timber in new and existing government buildings, and is developing a broader green procurement policy.

In April 2006, Japan adopted a new green procurement policy, which includes the requirement that all timber and timber products should have been harvested in a legal manner consistent with procedures in the forest laws of timber-producing countries and harvested from forests under sustainable management. Verification of these criteria can be through certification schemes or other and chain-of-custody or company-determined methods. More recently, New Zealand, Norway and, less formally, Australia, have begun to explore options for removing illegal timber from their markets, particularly the possibility of developing public procurement policies.

1.2.4. PRIVATE SECTOR SUPPLY CHAIN TRENDS

The key question for all of these government policies is to what extent they change the behavior of the private-sector companies that actually supply them. Government measures are not the only driver acting on suppliers, however; they are also responsive to direct public and NGO pressure and the changing requirements of their final consumers, private as well as public. A significant and growing minority of the UK private sector, for example, is actively responding to policy signals and market changes encouraging verified legal and certified sustainable timber. These responses are manifest in a range of individual actions and group initiatives, but a number of trends can be identified:

- A move from policy statements to compliance and verification procedures.
- Rationalization of supplier networks and increasing vertical integration.
- A move away from spot markets to longer-term supply contracts.
- A move from country-based to supplier-based risk assessment.
- Recognition that independent verification is critical to credibility of claims.
- The development of progressive coalitions along the supply chain.
- The development of progressive coalitions with actors in other countries.

Individual companies with a long-term view on the sector, particularly those that are exposed to reputational risk through well-recognized brands or retail operations, have developed policies that explicitly commit them to buying only legal timber and timber products. There is a clear trend towards implementing and verifying these commitments. Most companies that have not yet developed verification mechanisms have, at least, recognized that the credibility of their policy depends on them in the medium- to long-term.

In addition to demonstrating legal compliance in their own operations, companies are increasingly concerned about the reputational risk associated with their suppliers. Some have responded by reducing the number of suppliers and buying the total output of a given operation over a specific time period in order to reconcile output with legal quotas; however, in the longer term, many recognize that addressing these risks systemically will require significant investment in chain-of-custody systems, and as a result are increasingly considering the benefits of vertical integration. This trend is in line with developments in other natural resource sectors, driven by improvements in supply chain management technology and communications and the possibility of increased efficiency. There is little consensus among individual companies about issues such as workable definitions of legality, credible auditing frequencies or methods of judging evidence. Furthermore the internal capacity on many companies is limited and thus their ability to address these issues, at least in the short term.

1.2.5. TIMBER TRADE ACTION PLAN

The Timber Trade Action Plan (TTAP) developed out of collaboration between the UK and Dutch timber trade federations in Indonesia. The Plan is a five-year program, funded primarily by the EU Tropical Forest Budget line in 2005, which operates in five producer countries (Indonesia, Malaysia, Cameroon, Gabon and Congo Brazzaville) and three consumer countries (Belgium, the Netherlands and the UK). It aims to develop national guides to legality and standards for chain of custody and auditing, and to verify the legality of at least 20 per cent of the timber bought by members of the UK, Dutch and Belgian federations from the participating producer countries, by 2009. The Plan is being implemented by the Tropical Forest Trust and the trade federations mentioned above, in collaboration with GFTN. The plan is focused on consumer requirements in the three federations' markets and operates on a business-to-business level. Legality requirements are in line with the expected design of FLEGT legality licenses in the producer countries in question.

1.3. ACTIONS BEING TAKEN BY COMPETING COUNTRIES IN THE REGION

1.3.1. CHINA

The two main competing countries in the region for Indonesian are China and Vietnam. These countries are also seeing the increased demand for responsibly procurement of wooden products. And the recognition that forest resources are in actual fact finite and thus some form of sustainable forest management must be sought. China is a major player in the global forest products market, both as a producer and consumer. China's market for industrial timber, pulp, and paper is the second largest in the world, outranked only by the massive US market. It has relatively limited forest resources and a great potential for increases in consumption of wood and paper products

China's domestic wood production rates have been in decline since 1995. In many regions, decades of over exploitation of natural forests have depleted standing wood volumes. Logging bans and restrictions, introduced in the wake of the devastating 1998 Yangtze River floods, have cut production further, particularly in the few regions where forests remain relatively well-stocked with timber. Although the maturation of domestic forest plantations will help to bridge the gap between domestic supply and demand, China is likely to continue to face a severe shortage of wood in the coming decades. Imports have expanded dramatically, and may continue to expand, to meet demand

Currently the majority of timber imports into China originate in countries with very significant problems, such as illegal logging and forest crimes, loss of natural forest to agriculture and silviculture, and loss of biodiversity, including threats to highly endangered species such as elephants and tigers, gorillas and orangutans. China is a major importer from Russia, Indonesia and Central Africa, all countries where the majority of timber exported has been illegally harvested or exported.

Government agencies, academics and forest experts in China are currently working to develop standards and systems for certification in China. Under new regulations these will need the approval of China's National Accreditation Committee. To attain market credibility, they will also need to satisfy the demands of international stakeholders for performance-based social and environmental standards, independent assessment and transparency.

Forest certification offers China a means to move beyond the 1998 logging ban imposed country-wide by the central government after the 1998 floods. The ban encompasses natural forests in much of the country, and contributes toward the establishment of a sustainable domestic forest industry. It is also a means to slow China's rapidly growing environmental footprint caused by demand for unsustainably sourced timber from other countries, hastening forest destruction in those nations.

The International Board of Directors of the Forest Stewardship Council (FSC) has announced the accreditation of the Forest Certification Working Group in China as the official FSC National Initiative in China (FSC China). FSC China will promote responsible forest management. Its key activities will be to promote FSC Chain of Custody certification for the timber manufacturing industry and lead the development of China's national FSC standards. FSC Chain of Custody certification in China is growing faster than anywhere else in the world. To date over 300 companies in China hold an FSC certificates with more than 700,000 hectares of forest are currently FSC certified.

1.3.2. VIETNAM

In Vietnam according to FAO's statistics (2000), Vietnam's forest cover stands at 9.8 million hectares, which is about 30 percent of the land area. About 24 million people live in or around forests depending on them for food and income. Unfortunately, deforestation and unsustainable harvesting over many

decades have reduced the cover rate from 43 percent in 1943 to 23.3 percent in 1983. Most of the remaining natural forests are now concentrated in the highlands (Tay Nguyen) or central and south-eastern Vietnam. In Vietnam, forests are owned by the state, managed and monitored by the State Forest Enterprises (SFE). The focus of SFEs has been mainly on commercial timber production, paying little attention to the long term sustainability of the forests. In addition, ethnic minorities living in forest areas as well as migrant farmers from the delta areas contributed to deforestation.

In response to the crisis caused by unsustainable logging, in July 1997 the Government decided to temporarily limit harvesting in remaining natural forests and place emphasis on greater protection and regeneration activities. Since 1997, logging has been scaled back significantly, to the extent that only 105 out of 241 SFEs have been allowed to continue harvesting the natural forests. To meet the still rising demand for timber, the government started to look for new management techniques to improve natural forest management. While heeding calls for caution, the government is pursuing the strategy of third-party forest certification as one tool to promote responsible forest management and stem the tide of forest loss.

In early 1998, the Vietnam National Working Group on Sustainable Forest Management and Forest Certification (NWG) was established to develop a set of national standards for SFM in accordance with the Forest Stewardship Council's (FSC) principles and criteria. With technical and financial support from WWF and the joint GTZ/Ministry of Agriculture and Rural Development Reform of the Forestry Administration Structure (REFAS) project, the NWG has completed a draft set of criteria and indicators for SFM. Efforts at the local level are helping to raise awareness on the benefits of SFM and certification among provincial officials and forest managers. Currently, FSC is the only certification scheme active in Vietnam. An initiative to develop National Forest Management Standards that can be used as a basis for forest certification is still ongoing.

1.4. CONCLUSION

Illegal logging results in serious environmental and social damage, as well as costing governments an estimated US\$15 billion every year in lost revenues. This was recognized in a G8 Summit in 1998, where measures to tackle illegal logging were discussed and an 'Action Program on Forests' formally adopted. Subsequently, in April 2002, the European Commission hosted an international workshop to discuss how the EU could contribute to measures to combat illegal logging. At the World Summit on Sustainable Development (WSSD), held in Johannesburg in the same year, the European Commission set out a strong commitment to combat illegal logging and the associated trade in illegally-harvested timber. The EU published its first proposal for a FLEGT action plan in May 2003.

A number of other initiatives, arising from both national and international commitments, have also developed in parallel. In particular, three regional FLEG (Forest Law Enforcement and Governance) processes have been established in South East Asia, Africa (AFLEG) and Europe and North Asia (ENAFLEG). These processes, coordinated by the World Bank, have resulted in ministerial commitments to identify and implement actions to combat illegal logging in each region.

Currently the FLEGT process will potentially have the greatest impact for Indonesia. The FLEGT VPA and its associated legal licensing scheme is at the time of writing being negotiated between the EU and the Government of Indonesia. The EU's new legal system will require that the EU customs authorities will refuse entry to unlicensed products from partner countries. Unlicensed means goods that are not licensed under the associated VPA legal licensing schemes.

Initially the licensing scheme will only cover a limited range of products – raw timber, sawnwood, plywood and veneer – but the intention is to extend it to other products categories as quickly as

feasible and this is expected to include furniture. Thus in conjunction with these new EU regulations and the myriad of other initiatives that are being developed and mentioned in this report it will become increasingly important to ensure that forest products are legally and sustainably produced in Indonesia. It is an important time for the Indonesian forest product sector to place itself in a position to meet these new demands.

As one of the world's largest producers of timber Indonesia will increasingly be required to show that forest products are derived from legal source. This will require a new legal definition which at the time of writing is being created under the auspicious of the FLEGT program. It will require that there is a reputable third party licensing scheme. This scheme will be the underpinning activity associated with the FLEGT VPA. It will require that companies attain third party assessments to show proof of legal origin of raw material and that the companies have an adequate timber tracking scheme in place.

The third party verification of legal origin is where the SENADA project is currently focusing its efforts. The institutional development of legal definitions and licensing schemes has been under development now for the last five years. And currently third party verification is mainly carried out by international forest certifying bodies which can offer reputable certificates of legal origin. To work with the international certify bodies requires that a company is fully conversant with the requirements of set standards and how to meet these standards. This requires a high level of training and support. The SENADA program is an ideal position to offer this support to assure that the furniture manufacturing sector of Indonesia can reach the required level of understanding and competence.

Whilst the FLEGT VPA is being negotiated, the US Lacey Act is strengthened and responsible procurement policies are implemented the international markets will become increasingly demanding in their requirements for proof of legality and sustainability. With the support of the SENADA program the furniture manufacturers in central Java will find that they ideally situated to meet these new demands and be able to compete more aggressively in the international furniture market.

2. STRATEGIES FOR SENADA INTERVENTION

The concept of market competitiveness through improved timber procurement policies stems from the growing demand for certified or legally verified products. Through this mission SENADA has planned and developed programming activities that will seek to assist the Indonesian wood furniture sector to maintain and develop international market share. This will be done through the pursuit of responsible timber procurement ensuring that all supplies of raw material are verified as legal at the point of origin.

The basic strategy of the program will assist a select group of furniture manufacturers through a legal verification program that can be used as a basis for exporting to green markets. The program will disseminate this success to the furniture sector as part of a broader advocacy campaign on the importance of green market certification. The following will outline the key proposed strategies and justification for inclusion in this project design proposal.

2.1. KEY STRATEGIES AND JUSTIFICATION

2.1.1. IDENTIFICATION OF POTENTIAL CLIENT COMPANIES

The fundamental need of the program is the identification of wood-furniture sector clients that have the potential and need to improve their procurement policies to maintain or extend or even maintain their market base through some form of legal verification. The program shall need to identify and stratify clients between those that have the ability to reach the required standard quickly and are progressive in their approach. And the other companies that will need more work and time to reach said standard requirements. A major issue to be considered here is the complexity of supply chains. This is particularly important in Java because many furniture manufacturing supply chains are extremely convoluted with traders and sub contracting manufactures used to obtain the required raw material.

2.1.2. CLIENT SUPPORT

The support of the identified clients is an extremely important facet of the program. It takes a lot of time and effort to transform a chain of custody system that is functioning in a business sense to one that can meet the requirements of a third party assessment set against an international environmental procurement standard. The best and quickest way for SENADA to achieve this is to use competent and experienced consultants. These firms will be able to supply the continuous support required to ensure a company is able to adapt their procedures to meet international environmental standards.

2.1.3. IDENTIFY PARTNER ORGANIZATIONS (DONORS, NGOs AND CERTIFYING BODIES)

It will be important to foster and maintain key partnerships with the donor, NGO and private sector communities. The donor community's involvement is increasing in the forestry sector and subsequently the trade in forest products in Indonesia. With the increase awareness in the vanishing Indonesian rainforests and the impact illegal logging is having the donor community is now increasing funding and the number of projects in this sector. Thus it is important for SENADA to maintain contact.

In addition the environmental and conservation NGOs have been key partners for many donors in developing analyses of key commercial forestry issues and contributing to ongoing dialogue processes (e.g., Forest Watch Indonesia, TNC, and WWF Indonesia). Several NGOs have developed constructive partnerships with the Department of Forestry on critical governance issues (e.g.

Indonesian Corruption Watch and Greenomics). This is therefore an important sector for SENADA to become involved and foster meaningful partnerships to help promote its work. Finally it will be important that SENADA maintains a close working relationship with any chosen certifying bodies. This will ensure that the SENADA team is aware of the body's requirements for assessment and to ensure that all SENADA clients will reach the required standard.

2.1.4. MARKET LINKS

The purpose of the SENADA project is to help improve competitiveness. Thus the issue of market links is strategically very important. Through this program SENADA's clients will be able to maintain current and gain access to new markets. It will be important to work with other donor lead projects such as the IFC's PENSA program on the promotion of the programs clients. And for access to new markets in the EU the European timber trade associations will be an important resource.

2.1.5. CONDUCT ADVOCACY WORK

It will be extremely important for the program to demonstrate its success to the broader sector. The role of the advocacy program will also serve to help create and maintain market links and promote the issue of responsible purchasing. The advocacy work should be done through focused workshops and promotional adverts. The workshops should ideally be done in partnership with identified partner organizations to help promote the need for responsible procurement.

3. POTENTIAL PARTNER ORGANIZATION ASSESSMENT (STRENGTHS AND WEAKNESSES)

3.1. RAINFOREST ALLIANCE'S SMARTWOOD PROGRAM (CERTIFYING BODY)

The Rainforest Alliance's certification program, SmartWood, was founded in 1989 to certify responsible forestry practices and now focuses on providing a variety of certification tools. To improve certification's effectiveness as a tool for biodiversity conservation and economic support for local communities, the Rainforest Alliance also established the Training, Research, Extension, Education and Systems program. SmartWood works to strengthen supply chains and build market linkages for certified wood and forest products, by helping companies incorporate sustainability into their sourcing strategies. SENADA could work with SmartWood to provide reputable third party legal verification of SENADA clients.

Strengths	Weaknesses
<ol style="list-style-type: none"> 1. Internationally recognized 2. Reputable standards and accredited by FSC 3. Have established their own Legal Verification program that is accepted by the market. 4. They have experience in Indonesia in certification 5. Forest certification is their only focus 6. Have very good in country personnel capacity 	<ol style="list-style-type: none"> 1. Not able to supply market links 2. They can not offer consultation to individual SENADA clients. 3. They have the reputation of being slow with feedback and report writing.

3.2. SGS (CERTIFYING BODY)

SGS is one of the leading forest certification programs with more than 2000 chain of custody and more than 200 forest management certificates covering over 20 million hectares of forest world-wide. SENADA could work with SGS to provide reputable third party legal verification of SENADA clients.

Strengths	Weaknesses
<ol style="list-style-type: none"> 1. Internationally recognized 2. Reputable standards and accredited by FSC 3. Have established their own Legal Verification program that is accepted by the market. 4. They have good experience in Indonesia in certification 	<ol style="list-style-type: none"> 1. Not able to supply market links 2. The forest certification program is not their only focus 3. They are not based in Indonesia 4. They can not offer consultation to individual SENADA clients

3.3. TROPICAL FOREST TRUST

Established in 1999, the TFT aims to conserve threatened tropical forests through sustainable management. TFT aims to ensure that tropical forests are managed for their long-term future and to maximize their value to people, wildlife and the environment. TFT supports forest projects with advice, and by linking them to responsible buyers committed to sourcing sustainable timber.

TFT member companies are committed to sourcing wood from TFT forest projects and Forest Stewardship Council (FSC) certified forests. The organization is funded mainly through member contributions, but also through grants and donations. SENADA can work with TFT to provide certification support and market linkages for SENADA clients.

Strengths	Weaknesses
<ol style="list-style-type: none"> 1. Internationally recognized 2. Have established their own Legal Verification program that is accepted by the market. 3. They have good experience in Indonesia. 4. They have good in country personnel capacity 5. They can offer training 	<ol style="list-style-type: none"> 1. Not accredited by the FSC 2. The market linkages they can offer or locked in and determined by TFT clients in Europe 3. The suppliers in Indonesia would not have freedom to trade outside the TFT framework.

3.4. TROPICAL FOREST FOUNDATION

The Tropical Forest Foundation is a non-profit, educational institution dedicated to the conservation of tropical forests through sustainable forestry. TFF has become widely recognized for establishing demonstration models and training schools to show the advantages and teach the principles of sustainable forest management/Reduced-impact Logging. In Indonesia now they are seeing an increase in interest in the sourcing of sustainable timber from Europe. And as such they have no begun a program to help support responsible purchasing. SENADA can work with TFF to provide certification support, third party certification and market linkages for SENADA clients.

Strengths	Weaknesses
<ol style="list-style-type: none"> 1. Internationally recognized 2. Have established their own Legal Verification program that is accepted by the market. 3. They have experience in Indonesia in certification 4. They are able to help in the creation of limited market links 5. They have good in country personnel capacity 6. They can offer training 	<ol style="list-style-type: none"> 1. The forest certification program is not their only focus 2. Their standard although recognized international it is not as well received as the CBs standard

3.5. TUV

TÜV Rheinland Indonesia is member of TÜV Rheinland Group, a global leader in independent testing and assessment services. In Indonesia TÜV offers (a) Forest Certification (Natural Production Forest, Timber Plantation, Community Based Forest Management) against LEI standards 5000-1, 5000-2 and 5000-3; (b) Chain of Custody; and (c) Timber Legality Verification and Timber Tracking (Verification of Legal Origin) SENADA can work with TÜV to provide certification support and third party certification for SENADA clients.

Strengths	Weaknesses
<ol style="list-style-type: none"> 1. Internationally recognized 2. They have good experience in Indonesia in certification 3. They have good in country personnel capacity 4. They can offer training 	<ol style="list-style-type: none"> 1. They will only verify against other organizations VLO standards. 2. It is unsure how much market recognition TÜV VLO will have in the market place. 3. They can not offer market links.

3.6. WWF – GLOBAL FOREST & TRADE NETWORK (GFTN)

The Global Forest & Trade Network (GFTN) is WWF's initiative to eliminate illegal logging and improve the management of valuable and threatened forests. By facilitating trade links between companies committed to achieving and supporting responsible forestry, the GFTN creates market conditions that help conserve the world's forests while providing economic and social benefits for the businesses and people that depend on them. SENADA can work with GFTN provide certification support and market linkages for SENADA clients.

Strengths	Weaknesses
<ol style="list-style-type: none"> 1. WWF is obviously recognized and accepted throughout the world. 2. The GFTN program offers opportunity for market links 	<ol style="list-style-type: none"> 1. There is little follow up in regard to individual client support. 2. The actual global capacity to create market links is questionable 3. The focus of the program is FSC certification and not legality.

3.7. PENSA (DONOR)

The Program for Eastern Indonesia Small and Medium Enterprise Assistance – PENSA – was created in September 2003 with the task of improving lives and livelihoods by expanding the range of opportunities and capabilities for small and medium businesses. The program concentrates on six key areas where local comparative advantage can be converted into international competitive advantage:

- Handicraft export promotion
- Sustainable supply chain linkages
- Agribusiness linkages
- Small and medium enterprise linkages to oil, gas and mining companies
- Access to finance for small and medium enterprises
- Business enabling environment

The most relevant to SENADA's support of wooden furniture is the supply chain linkages program. The program creates business opportunities in three sectors – forestry/furniture, tourism and fisheries – by improving environmental management and encouraging sustainability. In particular, the program aims to develop the supply of, and market for, responsibly sourced forest products and improve market access for furniture made with "good wood". SENADA can work with PENSA to form a partnership for the promotion of the programs and goals.

Strengths	Weaknesses
<ol style="list-style-type: none"> 1. They have good experience in Indonesia in certification 2. They are able to help in the creation of limited market links 3. They have good in country personnel capacity 4. They can offer training 	<ol style="list-style-type: none"> 1. They are focusing on forest certification and the promotion of FSC and not legality. 2. The programs focus is on Acacia from Kalimantan not teak from Java.

3.8. INDONESIAN (NATURAL) RESOURCES INSTITUTE (INDRI)

Indonesian (Natural) Resources Institute is an organization that has been created by individuals that work in the field of certification and forest management. The organization is a loose affiliation of part time individuals that have created INDRI as a vehicle to offer support to the market. SENADA can work with INDRI to offer training and consultancy support to SENADA's clients.

Strengths	Weaknesses
<ol style="list-style-type: none"> 1. They are an Indonesian organization 2. They have good experience in Indonesia in certification 3. They can offer training. 	<ol style="list-style-type: none"> 1. There are no full time employees 2. They are not internationally recognized thus will assess against the standard of a certify body 3. They can not issue any certificates of legal origin. 4. They can not offer market linkage support.

3.9. GLOBAL FOREST SERVICES

GFS is a consulting company that was established to provide market oriented solutions to improving forest management and the sustainability of forest-based industries. GFS aims to provide solutions to assist in the demonstration that products are responsibly sourced and traceable back to origin by giving clients clear guidance on how to address the needs of the supply chain from the forest stump to the shop floor. SENADA can work with GFS to offer training and consultancy support to SENADA's clients.

Strengths	Weaknesses
<ol style="list-style-type: none"> 1. They have good experience in Indonesia in certification 2. They are able to help in the creation of limited market links 3. They have good in country personnel capacity 4. They can offer training 	<ol style="list-style-type: none"> 1. They are not internationally recognized thus will assess against the standard of a certify body 2. They can not issue any certificates of legal origin.

3.10. C8-GLOBAL

C8-global is similar to GFS it is a consulting company that was established to provide market oriented solutions to improving forest management and the sustainability of forest-based industries. GFS aims to provide solutions to assist in the demonstration that products are responsibly sourced and traceable back to origin by giving clients clear guidance on how to address the needs of the supply chain from the forest stump to the shop floor. SENADA can work with C8-Global to offer training and consultancy support to SENADA's clients.

Strengths	Weaknesses
<ol style="list-style-type: none"> 1. They have good experience in Indonesia in certification 2. They have good in country personnel capacity 3. They can offer training 	<ol style="list-style-type: none"> 1. They are not internationally recognized thus will assess against the standard of a certify body 2. They can not issue any certificates of legal origin. 3. They have no ability to offer help with market linkages.

4. PROGRAM IMPLEMENTATION PLAN

SENADA has a great opportunity to provide meaningful and needed assistance to the Indonesian wooden furniture industry. There is every reason to believe that a knowledgeable and professional approach can greatly increase the competitiveness of the industry, provide substantial opportunities for individual companies, increase the quantity and quality of industry employment, and be a beneficial use of the USAID funds.

The international trade in forest products is in the process of a shift to a more responsible purchasing approach. The Indonesian furniture sector only accounts for approximately 6% of the global market. Therefore to increase this percentage the sector must now be able to meet the increase responsible procurement demands of the market. The following is an outline of the actions required to ensure that SENADA's clients are well placed to meet future requirements for proof of legal origin from European and US buyers.

3.11. ACTION PLAN

3.11.1. ENGAGE CONSULTING COMPANY

There is a need to use consulting companies to ensure that the furniture manufacturers can meet the standard to attain legal verification of origin. The in house capacity of SENADA is not compatible with all the requirements of VLO and thus a reputable consulting company is required. There have been three potential candidates namely INDRI, Global Forest Services, and C8-Global. The strengths and weakness have been reviewed in Chapter III. The SENADA team decided that INDRI would be contracted to assist the SENADA clients.

3.11.2. WORK WITH CONSULTING COMPANY TO GET FIRST CLIENTS VERIFIED

The initial planning phase of the SENADA wood furniture program identified clients in need of obtaining VLO almost immediately. All of these companies had already been asked by their clients for VLO. These companies were stratified into complicated and less complicated supply chains. The less complicated supply chains will be targeted first for support and the more complicated at a later date. The initial clients chosen are: PT Wisanka, PT Acacia, CV Mekar Jati and PT Hartco. These clients now need to have intensive support to attain VLO by end of September 2007. INDRI has already been contracted to complete this work and an in depth work schedule supplied. SENADA must now ensure that this work schedule is followed and that the clients are given the right level of support. The level of support must include the verification of supplying traders and original forest management unit and not just internal company administration.

3.11.3. CONSTANTLY REVIEW THE COMPETENCY AND QUALITY OF CONSULTING COMPANY

The success of this program largely rests on the competency of the consulting company. At the time of writing INDRI was the contracted consulting company. The work of INDRI and any other consulting company should be regularly assessed to ensure SENADA clients are receiving adequate support.

3.11.4. REVIEW AND EVALUATE THE CHOSEN CERTIFICATION BODY

The SENADA team must keep in mind that there are many certifying bodies and other organizations that can supply market reputable VLO. At the time of writing the chosen certification body for this project was SmartWood. This needs to be constantly reviewed and the professionalism and speed of

feedback considered. The chosen certification body needs to not only conduct assessments it must also supply timely and competent feedback to all its clients. If this is not done then the SENADA team should consider changing certification body for the remainder of the program.

3.11.5. SELECT FURTHER CLIENTS FOR ASSISTANCE AND CONTACT CONSULTING COMPANY

The SENADA project currently has eighteen clients. The initial phase of the project was to get four VLO certified in September. Assuming that this is completed then the SENADA team needs to stratify the remaining fourteen clients again into complicated and not so complicated supply chains. At all times the SENADA team must consider the source of raw material over the internal administration within the manufacturing sites.

3.11.6. FACILITATE MARKET LINKAGES FOR SENADA CLIENTS

During the process of supporting client manufacturers attaining VLO the SENADA team also need to start working in partnership with other donor agencies and the private sector to create market links. An example of a donor agency that will add value is the IFC's PENSA program. The PENSA program's work complements the work of this program well and there is a lot of synergy there that will prove useful for the creation of market links. In addition SENADA should start a dialogue with the Timber Trade Federations in individual countries in Europe. These federations are supporting the creation of responsible public and private procurement policies and thus again would be a good partner for creating market links.

3.11.7. CONDUCT PUBLIC AWARENESS CAMPAIGN

There is a need to conduct advocacy work. The initial clients identified by SENADA have been on the whole already aware of the upcoming changes. However there are still many manufacturers in Indonesia unaware of the changing procurement policies and legislation being written in Europe. These changes need to be explained through various public awareness campaigns.

3.12. IMPLEMENTATION PLAN SCHEDULE

Action	2007				
	Aug	Sept	Oct	Nov	Dec
Engage Consulting Company					
Intro Consulting Co to Consultant					
Consultant works with all clients for 1st tranche support					
Dry run assessments for all clients - Senada/consulting					
SmartWood Assessments					
SENADA review of consulting company					
SENADA review of CB company					
Select client for 2nd tranche of support					
Engage Consulting Company for 2nd tranche					
Consultant works with all clients for 2nd tranche support					
Certification body conducts assessments					

Action	2008											
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Certification Body conducts Assessment												
Engage Consulting Company for 3rd tranche												
Facilitation of Market linkages												
Public awareness campaign												
Consulting company works with all clients for 3rd tranche												
Certification Body conducts Assessment												

Action	2009								
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
Facilitation of Market linkages									
Public awareness campaign									

4. IMPLEMENTATION ACTIVITIES

The following sections will outline the activities undertaken in the period of this mission to design SENADA's program for improvement of the Indonesian wood furniture penetration of the green markets through implementation of Verification of Legal Origin. The mission design stage lasted from May to July and activities undertaken included:

- Initial team meetings and training on legality and certification in the forest sector
- Introductory advocacy workshops
- Potential partner meetings
- Individual clients gap analysis assessments and action plan creation
- Documentation and resources created

The above activities were undertaken to introduce the concept to the SENADA team, introduce the idea to potential clients in the field and then identify potential partners for SENADA. During this process it became apparent that a number of clients were already being asked for legal verification from their EU clients. Thus it was possible during the design stage to conduct gap analysis assessments and create action plans for these manufactures.

4.1. INITIAL TEAM MEETING AND TRAINING ON LEGALITY AND CERTIFICATION IN THE FOREST SECTOR

The concept of forest certification and subsequent chain of custody certification for the tracking of raw material and products has now been in the market place since the early 1990s. However due to the difficulty of actually certifying forests, especially in the tropics, there has been a need to create an intermediate step to assure legal supply of timber to the market. It is in this developing process that the SENADA program is positioned. The SENADA team although having good experience in manufacturing and markets had little knowledge of the forest industry and the certification and legality process and nuances. It was thus important to train the team in the development of forest certification and legality.

Initially a team meeting in May was held in this meeting the issue of certification was explained and how verification of legal origin sits within this framework and why. In addition this initial training session it was important to work with the team and team members all through the project design process. Many small individual training sessions were held to consolidate what had initially been explained and answer team members' questions as they worked through the process of legality verification.

4.2. SENADA INTRODUCTORY ADVOCACY WORKSHOPS

In the beginning of the process four advocacy workshops were held in Jepara, Semarang, Surabaya and Pasuruan. And then in July in a second phase of advocacy workshops were held in Malang, Solo, Klaten and Jogja. These workshops were held to introduce the SENADA's legality verification program to furniture manufacturers in the region, local government departments, local trade federations such as ASMINDO and the general public.

All four of these workshops were well attended with approximately 10 to 15 potential new clients for SENADA in each. The interest in this program was great with most of the participants asking to join the program. A SENADA application form was created to help evaluate potential clients which were handed out during these meetings. The response was such that it was possible for the SENADA team to evaluate all applicants and choose the best which totaled 18 clients for the program.

It was possible from these 18 new clients to identify four clients that had the potential to attain, and the need for legal verification immediately. It was explained to the team by these clients that their customers in Europe and primarily from UK were already asking for legal verification of product.

4.3. POTENTIAL PARTNER MEETINGS

The work of the SENADA program will depend on partners. The program is going to need a range of partners from consulting companies to help with training clients, to the actual third party certifying body. In addition SENADA will find the need to partner with other donor organizations working in this area to help with market linkages and advocacy.

Throughout the design stage potential partners were met with. Chapter III is a list of those that were met and the strengths and weakness of each compared to what they can offer the program. It was decided that for the third party assessment of VLO that SmartWood is the best choice for partner. This decision was based on the fact that they have the best international reputation and thus their certificate will be accepted by the market place. They have the most experience in Indonesia in certification and they are the most professional in regard to procedures, assessments and audits.

The firm chosen to help the program's clients implement a robust chain of custody system was INDRI. The decision was made because INDRI is a local Indonesian company and thus viewed as the best option by the SENADA team. As for other partners such as donors this is still to be decided however it is perceived that PENSA will be the logical choice to help with marketing and public awareness programs and as such should be approached at such time SENADA is in a position to move on this.

4.4. INDIVIDUAL CLIENTS GAP ANALYSIS ASSESSMENTS AND ACTION PLAN CREATION

The SENADA project through the initial advocacy workshops selected a total of 18 clients to take through the VLO procedure. It was then decided to stratify these 18 into complicate supply chains and easy supply chains. Through this stratification a list of four companies was create; two companies in the Semarang area was identified, one in Solo and one in Surabaya. The four companies identified will be worked with closely to allow them to attain a VLO certificate as soon as possible. The timeframe for this is the end of September 2007. To speed up this process a full a pre-assessment gap analysis was conducted on all four companies. An action plan was then drawn up from the gaps identified in the pre-assessment and then presented to the clients.

The SENADA team has followed up on these action plans on a weekly basis to ascertain compliance and progress. During these visits it was possible to conduct training for the clients on chain of custody procedures and supply them with generic procedural documents. The two biggest issues for all clients was the need to ensure that all deliveries to their factories were accompanied with full transportation documents. The second was the need to be able to track back from the point of sale of finished product to the actual forest management block the timber was harvested. The generic procedural package will help the companies to fine tune their current chain of custody systems to the requirements of VLO and allow them to track back from point of sale of product to the actual raw material used.

4.5. RESOURCE INFORMATION AND MATERIAL

Throughout the mission design period resource information and material was made available to the SENADA team. The resources material was created to enable the SENADA team to work with their clients and understand the processes involved and ensure that the clients chosen have the potential to achieve VLO. The material created is as follows:

- **Client Application Form.** This form was issued to potential clients so that they could give SENADA the relevant information needed to evaluate the clients potential for attaining VLO.
- **Client Evaluation Framework.** The evaluation form was created to be used in conjunction with the application form. The evaluation form is a framework to be used to asses the applicant. The resulting scoring will tell the SENADA team whether the applicant company is a viable applicant for the program.
- **VLO Pre-assessment report template and checklist.** The VLO pre-assessment report template has been created from the SmartWood standard for VLO and SmartWood's checklist requirements. This template has been created to be used as a gap analysis and action plan development tool.
- **Chain of Custody procedural framework.** The chain of custody procedural framework has been created to be used as a resource for the client to use a guide to create a robust chain of custody system that will adhere to the requirements of third party verification

5. CONCLUSIONS AND RECOMMENDATIONS

5.1. CONCLUSIONS

SENADA has a great opportunity to provide meaningful and needed assistance to the Indonesian wood furniture industry by supporting the sector to improve its procurement of raw material through verification of legal origin. There is every reason to believe that a knowledgeable and professional approach can greatly increase the competitiveness of the industry, provide substantial opportunities for individual companies, increase the quantity and quality of industry employment, and be a beneficial use of the USAID funds.

A responsible purchasing program for forest products should aim to improve the environmental and social performance of the supply base by ending the purchase of products that contain timber from illegal or controversial sources and by continuously increasing the proportion of forest products purchased that contain timber from credibly certified forests. To achieve this transition, from whatever starting point, SENADA has developed a program of activities that will seek to assist the Indonesian wood furniture sector to maintain and develop international market share.

This shall be done by pursuing the practice of responsible timber procurement and thus ensuring that all supplies of raw material are verified as legal at the point of origin. SENADA will then disseminate successes to the rest of the sector as part of a broader advocacy campaign on the importance of responsible procurement and verification of such through third party verification.

5.2. RECOMMENDATIONS

- 1. SENADA should be extremely careful when choosing clients.** Those that are only sourcing from within Java should be chosen. Manufacturing companies that are sourcing hard wood from other islands in Indonesia will find it extremely difficult to prove that the origin of the raw material is legal. A major issue for this program to be considered is the complexity of supply chains. The supply chains in Java although complex will only originate from a few major plantation sources and thus the risk to SENADA is reduced. Once manufactures begin to purchase raw material from Kalimantan and Papua then the risk of illegal timber getting into the supply chain increases exponentially.
- 2. SENADA needs to be extremely careful with the selection of consulting companies.** The support of clients is an extremely important facet of the program. It takes a lot of time and effort to transform a chain of custody system that is functioning in a business sense to one that can meet the requirements of a third party assessment set against an international environmental procurement standard. The best and quickest way for SENADA to achieve this transition is to use competent and experienced consultants. These firms will be able to supply the continuous support required to ensure a company is able to adapt their procedures to meet international environmental standards.
- 3. External promotional efforts and market linkages.** SENADA should further develop a plan for assisting the industry in increasing its export promotion process. SENADA has made a good start by working with the Swiss Import Promotion Program (SIPPO). This should now be built upon and efforts should encompass creating further partnerships with European trade federations for furniture and timber. Furthermore, the development of a promotional and informational web site, combined with participation in the myriad of international trade shows

will prove useful to SENADA's clients. And finally press releases and articles should be posted in the major trade related journals.

4. **Social Accountability Issues.** SENADA should develop the capability to acquaint Indonesian companies with worldwide social accountability standards (SA8000, WRAP) and to use these in a positive and proactive manner for marketing purposes.
5. **Build a cross-project approach.** The international focus is now building on Indonesia and how it manages its forests. SENADA should build relationships with the many donor agency projects involved in forestry to gain an understanding of their work and develop areas of cooperation.

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APPENDIX

A. LIST OF COMPANIES AND PARTNERS VISITED

Potential Partners

C8-Global Pty Ltd.	<i>Address Unknown</i> Tel: +62-813-258-777-13 (Indonesia) Tel: +84-908-721-636 (Vietnam) Email: dejan@c8-global.com
GFS	Global Forestry Services Sdn Bhd, 9B Jl. Setiapuspa Medan Damansara, 50490 Kuala Lumpur, Malaysia Tel: +603-2093-5007, Fax: +603-2093-2007, HP: +601-2376-0608 www.gfsinc.biz
INDRI	Jl. Gereja No. 4 Paledang Bogor 16122, Indonesia Tel: +62-251-387-385 www.indri-indonesia.org
PENSA	Jl. Raya By Pass Ngurah Rai No. 108X Pedungan, Denpasar Bali 80223, Indonesia Tel: +62-361-72-5599, or +62-8111-92511, or +62-361-724-220 www.ifc.org/pensa
SGS	Cilandak Commercial Estate No.108C Jl. Raya Cilandak KKO Jakarta 12560, Indonesia Tel: +62-21-781-8111, Fax: +62-21-781-8222 www.sgs.com
SmartWood	SmartWood Program, Rainforest Alliance Jl. Ciung Wanara No. 1X Ronon, Denpasar Bali 80225, Indonesia Tel: +62-361-224-356, Fax: +62-361-235-875 www.rainforest-alliance.org
TFF	Manggala Wanabakti Bld IV, 9th Floor, Wing B Jl. Jend. Gatat Subroto, Senayan Jakarta 10270, Indonesia Tel: +62-21-573-5589, Fax: +62-21-5790-2925
TFT	Graha Perentis Kemerdekaan 77 Semarang, Indonesia Tel: +62-24-746-3401, Fax: +62-24-746-3406
WWF	Kantor Taman A9, Unit A-1, Jl. Mega Kuningan Lot B 8-9/A9 Kawasan Mega Kuningan Jakarta 12950, Indonesia Tel: +62-21-576-1070, Fax: +62-21-576-1080 www.wwf.or.id

Surabaya Area Companies

PT Acaccia

PT Anggun

PT Katwara

PT Kernel

PT Kurnia

PT Mahkota

PT Mitra Mandiri

PT Nathania

Semarang and Solo Area Companies

PT Dhana Dito

PT Artanis

PT Hartco

CV Mekar Jaya.

PT Mirota

PT Nathania

PT Putra

Bengawan

PT Roda Jati

PT Wisanka

PT Surya Gumilar

PT Sylva

PT Tradesa

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