Investing in disaster: the IFC and palm oil plantations in Indonesia

Indonesia has the third most extensive area of tropical forest on earth and is one of its richest centres of biodiversity. It is also the world's second largest palm oil producer with an output of over 11 million tonnes of Crude Palm Oil (CPO) in 2004. With Indonesia's forests disappearing at 3.8 million hectares per year, the land area converted to oil palm plantations has doubled during the past decade to nearly 5 million ha - an area roughly the size of Costa Rica. Most oil palm plantations in Indonesia are established on land which was, until very recently, mature rainforest. According to a report commissioned by the World Bank, around 50 million people live on state forest land in Indonesia with 20 million more living in villages near forests, of which about 6 million receive much of their cash income from forests. It should be no surprise, then, that the expansion of large-scale oil palm plantations has brought widespread environmental destruction and social conflict. The financial institutions that provide, including the World Bank Group, must share responsibility for these adverse impacts.

The World Bank Group has directly and indirectly assisted the development of large-scale palm oil plantations in Indonesia. The World Bank was heavily involved in 'development' projects throughout the three decades of the Suharto regime. Forestry programmes during the late 1980s and early 90s supported the official forest policy in which over one third of the country's forests was handed over to commercial logging companies while another third was destined for 'conversion' to plantations. Typically, same conglomerates owned both the companies that destroyed the forest by over-logging and the plantation companies that benefit from the land clearance. During the same period, the World Bank helped to finance Indonesia's transmigration programme. Government-sponsored transmigrants and other settlers encouraged through Indonesia's resettlement policy were a readily available source of cheap labour for the nucleus-estate plantation system (PIR). Plantations also benefited from Bank-funded infrastructure projects, including roads. The International Finance Group (IFC) provided at least one loan to an Indonesian company during the 1990s to develop oil palm plantations and CPO mills.

When the Indonesian economy collapsed in 1998, the IMF and World Bank imposed conditionalities on a financial 'rescue package'. These included measures to promote the palm oil sector, including reductions of export taxes on CPO and lifting the ban on foreign investment in palm oil ventures in Indonesia. The IMF/WB deal also helped to restructure Indonesia's banking sector. As bankrupted conglomerates had interests in forestry as well as banking, over 100 heavily indebted forest-related companies benefited to the tune of at least US$ 2bn when the state took over some of their private debts. An internal review of World Bank forestry policy and practices, which included Indonesia, came to the damning conclusion that both deforestation and poverty increased during the 1990s.

Indonesia is still expanding its plantations, not least to satisfy the demands of local governments who were given considerable power over land use decisions and income generation when regional autonomy was introduced in 2001. Large areas have already been allocated for oil palm - 1 million ha in Jambi; 1 million ha in East Kalimantan; 3 million ha in West Kalimantan – with overall targets of over 9 million ha. Central and local governments now look to the plantation sector as the driving force for development and a major revenue earner for the economy. Ironically, this replaces the woodprocessing sector – relegated to a sunset industry as forests outside protected areas in the western part of the archipelago have been logged to the extent that they are no longer commercially attractive.

The private lending branch of the World Bank Group, the International Finance Corporation, has been increasingly active in Indonesia. The IFC's mission is to promote sustainable private investment in developing countries by mobilising capital in international markets and providing technical advice for businesses and governments. In the Indonesian context, the IFC wants to promote exports – particularly from agribusiness - and to improve the climate for investment. However, the IFC has no oil palm policy to define the conditions under which plantation companies and their financial backers are eligible for IFC support.

Like other parts of the World Bank Group, the IFC shares a duty to help reduce poverty and improve people's lives in line with the UN's Millennium Development Goals. Arguably, it should be trying to help small and medium Indonesian enterprises, owned by independent small-holders, to attract financing so that they can improve the productivity and management of existing plantations. Instead, the IFC is offering support to some of the biggest operators in the Indonesian oil palm sector, including foreign investors and companies with very poor environmental and social track records who are expanding into new areas.

Under IFC's Environmental & Social Guidelines, projects are classified in three ways:

Category A: Major economic and social impacts

Category B: "Limited number of specific environmental and social impacts may result that can be avoided or mitigated by adhering to generally recognised performance standards, guidelines or design criteria".

Category C: minimal or no adverse environmental impacts.

It is not clear what sanctions, if any, the IFC will impose if its Environmental and Social Guidelines are ignored.

Equity and loans directly for Indonesian oil palm plantations are generally graded as Category B, so an Environmental Impact Assessment is required. In practice this provides few safeguards. EIAs in Indonesia are often perfunctory exercises and it is not uncommon for the study to be carried out several years after a plantation has been developed. Furthermore, compliance with host country laws and local regulations means indigenous peoples' rights can be ignored with impunity and there is weak enforcement of environmental and labour standards.

The situation is even worse for trade-related IFC financing which is classified as Category C. Here there is a presumption of no adverse environmental impacts, while social impacts are not even considered, let alone checked in the field. This means that the IFC cannot obtain the information necessary to ensure compliance with its own standards.

A case in point is the IFC's pre-shipment financial support for the Singaporean company Wilmar Trading. The Wilmar Group is the biggest crude oil palm refiner and exporter in Indonesia. It owns four CPO refineries in Indonesia and another in Malaysia, with a total production of 3.3 million tonnes/year.It has investments in at least 85,000ha of oil palm plantations, but buys some 90% of its supplies from Indonesian producers belonging to other conglomerates.

The IFC describes this project as “enabling Wilmar to meet its workingcapital requirement to purchase crude palm oil from plantations in Indonesia and process them (sic) into refined oil for export.” In other words, the IFC provides a US$ 33.3 million guarantee, renewable annually for three years, so Wilmar can borrow money more easily from commercial banks to buy palm oil supplies. The loans are repaid after the CPO has been delivered to overseas purchasers such as detergent companies or food processors. Unilever is one of Wilmar’s clients.

It is not clear why this project is considered worthy of IFC’s support. Wilmar is the second-largest edible oils trader in the world. In 2002, Wilmar Holdings had an annual turnover of US$ 3,530 million and made a net profit of US$ 52.2 million.The IFC justifies its action by saying that commercial banks are nervous about investing in Indonesia. Yet Wilmar has obtained loans from several international sources on its own or through the services of the Dutch-based international bank, Rabobank. Rabobank may even be an investor in Wilmar.

There is no doubt that the IFC’s credit guarantee will facilitate exports of Indonesian palm oil and benefit the Wilmar group and its Indonesian subsidiaries. What is less clear is whether IFC’s claims of positive benefits for local farmers can be justified. Indeed, the IFC has no means of gauging the impact on small-scale sharecroppers or local economies as the Wilmar deal is graded Category C.

The IFC has never made public basic information on all Wilmar’s subsidiaries – including the plantations, CPO mills and other investments in Indonesia.Although Wilmar apparently holds this list on its website, it is perpetually inaccessible. It is therefore very difficult to assess the full extent of the IFC’s responsibilities.Neither the IFC nor Wilmar has attended any meetings of the Roundtable on Sustainable Palm Oil. Even so, Dutch and Indonesian NGOs who are trying to track down Wilmar’s connections have raised concerns about a number of environmental, social and human rights issues.

These include the following issues:

- Wilmar subsidiary PT Jatim Perkasa Jaya in Riau province owns a plantation in an area of peat swamp forest. That part of the Rokan Hilir district has been repeatedly burned in forest fires. The local authorities and environmental NGOs are convinced the company is implicated in this illegal land clearance, but the case has yet to be proven in court.

- The development of oil palm plantations in West Sumatra has been the focus of violent conflicts since April 2000, when armed police tried to bully local people into giving up their land to Wilmar-subsidiary, PT Permata Hijau Pasaman. A local NGO monitored instances of intimidation, raids, shooting, kidnapping, arrest and torture by the security forces.

- There is evidence that Wilmar’s third party suppliers, belonging to the Salim, London Sumatra, Sinar Mas and Surya Dumai Groups, have also been involved in forest destruction, illegal land clearing by burning, land seizure and human rights violations.

- Further investigations have revealed company-led cooperatives which left smallholders waiting for plot allocations; serious cases of water pollution due to palm waste and at least one CPO mill which has been operating for 4 years without an EIA.

IFC’s immediate reaction to the NGOs’ study was to deny that it was supporting the expansion of oil palm plantations or that there were social and environmental problems associated with Wilmar’s subsidiaries. It dismissed reports of land disputes, saying that Wilmar was not responsible for the initial land acquisition for the plantations. Wilmar also condemned the briefing document as “incomplete and inaccurate” and told Rabobank that PT Jatim was sold in late 2003.Later Wilmar agreed to engage a consultant to carry out an independent study of its social and environmental performance.Before this took place, the IFC Board announced in May 2004 that the US$ 33.3 million guarantee for Wilmar had been approved.

Wilmar Trading is only one of several deals in Indonesia that raise questions about the IFC’s commitment to promoting environmental sustainability, social justice and the eradication of poverty. Since 2002, the IFC has invested about US$ 3.5 million and provided stand-by equity for up to US$ 16.5 million to PT Astra International for debt restructuring in order to support the company’s existing operations and future development. Astra is one of Indonesia’s largest conglomerates whose interests include cars, banking and real estate, in addition to oil palm plantations. The IFC has also made a US$ 40 million loan to Verdaine – a Mauritius-based company set up as a vehicle to acquire and manage oil palm plantations in Indonesia. It currently controls a 9,100ha plantation in the Tapanuli Selatan district of North Sumatra and a 5,000 ha concession on Belitung island, off the east Sumatran coast. One of its founders is Austindo Nusantara Jaya, another Indonesian conglomerate with interests in agribusiness, electric power generation, mining and financial services. The IFC had already bought a 7% stake in an Indonesian palm oil plantation subsidiary of Austindo called PT Agro Muko in Bengkulu. The IFC is also helping the Indonesian Wings Group to move into the lucrative market of cooking oil, in addition to its existing ventures in toiletries, building materials, ceramics, cement, asbestos, banking and property. It provided a US$ 10 million loan and helped organise a US$ 11 million syndicated loan for three oil palm estates in South Kalimantan under PT Gawi.

The IFC still maintains that its engagement can have an impact, both in terms of broad, beneficial economic impacts and of improvements in environmental and social performance. “The renewed involvement of the IFC in funding projects in Indonesia sends a very positive message to companies with a commitment to good corporate governance, sustainable development and the creation of employment opportunities for the Indonesian people”, said one of Verdaine’s directors. However, the significant issue here is that the IFC completely denies responsibility for its investments higher up the trade chain. And local communities are telling a very different story from the rosypicture painted by IFC representatives.

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