Export credits: Fuelling illegal logging

Export Credit Agencies (ECAs) provide the largest source of government – i.e., taxpayer's – financing to projects in the South and the East. During the 1990s, ECA financing averaged $80-$100 billion or more per annum, roughly twice the level of the world's total official development assistance. ECAs provide the financing behind many destructive projects, from pulp and paper mills to oil pipelines and large dams. They contribute directly and indirectly to illegal logging. This briefing note details the relationship between ECAs and illegal logging and argues that, in order to address the problem of illegal logging, the EU cannot limit its activities to address illegal logging to the forestry sector, but must address the financial sector as well. The wider application of existing rules and development of binding social and environmental guidelines, based on existing guidelines, for the financial sector, including ECAs, is needed for the EU to move forward.

What are ECAs?

Export Credit Agencies and Investment Insurance Agencies, commonly known as ECAs, are public or parastatal agencies that provide government-backed loans, guarantees and insurance to corporations seeking to do business in countries where the investment climate is judged to be too risky for conventional corporate financing. Most countries of the Organization for Economic Co-operation and Development (OECD) possess at least one ECA; worldwide, ECAs currently support an estimated US$ 432 billion in trade and investment – nearly 10 percent of world exports. Longer term loans and guarantees by ECAs increased four-fold between 1988 and 1996, from $26 billion to $105 billion annually – twice the amount of official development assistance. Export Credit Agencies (ECAs) provide the single largest source of taxpayer support for projects in the South and in Eastern Europe, underwriting projects several times greater in value than the combined annual funding of all Multilateral Development Banks. However, unlike most of these Banks, most ECAs are not subject to any binding environmental, human rights or development guidelines. Not surprisingly perhaps, ECAs are involved in many destructive projects.

All 15 EU member states have ECAs. Most EU-based ECAs have no criteria for assessing the environmental and societal impacts of the projects they support. The EU lags behind the US and Japan in this respect.

ECAs and illegal logging

During the mid-1990s the value of total trade in forest products was US$ 152 billion a year; the illegal timber trade was valued at US$15 billion per year, robbing national governments of considerable revenues . ECAs backed many projects that contribute directly or indirectly to illegal logging. The following case studies demonstrate how ECA-backed projects contribute to illegal forest exploitation either directly, as in Indonesia where pulp and paper mills are estimated to source up to 40% of the wood they consume from illegal sources ; or indirectly, by opening forest areas to infrastructure projects and pipelines, or using illegally harvested timber for construction.

Illegal forest activities are clearly linked to the lack of due diligence on the part of ECAs. The availability of government-backed credits and guarantees, in turn, allows private sector actors such as banks and companies to invest in riskier projects than they would otherwise consider.

The EU has relatively strong environmental legislation for its internal market and is advocating environmental integration in its external policies. In multilateral environmental negotiations, such as those on climate change and biodiversity, the EU position is frequently stronger than those of other OECD countries, specifically the US and Japan. Recently, the Commission committed itself to developing a EU strategy to combat illegal logging and associated trade by the end of 2002. By contrast the EU trails the US and Japan in the development of guidelines for ECAs. And by neglecting to address the activities of the European-based ECAs that continue to fund projects involved in illegal logging, the EU dooms its efforts to address illegal logging to failure.

Case Studies

1. The Indonesian Pulp and Paper Industry

The Indonesia's pulp and paper industry is ranked amongst the top ten in the world. This has been made possible by international investment of more than US$15 billion during the 1990s –investment that was obtained without securing a legal and sustainable source of raw material, leading to a substantial degree of financial risk . Furthermore, for Indonesia's two largest pulp producers – Asia Pulp and Paper (APP) and Asia Pacific Resources International, Ltd (APRIL) – the process of resolving outstanding foreign debt was linked to further expansion: a nine-fold increase in output between 1988 and 1999, which in turn entailed an increase in annual pulpwood consumption from 1.8 million m3 to 16.7 million m3. The Indonesian government promotes the establishment of tree plantations to supply a 'sustainable' source of fiber for the pulp industry, despite the social and environmental problems these create. Still, the development of plantations has lagged far behind the increase in processing capacity of the industry, rendering pulp producers dependent on a mix of tropical hard woods. A World Bank study estimates that deforestation in Indonesia is equivalent to 2 million ha/year, or roughly the size of Belgium .

In addition to the large volumes of legal but unsustainably harvested wood, a substantial volume of fiber consumed by the industry comes from undocumented sources. It is estimated that as much as 20 million m3 – i.e. 40% of the wood – comes from illegal sources . Companies that finance illegal logging operations not only circumvent royalty fees on the wood harvest, and race to secure use of the wood before others can establish control over the land. Companies have been known to provide illegal loggers with chainsaws. The Indonesian government estimates that the trade in illegal logs costs the country US$ 3 billion per year.

The expansion of this high-risk industry is facilitated by investments and subsidies from the Indonesian government. However, the international community also bears considerable responsibility. Indeed, the ease with which APP and APRIL obtained foreign investment underlines the fact that the international investment community has ignored the inherent risks. This underestimation of financial risk can be attributed to two factors: the weakness in due diligence practices by banks and other financial institutions, and the ECA loan guarantees provided that reduce the banks' exposure.

After Suharto's fall, ECAs with heavy exposure in Indonesia found that the web of business contracts they had underwritten were in danger. As the newly independent Indonesian press brought to light evidence of massive corruption, environmental devastation and human rights violations linked to ECA-backed investments, the likelihood of substantial claims against the ECAs' political risk insurance and guarantees increased dramatically. In 1999, two weeks before the Consultative Group on Indonesia (CGI) was to hold its international donor meeting, the ECA 'swat team' – Germany's Hermes Agency, the US Export and Import Bank (Ex-Im), the Swiss export credit and Japan Bank for International Co-operation (JBIC) – descended on the Indonesian Government in an attempt to force them to honor the contracts of the previous government.

A more detailed description of the two main pulp and paper companies APP and APRIL underlines the connection between illegal logging and ECAs.

Asia Pulp and Paper (APP)

APP owns the Indah Kiat pulp mill in Perawang, Sumatra: this is financed through a US$500 million investment package supported by Finnvera, the Finnish Guarantee Board, Spain's CESCE, Denmark's Exportkreditfonden, and Canada's Export Development Corporation. It seems Hermes, the German investment guarantee agency, and Ex-Im have also respectively provided a US$ 5.6 million guarantee and a US$ 4.5 million loan for this mill, under separate financial arrangements.

For years, the mill has been embroiled in conflicts pertaining to the source of its timber for pulping. In 1993, it was fined US$ 1.4 million for the utilization of illegally felled timber. In 2001, APP collapsed under debts of US$ 13.4 billion .

Asia Pacific Resources International Holding Ltd (APRIL)

APRIL's main pulp subsidiary is Riau Andalan Pulp and Paper (RAPP) located in the province of Riau on the island of Sumatra. An investigation by WWF Indonesia in 2001 concluded that RAPP has been clearcutting the Tesso Nilo forest in the Riau province; gazetted as a limited production forest (selectively logging only), this forest is considered to have the richest biodiversity of any lowland forest on Earth.

Not only has RAPP been clearcutting Tesso Nilo, in clear violation of existing rules, it appears that RAPP is acting without any type of permit . The Head of the Forestry Service confirmed that they had never issued the utilization permit . In addition, the Indonesian Minister of Forestry decreed a moratorium on forest conversion in 2000.

Furthermore, the SGS study that APRIL commissioned found that local communities claim at least 40,000 hectares of APRIL's concessions .

Export Credit Agencies have played an important role in supporting APRIL's operations. EKN of Sweden and Finland's Finnvera guaranteed two loans totaling US$ 217 million, Germany's Hermes guaranteed another loan of US$ 33 million.

The financial institutions (public and private) responsible for funding Indonesia's pulp and paper sector must accept a large degree of responsibility not only for the failure of the Indonesian pulp and paper industry to pay back its debts but also for fuelling the destruction of Indonesia's forests. By willfully avoiding due diligence and ignoring the unsustainable and illegal supply of APRIL's raw materials, they have grossly underestimated the risk. They must be made to take the lead in ensuring that the Indonesia pulp and paper industry rapidly changes its management practice to ensure a transparent, legal and sustainable supply of raw materials.

Sources:
Friends of the Earth: www.foe.org;
Environmental Defense: www.environmentaldefense.org;
CIFOR: www.cifor.cgiar.org.

2. The Bolivia Brazil Natural Gas pipelines

The Bolivia-Brazil natural gas pipeline, costing a total of US$ 2 billion , stretches over approximately 3150-kilometers, from Santa Cruz, Bolivia to Brazil's Mato Grosso do Sul. It cuts across several important ecosystems: the Gran Chaco, a protected area of primary dry tropical forest in Bolivia; the Pantanal, the world's largest wetland; and the remaining Mata Atlantica Rainforest of Southeastern Brazil. The project, with its attendant social problems, also has significant impacts on local communities in Brazil and Bolivia. In Bolivia the pipeline traversed a number of indigenous communities and a protected area managed by an indigenous organization.

In Brazil, Transportadora Brasileira Gasoduto Bolivia-Brasil (TBG), whose investors include Pertobras, Transredes Enron and Shell, owns the pipeline; Gas Transboliviano S.A., a consortium comprising Transredes, Enron, Shell and Petrobras, owns the Bolivian portion of the pipeline. In 1997, the World Bank became the first multilateral agency to fund the pipeline. Other multilateral banks involved include the Inter-American Development Bank and the European Investment Bank (EIB). Export Credit Agencies involved include the Japan Bank for International Cooperation (JBIC), and the Italian Export Credit Agency, SACE, who jointly provided US$ 346 million . The Brazilian Development Bank BNDES, funding US$ 303 million, and the Multilateral Investment Guarantee Agency (MIGA the political-risk insurance arm of the World Bank) have also invested.

Construction of the pipeline required the clearing of the forest. The project's environmental management plan stated that mitigation measures would be taken to restore the native vegetation and vehicular access to the pipeline would be prevented: this has not been carried out. Already in 1998, the Comite de Fiscalization de el Carmen, a local monitoring body, documented a number of serious social and environmental impacts and violations. These include the close proximity of the pipeline route and worker camps to the town; inadequate erosion control measures; reduced community access to food and medicine; new access roads into the forest and the purchasing of illegally harvested wood for the construction of the pipeline. The pipeline companies also admit that wildlife poaching along the pipeline has increased.

There is a general concern that access roads and improved communications will intensify resource exploitation in the area in the longer term, and pressure from colonists on indigenous lands in Bolivia remains a major proble.

A second pipeline of 630 kilometers starts in Ipiás, Bolivia, where it branches from the main Bolivia-Brazil pipeline and runs northeast to San Matias and on to Cuiaba, Brazil. This pipeline cuts through 200 kilometers of primary Chiquitano tropical forest, 100 kilometers of pristine Pantanal wetlands and bisects Bolivia's San Matias Integrated Management Area, the only protected area for the world's largest intact dry tropical forest and the headwaters of the Pantanal.

This project is financed by Gas Oriente Boliviano (GOB), a consortium made up of Enron, Shell and Transredes. In 1999, Enron obtained a US$ 200 million financing from the US government via one of its Export Credit Agencies: the overseas Private Investment Corporation (OPIC). Financing was approved despite the prohibition in the Foreign Assistance Act on funding projects in "primary tropical forests". The Project's Environmental Impact Assessment (EIA) and independent scientists classify this region as "primary tropical forest". Using previous degradation to justify further degradation, Enron, the main project sponsor, contended that the forest is "secondary" due to sporadic logging activities in some parts.

Indigenous and farming communities unsuccessfully demanded that the pipeline be rerouted along existing roads to preserve ecosystems and minimize social disturbance. To cut its losses in Enron's bankruptcy, OPIC pulled out in February 2002. The local impacts on the Chiquitano forest region and the local populations have been significant nonetheless: pollution of local water resources, degradation of local roads, soil and air pollution, an increase in crime, prostitution, and the disruption of local towns by workers camps. Both illegal logging and hunting have been a direct consequence of the pipeline's construction.

A general disregard for rules, such as the clearing of unauthorized access roads, and the failure to control access to the pipeline, facilitating entry to the forest and encouraging the activities of poachers and illegal loggers, have paved the way for an increase in illegal logging and hunting .

Sources:
Amazon Watch: www.amazonwatch.org;
SEEN: www.seen.org;
Bank Information Center: www.bicusa.org;
Friends of the Earth:
www.foe.org/international/omg/casestudies.html .

3. The Camisea natural gas project

The Camisea natural gas project, the first major natural gas development in Peru, is located in one of the world's most ecologically prized rainforest in the remote Lower Urubamba Valley of the Peruvian Amazon, between the Alpurimac Reserve and the Manu National Park. According to the biological inventory of the Smithsonian Institute, commissioned by Shell before it pulled out, the biodiversity of the Camisea region is unsurpassed in the world; the Netherlands Committee of IUCN stated that, in view of the global uniqueness of the Camisea region, the latter should be one of the last places on earth from which to extract fossil fuels . Moreover, the gas development area (Block 88) covers the legally titled territory of several isolated and uncontacted indigenous peoples.

A US$ 2.7 billion project, Camisea involves the construction of gas wells, a processing plant and two parallel pipelines to the Peruvian coast. Preliminary construction has begun, and the project is expected to be on line by December 2003.

The Camisea project involves two consortia of energy companies, upstream (gas production) and downstream (gas transportation). Members of the upstream consortium are Pluspetrol, Hunt Oil, SK Corporation. Downstream members are Techint, Pluspetrol, Hunt Oil, SK Corporation, Grana y Montero and Sonatrach. Tractebel recently joined as their new distribution partner.

Citigroup, the project's financial advisor, is arranging financing. Currently the Inter-American Development Bank and two ECAs are implicated: the US Ex-Im and the Italian SACE are reviewing financing; decisions are expected by the end of spring 2002. Chase Manhattan Bank has contributed a US$ 25 million loan, guaranteed by Ex-Im, to Pluspetrol.

In a scenario that is repeated throughout the Amazon, the opening of forests to build gas pipelines brings in waves of workers, colonists and loggers. Already the building of access roads for these pipelines has encouraged colonists to settle on indigenous lands. Illegal logging in indigenous territories is increasing dramatically.

For instance, from May 2001, 16 logging groups from the town of Sepahua in Ucayali invaded the territory of a recently contacted indigenous group, known as the Nahua (or Yora) on the western border of Manu National Park. The loggers, working illegally, have extracted more than 600,000 feet of mahogany and cedar, threatened community members and depleted the wildlife on which Nahua livelihood depends. Since the loggers invaded, the Nahua have faced intimidation and threats to abduct Nahua women.

The loggers have acknowledged that they acted illegally, have agreed not to return to the forest this year and promised to commit 25% of the revenue from the timber to establish a communal fund for the Nahua . Despite this agreement, several loggers continue to extract timber. To avoid further infringements of the law, the government must commit the necessary resources to control effectively the illegal timber extraction. Notably, the companies involved in the construction of the gas field and pipelines continue to shrug off responsibility and refuse to take mitigating measures.

Additionally, the downstream consortium began preparatory work on the pipeline route and access roads without an environmental permit. Local accounts reveal that Techint has cleared a 1-2 meter trail through the forest and marked the majority of the route without prior authorization or permission from landowners. In itself illegal, this will also lead to more illegal logging.

Sources:
World Rainforest Movement: www.wrm.org.uy;
Amazon Watch: www.amazonwatch.org

Recommendations

There are no insurmountable technical obstacles to overcome to make ECAs accountable. The following recommendations intend to ensure that Export Credit Loans and Guarantees do not support illegal logging or destruction of forest ecosystems.

Increasing transparency and eliminating corruption are significant first hurdles; addressing social issues, such as full prior informed consent and land rights, present a second hurdle. Therefore:

- Export Credit Agencies must publish relevant information on the projects they support or are considering, including a description of the project (nature of the project, exact location, social and environmental impact, companies involved and their roles), company or bank, the amount and nature of the support, and listing the Environmental and Social Impact Assessments, and licenses necessary for construction to start; it is unacceptable to maintain ignorance in the hope of avoiding responsibility in the event of a challenge.
- In the case of forest operations, all legislation, rules and regulations, concession maps, details of concession companies, cutting licenses and transport permits must be made freely available. Forestry Departments should be encouraged and supported in making these data available. In the absence of this information, ECAs must not fund a project; again, ignorance is unacceptable.
- EU-based export credit agencies must monitor that the companies and financial institutions are in line with the OECD Anti-Bribery Convention . If a company or bank is found to have contravened the Convention, the ECAs' support should be suspended, other ECAs supporting the project should be informed and effective and dissuasive sanctions should be taken.
- The existence of land right conflicts between local communities or indigenous peoples and the company or government must be investigated. Furthermore local communities and Indigenous Peoples should be effectively included in all decision-making processes from the conception of the project. Prior informed consent of all parties involved is an essential precondition.

Specific recommendations for forest sector support

- Enforcement of improved due diligence practices must be prioritized. Financial institutions funding pulp and paper projects must ensure that the financial risks associated with these projects are fully assessed and finance is not allocated to projects involved in illegal practices, including use of illegally obtained raw material. Once it has become clear that an ECA has made such investments or guarantees, it must cancel these guarantees and investments.
- Before financing or underwriting any forestry projects, ECAs must be required to demand third-party independently verifiable certification with equal participation of all stakeholders in standards. Only then is there some guarantee that the forest concessions and plantations are managed in a socially responsible, ecologically acceptable and economically viable manner, and that land rights and tenure rights are not in dispute.

Specific recommendations to the EU with regard to ECAs:

A Council Regulation on binding social and environmental guidelines for ECAs, based on the mandatory application of existing legal instruments and guidelines listed below, would be an appropriate vehicle for EU action to address ECA activities that promote illegal logging. The 'European ECA' Campaign will shortly produce and present such draft legislation.

EU legislation that is or should be made applicable to Export Credit Agencies (not exhaustive) includes:

- Mandatory application of Council Directive 97/11/EC of 3 March 1997 amending Directive 85/337/EEC of 27 June 1985 on the Assessment of the Effects of Certain Public and Private Projects on the Environment;
- Mandatory application of Directive 2001/42/EC of

the European Parliament and of the Council on the Assessment of the Effects of Certain Plans and Programmes on the Environment;
- Mandatory application of Regulation 1049/2001 on Public Access to Documents;
- Mandatory application of Directive 2001/97/EC of the European Parliament and 0f the Council amending Council Directive 91/308/EEC on Prevention of the use of the financial system for the purpose of money laundering;
- Mandatory application of the OECD Guidelines for Multinational Enterprises, Revision 2000;
- Implementation of the Convention on Environmental Impact Assessment in a Transboundary Context: 1991 (Espoo Convention);
- Implementation of UN/ECE Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters, 1998 (Aarhus Convention).

In addition, guidelines and conditionality requirements should incorporate international human rights standards as defined by international instruments, and particularly:
a. the Universal Declaration of Human Rights;
b. the UN Covenant on Economic, Social and Cultural Rights;
c. the UN Covenant on Civil and Political Rights;
d. the UN Convention on the Rights of the Child;
e. the five core ILO Conventions (on the elimination of forced labour, of child labour, on non-discrimination, on freedom of association, and the right to collective bargaining);
f. the UN Convention on the Elimination of Discrimination Against Women.

Also, procedures must be adopted on ex ante disclosure of category A and B projects and on effective public consultation (especially for affected communities). Some guidance may be found in the Japan Bank for International Cooperation (JBIC) Guidelines for Confirmation of Environmental and Social Considerations, April 2002.

Conclusion

This briefing note details the relationship between ECAs and illegal logging and argues that, in order to address the problem of illegal logging, the EU must address the financial sector, including Export Credits. The wider application of existing rules and development of binding social and environment guidelines, to some extent based on existing guidelines, for the financial sector is needed for the EU to move forward.

This briefing note argues that a Council Regulation on binding social and environmental guidelines for ECAs, based on the mandatory application of existing legal instruments and guidelines listed above, would be an appropriate vehicle for the UE action to address ECA activities that promote illegal logging. The 'European ECA' Campaign will shortly produce and present such draft legislation.

Briefing Note: Fern, April 2002

Author: Chantal Marijnissen
Editors: Nicole Gérard and Saskia Ozinga

Fern Belgium, 20 Avenue des Celtes, 1040 Brussels, Belgium Tel: +322 742 24 36 Fax: +322 736 80 54 email: fern.belgium@wanadoo.be

Fern UK, 1C Fosseway Business Centre, GL 56 9 NQ, Moreton in Marsh, UK Tel : +44 1608 65 28 95 Fax: + 44 1608 65 28 78 email: info@gn.apc.org

Website: www.fern.org