

The Hesitant Boom: Indonesia's Oil Palm Sub-Sector in an Era of Economic Crisis and Political Change

Anne Casson
November 1999

Center for International Forestry Research
Office address: Jalan CIFOR, Situ Gede, Sindangbarang, Bogor 16680, Indonesia.
Mailing address: P.O Box 6596, JKPWB, Jakarta 10065, Indonesia.
Tel: +62 (251) 622 622; Fax: +62 (251) 622 100
Email: a.casson@cgiar.org
Website: <http://www.cifor.org/cifor>

Acknowledgments

This report was prepared with assistance from the Center for International Forestry Research (CIFOR). I am grateful for the guidance and support I have received there. I would especially like to thank Dr William Sunderlin who has provided endless academic support and constructive advice. The following people from CIFOR have also offered a great deal of assistance: Grahame Applegate, Chris Barr, Brian Belcher, Emily Boyd, Unna Chokkalingam, Carol Colfer, Rona Dennis, David Edmunds, Carmen Garcia, Wil De Jong, David Kaimowitz, Ken MacDicken, Cynthia McDougall, Michael Spilsbury, and Rachel Wrangham. Outside of CIFOR I have also received a great deal of support and assistance from: Peter Dauvergne, Chip Fey, Peter Kanowski, Togu Manurang, Stephen Midgley, Lesley Potter, Ben Santoso, Martua Sirait and Eric Wakker. Timothy Brown deserves special credit for providing very detailed and constructive comments on a final draft. Finally, I would like to thank all of the people interviewed who have given their time to help me put this paper together. Despite all the assistance I have received from the above people, any errors are my own.

This paper was prepared for the Program on the Underlying Causes of Deforestation, Centre for International Forestry Research (CIFOR), Bogor, Indonesia, under the guidance of Dr William Sunderlin.

Any reproduction should mention the title of the report and credit CIFOR as the publisher. The correct citation for this paper is: Casson, Anne, 1999. *The Hesitant Boom: Indonesia's oil palm sub-sector in an era of economic crisis and political change*, Program on the Underlying Causes of Deforestation, Bogor Indonesia, Centre for International Forestry Research.

The author

Anne Casson is a Doctoral candidate in the Department of Forestry, Australian National University, Australia. She undertook this work while based at CIFOR. This paper constitutes partial fulfillment of her PhD.

Contents

LIST OF TABLES	4
ABBREVIATIONS AND GLOSSARY	5
EXECUTIVE SUMMARY	7
I. INTRODUCTION	8
II. RAPID DEVELOPMENT OF THE OIL PALM SUB-SECTOR UNTIL 1997	10
Prospects for the oil palm sub-sector before the crisis	15
III. THE HESITANT BOOM	18
Reasons behind the slowdown in palm oil area expansion	21
1. The Government's export tax policy	21
2. Reform policies that target the oil palm sub-sector	25
3. Social unrest and withdrawal and withholding of foreign investment	27
4. Changes to the CPO distribution system	28
5. Credit access difficulties	29
6. Changes to the state-owned plantation sector	30
7. ENSO, drought and fires limit CPO production	31
8. A precipitous decline in the world price of CPO	32
9. Increased production costs	33
IV. PROSPECTS FOR RESUMED GROWTH AND THE FATE OF FORESTS	34
Prospects for renewed growth	34
1. Lower interest rates	35
2. Regulatory changes that facilitate further oil palm development	35
3. Debt restructuring opportunities	38
4. Land made available through the El Niño drought and related forest fires	40
5. Growing world demand for crude palm oil	40
6. The government's drastic reduction of the export tax	41
7. Plans to boost the world price for CPO	41
The impact of resumed growth on Indonesia's natural forest cover	42
CONCLUSION	51
RECOMMENDATIONS	53
REFERENCES	56
APPENDIX A—LIST OF PEOPLE CONSULTED	61
APPENDIX B—AREA AND PRODUCTION OF OIL PALM PLANTATIONS BY OWNER TYPE 1967-1997	64
APPENDIX C—MALAYSIAN INVESTMENT IN THE INDONESIAN OIL PALM SECTOR	65
APPENDIX D—THE IMPACT OF THE ECONOMIC CRISIS AND VARIOUS GOVERNMENT POLICIES ON PLANTATION SHARE PRICES (1997-1999)	68
APPENDIX E—POLICY CHANGES AFFECTING DOMESTIC AND INTERNATIONAL CPO AND COOKING OIL PRICES	69
APPENDIX F—SOME INCIDENTS OF VIOLENCE ON OIL PALM ESTATES	70
APPENDIX G—THE GOVERNMENTS NEW SCHEMES FOR OIL PALM DEVELOPMENT	72
APPENDIX H—FOREST LAND CONVERTED TO PLANTATIONS AND CONVERSION FOREST DEFICITS	73

LIST OF TABLES

Table 1—Area and CPO production by province and category in 1997	13
Table 2—Land holdings owned by some Indonesian oil palm conglomerates in 1997	15
Table 3—Comparison of CPO production costs in 1997.....	15
Table 4—Loans taken out by some Indonesian listed oil palm plantation companies prior to the crisis.....	23
Table 5—Changes to the CPO distribution system in 1998 and 1999.....	28

LIST OF FIGURES

Figure 1—Geographical distribution of palm tree plantations 1991-1997	10
Figure 2—Indonesia's share of CPO world production compared to other CPO producers in 1997	11
Figure 3—Indonesia's 1997 palm oil exports by country destination	11
Figure 4—Yearend 1997 global vegetable oil price comparison.....	16
Figure 5—1997 global palm oil consumption by country	16
Figure 6—Net profits of some listed oil palm plantation companies (1994-1999 est)	19
Figure 7—Incremental growth in area planted to oil palm between 1993-1999 est.	20
Figure 8—CPO production growth (1990-1999 est).....	21
Figure 9—Crude palm oil total production, export production and export value, 1990-1998.....	22
Figure 10—The impact of the devaluation of the Brazilian Real on soybean and palm oil prices	33
Figure 11—Actual and projected global demand for CPO up until 2020.....	40
Figure 12—The net export tax price for CPO compared to the Indonesian domestic price for CPO.	41
Figure 13—Forest land converted to plantations according to forest type and province since the 1982 TGHK.....	46
Figure 14—Remaining conversion forest according to the 1982 TGHK as of March 1999.....	47
Figure 15—Remaining conversion forest according to the 1999 RTRWP and conversion forest remaining after outstanding applications are processed.	49
Figure 16—Available degraded land in 1998.	50

ABBREVIATIONS AND GLOSSARY

AMDAL	<i>Analisa Mengenai Dampak Lingkungan</i> , Environmental Impact Assessment
AIMMI	<i>Assosiasi Industri Minyak Makan Indonesia</i> , The Association of Indonesian Cooking Oil Industries
BKPM	<i>Badan Koordinasi Penanaman Modal</i> , Investment Coordinating Board
BKPMD	<i>Badan Koordinasi Penanaman Modal Daerah</i> , Provincial Investment Office
BPN	<i>Badan Pertanahan Nasional</i> , National Land Agency
BULOG	<i>Badan Urusan Logistik</i> , State Logistics Agency
BUMN	<i>Badan Usaha Milik Negara</i> , State-Owned Plantation Firms
CIFOR	Center for International Forestry Research
CPO	Crude Palm Oil
ENSO	El Nino Southern Oscillation
FFB	Fresh Fruit Bunches
GAPKI	<i>Gabungan Pengusaha Kelapa Sawit Indonesia</i> , Association of Indonesian Palm Oil Producers
HGU	<i>Hak Guna Usaha</i> , Land Use Rights
HPH	<i>Hak Pengusahaan Hutan</i> , Forest Use Right
HP	<i>Hutan Produksi</i> , Production Forest
HPK	<i>Hutan Produksi Konversi</i> , Conversion Forest
HPT	<i>Hutan Produksi Terbatas</i> , Limited Production Forest
HT	<i>Hutan Tetap</i> , Forest Land
HTC	<i>Hutan Tanaman Campuran</i> , Mixed Forest Plantings
ICBS	International Contact Business System
IL	<i>Izin Lokasi</i> , Location Permit
IMF	International Monetary Fund
IP	<i>Izin Prinsip</i> , Permit in Principal
IPK	<i>Izin Pemanfaatan Kayu</i> , Timber Use Permit
KPB	<i>Kantor Pemasaran Bersama</i> , State Joint Marketing Office
KDI	<i>Koperasi Distribusi Indonesia</i> , Indonesian Distribution Cooperative
KKPA	<i>Koperasi Kredit Primer Anggota</i> , Prime Cooperative Credit for Members
KKN	<i>Kolusi, Korupsi dan Nepotisme</i> , Corruption, Collusion and Nepotism
KRISMON	<i>Krisis Moneter</i> , Monetary Crisis
LonSum	PT PP London Sumatra Indonesia Tbk
MIT	Ministry of Industry and Trade
PAPL	<i>Penyediaan Area Penggunaan Lain</i> , Forest Land Designated for Other Uses.
PIR/NES	<i>Perkebunan Inti Rakyat</i> , Nucleus Estate and Smallholder Scheme
PIR-Trans	<i>Perkebunan Inti Rakyat Transmigrasi</i> , Nucleus Estate and Smallholder Scheme for Transmigrants
PMA	<i>Penanaman Modal Asing</i> , Foreign Investment Approval
PPKS	<i>Pusat Penelitian Kelapa Sawit</i> , Oil Palm Research Centre
RTRWP	<i>Rencana Tata Ruang Wilayah</i> , Provincial Spatial Plan
SBI	<i>Sertifikat Bank Indonesia</i> , Bank Indonesia Certificate
SFC	State Forest Companies

SME	Small and Medium Enterprises
TGHK	<i>Tata Guna Hutan Kesepakatan</i> , Forest Land Use Consensus
USD	United States Dollars

EXECUTIVE SUMMARY

From 1967 through to 1997, oil palm was one of the fastest growing sub-sectors of the Indonesian economy, increasing 20-fold in planted area and showing 12 percent average annual increases in crude palm oil (CPO) production. While the growth of the oil palm sub-sector has conferred important economic benefits, it has posed an increasing threat to Indonesia's natural forest cover. Local communities have also been displaced by the large scale oil palm plantations and social conflict has resulted.

At the beginning of the economic crisis, there was every expectation that the oil palm boom would not only continue, but would also be propelled by the currency depreciation and lifting of foreign investment constraints. But a slowdown in area expansion and CPO production took hold instead. For 1999, the government estimate that only 177, 197 hectares of oil palm will be planted. While this is a large area increase, it is a 33 percent decline in growth compared to the 266,565 hectares planted in 1997. CPO production also declined for the first time since 1969 and reached only 5 million tonnes in 1998. This was a 7 percent decline in growth from 1997 production which almost reached 5.4 million tonnes.

Among the key reasons for the slowdown are: (1) the government's export tax policy; (2) reform policies that targeted the oil palm sub-sector; (3) social unrest and the consequent withdrawal and withholding of foreign; (4) changes to the CPO distribution system; (5) credit access difficulties; (6) changes to the state-owned plantation sector; (7) the 1997-1998 El Niño Southern Oscillation phenomenon and consequent drought and fires; (8) a precipitous decline in the world price of crude palm oil; and (9) increased production costs.

It now seems the Indonesian oil palm sub-sector is poised for a return to the pace of growth that prevailed prior to the economic crisis. Many companies have already begun to increase their planting targets for 1999 and CPO production is expected to increase by 12 percent to 5.6 million tonnes in 1999. The increase in CPO production is mainly attributed to an increase in rainfall after the 1997/98 El Niño Southern Oscillation phenomenon. However, several factors have, and will continue to, stimulate plantation development. Among these factors are: (1) lower interest rates; (2) regulatory changes that facilitate further oil palm development; (3) debt restructuring opportunities; (4) the availability of land cleared through the El Niño drought and related forest fires; (5) predicted growing global demand for CPO; (6) the government's drastic reduction of the export tax; (7) cooperation between Indonesian and Malaysian oil palm producers to push up the price of oil palm and regain their share of the vegetable oil market.

While the government is committed to emphasizing oil palm development in Eastern Indonesia, particularly in Kalimantan and Irian Jaya, most oil palm expansion can be expected to occur in Sumatra in the near future. Oil palm companies will, however, continue to apply for concession areas in Kalimantan, Irian Jaya and Sulawesi in the near term to gain access to forest land. Unless there are fundamental changes in the way forest land is allocated in Indonesia, further expansion in the oil palm sub-sector will continue to pose a significant threat to Indonesia's forest cover.

I. INTRODUCTION

Oil palm has been one of the most dynamic of Indonesia's agricultural sub-sectors. Dating from the late 1960s, the oil palm sub-sector expanded from around 106,000 hectares to 2.5 million hectares in 1997. This prolific growth has conferred important economic benefits, inasmuch as it has become an important source of foreign exchange and employment. However, it has also become a source of concern, because much of oil palm expansion has happened at the expense of Indonesia's humid tropical forest cover.¹ Oil palm expansion has also been held partly responsible for the 1997-98 forest and land fires that affected more than 5 million hectares in Kalimantan alone.²

During Indonesia's recent period of economic crisis and political change (mid-1997 to mid-1999) the boom period subsided. From early 1998 through to mid-1999, oil palm area expansion slowed significantly. For 1999, the government estimates that only 177, 197 hectares of oil palm will be planted. While this is still a significant increase of oil palm area, it is a 33 percent decline in growth compared to the 266,565 hectares planted in 1997.

In 1998, CPO production declined for the first time since 1969. Total production only reached 5 million tonnes in 1998. This was a 7 percent decline in growth from 1997 production which almost reached 5.4 million tonnes. The decline in CPO production is mainly attributed to the recent El Niño Southern Oscillation phenomenon.

The recent slowdown in oil palm area expansion and CPO production is ironic because in the latter half of 1997, conditions seemed to be optimal not only for continued growth, but even for accelerated growth due to increasing world and domestic demand, and cheap production costs in Indonesia. Just prior to the crisis, the Suharto government had reduced the export tax on CPO products from a progressive tax to 5 percent, promoted the development of oil palm in Eastern Indonesia through the KKPA (Prime Cooperative Credit for Members) scheme and designated large tracts of land for oil palm development. In 1996, the Suharto government pledged to overtake Malaysia as the world's largest oil palm producer by doubling the area for palm oil production to 5.5 million hectares by the year 2000. Half of this was to be allocated to foreign owned private estate companies. Most of these plantations were to be established on the outer islands of Indonesia, primarily Kalimantan, Sumatra, Sulawesi and Irian Jaya. Correspondingly, Indonesian palm oil production was also

¹ For further information on this see: EIA, 1998. *The Politics of Extinction: The orangutan crisis, the destruction of Indonesia's forests*, Environmental Investigation Agency; Potter, L & Lee, J. 1998a. *Oil palm in Indonesia: its role in forest conversion and the fires of 1997/98*, a report for WWF, Indonesia Programme; Potter L & Lee J 1998a, *Tree planting in Indonesia: trends, impacts and directions*, CIFOR Occasional Paper No. 18, CIFOR, Bogor, Indonesia; Wakker Eric, 1998. *Introducing zero-burning techniques in Indonesia's oil palm plantations*: Report prepared for WWF-Indonesia Programme, AIDE Environment, The Netherlands; Wakker Eric, 1998. *Lipsticks from the rainforest: Palm oil, crisis and forest loss in Indonesia: the role of Germany*, WWF; Hakim Basyar, 1999. *Perkebunan Besar Kelapa Sawit: Blunder ketiga kebijakan sektor kehutanan*, Elaw Indonesia and CePas.

² Department of Forestry and Plantations, 1998. *Executive Data and Information on Forestry and Plantations, Planning Bureau*, Department of Forestry and Plantations, V.8.1.C.

expected to increase reaching 7.2 million tonnes in 2000 and 10.6 million tonnes in 2005.³

This paper seeks: (1) to explain factors behind the extraordinary growth of the oil palm sub-sector up until late 1997; (2) to explain the causes of the slowdown in area expansion since the beginning of 1998, and (3) to assess the possibilities for renewed growth in the sector. It then goes on to consider the implications of renewed growth on Indonesia's forest cover. CIFOR has commissioned such a study because oil palm development is viewed as a major cause of forest conversion in Indonesia. Oil palm development has also been linked to an increase in social conflict resulting from allocation of large tracts of land to oil palm companies. This was brought to the fore by a ground breaking study on the trends, impacts and directions of tree planting activities, including oil palm, by Lesley Potter and Justin Lee in 1998.⁴ Further understanding of factors underlying or impeding the growth of the oil palm sub-sector is therefore considered necessary in order to determine the extent to which further growth in the oil palm sub-sector will pose a threat to Indonesia's existing forest cover.

The present study primarily focuses on economic and political change during the period of President Habibie's rule. It has been researched through three approaches. First a review of secondary literature, including scholarly articles, industry literature, and the print media. Second, the research involved semi-structured interviews with industry representatives, non-government organizations and government officials in Indonesian and Malaysia (See Appendix A). Third, field visits were made to North Sumatra, West Kalimantan, Jambi and Riau.

The paper is presented in three subsequent parts. Part II summarizes basic information on the growth of oil palm in Indonesia up until the end of 1997. This provides a context through which to understand the pace and character of oil palm growth, and the conditions and policies encouraging growth. Part III identifies and analyses the conditions leading to a slowdown in area growth during the recent period of economic crisis and political change. The concluding part briefly analyses the prospects for resumed growth and the implications for tropical forest cover in Indonesia.

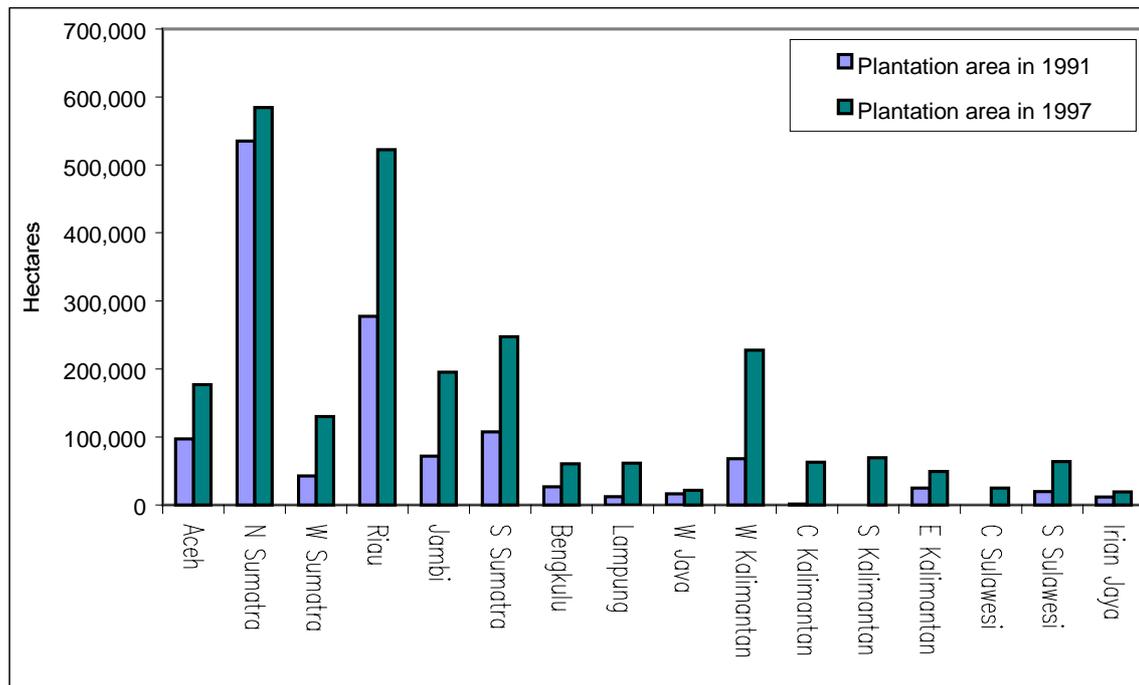
³ Arifin S and W.R Susila, 1998. *Indonesia as a Major Oil Palm Producer: Prospects and Challenges*, Center for Economic Studies, Research and Development, Dept of Agriculture, Bogor.

⁴ Potter Lesley, and Lee Justin, 1998. *Tree Planting in Indonesia: Trends, Impacts and Directions*, Occasional Paper No. 18, Center for International Forestry Research.

II. RAPID DEVELOPMENT OF THE OIL PALM SUB-SECTOR UNTIL 1997

The Indonesian oil palm sub-sector has experienced remarkable growth since the late 1960s. The area of oil palm plantations has increased from 106,000 hectares in 1967 to 2.5 million hectares in 1997, implying an average growth rate of 10.6 percent per annum (See Appendix B). Most of this oil palm plantation area is concentrated in five provinces, namely, North Sumatra, Riau, South Sumatra, West Kalimantan, Jambi and Aceh (See Figure 1). While North Sumatra could be perceived as a traditional area,⁵ the others are areas of new development, having experienced sharp growth in the last decade. For example, Riau and West Kalimantan experienced 12.1 and 25.4 percent average annual area growth rates, respectively, between 1991-1997.

Figure 1—Geographical distribution of palm tree plantations 1991-1997

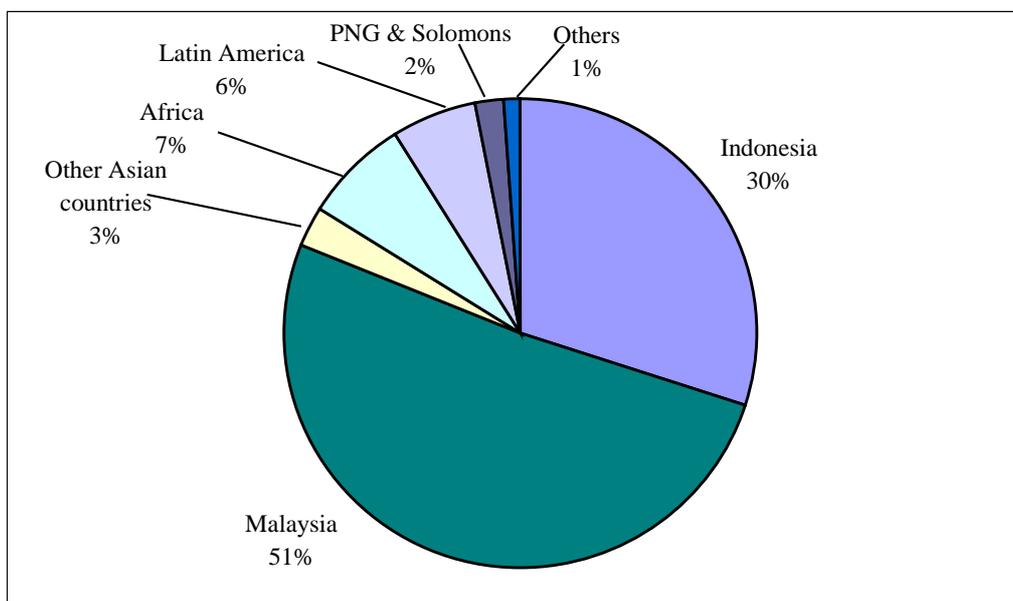


Source: Directorate General of Plantation Estates, 1998.

As the plantation area increased in Indonesia, CPO production has correspondingly increased by around 12 percent per annum, from 167,669 tonnes in 1967 to 5.4 million tonnes in 1997 (see Appendix B). This remarkable growth made Indonesia the world's second largest CPO producer after Malaysia, with a 30 percent contribution to the 1997 global palm oil supply (see Figure 2).

⁵ North Sumatra is viewed as a traditional area for oil palm development because the Dutch initially established estates in this region. Early oil palm plantations were established in North Sumatra because the province has some of the most suitable soil conditions for this crop.

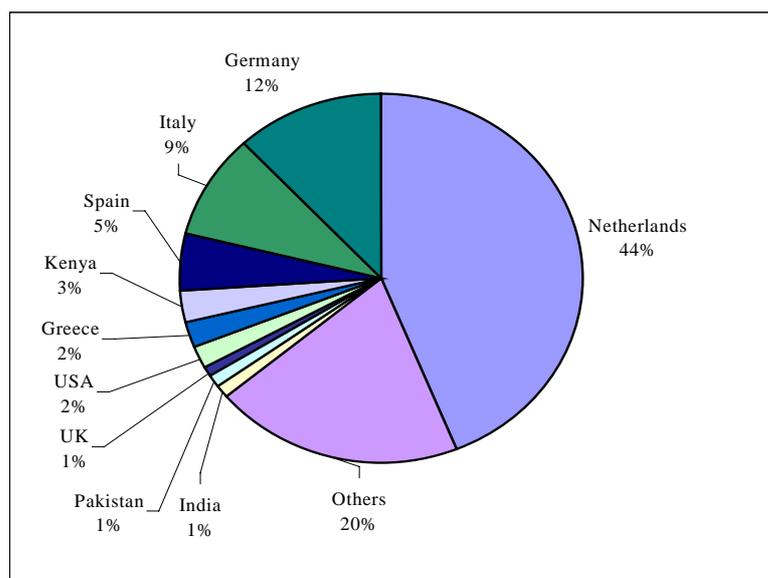
Figure 2—Indonesia’s share of CPO world production compared to other CPO producers in 1997



Source: Directorate General of Plantation Estates, 1998 and Oil World.

The prolific growth of the oil palm sub-sector has conferred important economic benefits. This is because palm oil has become a valuable source of foreign exchange. For instance, in 1997, 2.9 million tonnes of palm oil were exported bringing in earnings valued at 1.4 billion USD.⁶ This was 31 percent of Indonesia’s agricultural exports in 1997, and 3.5 percent of Indonesia’s total non oil and gas exports. The main destinations of the Indonesian exports were Holland, Germany, Italy, Spain and Kenya (See Figure 3).

Figure 3—Indonesia’s 1997 palm oil exports by country destination



Source: Oil World, Directorate General of Plantation Estates, 1998.

⁶ Agriculture Department, Director General of Plantations, 1998. *Indonesian Plantation Statistics, 1997-1999, Oil Palm*, Agriculture Department, Director General of Plantations.

Moreover, crude palm oil is considered to be a strategic commodity because it is the raw material of the main cooking oil consumed in Indonesia. Palm oil industries are also considered to be important because they are labor-intensive and are able to contribute employment opportunities for Indonesia's growing population. For instance, in 1997, Indonesia's oil palm industry employed over 2 million people.⁷

In light of the economic importance of palm oil to the Indonesian economy, the Indonesian government has facilitated the growth of the sector through various schemes. These schemes have led to the emergence of three categories of oil palm estates: state-owned estates, smallholder estates and privately owned estates. Prior to 1990, state-owned estate companies had the largest area of oil palm plantations in Indonesia. Most of the state-owned estates were originally established by the Dutch colonial government between 1870 and 1930. This was made possible by the 1870 Agrarian Law which declared all land not under permanent cultivation to be 'waste land'. Dutch developers were then offered as much land as needed on 75-year renewable leases at nominal rent.⁸

When Indonesia gained independence in 1945, the plantation system partly collapsed as Dutch plantation owners no longer had the backing of the colonial government and labour migration was no longer undertaken with government help.⁹ Also President Sukarno promoted an isolationist policy during the period of Guided Democracy which was antagonistic towards the entry of foreign capital or foreign loans.¹⁰ But the pattern of property ownership remained unaltered and individual plantations continued to be established until all Dutch-owned plantations were nationalized and placed under the control of the New State Plantation Company (*Perusahaan Perkebunan Negara Baru*) in 1957.¹¹ During this time, the sector was impeded by an unrealistic exchange rate regime (notwithstanding widespread smuggling), by the loss of Dutch technical expertise after 1957-58, and by the general political uncertainty which discouraged investment in crops not offering immediate yields. More generally, rural markets were unable to function effectively due to the deteriorating state of infrastructure and a plethora of unrealistic government pricing and output regulations.

State-owned estates next experienced growth from 1968 onwards when the Suharto government (with World Bank assistance) boosted the oil palm industry by making direct investment via state run companies called PTPs (*Perseroan Terbatas Perkebunan*).¹² During this period, the area planted in oil palm on government estates

⁷ Arifin S and Susila W, 1998. *Development and prospect of palm oil industry in Indonesia*, IARD Journal, Vol. 20, No.2, 1998, p1.

⁸ Gordon A, 1982. Indonesia, Plantations and the 'Post-Colonial' Mode of Production, in *Journal of Contemporary Asia*, Vol 12, p179.

⁹ Gordon A, 1982. Indonesia, Plantations and the 'Post-Colonial' Mode of Production, in *Journal of Contemporary Asia*, Vol 12, p181.

¹⁰ Robinson R, 1986. *Indonesia: the rise of capital*, Asian Studies Association of Australia, Canberra, p 73.

¹¹ See Gordon A, 1982. Indonesia, Plantations and the 'Post-Colonial' Mode of Production, in *Journal of Contemporary Asia*, Vol 12 and Sarin S, 1996. The Appeal of Plantation Labour: Economic imperatives and cultural considerations among Javanese workers in North Sumatra, in *Sojourn*, Vol.11, No.1, pp1-23.

¹² Larson D.F. 1996. *Indonesia's Palm oil Subsector*. Policy Research Working Paper No 1654, International Economics Department, Commodity Policy and Analysis Unit, World Bank, Washington, D.C.

grew from 84,640 hectares in 1969 to 176,408 hectares in 1979. Correspondingly, production increased by an average of 9 percent per annum from 128,561 tonnes in 1969 to 438,756 tonnes in 1979 (Appendix B). By early 1997, nine out of fourteen state-owned plantation companies in Indonesia operated oil palm plantations. Most of these plantations were found in Sumatra, primarily North Sumatra. However, the government had begun to expand state-owned plantations into Kalimantan and Irian Jaya in the late 1980s.

Smallholder estates expanded after 1979 through government initiative and with World Bank assistance for the PIR/NES schemes (*Perkebunan Inti Rakyat* or Nucleus Estate and Smallholder Scheme). Under these schemes private developers (known as *Inti* or Nucleus) prepared plots of land for smallholders located nearby. As these plots matured, usually after three to four years, the operations were transferred to the smallholders (known as Plasma), who developed the plantations under the supervision of the Inti developers. Inti developers were then required to purchase the oil palm fresh fruit bunches (FFB, from which the oil is extracted) from the smallholders. Since the PIR/NES scheme was initiated, smallholder plantations have expanded under the PIR-trans program (1986-1994) and the KKPA scheme (1995-1998). Non-existent in 1978, planted area held by smallholders grew to 824,298 hectares in 1997 and production jumped to more than 1.15 million tonnes (See Appendix B). In 1997, most smallholder estates were found in Riau, North Sumatra, Jambi and West Kalimantan (See Table 1).

Table 1—Area and CPO production by province and category in 1997

Province	Smallholders		Government Estate		Private Estate		Total	
	Area (ha)	Production (tonnes)	Area (ha)	Production (Tonnes)	Area (Ha)	Production (Tonnes)	Area (Ha)	Production (Tonnes)
Aceh	39,249	34,799	31,593	70,210	105,704	223,300	176,546	328,309
N Sumatra	99,344	255,614	237,726	1,120,680	247,676	905,119	584,746	2,281,413
W Sumatra	41,599	46,110	3,256	15,509	85,283	156,660	130,138	218,279
Riau	165,861	388,663	56,460	252,126	300,113	545,160	522,434	1,185,949
Jambi	112,749	148,044	8,326	29,028	74,385	78,430	195,460	255,502
S Sumatra	113,680	109,055	27,209	100,680	106,220	143,847	247,109	353,582
Bengkulu	17,380	17,648	4,345	5,100	38,672	56,160	60,397	78,908
Lampung	21,537	4,456	12,996	44,116	26,556	17,300	61,089	65,872
W Java	6,296	13,758	11,071	12,160	4,135	7,450	21,502	33,368
W Kalimantan	125,420	142,651	28,179	99,589	74,113	53,237	227,712	295,477
C Kalimantan	10,641	8,291	0	0	52,595	24,355	63,236	32,646
S Kalimantan	350	0	0	0	68,891	37,198	69,241	37,198
E Kalimantan	22,816	44,241	9,360	15,340	17,043	12,296	49,219	71,877
C Sulawesi	6,047	12,900	2,000	0	16,569	6,839	24,616	19,739
S Sulawesi	19,206	30,427	7,964	20,644	36,214	20,015	63,384	71,086
Irian Jaya	11,000	36,172	8,250	15,070	0	0	19,250	51,242
Total	813,175	1,292,829	448,735	1,800,252	1,254,169	2,287,366	2,516,079	5,380,447

Source: Directorate General of Plantation Estates 1998.

From 1986 onwards, the Indonesian private estate sector experienced rapid growth. By 1996, 1.1 million hectares of oil palm had been planted by the private sector compared to just 144,182 hectares in 1986. This was a 24 percent average annual growth rate compared to a 7.6 percent average annual growth rate between 1969 and 1986. The Indonesian government encouraged greater private sector involvement in the oil palm sector between 1986-1996 by granting access to credit at concessionary rates for estate development, new crop planting and crushing facilities. Newly

established companies could then draw on a loan from an 'executing bank' at a rate of 11 percent during land preparation and establishment of the trees and 14 percent after the trees yielded. In turn, the 'executing bank' was eligible to borrow from the Bank of Indonesia at a concessionary rate of 4 percent. The interest subsidies were intended to help investors overcome risks and uncertainties associated with establishing estates involving smallholders.¹³

In 1997, the Indonesian private estate sector was dominated by eight conglomerates¹⁴ including the Raja Garuda Mas Group¹⁵, the Astra International Group¹⁶, the Sinar Mas Group¹⁷, the SIPEF Group¹⁸, the Socfin Group¹⁹, the Napan Group²⁰, the Bakrie Group²¹ and the Salim Group.²² Before the economic crisis, these eight conglomerates owned land banks²³ totaling approximately 2.1 million hectares. This was just 300,000 hectares less than the total planted area of oil palm plantations in Indonesia. However, only around 821,369 ha of the total land bank acquired by these companies had been planted by the end of 1997 (See Table 2). This is still significant as it means that around 69 percent of the total planted area owned by private companies was owned by just eight conglomerates.

¹³ Larson D.F. 1996. *Indonesia's Palm oil Subsector*. Policy Research Working Paper No 1654, International Economics Department, Commodity Policy and Analysis Unit, World Bank, Washington, D.C.

¹⁴ Four of these conglomerates had their plantation holding companies listed on the Jakarta and Surabaya Stock Exchange: PT Astra Agro Lestari TBK (Astra International Group), PT PP London Sumatra Indonesia Tbk (Napan Group) PT SMART (Sinar Mas Group), and PT Bakrie Sumatra Plantations (Bakrie & Brothers). The Salim Group has a listed company called PT Indofood which has some investments in oil palm plantations and commands a 60% share of the cooking oil industry.

¹⁵ The plantation holding company owned by the Raja Garuda Mas Group is called PT Asian Agri. The Raja Garuda Mas is led by Sukanto Tanoto.

¹⁶ The plantation holding company owned by the Astra International Group is called PT Astra Agro Lestari. Astra Agro Lestari was founded by forestry tycoon and former Minister of Trade, Bob Mohamad Hasan. Bob Hasan is also a close friend of former President Suharto.

¹⁷ The plantation holding company owned by the Sinar Mas Group is called PT Golden Agri Resources. PT Golen Agri Resources was listed on the Singapore Stock Exchange in early 1999. Sinar Mas was founded by chairman Eka Tjipta Widjaja.

¹⁸ The plantation holding company owned by the SIPEF Group is called PT Tolan Tiga Indonesia.

¹⁹ The main plantation holding company owned by the Socfin Group is called PT Socfindo Indonesia.

²⁰ The largest plantation holding company owned by the Napan is called PT Pan London Sumatra Indonesia. Among the shareholders of this company were: Henry Liem, Andry Pribadi, Wilson Pribadi and Ibrahim Risjad.

²¹ The plantation holding company owned by the Bakrie & Brothers Group is called PT Bakrie Sumatera Plantations.

²² The Salim Group was founded by Liem Sioe Liong in the 1940s. The current management of the group is now in the hands of his eldest son Anthony Salim. Liem Sioe Liong is a close friend of former President Suharto.

²³ Area of land agree to be developed in principle by the Governor of a given province.

Table 2—Land holdings owned by some Indonesian oil palm conglomerates in 1997

Holding Company	Group	Total land bank area (Ha)	Total area planted (Ha)
PT Pan London Sumatra Indonesia Tbk	Napan Group	245,629	78,944
PT Bakrie Sumatra Plantations	Bakrie and Brothers	376,041	34,392
PT Golden Agri Resources	Sinar Mas Group	582,208	211,713
PT Astra Agro Lestari Tbk	Astra International	280,000	177,976
PT Asian Agri	Raja Garuda Mas	200,000	110,000
PT Salim Plantations	Salim Group	275,000	125,000
PT Socfindo	Socfin Group	47,777	37,180
PT Tolan Tiga	SIPEF Group	52,869	36,312
Total		1,982,242	821,369

Source: From all of the companies involved.

Prospects for the oil palm sub-sector before the crisis

Prior to the crisis, prospects for the Indonesian oil palm sub-sector looked extremely promising and all three producer groups, particularly the private sector, were expected to rapidly expand for the following reasons. First, the CPO production process in Indonesia was highly efficient due to the relatively high yield obtained from trees²⁴ and the trees' ability to be harvested throughout the year. These factors, combined with low labour costs, an abundance of undeveloped land, and favorable climate and soil conditions particularly in Sumatra, resulted in lower production costs than for other edible oils. Indonesia was, therefore, one of the most cost effective countries in the world for the establishment of oil palm plantations (see Table 3).

Table 3—Comparison of CPO production costs in 1997

US\$ per tonne	Colombia	Cote d'Ivoire	Indonesia	Malaysia	Nigeria	World Average
Establishment	71.2	69.5	64.3	60.7	224.5	72.1
Cultivation	91.2	136.1	72.5	75.7	113.7	79.3
Harvesting/transport	78.9	33.8	40.2	45.1	90.7	47.3
Milling costs	106.1	105.3	82.6	98.3	130.7	96.6
Kernel milling costs	6.9	7.7	7.2	7.6	8.2	7.5
Kernel oil and meal credits	(58.2)	(54.0)	(60.0)	(61.9)	(65.6)	(61.5)
Total	296.1	298.4	206.2	225.5	502.2	241.6

Source: PT Purimas Sasmita.

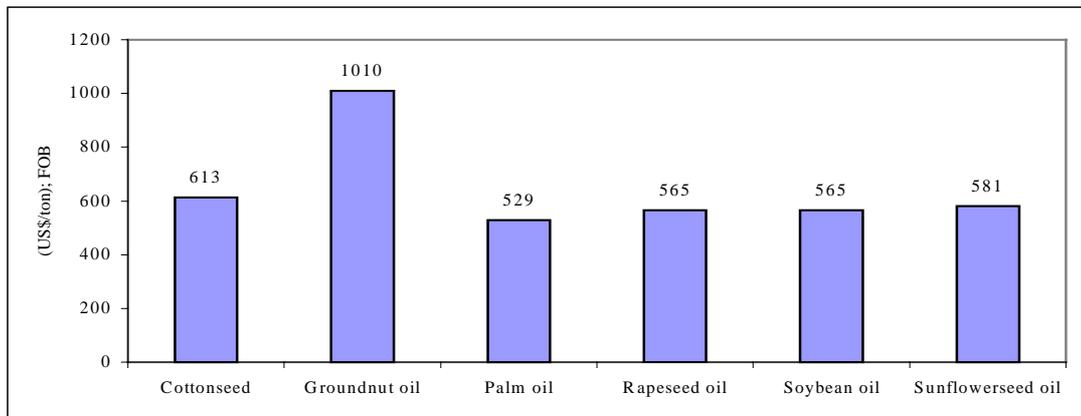
Second, from an investor's perspective, the domestic and international market for crude palm oil looked promising. Before the economic crisis hit Indonesia, palm oil was projected to replace soybean oil as the world's most consumed oil by the year 2000.²⁵ Global demand growth for palm oil was attributed to world population growth and rising spending power. There had been an increasing preference for CPO over

²⁴ For instance in 1997, Indonesia's oil palm trees produced an average of 3.37 tonnes per hectare. This is slightly below the Malaysian average of 3.68 million tonnes per hectare but higher than the world average of 3.21 tonnes per hectare (Oil World).

²⁵ Danareksa, 1998, *Plantation Sector Review*, Danareksa, p 2.

other edible oils because it was cheaper than other vegetable oils such as soybean and rapeseed oil prior to 1998 (See Figure 4).

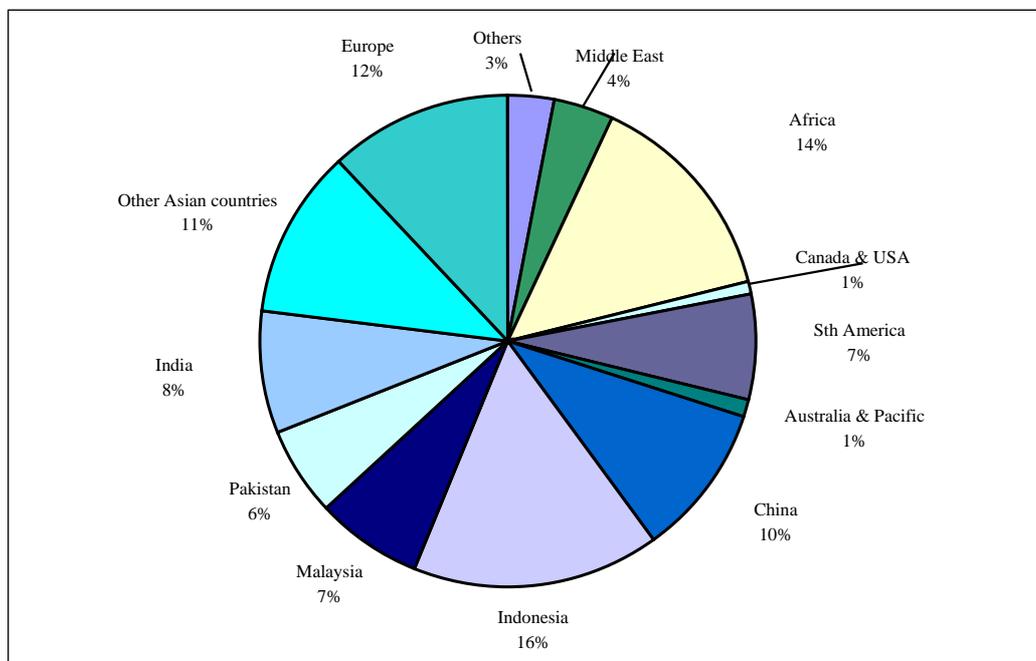
Figure 4—Yearend 1997 global vegetable oil price comparison



Source: Oil World, January 8, 1998.

On the international market, the compound average growth rate of palm oil consumption was the highest among vegetable oils and all major categories of oils and fats since 1992. Between the period 1992-1997, global demand for palm oil grew around 7 percent per annum, followed by soybean oil at 5 percent while other vegetable oils grew less than 4 percent per annum.²⁶ Most of this palm oil was consumed in Asia, primarily by Indonesia, China, Malaysia and Pakistan (See Figure 5). This is mainly because of the type of food typical to the region which is usually stir fried and fried.

Figure 5—1997 global palm oil consumption by country



Source: Oil World Annual 1999

²⁶ Goldman Sachs, 1998. Indonesia Research, Plantation Industry: *Green Giant in the Making*, p5.

The processing of CPO by various industries in Indonesia, especially for cooking oil, was also expanding with an annual growth rate of 13.0 percent since 1986. For instance, in 1986, domestic consumption was just 0.66 million tonnes and it jumped to 2.8 million tonnes in 1997.²⁷ This sharp increase is explained by several factors, mainly increasing population and income per capita. In 1990 per capita consumption was 6.9kg and it rose to 10.4 kg in 1995, implying an 8.6 percent annual increase.²⁸ In 1997, the Indonesian market consumed around 55 percent of domestic CPO production (or 20 percent of global production), making Indonesia the world's largest market for palm oil.²⁹

Third, the Indonesian oil palm sub-sector looked promising because the Indonesian government had demonstrated that it was committed to the development of the palm oil sub-sector by offering numerous incentives to both domestic and international investors. For instance, just prior to the crisis, the government had reduced the export tax on CPO products from a progressive tax to 5 percent, promoted the development of oil palm in Eastern Indonesia through the KKPA scheme, and designated large tracts of land for oil palm development. In 1997, the Suharto government pledged to overtake Malaysia as the world's largest oil palm producer by doubling the oil palm area to 5.5 million hectares by the year 2000. Correspondingly, Indonesian palm oil production was also expected to increase, reaching 7.2 million tonnes in 2000 and 10.6 million tonnes in 2005.³⁰

Most of these new plantations were to be established on the outer islands of Indonesia, primarily Kalimantan, Sumatra, Sulawesi and Irian Jaya. Half of the area allocated for oil palm development was to be offered to foreign owned private estate companies. As a result, the sector attracted considerable investment from overseas investors, primarily from Malaysia, Singapore, England, Hong Kong, Belgium, South Korea, and the British Virgin Islands. In fact, foreign investor interest had become so strong that the government was forced to close the oil palm sub-sector to foreigners in early 1997 because domestic companies had begun to complain about having to compete for land with foreign investors, particularly from Malaysia. Malaysian investors had been particularly active in the Indonesian oil palm sub-sector because land had recently become scarce in Malaysia and rising wages had increased the cost of Malaysian CPO production. With much encouragement from the Indonesian government,³¹ Malaysian investors were able to acquire land banks totaling at least 1.3 million hectares before the crisis hit Indonesia. Most of these land banks were in West Kalimantan, Central Kalimantan, South Sumatra, Riau, and Jambi (For details on Malaysian investors in the Indonesian oil palm sub-sector see Appendix C).

²⁷ Oil World, 1999, *Oil World Annual*.

²⁸ Arifin Sultoni and Susila Wayan, 1998. *Development and prospects of the palm oil industry in Indonesia*, IARD Journal, Vol. 20, No 2, 1998, p 28.

²⁹ Ing Barings, Oct 1998, *Plantation Sector Review*, Ing Barings, Indonesia.

³⁰ Arifin S, and W.R Susila, 1998. *Indonesia as a Major Oil Palm Producer: Prospects and Challenges*. Center for Economic Studies, Research and Development, Dept of Agriculture, Bogor.

³¹ The Indonesian government had pledged to allocated 1.5 million hectares of land to Malaysian developers for oil palm development.

III. THE HESITANT BOOM

From the beginning of economic crisis (mid-1997) through to early 1998, it appeared that the Indonesian oil palm sub-sector would continue to expand. Indeed, it seemed as if changes resulting from the crisis would not only allow continued growth but even encourage faster growth. Most important were windfall profits made possible through depreciation of the rupiah against the dollar and a low export tax of 5 percent. By increasing sales to the export market, companies were able to take advantage of high international CPO prices and low production costs. The government then issued a directive removing barriers to foreign investment in oil palm plantations and sped up the processing of applications, in line with International Monetary Fund (IMF) demands. With the collapse of many industries across the country, the plantation sector was hailed as the ‘primadonna’ of the Indonesian economy.

In January 1998, the Far Eastern Economic Review drew attention to the performance of the oil palm sub-sector by producing an article on PT PP London Sumatra Indonesia’s (LonSum) record profits which ‘were going through the roof’. The author of this article stated that in 1996, LonSum’s net profit was 80.6 billion rupiah (about \$34 million at 1996 exchange rates) on sales of 208 billion rupiah. For the first nine months of 1997, operating profit totaled 83 billion rupiah, a 17 percent year-on-year increase. LonSum was able to increase its profit margin by increasing its exports to 60 percent of its output to take advantage of record world prices for CPO on the world market. Moreover, when the rupiah was floated in mid-August 1997, each 5 percent depreciation against the U.S. dollar added two percent to LonSum’s rupiah earnings.³²

Because of record earnings during the crisis, companies such as LonSum were able to demonstrate that the agribusiness sector, particularly the oil palm sub-sector, ‘remained a bedrock of the region’s economy’³³ despite the economic crisis.

As Indonesian companies ponder their fate, they might want to consider the country’s comparative advantages once again: natural resources, land, labour. Returning to basics, to farms and plantations, may not sound as glamorous as gleaming office towers, plush resort hotels and manicured golf courses. But it would be sound and profitable. Ask London Sumatra.³⁴

While the article did acknowledge that the rupiah’s collapse, while boosting earnings, dampened the company’s plans to continue planting and the availability of short and long term US dollar loans, LonSum was thought to be in good shape, unlike the majority of debt-saddled Indonesian companies. In fact, the company was said to be cash rich and able to write off its foreign exchange losses.³⁵

However, by 1998, it became clear that several companies, including LonSum, had begun to experience difficulties and it was revealed that they had not performed so

³² Tripathi, Salil, January 29 1998, ‘Natural Advantage: An Indonesian plantation company sticks to what it does best, making it a rare winner in the region’s worsening downturn,’ in *Far Eastern Economic Review*.

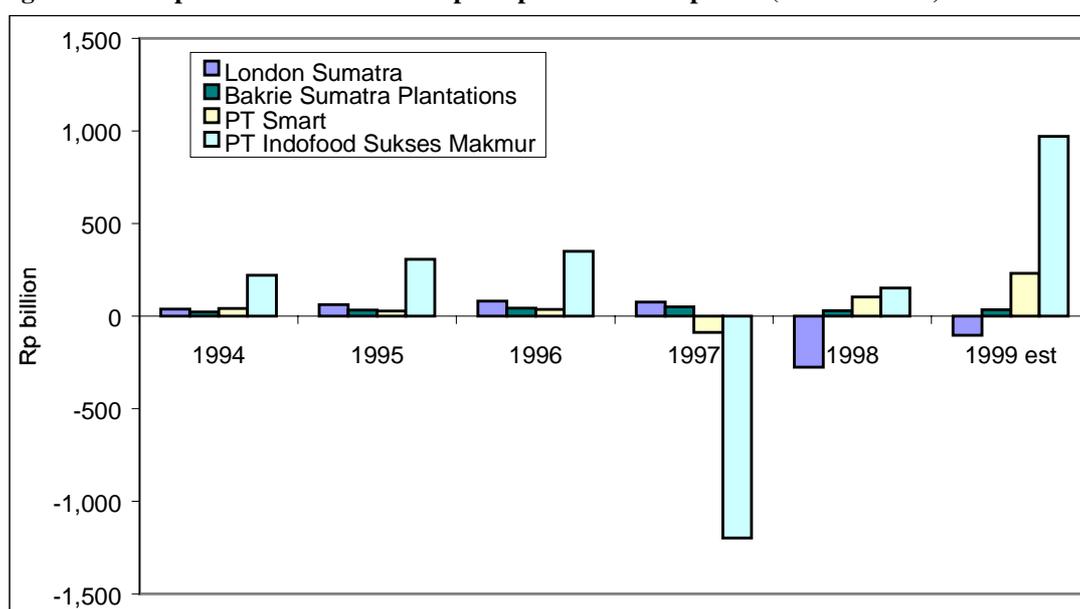
³³ Tripathi, Salil, January 29 1998, *Far Eastern Economic Review*.

³⁴ Tripathi, Salil, January 29 1998, *Far Eastern Economic Review*.

³⁵ Tripathi, Salil, January 29 1998. *Far Eastern Economic Review*.

well in the midst of the economic crisis. In fact, 1997 marked the first year in which LonSum's growth in net profit³⁶ actually declined. LonSum achieved a net profit of Rp 76.5 billion in 1997, a 5 percent decline against Rp 80.6 billion in 1996.³⁷ And in 1998, LonSum recorded a negative net profit of Rp -274.6 billion. However, LonSum failed to recognize certain losses in its 1998 profit and loss statement. If the company had recognized these losses it would have booked a net loss of Rp 1.5 trillion in 1998.³⁸ Technically the company is bankrupt. Similarly PT SMART, a subsidiary of the Sinar Mas Group and one of Indonesia's largest oil palm companies, recorded a negative net profit of Rp -87.7 billion in 1997 compared to Rp 37.0 billion in 1996. Bakrie recorded a profit of Rp 28.2 billion in 1998 compared to 50 billion in 1997 and PT Indofood Sukses Makmur recorded a negative net profit of -1.2 trillion in 1997 compared to 351.3 billion in 1996 (See Figure 6).

Figure 6—Net profits of some listed oil palm plantation companies (1994-1999 est)



Source: Annual reports of companies involved, Danareksa and Ing Barings.

Because of the financial difficulties companies began to face in 1998, oil palm expansion began to slow down. According to the Indonesian government, an average of approximately 200,000 hectares of oil palm was planted per annum between 1990 and 1997. *OilWorld* estimated that during January-December 1998 only 70-80,000 thousand hectares were newly planted.³⁹ The Indonesian government's planting estimates for 1998 are much higher than this but they do show that area expansion started to slow down and the government now estimates that 177,197 hectares of oil

³⁶ It's important to draw a distinction between net profit and operating profit. Net profit refers to: 'the net excess of all the revenues over all the expenses'. Operating profit refers to: 'revenues generated from sales minus operational expenses'. The Operating profit referred to in the Far Eastern Economic Review did not, therefore, take into account expenses incurred from US dollar liabilities.

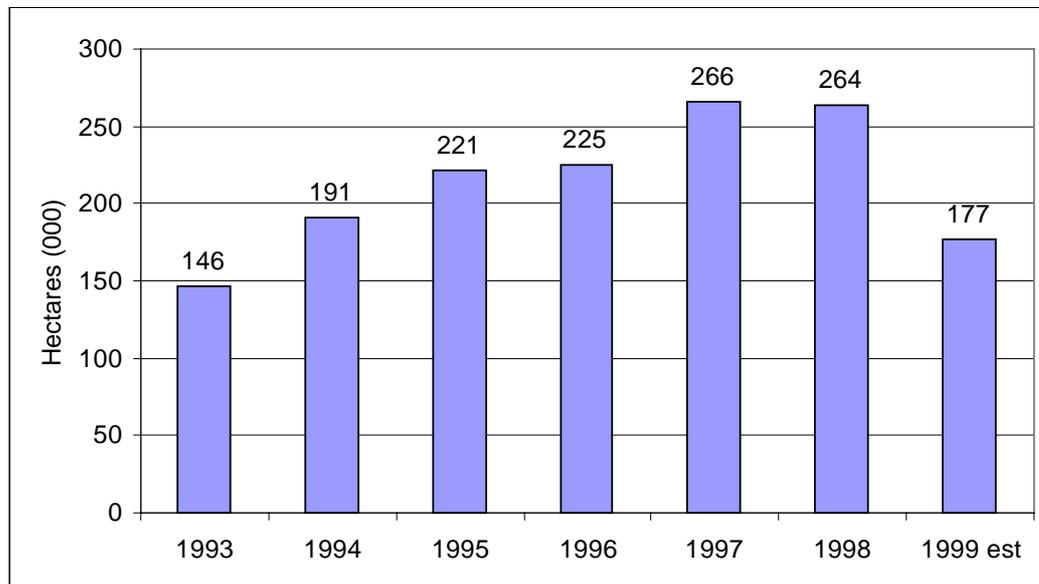
³⁷ Ing Barings, Oct 1998, Plantation Sector Review.

³⁸ These losses mainly arose from unfulfilled off and on balance sheet contractual obligations: including: USD sell forward contracts to Credit Agricole Indosuez, Union Bank of Switzerland, and Citicorp Financial Services Limited; an interest swap extension contract between the company and Citicorp Financial services Limited; a commodity par-forward contract with Citibank; losses on advances to smallholder projects; and doubtful affiliates receivable. These losses totaled around Rp 1.2 trillion.

³⁹ *Oil World*, January 29, 1999, p32.

palm will be planted in 1999 (See Figure 7). This constitutes a 33 percent decline in growth compared to the 266,565 hectares planted in 1997.

Figure 7—Incremental growth in area planted to oil palm between 1993-1999 est.



Source: Director General of Plantations, 1999.

The decline in new plantings occurred because many companies, burdened with USD liabilities reduced their plantation targets in 1998. For instance, PT Astra Agro Lestari previously planned to plant around 20,000 ha per year. However, they were only able to plant 3,000 ha in 1998. Similarly PT Asian Agri Agro, a subsidiary of the Raja Garuda Mas Group, planned to plant 30,000 ha per year but reduced their planting target to 10,000 ha in 1998. PT SMART planned to plant 70,000 ha per year but reduced their planting target in 1998 to 20,000 ha per year. And LonSum was forced to cut its planting program altogether except on already prepared land.⁴⁰ As a consequence, the seed sales of Indonesia's three oil palm seed suppliers—LonSum, Socfindo, and *Pusat Penelitian Kelapa Sawit* (The Centre for Oil Palm Research, PPKS)—declined. Socfindo's seed sales decreased from 17 million in 1997 to 14 million in 1998. Similarly, seed sales recorded by PPKS declined from 51 million in 1997 to 37 million in 1998. PPKS estimated that they would only be able to sell around 20 million seeds in 1999.⁴¹

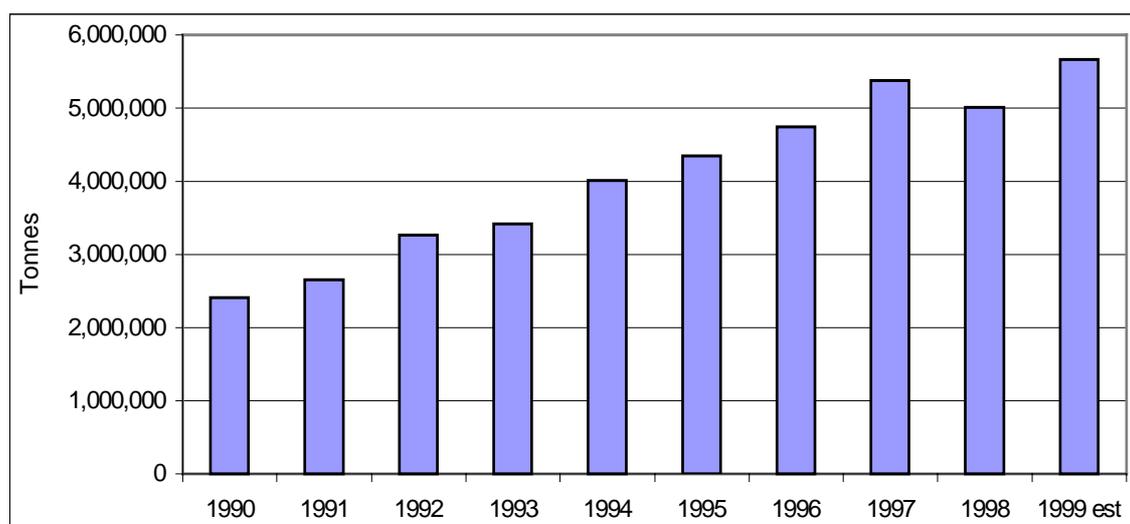
Palm oil production growth also declined in 1998. Despite a large expansion in the average mature area of oil palm in 1998 by over 12 percent,⁴² 1998 CPO production only reached around 5 million tonnes. This was a 7 percent decline in CPO growth from 1997 production which reached almost 5.4 million tonnes (see Figure 8). The decline in CPO production in 1998 signified the first time that CPO production had stagnated since 1969.

⁴⁰ Personal correspondence with companies involved in April 1999.

⁴¹ Personal correspondence with LonSum, Socfindo, and *Pusat Penelitian Kelapa Sawit* in April 1999.

⁴² This is a consequence of record new plantings in 1994 and 1995, primarily in Kalimantan.

Figure 8—CPO production growth (1990-1999 est)



Source: Director General of Plantations, 1999.

Reasons behind the slowdown in palm oil area expansion

While the decline in CPO production is mainly explained by the recent El Niño Southern Oscillation phenomenon, the slowdown in area expansion is primarily explained by hardship encountered during the period of economic and political change. The following section primarily explains some of the reasons behind the slowdown in area expansion. These factors vary greatly in magnitude. Jointly, they have acted as a powerful brake on land acquisition, planting, investment and planned development.

1. The Government's export tax policy

As previously mentioned, the collapse in the value of the rupiah from mid 1997 prompted most local CPO producers to increase their sales to the export markets,⁴³ resulting in a substantial drop in local supply. Exports of Indonesian edible oils then surged 59 percent (including a 75 percent increase in the export of crude palm oil) in 1997 to \$2.23 billion.⁴⁴ With local demand rising gradually towards the end of 1997 as Christmas and Lebaran approached, the domestic supply situation became critical and led to a dramatic price jump on the domestic market for CPO from Rp 1,245/tonne before the economic crisis to Rp 3,277/tonne at the beginning of 1998. This trend could also be seen in the price of cooking oil, which rose to Rp 3,767/tonne in January 1998 from Rp 1,439/tonne in May 1997 (see Appendix D).

As CPO and cooking oil prices soared on the domestic market, the Ministry of Industry and Trade (MIT) introduced a temporary export quota⁴⁵ for CPO producers,

⁴³ Agricultural export income was lucrative because the drastic currency depreciation makes Indonesian commodities cheap on the international market, and because earnings are in US dollars while costs are in local currency. The export market became even more attractive when world CPO prices rose from USD 456 in July 1997 to USD 584 in January 1998.

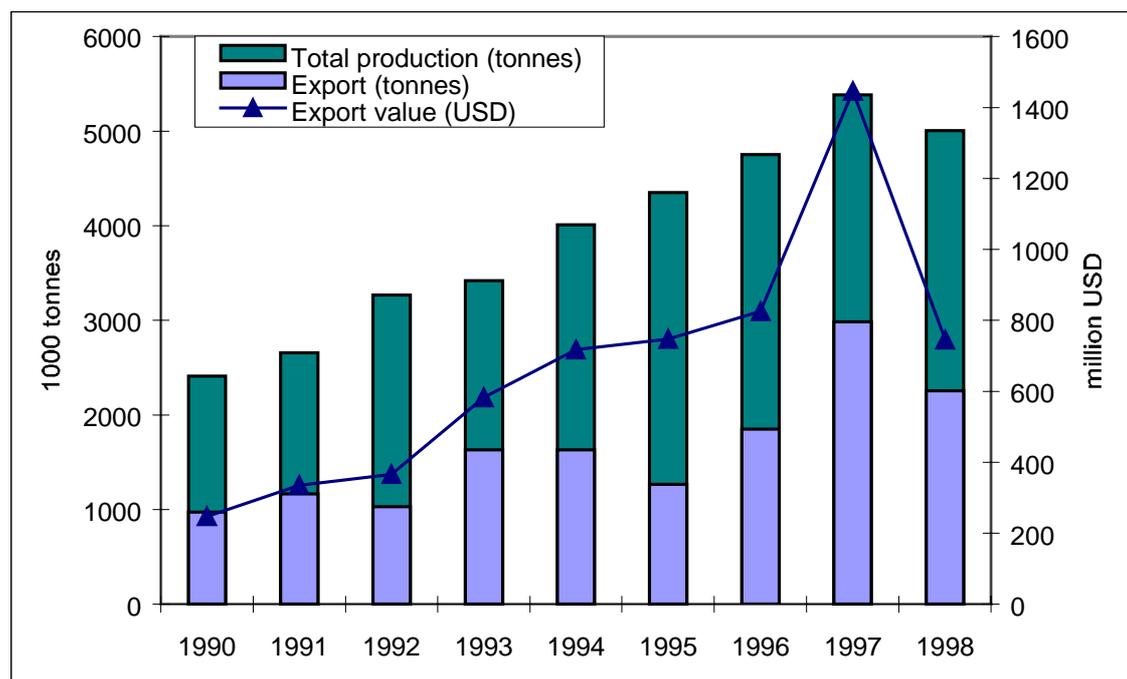
⁴⁴ Ing Barings, 1998. *Plantation Sector Review*, Ing Barings, Indonesia.

⁴⁵ The export quota required Indonesia's 17 largest palm oil producers to supply 80 percent of their production to the local market and only 20 percent for export in December.

before banning exports altogether in early 1998.⁴⁶ The ban was removed in mid 1998, but replaced by a higher set of export tax rates, including a 40 percent rate on CPO.⁴⁷ This was later increased to 60 percent in July 1998 in response to a jump in domestic cooking oil prices in May 1998.

The export ban and higher export taxes reduced Indonesia's export earnings by an estimated USD 1 billion 1998.⁴⁸ In 1998, CPO exports declined by 27 percent to 2.2 million tons from 3 million tons in 1997.⁴⁹ Revenue generated from palm oil exports correspondingly declined by 48 percent from USD 1.4 billion in 1997 to USD 745 million in 1998 (See Figure 9).

Figure 9—Crude palm oil total production, export production and export value, 1990-1998



Source: BPS and Ministry of Forestry and Estate Crops.

Throughout this period, the industry fervently argued that the government's export tax policy was harming the industry. They were supported by the Minister of Forestry and Estate Crops, Muslimin Nasution, who made a strong statement publicly criticising the Ministry of Trade and Industries' export tax policy in early 1999. He was quoted as saying that the high export tax on CPO and its byproducts had halved the incomes of oil palm farmers, been ineffective in terms of stabilizing domestic cooking oil prices and discouraged foreign investors. He then went on to say that:

⁴⁶ The ban was enforced in contravention of the IMF agreement which stipulated that the export tax on crude palm oil was to be decreased to 10% by the end of December 1999. The decision to enforce the ban damaged positive sentiment in financial markets and raised concerns about the government's willingness to implement the IMF program. (See Johnson C, 1998, p34).

⁴⁷ Oil World, April 17, 1998.

⁴⁸ This is because the price of CPO was unusually high during 1998 at around \$USD 600 per tonne.

⁴⁹ Note that these are the government's official figures which do not account for CPO smuggled out of the country during 1998. Some 767,000 tonnes of Indonesian CPO was smuggled out of the country in 1998 (Danareksa Plantation Sector Review 1999).

*‘inconsistency in government regulations, including those on trade in CPO and cooking oil, will kill the palm oil business in the long term because international investors will come to view opening palm oil plantations here as risky’.*⁵⁰

Observers were skeptical of the oil palm industry claims,⁵¹ however it is now clear that the export ban and consequent high export taxes did actually prevent companies from continuing to make windfall profits from CPO export sales.⁵² Companies such as PT Bakrie Sumatera Plantations, PT Indofood Makmur, LonSum and PT SMART then began to experience difficulties because they had substantial USD liabilities (see Table 4). Some companies also lost money because of prior commitments to sell their CPO at the pre-crisis exchange rate of Rp 2,500. In fact, *OilWorld* estimated that at least 0.2 million tonnes of oil had already been sold for export in January/March 1998 when the government placed the ban on CPO exports.⁵³

Table 4—Loans taken out by some Indonesian listed oil palm plantation companies prior to the crisis.

Company	Total US Dollar Loan USD million	Date Loan taken out	Date Due USD million	Lending Banks of USD loans
PT London Sumatra Indonesia Tbk	Syndicated loan: \$122 (unhedged) Promissory notes: \$40 (unhedged) Forward contracts: US\$103.5	Early 1997	\$46.6 due in 1998 \$97 due in 1999	Syndicated loan —a consortium of banks including: <ul style="list-style-type: none"> • Citicorp International Ltd, USA • Commerzbank, Singapore Branch • Rabobank, Hong Kong Branch • Hong Kong Bank, Singapore Branch • Shanghai Banking Corporation, Singapore. • Union Bank of Switzerland • Sumitomo Bank Ltd, Singapore Branch • Bank of Taiwan Promissory notes <ul style="list-style-type: none"> • Indosuez Bank, France • Citibank, United States • LTCB, Japan. Forward contracts <ul style="list-style-type: none"> • Credit Agricole Indosuez • Union Bank of Switzerland • Citicorp Financial Services Limited
PT Bakrie Sumatra Plantations Bakrie & Brothers	\$70 \$1,020	1996	1999	<ul style="list-style-type: none"> • Rabobank Nederland—Singapore Branch • PT Bank Credit Lyonnais Indonesia, Medan • Credit Suisse, Singapore • Japan Asia Investment
PT SMART	Total USD loan: \$212.1 Hedged: \$97.0 Unhedged: \$115.1 Deposit: \$70 Total USD exposure: \$45.1	April 95	\$104 was paid off in August 98 \$14 is due in 1999 \$62.8 is	<ul style="list-style-type: none"> • The Chase Manhattan Bank, New York • ABN-Amro Bank N.V. Jakarta. • Fuju Bank Limited, Singapore • Nederlandse Financierings-Maatschappij Voor Ontwikkelingslanden N.V. (FMO) • PT Bank Societe Generale Indonesia • PT Bank Credit Lyonnais Indonesia • PT Sanwa Indonesia Bank • PT Bank Sakura Swadharma • PT Bank Internasional Indonesia

⁵⁰ The Jakarta Post, Conflicting strategies on CPO tax, January 26, 1999, p12.

⁵¹ For instance, see Sunderlin, W.D, 1998. *Between danger and opportunity: Indonesia's forests in an era of economic crisis and political change*; 11 September 1998 at <http://www.cgiar.org/cifor/>.

⁵² For further analysis on this subject see: Marks Stephen, Larson Donald, and Pomeroy Jacqueline, 1998. Economic effects of taxes on exports of palm oil products, in *Bulletin of Indonesian Economic Studies*, Vol 34, No 3, pp 37-58.

⁵³ Oil World, January 2, 1998.

			due in 2000	<ul style="list-style-type: none"> • PT Bank Danamon Indonesia • PT Bank Dagang Negara (Persero) • Jaya Fuju Leasing • PT Sinar Mas Multifiance.
PT Indofood Sukses Makmur	\$1,047.7	1996 and early 1997	81.1 was due in 1997 449.1 was due in 1998 417.4 is due in 1999 126.5 is due in 2000	<ul style="list-style-type: none"> • Citibank N.A Jakarta • PT Bank Central Asia • The Hong Kong & Shanghai Banking Corporation • Bank of Tokyo-Mitsubishi, Ltd • Bank Societe Generale Indonesia • Deutsche Bank • Credit Suisse First Boston, Singapore • Citicorp Investment Bank • The Chase Manhattan Asia Limited • LTCB Merchant Bank • Fuji Bank Limited, Singapore • Bank of Tokyo, Mitsubishi Ltd, Singapore • Bankers Trust Company, Hong Kong • Bank of America Asia Limited • Ocrim SPA, Italy • Yasuda Trust & Banking Co, ltd • PT Bank Daiwa Perdana

Source: Annual reports of companies involved, Danareksa and Ing Barings.

Having lost the opportunity to benefit from the fall of the rupiah and increased CPO prices on the world market, these companies began to find it difficult to meet their loan repayments and some have been forced into debt restructuring programs. PT Bakrie Sumatra Plantations has managed to stay afloat by deciding not to develop the large land banks formerly acquired in West Kalimantan and by deferring its foreign exchange losses as a contra account to its long term liabilities. Most of the concessions formerly acquired in West Kalimantan by Bakrie Sumatra Plantations have been revoked by the Ministry of Plantation and Forest Estates because the company has failed to develop them.⁵⁴ PT SMART has been more fortunate because its parent company, Sinar Mas, paid off USD 100 million of the companies' USD 150 million debt in August 1998.⁵⁵ PT Indofood Sukses Makmur was able to hedge a significant portion of its loan and attempted to sell a 60 percent stake to a foreign holding company based in Holland.⁵⁶

Difficulties encountered because of USD liabilities, along with the government's reluctance to drop the export tax, affected investor confidence in the industry and share prices in the oil palm sub-sector plummeted as a result. For instance, LonSum's

⁵⁴ Dinas Perkebunan, March 1999, *Informasi Pembangunan Perkebunan di Kalimantan Barat*, Pontianak.

⁵⁵ This sort of move is almost unheard of anywhere else in the world as liabilities should be shared equally by the public shareholders (who in this case own 49 percent) and the majority shareholder. The entire debt was therefore absorbed only by the majority shareholder PT Purimas, who represents Sinar Mas. The Sinar Mas Group decided to make this move because PT SMART is the only public company under the Sinar Mas (Purimas Group) and it therefore acts as a buffer, or front, for the other less transparent companies under the Group.

⁵⁶ The transfer would have enabled Indofood's parent company, the Salim Group, to control all of the holding company's shares. The transfer was to be preceded by the signing of an accord between the Salim Group, Nissin of Japan and First Pacific of Hong Kong. Nissin and First Pacific would each hold a 30 percent stake in the company (Antara, 17 December 1998). However, in late April 1999, First Pacific and Nissin Food Products cancelled the share purchase agreement. In the acquisition agreement, there was a condition that the transaction could only be carried out if Indofood's creditors endorsed the agreement. In a meeting held in January 1999, the majority of independent shareholders did not approve of the transaction so the deal was cancelled. The breakoff in the share transaction agreement is not expected to have much of an impact on the company's operational activities now that a significant portion of the companies' USD liabilities have been hedged (Antara, 29 April 1999).

shares fell from Rp 6,650 in January 1997 to Rp 1,375 in January 1999. Similarly, PT Bakrie Sumatra Plantation shares fell from Rp 2,275 in January 1997 to Rp 925 in January 1999 (See Appendix E). Both of these companies are now at risk of being delisted from the Jakarta Stock Exchange and LonSum is intending to sell a 50 percent stake in the company to Lazard Asia Investment—a Hong Kong based investment bank—in order to stay afloat.

2. Reform policies that target the oil palm sub-sector

After Suharto stood down in May 1998, the new Habibie government was under a great deal of pressure to reform the forest sector and rid Indonesia of corruption, collusion and nepotism (KKN). Some of these changes have deterred investment. The three changes that most concern the industry are discussed in further detail below.

- (a) In early June 1998, the Directorate of Inventory and Forest Land Use, within the Ministry of Forestry and Estate Crops, instructed all provincial forestry and plantation offices to revoke the forest use and conversion permits of estate crop companies that were only interested in cutting timber from their concessions and had failed to develop their estates. This instruction was strengthened when, in October 1998, the Ministry of Forestry and Plantation Estates issued a statement saying that they had stopped issuing new licenses to open up conversion forest land for plantation estates because many investors had neglected their projects. According to the government, only 1.4 million hectares (16.5 percent) had been realized from the nine million hectares of forests licensed for plantation estates since early 1990. Investors were then warned that the government would revoke their licenses if they did not start their project within the next year.

The instruction to revoke the plantation licenses of companies that had failed to develop their estates has been implemented at the provincial level. For instance, in West Kalimantan, 36 oil palm companies have recently had their licenses revoked.⁵⁷ The government's threat to revoke licenses given to companies who had not realized their plantations has greatly concerned the industry, particularly since many companies have had to reduce their planting targets due to increased planting costs and USD liabilities. New investors have also been deterred from the sub-sector by this instruction and are waiting until the process has been completed before they go ahead with their investments. The government is currently assessing the performance of a number of companies on the ground and will lift the moratorium on issuing new licenses to open up conversion forest land for plantations once they have finished. The concessions of companies that have failed to realize their plantations will be revoked and reallocated to new investors.

- b) In March 1999, the Ministry of Forestry and Estate Crops released a regulation⁵⁸ that limited plantation concession sizes. In this regulation, tree crop plantation development area was set at 20,000 hectares in any one province, and up to a maximum of 100,000 hectares in the whole country for a given company. This regulation was supposed to prevent a handful of business groups, who had greatly benefited from KKN during the Suharto era, from controlling large tracts of land.

⁵⁷ Dinas Perkebunan, 1999. *Perkembangan Pemanfaatan Lahan Perkebunan Besar Di Kalimantan Barat Keadaan Triwulan 1 Pontianak*.

⁵⁸ Plantation Use Permit Regulation, 107/Kpts-II/1999.

The proposal to limit the size of forest concessions has raised concerns over the government's commitment to attract investment in the oil palm sub-sector. Although the policy appears to be aimed at preventing the build-up of monopolies, it is expected to hurt the efficiency and productivity of the sector. Moreover, uncertainties still exist over this new regulation, and some financial analysts⁵⁹ believe that the lack of clarity will endanger the industry's attractiveness to foreign investors. Analysts also believe that this new regulation could have an adverse impact on major CPO plantations given that a maximum of only 20,000 hectares of planted area would hurt the economies of scale.⁶⁰

The industry has, however, noted a loophole in the regulation. The regulation states that *companies* are not allowed to own more than 20,000 hectares in each province, but there is nothing stopping *conglomerates* from starting up new companies in order to obtain more land. In fact, most Indonesian plantation conglomerates only own an average of 6,000 hectares under the one company as this is the minimum amount of land required to establish a processing mill. But conglomerates can establish as many companies as they like. For instance, 42 plantation companies are owned by PT Astra Agro Lestari and 23 plantation companies are owned by PT SMART. Each of the companies that fall under these conglomerates lease at least 6,000 hectares of land. Under this new regulation these conglomerates can therefore continue to acquire more land by merely establishing a new company. The process could, however, be more costly and bureaucratic than it was before this regulation came into effect and companies are unsure about whether the government will allow them to get away with opening more companies to gain access to land. Oil palm conglomerates are therefore waiting until the regulation becomes more transparent before they begin to open up new companies to acquire larger land banks.

- c) In line with the government's promotion of a 'people's economy' (*ekonomi kerakyatan*)⁶¹ the Indonesian government has encouraged investors to cooperate with local farmers and cooperatives in the ownership and operation of oil palm plantations through five new schemes which offer incentives to both cooperatives and private enterprise (see Appendix G). The program is extremely complicated and few people, including government representatives at the provincial level, seem to know how it will be implemented. Many plantation companies and new investors have therefore put off their plans to develop further plantations until the

⁵⁹ Ing Barings, PT Danareksa Sekuritas and Goldman Sachs.

⁶⁰ Personal correspondence with analysts from Ing Barings and Danareksa in June 1999.

⁶¹ The Minister of Cooperatives and Small Enterprises in the Habibie cabinet, Adi Sasono, staunchly promoted the people's economy concept since June 1998. Policies under the people's economy concept aimed to 'create a broad base of small and medium-scale enterprises [SME's]...and to foster mutually beneficial linkages between cooperatives, SME's, large companies and state enterprises'. In accordance with this new concept, 'national land use rights and land ownership in the hands of a few individuals or companies shall be prevented in light of efforts to enhance the strength of cooperatives, SMEs and the people at large' (See Decree No. XVI/MPR/1998 on Political Economy within Economic Democracy). The people's economy concept attracted much controversy and criticism. This was mainly triggered by Adi's promotion of the concept and his constant attacks on ethnic-Chinese business people. It was suggested that Sasono was using the 'people's economy' concept to appeal to the strong being of economic nationalism and anti-Chinese sentiment within the body politic (See Cameron, pp30-32). The program is also thought to be highly vulnerable to corruption and failure if adequate institutional capacity as well as competent and highly dedicated personnel are not in place to manage and oversee the program.

government's intentions about this regulation become clear. Having realized that the industry is concerned about this regulation, the Ministry of Forestry and Estate Crops has gone to great lengths to reassure the plantation sector that the new investment schemes would only affect new investors, and would not affect existing plantation firms. But they have urged existing plantation firms to adopt these schemes, 'because they will create a sense of belonging for the local people' and 'encourage the local people to protect plantation areas from looting, theft and damage'.⁶²

The above regulations have deterred investors from the oil palm sub-sector and existing companies have either cancelled or frozen previous expansion plans until they know the government's stance on land use.⁶³ Government representatives are well aware of this and have been desperate to cover up poor investment confidence in the sector. For instance, when an article appeared in the *Malaysian Star Daily* in July 1998 stating that Malaysian oil palm plantation firms in Indonesia had slowed down their operations and were considering pulling out their investments because of new land use laws, the Indonesian government was quick to refute these claims by stating that the country's plantation sector remains as attractive as ever. The Ministry of Forestry and Plantations then claimed it had sent a special team to several regions in the country to look for land where investors could immediately open new plantations. In doing so, the Ministry failed to acknowledge that investors are no longer concerned about the availability of land. They want to have secure land title, a stable economic and political environment, and consistent land use regulations and export tax policies. Since the crisis unfolded, the Indonesian government has not been able to offer these conditions and investors are expected to keep away from the oil palm sub-sector until conditions improve.⁶⁴

3. Social unrest and withdrawal and withholding of foreign investment

Since the resignation of President Suharto in May 1998, there has been a marked increase in social unrest in and around oil palm estates. This has resulted in the consequent withdrawal and withholding of foreign investment. Since May 1998, reformists have called upon the national government to examine the domination of conglomerates in the forestry sector and allow local communities to play a larger role in new economic development. Unrest has also increased in and around estates because the 'reform era' has provided an opportunity for communities to reclaim their land from plantation companies. Communities have stepped up protests against further oil palm expansion by burning estate offices, large machinery, processing plants and plantations. Conflicts between estate workers and communities have also increased and many have resulted in injury or death (see Appendix F).

Looting also increased on estates because estate workers and local communities began to incur increased living costs after the rupiah depreciated against the dollar. Some resorted to looting in order to supplement their incomes. In January 1999, the Ministry of Forestry and Plantations estimated that at least 39,800 hectares of oil palm

⁶² Muslimin Nasution, quoted in the Jakarta Post, July 1999.

⁶³ OilWorld January 29, 1999

⁶⁴ It is worth noting that the oil palm sector is only one of many sectors to register poor performance in terms of foreign investment. According to the Investment Coordinating Board (BKPM), first half-year foreign investment approvals were just under \$2 billion in 1999, having peaked at \$21 billion in 1996 (See Pardede 1999).

plantations were looted during 1998, causing an estimated material loss of around Rp 196 billion (about US\$26 million).⁶⁵

The government made numerous statements saying it would increase security on the estates to protect companies from looting and social unrest. However many companies have said that, since the fall of Suharto, they can no longer call on the armed forces to control the security situation.⁶⁶ The armed forces have distanced themselves from handling such matters and many companies believe the armed forces are behind most of the organized looting.⁶⁷ Unable to rely on Indonesian authorities for assistance some companies have been forced to close down their operations, reduce their planting targets, or withdraw their investments. New investors have also been deterred from the sector by increasing reports of looting and conflict and some have held back their investments as a consequence.

4. Changes to the CPO distribution system

Changes to the distribution system of oil palm products contributed to the slowdown of production and area expansion by sending confusing signals to producers and traders, by increasing wariness of investing in the sector, and by doing little to alleviate upward pressure on domestic prices. After the Ministry of Industry and Trade lifted the ban on CPO exports and replaced it with a 40 percent tax in April 1998,⁶⁸ cooking oil prices on the domestic market continued to rise. The price situation worsened when rioting in Medan and other cities in early May 1998 increased panic buying and impeded the distribution of CPO on the domestic market.⁶⁹ The International Monetary Fund would not allow the government to reinstate the ban on CPO exports to control the domestic price of CPO, so the Ministry of Industry and Trade was forced to reconsider the way cooking oil was being distributed between producers and consumers. It equivocated, however, over the agency best suited for the task and numerous changes were made to the distribution system as a result (See Table 5). The changes greatly confused the industry and did little to control the price of cooking oil on the domestic market. Investors were also deterred by the changes and many raised concerns about the way in which European traders would react to such uncertainty.⁷⁰

Table 5—Changes to the CPO distribution system in 1998 and 1999

April 1998	State-owned plantation companies were told to supply their entire CPO production to the three government-owned refineries (which were supported by 12 additional refineries owned by smaller private producers), as opposed to 12 private refineries. These products would be distributed by Bulog and other state-owned distribution companies to assure price stabilization in the market. Distribution of cooking oil processed by the private sector was independent of this system.
May 25	The new Habibie government signed a Ministerial decree which revoked the exclusive rights given to private companies to process CPO produced by state-owned plantation firms.
May 27	Bulog was stripped of its role to distribute CPO on the domestic market and the Government made the State Joint Marketing Office (<i>Kantor Pemasaran Bersama</i> , KPB) and the state distribution company PT Dharma Niaga responsible for ensuring

⁶⁵ Jakarta Post, 39,800 ha of plantation areas looted last year, January 13, 1999, p8.

⁶⁶ Personal correspondence with a number of oil palm companies in April 1999.

⁶⁷ Interview with D.R. Hoare, President Director of PT Tolan Tiga. 14 April, 1999.

⁶⁸ This was later increased to 60 percent.

⁶⁹ Johnson, Colin, 1998. Survey of recent developments, in *Bulletin of Indonesian Economic Studies*, Vol 34, No.2, August 1998, Indonesia Project, the Australian National University, p38.

⁷⁰ The Indonesian Observer, European vegetable oil traders wary of Indonesia, July 1, 1998, p13.

	the supply of cooking oil around the country. Under the new scheme, KPB would buy all cooking oil from The Association of Indonesian Cooking Oil Industries (AIMMI) and sell it directly to market retail cooperatives (Inkoppas) in the city at a subsidized price.
July 1998	The government directed PT Dharma Niaga to sell olein at a subsidized price to the cooperatives, who were supposed to channel the cooking oil directly to retail consumers.
July 1998	The government instructed the State Joint Marketing Office to buy 176,850 tons of palm olein from private companies at international prices. The palm oil would then be sold domestically at a subsidized price. This move was made as an effort to curb smuggling.
July 1998	State plantation companies were ordered to sell their CPO to private refineries and Bulog was directed to buy it and sell it at a subsidized price. PT Dharma Niaga and was then removed from the distribution chain.
7 Sept 1998	The government handed over the task of distributing cooking oil produced by state-owned refineries to the Indonesian Distribution Cooperative (KDI), with Bulog's assistance until the end of 1998.
June 1999	The government lifted the monopoly granted to the Indonesian Distribution Cooperative (KDI) to distribute cooking oil from state-owned companies on the domestic market.

Source: Various newspaper articles and Ing Barings, October 1998. Plantation Sector Review.

5. Credit access difficulties

Local investment in the oil palm sub-sector has also declined because local investors were unable to obtain credit at affordable interest rates. Before the economic crisis it cost around Rp 200 billion to set up a 10,000 hectare oil palm plantation in Indonesia, or about USD 80 million at pre-crisis exchange rates.⁷¹ Data on 56 private domestic companies collected by the International Contact Business System⁷² revealed that on average each company borrowed about 77 percent of the total establishment cost of their plantations. In August 1998, the benchmark interest rate of Bank Indonesia's one-month SBI (*Sertifikat Bank Indonesia*, Bank Indonesia Certificate) promissory notes jumped to as high as 70 percent from about 16 percent in June 1997.⁷³ The IMF encouraged the Indonesian government to raise interest rates to induce savers to keep their money in banks and to entice money back into the banking sector.⁷⁴ This was supposed to stabilize the exchange rate and bring an end to the decline of the rupiah.⁷⁵ When interest rates were around 70 percent, it was costly for Indonesian companies to obtain credit. For the period January through June 1999, domestic investment approvals amounted to less than \$3 billion at the mid year exchange rate; this compares with amounts of about \$27 billion for the same periods of both 1996 and 1997, and about \$13 billion in both 1994 and 1995.⁷⁶ This made it difficult for companies to finance new planting schemes or acquire land. Moreover, the ability of

⁷¹ Gatra February 7, 1998.

⁷² ICBS, 1997. *Study on oil palm plantations and marketing of Indonesian palm oil*. PT International Contact Business System, Jakarta, Indonesia.

⁷³ Jakarta Post, Interest rate may return to 15%, BI says, June 28, 1999, p1.

⁷⁴ Johnson, Colin, Survey of recent developments, in *Bulletin of Indonesian Economic Studies*, Vol 34, No2, August 1998, Indonesia Project, The Australian National University, p43.

⁷⁵ Pardede, Raden, 1999. Survey of recent developments, in *Bulletin of Indonesian Economic Studies*, Vol 35, No2, August 1999, Indonesia Project, The Australian National University, pp16-17.

⁷⁶ Pardede Raden, 1999, Survey of Recent Developments, in *Bulletin of Indonesian Economic Studies*, Vol 35, No2, August 1999, Indonesia Project, The Australian National University, p33.

companies to obtain credit was further impeded by the virtual collapse of the Indonesian banking system.⁷⁷

6. Changes to the state-owned plantation sector

The government made several confusing statements concerning its plans for the state-owned plantation sub-sector. The confusion has greatly concerned the industry and raised concerns about the future performance of the state-owned plantation sub-sector. The confusion began when the government announced its intention to float the shares of five state companies on the Jakarta stock exchange in April 1998. The float included the state-owned plantation company PTPN IV—one of the largest plantation companies in Indonesia in terms of mature hectareage, and the largest CPO producer amongst the state owned plantation companies. By July 1998, however, the State Minister for the Empowerment of State Enterprises, Tanri Abeng, said the five companies would no longer be sold to the public but to strategic partners in accordance with the IMF agreement. The new agreement planned to accelerate state enterprise reform in order to increase budget revenue and achieve efficiencies.⁷⁸ PTPN IV was to be sold to a foreign business partner with wide market access overseas and the technological ability to develop downstream industry within Indonesia.⁷⁹ Investors were invited to purchase either a minority equity interest of approximately 30 percent, or a majority equity interest of 51 percent.⁸⁰ Because PTPN IV owns some of the most suitable land for oil palm in Indonesia, the offer attracted interest from several foreign investors including Tanpa Bay International (Hong Kong), Felda Enterprises Sdn Bhd (Malaysia), and Auric Pacific Group (Singapore). All of these companies expressed an interest in purchasing a 51 percent majority stake in the company.⁸¹ However, in late May 1999, after a number of foreign investors had already submitted their proposals to purchase a majority stake in the company, the government retracted its offer and decided to sell 40 percent of the companies shares to the public on the Jakarta Stock Exchange.⁸² Shortly after this decision was made, Tanri Abeng released plans to consolidate the country's 159 state companies into 10 holding companies. All of the State's 14 plantation companies would be merged into one state-owned plantation holding company according to this plan.⁸³ He argued that the merger would raise the sale price of state firms earmarked for privatization.⁸⁴

The decisions to form one state-owned plantation holding company and to cancel the sale of PTPN IV have eroded confidence in the future performance of the state-owned

⁷⁷ See Cole D and Slade B, 1998. Why has Indonesia's Financial Crisis been so bad? in *Bulletin of Indonesian Economic Studies*, Vol 34, No. 2, August 1998, Indonesia Project, Australian National University, p62.

⁷⁸ Johnson, Colin, 1998. Survey of recent developments, *Bulletin of Indonesian Economic Studies* Vol 34, No. 2, August 1998, Indonesia Project, Australian National University, p33.

⁷⁹ Potter L & Lee, J, 1998b. *Oil palm in Indonesia, its role in forest conversion and the fires of 1997/98*, a report for WWF-Indonesia Programme.

⁸⁰ Information Memorandum on PT Perkebunan Nusantara IV prepared by Danareksa Sekuritas, Jardine Fleming International Inc and PT Bahana Securities for potential investors, November 1998.

⁸¹ Personal correspondence with the PTPN IV's Production Director, Bapak Soehardjo in early June 1999.

⁸² Personal correspondence with the PTPN IV's Production Director, Bapak Soehardjo in early June 1999.

⁸³ http://www.bisnis.com/bisnis/owa/frame.fstoryf_othernewsf?cookie=2&cdate=28-May-1999&inw_id=93314.

⁸⁴ EIU, 1999, *EIU Country Report 3rd quarter 1999, Indonesia*, The Economist Intelligence Unit Limited, p29.

plantation sector. H.S Dillon, a vocal promoter of the oil palm sub-sector, argued that the process would inhibit investment, make the sub-sector more bureaucratic, and damage the future performance of the state-owned plantation sector.⁸⁵ His concerns were echoed by the IMF and World Bank. Both rejected the plan arguing that it would hinder the government's privatization program and the performance of the companies involved. Economist, Sri Mulyani, warned that the holding companies would merely serve to obstruct the privatization programme and provide those in charge with the opportunity to extract rent from the assets under their control.⁸⁶ Their concerns were confirmed when Muslimin Nasution asserted that none of the state-owned plantation or forestry companies could be privatized because they were 'public goods'.⁸⁷ The government's reluctance to go ahead with the privatization of PTPN IV and other state companies formerly targeted for privatization is explained by cultural resistance to foreign ownership, and recent improvements in the exchange rate and other economic indicators.⁸⁸

7. ENSO, drought and fires limit CPO production

From January 1997 until April 1998 many areas in Indonesia, the Philippines and Malaysia and other South East Asian countries were severely hit by drought and forest fires resulting from the El Niño Southern Oscillation phenomenon. During this period, precipitation fell 25 percent below normal rainfall levels in Sumatra and Kalimantan. The drought placed oil palm trees under considerable stress and many trees were unable to produce fruit.

Palm oil plantation companies in East Kalimantan and Sumatra took advantage of the dry conditions to burn and clear land, but in doing so they inadvertently affected the production of existing palm oil trees. The haze had the following impacts on palm oil production: (1) Oil palm trees suffered from the absence of sunshine because of limited photosynthesis;⁸⁹ (2) Weevils died on a number of estates and were therefore unable to carry out the process of pollination; (3) and workers were unable to go out into the plantations to collect fruit because the smoke and haze affected their health and vision.⁹⁰

The El Niño related drought and forest fires are held primarily responsible for the marked decline in crude palm oil production in 1998.⁹¹ As world CPO stocks declined, the price of CPO on the world market increased to a record USD 700 in May 1998. This encouraged Indonesian producers to boost their CPO exports. Domestic supply then declined and the domestic price of cooking oil jumped from Rp 1,750 per tonne in July 1997 to Rp 6,900 per tonne in March 1998 (See Appendix D). Unable to control the price of CPO, the government was forced to impose the export ban and high export taxes in order to control domestic prices. As previously

⁸⁵http://www.bisnis.com/bisnis/owa/frame.fstoryf_othernewsf?cookie=2&cdate=28-May-1999&inw_id=93314.

⁸⁶ EIU, 1999, *EIU Country Report 3rd quarter 1999, Indonesia*, The Economist Intelligence Unit Limited, p29.

⁸⁷http://www.bisnis.com/bisnis/owa/frame.fstoryf_othernewsf?cookie=2&cdate=17-May-1999&inw_id=93314.

⁸⁸ Cameron, Lisa, 1999. Survey of recent developments, in *Bulletin of Indonesian Economic Studies*, Vol 35, No1, Indonesia Project, The Australian National University, p26.

⁸⁹ OilWorld Jan 29, 1999 and confirmed by interviews with various oil palm companies.

⁹⁰ Oil World, Sept 1997, p 344

⁹¹ Oil World, numerous

mentioned in Section III.1, this prevented companies from making windfall profits after the rupiah depreciated and affected their ability to expand their estates.

8. A precipitous decline in the world price of CPO

Investors were temporarily deterred from the sub-sector by the 60 percent drop in the world price of CPO from over \$USD700/ton in late 1997 to \$USD287 in August 1999 (see Appendix D). This was the lowest it had been since the mid 1980s. The price of CPO on the world market is explained by a number of factors that jointly pushed the world price downwards. Some of the most significant are:

- 1) *The devaluation of the Brazilian Real.* Brazil is the second largest producer of soybean oil in the world after the US. In mid January 1999, the devaluation of the Brazilian Real simultaneously pulled down the price of soybean oil. As soybean oil prices decreased, CPO prices correspondingly declined (See Figure 10).
- 1) *Smuggling.* Estimated to be over 760,000 tonnes⁹² (15% of total Indonesian CPO production in 1998) pushed international prices down as smuggled CPO was sold below market price on the world market.
- 2) *Increased preference for soybean oil.* As CPO's price premium against soybean oil was extremely high in 1998, many CPO buyers switched to soybean oil. Although the CPO premium over soybean oil is disappearing, buyers are not expected to switch back to CPO until the price falls below the price of soybean oil.
- 3) *Increased CPO production.* Between April and May 1999, Malaysian and Indonesian CPO production was unusually high. This was attributed to increased rainfall levels following the 1997 El Niño drought and related forest fires.⁹³ As production increased, the industry was forced to lower the price of CPO to compete with soya oil and rape oil. This was done in order to regain market shares lost during the preceding 12 months when world CPO prices were high and palm oil production low.⁹⁴ Palm oil producers lost their market share of the vegetable oil market because consumers reacted to the extraordinary palm oil price situation by switching part of their oil demand to more attractively priced soya oil, rape oil or sunflower oil.

In mid July 1999, Agus Pakpahan, the Director General of Plantations within the Ministry of Forestry and Estate Crops voiced concern over the CPO price situation and predicted that prices would continue to fall. This was because both Malaysia and Indonesia were expecting good harvests in the coming months. CPO produced from these harvests was expected to flood the oil market and bring prices down even further.⁹⁵ The Malaysian government was also concerned about decline in the world CPO price. In July 1999, the Malaysian Primary Industries Minister, Lim Keng Yaik, was quoted as saying: 'If prices decline further, Malaysian and Indonesian producers

⁹² Danareksa, October 1999, *Plantation Sector Overview*.

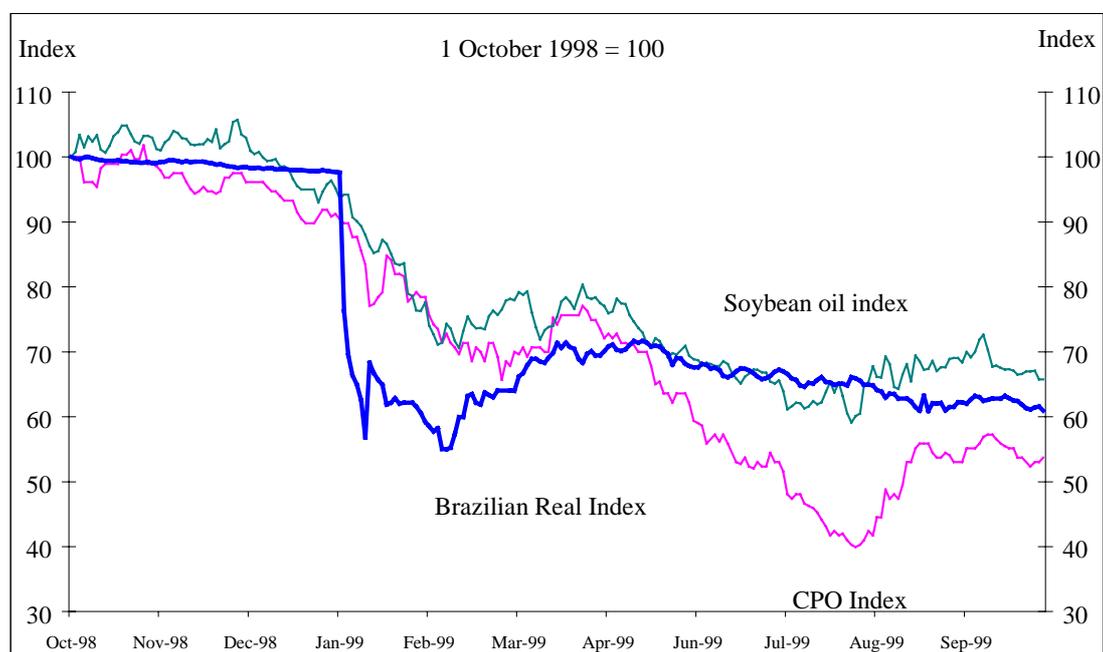
⁹³ Danareksa, October 1999, *Plantation Sector Overview*.

⁹⁴ Oil World, May 21 1999

⁹⁵ Danareksa, September 1999, *Indonesia Investment Overview*, p32.

will not be able to make any profit because of the high production cost and many may not survive'.⁹⁶

Figure 10—The impact of the devaluation of the Brazilian Real on soybean and palm oil prices



Source: Danareksa, Indonesia Investment Overview, September 1999.

9. Increased production costs

Shortly after the rupiah depreciated against the US dollar in mid 1997, several companies and industry representatives said that oil palm companies have been burdened with increased production costs. Initially, the sharp depreciation of the Indonesian rupiah lowered Indonesian producers' US-dollar production costs given the relatively high proportion of local currency costs.⁹⁷ However, after USD earnings decreased because of the export tax and the prices of goods were adjusted to accommodate the rising rupiah, production costs began to show a marked increase. Production costs also increased because imported goods such as machinery, fertilizers and pesticide were paid for in US-dollars. The situation worsened when the government instituted official wage increases to accommodate the rising cost of living incurred from the rupiah depreciation. In July 1998, The Ministry of Manpower announced it would increase minimum wages by an average of 15 percent. Wages were then further increased in April 1999 when the Chairman of the Planters Association, Soedjai Kartasmita, signed an agreement to increase estate workers' wages by another 40 percent.⁹⁸ Once this had been taken into account, companies were forced to pay their estate workers around Rp 250,000-Rp 260,000 a month compared to Rp 170,000 a month prior to the crisis.⁹⁹ This included a KRISMON (monetary crisis) allowance of around Rp 12,000-25,000 per month and a large

⁹⁶ Production costs in Malaysia now amount to 850 ringgit (US\$224) per ton compared with 450 per ton about a decade ago (Jakarta Post, Wednesday July 16, 1999).

⁹⁷ Ing Barings, 1998. *Plantation Sector Review*, Ing Barings Indonesia.

⁹⁸ Personal correspondence with Soedjai Kartasmita, Chairman of the Indonesian Planters Association in April 1999.

⁹⁹ Personal correspondence with the General Manager of Socfindo in April 1999.

subsidy for rice.¹⁰⁰ Given the above, the Chairman of GAPKI, Derom Bangun, estimated that oil palm expansion costs had increased from Rp 10 million per hectare before the economic crisis hit Indonesia to around Rp 20 million per hectare in 1998.¹⁰¹ It is likely that Bangun exaggerated these figures in order to build a case against the government's export tax policy. Imported goods and wage increases only account for a small proportion of production costs. Production costs did, however, increase marginally and this may have deterred some investors, particularly the smaller investors, from planting oil palm since early 1998.

IV. PROSPECTS FOR RESUMED GROWTH AND THE FATE OF FORESTS

In the foregoing we have seen that the Indonesian oil palm sub-sector grew at a phenomenal pace in the three decades prior to 1998, and then entered a period in which CPO production declined for the first time since 1969 and area growth began to slow down. The relevant questions to pose at this juncture are: (1) What are the prospects for renewed area growth?; and (2) If growth does resume, what potential impacts will this have on Indonesia's remaining natural forest cover?

Prospects for renewed growth

It is difficult to answer the first question with any degree of certainty because economic and political conditions in Indonesia remain unstable. However, it is possible to surmise that the oil palm sub-sector will continue to expand in the near future, in spite of the conditions described in Section III which have inhibited the process of growth. In fact, many companies have already started to boost their planting targets. For instance, PT Astra Agro Lestari has increased its planting target from 6,000 ha in 1998 to 10,000 ha in 1999.¹⁰² PT SMART also expects to increase its planting target from 20,000 ha in 1998/99 to 50,000 ha in 2000. These new plantings will come into production in the next four to five years.

CPO production is also expected to increase in 1999 to 5.6 million tonnes, a 13 percent increase over the 5 million tonnes produced in 1998. The increase in CPO production is mainly explained by increased rainfall once the El Niño drought subsided in mid-1998, and the maturation of plantings prior to the crisis. Increased yields per unit area will make investment more attractive in terms of increased efficiency of investment.

Several factors can stimulate the growth of the oil palm sub-sector. Among these factors are the following: (1) lower interest rates; (2) regulatory changes that facilitate further oil palm development; (3) debt restructuring opportunities; (4) land made available through the El Niño drought and related forest fires; (5) predicted growing world demand for crude palm oil; (6) the government's new export tax policy; and (7) cooperation between Indonesian and Malaysian producers to push up the price of oil palm and regain shares in the vegetable oil market.

¹⁰⁰ Personal correspondence with D.R. Hoare, President Director of PT Tolan Tiga in April 1999.

¹⁰¹ Personal correspondence with Derom Bangun in April 1999.

¹⁰² PT Astra Agro Lestari has in fact performed very well during the economic crisis as it recorded a net profit of Rp 223.4 billion in 1998 compared to Rp 90.6 billion in 1997. The company is expected to record a net profit of Rp187.3 billion in 1999.

1. Lower interest rates

Investors have recently been attracted to the sector by lower interest rates. In early 1999, the State Bank interest rate started to decline and reached 17.15 percent at the end of the first week of July 1999. This is a stark contrast to the extraordinary interest rate of 70% in mid 1998. The decline results from easing inflationary pressure and the strengthening of the rupiah. The interest rate is expected to decline further and return to its pre-crisis level of 15 percent within the next few months.¹⁰³ While this is good news for investors wishing to obtain credit to open up oil palm plantations, investors have been told that Indonesia's real sector should not expect local banks to resume significant lending in the immediate future even though the central bank benchmark interest rate has dropped to the pre-crisis level and major banks have been recapitalized. This is because domestic banks need more time to adjust their lending rate structure to reflect the current low interest rate environment. Banks that have received import financing deposits from the government may be able to immediately resume lending, albeit at a limited capacity because the funds were free of interest costs.¹⁰⁴ However, these banks are expected to adopt more stringent lending policies in order to differentiate between good and bad loan applicants.¹⁰⁵ In any case, once banks are able to resume lending, the lower interest rate environment is expected to encourage domestic investors to resume borrowing capital to establish oil palm plantations.

2. Regulatory changes that facilitate further oil palm development

In addition to regulatory changes aiming to reform the plantation sector, the government has made a number of regulations designed to stimulate the growth of the plantation sector. Some of these are discussed in further detail below.

- a) In January 1998, the government relaxed the foreign investment ban and encouraged investors to develop estates in Eastern Indonesia. By February 1999, the restriction was lifted altogether and foreign developers were invited to invest in the oil palm sub-sector throughout Indonesia. The government was initially forced to make this decision in accordance with the IMF agreement but it began to see the merits of the decision once the economic crisis worsened. Many domestic companies had by then begun to run out of capital to invest in the sector and the government began to actively encourage greater foreign investment in the sector again to keep the sector moving. The decision to open up the oil palm sub-sector to foreign investment has the potential to place greater pressure on Indonesia's forest cover. However, foreign investment performance has been relatively poor since the crisis unfolded and the consequences of this decision are yet to be realized.
- b) On 18 June 1998, the government gave State Forestry Companies (SFCs) permission to use 30 per cent of their concession areas for estate crops, including oil palm. Shortly after this decision was made, Inhutani III announced that it intended to convert 60,000 hectares or 20 per cent of its concessions, totaling 300,000 hectares in West and Central Kalimantan, into oil palm.¹⁰⁶ State Forestry

¹⁰³ Miranda Goeltom, Deputy Governor of Bank Indonesia, quoted in Jakarta Post, Interest rate may return to 15%, BI says, June 29, 1999, p1.

¹⁰⁴ Jakarta Post, Interest rate may return to 15%, BI says, June 28, 1999, p1.

¹⁰⁵ Pardede, Raden, 1999, Survey of Recent Developments, in *Bulletin of Indonesian Economic Studies*, Vol 35, no. 2, Indonesia Project, The Australian National University, p35.

¹⁰⁶ Jakarta Post, June 18, 1998.

Companies are usually awarded concession rights in permanent production forest rather than conversion forest lands. The decision will therefore contribute to, and legitimize, expansion of estate crops onto permanent production forest land. Estate crops were previously only supposed to be established on conversion forest land, which supposedly have less forest cover than permanent production forest land.

- c) In June 1998, the government released plans to increase the budget allocations for local administrations in the 1999/2000 fiscal year in a bid to give them greater autonomy in managing the country's forest assets. The Minister of Forestry and Plantations, Muslimin Nasution, said that the amount to be managed by provincial offices to develop forests in their areas would be raised by 79.1 per cent to Rp 177.4 billion from Rp 99 billion in the current fiscal year, ending in March 1999.

The decision to give local administrations greater autonomy has been formalized through the passing of two laws (UU No 22 and 25). Law No.22, merely states that that the central government will endeavor to delegate more authority to the provincial and *Kabupaten* (regional) governments. Law No 25¹⁰⁷ outlines tax revenue allocations for natural resource sectors. Under the allocation system devised in the law, regional governments would receive 80 percent of tax revenues from fisheries, forestry and mining.

Both of these laws, particularly Law No 25, have the potential to accelerate deforestation and plantation development. According to Brown (1998) the natural resource tax revenue allocations will not be sufficient to maintain or replace regional government budgets in most cases. Provincial governments will therefore find it difficult to generate enough revenue from current levels of resource exploitation. This will force them to further exploit their natural resources in order to make up for the shortfall in revenue.

- d) In March 1999, the government released a regulation¹⁰⁸ that seeks to simplify the licensing procedure for developing new plantation areas to encourage more investment in the oil palm sub-sector. Investors have long been complaining about the arduous and costly application process they have had to undergo to acquire a HGU (right to use land). The process requires investors to go through a ten step process in order to obtain five licenses from the Ministry of Forestry and Estate Crops, including forest relinquishment and wood use permits, before they can clear land and start planting.¹⁰⁹ In late June 1999, the Investment Coordinating Board (BKPM) threw its support behind the plan and asked the President's approval to become the sole agency responsible for issuing business permits in the

¹⁰⁷ See Chapter 3, Article 6.

¹⁰⁸ Plantation Use Permit Regulation, 107/Kpts-II/1999.

¹⁰⁹ (1) Submit an application to the Governor stating an intention to develop a plantation in a set area to various provincial bodies; (2) conduct a land survey of the area; (3) submit an application to the Ministry of Forestry and Estate Crops stating a desire to develop a plantation in a set area once the development has been approved by provincial bodies; (4) apply to the Ministry of Forestry and Estate Crops for an agreement in principal (*izin prinsip*); (5) conduct a feasibility study on the development; (6) apply to Kepala Badan Pertanahan Nasional Kabupaten for a location permit (*izin lokasi*); (7) apply for acquisition of land (*pembebasan tanah*) and pay out compensation payments; (8) apply to the Ministry of Forestry and Estate Crops for a permit to release any forest land (*izin pemanfaatan kayu*); (9) apply to the Kepala Badan Pertanahan Nasional for the right to use the land (*Hak Guna Usaha*); (10) conduct an environmental impact statement (AMDAL).

plantation sector.¹¹⁰ The agency argued that pooling the licensing process under BKPM would cut the complicated bureaucratic procedures faced by potential investors when applying for business permits. Instead of going to four agencies¹¹¹ in order to acquire the necessary licenses required, potential investors could just go to the one agency—BKPM. The government has not yet made any changes to the HGU application process but the concept has been well received by potential investors.

- e) In August 1999, the government released a new regulation which gives plantation companies the right to establish tree crops and timber plantations in non-productive¹¹² production forest formerly allocated to logging companies.¹¹³ This new development has been termed *Hutan Tanaman Campuran*, or Mixed Forest Plantings. Companies that choose to use this opportunity will be required to adopt one of the government's cooperative schemes mentioned in Section III. Companies are then able to obtain a maximum land holding of 50,000 hectares in any one province or 100,000 hectares in Irian Jaya. Forty percent of the concession can be allocated to estate crops and the rest is to be planted with timber plantations. However, if companies wish to invest in rubber they can develop the entire concession area with rubber trees.

This new regulation has the potential to be particularly damaging to Indonesia's forest cover as it gives plantation companies the right to plant oil palm, or other tree crops, in production forest. The regulation also gives logging companies little incentive to practice sustainable logging techniques or to rehabilitate their concessions. This is because forest land allocated to logging companies can now be directly converted to plantation crops after the HPH license expires. Logging companies are therefore more likely to clear cut their concessions rather than use selective logging techniques.

- f) In October 1999, within the last days of President Habibie's presidency, a new presidential decree was announced which gave provincial administrations full authority to approve foreign and domestic investment. Under the new regulation, foreign investors have three options for obtaining investment approvals: through Indonesian representative offices in their respective countries; through the Investment Coordinating Board (BKPM) in Jakarta; or by applying directly to the Provincial Investment Office (BKPMO). Foreign investments worth up to US\$100 million could previously only be issued by BKPM or by the President himself if the investment exceeded \$100 million. BKPMO was previously only allowed to approve domestic investment on projects worth less than Rp 10 billion.¹¹⁴ Provincial Investment Offices will be eager to accept investment in order to generate much needed revenue and oil palm investors will be eager to take advantage of simplified investment procedures. It is possible investments will be

¹¹⁰ The Jakarta Post, BKPM wants monopoly in plantation permits, June 23, 1999, p8.

¹¹¹ For instance, Investors must obtain a forest relinquishment permit from the Ministry of Forestry and Plantations, the right-to-use land title from the National Land Agency (BPN), a location permit from the local administration and investment approval from BKPN.

¹¹² Containing less than 20 cubic metres of timber per hectare.

¹¹³ Ministry of Forestry and Estate Crops Regulation, Number 614/Kpts-II/1999 about Directives on the Development of Mixed Forest Plantings.

¹¹⁴ Jakarta Post, Provinces may issue investment permits, 14 October 1999, p1.

pushed through without much consideration for local communities or the environment.

3. Debt restructuring opportunities

Since mid-1997, the IMF has encouraged private companies to restructure their debts.¹¹⁵ The restructuring of corporate debt is considered to be imperative for the recovery of the Indonesian economy and IBRA (The Indonesian Bank Restructuring Agency) has been established to restructure the nation's collapsed banking system. In this capacity, IBRA has the legal authority to require companies to pay back non-performing loans and seize corporate assets of companies that do not pay their debts to banks under IBRA's management. However, the agency has been reluctant to call in non-performing loans because they wish to allow companies to record positive cash flows in order to maintain asset value and contribute to Indonesia's economic recovery. In doing so, the agency has allowed many companies to continue to operate despite being technically bankrupt.¹¹⁶

In addition to corporate debt restructuring being undertaken by IBRA, a number of Indonesia's oil palm companies have entered into private debt restructuring programs with their creditors to stay afloat. While the fate of these companies is uncertain, debt restructuring has raised their chances of survival and it may enable them to continue with their expansion programs. The most significant debt restructuring programs being undertaken in the oil palm sub-sector are those of PT London Sumatra Indonesia Tbk and PT Bakrie Sumatra Plantations.¹¹⁷

PT London Sumatra Indonesia appointed HSBC Investment Bank Plc as the coordinator of its debt restructuring program with external creditors in April 1998. However, HSBC was unable to successfully restructure the company's US\$ 262 million debt before it was announced that a memorandum of understanding between LonSum and Lazard Asia Investment Ltd¹¹⁸—a Hong Kong investment bank—had been entered into. In accordance with this memorandum, LonSum agreed to replace three of its board members with Lazard Asia executives.¹¹⁹ While Lazard Asia agreed to take over LonSum's debt restructuring program and expressed an intent to acquire a 50 percent stake in the company through the issuance of 486.5 million new shares valued at \$US100 million.¹²⁰ Funds generated through this transaction will be injected directly into the company. The funds will be used to finance the construction of a new

¹¹⁵ According to BPPN, there is approximately US\$65 billion in offshore debts and Rp 150 trillion of domestic unserviced debts outstanding. See the IBRA homepage: <http://www.bppn.go.id>.

¹¹⁶ For instance, the Salim Group pledged a mixture of cash, property and assets to IBRA to pay for liquidity injections made by the government to their banks amid bank runs during the early weeks of the crisis. While IBRA could directly manage those assets if it chose to do so, it has instead allowed the previous owner to continue running their companies with virtually no oversight.

¹¹⁷ Whilst PT Astra International is undergoing debt restructuring, the company's plantation subsidiary PT Astra Agro Lestari is performing well and is not involved in the process.

¹¹⁸ Lazard Asia, part of the Lazard Group, attracted market attention last year when it bought a controlling stake in the listed newspaper company Sing Tao Holdings which runs English and Chinese dailies in Hong Kong. In Indonesia it is the second largest shareholder of Jakarta International Hotel and Development—the owner of the five-star Hotel Borobodur.

¹¹⁹ Andre Pribadi, Wilson Pribadi, Ibrahim Risjad and Henry Liem resigned from the Board in June 1999. They were replaced by four Lazard Asia executives including Chief Executive Patrick Cheung and Deputy Chief Executive Helen Wong. (The Asian Wall Street Journal, 30 June 1999, p4).

¹²⁰ Financial Times, Troubled Indonesian Plantation Owner sells stake to Lazard Asia, 30 June 1999, p14.

mill in South Sumatra. Any remaining funds will be used to develop LonSum's concessions in South Sumatra and East Kalimantan.¹²¹ As oil palm takes at least 3 years to mature from planting, it is in LonSum's best interest to expedite the planting program to generate cash flow to repay its rescheduled loans starting in 2003.¹²²

Bakrie & Brothers entered into negotiations to restructure the group's US\$1.02 billion debt in January 1998.¹²³ Eight of the group's subsidiaries, including PT Bakrie Sumatra Plantations are involved in the process. In early September 1999, the conglomerate signed a debt restructuring agreement with its 300 creditors.¹²⁴ Under this agreement, Bakrie and Brothers will restructure its debt through a debt-to-equity swap. The restructuring involves the establishment of a Master Special Purpose Vehicle (MSPV) company, through which creditors will take over 80 percent of Bakrie & Brothers' shares in five of its subsidiaries—Iridium (2.2%), PT Arutmin Indonesia (20%), PT Bakrie Kasei Corporation (25.5%), PT Bakrie Electronics Company (70%) and PT Bakrie Sumatera Plantations (52.5%).¹²⁵ In addition, this new company will own 30 percent of Bakrie & Brothers through the issuance of new shares on a fully diluted basis.¹²⁶ Once Bakrie & Brothers have successfully restructured the companies debt, the company will be able to continue its operations and enhance its future performance. While, Bakrie Sumatra Plantations is not expected to expand its plantation estate in the very near future, the debt restructuring process will enable it to consider the prospect in the year 2000. While Bakrie's concessions in West Kalimantan¹²⁷ have already been revoked by the Ministry of Forestry and Estate Crops, the company hopes to be able to expand its oil palm estate area in Sumatra.¹²⁸

¹²¹ Business Times, Lazard Asia buys 50% stake in London Sumatra, 30 June 1999, p8.

¹²² Lazard Asia has, however, stressed that they will only purchase a 50 percent stake in the company if they can be assured of the right to use the land (HGU) for up to 25 years in South Sumatra and East Kalimantan. LonSum are therefore expected to make every effort possible to secure the title to this land in the very near future. They have too much at stake if Lazard Asia does not buy a 50 percent stake in the company. The process to obtain a HGU for these areas is therefore expected to be pushed through quickly in order to secure the deal. While social and environmental due diligence is supposed to be adhered to when restructuring corporate debt, LonSum's expansion plans will undoubtedly increase social conflict and adversely affect the livelihoods of local communities. Local communities and NGOs have long been protesting against the planting of oil palm on their traditional lands in both of LonSum's expansion areas. LonSum is accused of violating the communities' customary land rights, destroying productive agro-forestry gardens, desecrating Dayak burial sites to clear forest land for oil palm, and clearing forest land without an IPK (permit to clear timber). Previous activities in LonSum's expansion areas have already resulted in local NGO staff being fired on by security forces, the arrest of 12 villagers and the disappearance of four others. For further information on this see Christian Goenner's web site on London Sumatra: <http://members.xoom.com/Oilpalm/LonSum.html>.

¹²³ Jakarta Post, Bakrie to complete debt restructuring in September, June 25, 1999, p8.

¹²⁴ Among Bakrie & Brothers creditors are: Credit Suisse, Rabobank Nederlands, PT Bank Credit Lyonnais, Japan Asia Investment, Chase Manhattan Bank, Bankers Trust Company, NM Rothschild and Sons, Deutsche Bank, National Australia Bank, HSBC, and American Express Bank. These creditors will eventually own a stake in the company in accordance with the debt restructuring program.

¹²⁵ Bakrie & Brothers, Annual Report, 1999, Bakrie & Brothers, Jakarta.

¹²⁶ Jakarta Post, Bakrie to complete debt restructuring in September, June 25, 1999, p8.

¹²⁷ Dinas Perkebunan, March 1999, Informasi Pembangunan Perkebunan di Kalimantan Barat, Pontianak.

¹²⁸ Personal correspondence with the Director of Finance, Bakrie Sumatra Plantations, in April 1999.

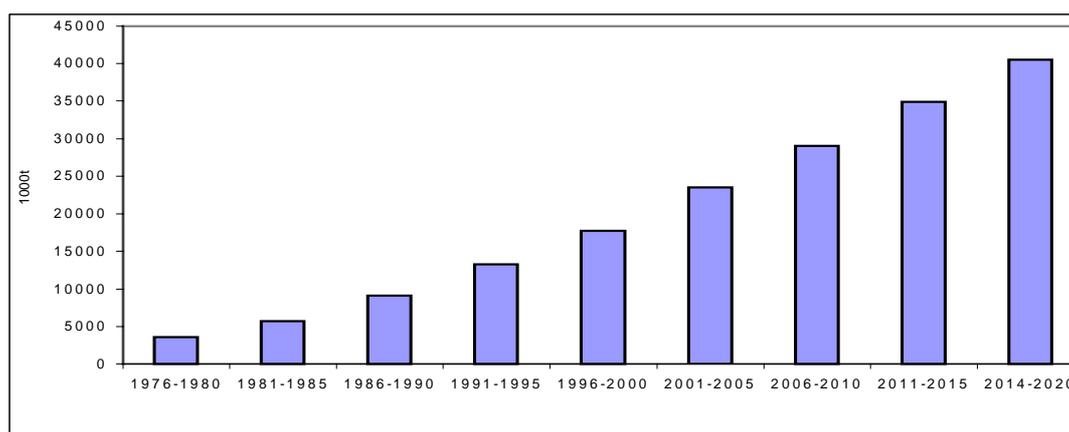
4. Land made available through the El Niño drought and related forest fires

The 1997-98 forest fires have left behind large tracts of degraded land that will be attractive to prospective investors if the regulatory environment improves in Indonesia. When the El Niño drought hit Indonesia, palm oil companies took advantage of dry conditions to burn in order to clear land for oil palm plantations. In October 1998, 176 companies were accused of practicing forest burning, 133 of which were oil palm plantation companies.¹²⁹ These companies originally intended to use land cleared by fire for further oil palm development. However, many companies have not yet been able to because of difficulties faced during the recent period of economic and political change. Once the regulatory environment improves and the political and economic situation in Indonesia stabilizes, oil palm companies will inevitably return to land cleared by the fires to establish further plantations. The government has also indicated that idle forest land burned during the 1997-98 forest fires will eventually be allocated to plantation companies.¹³⁰

5. Growing world demand for crude palm oil

Demand for crude palm oil is expected to grow in coming years and reach 40.5 million tonnes by the year 2020 (See Figure 11).¹³¹ This will be a 42 percent increase compared to total world production in 1998 which reached 17.7 million tonnes. Most of the demand for palm oil will continue to come from within Indonesia itself, China, India, Pakistan and Malaysia. As demand increases, *OilWorld* predicts that palm oil will become the leading oil in about 2012.¹³² Palm oil producers are expected to increase their share in the vegetable oil market because: (1) palm oil trees produce a much higher yield per hectare than any other seed oil; and (2) palm oil can usually be produced more cheaply than other vegetable oils. World demand for palm oil may, however, be deterred by the political and economic crisis in Indonesia. If political and economic stability does not soon return to the country, investors will be kept away and palm oil producers will find it difficult to increase their share in the vegetable oil market.

Figure 11—Actual and projected global demand for CPO up until 2020



Source: OilWorld 2020.

¹²⁹ See Wakker Eric, 1998. *Lipsticks from the rainforest: Palm oil, crisis and forest loss in Indonesia: the role of Germany*, WWF Germany, p 3.

¹³⁰ Personal correspondence with Director of Planning, Ministry of Forestry and Estate Crops, in October 1999.

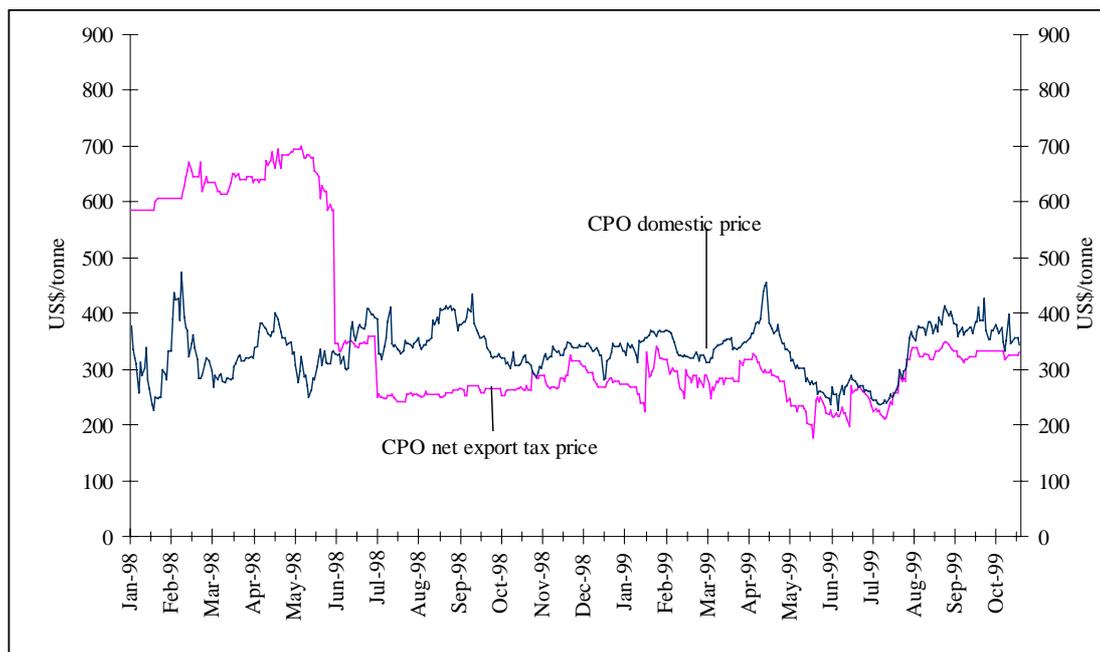
¹³¹ OilWorld 2020, p46.

¹³² Oil World 2020, May 1999, p12.

6. The government's drastic reduction of the export tax

Some investors have recently returned to the oil palm sub-sector because of the government's willingness to reduce the export tax on CPO. In June 1999, the price of CPO and cooking oil on the domestic market stabilized and the export tax was reduced to 30 percent. This was later reduced to 10 percent in July 1999, almost six months before the Indonesian government was obliged to in accordance with the IMF agreement. The market initially reacted positively to the decision. Shortly after the tax was reduced from 60 percent to 30 percent, share prices of listed oil palm companies jumped to near pre-crisis levels. These share prices have since declined in response to the record low price for CPO on the world market, but PT SMART's shares seem to have continued to increase since its holding company—PT Golden Agri Resources was listed on the Singapore Stock Exchange in early 1999 (See Appendix C). The government is obliged to keep the export tax at a maximum of 10 percent in accordance with the IMF agreement. Many companies have not yet taken advantage of the government's new export tax policy because the domestic price for CPO has exceeded the world price for CPO (see Figure 12). However, a low and consistent export tax policy will attract investors to the sector once the world CPO price increases. Companies will then be able to increase their profit margins and resume planting programs.

Figure 12—The net export tax price for CPO compared to the Indonesian domestic price for CPO.



Source: PPS, Ministry of Industry and Trade, Danareksa Sekuritas.

7. Plans to boost the world price for CPO

The Indonesian government has begun to cooperate with the Malaysian government to increase the CPO price and regain palm oil's former share of the world vegetable oil market. The cooperation would be focused on ways to promote the use of CPO on the world market amid the increasingly popular use of other edible oil such as soybean. Muslimin Nasution said the cooperation could be directed toward forming a

joint marketing agreement to control supply and demand to make prices stable.¹³³ Muslimin was, however, careful to add that the joint marketing agreement would not operate as a cartel, since it could not set prices.¹³⁴

The Malaysian Primary Industries Minister, Lim Keng Yaik, has also urged Malaysian palm oil producers to form partnerships with producers in Indonesia as prices decline.¹³⁵ Malaysian producers have been encouraged to engage Indonesian producers and exporters in talks to improve the price situation and formulate a 'combined marketing strategy'.¹³⁶ Lim encouraged palm oil producers to cut or at least stabilize the cost of production to ensure profitability and reduce the impact of the steep decline in palm oil prices.

If partnerships between Indonesian and Malaysian producers are formed, we can expect to see an increase in the world price of CPO. In fact, prices have already increased slightly since August 1999 and in September 1999 reached an average of \$USD386 per tonne. The increase is mainly attributed to increased demand for CPO in India and less than expected soybean oil production. CPO prices are likely to remain low until demand increases during the month of Ramadan at the end of 1999. Once CPO prices increase, we can expect to see further expansion occur in the oil palm sub-sector. A price increase will encourage companies to increase CPO exports. In doing so, they will be able to increase their net profits and cash flow, especially now that the export tax on CPO has been cut to 10 percent. They will then be more able to finance further planting programs.

The impact of resumed growth on Indonesia's natural forest cover

Having argued that the Indonesian oil palm sub-sector looks poised for further growth, it is important to determine where this growth will occur and what implications it will have on Indonesia's forest cover. Prior to the crisis, most oil palm development occurred within Sumatra. However, since the late 1980's the Suharto government attempted to redirect development into Eastern Indonesia. This has resulted in some oil palm development in Kalimantan and Irian Jaya (See Figure 1). The Habibie government was committed to former President Suharto's policy of directing plantation development to Eastern Indonesia, primarily Kalimantan and Irian Jaya. To facilitate this growth, the Habibie government allowed companies wishing to establish plantations in Irian Jaya to double their land holdings. Companies were able to utilize 40,000 hectares of land in Irian Jaya as opposed to 20,000 hectares in other provinces.

The Habibie government also demonstrated its willingness to support further development in Irian Jaya by giving permission to 28 Indonesian private companies to open large scale oil palm plantations in that province. If realized, the investment would make the province one of the world's main crude palm oil producers.¹³⁷ Five of the 28 investors have already opened plantations in Irian Jaya.¹³⁸

¹³³ Jakarta Post, Malaysia's help sought for CPO price hike, July 28, 1999, p9.

¹³⁴ The Jakarta Post, Malaysia's help sought for CPO price hike, July 28, 1999, p9.

¹³⁵ Jakarta Post, Malaysian-RI palm oil producers' axis sought, July 14, 1999, p9.

¹³⁶ Jakarta Post, Malaysian-RI palm oil producers' axis sought, July 14, 1999, p9.

¹³⁷ The Jakarta Post, Irian Jaya attracts 29 local oil palm investors, November 9, 1998, p11.

¹³⁸ They are state plantation company PT Perkebunan Nusantara II, PT Varita Majutama, PT Sinar Mas Group, PT Texmaco and PT Korindo. PT Perkebunan Nusantara II is a BUMN company which in 1982 opened oil palm plantations on 10,000 hectares in the Arso subdistrict, Jayapura district, and on 4000

In addition to Irian Jaya, the Habibie government also had large-scale plans for oil palm expansion in Kalimantan. In October 1998, the government announced plans to establish one million hectares of oil palm in East Kalimantan in the Kutai, Pasir and Bulungan regencies.¹³⁹ Moreover, according to a report published by the West Kalimantan regional plantation office, *Dinas Perkebunan*, the government has already allocated around 1.5 million hectares of land to oil palm companies for development in the near future.¹⁴⁰

However, despite the government's grand plans for expansion of the oil palm sub-sector, some oil palm companies are hesitant about establishing plantations in Irian Jaya and Kalimantan for the following reasons:

- *Ethnic unrest.* This is often attributed to the government's PIR-transmigration program, which established plantations with transmigrant labor in the outer islands of Indonesia and often resulted in social conflict between local people and transmigrants. These conflicts have increased during the reform era.
- *Poor infrastructure.* Oil palm trees produce fruit on a continuous basis, with seasonal variations. Once ripe, the fresh fruit bunches must be processed quickly to prevent a build up of acid in the oil. Fruit which has not been crushed within 48 hours has limited value. Roads in Kalimantan and Irian Jaya tend to be poor in comparison to roads in Sumatra and this can greatly affect the ability of companies to process the fruit within 48 hours.

Companies are, however, interested in the timber that can be harvested from oil palm concessions in Irian Jaya and Kalimantan. This explains why the majority of companies setting up in these regions have strong links with logging companies.¹⁴¹ It also may explain poor performance in realizing their plantation targets. For example, by March 1999, the government had issued location permits for the development of 871,211 hectares of oil palm plantations in West Kalimantan. However only 18,278 hectares had actually been planted.¹⁴² Admittedly some companies have been unable to plant oil palm because of the above mentioned difficulties encountered during the economic crisis. But, despite these difficulties, performance has been extremely poor and this fuels the suspicion that these companies are more interested in exploiting the timber from allocated concessions than in establishing oil palm plantations.

hectares in the Prafi subdistrict, Manokwari district. The state company has also developed a CPO processing plant and is currently harvesting. Varita Majutama has opened a 2,500 hectare oil palm plantation in Babo subdistrict, Manokwari district. Sinar Mas, one of the country's biggest CPO producers, opened oil palm plantations on 4000 hectares Lereh, Kabupaten Manokwari. Texmaco and Korindo opened plantations in the Merauke district, each on 3,000 hectares.

¹³⁹ The project is estimated to need Rp 7 trillion in investment.

¹⁴⁰ Dinas Perkebunan, March 1999, *Informasi Pembangunan Perkebunan Di Kalimantan Barat*, Pontianak.

¹⁴¹ A number of conglomerates are involved in the pulp and paper as well as the plywood sector. Some of these include: Raja Garuda Mas, Sinar Mas, Korindo, Benua Indah, Astra International, Barito Pacific and the Salim Group.

¹⁴²¹⁴² Dinas Perkebunan, March 1999, *Informasi Pembangunan Perkebunan Di Kalimantan Barat*, Pontianak.

Companies actually interested in establishing oil palm are more likely to develop estates in the provinces of Riau, Jambi, and South Sumatra in the near future. Oil palm investors prefer to establish estates in these regions because Sumatra possesses the best climate and soil conditions in the country for cultivating oil palm and has the necessary infrastructure for palm oil processing already in place. Companies also prefer to invest in Sumatra because the estate workers (primarily Javanese in origin) are used to plantation life and culture and work harder than the indigenous peoples of Kalimantan, Sulawesi and Irian Jaya.¹⁴³

The desire to open oil palm plantations in Sumatra is confirmed by the recent forest fires that occurred in August 1999. Using satellite imagery, these fires have already been linked to oil palm companies wishing to clear land for further oil palm development.¹⁴⁴ The Director of *Dinas Perkebunan*¹⁴⁵ in Pekanbaru, Riau, also revealed that investors, particularly Malaysian investors, are continuing to expand and develop estates in the province. This is despite problems arising from recent political and economic change. The regional forestry and plantation office is hard-pressed to find land for these new developments and have asked the Malaysians to invest in down-stream processing plants rather than oil palm plantations. The Malaysians rejected the offer and stressed their desire to invest in plantations only.¹⁴⁶

Because most plantation companies still wish to open estates in Sumatra, forest area allocated for conversion to plantations (*Hutan Produksi yang dapat dikonversi*, HPK) has been placed under considerable pressure. According to the Ministry of Forestry and Estate Crops, approximately 4.1 million hectares of forest land has been converted to plantations since 1982.¹⁴⁷ Most of the land converted (3.3 million hectares) was on conversion forest land—forest land actually designated for plantation development. However, plantations were also developed on around 166, 532 hectares of limited production forest (*Hutan Produksi Terbatas*, HPT),¹⁴⁸ 455, 009 hectares of production forest (*Hutan Produksi*, HP),¹⁴⁹ and 129, 449 hectares of forest land designated for other uses (*Penyediaan Area Penggunaan Lain*, PAPL) (See Figure 13).¹⁵⁰

¹⁴³ This view was expressed by a number of plantation companies interviewed during the period in which this research took place.

¹⁴⁴ See for instance, the Centre for Remote Imaging, Sensing and Processing (CRISP), National University of Singapore website at: <http://www.crisp.nus.edu.sg/>. This has also been confirmed by field visits conducted by USAID.

¹⁴⁵ The provincial office for plantations. Dinas Perkebunan is answerable to the governor of a given province.

¹⁴⁶ Personal correspondence with the Director of Dinas Perkebunan, Pekanbaru, Riau in October 1999.

¹⁴⁷ It's important to note that this figure includes rubber, coffee, tea and other estate crop plantations, as well as oil palm.

¹⁴⁸ According to the government, limited production forest can only be selectively logged. Only logs more than 50 cm³ can be extracted from limited production forest.

¹⁴⁹ Production forest is designated for timber extraction.

¹⁵⁰ In accordance with the original Forest Land Use Consensus (TGHK), this category doesn't exist. It seems to have been created in order to accommodate conversion and timber extraction.

The conversion of forest land to plantations has resulted in significant conversion forest deficits¹⁵¹ in the provinces of Riau, Jambi, Bengkulu and West Sumatra. This is confirmed by statistics recently released by the government which show conversion forest deficits in a number of Sumatra's provinces. Conversion forest deficit is here defined as the total area of conversion forest converted to use for plantations and transmigration subtracted from the available conversion forest according to the 1982 Forest Land Use Consensus (TGHK) (See Figure 14).¹⁵²

The existence of conversion forest deficits in much of Sumatra partly explains why large areas of production forest and limited production forest are now being allocated to plantation companies in Aceh, North Sumatra, Riau, Bengkulu, Jambi, South Sumatra and Lampung. However, it does not explain why production forest is also being allocated to companies in the provinces of Central Kalimantan, East Kalimantan and Irian Jaya. Large areas of conversion forest are still available in these three provinces yet Figure 13 shows that a significant area of production forest has already been allocated to plantation companies in these three provinces. This suggests that oil palm plantations are going directly onto former HPH¹⁵³ sites. This has far-reaching implications as it means that logging companies are clear cutting their concessions in order to make way for oil palm plantations.

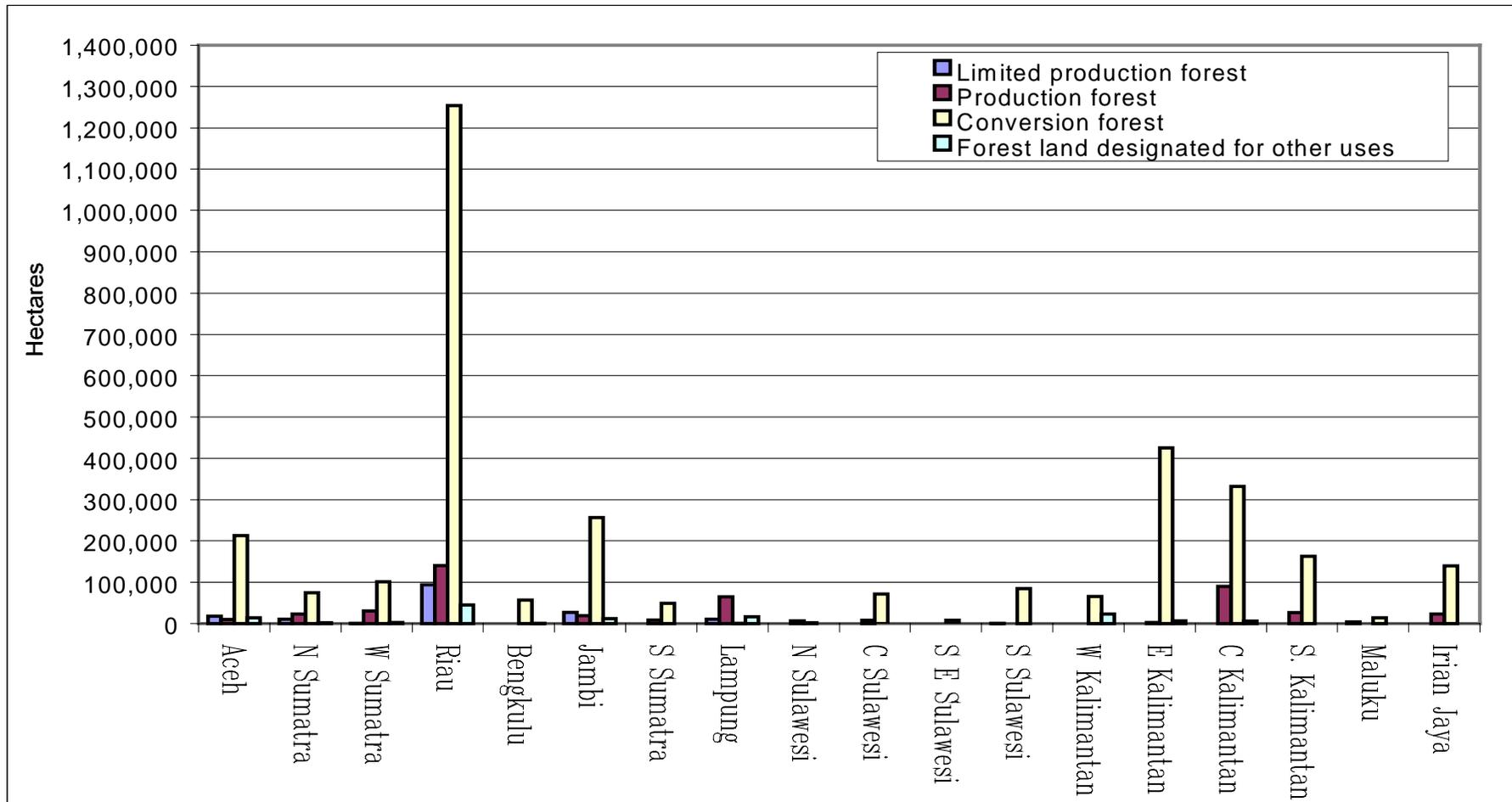
In recent years, the Indonesian government has faced mounting criticism from international donors and non government organizations about its policy to develop oil palm plantations on forest land. The Habibie government did take progressive steps to address the conversion of forest land to plantations by: (1) revoking the licenses of companies that have failed to realize their plantations; (2) placing a temporary moratorium on any new applications for forest conversion in October 1998; and (3) reassessing existing forest land in Indonesia through the 1999 Provincial Spatial Plan (RTRWP). The new Provincial Spatial Plan acknowledges that there is little conversion forest remaining in Sumatra's provinces, especially Aceh, Jambi, North Sumatra and Bengkulu. However, the new RTRWP states that 334, 521 hectares of conversion forest remain in Riau despite the significant conversion forest deficit revealed in Figure 15. Clearly the government has tinkered with these figures and they can not be considered accurate. They do, however, reveal the fact that serious problems exist in terms of forest land allocation and the way in which forest land is classified in Indonesia.

¹⁵¹ This implies that land already converted to plantations and use for transmigration exceeds forest land designated as conversion forest land in the 1982 TGHK.

¹⁵² Badan Planologi Kehutanan dan Perkebunan, March 1999, *Statistik Badan Planologi Kehutanan dan Perkebunan Tahun 1998/99*.

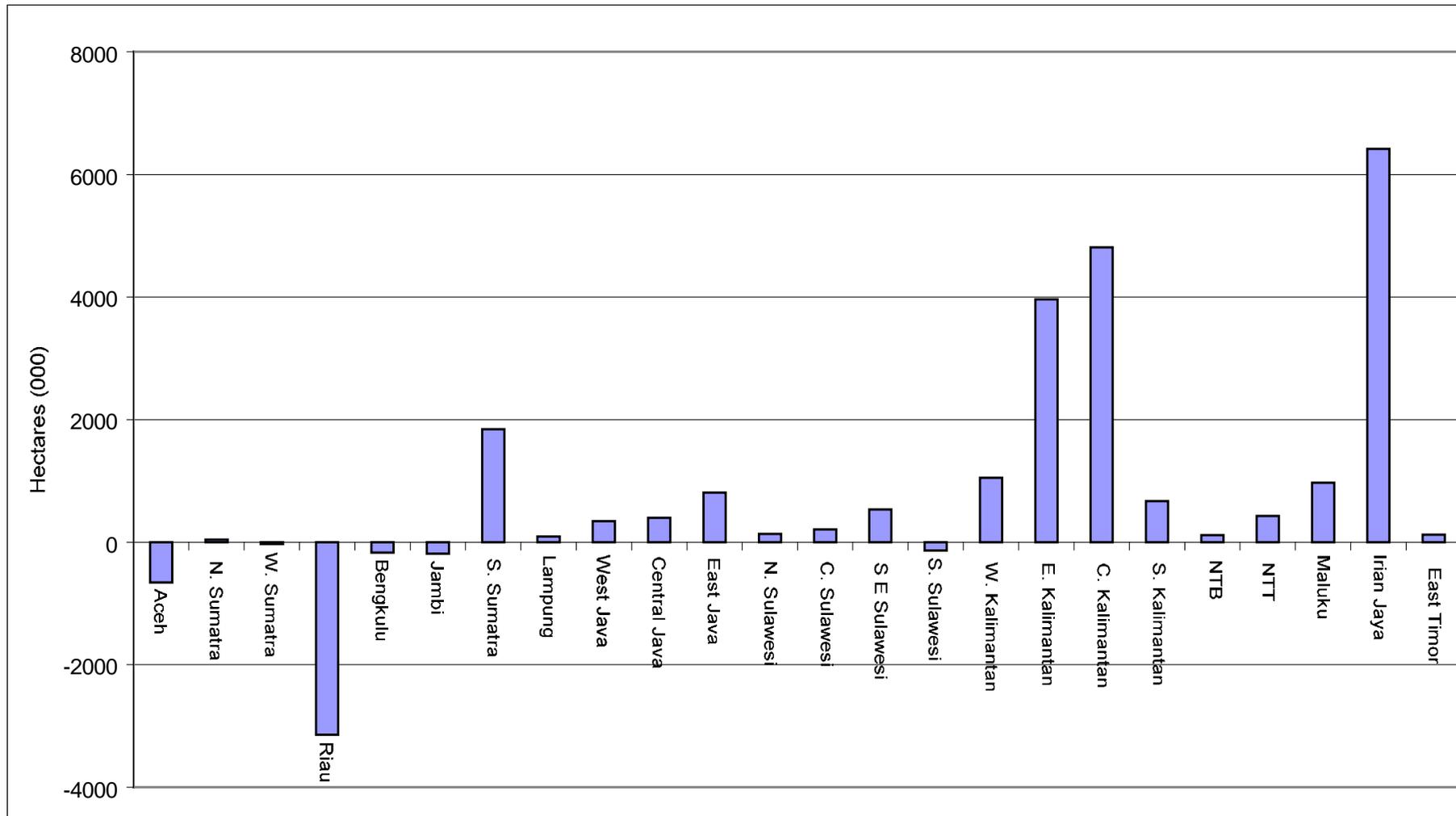
¹⁵³ Areas of land where a company has been granted a license for the selective harvest of natural forests over a 20 year period. This license is renewable for another 15 years. Indonesia has 464 HPH's spread across 51.5 million hectares, with 30 percent licensed to just five conglomerates (Brown 1998, pVI)

Figure 13—Forest land converted to plantations according to forest type and province since the 1982 TGHK



Source: Badan Planologi Kehutanan dan Perkebunan, March 1999, *Statistik Badan Planologi Kehutanan dan Perkebunan Tahun 1998/99*.

Figure 14—Remaining conversion forest according to the 1982 TGHK as of March 1999



Source: Badan Planologi Kehutanan dan Perkebunan, March 1999, *Statistik Badan Planologi Kehutanan dan Perkebunan Tahun 1998/99*.

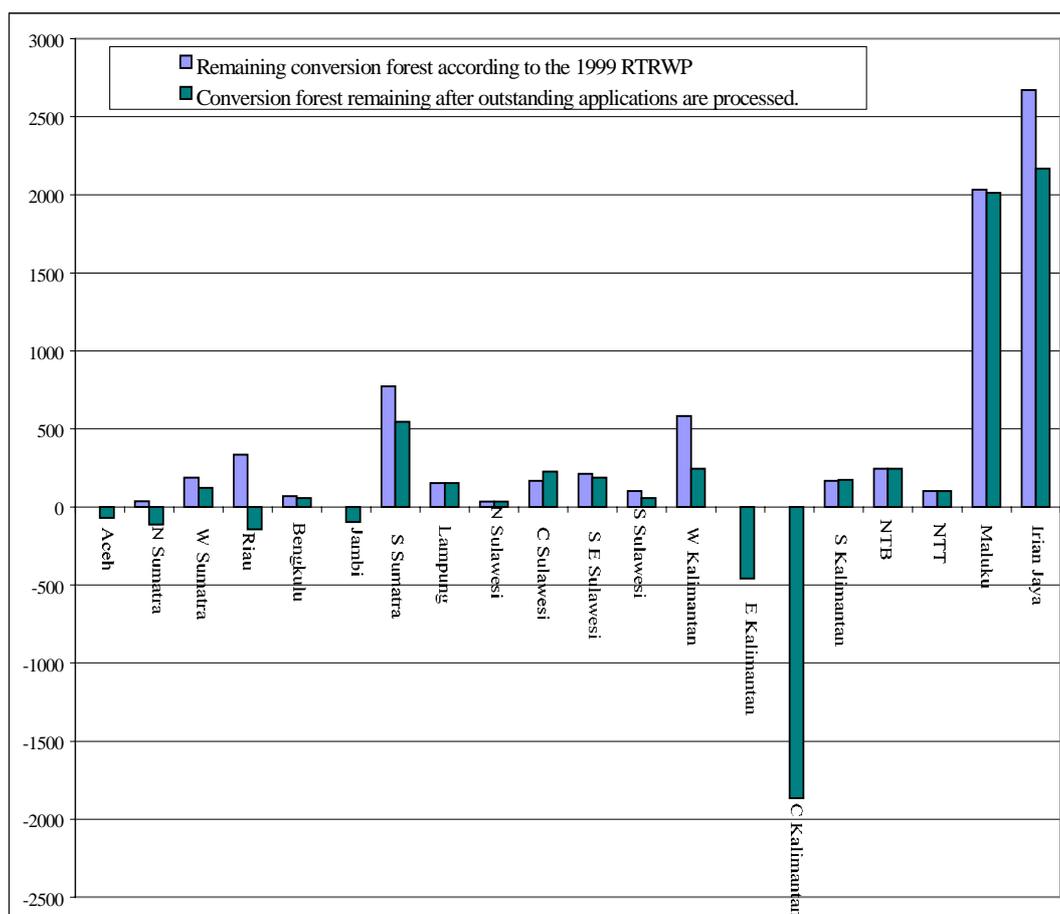
Questions surround the remaining outstanding applications for the release of 4.5 million hectares of forest land to plantations. The government has decided that any outstanding applications for the release of forest land, agreed to in principle and received before February 1999, will be processed. Preliminary data indicate that the outstanding applications already agreed to in principle will consume around 843,058 hectares of forest land. Around 70 percent of this land will be converted to oil palm.¹⁵⁴ Most of this forest land is in Riau (417,503 ha), Lampung (74,779 ha), Central Kalimantan (100,100 ha) and East Kalimantan (168,848 ha). Once these outstanding applications are processed there will be conversion forest deficits in Aceh, Riau, Jambi, East Kalimantan and Central Kalimantan in accordance with the new 1999 Provincial Spatial Plan (See Appendix H, Table 2). While we can expect to see real oil palm development in Aceh, Riau, South Sumatra and Lampung, many developers will only extract the timber they can fell in Central and East Kalimantan in the near term. This may, however, change once the environment for oil palm development in Indonesia becomes more favorable.

The fate of the remaining 3.6 million hectares already agreed to in principle is uncertain. The moratorium on further forest conversion for plantation development is only temporary and can be lifted at any time. If the government allows the remaining applications to be processed on conversion forest lands in accordance with the 1999 RTRWP, there would still be conversion forest deficits in Aceh, North Sumatra, Riau, Jambi, and significant conversion forest deficits would arise in East Kalimantan and Central Kalimantan (See Figure 15). This would inevitably mean that some of the outstanding applications will be located on remaining production forest land and increasingly on limited production forest land, particularly in East and Central Kalimantan. This has now been legitimized by the new *Hutan Tanaman Campuran* regulation and the decision to allow Inhutani's to convert 30 percent of their logging concessions to oil palm. Mounting anecdotal evidence also suggests that estate developments are moving into national parks and other forest areas of high conservation value.¹⁵⁵

¹⁵⁴ Personal correspondence with the Director of Planning, Ministry of Forestry and Estate Crops, Ir. Iman Santoso, October 1999.

¹⁵⁵ See for instance, Potter and Lee 1998b. Oil palm in Indonesia: its role in forest conversion and the fires of 1997/98, a report for WWF-Indonesia Programme; Basyar Hakim, *Perkebunan Besar Kelapa Sawit: Blunder ketiga kebijakan sektor kehutanan*, Elaw Indonesia and CePAS; EIA/Telapak. 1999. *The Final Cut: Illegal Logging in Indonesia's Orangutan Parks*. Environmental Investigation Agency, United Kingdom and Telapak Indonesia; and Sunderlin, W.D., 1998. *Between danger and opportunity: Indonesia's forests in an era of economic crisis and political change*; 11 September 1998 at <http://www.cgiar.org/cifor/>.

Figure 15—Remaining conversion forest according to the 1999 RTRWP and conversion forest remaining after outstanding applications are processed.

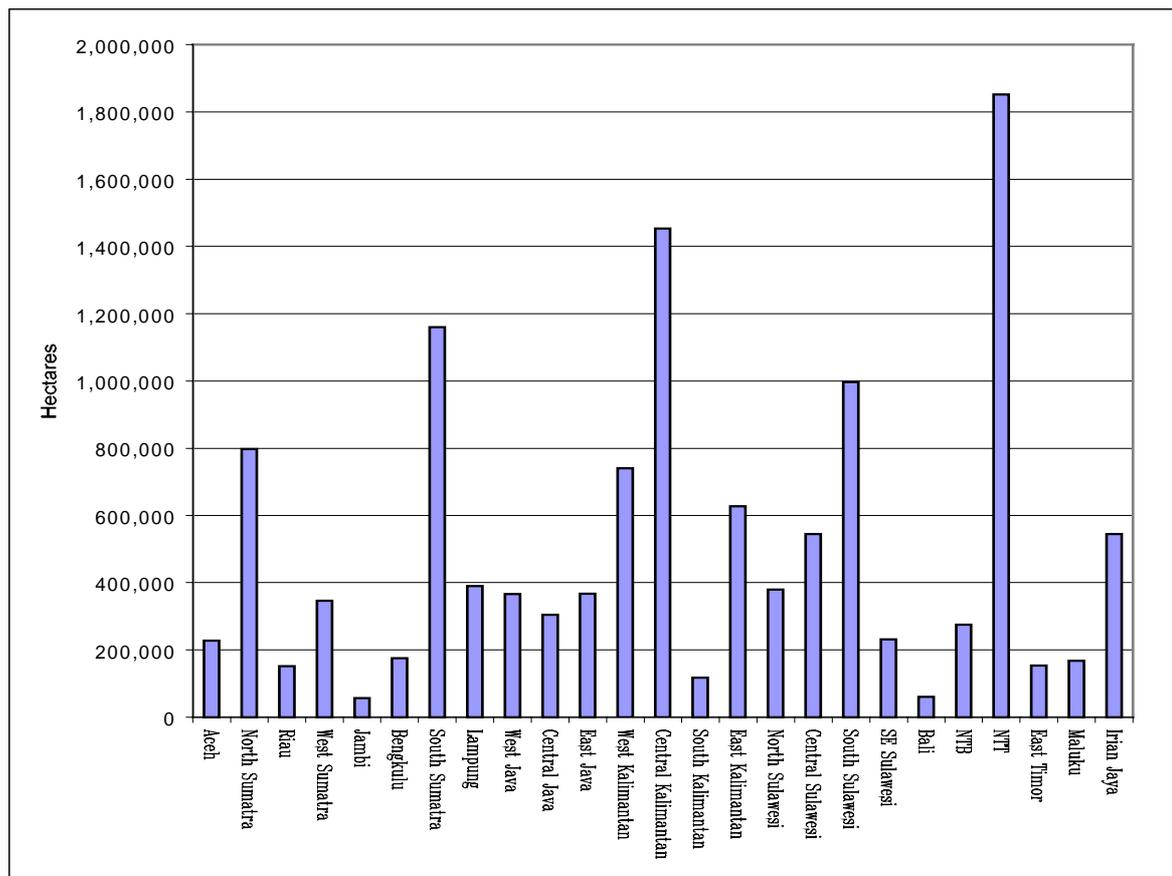


Source: Badan Planologi Kehutanan dan Perkebunan, March 1999, *Statistik Badan Planologi Kehutanan dan Perkebunan Tahun 1998/99*.

Alternatively, there is potential for outstanding applications and any future applications to be directed onto degraded lands.¹⁵⁶ Figure 16 shows that large areas of degraded land exist in many of the provinces earmarked for plantation development. This is particularly the case for Central and East Kalimantan. Redirecting plantation development to degraded lands would allow the government to continue to facilitate the development of the oil palm sub-sector while minimizing the impact of further development on Indonesia's existing forest cover. However, great care will need to be taken in order to ensure that further plantation development does not displace local people who have already occupied these lands. Care will also need to be taken to ensure that such a policy does not encourage plantation companies to purposely light fires in order to reclassify forest land as degraded land.

¹⁵⁶ This alternative is supported by a number of international institutions including the IMF and World Bank.

Figure 16—Available degraded land in 1998.



Source: Departemen Kehutanan dan Perkebunan, 1998. *Eksekutif Data dan Informasi Kehutanan dan Perkebunan, Biro Perencanaan, Sekretariat Jenderal, Departemen Kehutanan dan Perkebunan.*

CONCLUSION

The Indonesian oil palm sub-sector has rapidly expanded since 1967. Much of this growth has occurred in the last decade and posed a significant threat to Indonesia's existing forest cover. It has also displaced local communities and increased social conflict. At the beginning of the economic crisis, there was every expectation that the oil palm boom would not only continue, but also be propelled by the currency depreciation and lifting of foreign investment constraints. But a slowdown in area expansion and CPO production took hold instead. From early 1998 through to mid-1999, oil palm area expansion slowed significantly and CPO production declined for the first time since 1969.

The decline in growth can be attributed to the following factors: (1) the government's export tax policy; (2) reform policies that targeted the oil palm sub-sector; (3) social unrest and consequent withdrawal and withholding of foreign investment; (4) changes to the CPO distribution system; (5) credit access difficulties; (6) changes to the state-owned plantation sector; (7) the 1997-1998 El Niño Southern Oscillation phenomenon and consequent drought and fires; (8) and a precipitous decline in the world price of crude palm oil; and (9) higher than expected production costs

It now looks like the sector is poised for further growth because many companies have begun to increase their planting targets for 1999 and share prices have stabilized. Several factors have, and will continue to, stimulate this growth. Among these factors are: (1) lower interest rates; (2) regulatory changes that facilitate further oil palm development; (3) debt restructuring opportunities; (4) the availability of land cleared through the El Niño drought and related forest fires; (5) predicted growing global demand for CPO; (6) the government's drastic reduction of the export tax; (7) cooperation between Indonesian and Malaysian oil palm producers to push up the price of oil palm and regain their share of the vegetable oil market.

As the oil palm sub-sector is poised for further growth this paper attempted to determine where growth has already occurred, what impact this growth had on Indonesia's forest cover and the implications of further growth on Indonesia's forests. Over the last decade, oil palm development has primarily occurred within Sumatra and increasingly in Kalimantan. The Habibie government was committed to the Suharto government's former policy of directing plantation development to Eastern Indonesia, primarily Kalimantan and Irian Jaya, but the industry was more interested in developing palm oil plantations in Sumatra. This is because Sumatra has the necessary infrastructure required to process palm oil and an established plantation labor force.

The rapid development of oil palm in much of Sumatra has already resulted in significant conversion forest deficits. This has increased the potential for further expansion to be located within production forest, limited production forest and increasingly into protected forest areas.

While there has been less interest in developing oil palm plantations in Kalimantan and Irian Jaya, companies continue to apply for concessions so that they can gain access to timber readily available in these two outer island provinces. Although some of these companies actually intend to plant oil palm, many are primarily interested in the timber they can extract. This explains why many oil palm developments are

occurring on production forest land in Kalimantan and Irian Jaya. This is despite the availability of large areas of degraded land in much of Kalimantan. The allocation of production forest land to oil palm developers has accelerated conversion and environmental degradation.

It is too early to say whether or not the new government, led by President Abdurrahman Wahid and Vice President Megawati Soekarnoputri, will uphold recent policies implemented by the Habibie government. However, the new government is still in great need of export revenue and will probably facilitate further development of the oil palm sub-sector. This is evidenced by Gus Dur's recent attempts to encourage Chinese investors to return to Indonesia.¹⁵⁷ Further oil palm development will undoubtedly have an adverse impact on Indonesia's forest cover unless fundamental changes are made in the way it is implemented in the near future.

¹⁵⁷ Jakarta Post, Indonesia strives to woo investors, November 7, 1999, p1.

RECOMMENDATIONS

The Indonesian government, IMF and World Bank wish to support the development of the Indonesian palm oil sub-sector, particularly in the current era of economic crisis, for the following reasons: (a) the oil palm sub-sector has the ability to generate much needed foreign exchange; (b) the oil palm sub-sector is labor-intensive and can provide employment opportunities for those that have lost their jobs in the manufacturing and industry sectors; (c) and crude palm oil is a strategic commodity because it is a raw material of the main cooking oil consumed in Indonesia.

However, despite these benefits the rapid growth of the oil palm sub-sector has displaced local communities, resulted in social conflict, contributed to the devastation caused by the 1997-98 forest fires, and posed a significant threat to Indonesia's existing forest cover.

Given the above, it is necessary to promote policies that will allow the Indonesian people to continue to benefit from further oil palm development, yet minimize the adverse impact of future oil palm developments on local communities and Indonesia's remaining natural forest cover. The following proposed policy aims would address these diverging goals:

- The government should allocate concessions to companies wishing to open up plantations in Irian Jaya and Kalimantan only if they can demonstrate they can properly police their operations and ensure that these companies will in fact establish oil palm plantations rather than just exploit the timber.
- The government should not allocate any more production forest or limited production forest to plantation companies in Kalimantan and Irian Jaya. These parts of the country still have large areas of conversion forest remaining.
- The government should carefully consider further oil palm development in the provinces of Riau, Jambi, Aceh, Bengkulu, West Sumatra, North Sumatra, East Kalimantan and Central Kalimantan. The area of forest land considered suitable for oil palm development and conversion is already limited in these provinces. This increases the possibility of further oil palm development falling into production forest land, limited production forest land, protected forest land or national parks.
- The government should rethink its current procedure for land applications. Companies now receive a location permit and permit for clearing land before they have to carry out an environmental impact assessment.
- If the government is serious about limiting the size of land holdings private companies can obtain they should make sure that conglomerates can not acquire more land by opening up new companies.
- Local governments should actively consult local communities about further oil palm development before they allocate land to a particular company. When undergoing this process, communities should be given the opportunity to map

their land rights and reject applications that fall within customary forest land, fallow, sacred sites and community gardens. This process should help to minimize conflict on oil palm estates and be of benefit to both the community and the company involved.

- Estate companies should be encouraged to be more environmentally sensitive in site selection and preparation. The government may be able to facilitate this by putting in place a system of taxes, fines and other incentives that will lead to environmentally and socially acceptable plantation management. This should be accompanied by procedures for independent monitoring and enforcement.
- Funding agencies, particularly overseas funding agencies, should practice more due diligence when providing loans to oil palm companies. They should ensure that companies do have the intention of planting oil palm rather than just exploiting timber and should ensure that the companies they fund adequately consult the communities involved before starting operations. Funding agencies should also ensure that companies carry out environmental impact assessments before clearing land and establishing oil palm plantations.
- The government should reconsider its decision to allow plantation development on production forest land via the new *Hutan Tanaman Campuran* (HTC) regulation. The conversion of production forest land to oil palm is not considered to be necessary given that large areas of degraded land in Indonesia.
- The provincial land use plan (RTRWP) process clearly needs to be re-examined before any more applications for oil palm development are approved. There are numerous discrepancies in the process and quantitative data already suggest that there is a significant conversion forest deficit which needs to be addressed. Non governmental organizations and local communities should be encouraged to participate in the process to facilitate the designation of *adat* and community lands in future spatial plans.
- There is potential for directing outstanding applications and future applications to degraded lands rather than forest lands. Redirecting plantation development to degraded lands would allow the government to facilitate the development of the oil palm sub-sector while minimizing the impact of further development on Indonesia's existing forest cover. However, great care will be need to be taken to ensure that further plantation development does not displace local people who have already occupied these lands. Care will also need to be taken to ensure that such a policy does not encourage plantation companies to purposefully set fires in order to reclassify forest land as degraded land.
- The governments export tax policy may need to be reconsidered. The recent policy did appear to reduce the domestic price of palm oil products and address the domestic supply shortage. However, the policy also reduced revenues of the government and lowered profits for oil palm companies, and more importantly smallholders. Keeping the export tax policy down will certainly encourage further investment in the sector, especially once the price of oil palm on the world market increases. If further development benefits local people then this could be a good thing. But the trend seems to be that further development has an adverse impact

on the environment particularly forest cover. It also seems to displace local communities and increase social conflict.

- The decision to remove restrictions on foreign direct investment should be reconsidered. The Ministry of Forestry and Estate Crops initially enforced the ban on further foreign investment because competition for land in a number of Sumatra's provinces was excessively high. Recent statistics released by the government and discussed in the final section of this paper confirm this.

REFERENCES

- Amiruddin Mohd. Nasir, 1997. *Indonesian Palm Oil Industry—Kalimantan*, PORIM VIVA Committee, Viva No. 0044/97(25).
- Arifin Sultoni and Susila Wayan, 1998. *Development and prospects of the palm oil industry in Indonesia*, IARD Journal, Vol. 20, No 2, 1998.
- Arifin Sultoni, Drajat Bambang, Susila Wayang, Supriono Agus, Unpublished Paper, *The Impact of Economic Crisis on the Development of the Crop Sub-sector*, Kelompok Pengkajian dan Pengelolaan Sumberdaya Berkelanjutan.
- Astra Agro Lestari Tbk, 1997, *Annual Report*, Jakarta.
- Astra Agro Lestari Tbk, 1998, *Annual Report*, Jakarta.
- Badan Planologi Kehutanan dan Perkebunan, March 1999, *Statistik Badan Planologi Kehutanan dan Perkebunan Tahun 1998/99*.
- Bakrie & Brothers, 1998, *Annual Report*, Jakarta.
- Barlow, C. 1991. 'Developments in plantation agriculture and smallholder cash-crop production'. In: Hardjono, J (ed.) *Indonesia: resources, ecology and environment*. Oxford University Press, Singapore, 85-103.
- BPS 1997. *Statistik Indonesia: Statistical Yearbook of Indonesia 1996*. Biro Pusat Statistik, Jakarta Indonesia.
- Brown, Timothy, 1998. *Economic Crisis, Fiscal Decentralization, and Autonomy: Prospects for Natural Resource Management*, paper presented at an International Conference on 'The Economic Issues Facing the New Government', sponsored by the Institute for Economic and Social Research, Faculty of Economics, University of Indonesia and the United States Agency for International Development, Jakarta, August 18-19, 1998.
- Brown, David, 1999. *Addicted to Rent: Corporate and Spatial Distribution of Forest Resources in Indonesia; Implications for Forest Sustainability and Government Policy*, Report No: PFM/EC/99/06, DFID/ITFMP, Jakarta.
- Cameron Lisa, 1999. Survey of recent developments, in *Bulletin of Indonesian Economic Studies*, Vol 35, No1, April 1999, Indonesia Project, The Australian National University, pp3-41.
- Centre for Remote Imaging, Sensing and Processing (CRISP), National University of Singapore. Homepage: <http://www.crisp.nus.edu.sg/>.

- CIC (PT Capricorn Indonesia Consult Inc.). 1997. *Study on palm oil industry and plantation in Indonesia, 1997*, PT Capricorn Indonesia Consult Inc, Member of the CIC Consulting Group.
- Cole D and Slade B, 1998. Why has Indonesia's Financial Crisis been so bad? in *Bulletin of Indonesian Economic Studies*, Vol 34, No 2, August 1998, Indonesia Project, The Australian National University, pp61-67.
- Danareksa Sekuritas, Various, *Plantation Sector Review*, PT Danareksa Sekuritas.
- Danareksa Sekuritas, Jardine Fleming International Inc and PT Bahana Securities, November 1998. *Information Memorandum on PT Perkebunan Nusantara IV*.
- Danareksa Sekuritas, September 1999, *Indonesian Investment Overview*, Danareksa Sekuritas.
- Danareksa Sekuritas, October 1999, *Plantation Sector Overview*, Danareksa Sekuritas.
- Dauvergne P, 1998. Burning down Indonesia, in *The Asia-Pacific Magazine*, 11:34-37.
- Departemen Kehutanan dan Perkebunan, 1998. *Eksekutif Data dan Informasi Kehutanan dan Perkebunan, Biro Perencanaan*, Sekretariat Jenderal, Departemen Kehutanan dan Perkebunan.
- Departemen Pertanian Direktorat Jenderal Perkebunan, 1996. *Statistik Perkebunan Indonesia, 1995-1997, Kelapa Sawit*, Departemen Pertanian Direktorat Jenderal Perkebunan.
- Departemen Pertanian Direktorat Jenderal Perkebunan, 1997. *Statistik Perkebunan Indonesia, 1996-1998, Kelapa Sawit*, Departemen Pertanian Direktorat Jenderal Perkebunan.
- Departemen Pertanian Direktorat Jenderal Perkebunan, 1998. *Statistik Perkebunan Indonesia, 1997-1999, Kelapa Sawit*, Departemen Pertanian Direktorat Jenderal Perkebunan.
- Dinas Perkebunan, March 1999. *Informasi Pembangunan Perkebunan Di Kalimantan Barat*, Pontianak.
- EIA, 1998. *The Politics of Extinction: The orangutan crisis, the destruction of Indonesia's forests*, Environmental Investigation Agency.
- EIA/Telapak. 1999. *The Final Cut: Illegal Logging in Indonesia's Orangutan Parks*. Environmental Investigation Agency; London, and Telapak, Bogor, Indonesia.

- Economic Intelligence Unit, 1999. *EIU Country Report 3rd Quarter, Indonesia*, The Economist Intelligence Unit Limited, 1999.
- Golden Agri-Resources Ltd, 1999, *Prospectus*, Golden Agri-Resources, Singapore.
- Goldman Sachs, March 1998. *Plantation Industry Indonesian Research*, Goldman Sachs Singapore.
- Gordon A, 1982. Indonesia, Plantations and the 'Post-Colonial' Mode of Production, in *Journal of Contemporary Asia*, Vol 12, pp168-187.
- Hakim Basyar, 1999. *Perkebuanan Besar Kelapa Sawit: Blunder ketiga kebijakan sektor kehutanan*, ELaw Indonesia and CePas.
- Iqbal M. Ali, Unpublished Paper, *Sawit Komoti Andalan di Mas Krisis*, Director Centre for Agricultural Policy Studies.
- IMF, October 1997-March 1999, *Memorandums of Economic and Financial Policies*, IMF.
- Ing Barings, Various, *Plantation Sector Review*, Ing Barings.
- ICBS, 1997. *Study on Oil Palm Plantations and Marketing of Indonesian Palm Oil*, PT International Contact Business System, Jakarta, Indonesia.
- Johnson, Colin, 1998. Survey of recent developments, *Bulletin of Indonesian Economic Studies*, Vol 34, No. 2, August 1998, Indonesia Project, The Australian National University, pp3-61.
- Larson, D.F. 1996. *Indonesia's palm oil sub-sector*. Policy Research Working Paper No 1654, International Economics Department, Commodity Policy and Analysis Unit, World Bank, Washington, D.C.
- London Sumatra Indonesia Tbk, 1997. *Annual Report*, Jakarta.
- London Sumatra Indonesia Tbk, 1998. *Annual Report*, Jakarta.
- Marks, S, Larson D.F, Pomeroy, J. 1998. *Economic effects of taxes on exports of palm oil products*, Bulletin of Indonesian Economic Studies, Vol. 34. No.3, December 1998, pp.37-38.
- Nababan, A. 1998. *The German involvement in and contribution for invasion of oil palm plantation and related industries in Indonesia*, Research contribution to WWF, Germany.
- Oil World, various issues, December 1997-1999, Germany.
- Oil World, 1999. *Oil World 2020: Supply, Demand and Prices from 1976 through 2020*, Germany.

- Oil World, 1999. *Oil World Annual 1999*, Germany.
- Pardede, Raden, 1999. Survey of recent developments, in *Bulletin of Indonesian Economic Studies*, Vol 35, No. 2, August 1999, Indonesia Project, The Australian National University, pp3-40.
- Potter, L & Lee, J. 1998a. *Tree planting in Indonesia: trends, impacts and directions*, CIFOR Occasional Paper No.18, CIFOR, Bogor, Indonesia.
- Potter, L & Lee, J. 1998b. *Oil palm in Indonesia: its role in forest conversion and the fires of 1997/98*, a report for WWF, Indonesia Programme.
- Purimas Sasmita, 1998. *PT Purimas Sasmita: Introductory Presentation*, Jakarta.
- Pusat Penelitian Kelapa Sawit, 1997. *Prosiding pertemuan teknis kelapa sawit: pembukaan areal dengan cara zero burning*, PPKS, Medan.
- Rangkuti, T, 1998. *The impact of the fluctuation in the exchange rate of the rupiah towards the palm oil industry in Indonesia*, FAMNI.
- Robinson R, 1986. *Indonesia: the rise of capital*, Asian Studies Association of Australia, Canberra.
- Sarin S, 1996. The Appeal of Plantation Labour: Economic imperatives and cultural considerations among Javanese workers in North Sumatra, in *Sojourn*, Vol.11, No.1, pp1-23.
- SMART, 1997, *Annual Report*, Jakarta.
- SMART, 1997, *Annual Report*, Jakarta.
- Stoler, A.L. 1985. *Capitalism and Confrontation in Sumatra's Plantation Belt, 1870-1979*. Yale University Press, New Haven, Conn and London, UK.
- Sunderlin, W.D, 1998. *Between danger and opportunity: Indonesia's forests in an era of economic crisis and political change*; 11 September at <http://www.cgiar.org/cifor/>
- Tomich T.P and Mawardi, M.S. 1995. *Evolution of palm oil trade policy in Indonesia, 1978-1991*. *Elaeis* 7(1): 87-102.
- Tripathi, Salil, Jan 29, 1998. *Far Eastern Economic Review*,
- Wakker Eric, 1998. *Introducing zero-burning techniques in Indonesia's oil palm plantations*: Report prepared for WWF-Indonesia Programme, AIDE Environment, The Netherlands.
- Wakker Eric, 1998. *Lipsticks from the rainforest: Palm oil, crisis and forest loss in Indonesia: the role of Germany*, WWF, A Forest Campaign Project of WWF German in collaboration with WWF Indonesia.

Newspapers

- Jakarta Post
- Gatra
- The Indonesian Observer
- New Strait Times
- The Malaysian Star Daily
- The Asian Wall Street Journal
- Business Times

APPENDIX A—LIST OF PEOPLE CONSULTED

Industry representatives

- PT Astra Agro Lestari Tbk—Benny Tjoeng, Director of Finance
- Soedjai Kartasmita, Director
- PT Asian Agri—Ricky Hermanto, Finance Director
- PT Asian Agri—Goh Cheng Beng, Managing Director
- PT Tolan Tiga Indonesia—D.R. Hoare, President Director,
- PT London Sumatra Indonesia Tbk—Claudia Lauw, Finance and Investor Relations
- PT London Sumatra Indonesia Tbk—G.C Eastaugh, Director Estates
- PT Perkebunan Nusantara II—Ir. Hendi Ramon Roza Lubis
- PT Perkebunan Nusantara II—Ir Wisetyo Sasongko, MM
- PT Perkebunan Nusantara IV—IR.H.Soehardjo, Production Director
- PT Socfin Indonesia—Ir. H. Artas Soewar, General Manager
- PT Socfin Indonesia—Ir. H. Asmady, Head of Agricultural Dept.
- PT Socfin Indonesia—A Rasep, Sales Manager
- PT Bakrie Sumatera Plantations—Dr. Ir. Hari Witono, President Director
- PT Bakrie Sumatera Plantations—R.Wina Johanes, Corporate Secretary
- PT Korindo Group—Lee Lou Tack, General Advisor
- PT Korindo Group—Kim Hoon, General Manager
- PT Plantana Razindo—Suty Suryatno, Estate Manager.
- PT Torganda—Pak Sitorus
- PT Sime Indo Agro—Ahmad Fisol Fadzil, General Manager.
- PT Sinar Mas Group—Simon Lim, Executive Director
- PT Sinar Mas Group—Rafael B Concepcion, Jr, General Manager-Finance

Government officials

- Badan Koordinasi Penanaman Modal—Drs. Djadjat Sudradjat R
- Ministry of Industry and Trade—Sujaya M. Widodo, Expert staff to the Minister
- Department of Forestry and Plantation Estates—Dr Ir. Agus Pakpahan, Director General.
- Department of Forestry and Plantation Estates—Ali Djajono.
- Department of Forestry and Plantation Estates—Dr.Ir.Yetti Rusli.
- Department of Forestry and Plantation Estates—Ir, Iman Santoso, Director of Forest Change.
- Dinas Perkebunan, West Kalimantan—Ir Kasan Sukardi.
- Joint Marketing Office—Asep Tojib.
- Joint Marketing Office—Yuddy Sulaeman
- Department of Forestry and Plantation Estates—Ir. Suherdi.
- Kanwil Kehutanan dan Perkebunan Propinsi Riau—Ir. Darminto Soetono, Kepala Kanwil.
- Dinas Perkebunan, Jambi—Ir. Riuai' Badri
- Dinas Kehutanan, Jambi—Pak Wisnu
- Dinas Perkebunan, Muarabungo, Jambi—Ir.Khairul Saleh

Industry analysts and representatives

- Asosiasi Penelitian Perkebunan Indonesia (APPI)—Ir. Bambang Drajat
- Asosiasi Penelitian Perkebunan Indonesia (APPI)—Ir. Agus Supriono, Agro Socioeconomist
- Asosiasi Penelitian Perkebunan Indonesia (APPI)—Ir. Wayan R. Susila
- Centre for Agricultural Policy Studies (CAPS)—Yadi S.A. Suriadinata, Director
- PT Danareksa Sekuritas, Ben Santoso
- Federasi Asosiasi Minyak dan Lemak Nabati Indonesia—H. Tarmidzi Rangkuti, Vice Chairman
- Gabungan Pengusaha Kelapa Sawit Indonesia (GAPKI)—Derom Bangun, Vice Chairman
- Pusat Penelitian Kelapa Sawit (PPKS)—Dr. Teguh Wayono, Agrosocioeconomist
- Pusat Penelitian Kelapa Sawit (PPKS)—Dr Ir Purboyo Guritno
- Ing Barings—Luciana Budiman
- Goldman Sachs (Singapore)—Elaine Tejojuwono
- The World Bank—Jacqueline L. Pomeroy

Non Governmental Organizations

- AidEnvironment—Eric Wakker
- Forest Watch Indonesia—Abdon Nababan
- PLASMA—IR.Niel Makinuddin, MA, Executive Director
- WALHI—Joko Waluyu
- WWF Indonesia—Dr Togu Manurang & Darrell Kichener
- WWF Germany—Markus Radday
- WWF Indonesia, Project ID 0117 Bukit Tigapuluh—Mangara Silalahi
- WWF Indonesia, Project ID 0117 Bukit Tigapuluh—Ronny Syam
- Yayasan Lembaga Bantuan Hukum Indonesia—Nur Amalia

Academics and researchers

- Australian National University—Chris Ballard
- Australian National University—Colin Barlow
- Australian National University—Peter Kanowski
- CIFOR—Graheme Applegate
- CIFOR—Aulia Aruan
- CIFOR—Chris Barr
- CIFOR—Brian Belcher
- CIFOR—Carol Colfer
- CIFOR—Christian Cossalter
- CIFOR—Rona Dennis
- CIFOR—Judith Mayer
- CIFOR—William Sunderlin
- ICRAF—Chip Fay
- ICRAF—Thomas Tomich
- ICRAF—Martua Sirait
- Sydney University—Peter Dauvergne
- Universitas Cenderawasih—Agus Sumule
- University of Adelaide—Lesley Potter

People consulted in Malaysia

- Austral Enterprises—Ahmad Redzwan Md Nor, Senior Manager, Plantation Administration
- Austral Enterprises Berhad—Md Tahir Mohammad, President Director
- Austral Enterprises Berhad—Haji Abdul Rashid Salleh, General Manager
- Island and Peninsular Berhad—Haji Abdul Rashid Salleh, General Manager (Plantation)
- Golden Hope Plantations Berhad—Sabri Ahmad, Group Director, Overseas Operations/Marketing.
- Malaysian Palm Oil Promotion Council—Tan Sri Dato' Dr Mohd Yusof Hashim, Chief Executive
- Palm Oil Research Institute of Malaysia—Mohd Tayeh Domat, Head Smallholders Development and Technology Transfer Unit
- Palm Oil Research Institute of Malaysia—Mohd. Nasir Bin Hj. Amiruddin, Head Techno-Economic Unit
- Palm Oil Research Institute of Malaysia—Hamirin Kifli, Director Techno-Economic & Technical Advisory Services Division
- Palm Oil Research Institute of Malaysia—Ab. Aziz Md. Yusof, Head, Publication Unit

**APPENDIX B—AREA AND PRODUCTION OF OIL PALM PLANTATIONS
BY OWNER TYPE 1967-1997.**

Year	Area (Hectares)				Production (Tonnes)			
	Small Holders	State-Owned	Private	Total	Small Holders	State-Owned	Private	Total
1967	0	65,573	40,235	105,808	0	108,514	59,155	167,669
1968	0	79,209	40,451	119,660	0	122,369	59,075	181,444
1969	0	84,640	34,880	119,520	0	128,561	60,240	188,801
1970	0	86,640	46,658	133,298	0	147,003	69,824	216,827
1971	0	91,153	47,950	139,103	0	170,304	79,653	249,957
1972	0	96,562	55,497	152,059	0	189,261	80,203	269,464
1973	0	98,033	59,747	157,780	0	207,448	82,229	289,677
1974	0	117,513	64,223	181,736	0	243,641	104,035	347,676
1975	0	120,940	67,885	188,825	0	271,171	126,082	397,253
1976	0	141,333	69,772	211,105	0	286,096	144,910	431,006
1977	0	148,775	71,626	220,401	0	336,891	120,716	457,607
1978	0	163,465	86,651	250,116	0	336,224	165,060	501,284
1979	3,125	176,408	81,406	260,939	760	438,756	201,724	641,240
1980	6,175	199,538	88,847	294,560	770	498,858	221,544	721,172
1981	5,695	213,264	100,008	318,967	1,045	533,399	265,616	800,060
1982	8,537	224,440	96,924	329,901	2,955	598,653	285,212	886,820
1983	37,043	261,339	107,264	405,646	3,454	710,431	269,102	982,987
1984	40,552	340,511	130,958	512,021	4,031	814,015	329,144	1,147,190
1985	118,564	335,195	143,603	597,362	43,016	861,173	339,241	1,243,430
1986	129,904	332,694	144,182	606,780	53,504	912,306	384,919	1,350,729
1987	203,047	365,575	160,040	728,662	165,162	988,480	352,413	1,506,055
1988	196,279	373,409	293,171	862,859	156,148	1,102,692	454,495	1,713,335
1989	223,832	366,028	383,668	973,528	183,689	1,184,226	597,039	1,964,954
1990	291,338	372,246	463,093	1,126,677	376,950	1,127,156	788,506	2,412,612
1991	384,594	395,183	531,219	1,310,996	413,319	1,360,363	883,918	2,657,600
1992	439,468	389,761	638,241	1,467,470	699,605	1,489,745	1,076,900	3,266,250
1993	502,332	380,746	730,109	1,613,187	582,021	1,469,156	1,370,272	3,421,449
1994	572,544	386,309	845,296	1,804,149	839,334	1,571,501	1,597,227	4,008,062
1995	658,536	404,732	961,718	2,024,986	1,001,443	1,613,848	1,734,709	4,350,000
1996	738,887	426,804	1,083,823	2,249,514	1,133,547	1,706,852	1,909,601	4,750,000
1997	813,175	448,735	1,254,169	2,516,079	1,292,829	1,800,252	2,287,366	5,380,447
1998	891,995	484,794	1,403,093	2,779,882	1,245,647	1,698,693	2,061,563	5,005,903
1999*	972,745	489,794	1,494,540	2,957,079	1,326,618	1,830,860	2,501,532	5,659,010

Source: Directorate General of Plantation Estates, 1998.

APPENDIX C—MALAYSIAN INVESTMENT IN THE INDONESIAN OIL PALM SECTOR

Malaysian Plantation Company	Indonesian Partner	Location	Land bank (Ha)
Agro Hope Sdn Bhd	PT Agro Indomas	Kabupaten Kotawaringin Timur, Central Kalimantan	17,500
		Kabupaten Kotawaringin Timur, Central Kalimantan	10,000
Aras Suci Sdn Bhd	PT Aras Malindo Makmur	South Bengkulu	7,200
	PT Andalas Etika Plantation	Sawahlunto-Sijunjung, Sumatra	14,000
Austral Enterprises Berhad	PT Mitra Austral Sejahtera (PT MAS I & II)	Tayan, Hulu, Bonti, Kembayan Sanggau, West Kalimantan	26,250
Cidar Engineering Sdn Bhd	PT Agroindo Cidar Corporation	Kab Labuhan Batu, Sumatra	5,000
Boustead Holdings Berhad	PT Dandimaka	Lubok Ingau, South Sumatra	17,500
	PT Anam Kotor	Pasaman, West Sumatra	12,300
The Brooklands Selangor	PT Kebunnira	Pontianak, West Kalimantan	40,500
Creative Investor Ltd	PT Nusantara Indah Api-Api		14,000
EPA Management Sendirian Berhad	PT Trimitra Sumber Perkasa	Lahat, South Sumatra	12,000
	PT Trimitra Panquiet	Lahat, South Sumatra	15,600
	Pt Sumber Mahardika Graha	Kota, Central Kalimantan	15,000
	PT Graha Cakramulia	Kota, Central Kalimantan	15,000
	PT Harapan Ibrida KalBar	West/Central Kalimantan	12,500
	PT Bintara Tani Nusantara	Sumatra	7,000
	PT Gonjong Limo	Sumatra	3,000
	PT Salanok Padang Mas	Kalimantan	13,000
	PT Bisma Derma Kencana	Kalimantan	10,000
	PT Subur Sawit Lesatri	West Kalimantan	10,000
Dara Lam Soon	PT Bakrie Sumatera Plantations I & II	Simpang Hulu, Ketapang, West Kalimantan	41,750
Geroda Jaya Sdn Bhd	PT Sawit Karmia Seriang	Kapuas Hulu, West Kalimantan	16,000
Golden Hope Plantations Berhad	PT Benua Indah	Kalapang, West Kalimantan	76,000
	PT Budidaya Agro Lestari	Marau, Kabupaten Ketapang, West Kalimantan	22,000

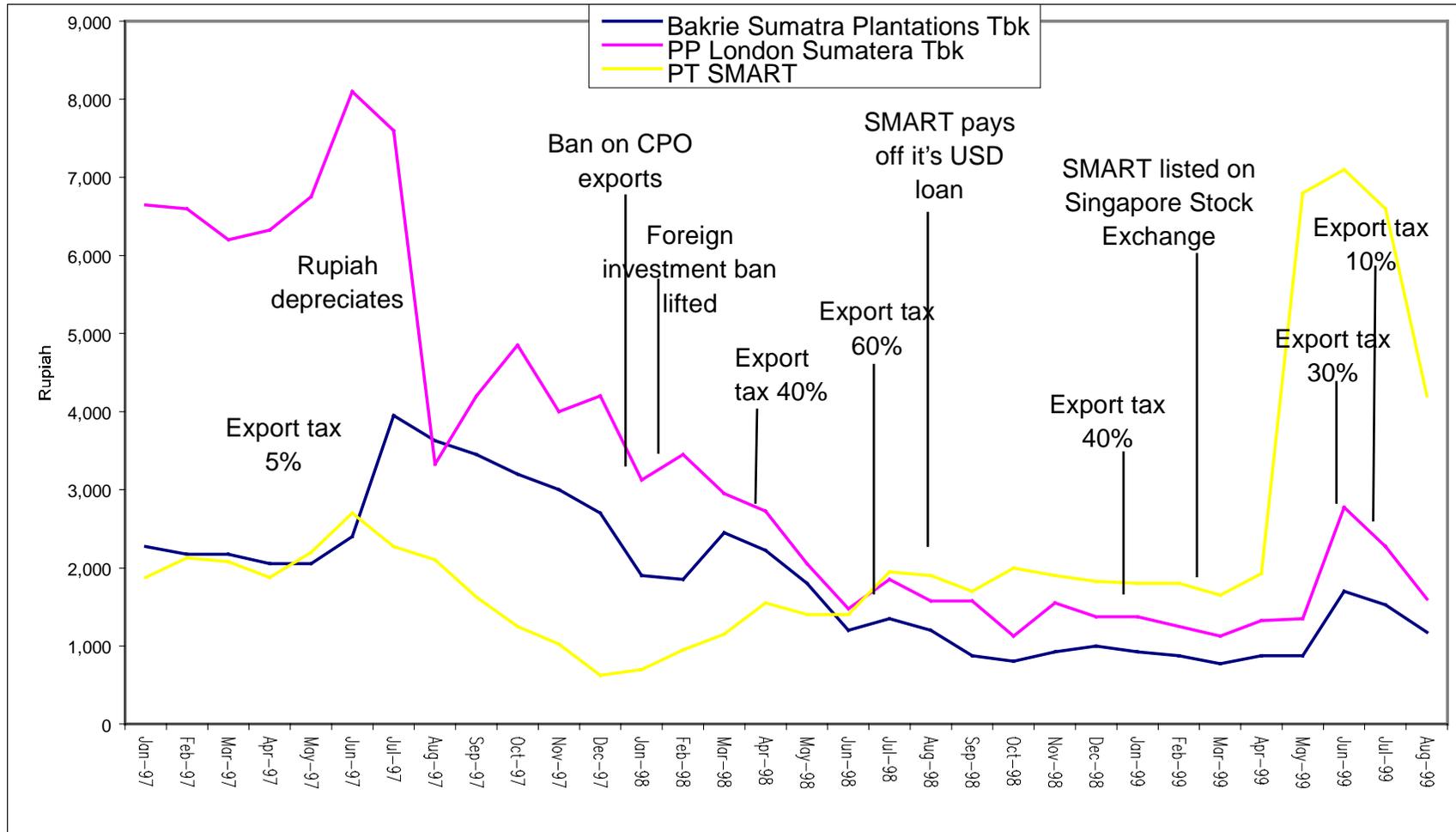
	PT Sandika Natapalma	Kabupaten Ketapang, West Kalimantan.	24,000
Hak Corporation Sdn Bhd	PT Plantana Razsindo	Badau, Kapuas Hulu, West Kalimantan	47,000
Inch Kenneth Kajang	PT Ceria Prima	Sanggau	6,200
	PT Ceria Karya Purnama	Sanggau	4,000
KBS Properties Sdn Bhd of Malaysia	PT Bina Pitri Jaya	Sam-Sam Mandau Bengkalis, Riau	8,500
Klau River Enterprise Sdn Bhd	PT Langgam Inti Hibrino	Kampar, Riau	15,000
KPLB Plantation Sdn Bhd	PT Kebon Ganda Prima	Kampar, Riau	15,000
Kretam Holding	Pt Kretam Ira Mondo	Bengkulu	40,000
	PT Terum Citrawara	Sanggau, West Kalimantan	20,000
KUB Agrotech	PT Dirgahayu Palmma	Bengkulu	25,000
Gopeng Bhd	PT Bina Usaha Warga Sejahtera	Jambi, and South Sumatra	35,000
Kuala Lumpur Kepong Bhd	PT Adei Plantation and Industry	Riau	42,000
	PT Steelindo Wahana Perkasa	Belitung	14,000
Kumpulan Guthrie Berhad	PT Guthrie Pecconina Indonesia	Musi Banyuasin, South Sumatra	60,000
Ladang Likir Sdn. Bhd	PT Pinang Witmas Sejati	Banyu Lincir, Kabupaten Musi Banyuasin, South Sumatra	14,000
LKKP Pahang	PT Jambi Tani Tulen	Jambi	25,000
Liminvest Resources Sdn Bhd	PT Sarpindo Graha Sawit Tani	Dumai, Riau	8,500
Minat Warisan Sdn Bhd	PT Anam Koto	Pasaman, West Sumatra	14,000
Nafas Estate Sdn Bhd	PT Ubertico	South Aceh	14,000
Pelaburan Johor Bhd	PT Trimatra Sumber Perkasa	Palembang, Lahat	12,000
Perisind Plantation Bhd	PT Dendymarker Indahlestari	Musi, South Sumatra	40,000
Perlis Plantation Bhd	PT Tidar Sungkai Sawit	Solok, South Sumatra	10,000
Permdalan Perak Bhd	PT Pinang Witmas Sejati	Kalbar, Sanggau, West Kalimantan	15,700
Selasih Permata Sdh Bhd	PT Gunung Maras Lestari	South Sumatra	22,000
Selat Bersatu Sdh Bhd	PT Rebinas Jaya	Belitung, South Sumatra	25,000
Semai Sempurna Sdn Bhd	PT Pusaka Megah Bumi	Pekanbaru	7,000
Sentri Holdings	PT Dutawangsa Keriasi	East Kalimantan	25,000
Tenaga Lestari Sdh (Oriental Holdings)	PT Gunung Sawit Bina Lestari	Bangka Island, South Sumatra	20,000
	PT Bumi Permai Suryalestari	Bangka Island, South Sumatra	8,000

Pahang Enterprise Sdn Bhd	PT Patriot Andalas (Bakrie Plantations)	Belitung Hulu, Sanggau, West Kalimantan	23,000
Sap Holding Bhd	PT Bengkulu Kelapa Sawit	Bengkulu	20,000
Sime Darby Bhd	PT Sime Indo Agro	Sanggau, West Kalimantan	22,000
Suka Chemical Berhad	PT Kalimantan Oleo Industri	Nanga Mahap, Sanggau, West Kalimantan	24,000
	PT Kalimantan Oleo Industri	Simpang Hulu, Ketapang, West Kalimantan	21,500
Tenaga Lestari M Sdn Bhd	PT Bumipermai Suryalestari	Kabupaten Bangka, South Sumatra	8,000
Tiara Etika Industry	PT Andalas Tuan Sakato	Padang	14,000
Tradewinds Bhd	PT Sadin Tradewinds Indonesia	Kab Bangka, South Sumatra	20,000
	PT Satia Dinamic Corporotama	Kab Bangka, South Sumatra	30,000
Lembaga Tabung Haji Pilgrimage Fund Board	PT Tidar Sungkai Sawit	Riau	80,000
		Taloto and Sungai Sungkai, Solok, West Sumatra	10,000
Yayasan Pelaburan Johor	PT Agritasari	Riau	10,700
YPJ Holdings	PT Agritasari Prima	Kampar/Langgar, Riau.	9,000
Total			1,341,200

Source: Numerous interviews with some of the companies involved, New Strait Times, various annual reports, and The CIC Consulting Group.

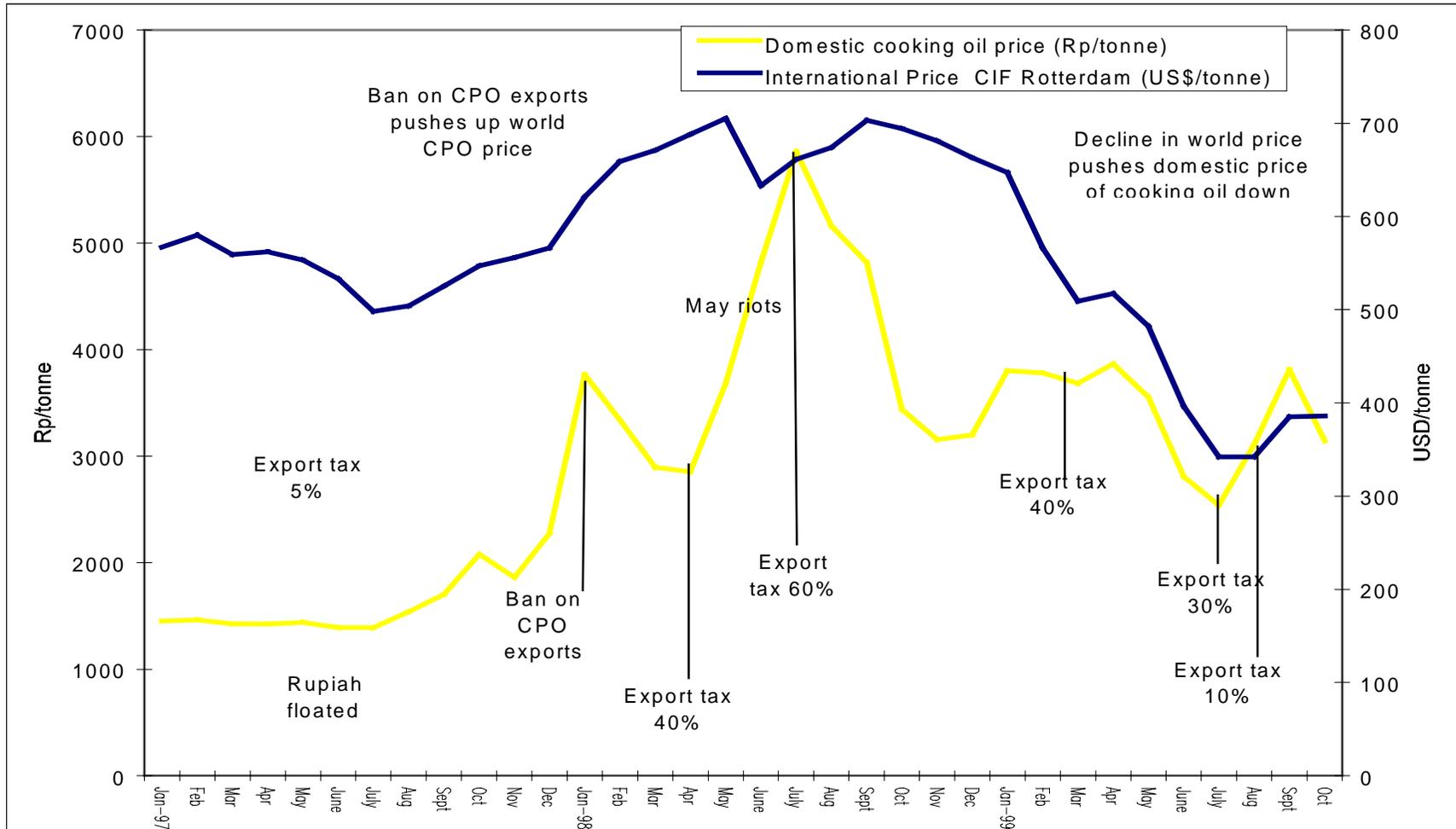
APPENDIX D—THE IMPACT OF THE ECONOMIC CRISIS AND VARIOUS GOVERNMENT POLICIES ON PLANTATION SHARE PRICES (1997-1999)

Source: Jakarta Stock Exchange.



APPENDIX E—POLICY CHANGES AFFECTING DOMESTIC AND INTERNATIONAL CPO AND COOKING OIL PRICES

Source: Joint Marketing Office, PTP Nusantara (Persero), Jakarta.



APPENDIX F—SOME INCIDENTS OF VIOLENCE ON OIL PALM ESTATES

Company	Location	Issue	Action taken by local communities	Action Taken by the Company
PT PP London Sumatra Indonesia	Muara Pahu, Jempang and Bongan, East Kalimantan	<ul style="list-style-type: none"> • LonSum have been accused of clearing land and planting oil palm before they obtained a permit to clear timber. • Villagers are unhappy about the compensation payments they have been given. • Villagers are being intimidated with threats of violence by the armed forces. They strongly believe that LonSum is paying the armed forces to intimidate them. 	<p>November 1998 Representatives from 9 villagers went to LonSum's estate office in East Kalimantan to present their demands for compensation. They requested Rp 250 billion (approximately \$US 25 million) for land, crops and damage to burial sites.</p> <p>December 1998 Villages seized heavy equipment, including bulldozers and trucks and set fire to part of the base camp. Two office buildings, a fertilizer store and some workers accommodation were destroyed in this incident.</p> <p>May 1998 Local NGOs, in collaboration with NGOs based in Bogor, launched a campaign against the company through Sawitwatch—a NGO network specifically established to campaign against further oil palm development.</p>	LonSum is accused of paying the armed forces to disband the communities occupation of the companies base camp on May 7 1999. 12 villagers were arrested after this incident. 4 people disappeared after this incident and the death of two others is thought to be linked to the incident.
PT Socfindo	Senangan and Lae Butar estates in Aceh province.	Socfindo is presently expanding their plantation estate into Aceh. Local communities in the expansion areas have claimed that they were not paid adequate compensation and that the company acquired the land without their permission. The community is now insisting that the land be returned to them.	<p>January 1998 Socfindo claim that two of their staff were tortured and three seriously beaten.</p> <p>The company also accused the local community of destroying oil palm plantations, and staff houses.</p>	The Company is accused of paying the armed forces to control the security problem. Several villagers have died as a result.
PT Torganda	South Tapanuli, North Sumatra Riau	The customary land of a number of communities has been allocated to the company without their consent. Many villagers have also complained about inadequate compensation payments	<p>On 3 August 1998, hundreds of villagers from Ujung Gading Jae village clashed with PT Torganda. The clash resulted in two villagers being wounded and a bulldozer being burnt. The incident occurred after farmers ambushed PT Torganda workers who were clearing land to make way for oil palm plantations in Bukit Harapan, Ujung Gading. The land being cleared by the company was land planted with fruit trees—it was not forested land.</p> <p>The case has been taken up by the North Sumatra SPSU who posted information about the companies practices on the Sawit Watch email list.</p>	<p>The company is accused of manipulating these tensions to acquire land. They are also accused of the following:</p> <ul style="list-style-type: none"> • Ordering their employees to burn villagers land. For instance in Mahato village, Riau over a hundred houses were burned by PT Torganda and land has been burnt in Sie Piandang, Kecamatan Kualuh Hilir, Labuhan Batu and now in Ujung Gading Tapanuli Selatan. • Sitorus has also being accused of increasing conflict amongst the

				communities in order to acquire land ownership.
Boustead Holdings	Lubok Lingau, South Sumatra	Boustead is accused of planting oil palm on customary land without adequate compensation. The community is now demanding that land, already planted with oil palm, be returned to them.	In March 1998, villagers occupied the companies base camp in Lublok Lingau, South Sumatra. They then confiscated their machinery and burnt some plantations and vehicles. They kept a vigil at the base camp for 45 days before being forced to move by angry estate workers who claimed that the villagers were keeping them from working and therefore getting paid.	The company has tried to organize several meetings with the local Bupati, Minister of Land and Reform and the Governor of Sumatra to settle the land issue. There has been little progress to date and the company has stopped further planting until they are sure that the land will not be taken away from them.

APPENDIX G—THE GOVERNMENTS NEW SCHEMES FOR OIL PALM DEVELOPMENT

The government has proposed several regulations requiring plantation companies to involve cooperatives in the plantation business. This is part of the government's effort to boost its 'people's economy' campaign by providing more opportunities to small-scale plantation operators, and at the same time prevent the build up of monopolies. While the regulations, after being deliberated, will not affect those who already own *Hak Guna Usaha* (HGU) licenses (30 year plantation licenses), they will be applicable to companies planning to renew or acquire new HGU's. According to Plantation Use Permit Regulation, 107/Kpts-II/1999, HGU applicants can choose from the following five partnership schemes.

1. *Management operator*. A plantation company is given the mandate to operate the cooperative plantations on a fee basis. The fee and payment structure is still unclear.
2. *35:65 equity ownership*. Cooperatives will buy a 35 percent stake of the plantation owner's equity or will inject money. The government is expected to provide the funds through the social safety net fund. The distribution procedure of the fund, however, is unclear.
3. *20:80 equity ownership*. Instead of injecting funds into plantation companies, cooperatives will provide land. In return, they can own a 20 percent stake in a plantation. Thereafter, cooperatives can increase their ownership by one percent per annum up to 51 percent. How the land will be valued against the equity has yet to be explained.
4. *Build, Operate and Transfer (BOT)*. Under this scheme, the plantation company will fully operate the plantation owned by cooperatives from the tree planting stage and transfer the operation to the cooperatives after 15 years. During the 15 years, expenses and income will be recorded by the plantation company.
5. *Mortgage system*. This allows cooperatives to borrow money from banks to finance the acquisition of plantations from developers. The principal along with the interest will be paid over several years.

Among the five proposed schemes, the second appears to be the most practical form of joint venture as it is closest to the current 'nucleus-plasma program. Many analysts do not consider the other four schemes to be attractive to foreign investors.¹⁵⁸

¹⁵⁸ Ing Barings, and Danareksa.

APPENDIX H—FOREST LAND CONVERTED TO PLANTATIONS AND CONVERSION FOREST DEFICITS

Forest land converted to plantations (1982-1999)

Province	Limited production forest already converted to plantations as of March 99	Production forest already converted to plantations by March 1999	Conversion forest already converted to plantations by March 1999	Forest area designated for other uses	Total forest land already converted to plantations by March 99 acc to MOFEC	Total oil palm area by 1998	Total rubber area by 1998
Aceh	17,635.00	10,095.00	213,475.90	13,495.70	254,701.60	196,912	410,388
North Sumatra	10,903.80	23,928.19	75,049.69	1,756.80	111,638.48	603,247	678,297
West Sumatra	550.00	30,117.26	101,114.61	3,104.00	134,885.87	131,306	232,421
Riau	94,616.45	140,025.50	1,253,332.74	45,055.65	1,533,030.34	573,621	1,826,954
Bengkulu	0	0	56,843.25	800.00	57,643.25	65,359	122,202
Jambi	27,675.00	19,645.00	256,593.63	11,960.25	315,873.88	222,096	478,690
South Sumatra	0	9,265.00	48,644.40	0.00	57,909.40	278,761	327,405
Lampung	10,510.00	64,484.96	1,104.35	16,221.04	92,320.35	68,530	69,634
Total	161,890.25	297,560.91	2,006,158.57	92,393.44	2,558,003.17	2,139,832	4,145,991
West Java	0	0	0	0	0.	21,502	21,502
Central Java	0	0	0	0	0	0	0
East Java	0	0	0	0	0	0	0
DI Yogyakarta	0	0	0	0	0	0	0
DKI Jakarta	0	0	0	0	0	0	0
Total	0	0	0	0	0	21,502	21,502
North Sulawesi	0	6,887.83	2,000.00	0.00	8,887.83	0	2,000
Central Sulawesi	0	7,740.00	71,733.00	0.00	79,473.00	24,036	95,769
SE Sulawesi	0	0	7,862.00	0.00	7,862.00	0	7,862
South Sulawesi	802.00	0	84,134.50	0.00	84,936.50	77,184	161,319
Total	802	14,627.83	165,729.50	0.00	181,159.33	101,220	266,950
W. Kalimantan	0	0	65,605.06	23,795.00	89,400.06	266,035	331,640
East Kalimantan	0	2,507.00	425,306.00	6,925.37	434,738.37	68,938	494,244
C Kalimantan	0	89,989.54	332,118.35	5,946.00	428,053.89	74,140	406,258
S. Kalimantan	0	26,454.08	162,834.46	390.00	189,678.54	83,538	246,372
Total	0	118950.62	985,863.87	37,056.37	1,141,870.86	492,651	1,478,515
Bali	0	0	0	0	0	0	0
NTB	0	0	753.36	0	753.36	0	753
NTT	0	0	0	0	0	0	0
Maluku	3,840	0	13,566.22	0.00	17,406.22	0	13,566
Irian Jaya	0	23,870.00	139,992.34	0.00	163,862.34	24,677	164,669
East Timor	0	0	0	0	0	0	0
Total	3,840	23870	154311.92	0	182,021.92	24677	178,989
Grand total	166,532.25	455,009.36	3,312,063.86	129,449.81	4,063,055.28	2,779,882	6,091,946

Source: Ministry of Forestry and Estate Crops.

Conversion forest deficits according to the 1982 Forest Land Use Consensus

Province	Available conversion forest acc. to TGHK 1982 (Paduserasi)	Forest land agreed in principle to be converted to plantation as of March 1999	Total forest land converted to plantations by March 99	Conversion forest already converted to plantations by March 1999	Total Conversion forest converted to plantations and transmigration by March 99	Conversion forest remaining in acc. with TGHK 1982	Applications for release of forest land agreed to in principle acc. to March 99 data.
Aceh	188,350	324,661.95	254,701.60	213,475.90	844,571.15	-656,221.15	69,960.35
N. Sumatra	351,548	261,977.00	111,638.48	75,049.69	311,622.25	39,925.75	150,338.52
W. Sumatra	407,849	201,863.90	134,885.87	101,114.61	438,243.34	-30,394.34	66,978.03
Riau	1,866,132	2,010,182.40	1,533,031.14	1,253,332.74	5,006,858.66	-3,140,726.66	477,151.26
Bengkulu	34,965	70,415.00	57,643.25	56,843.25	206,731.35	-171,766.35	12,771.75
Jambi	968,490	412,213.50	315,113.88	256,593.63	1,157,773.36	-189,283.36	97,099.62
S. Sumatra	2,124,000	285,097.50	57,909.40	48,644.40	282,663.71	1,841,336.29	227,188.10
Lampung	192,902	90,625.00	92,320.35	1,104.35	101,147.05	91,754.95	-1,695.35
Total	6,134,236	3,657,036.25	2,557,243.97	2,006,158.57	8,349,610.87	-2,215,374.87	1,099,792.28
West Java	338,653	0	0	0	0	338,653.00	0
Central Java	396,751	0	0	0	0	396,751.00	0
East Java	811,453	0	0	0	0	811,453.00	0
DI Yogya	16,000	0	0	0	0	16,000.00	0
DKI Jakarta	1,000	0	0	0	0	1,000.00	0
Total	1,563,857	0	0	0	0	1,563,857.00	0
N. Sulawesi	168,108	10,000.00	8,887.83	2,000.00	23,853.76	144,254.24	1,112.17
C. Sulawesi	491,346	122,955.00	79,473.00	71,733.00	286,624.96	204,721.04	43,482.00
S E Sulawesi	633,431	32,960.00	7,862.00	7,862.00	98,978.70	534,452.30	25,098.00
S. Sulawesi	164,998	128,815.00	84,936.50	84,134.50	299,694.00	-134,696.00	43,878.50
Total	1,457,883	294,730.00	181,159.33	165,729.50	709,151.42	748,731.58	113,570.67
W. Kalimantan	1,323,000	426,589.00	89,400.06	65,605.06	271,693.23	1,051,306.77	337,188.94
E. Kalimantan	5,513,060	891,812.35	434,738.37	425,306.00	1,550,145.82	3,962,914.18	457,073.98
C. Kalimantan	6,088,000	2,294,104.00	428,053.89	332,118.35	1,276,258.61	4,811,741.39	1,866,050.11
S. Kalimantan	1,325,024	282,000.00	189,678.54	162,834.46	653,958.46	671,065.54	92,321.46
Total	14,249,084	3,894,505.35	1,141,870.86	985,863.87	3,752,056.12	10,497,027.88	2,752,634.49
Bali	1,907	0	0	0	0	1,907.00	0
NTB	126,278	643	753.36	753.36	9,938.44	116,339.56	-110.36
NTT	428,360	0	0	0	387.00	427,973.00	0
Maluku	1,053,171	40,801.57	17,406.22	13,566.22	86,348.59	966,822.41	23,395.35
Irian Jaya	7,123,480	665,900.00	163,862.34	139,992.34	706,967.88	6,416,512.12	502,037.66
East Timor	121,690	0	0	0	0	121,690.00	0
Total	8,854,886	707,344.57	182,021.92	154,311.92	803,641.91	8,051,244.09	525,322.65
Grand total	32,259,946	8,553,616.17	4,062,296.08	3,312,063.86	13,614,460.32	18,645,485.68	4,491,320.09

Source: Ministry of Forestry and Estate Crops.

Conversion forest deficits according to the 1999 Provincial Spatial Plan

Province	Conversion forest remaining acc.to March 1999 RTRWP	Applications to be processed within conversion forest as of August 99	Conversion forest remaining acc to RTRWP 99 after August applications processed	Applications for release of forest land agreed to in principle acc to March 99 data.	Conversion forest remaining if existing applications fell into conversion forest
Aceh	0	593	-593	69,960.35	-69,960.35
North Sumatra	37,797	14,662	23,135	150,338.52	-112,541.52
West Sumatra	189,346	13,654	175,692	66,978.03	122,367.97
Riau	334,521	417,503	-82,982	477,151.26	-142,630.26
Bengkulu	70,360		70,360	12,771.75	57,588.25
Jambi	0	6,900	-6,900	97,009.62	-97,009.62
South Sumatra	774,100	7,227.50	766,872.5	227,118.10	546,981.90
Lampung	153,459	74,779	78,680	0	153,459.00
Total	1,559,583	535,318.5	1,024,264.5	1,099,792.28	459,790.72
West Java	0	0	0	0	0
Central Java	0	0	0	0	0
East Java	0	0	0	0	0
DI Yogyakarta	0	0	0	0	0
DKI Jakarta	0	0	0	0	0
Total	0	0	0	0	0
North Sulawesi	34,812	0	3,4812	1,112.17	33,699.83
Central Sulawesi	269,411	9,393	2,60018	43,482.00	225,929.00
SE Sulawesi.	212,123	0	212,123	25,098.00	187,025.00
South Sulawesi	102,073	19,288	82,785	43,878.50	58,194.50
Total	618,419	28,681	589,738	113,570.67	504,848.33
West Kalimantan	582,320	0	582,320	337,188.94	245,131.06
East Kalimantan	0	168,848	-168,848	457,073.98	-457,073.98
C. Kalimantan	0	100,100	-100,100	1,866,050.11	-1,866,050.11
S. Kalimantan	265,638	0	265,638	92,321.46	173,316.54
Total	847,958	268,948	579,010	2,752,634.49	-1,904,676.49
Bali	0	0	0	0	0
NTB	244,062	0	244,062	0	244,062.00
NTT	101,877	0	101,877	0	101,877.00
Maluku	2,034,932	4,064	2,030,868	23,395.35	2,011,536.65
Irian Jaya	2,671,275	6,050	2,665,225	502,037.66	2,169,237.34
East Timor	6,778	0	6,778	0	6,778.00
Total	5,058,924	10,114	5,048,810	525,322.65	4,533,601.35
Grand total	8,084,884	843,061.5	7,241,822.5	4,491,320.09	3,593,563.91

Source: Ministry of Forestry and Estate Crops