

FLEGT licensing: lessons from Indonesia's experience

Executive summary

This brief builds on Indonesia's experiences to draw lessons on the implementation of the Forest Law Enforcement, Governance and Trade (FLEGT) licensing system, with a focus on system design, implementation, capacity and communications.

1. A FLEGT licence is a document issued by a licencing authority in countries that have ratified a FLEGT Voluntary Partnership Agreement (VPA) with the European Union (EU) and have an operational FLEGT licencing scheme. A FLEGT licence confirms that a shipment of timber or timber products has been legally produced, in accordance with the applicable laws and regulations of the partner country.
2. Indonesia was the first country in the world to start issuing FLEGT licences. As of July 2019, according to the Government of Indonesia, a total of 104 719 FLEGT licences, worth USD 2.87 billion in value, have been issued.
3. Findings from the first joint periodic evaluation¹ confirmed that Indonesia's FLEGT-licensing system has overall performed satisfactorily.
4. The FLEGT Competent Authorities (CAs) of European Member States have experienced some challenges with FLEGT licences on a number of issues. The most commonly reported issues were mismatches between the Harmonized System (HS) codes contained in the FLEGT licence and the HS codes contained in the EU customs declaration, as well as mismatches between information contained in the shipping documents (for example invoice, bill of lading) and the FLEGT licence. These mismatches concerned mostly FLEGT licences issued for small and medium enterprises.
5. Indonesia acknowledges these licensing issues and has been working to address them through regulatory adjustments, capacity-building initiatives and communication improvements.
6. Indonesia and the EU are exploring the prospect of implementing electronic licensing. Once operational, electronic licensing will enable real-time data reconciliation and simplify licensing procedures. This will contribute to addressing issues related to paper-based licensing.

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General view of
Sunteak Furniture
Company Jepara,
Indonesia.

Photo: Robertus
Pudyanto, EU FLEGT
Facility

1. Introduction to FLEGT licences

In 2003, the EU adopted the FLEGT Action Plan to address illegal logging and associated trade on the basis of cooperation between producers and consumers, as well as a combination of demand- and supply-side measures. The EU FLEGT Action Plan's demand-side measures include the EU Timber Regulation (EUTR),² which prohibits the placing of illegally-harvested timber and timber products on the EU market and requires that operators exercise due diligence when sourcing timber and timber products. Its supply-side measures include VPAs, legally-binding trade agreements between the EU and timber-exporting countries outside the EU.

A FLEGT licence is a document that confirms that a shipment of timber or timber products has been legally produced, in accordance with the applicable laws and regulations of the partner country. FLEGT-licensed timber and timber products are considered to have been legally harvested for the purposes of the EUTR. As such, operators in the EU do not need to exercise due diligence on imports of timber and timber products covered by valid FLEGT licences.

FLEGT licences can only be issued by countries that have ratified a VPA with the EU and have an operational FLEGT licensing scheme. To issue FLEGT licences, a VPA partner country must implement a Timber Legality Assurance System (TLAS) and other measures specified in the VPA.

A TLAS is built around a definition of legality that has been agreed through a participatory process involving stakeholders from government, the private sector and civil society. This definition includes social, environmental and economic considerations. A TLAS incorporates strong safeguards, such as independent audits –called 'periodic evaluation' in Indonesia- that apply clear rules and procedures to detect system failures.

Independent auditors report to the VPA joint implementation committees set up by the EU and the partner country. In many VPA countries, civil society plays an important role in carrying out independent observation to detect forest law enforcement problems. Such independent observation may be formally integrated into the TLAS or function outside of it but contribute to the VPA's objectives.

FLEGT licensing cannot begin until the EU and the VPA partner country have confirmed, through a joint independent assessment, that the country's TLAS functions as described in the Agreement.

2. Indonesia's FLEGT licensing system

For a FLEGT licence to be issued in Indonesia, all suppliers in the exporter's supply chain that provide raw materials included in the consignment must have been covered by a valid legality certificate (SVLK), a standard and guidelines on assessment of performance in sustainable forest management (SFM) certificate,³ or a supplier's declaration of conformity⁴ (SDoC).

Independent Licensing Authorities (LAs) are authorised by the Ministry of Environment and Forestry (MoEF) to issue FLEGT licences after they have verified the validity of the operator's legality certificate and checked whether the licence data matches production records. If an operator complies with legality and supply chain requirements, the LA issues a FLEGT licence in the format presented in Annex IV of the VPA.



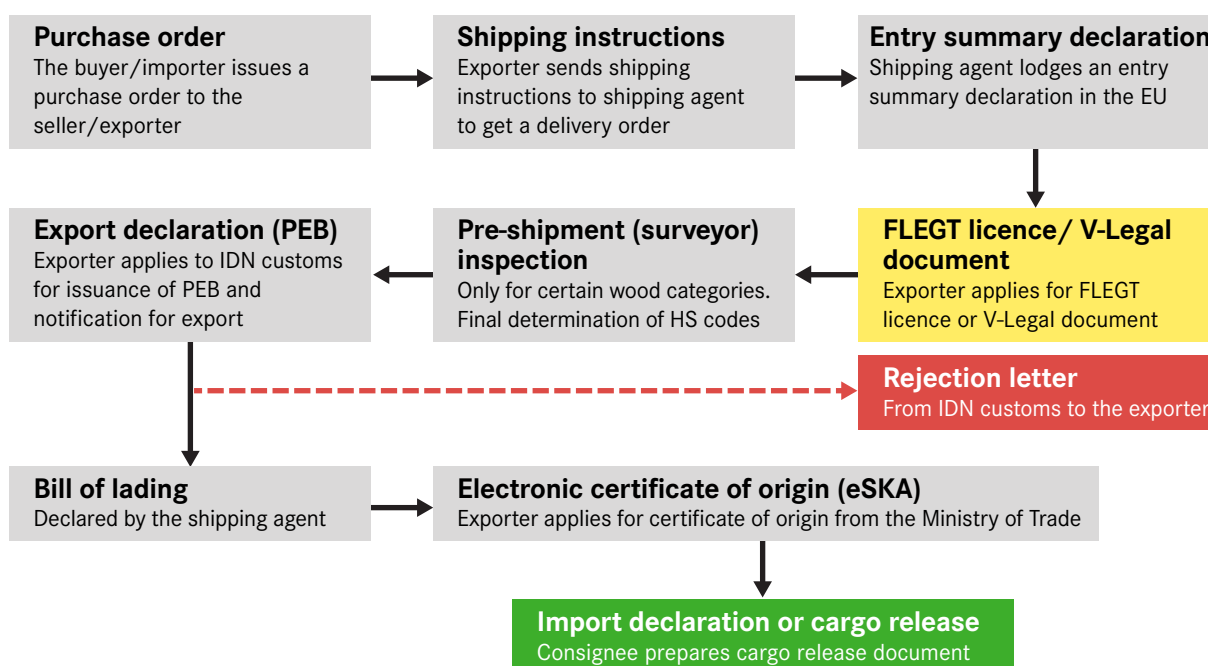
◀ **Maria Murliantini, owner of Sunteak Furniture Company Jepara, Indonesia.**

Photo: Robertus Pudyanto, EU FLEGT Facility

2.1 Steps required to export FLEGT-licensed timber

There are nine critical steps to export FLEGT-licensed products. Seven are the responsibility of the consignor and two are the responsibility of the consignee. The critical timeline in the export process is one week prior and one week after the consignment departs Indonesia. Implementation of these steps has major implications in relation to document mismatches that may occur between the FLEGT licence and other shipping documents. Graph 1 outlines these nine steps.

Graph 1. Process to export FLEGT-licensed timber



As shown in Graph 1, the process to export FLEGT-licensed timber starts with a purchase order from the importer informing the shipper what products to ship, when and how. Before loading the container, the exporter will send a preliminary/draft packing list and invoice for each container to the importer for confirmation. The exporter then sends shipping instructions to a freight forwarding or shipping agent to book a container from a shipping line. If the shipping space is available, the exporter will get a delivery order. Within 24 hours before the container is loaded onto the vessel at the port of embarkation, the carrier or consignee in the EU is required to lodge an import declaration, better known as 'entry summary declaration' with customs in the country of import. Next, the exporter lodges an application for FLEGT licence with the LA, together with the final packing list and commercial invoice. The FLEGT licence can be issued on the same day. For certain woodworking products (HS4407, 4412 and 4418), pre-shipment inspection is conducted on the day of loading by PT Sucofindo, a government-appointed surveyor. The surveyor provides the final determination of HS code for the item(s) inspected. The shipper usually has a FLEGT licence in hand before the inspection by the surveyor takes place. If the surveyor determines a change in HS code, the FLEGT licence is to be cancelled and a new one to be issued.⁵ After the inspection is completed, the exporter applies to Indonesian customs for an export declaration (PEB). The PEB process entails submitting a FLEGT licence and a surveyor's report (if required). When the container is delivered to the port of embarkation and if everything is in order, Indonesian customs will issue an approval notification for export.

Once the container is loaded on-board, the shipping line will issue the original bill of lading. As a legally binding document, the bill of lading must be complete and accurate in stating the content of the cargo, the name of the shipper and consignee. For the exporter, the bill of lading is an instrument to request payment from a consignee for the goods delivered on board of the vessel. The exporter needs the bill of lading in hand to apply for the certificate of origin, which can reduce the import tariff for timber products from Indonesia to the EU by up to 3.5%. For the consignee, once the bill of lading is in hand, it is an instrument to release the cargo (customs clearance) at the port of entry. A week before arrival at the EU port of entry, the consignee will receive an arrival notice from the shipping line. The consignee, or appointed freight forwarder, can begin preparing the 'cargo release' document.

3. Operationalisation of the FELGT-licensing system

On 15 November 2016, Indonesia became the first country in the world to start FLEGT-licensing. As stated in Annex V of the VPA, FLEGT licences are issued at the point at which the consignment is consolidated prior to export. From November 2016 to July 2019, Indonesia reported that a total of 104 719 FLEGT licences, worth USD 2.87 billion in value, were issued for exports to all 28 EU Member States. These licences left Indonesia from 697 points of discharge, involving 1 191 registered exporters.

5th meeting of the JIC on 15th September 2016 announced the date that Indonesia and the EU set to start FLEGT licensing.
Photo: Tom ter Horst, EU FLEGT Facility



Since the start of FLEGT licensing until August 2019, based on findings from the first periodic evaluation,⁶ the system has overall performed satisfactorily. There have been reported cases of issues with FLEGT licences, however these make up of less than 1% of the total number of licences issued. The most commonly reported issues were mismatches between the HS codes contained in the FLEGT licence and the HS codes contained in the EU customs declaration, as well as discrepancies between information contained in the shipping documents (for example, invoice or bill of lading) and the FLEGT licence. Other issues concern mismatching information on species, weight/volume on the licence and invoice. Factors contributing to these mismatches are described below.

3.1 Systematic factors

FLEGT licensing in Indonesia is paper-based. As close to 40 000 licences are issued in Indonesia annually, the amount of paper and the complexity of the paper trail that needs to operate uninterrupted in several directions at once is a challenge. Experience thus far shows that paper-based systems are prone to errors, even if the system itself is well designed. Some of the reported issues include the modification of the PDF files containing the embedded e-signature of the LAs, or not printing on the embossed paper supplied by LAs.⁷ In cases where consignment specifications change and the FLEGT licence needs revision, the process requires the paper licence to be sent back to the relevant LA to be cancelled and a new licence to be issued.

Besides the time factor, there are additional costs involved in licence issuance and printing⁸ that makes exporters, in particular small and medium-sized enterprises (SMEs), reluctant to revise faulty FLEGT licences. This has resulted in situations where consignments departed Indonesia with incorrect shipment descriptions in the FLEGT licences. Also, Indonesia has opted for a decentralised licensing system, where the control and power to issue FLEGT licences is devolved to 25 independent private sector LAs working in different parts of a vast country.

3.2 Operational factors

Operational challenges often involved exporters that are SMEs, in particular small and micro entities working in the furniture sector. During the purchase order phase, SME exporters often shared draft documents late or shared documents without HS codes. With the late or incomplete documents shared by SMEs, importers rely on their understanding of applicable HS coding and file the entry summary declaration accordingly. While importers could address this inconsistency two weeks before the consignment's arrival, entry summary declaration entries are often not revised. There are also differences between EU FLEGT CAs and Indonesia in their interpretation of the essential character of goods that stem from varying level of emphasis on the production process, dimensions or application. For example, the classification of a product as wooden or rattan furniture, and different opinions/interpretation of World Customs Organization rules.

The process for application for the issuance of a FLEGT licence is also a source of difficulties because, particularly among SMEs, there is a tendency to apply for FLEGT licences using draft or pro forma documents before the consignment is consolidated. SMEs resort to pro forma documents because: they handle complex or unorthodox consignments (for example, multiple products with different HS codes); accept new products for which HS coding is not always clear; conduct business with very basic operational means; and need to complete consignments in time for container queues and loading schedules organised by agent shippers. Other key issues encountered during the FLEGT licence application process include incorrect HS code determination, incorrect species identification, or incorrect understanding of the specification of the volume, weight and unit numbers.

3.3 Capacity and communication factors

There is a mismatch between the human and technological capacities of the Licensing Information Unit (LIU) established in the MoEF that oversees the licensing process and the magnitude of tasks it is expected to perform.⁹ As FLEGT licence difficulties emerged and inquiries for clarification from CAs began, the LIU faced challenges with timely and coherent responses. LIU staff did not have a defined communication strategy nor instruments to communicate efficiently. Also, to communicate and clarify these issues with LAs, the LIU often exceeds the 21 calendar days stated in the VPA. The language barrier (all communication is in English) is also a contributing factor on both sides.

4. Addressing licensing issues

Indonesia has taken several steps to address FLEGT licensing issues. Concerning regulatory adjustments, Indonesia issued three circulars¹⁰ to clarify questions on problematic topics such as HS codes, weight, volume, species, error margin allowance, appearance of licences and others. An additional circular letter is being drafted to enable the revision and re-issuance of FLEGT licences after consignments depart Indonesia.

The MoEF also has engaged in intensive dissemination of the licensing requirements among industry and exporter associations, as well as at dedicated meetings with LAs, exporters and customs. The Ministry held dedicated sessions to improve the capacity among the LAs and exporters on HS code determination. This is a critical area for improvement as HS code mismatches account for 80% of the FLEGT licensing-related issues. Indonesia also enhanced LIU's technical and human resource capabilities. It increased its operational budget, improved the quality of communications, and increased engagement with CA counterparts in the EU. For example, the LIU carried out a mission to the Netherlands for direct consultations. The LIU was also pro-active in hosting EU Member States delegations seeking to gain first-hand understanding of licensing issues. Furthermore, Indonesia and the EU are exploring the prospect of implementing electronic licensing. Once operational, electronic licensing will enable real-time data reconciliation and simplify licensing procedures. This will contribute to addressing issues related to paper-based licensing.

5. Lessons learned

Based on Indonesia's experience, the following lessons might be of relevance to other VPA partner countries.

5.1 System design

- **Understanding procedures.** Before designing the FLEGT licensing system, a thorough analysis of the export and customs procedures in the VPA country is recommended. The analysis should cover the entire product scope of the VPA, including procedures for less common cases, such as products made from rattan, bamboo, coconut or recycled sources.¹¹ The assessment should also document challenges of exporters of different sizes (in particular small and medium-sized exporters) to comply with current requirements.
- **Centralised and integrated licensing.** While design of the system should be context-specific, it is suggested that FLEGT licensing should be centralised and integrated into broader export processes managed by customs if the country's complexity and size allows it. This will shorten time needed for licence issuance and facilitate real-time information flow between the LA and customs.

- **Licences in electronic form.** If applicable, FLEGT licences should be issued electronically as this offers greater possibilities for synchronisation between the authorities in the licensing country and authorities and importers in the EU, thereby reducing the possible errors resulting from paper-based licensing.
- **Consignment specifications.** It is crucial to pay attention to issues related to consignment specification (HS codes, weight, volume, species and unit numbers) to ensure that operators and LAs have a clear and consistent understanding of these requirements. Coordination between the exporting country and CAs through a consignment test before FLEGT licensing starts, as well as through a country support desk for private sector actors (in particular SMEs) is deemed useful.
- **Consignment consolidation.** Consignment should be consolidated before FLEGT licences are issued to ensure that the FLEGT licence matches the physical consignment prior to export. The Indonesian case indicates that allowing the issuance of a FLEGT licence before consolidation may be justified if the complexity of the trade is high. However, this increases the risk of data inconsistencies between consignment documents and FLEGT licences.
- **Cancellation, re-issuance, revision and replacement of FLEGT licences.** Partner countries negotiating VPAs should clearly describe the processes for cancellation, re-issuance, revision and replacement of FLEGT licences. Countries with VPAs in force can revise their relevant annexes to include these topics.
- **Other issues** to be considered to prevent potential cases of mismatches include licensing fees (affordability), format (correct template and allocated embossed papers), signature and stamps (missing, inconsistent or incorrect signee), and period of validity.

5.2 Capacity

- **Sufficient capacities.** In the preparatory phase for licensing, VPA countries and supporting partners should ensure that sufficient capacities are developed. This involves ensuring that the LAs have adequate budget, sufficiently trained human resources and appropriate technical tools (such as a licence database). It is important that capacity to provide support to the private sector is in place.
- **Small and medium-sized exporters.** In cases where SMEs play an important role in timber exports, tailored information material on the sequence of steps that must take place in order for a FLEGT-licensed consignment to be shipped should be developed. Indonesia published a simple handbook with drawings that was useful during awareness campaigns and capacity-building activities.

5.3 Communication

- **Communication preparedness.** Effective communication, including English language proficiency, is of crucial importance in operating FLEGT licensing. In Indonesia, communication preparedness was an afterthought. As part of capacity preparedness process, LAs and relevant authorities involved in the VPA country need assistance in developing sub-departments, taskforces, or dedicated officers to manage information and communications.
- **Communications between VPA countries and the EU Member States.** It is important to ensure two-way communications between the VPA countries and the EU Member States to better understand the practices on the exporter and importer side. While the focus is rightfully on the complexities associated with FLEGT licensing and dispatching of consignments in producer countries, it is crucial that importer actions are also monitored, well understood and communicated.

6. Moving forward: electronic licensing prospect

In January 2019, Indonesia and the EU concluded a feasibility assessment and agreed to proceed with the design and piloting of electronic licensing (e-licensing). A transition from paper-based to e-licensing is likely to result in a number of key benefits, such as: reduction in errors, improved control via real-time data reconciliation, improved coordination between Indonesia and CAs in EU Member States, and reduced pressure and workload on both sides. The transition links the Indonesian licence database (SILK) and the EU system for receiving and managing FLEGT licences (FLEGIT) electronically. FLEGIT will serve as a hub to distribute e-licences received from SILK to CAs (for those using FLEGIT and those using their national systems).

The interconnection of SILK with FLEGIT will align the export and import declaration procedures. Currently, exporters have to send a paper copy of the FLEGT licence to importers in the EU for entry summary declaration and import clearance, and importers need to key in the information on the FLEGT licence in FLEGIT. In the future, importers will no longer need to key in licence information in FLEGIT but just claim the e-licences by providing their licence number together with a specific verification code. SILK will generate the verification codes and send them to exporters through secure emails when FLEGT licences are submitted to SILK. That new workflow will ensure that the same documents and information are used for export and import declaration. While electronic linking of SILK and FLEGIT will offer improvements, the onus is still on exporters and LAs to ensure that the correct information is submitted for the issuance of FLEGT licences and that appropriate corrective action (revision, cancellation) is taken, if needed, before and after consignments depart Indonesia. E-licensing will help to further improve a conventional system that has proven to work in a complex and often challenging circumstances.

References

- ¹ Periodic evaluation or independent audit: is a compulsory component of a VPA timber legality assurance system. The purpose of periodic evaluation is to review and report on the timber legality assurance system and check that components of the system function as described in the VPA. Periodic evaluation, therefore, contributes to the credibility of a VPA. Auditors' reports may identify ways for a VPA's joint implementation committee to improve a timber legality assurance system or its implementation.
- ² Link to the EUTR: https://ec.europa.eu/environment/forests/timber_regulation.htm
- ³ The assessment of sustainable forest management using the SFM standard verifies that the operator complies with the relevant legality criteria of the TLAS and with additional SFM criteria. Permit holders operating within production forest zones on state-owned lands (permanent forest domain) must, after a transition period, adhere to the SFM standard. The SFM (PHPL) is a mandatory, national certificate.
- ⁴ The SDoC can be used by (i) private forest owners, (ii) registered timber depots (only timber depots that exclusively receive timber from privately owned forests/lands or receive SVLK certified timber from Perum Perhutani), (iii) household industries/crafts men/artisans, (iv) primary and secondary industries that exclusively process timber from privately owned forests/lands and hold no export permit. The SDoC applies to: (a) timber from privately-owned forests/lands, (b) timber from regenerations of roadsides and graveyards, (c) recycled /demolished timber, and (d) imported timber or timber products.
- ⁵ There are regulatory revisions currently taking place that will move pre-shipment inspections by PT surveyor to customs.
- ⁶ First periodic evaluation of FLEGT VPA: Indonesia and the EU. http://www.euflegt.efi.int/documents/10180/438736/Periodic+evaluation+Indonesia_final.pdf/ce95b6ef-aeae-2ec8-b600-cba756018780 . The second periodic evaluation should be completed by 18 November 2019.
- ⁷ It should be mentioned that due to the large number of harbours and long distances, the LAs allow their clients to print their FLEGT licences after issuance by the respective LA.
- ⁸ LAs in general collect a small licensing fee of Indonesian Rupiah 100 000 to 200 000 (or USD 7 - 14) per licence for verification and licence issuance. This fee is determined on a case-by-case basis.
- ⁹ The LIU is tasked with coordinating in total 24 active LAs, filing copies of about 40 000 licences that are issued annually, operating the online SILK, and interacting with the CAs on the EU side. Furthermore, the LIU manages trade with other markets (V-Legal Documents), worth USD 9 billion annually, while simultaneously overseeing the legality of timber imports into Indonesia.
- ¹⁰ These three circulars were: Circular Letter (SE/PPHH/NEIP/PHPL.3/12/2016) in December 2016; Circular Letter (SE/PPHH/NEIP/PHPL.3/4/2017) in April 2017; and Circular Letter SE/PPHH/NEIP/HPL.3/4/2018 in January 2018.
- ¹¹ If procedures are not covered under the country's TLAS, such sources may have to be excluded from the product scope of the VPA.

About the EU FLEGT Facility

The EU FLEGT Facility supports the implementation of the EU FLEGT Action Plan with a focus on Voluntary Partnership Agreements (VPAs). The EU FLEGT Action Plan sets out a programme of actions that forms the EU's response to the problem of illegal logging and the trade in associated timber products. The Facility is hosted by the European Forest Institute (EFI), and was established in 2007.

Disclaimer

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