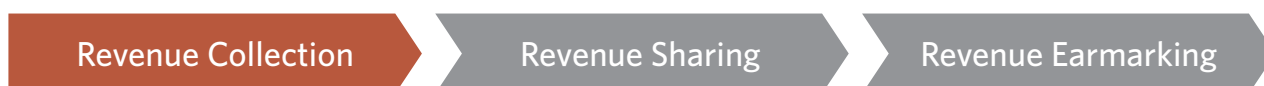


Fiscal Policies: A key tool to achieve Indonesia's land use goals?

Indonesia's land use sector — including forestry, oil and gas, mining, and agriculture — is growing rapidly. Land use currently contributes almost a third of Indonesia's national revenue and nearly half of Indonesia's GDP. However, the land use sector is also known as Indonesia's leading driver of deforestation and greenhouse gas emissions. If Indonesia aims to grow this sector and at the same time reduce its greenhouse gas emissions by 29% by 2030, it's crucial to find ways to encourage productive and efficient land use.

New research from Climate Policy Initiative scopes and identifies opportunities for policy makers to meet these goals by adjusting Indonesia's fiscal policies.

Our study points to three areas of opportunity to improve fiscal policies: 1) adjusting existing revenue collection instruments 2) increasing revenue sharing to local government and 3) earmarking more revenues to support reduced deforestation. This study recommends more detailed studies to investigate the viability of these opportunities.

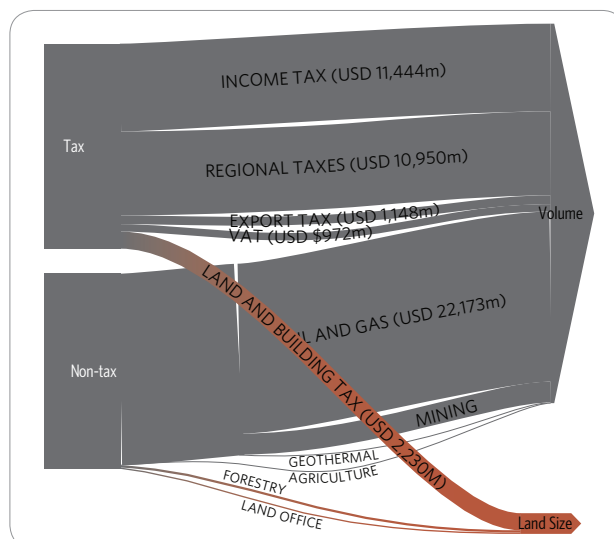


While there is obvious GDP growth in the land use sector, government revenue is not growing at the same rate. The tax-to-GDP ratio in agriculture is underperforming at only 1.2%, well below Indonesia's average ratio of 12%.

In addition, a disproportionate amount of revenue comes from production-based levies, instead of land-size based levies. In fact, 93.5% of all land use revenue (IDR 400 trillion) comes from taxing profitability instead of taxing land size. There is therefore no incentive for producers to use land more efficiently.

RECOMMENDATION: The Government could shift the balance so that more revenue collection comes from land size-based instruments. The government could tax production area rather than production volumes or profits to encourage high productivity per hectare of land. The government could also introduce sustainability indicators into tax holiday eligibility criteria, or link tax rates to sustainability criteria.

Figure 1. Illustrates the proportion of land-size based levies relative to production-based levies



Revenue transfers from the central government are an important part of regional government revenues. However, the current revenue transfers may be indirectly incentivizing land expansion, which is against Indonesia's emissions reduction goals. For example:

- Land and building taxes, and non-tax collection from certain sectors, e.g. forestry and mining, currently provide large percentages of revenue to regions;
- Oil and gas revenues remain one of the largest sources for regional governments; and
- VAT, corporate and export taxes, as well as agriculture non-tax revenue, are spent entirely by the central government, thus there is almost no revenue-sharing from the plantation sector.

These conditions may encourage local governments to support expansion of extractive industries, agricultural lands and land-clearing, rather than productivity increases.

RECOMMENDATION: The central government could increase tax revenue allocation to local governments to incentivize productivity-per-hectare. For example, the revenue sharing percentages could be amended to shift away from Land & Building Tax towards Income Tax, thus reducing incentives for land expansion.

Revenue Collection

Revenue Sharing

Revenue Earmarking

Earmarked revenue may provide a mechanism for funds to be used for the sector they come from. The current earmarking can be optimized. The Adjustment Funds show particular promise, due to their surging utilization and the relative flexibility with which they can be allocated.

Since 2010 there has been an increase in the Adjustment Funds allocation. While the amount allocated to Revenue Sharing and Special Allocation Fund stagnated, the Adjustment Funds nearly tripled from IDR 20 trillion in 2010 to IDR 56 trillion in 2011.

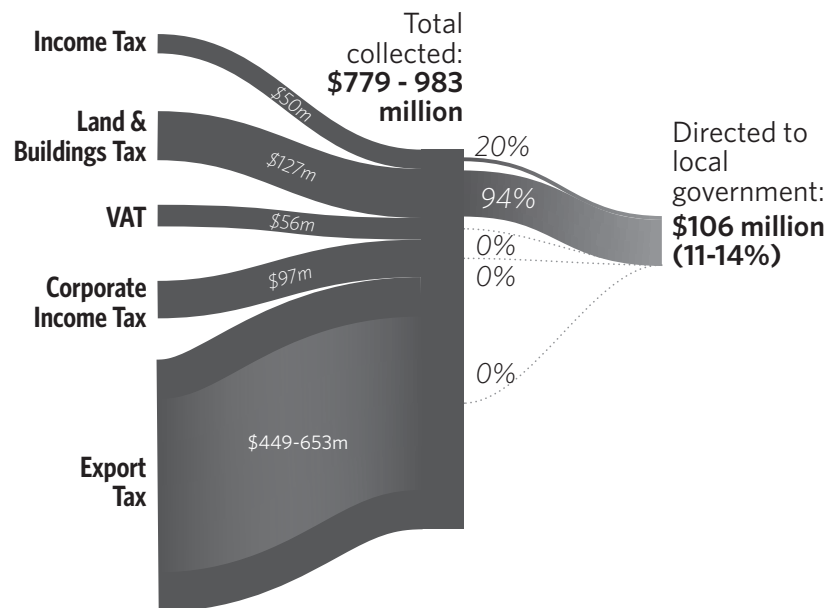
However, none of this is currently used to support programs aimed at sustainable land use management.

RECOMMENDATION: The Government could earmark some of the Adjustment Fund to support sustainable land use programs. This could encourage regional governments to implement sustainability programs or meet sustainability targets in order to be eligible for earmarked funds.

How does palm oil fit in?

Indonesia is the largest producer of palm oil, which makes a significant contribution to the national economy. However, palm oil is also a primary driver of deforestation and greenhouse gas emissions. In a case study that looks specifically at palm oil taxation, we find that the industry contributed at least IDR 10 trillion (USD 1 billion) to national tax revenues in 2012/2013. However, the sector has a relatively low tax-to-GDP ratio of around 3.4%, confirming there is an opportunity to increase tax collection levels. The study also estimates that just 11-14% (IDR 1,103 billion/USD 106 million) of revenue from the palm oil sector was directly redistributed to local governments in 2012/2013, confirming the potential to increase and earmark revenue sharing, while paying due attention to the broader fiscal landscape.

Figure 2. Estimated total national tax revenues from Indonesian oil palm plantations and palm oil production (export tax only) in 2012/2013 and the distribution of revenues to central and local government



For more:

Read both studies at www.ClimatePolicyInitiative.com/Indonesia to learn more about adjusting Indonesia's fiscal policies to better support efficient and productive land use.