

P R A K A R S A *Policy Brief*

September 2024

Financial Footprints that Threaten the Environment and Human Rights: The Pulp and Paper Case in Riau



Key Points:

- Banks contribute to environmental degradation and human rights violations through irresponsible funding and investment in the pulp and paper industry.
- BRI, Mandiri, BCA, BNI, and Mizuho Financial are the banks with the highest levels of financing in the pulp and paper industry in Indonesia from 2016 to September 2022.
- The Financial Services Authority (OJK) needs to require banks to review the financing provided to pulp and paper companies, considering the policies and implementation of Environmental, Social, and Governance (ESG) aspects, including respect for human rights in communities living around the companies' operational areas.

Global paper production and consumption

Global paper consumption continues to rise. It is projected to keep increasing in the coming decades, reaching 476 million metric tons by 2032, an increase of 59 million metric tons compared to 2021 (Statista, 2024). The highest demand is for packaging paper, which was estimated to account for 178 million tons or 40 percent of global paper demand in 2021 (Statista, 2024).

China is the largest consumer of paper and cardboard in the world, with consumption reaching 130.3 million metric tons in 2022. This amount is equivalent to the total paper and cardboard consumption of the United States, Japan, Germany, India, and Italy combined, representing 32 percent of global paper and cardboard consumption that year (Statista, 2024). Meanwhile, Indonesia ranks among the top ten largest pulp producers in the world (Statista, 2024).

Pulp and paper production not only has a significant environmental impact due to its high consumption of energy, water, and wood, but the industry also faces issues such as deforestation, loss of biodiversity, water scarcity, and waste management. In Indonesia, land conversion into Industrial Plantation Forests (HTI) also affects local communities.

The growth of pulp and paper industry is closely linked to the involvement of financial institutions that fund company business activities. Banks play a crucial role in influencing the sustainability of business practices. They can encourage borrowers to take greater responsibility for environmental, social, and governance aspects. However, banks in Indonesia do not yet have specific policies regulating financing in the pulp and paper sector, which is highly risky for the environment and society.

The pulp and paper industry in Riau: environmental destruction and social conflict

Riau is one of the regions in Indonesia with the most Industrial Plantation Forest (HTI) permits. Among its 12 regencies/cities, Pelalawan, Siak, and Bengkalis are the industrial centers with the largest plantation areas and the most HTI permits. Data from the Riau Forest Rescue Network/*Jaringan Kerja Penyelamat Hutan Riau* (Jikalahari) shows that Siak has 15 HTI concession permits covering 289,000 hectares, Pelalawan has 30 HTI permits with an area of 493,000 hectares, and Bengkalis has 11 HTI permits covering 288,000 hectares (PRAKARSA, 2024).

The pulp and paper industry in Riau Province is considered important because it is assumed to boost the regional economy by creating jobs and generating foreign exchange. However, the industry is plagued with issues, even from the HTI permit issuance process. Poor licensing governance and corruption cases involving regional heads and civil servants have surfaced. It is estimated that corruption in Riau has cost the state around 3.3 trillion rupiahs, involving 20 companies, including those affiliated with APP and Asia Pacific Resources International Holdings (APRIL) Group.

The HTI areas in Riau are mainly controlled by two major paper mills. These companies are PT Riau Andalan Pulp and Paper (RAPP), a subsidiary of the Asia Pacific Resources International Holdings (APRIL) Group, and PT Indah Kiat Pulp and Paper (IKPP), owned by Asia Pulp and Paper (APP/Sinar Mas Group). These mills operate using raw materials sourced from subsidiaries and partners spread across various regencies in Riau Province.

This industry's presence has led to a decline in natural forest coverage year after year. Satellite imagery monitoring shows that natural forests in

Riau have drastically decreased from 6.4 million hectares in 1982 to 1.3 million hectares in 2023. Over four decades (1982–2023), Riau lost 5.1 million hectares of forest cover, nearly seven times the size of DKI Jakarta (7,659.02 km²). This decline is primarily due to the conversion of natural forests into HTI and oil palm plantations, which now cover 2.3 million hectares (PRAKARSA, 2024). The loss of forest cover has caused various natural disasters such as floods, landslides, and droughts. The loss of forests also negatively impacts the flora and fauna that depend on the forest ecosystem.

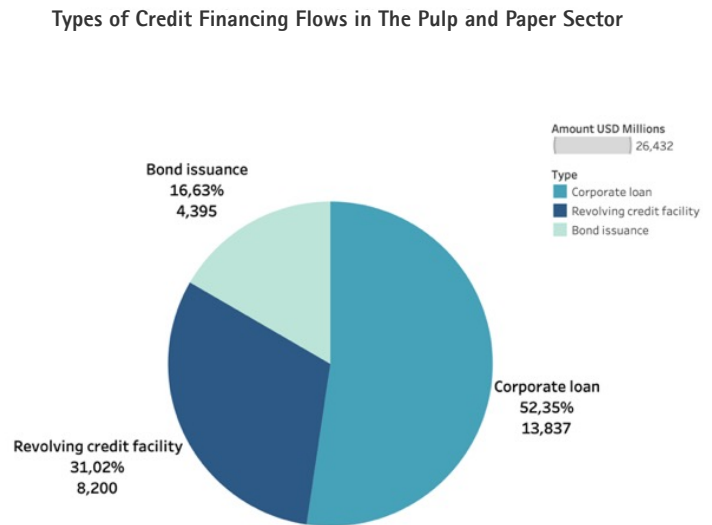
Indigenous peoples and residents are also affected by this industry. Many of them rely on forest resources and have lost their livelihoods, exacerbating conflicts between communities and landowners. These conflicts are generally related to land boundary disputes, forced relocations, loss of livelihoods, violence, criminalization, unfavorable partnership patterns, waste, pollution, and infrastructure damage. These issues are worsened by legal uncertainties surrounding customary land ownership and the lack of transparency from companies in resolving conflicts (Environmental Paper Network, 2019).

The activities of this industry have caused thousands of conflicts with communities. Over two decades, 2,585 conflict cases were recorded across 27 provinces in Indonesia from 1990 to 2010 (Forest Watch Indonesia, 2014). Of these, 1,065 cases involved indigenous and local communities in the forestry sector, and 563 cases in the plantation sector (Forest Watch Indonesia, 2014). The Environmental Paper Network (EPN) recorded that in 2019, many conflicts occurred between communities and companies affiliated with the APRIL Group and Sinarmas Group. During the same year, more than 72 conflicts involved APRIL-affiliated companies, and 20 conflicts involved APP Sinarmas affiliates (Environmental Paper Network, 2019a, 2019b). There has been no concrete resolution from the government, causing the impact of these conflicts to continue to escalate, affecting the quality of life of the communities.

The five largest banks in pulp and paper financing in Indonesia

The financing of the pulp and paper industry in Indonesia is predominantly dominated by credit flows from the banking sector. From 2016 to September 2022, the total financing inflows reached USD 26.432 billion, with approximately 98.26 percent coming from credit, and only 1.74 percent from investments, amounting to around USD 0.467 billion. Most of the credit financing flows came from domestic sources, reaching USD 16.702 billion. Foreign financing also plays a significant role, with contributions from China amounting to USD 2.914 billion, Japan USD 2.232 billion, Taiwan USD 1.181 billion, and Malaysia USD 1.145 billion.

Figure 1 Types of credit financing in the pulp and paper sector from 2016 to September 2022 (in % and USD)



Type, % of Total Amount USD Millions and sum of Amount USD Millions. Color shows details about Type. Size shows sum of Amount USD Millions. The marks are labeled by Type, % of Total Amount USD Millions and sum of Amount USD Millions. The view is filtered on Type, which keeps Bond issuance, Corporate loan and Revolving credit facility.

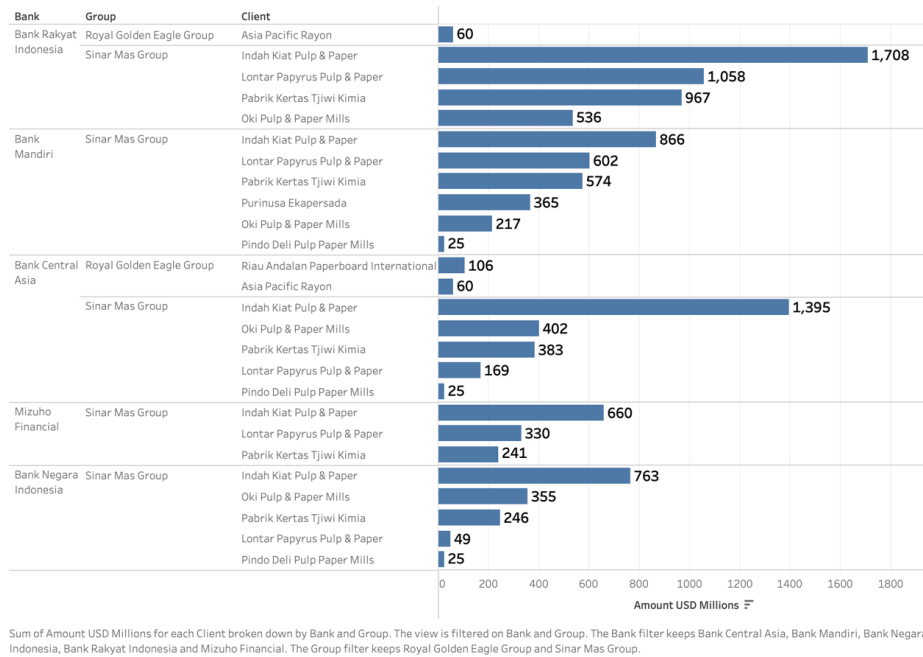
Source: The PRAKARSA, 2024

Corporate loans are the most accessible credit instruments for companies to obtain financing from banks. In general, corporate loans can be either short-term or long-term. Of the total credit provided, corporate loans accounted for 52.35 percent or USD 13.84 billion. Meanwhile, revolving credit facilities contributed USD 8.2 billion or 31.02 percent, and bond issuance amounted to USD 4.39 billion or 16.63 percent.

The five banks that dominated credit financing in the pulp and paper sector in Indonesia from 2016 to September 2022 are BRI, Bank Mandiri, BCA, BNI, and Mizuho Financial. Bank Rakyat Indonesia (BRI) provided approximately USD 4.33 billion in credit, followed by Bank Mandiri with USD 2.65 billion, Bank Central Asia (BCA) with USD 2.54 billion, Bank Negara Indonesia (BNI) with USD 1.47 billion, and Japan's Mizuho Financial with USD 1.522 billion.

Credit financing flows to companies in the pulp and paper sector were dominated by Sinar Mas Group and Royal Golden Eagle Group (RGE). Sinar Mas received USD 20.87 billion in financing, while RGE obtained USD 4.32 billion. Most of the credit flows to these two companies came from corporate loans. PT Indah Kiat Pulp and Paper Tbk and PT Oki Pulp and Paper Mills, subsidiaries of Sinar Mas Group, were the main recipients of credit financing from these five banks.

Figure 2 Credit financing flows to Sinar Mas and Royal Golden Eagle Group (RGE) companies from 2016 to November 2022 (in million USD)



Sum of Amount USD Millions for each Client broken down by Bank and Group. The view is filtered on Bank and Group. The Bank filter keeps Bank Central Asia, Bank Mandiri, Bank Negara Indonesia, Bank Rakyat Indonesia and Mizuho Financial. The Group filter keeps Royal Golden Eagle Group and Sinar Mas Group.

Source: The PRAKARSA, 2024

These two groups have committed a decade ago to conducting their businesses responsibly by reducing deforestation, preventing environmental damage, and protecting peatlands. Sinar Mas Group implemented a Forest Conservation Policy (FCP), while Royal Golden Eagle Group (RGE) has a Sustainable Forestry Management Policy (SFMP). However, research by The PRAKARSA (2024) found that PT Indah Kiat Pulp and Paper in Riau continues to cause environmental damage. The disposal of chlorine waste from the company has also led to water pollution and fish deaths in the river. Additionally, the HTI industry, especially those affiliated with Sinar Mas and RGE, still contributes to deforestation in Riau.

The urgency of strengthening regulations and banking commitments for the environment and human rights protection

Banks, as credit providers in the pulp and paper sector, indirectly contribute to the negative impacts resulting from operations of the companies they finance. Our assessment shows that the five banks most heavily involved in financing pulp and paper—BRI, Mandiri, BCA, BNI, and Mizuho—have relatively low commitments to policies related to climate change, human rights, natural resources, and forest management.

BRI has developed and established a specific financing policy for the pulp and paper subsector based on Environmental, Social, and Governance (ESG) criteria, as outlined in its 2022 sustainability report. BRI claims to be committed to implementing green financing policies, emphasizing its dedication to environmental preservation for businesses that receive its financial support. Additionally, BRI has Loan Portfolio Guidelines (LPG) that consider environmental aspects in credit distribution, including negative lists and

sector policies, particularly in the palm oil and pulp and paper sectors (BRI, 2022, p. 32). However, despite this, BRI still provides the most financing to PT Indah Kiat Pulp and Paper, which has been shown to have negative impacts on the surrounding and marginalized communities.

The other four banks—Bank Mandiri, BCA, BNI, and Mizuho Financial—do not yet have specific policies that consider the debtor's track record based on ESG aspects in the pulp and paper sector. Bank Mandiri and BCA, as pioneers in sustainable finance, have committed to integrating ESG aspects. However, this currently only applies to the palm oil and mining sectors. There is no information on the integration of ESG in the pulp and paper sector. Additionally, these two banks have not explicitly disclosed credit policies that have conducted human rights due diligence.

In its 2022 sustainability report, BNI has made efforts to account for financing emissions for debtors, including in the pulp and paper sector (BNI, 2022, p. 63). However, there is no policy requiring debtors to undergo human rights due diligence, provide remediation, respect community rights (such as for indigenous peoples, children, and persons with disabilities), or apply the Free, Prior, and Informed Consent (FPIC) principle.

Mizuho Financial has established a policy requiring companies in the pulp and paper sector, particularly in non-OECD countries, to obtain certification from the Forest Stewardship Council (FSC) or Programme for the Endorsement of Forest Certification (PEFC) (Mizuho Financial Group, 2022, p. 68). PEFC certification aims to promote sustainable forest management. However, Mizuho Financial continues to provide financing to PT Indah Kiat Pulp and Paper.

Overall, banks providing financing to companies have not comprehensively prioritized environmental aspects and

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human rights due diligence as prerequisites for credit issuance. Banks tend to evaluate potential debtors solely based on their ability to repay interest and principal, with ESG aspects according to international agreements and various conventions not yet well integrated. Banks still consider environmental permits as an administrative requirement without directly assessing the impacts on the ground. On the other hand, human rights due diligence is not conducted due to the lack of formal policy impetus.

The capacity and implementation of integrating ESG aspects into sustainable financial policies remain relatively weak. Although the Financial Services Authority (OJK) has issued the Sustainable Finance Roadmap Phase II (2021 - 2025) and plans to develop a green taxonomy, the integration of ESG aspects into risk management, real program development, and innovation in sustainable financial products and services still faces challenges. The main obstacle is the increasing demand for implementing ESG, which is not matched by adequate understanding and participation from financial institutions (Financial Services Authority, n.d.).

Additionally, environmental sustainability standards and respect for human rights, such as the UN Guiding Principles on Business and Human Rights (UNGPs), IFC Performance Standards, and FPIC principles, have not been integrated into the policy documents released by OJK. This policy gap means that banks' attention to these standards has not yet become a priority in providing financing to companies

Policy recommendations

Considering the above points, we recommend that policymakers and banks undertake the following actions:

1. The Financial Services Authority (OJK) needs to revise POJK No. 51/POJK.03/2017 on Sustainable Finance, including:
 - Adding a provision that requires banks to have financing policies that explicitly reflect their commitment to human rights and environmental protection standards. These policies should align with the UN Guiding Principles on Business and Human Rights (UNGP), the IFC Performance Standards, and the principles of Free, Prior, and Informed Consent (FPIC).
 - Adding a provision that requires banks to ask the companies they finance to disclose biodiversity metrics related to sectors that are at high risk of environmental impact.
 - Adding a provision that mandates banks to review the financing provided to pulp and paper companies, considering the companies' policies and implementation related to Environmental, Social, and Governance (ESG) aspects.
2. Banks should develop and implement human rights due diligence policies, as well as adhere to the principles of Free, Prior, and Informed Consent (FPIC) within their credit granting and risk management systems.
3. Banks should integrate Environmental, Social, and Governance (ESG) aspects into their core business, including in the supply chain, as criteria for credit guarantees, corporate financing, and investments in debt instruments.

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