

PT SMART Corporation Case Study

PT Matrasawit

Relations between Rabobank, ING and ABN-Amro and
forest destruction and poverty in East Kalimantan,
Indonesia

April 2001

AIDEnvironment

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Indonesia

Commissioned by Friends of the Earth Netherlands

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Main findings

Investment criteria	<p>In 2000, Greenpeace Netherlands and Milieudefensie requested Dutch banks to apply sustainability criteria when financial services are provided to the Indonesian oil palm sub-sector. The banks appear to support this concept but some state that they have since long applied environmental criteria to their investment decisions. The NGOs are still concerned that these banks may not fully acknowledge the environmental and social impacts of their investments in Indonesia's plantation business.</p>
Case PT Matrasawit	<p>To generate further company-specific and field-level information about the performance of the clients of Dutch banks, the oil palm plantation company PT Matrasawit in East Kalimantan was selected for a case study. PT Matrasawit is a full subsidiary of PT SMART, an Indonesian holding company that has repeatedly benefited from a range of financial services provided by Dutch banks, notably Rabobank, ING Group and ABN-Amro at least between 1995 and today. The case study aimed to determine if during these years PT Matrasawit:</p> <ul style="list-style-type: none">❑ Developed its plantation in a non-forest area;❑ Refrained from the use of fire to clear land;❑ Operated within the Indonesian law;❑ Respected the rights and wishes of the local communities. <p>These are the sustainability criteria that the NGOs proposed the banks to adopt, apply and monitor.</p>
Methodology	<p>The findings in this report are based on actual field visits in June 1998 and February-March 2001, video footage and literature study. The research revealed the following facts about PT Matrasawit:</p>
Deforestation and habitat loss	<p>The PT Matrasawit area in East Kalimantan contained approximately 50% lowland tropical rainforest when the company began to operate. Chainsaw crews within and in the vicinity of the PT Matrasawit area illegally cut commercially valuable hardwoods such as meranti until at least February 2001. According to records from the Court of Tenggarong, PT Matrasawit converted 2,500 hectares of primary forest into oil palm. This is an area equal to about half the National Park "De Hoge Veluwe" in the Netherlands. Recent field observations</p>

confirm that the area contained primary forest. Most of the forest has by now been destroyed.

The lowland forest in the PT Matrasawit area used to provide habitat for the orang-utan, an endangered and protected species in Indonesia. According to eyewitnesses, at least three orang-utans burned to death in the fires lit by PT Matrasawit in 1997 and another two infant orang-utans were captured and later brought to the Wana Riset Orang-utan Rehabilitation Centre.

Recent observations in the PT Matrasawit area prove that the company cleared its way up to the banks of smaller streams, causing soil erosion and the blockage water drainage. This resulted in stagnant mud pools which are likely to increase the incidence of malaria among local villagers and company workers.

Illegal burning

There is ample evidence that PT Matrasawit has burned intentionally and illegally within its area in 1997 and 1998. The company was found guilty of burning by the Court of Tenggaraong in 1999. In 1999/2000, satellites have not observed fire hot spots within the area.

Ultimately illegal

In 1998, PT Matrasawit was found to be operating completely outside the Indonesian law. The company possessed neither a permit for the conversion of forestland (Izin KBNK), nor an land clearing and use of timber permit (IPKH), nor an operation permit (Hak Guna Usaha). PT Matrasawit furthermore had not submitted an Environmental Impact Assessment statement (AMDAL).

Social conflicts

Indigenous Dayak and transmigrant communities nearby the PT Matrasawit area appear to resent the company's presence. They claim that PT Matrasawit has burned their forest gardens and coconut plantations. They allege they have not received compensation for their lost lands and that the smallholders' oil palm scheme that company promised to implement never materialised. The Dayak do not want oil palm in the area at all. In 1997, 600 people staged a demonstration against the company, which resulted in an intervention by the military. Since then, the protest has been silenced, but the conflict remains unsettled.

Financial woes

The Sinar Mas Group, to which PT SMART and PT Matrasawit ultimately belong, currently faces a range of lawsuits and other sanctions because its paper division, Asia Pulp and Paper (APP), fails to service its phenomenal US\$ 10 billion debt obligations. Industry analysts believe that, in order to generate cash flow to service this debt, Sinar Mas may withdraw capital from its oil palm division. This could explain why PT Matrasawit laid off most of its workers early this year, failed to construct processing facilities and leaves behind impoverished and unemployed communities. The economic viability of the PT Matrasawit must be seriously questioned.

Conclusions

This case study reconfirms that Dutch investments in Indonesia's oil palm sub-sector are related to utterly illegal, ecologically damaging, socially disruptive and even financially unsustainable practises.

Significant gaps exist between what ING Group and Rabobank claim with regards to the sustainability performance of their clients and what this investigation has uncovered.

This case study furthermore provides reasons to believe that if Dutch banks continue their financial involvement in the Sinar Mas group, they will facilitate further tropical forest destruction in the future.

It is ironic that on the one hand, conservation organisations in the Netherlands raise funds for the protection and rehabilitation of tropical forests and endangered species, such as the orang-utan, while on the other hand Dutch banks provide much larger amounts of capital to plantation companies to destroy the forests that endangered species depend on.

Recommendations

Withdraw from SMART

If Dutch banks are serious about applying the basic investment criteria for investments in the plantation sector as laid down by NGOs, they should refrain from investing in companies like PT SMART/PT Matrasawit. Adherence to the criteria implies that Rabobank, ING and ABN-Amro immediately withdraw their investments from PT SMART.

Reducing performance risk

To reduce future performance risk, banks should implement a mechanism for third-party verification for investments in natural resource based sectors to enable them to judge credit applicants' true objectives and ecological, social and economic performance. Such assessment should at least:

- ❑ Define *precisely* which companies may benefit from the financial services provided;
- ❑ Assure that high conservation value (HCV) forests within concession areas are identified, retained and/or well managed;
- ❑ Assure that environmental and social impact assessments have been conducted prior to commencing field operations;
- ❑ Verify that the company has (legally) obtained all required permits prior to commencing operations;
- ❑ Establish that indigenous and other local peoples' needs and concerns are satisfactorily addressed and sustained.

Contracts should specify that failure to comply with environmental and social conditions provides grounds for withdrawal of loans.

Reducing public image risk

To reduce future public image risk, banks should adopt third-party verification mechanisms to assure that 'green claims' on (mainstream) investment activity are validated. This enables shareholders, account holders, governments, NGOs and the general public to rely on the green claims made by banks and their debtors.¹

¹ FSC- and EKO chain-of-custody certificates enable timber traders to make independently verified claims about the origin of (part of) their products. Such a mechanism does not exist for the financial sector.

Restoring damage

To improve public image and to implement commitments to "ethical business"², it is recommended that Dutch banks set aside generous funds for the mapping and restoration of (illegally) cleared forests and landscapes, compensation schemes for badly affected local communities, the development of best management practise in natural resource sectors and fundamental reform of due diligence and monitoring procedures.

With such a move, Dutch banks would line up with, possibly surpass, the initiative of the German Development Bank (KfW) to swap its DM 50 million loans to Indonesia with the conservation of tropical forests.

² 'Maatschappelijk Verantwoord Ondernemen' in Dutch.

Acknowledgements

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Methodology

Friends of the Earth Netherlands commissioned this study to AIDEnvironment in December 2000. Ultimately, this project was funded by the Tropical Forest Programme of NC-IUCN who obtains these funds from the Dutch Ministry of Foreign Affairs.

The PT Matrasawit case was selected by use of the following criteria: relevant linkages to Dutch financial institutions, recent expansion activity, local research capacity and site accessibility.

Mr. Rudi Ranaq of Lembaga Bina Benua Puti Jaji, a legal and human rights NGO in Samarinda, East Kalimantan, conducted the field research for this report. He visited the PT Matrasawit area between February 17-21 and March 11-15, 2001. He had previously visited the area in June 1998.

Skephi Indonesia assisted in the purchase of video footage gathered by BBC Jakarta whose reporter, Jonathan Head, visited the PT Matrasawit area in June 1998.

The limited time available as well as the precarious security situation in Muara Wahau did not allow the consultants to conduct a full-scale survey that reflects the views of all involved. However, we do believe that within these limits, a best professional judgement has been made based on financial, environmental, social and legal expertise.

1 Introduction

NGO-Banks dialogue	In January 2001, Milieudefensie and Greenpeace Netherlands entered into dialogue with all major Dutch banks that provide financial services to oil palm plantation companies in Indonesia. The banks involved are Rabobank, ING Group, ABN-Amro Bank, Fortis/MeesPierson, FMO and NIB.
Funding Forest Destruction	The NGOs expressed concerns about the involvement of Dutch banks in the rapid expansion of Indonesia's oil palm sub-sector which goes along deforestation, forest fires, illegal land clearing, pollution, social conflicts, economic exposure and corruption, collusion and nepotism. ¹ The banks involved in the dialogue appear to acknowledge there are problems with the sector and expressed willingness to consider applying appropriate criteria during due diligence and monitoring procedures.
Verification of claims	Some of the banks involved in the dialogue, notably Rabobank and ING Group, argue they have since long applied meaningful criteria to their investments in oil palm sub-sector. These banks are confident that their clients behave responsibly:

ING Bank: The environmental policy of our current clients:

- The policy of the companies is to upkeep legal requirements.
 - Both companies (SMART Corporation and Raja Garuda Mas) are not involved in the deforestation of primary forest.
 - Both companies follow a policy to not burn during the deforestation process.
 - The correct approach to social conflicts is to engage the local population commercially in the activities of the plantation and to create certain levels of community aid. If this is done well, local communities will be much better off compared to the situation before the establishment of the plantation.
 - Our clients adhere to the local environmental policy, as far as we can judge. This means that no primary forest is cut, no burning takes place for cultivating the land and wastewater processing takes place at processing facilities. We are not aware of social conflicts in relation to the plantations involved.²
-

¹ See: Wakker, E., Van Gelder, J.W., and Telapak Sawit Research Team, 2000. Funding Forest Destruction: The Involvement of Dutch Banks in the Financing of Oil Palm Companies in Indonesia.

² Letter from ING Group to Greenpeace Netherlands, February 27, 2001.

Rabobank and the palm oil industry

- The Rabobank Group believes sustainable growth in prosperity and well-being requires the careful nurturing of natural resources and the living environment (..) We are quite naturally involved in the concept of sustainable development.³
 - (In 1999) Friends of the Earth and Greenpeace requested Rabobank to elaborate on its involvement in the palm oil industry. We want to be very clear in this matter:
 - We only finance projects that adhere to the environmental guidelines of the World Bank. We monitor this explicitly either by visiting the area ourselves or through special organisations, such as the French Centre de Coopération Internationale en Recherche Agronomique pour le Développement (CIRAD).
 - Especially plantations in the framework of the so-called plasma-programme appeal to us. This programme implies that 50% of the land of newly established plantation will be owned by the local population.⁴
 - Rabobank is not involved in palm oil plantations in East Kalimantan.⁵
 - No funding is provided if logging of tropical forest is involved.
 - For every request for finance, the site is visited by one of our people and, with the use of maps, the influence of the activities on the environment is mapped out.⁶
-

Case study PT Matrasawit

The oil palm plantation company PT Matrasawit Sarana Sejahtera Lestari Tbk. in East Kalimantan was chosen for further field research. The case study aimed to determine if PT Matrasawit adheres to the sustainability criteria as proposed by the Dutch NGOs and therefore:

- Developed its plantation in a non-forest area;
- Refrained from the use of fire to clear land;
- Operated within the Indonesian law;
- Respected the rights and wishes of the local communities.

³ Hans N.J. Smits, Chairman of the Executive Board Rabobank Nederland in: Sustainable Banking, The Greening of Finance. Bouma, J.J., M.Jeucken and L. Klinkers, 2001.

⁴ Rabobank Groep. Duurzaamheidsjaарverslag 1999.

⁵ Letter from Rabobank to Milieudéfensie, July 19, 1999.

⁶ De Rabobank en de palmolie-industrie. Attachment to letter from Rabobank to Milieudéfensie, July 19, 1999.

2 Company background

2.1 Dutch banks and PT Matrasawit

PT SMART subsidiary

In June 1997, PT SMART acquired 100% of the shares of the oil palm plantation company PT Matrasawit Sarana Sajahtera Lestari. This means that PT Matrasawit's field operations resort under the responsibility of the management of PT SMART. The two directors of PT Matrasawit are also on the Board of Management of PT SMART.

PT Matrasawit Sarana Sejahtera Lestari

Directors: Muktar Widjaja⁷, Peter Ong⁸

Address: Plaza BII Tower, Lt. 30

Jl. M.H. Thamrin, Kav. 22

Thamrin, Jakarta Pusat 10350

Phone: 021-2301410

Fax: 021-2301411

Relation with Dutch banks

Dutch banks have repeatedly provided various financial services to PT SMART in the past few years. Since 1995, they have arranged, led and participated in several bank syndicates that provided PT SMART with major commercial loans of several hundreds of millions of dollars. The three Dutch banks - ING, ABN-Amro and Rabobank - have until recently assisted PT SMART in obtaining debt.

Recent transactions

In 1999, together with another bank, ING Barings led the Initial Public Offering of Golden Agri Resources, the oil palm holding to which PT SMART ultimately belongs. In May 2000, PT SMART signed a restructuring agreement of a US\$ 45 million loan that was obtained from 11 syndication banks, including ABN-Amro, Rabobank and ING Bank. Rabobank acted as the financial advisor for this transaction.⁹

⁷ Also President Director of the Board of Management of PT SMART.

⁸ Also Director of the Board of Management of PT SMART.

⁹ PT SMART Tbk. Restructures US\$45 million loan. www.smart-corp.com. See further: Van Gelder, J. 2001. ING en ABN-Amro: Financiering van Indonesische Oliepalmplantages.

Loan conditions and contracts The financial connections between the three banks, PT SMART and its subsidiary PT Matrasawit are direct. This implies that Rabobank, ING Bank and ABN-Amro have the responsibility to assure that their client complies to the terms and conditions laid down in the contract.

Of course, these contracts with PT SMART are not publicly available documents. If these contracts specify conditions that PT SMART can not use the loans provided to develop the estate of PT Matrasawit, only then can the Dutch banks not be held accountable for PT Matrasawit's actions.

2.2 Sinar Mas Group

PT Sinar Mas Agro Resources Technology Corporation Tbk., better known as PT SMART, was first set up by a Dutch company in 1962. Today, PT SMART is owned by Golden Agri-Resources Ltd., a listed company in Singapore which is in turn part of Indonesia's second biggest corporate conglomerates, the Sinar Mas Group. This group is controlled by the Chinese-Indonesian Widjaja family, headed by Mr. Eka Tjipta Widjaja.

Sinar Mas in brief

The Sinar Mas Group rapidly expanded during the Soeharto regime. The group's 150+ subsidiaries are involved in several key economic activities in Indonesia and abroad, including logging, palm oil production, pulp and paper industries and banking.

Logging: The Sinar Mas had access to 6 logging concessions covering 526,000 hectares of forest for the production of tropical logs in 1994/95. Since then, Sinar Mas lost access to two of its logging concessions (216,000 hectares). By 1997/98, the Sinar Mas concessions could supply only two-thirds of the group's four sawmill units processing capacity.¹⁰

Oil palm: Through a complicated structure of oil palm holdings, Sinar Mas owns the largest area of established oil palm plantations in Indonesia. The group may have interests in some 60 plantation companies with a land bank of some 470.000 hectares. The group furthermore owns and manages numerous palm oil mills and refineries to produce cooking oil, margarine, shortening and oleo chemicals for the cosmetics industry.

¹⁰ Addicted to Rent: Corporate and Spatial Distribution of Forest Resources in Indonesia: Implications for Forest Sustainability and Government Policy. D. Brown, DFID/ITFMP 2000.

Pulp and paper: Asia Pulp & Paper (APP), a listed company in Singapore, is the main investment vehicle of the wide range of Sinar Mas' interests in the pulp and paper industry. APP owns logging concessions of at least 1,5 million hectares and 32 manufacturing facilities in Indonesia alone. With its US\$ 10 billion debt, APP currently faces huge financial problems. APP's Indonesian subsidiaries continue to rely heavily on processing tropical hardwood for pulp and paper production.

Banking: The direct involvement of the Widjaja family in the management of Bank Internasional Indonesia (BII) ended in August 1999, for failing a ethics test mandated by Bank Indonesia. Eka Tjipta Widjaja, the ultimate leader of the Sinar Mas, served as a board member of Soeharto's controversial welfare foundation "Dana Sejahtera Mandiri". Nevertheless, only four years earlier, ING Barings and International Media Partners had awarded Eka Tjipta Widjaja, the "1996 Emerging Markets CEO of the Year Award" for "his important contributions to the development of emerging economies".

2.3 PT SMART Tbk.

Company structure

According to company information, PT SMART controls majority shareholding in 13 oil palm plantation companies with estates in Sumatra, Irian Jaya and Kalimantan (see also figure 1). The total land bank that PT SMART claims to control for palm oil production is around 150.000 hectares, of which 88,000 hectares are under cultivation.¹¹

¹¹ PT SMART Annual Report 1998; PT SMART Annual Report 1998; Sinar Mas Libatkan 75,000 KK Penduduk Kaltim Untuk Kembangan Sawit. Suara Pembaruan. February 12, 1999.



Figure 1: PT SMART subsidiaries¹²

¹² PT SMART company website, www.smart-corp.com. The company probably has interests in a larger number of oil palm companies in East Kalimantan including Bulungan Sarana Utama, Nunukan Sarana Jaya, Pratita Laksana Setia, Sanggatta Andelan Utama, Sawit Agro Mas and Sawit Agrijaya.

Expansion in sensitive areas Over the last five years, PT SMART has announced it would develop new oil palm estates in Irian Jaya, Central Kalimantan and East Kalimantan. These are forest rich regions inhabited by indigenous peoples that require high priority attention from investors and buyers if they wish to assure that PT SMART's presence in these areas does not lead to deforestation and social unrest.

PT SMART in East Kalimantan PT SMART's pre-crisis rate of conversion of 7,000 - 10,000 hectares per year fell to 5,500 hectares in 1998, of which only 15% involved replanting of old trees.¹³ In January 2001, the company announced its intention to expand its area by 15,000 hectares this year.¹⁴ This expansion will mostly take place in East Kalimantan.

PT SMART has announced it has two oil palm projects in East Kalimantan to develop approximately 50,000 hectares of new plantations.¹⁵ They include a 40,000 hectare plantation in the forest rich region of Berau and PT Matrasawit Sejahtera Lestari in Wahau (16,500 ha).¹⁶ By early 1999, PT SMART had planted 4,500 hectares in East Kalimantan. The company planned to open up and establish 10,000 hectares of oil palm in 1999, and foresees that another 30,000 hectares will be planted in the next three years in East Kalimantan.¹⁷

¹³ PT SMART Annual Report 1999.

¹⁴ SMART Expects a 47% Increase in Palm Oil Output in 2001. Indonesian Observer, January 15, 2001.

¹⁵ SMART Annual Report 1999.

¹⁶ It is worth noting that the operation in Berau (Tanjung Redeb) can not be traced back by forestry and conservation specialists in East Kalimantan: the operation simply does not appear on maps, company lists and Annual Reports (up to 1999). Establishing an oil palm estate of 40,000 hectares in Berau regency would almost certainly involve the clearing of primary and old secondary tropical rainforests.

¹⁷ Smart Restructures US\$ 45 Million Loan. Jakarta Post, May 9, 2000; SMART Annual Report 1999.

3 PT Matrasawit Sejahtera Lestari

3.1 Location

PT Matrasawit is a medium-sized oil palm plantation company. It first began to develop its oil palm estate in Wahau sub-district in East Kalimantan in 1996. PT SMART acquired 100% of the company's shares in June 1997. According to company information, the PT Matrasawit area comprises 16,500 hectares.

PT Matrasawit's concession is located on the East bank of the Wahau river (see Map 1). This is a remote and inaccessible area that can best be reached by boat, a two-day trip from Samarinda, the capital of East Kalimantan.

PT SMART may have selected PT Matrasawit for its proximity to the Kalimantan Highway. Without an operational CPO mill, the company's operations are unlikely to be economically feasible because the highway is in an exceptionally poor condition in this area.

We will now describe the impacts that the company has had on the environment and communities along the river Wahau.

3.2 Deforestation and habitat loss

Background

In Southeast Asia, deforestation generally involves the following steps: legal selective logging - illegal selective logging - burning - clearing - plantation development. This process may take decades in a forest area, it may also take place within a few years.

Matrasawit in the frontier area

PT Matrasawit operates in the centre of East Kalimantan, one of the deforestation frontier areas of East Kalimantan. Overlay of the vegetation maps of East Kalimantan with the PT Matrasawit area proves that the area comprised about 40-50% lowland Dipterocarp forest and 50-60% secondary forest and farmland (see Map 2).

The area of PT Matrasawit overlaps with a logging concession controlled by PT Basu IMEX (see Map 3). According to records from the Court of Tenggara, PT Matrasawit converted 2,500 hectares of unlogged tropical forest into oil palm within the PT Basu IMEX area. During the field research, felled logs with 80-90 cm in diameter were observed,

which provides good reason to believe that that the PT Matrasawit area comprised primary or very old secondary forest (see also appendix 1).

Forest clearing and timber trade Villagers confirm that when PT Matrasawit began to develop the area, it was still mostly forested. They recall that logging crews began clearing in 1996-1997. Dozens of chainsaw operators are said to have felled trees both within the perimeter of the plantation as well as outside of it. Forest clearing and sawing of felled logs has been going on until the time of investigation in February 2001.

Logging and timber trade takes place as follows. Chainsaw operators saw the logs on the spot into squared blocks. Oxen pull these blocks to the edge of the road, where they are loaded onto trucks. The trucks take the timber to 5 different locations in Muara Wahau, Pantun and transmigrant settlements where processing is done by 16 operating sawmills. According to records from the Court of Tenggarong, PT Matrasawit cut 924 trees (1.223 cubic metres of timber) in the area in 1997. Since then, logging has been ongoing. A local timber trader confirmed that he obtained 600 m³ of meranti, bangkirai and kapur in the area in January 2001 and transported it to a sawmill in Muara Wahau for processing. From the sawmills onward, the timber is loaded on river cargo boats and shipped off to Samarinda and then on to Java. It may well be that this timber eventually ended up on the European market.

The area of PT Matrasawit contained at least 2,500 hectares of good primary forest where oil palms are planted today. An area equal to about half the National Park "De Hoge Veluwe" in the Netherlands has thus been deforested by the PT SMART subsidiary.

The logging activities in the PT Matrasawit area could not have gone unnoticed by the company. Yet, no action has been taken to prevent it.

"Environment is the primary consideration in all aspects and stages of our business"

"We preserve and protect the environment by preventing or minimising any potential adverse environmental impacts arising from our operations (...)"

PT SMART Annual Report 1996 and 1997

Clogged streams and rivers

The forest along rivers, streams and lakes provide key habitat and corridors for wildlife. Thus, it is prohibited in Indonesia to clear land for oil palm development all the way up to the shores of water bodies.

During the field survey, it was discovered that PT Matrasawit had bulldozed logging debris all the way up to a small river, thereby causing soil erosion and creating stagnant water and mud swamps (see appendix 1). Such pools can cause increased occurrence of malaria and other water borne diseases among plantation workers and local people in the area.

The fate of the orang-utan

East Kalimantan offers one of the few remaining habitats for the closest living relatives of our own species, whose Malay name, *orang-utan*, appropriately means 'forest people'. The orang-utan is a protected species in Indonesia. Yet, between 1960 and 1990, already 56% of the orang-utan habitat in East Kalimantan was lost. Even worse, **up to one third of Borneo's orang-utans died during the forest fires of 1997-98**. Today, there may be less than 15,000 orang-utans left in the whole of Borneo.¹⁸

Excerpt from an orang-utan specialist diary Part I

August 4, 1998

My friend Deddy who works in the concession recalls the terrible situation when the fires were raging. He will send me the pictures he took of a large adult male orang-utan in the top of a dead tree isolated in the middle of a sea of fire. Deddy could see him from 50 meters distance from a higher slope but was not able to do anything. The orang-utan male repeatedly threw his head

backwards and cried enormously loud while tears were running over his cheekpads. When the fire reached his legs he dropped down 40 meters into the flames. This intelligent orang-utan must have realised from the moment he got isolated what would happen to him. So much sadness and such a feeling of powerlessness when faced with all these problems.

Rijksen and Meijaard (1999) note that "behind the complex of proximate causes threatening the survival of the orang-utan, a

¹⁸ Orangutan Numbers Plummeting Worldwide: Species may Vanish in the Next Ten Years, Study Says. Wildlife Conservation Society. February 26, 2001; Our Vanishing Relative. The Status of Wild Orang-Utans at the Close of the Twentieth Century. Rijksen, H.D. and E. Meijaard 1999.

voracious international market is a major driving force." Both capital and products markets promote the expansion of logging, forest fires, hunting and plantation development in East Kalimantan, thereby pushing the chances for survival for the orang-utan to the very limit.

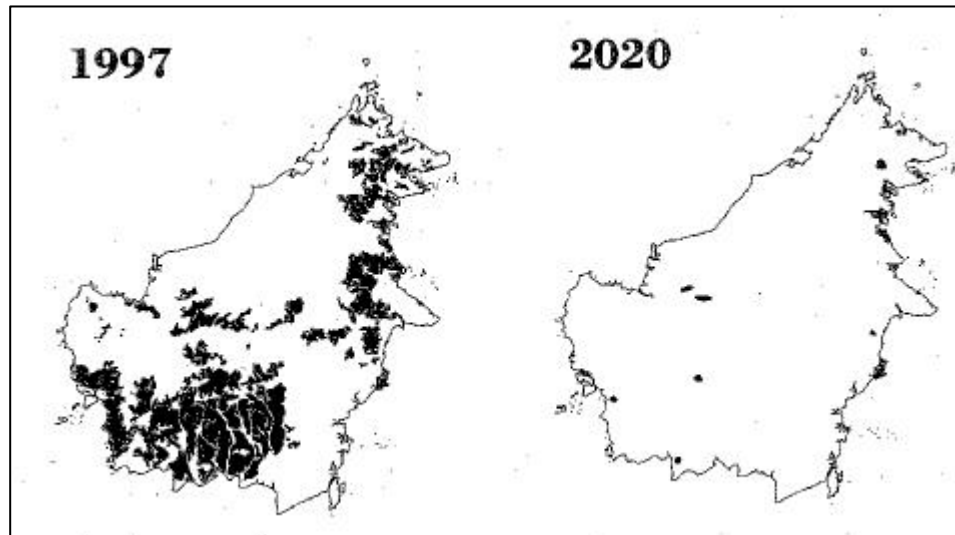


Figure 2: Map illustrating a worst-case scenario involving a *laissez-faire* attitude in Borneo; the projected remaining orang-utan distribution pattern in 2020.¹⁹

Orang-utans in the Matrasawit area The PT Matrasawit area is located in the Wahau river lowlands and thus provided habitat for endangered and protected orang-utan. Most, if not all, of this habitat has now been destroyed.

A former company employee says that when PT Matrasawit was burning to clear the forests in 1996-1997, he himself saw three orang-utans dying in the flames.

In July 1998, the people from the village of Nehes Laih Bing rescued two young orang-utans in the PT Matrasawit area. The animals were given to Wanariset Orang-utan Rehabilitation Centre near Balikpapan.

¹⁹ Our Vanishing Relative. The Status of Wild Orang-Utans at the Close of the Twentieth Century. Rijksen, H.D. and E. Meijaard 1999.

Excerpt from an orang-utan specialist diary Part II
Long Bau (North of Muara Wahau),

August 4, 1998

Soon we are leaving Muara Wahau again while the sun sets. More debris in the river but after about half an hour we reach the village of Long Bau. We go straight to the house of a street head. The man is not pleased at all to see us but he does show us the orang-utan baby. It is in a cloth bag hanging from a piece of wood in the infamous kitchen space platform again. Two months he has had it in the bag. Sometimes he takes it out but not often because the little one is naughty. We sit in the front room with low light and discuss why we have to come and confiscate his orang-utan. He complains about the oil palm plantation across the river that takes away all their forest and asks how they are now supposed to survive. He is a very bitter man. On the floor lays a heap of wood chips.

He has been cutting out the Gaharu a scent wood that yields an etheric oil for the production of perfumes in the west and represents one of the most secretive trades from the jungles of Borneo. Only the diseased heartwood of this tree known as *Aquilaria malaccensis* (Thymeliaceae) contains the etheric oil.

Finally the man accepts the fate that he loses the orang-utan and takes the parasite treatment we give for his family. The little one and a half year old male orang-utan baby is extremely lively. It does not look like an animal that has been tortured for two months in a bag. He also was caught when his mother was on the run for the fires entering the village of Long Bau.

Excerpt from an orang-utan specialist diary Part III
Lak Luay (South of Muara Wahau)

August 5, 1998

The old Dayak wearing only a pair of very old ripped shorts explains that the mother of the baby came into the garden and that they had darted the mother. They wanted to eat her because they were hungry but these Dayaks believe that the orang-utans once were humans and therefore they do not eat them. He feels so sorry for the orang-utan but they have no choice either. The orang-utan lost its

forest and the villagers lost their food. Both his eyes have severe cataracts and when he tells how their rice harvest failed two times because of the drought and the fires and that now the orang-utans came to eat the corn and manioc they planted to replace the lost rice we can see tears well in his eyes. He is so skinny and he tells how hungry they now are.

3.3 Illegal burning

Background

In 1997 and especially in 1998, East Kalimantan was badly hit by widespread forest fires. Approximately five million hectares of land were burned, among which primary forests, logged over forests, forest gardens and even plantations. When the haze began to clear in May 1998, Mr. Ludwig Schindler of the GTZ/IFFM fire-monitoring project noted:

"East Kalimantan is a burnt country beyond an outsiders imagination." ²⁰

Nearly all fires, controlled and wildfires, were manmade, and most were attributed to the rapidly expanding oil palm industry. In Indonesia, the use of fire for land clearing is prohibited since 1994 but the ban was widely ignored. When the fires caused a haze that suffocated the Southeast Asian region for several months in a row, the Indonesian government released a list of 176 companies that were suspected of causing the forest fires in Indonesia. The list was released in September 1997 and included 133 oil palm companies, among which the following Sinar Mas/PT SMART subsidiaries:

1. PT Kresna Duta Agroindo (in Jambi Province)
2. PT Tapan Nedenggan (in North Sumatra and Central Kalimantan),
3. PT Buana Wira Lestari (in Riau) and
4. PT Indah Kiat (in Riau), a pulp and paper company.

"We have been implementing strict no burning policy in conduction land clearing activities on the plantation site."

"The company has created an environmental section to (..) ensure the the 'No Burning Policy' is applied during land clearing activity"

PT SMART Annual Report 1997 and 1999

Evidence of burning

PT Matrasawit was not listed by the Ministry of Forestry and Estate Crops in September 1997.²¹ Yet, there is no doubt that the company burned illegally to rid the area of woody vegetation and debris in 1997/98:

²⁰ See www.iffm.org/ani98.html. This website provides detailed insights in the progressive expansion of fires in East Kalimantan in 1997 up to recently.

²¹ The list was compiled on the basis of just two weeks of satellite imagery. Therefore the fires lit by many companies before or after the analysis will have gone unnoticed.

- Overlay of the concession map and 1998 forest fire hot spot clearly indicate severe fire damage within the PT Matrasawit area (see Map 3).
- BBC's video footage shows dramatic images of burning inside the Matrasawit area in July 1998. The BBC team observed the presence of containers of petrol in the area (images not available).
- When interviewed last February, local workers recalled that the field managers had ordered them to burn the wood stacks in 1997 and early 1998. They confirmed that the company had provided them with petrol to execute the act.
- To the dismay of the communities involved, the fires spread into community coconut groves in the transmigration area of SP I-V and inside the Dayak forest gardens in Miau Baru. Villagers claim that the company did not stop the fires until they began to complain.
- The traces of burning are still visible today (see appendix 1). Large areas of coarse grassland have now developed in the area.

Legal action

In February 1998, local authorities first mentioned PT Matrasawit as one of three companies to be charged for burning "in the near future".²² Yet, no further action was taken.

In May 1998, PT Matrasawit was caught red-handed by Tim Satuan Koordinasi Nasional Penanggulangan Bencana (Sakornas), an investigative team from Jakarta, which brought along nine Police officers from Kalimantan Police Department.²³ PT Matrasawit would be the only company that the East Kalimantan Police Department would process for forest burning in 1998.²⁴

²² Forest Fires in East Kalimantan Bring Famine and Dispossession. Down to Earth, November 6, 1998.

²³ Media Indonesia May 3, 1998.

²⁴ Forestry Highlights from the Indonesian Press. July-August 1999. MoFEC/GTZ.

However, the provincial police withdrew the case due to 'lack of evidence' to proceed the case. This decision arrived at the utter disbelief of many because the Sakornas team included nine police officers who had seen the burning. The case was shelved, but as a consolation PT Matrasawit did appear in court in 1999 to answer to further allegations that it had burned in its area. The court ruled that the company was guilty and fined the company with Rp. 700,000, an equivalent of 200 Dutch guilders.

Improved performance?

The insignificant fine seems to have had a positive impact. Forest fire hot spot maps overlayed with PT Matrasawit's area suggest that the company has refrained from further burning activity in 1999 and 2000.

Background

3.4 Illegal clearing without permits

A plantation company can only fully engage in plantation development when it has recommendations from the Governor, provincial Forestry authorities and at least four other permits from the Ministry of Agriculture and the Ministry of Forestry and Estate Crops. Acquiring these permits can be a time-consuming process, which not all companies can afford if they already borrowed money from a syndicate of banks.

There are some documented cases where oil palm companies simply began to clear the forest after having obtained substantial debt from financial institutions and without having acquired the necessary permits. Among these are PT London Sumatra and PT Matrasawit.

Matrasawit and its permits

PT SMART acquired PT Matrasawit in June 1997, two years after it had attracted substantial long-term debt from a range of international financial institutions, among which Rabobank, ING Group and ABN-Amro. Part of this debt, that was acquired in April 1995, was restructured in May 2000.

In 1998, Indonesian NGOs and Dayak representatives discovered at the Ministry of Forestry and Estate Crops that PT Matrasawit operated illegally.²⁵ It was found that PT

²⁵ People Take Action Against Companies' Destructive Activities. Sawit Watch. WRM Bulletin, Issue Number 20 - February 1999.

Matrasawit possessed neither a permit for the release of conversion forestland (Izin KBNK), nor an IPKH permit (clearing and use of timber permit), nor an operation permit (Hak Guna Usaha) from the government.²⁶ It furthermore had no Environmental Impact Assessment statement (AMDAL).

An academic's view on PT Matrasawit

A Polish researcher at the University of Amsterdam, Krystof Obidzinsky who currently studies the history and impact of illegal logging found few forestry operations in East Kalimantan that operate within the law. Yet, he was shocked to learn about PT Matrasawit's malpractice. "Of course, the company operated without the obligatory Environmental Impact Assessment. Practically no company bothers to make such a statement, but PT Matrasawit operates *completely* outside the law. I can not believe that Dutch investors would not demand their clients submit copies of all permits required and that these documents are not double checked with the Ministry of Forestry and Estate Crops".²⁷

Inadequate legal action

Considering that the company worked illegally for quite some time in the Wahau area and considering that the company was charged with a negligibly small fine for burning, PT Matrasawit's managers are believed to be 'extremely well connected'.

Nevertheless, the provincial government (Pemprov), through regional forestry office (Kanwil Kehutanan) eventually ordered PT Matrasawit to cease all activities in 1998. The company ignored these orders. The authorities then instructed provincial Police (Polda) to investigate the matter and take the company to court because PT Matrasawit was believed to achieve no more than illegal logging.²⁸

Until today, it appears that no legal action has been taken. It may well be that some "paperwork" has been dealt with since

²⁶ Matra Sawit Merasa Diperlakukan Tak Adil Soal Kebakaran Hutan. Suara Pembaruan Daily. July 10, 1999.

²⁷ Krystof Obidzinsky, University of Amsterstam. Personal communication.

²⁸ Kaltim Post 28/11/1998.

the company's concession is shown on the concession map compiled by the Ministry of Forestry and Estate Crops in 2000.

3.5 Conflicts with local communities

Background

Under the Soeharto government, oil palm companies could enter forest areas without the consent of the local communities who might be affected by the project. The companies would simply rely on the police force or military to assure that disputes and protests were dealt with, often by means of intimidation and force.

Dayak Miau Baru community

The Dayak community in Miau Baru do not want oil palm around their villages, nor do they want to be part of it. They complain that PT Matrasawit infringed on their *ladang* (shifting cultivation) fields, fruit tree groves and forests on which the community depends for game and non-timber forest products. The Dayak noticed that the company followed a strategy of *fait accompli*: after the damage was caused and after the community had complained, only then would the company negotiate about the damage caused. It is not surprising that this approach nurtured the communities' resentment against oil palm and the company in particular.

Protests

The villagers state they have been pursuing peaceful means of protest, trying to negotiate and plead with the management, but to no avail. Eventually, their patience ran out. In 1997, they organised a demonstration involving 600 people to protest against PT Matrasawit and its unilateral actions. The angry villagers pushed a company bulldozer into a stream in order to challenge the company to negotiate.

Since New Order was still in effect at that time, the company called on local authorities to take care of the unrest. The military as well as sub-district government moved in and "restored order".

Until this day, the community has neither regained the land that was taken over by the company, nor did they receive any form of compensation. Negotiations have been at a stand-still since then.

Transmigration communities

Since 1980, transmigrant communities from Java and Sulawesi settled in the Wahau river area. As in the case of Miau Baru, PT Matrasawit burned and cleared an unknown part of their

community fields, coconut plantations and tree groves. The company offered the people a community oil palm plantation scheme (plasma scheme). The people were reluctant, but having little choice they eventually went along with the offer. However, up to date, no such scheme has materialised.

"We realise that human resources play an important role in the business development and growth of the company"

"SMART values the employees as one of the most important assets and investments"

"SMART Corporation recognises the important role of human resources for the company"

"Community development has been our main concern from the day we planned to open up a plantation area since it goes hand in hand with the security of the plantation itself"

PT SMART Annual Reports 1995, 1996, 1997, 1998 and 1999

PT Matrasawit's workers were paid Rp. 7,000/day in 1996-2000, less than US\$ 1 per day. Early 2001, the company raised wages to Rp. 14,400/day, but then laid off most contract and permanent transmigrant staff without prior notice or further compensation. The workers do not understand the company's motives for its decision.

Financial woes within Sinar Mas

One reason for the workers' lay off may be that PT Matrasawit has not built a Crude Palm Oil mill in the area. Such a CPO mill is indispensable because the "Fresh Fruit Bunches" must be processed 24 hours after harvesting. The oil palms in the PT Matrasawit area already begin to bear fruit (see picture 7, appendix 1) so the company loses income until a CPO mill comes online.

The workers lay off and the fact that a CPO mill has not been constructed may be related to the wider financial woes of the Sinar Mas group because financial analysts familiar with the group's debt management strategies have questioned whether the group's investments in oil palm are used to raise new capital for servicing the Asia Pulp and Paper's US\$ 10 billion outstanding debt.²⁹

²⁹ Profits on Paper: The Political Economy of Fibre, Finance, and Debt in Indonesia's Pulp and Paper Industries. Chr. Barr, 2000. CIFOR.

4 Discussion

Failure to comply

The case study on PT Matrasawit in East Kalimantan provides evidence that PT SMART, a major client of several Dutch banks, does not adhere to the sustainability criteria for oil palm investments as proposed by the NGOs. Nor does the company adhere to other standards such as those of the World Bank, ING Group or Rabobank. PT Matrasawit's practises are also not in line with PT SMART's own environmental and social policy statements. PT Matrasawit operated outside the Indonesian law. The economic viability of the project, as it stands now, must be seriously questioned. This provides the banks involved grounds to withdraw their loans from PT SMART.

Green claims

Significant gaps exist between what ING Group and Rabobank claim with regard to environmental and social policies and the actual practises of their clients, in this case PT SMART. There is an urgent need for both parties to go beyond general statements about environmental and social policies and criteria. Ultimately, an independent verification and monitoring mechanism will be required to establish by fact that investments are used to develop ecologically, socially and financially responsible projects. This will enable shareholders, accountholders, governments, NGOs and the general public to better judge the 'green claims' or commitments to 'ethical business' made by banks and their clients.

Unsustainable investments

In the past few years, financial institutions have eagerly provided project finance to the Sinar Mas Group. Until quite recently, they did not seem to be concerned by the fact that Sinar Mas/Asia Pulp and Paper already carried US\$ 10 billion in outstanding obligations on its balance sheet and uses much of its new debt to pay off old debt.³⁰ Financial institutions have also not been concerned with the fact that investments in Sinar Mas' pulp and paper and oil palm industries contributed to the destruction of Indonesia's unique tropical forest. If financial institutions continue to provide services to the Sinar Mas Group in order to recapture debt in the future, financial

³⁰ *Profits on Paper: The Political Economy of Fibre, Finance, and Debt in Indonesia's Pulp and Paper Industries.* Chr. Barr, 2000. CIFOR.

institutions will most likely continue facilitating the destruction of more tropical forests in Indonesia.

Recovery of debt

In the second half of 2000, banks finally begun to see that the group had built up a massive debt which it was unlikely to service.³¹ Rather than to continue rearranging Sinar Mas' debt, ABN-Amro decided to file a case against three of APP's operating subsidiaries (PT Indah Kiat Pulp and Paper, PT Pabrik Kertas Tjiwi Kimia and PT Pindo Deli Pulp and Paper) last March 2001 to recover US\$ 31 million.³² Sinar Mas/APP currently faces 8 lawsuits in total. The question arises what banks would do with the loans that they recover from APP and PT SMART.

Debt for forest swap

It is ironic that on the one hand, conservation organisations in the Netherlands raise funds for the protection and rehabilitation of tropical forests and endangered species, such as the orang-utan, while on the other hand Dutch banks provide much larger amounts of capital to plantation companies to destroy the forests that endangered species depend on.

Considering the widespread damage to Indonesia's forests that has already been caused with the aide of foreign capital in the past decade, banks should consider setting aside funds for the mapping and restoration of (illegally) cleared forests and landscapes, compensation schemes for local communities, the development of best management practises in the natural resource sectors and fundamental reform of due diligence and investment monitoring procedures.

In this context, a promising initiative was recently announced in the Jakarta Post. The German development bank (KfW) has proposed swapping its DM50 million loans to Indonesia with the conservation of more Indonesian forests. Co-ordinating Minister for the Economy Rizal Ramli said the Indonesian

³¹ *Profits on Paper: The Political Economy of Fibre, Finance, and Debt in Indonesia's Pulp and Paper Industries.* Chr. Barr, 2000. CIFOR.

³² *ABN-Amro Sues APP, Units to Recoup Debt.* Sara Webb, March 11, 2001.

government would offer such a "good move" of swapping debt with forest conservation to other creditors.³³

³³ German Loans to be Applied for Forest Conservation. Jakarta Post, March 31, 2001.