

Sustainability and Climate Change (S&CC)

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By Anthony Anderson and Simon McKenna

Significant developments for Indonesia in S&CC

Indonesia has continued to progress its bold agenda for climate change mitigation. In January 2010, Indonesia submitted its “mitigation actions” to the UNFCCC required by non-Annex 1 countries as part of the Copenhagen Accord. In this regard, Indonesia has committed to its previously publicly stated intention of reducing greenhouse emissions by 26% from business as usual levels by 2020 through (amongst others) the following actions:

- Sustainable peat land management;
- Reduction in the rate of deforestation and land degradation;
- Development of carbon sequestration projects in forestry and agriculture;
- Promotion of energy efficiency;
- Development of alternative and renewable energy sources;
- Reduction in solid and liquid waste;
- Shifting to low emission transportation modes.

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To support the stated intentions of the mitigation actions, Indonesia has recently undertaken a number of important steps including (amongst others):

- The establishment of a Directorate General for Alternative Energy under the auspices of the Ministry for Energy and Mineral Resources;
- The issuance of a government decree on green building standards;
- The announcement by Bank Indonesia that it intends to develop a “green banking” regulation to support sustainable lending practices and ensure banks consider environmental impacts in their lending criteria;
- The implementation of Phase 1 activities required under the Letter of Intent with Norway (see further below). This extends to a number of policy and regulatory matters that are required for the provision of US\$1b funding for deforestation and forest degradation projects.

Whilst important steps have been made and significant funding pledges by the international community have been forthcoming (see Funding Update below), much work remains for Indonesia to successfully attain its stated goals.

Funding update

Funding pledges for climate change mitigation actions in Indonesia continue to grow from across the globe. The most significant funding is for the support of climate change policy and institutional framework development and reducing emissions from deforestation and forest degradation (REDD+) programs (see also Joint Study findings from PwC and CFA report below). The following is an update on three significant international funding programs in 2010:

Progress of Norway's US\$1b pledge

On 26 May 2010, the governments of Norway and Indonesia entered into a Letter of Intent (LoI) for the “Cooperation on reducing green house gas emissions from deforestation and forest degradation”. Under the terms of the LoI, the government of Norway has pledged US\$1b in funding to Indonesia.

The funding is contingent upon Indonesia achieving a number of performance hurdles in the establishment of a robust REDD+ framework. The goals of the LoI are to be achieved over three phases:

- *Phase 1: Preparation* – this focuses on the development of Indonesia's REDD+ strategy including the establishment of a REDD+ agency that is directly responsible to the President; developing an independent framework for monitoring, reporting and verification (MRV) of forest and peat related greenhouse gases; designing a funding instrument in collaboration with donors to be managed by a internationally reputable financial institution; and the establishment of a province wide REDD+ pilot project.
- *Phase 2: Transformation* - it is envisaged that this phase will commence from 1 January 2011 with the aim of completion by 2013. The goals of this phase include national level capability building, policy development and implementation as well as legal reform and law enforcement; and one or more full scale province wide REDD+ pilot projects. This phase provides more prescriptive measures that Indonesia must take around MRV frameworks, suspension of forestry concessions, establishment of funding mechanisms and the development of legal and policy instruments. It also provides specific measures for the first REDD+ pilot project and the selection of a second REDD+ pilot project.
- *Phase 3: Contribution-for-verified emission reduction* – the parties intend to initiate this phase from 2014 based upon 2013 emissions reductions. The intention of this phase is to implement a contribution-for-verified emission reduction mechanism whereby Indonesia will receive annual contributions for independently verified national emissions reductions; and further financial contributions from Norway through the financial instrument selected in Phase 1.

Whilst lauded by the international community at large, the execution of the LoI has not been without controversy. Perhaps unremarkably, the moratorium on the issuance of new concessions for the conversion of peat and natural forests has been attacked by the palm oil and mining industries and indigenous groups. These interest groups believe REDD+ destroys the economic development of Indonesia; that those most affected by REDD+ do not receive any benefits of the international funding; and that the developed world has caused the climate change phenomenon and also stands to reap the rewards of any future carbon trading system. Conversely, climate change advocates have attacked the moratorium on the basis of doing too little to stop the destruction of forests that lie within concessions previously granted, but not yet developed.

Notwithstanding the controversy surrounding the detailed execution of the LoI, no one can ignore the sheer magnitude of the financial contribution that Norway has pledged and the framework that the LoI seeks to establish for the sustainable operation of REDD+ activities in Indonesia in the future.

Recently, the parties have met in Indonesia to discuss the progress of the aims set out under Phase 1 of the LoI. Whilst debate ensued as to the funding mechanism by which the money should flow to Indonesia (it is understood that Indonesia's preference was for local banks to disburse the money), it is understood that the first US\$30m for Phase 1 has now been provided by Norway.

In his recent visit, the Norwegian Foreign Minister, Jonas Gahr Stoere noted the example that the two nations had set as the basis for progress at the UN Framework Convention on Climate Change Conference in Cancun, Mexico which commences on 27 November 2010 (**CoP16**).

Recent visit by US President Barack Obama

In his recent visit to Jakarta, US President, Barack Obama and Indonesian President Susilo Bambang Yudhoyono formally announced the US – Indonesia Comprehensive Partnership. The Comprehensive Partnership encompasses a number of initiatives including with regard to environmental and climate change matters.

The Comprehensive Partnership formalises many of the announcements made in June 2010 (when President Obama previously planned to visit Indonesia). These include:

- A US\$136m funding commitment to climate change programs in Indonesia over three years;
- Increased technical assistance focused on forests and peat lands and related measuring and reporting; and
- The development of a Climate Change Centre in conjunction with the Norwegian and Indonesian governments.

“Climate Change Program Loan”

During 2010, additional “soft loans” have been made by France (via the Agence Francaise de Developpement) and Japan (via the Japanese International Cooperation Agency) of US\$300m each. Additionally, the World Bank has also provided US\$200m in funding as part of the Climate Change Program Loan which supports ongoing policy reforms for climate change mitigation and adaptation.

PwC and CFA launch joint study findings on REDD+ funding frameworks

PwC and the Conservation Finance Alliance (**CFA**) recently completed a joint study analysing how REDD+ funding is currently, or could in the future be managed and disbursed within the intended recipient nations. The report covers six in-depth case studies of nations where REDD+ funding will be significant, including Indonesia.

The study highlights the practical capacity and governance issues facing donor and recipient countries, in the roll out of Copenhagen's ‘fast start’ funding and prospects for long term engagement with donors and private sector investors. It makes a series of recommendations for the steps needed to encourage REDD+ funding at scale to recipient countries.

Whilst acknowledging that Indonesia has progressed in the development of REDD+ funding frameworks, the study also highlights significant barriers to achieving REDD+ funding “at scale” in Indonesia including:

- *The need for greater government coordination* – in particular the need for a clear definition of the distribution of responsibilities between various government institutions (Ministry of Finance, Ministry of Forestry, National Council on Climate Change, National Planning Authority (BAPPENAS) and the Ministry of Environment). It is understood that a specific REDD+ council will be established for this purpose.
- *Regulatory uncertainty* – in particular the need to resolve the dispute between the Ministry of Forestry and the Ministry of Finance on the REDD+ revenue split arrangements proposed under the current REDD+ regulations (P.36/Menhut-II/2009). We understand talks are currently progressing between the two ministries and a resolution should be reached shortly.

- *Community engagement and land tenure issues* – this extends to the overlap of titles and concessions issued by various levels of government and the recognition of indigenous land rights.
- *The Taxation of REDD+ activities* – in addition to the revenue split dispute, it remains uncertain how the Ministry of Finance and the Directorate General of Taxation will seek to tax REDD+ activities. This extends to matters such as the VAT status of carbon credits, transfer pricing and local and regional taxes.
- *The need to develop reliable national funding mechanisms* – in particular, Indonesia needs to address concerns about governance and funds management and develop a national funding framework that is robust and transparent. In this regard, Indonesia has been working with many parties, in particular the government of Norway under the terms of the LoI signed between the two nations for US\$1b in reforestation funding.

The study has been prepared in order to add to the discussion and stimulate debate amongst policymakers, the private sector, NGOs and academic institutions at a national and international level.

A copy of the report can be downloaded from:

<http://www.pwc.com/id/en/publications/Sustainability-and-Climate-Change.jhtml>

Alternatively, please contact one of the PwC Indonesia S&CC team listed in this NewsFlash.

Future publications

Low Carbon Economy Readiness scorecard - How will Indonesia rate?

PwC has recently been compiling a global Low Carbon Economy Readiness scorecard. Indonesia has participated in this study and results are due to be released shortly.

Launch of PwC Global Environmental Tax and Regulation Monitor

PwC, in collaboration with LexisNexis, has launched a Global Environmental Tax and Regulation Monitor. This subscription newsletter is based on articles drawn from over 80,000 news sources (including other leading environmental newsletters). It provides a concise summary of developments in the field of environmental tax and regulation across the globe. Please contact Anthony Anderson (anthony.j.anderson@id.pwc.com) should you be interested in subscribing to this new product.

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