

**Summary of**  
**Export Credit Agency Finance in Indonesia**  
**Featuring the Mining, Oil, and Gas Sectors**

With an  
Endnote on the "War Against Terrorism", OPIC and UNOCAL in East Kalimantan

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**DRAFT**  
**Summary of Export Credit Agency Finance in Indonesia**  
**With a Focus on the Mining, Oil, and Gas Sectors<sup>1</sup>**

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**Introduction**

After thirty two years under the Suharto regime, Indonesia is now trapped in an economic crisis with no clear signs of resolution in the near term. In the Suharto era, export credit agencies (ECAs) played a major role in financing environmentally and socially unsustainable investments that have depleted Indonesia's extraordinary natural wealth. Forest degradation reached a rate of close to two million hectares per year. Investment projects such as factories, plantations, and mines not only destroyed natural resources, but also gave rise to other significant environmental and social impacts including the destruction of the livelihoods of the local peoples who owned, managed, and utilized these resources. Security forces were routinely used to prevent forest-dwelling, rural, and river-side peoples from protecting and managing the natural resources upon which their livelihoods and communities depended. In resource-rich regions, the violation of human rights was a routine occurrence.

ECAs played a key role by assisting foreign investors in supporting General Suharto's system of economic and political monopolies. The regime's military security approach assured low costs for land appropriation and a relatively docile and inexpensive labor force. Major foreign investors, supported by ECA finance, competed to align themselves with powerful business interests close to the Suharto family, often by offering cost-free investment shares to Suharto's children, other relatives, and business associates. In return, investors were assured of access to lucrative sectors of the Indonesian economy and were able to receive "assistance" from Indonesia's armed forces when it came to clearing people off of land for their projects, stifling labor unrest, or preventing mobs from storming their polluting factories.

After Suharto's fall, export credit agencies with heavy exposure in Indonesia found that the web of business contracts that they had underwritten -- most of which were directly dependent on links to various Suharto relatives -- were endangered. As a newly independent Indonesian press brought to light evidence of the massive corruption, malfeasance, improper contracting procedures, environmental devastation,

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<sup>1</sup> Much of the information in the general introductory section of this report was condensed from the 38-page report by Fried and Soentoro, titled "Export Credit Agency Finance in Indonesia", 2000, available from NADI or Environmental Defense. A revised version the larger report is currently under publication and will be released in English and Bahasa Indonesia. This summary reflects a brief update of information on the mining/oil/gas sectors since the 2000 report. NADI is currently preparing a detailed report on the mining/oil/gas sectors to be released later this year.

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and human rights violations linked to ECA-backed investments, the likelihood of substantial claims against ECA political risk insurance and guarantees increased dramatically.

In the case of significant ECA-guaranteed investments like the notorious Paiton power plants, foreign ECA officials attempted to intervene in Indonesia's national policy-making process in order to reduce their own exposure. For example, the industrialized countries making up the Consultative Group on Indonesia (CGI), had scheduled their international donor meeting for July 28, 1999. At this meeting, the CGI was to finalize the details of various aid and loan packages which were to be made available to Indonesia during the economic crisis. Two weeks before the July 28<sup>th</sup> meetings, an ECA "SWAT team" consisting of government officials who were representatives of Japan's Export Import Bank, Germany's Hermes Agency, the Swiss Export Risk Guarantee Agency, the U.S. Export Import Bank and OPIC – all from CGI countries -- descended upon Indonesia's new government in an attempt to force it to honor the Suharto-era power sector contracts which had been written under conditions of extreme corruption. These contracts -- backed by ECA insurance and guarantees -- had been made by companies which -- as the Wall Street Journal reported -- "cut overpriced politically influenced deals that undermined the Indonesian economy."<sup>4</sup>

Two weeks before Indonesia's July, 1999, CGI donor meeting, the team of international ECA representatives warned the new government that a failure to honor contracts such as the massively corrupt Paiton power contract would "harm new foreign investment and delay Indonesia's economic recovery."<sup>5</sup>

A later investigation into power contracts by Indonesian Corruption Watch identified possible markups totaling US\$400 million in the country's foreign-funded power transmission projects. In October, 2000, the President of Indonesia's National Power Agency, Kuntoro Mangkusubroto, stated that most power transmission projects financed by foreign export credit agencies, *Kredit Ekspor* or KE, in Bahasa Indonesia, "smacked of markup practices. All KE [ECA] projects are problem sources ... we found that on average they cost 37 percent more compared to projects that underwent international tenders," Kuntoro said during a meeting with Indonesian House of Representatives Commission for Energy Affairs.<sup>6</sup>

It is clear that under the current conditions of democratization in Indonesia, export credit agencies -- whether through their links to corrupt Suharto-era business ventures or because of the secrecy with which they conduct their transactions -- remain a throwback to the politics and economic practices of the Suharto dictatorship.

## **Export Credit Agencies**

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<sup>4</sup> "Power Deals With Cuts for First Family In Indonesia are Coming Under Attack," Wall Street Journal, 12/23/98.

<sup>5</sup> "Credit Agencies Pressure Indonesia On Power Contracts," Dow Jones Newswires, 7/13/99.

<sup>6</sup> "Foreign-funded power projects marked up: PLN", Jakarta Post, 10/17/00.

Export Credit Agencies (ECAs) are governmental or quasi-governmental entities that subsidize and promote a country's exports and investment abroad. The amount of investment that ECAs support globally is large and growing—significantly greater than the total amount of lending from the World Bank, IMF, and all other multilateral institutions combined.<sup>7</sup> Most ECAs are not required to consider the social and environmental impacts of the projects they support. As a result, many projects funded by ECAs severely degrade the natural environment and lead to the impoverishment of directly affected local communities. Many of these projects would not go forward without the insurance against commercial and political risk, loan guarantees, and direct loans that ECAs provide.

In recent years, environmental and development NGOs have begun to call on all ECAs to adopt and upwardly harmonize their environmental and social policies in order to put a halt environmentally destructive investments supported by these agencies. Governments have begun to acknowledge the problem but are slow in taking decisive action. At present, an international grassroots movement is working to hold the world's industrial leaders to their commitments and ensure that they enact common environmental and social standards for ECAs.

### **The Role of Export Credit Agencies in Indonesia**

In 1996, officially supported export credits accounted for more than 24% of the total indebtedness of developing countries.<sup>8</sup> The years 1990-1995 saw export credit exposure to developing countries increase at an average growth rate of 11%.<sup>9</sup> In 1996, the top four recipients, Russia, China, Indonesia, and Nigeria, accounted for 40% of the export credit agencies' total exposure.<sup>10</sup> For the top four recipients, export credits accounted for between 24% to 71% of total external debt.<sup>11</sup>

	1996 Total External Debt Billions	1996 ECA Exposure Billions	1996 ECA Exposure As % of Total Debt
Russia	129	52.9	41%
China	128	44.8	35%
Indonesia	120.2	28.2	24%
Nigeria	34.9	24.8	71%

Figure 1a. Export Credit Agency Exposure and Debt<sup>12</sup>

Between 1992 and 1996, export credit agencies' exposure in Indonesia grew by 25%. By 1996, the level of ECA exposure in Indonesia – largely in support of foreign investment in mega-projects closely linked to the Suharto regime – was equivalent to

<sup>7</sup> Anthony Boote and Doris C. Ross, *Official Financing for Developing Countries* (Washington, D.C.: International Monetary Fund, February, 1998), p. 13, 17.

<sup>8</sup> Boote, A., D. Ross, et al. "Official Financing for Developing Countries," IMF, February, 1998, p.11

<sup>9</sup> *ibid*, p11

<sup>10</sup> *ibid*, p12

<sup>11</sup> *ibid*, based on data from pp. 12, 14

<sup>12</sup> *ibid*, based on data from pp.12, 14

24% of Indonesia's total external debt, approximately \$28 billion.<sup>13</sup> In this analysis, we will provide an overview of thirty-three projects in Indonesia supported by export credit agencies between 1994 and 1997, valued at total of \$15 billion dollars.<sup>14</sup> We will examine the relative contributions of the ten ECAs most active in Indonesia, looking in greater detail at the Export-Import Bank of Japan, and provide a brief overview of the ten largest ECA-supported projects which account for \$12.4 billion or 83% of the value of the thirty-three projects surveyed. Figure 1b indicates the distribution of project finance over time for the 33 projects.

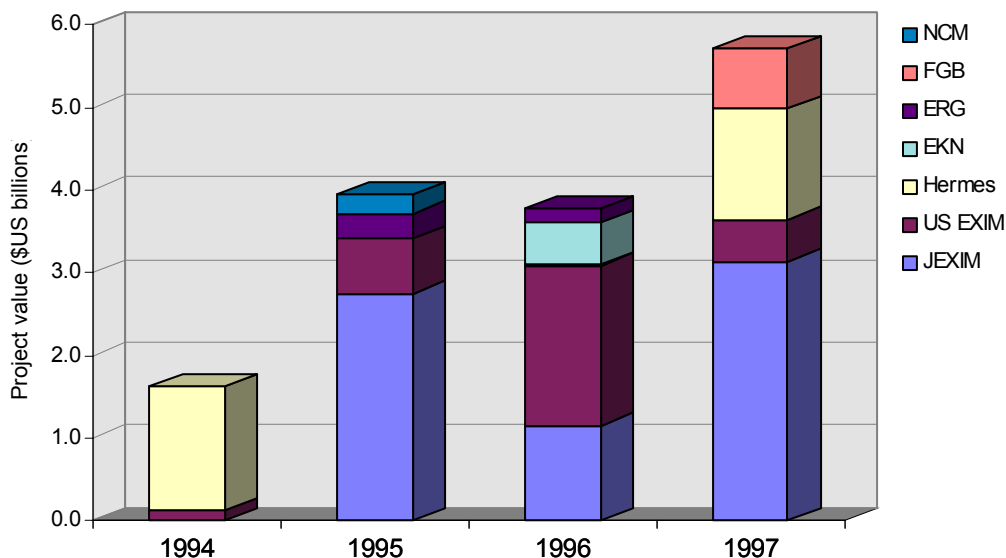


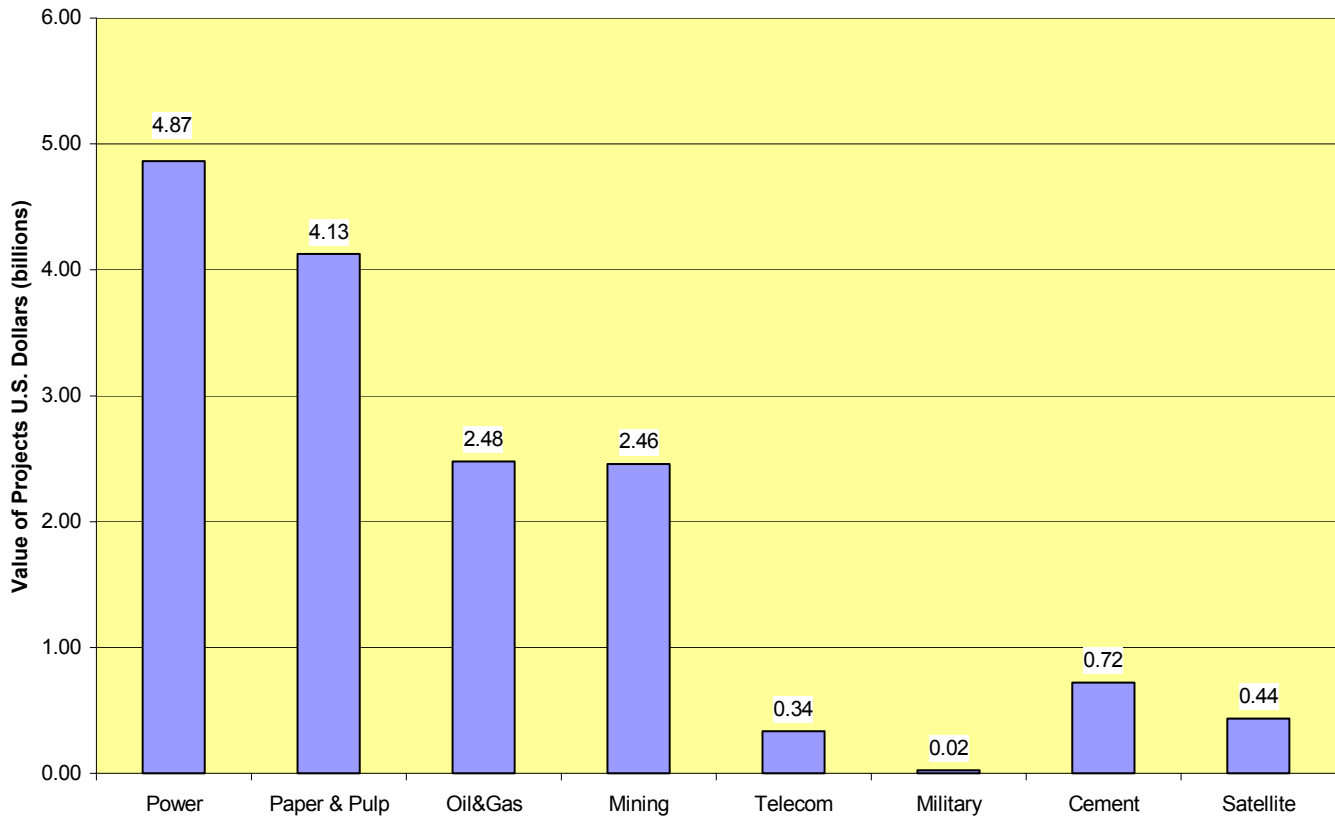
Figure 1b. Value of 33 Export Credit Agency-financed projects in Indonesia, 1994-1997. (Only lead ECAs are shown.)

<sup>13</sup> Given the climate of secrecy under which ECAs operate and the ensuing lack of data, the extent to which ECA exposure is linked to an increase in external debt of a host country is not easily determined. In quite a few cases, host governments of countries where ECA-supported projects have been financed were and are required to post callable counter-guarantees which expose the host country to a significant debt burden should the counter-guarantees be called. Data on the level of this type of exposure is not readily available.

<sup>14</sup> It has been very difficult to obtain information on ECA financed projects. The 33 sample projects analyzed in this report by no means represent an exhaustive list of ECA-financed projects in Indonesia from 1994-1997. The US Export-Import Bank alone approved 37 projects for finance during this period, of which only 17 are included in the above analysis. The value of the projects listed is the total value of the finance package, of which ECA coverage may only make up a small part.

**Figure 2. Thirty-four ECA-Supported Projects in Indonesia, 1994 - 2002**

Note: Includes Unocal/OPIC, but not proposed Hermes/Aneka Tambang

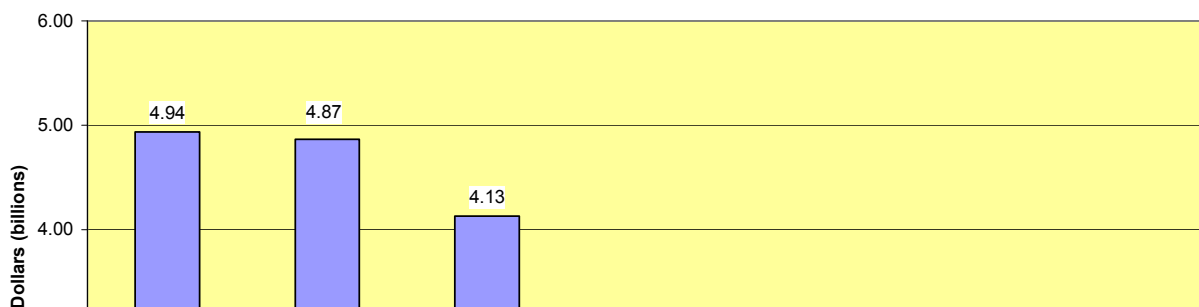


Of the 33 projects surveyed, the most significant amount of ECA-leveraged finance was concentrated in four sectors, the largest being the power and paper and pulp sectors. ECA-backed investments included support for a number of controversial mega-projects such as the giant Tanjung Enim Lestari (PT. TEL), Indah Kiat, and Riau Andalan paper and pulp mill projects in Sumatra and the notorious \$4 billion corruption-plagued Paton coal plants in Java and conflict-ridden mining/oil/gas projects, including the Newmont copper and gold mine in Sumbawa, the INCO nickel mine in Sulawesi, and gas fields and processing sites in East Kalimantan..

**Figure 2a. Thirty-four ECA-Supported Projects in Indonesia, 1994 - 2002**

**Mining/Oil & Gas Sectors Combined**

Note: Includes Unocal/OPIC but not proposed Hermes/Aneka Tambang



## **Project Finance Packages**

The finance packages for the larger ECA-supported projects typically involve a number of tranches (or parts), including long term commercial loans (some covered by private or public guarantees or insurance), equity, revolving credit, and often an “ECA tranche” which may be a commercially syndicated loan covered by ECA guarantees. ECAs also provide some direct loans. A 1997 \$1.3 billion loan to PT. TEL for the construction of a controversial pulp mill in South Sumatra, for example, involved 6 tranches:

1. A \$200 million, 10 year term commercial loan financed by 19 banks in 6 countries;
2. \$350 million in equity provided by two Indonesian companies (one under General Suharto’s eldest daughter, Siti Hardiyanta Rukmana , or “Tutut”), two Japanese companies, and Japan’s OECF;
3. A \$650 million, 12 year Export Credit tranche involving the Finnish Guarantee Board, the Swedish Exporkreditnamden, Germany’s Hermes, and Canada’s Export Development Corporation, funded by Germany’s KfW, two German commercial banks, a Finnish bank, Canada’s EDC and Finland’s FGB, and apparently guaranteed by FGB, EKN, Hermes, and EDC;
4. A \$41 million loan from Germany’s KfW;
5. A \$50 million, 5-year revolving credit line financed by 19 banks from 6 countries;
6. A \$50 million, 10 year loan arranged by Japanese, German, Korean, and Finnish Banks and AT&T.

The provision of the ECA guarantees in one tranche of the loan -- \$267.7 million from Hermes (the lead ECA), \$205.3 million from EDC, \$129 million from FGB, and \$52.6 million from EKN – leveraged total project finance of over \$1.3 billion.

## The Top 10 ECAs in the Indonesia Projects

In the 33 projects examined in this study, ten ECAs took lead roles in project finance. Lead ECAs are those which contribute the largest amount of coverage or loans in a given project. They also may act to coordinate other banks or as arrangers for commercial loan syndication on a given project. The top three lead ECAs active in the Indonesia projects in our sample were JEXIM, US EXIM, and Hermes. The Scandinavian ECAs -- FGB and EKN -- as well as the Canadian Export Development Corporation also played a significant role in the finance of these projects. The Swiss ECA, Export Risk Guarantee also played a role, especially in the financing of power and refinery investments. (See Figures 3 and 4.)

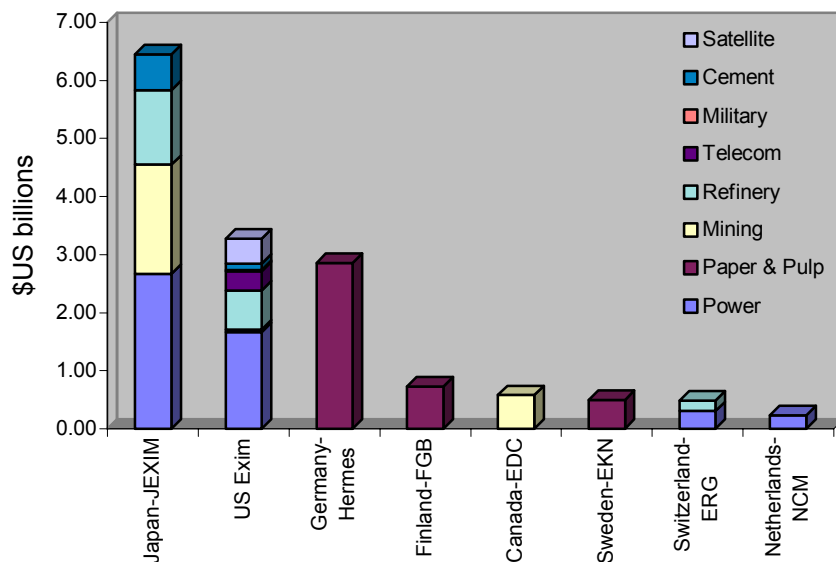


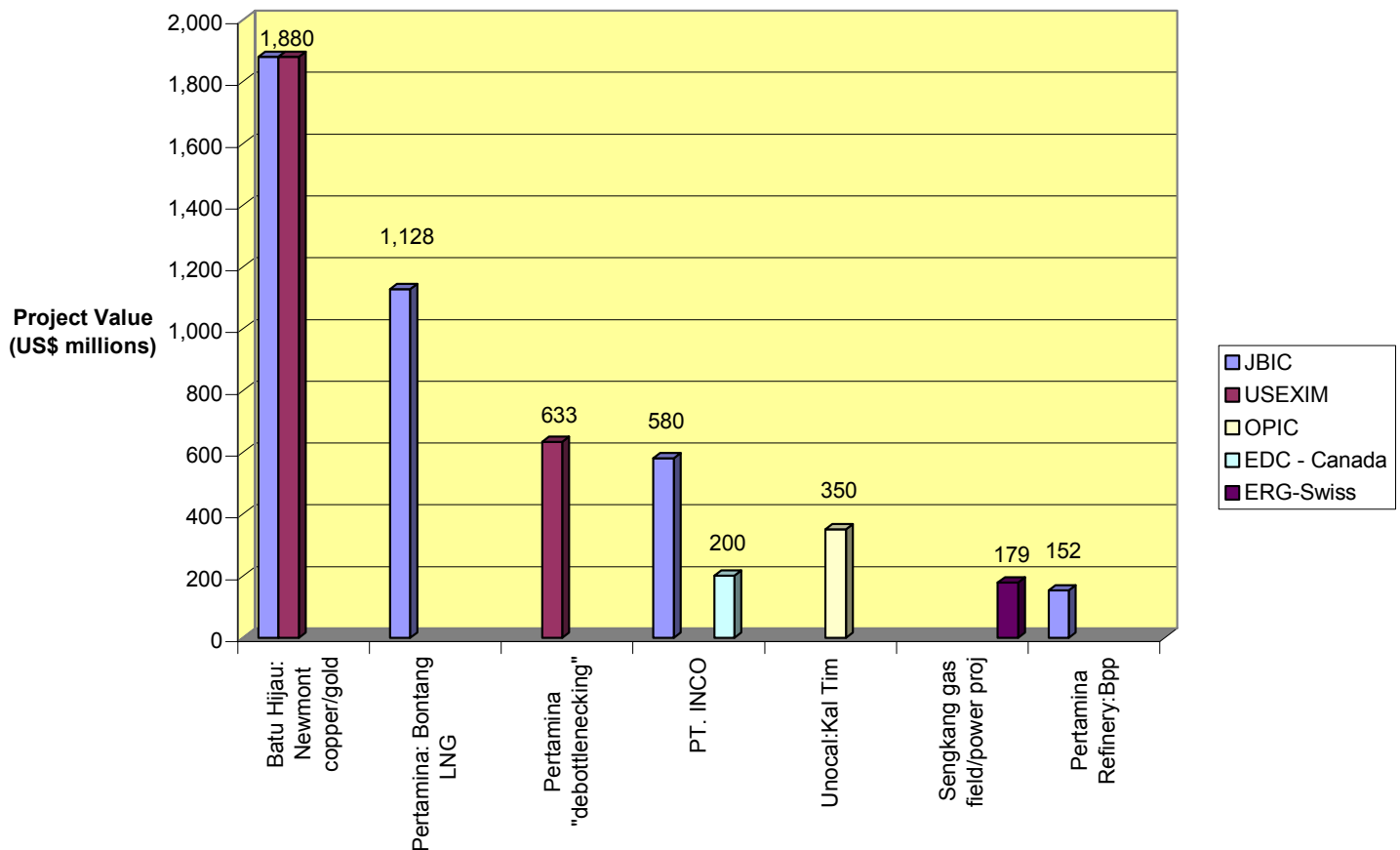
Figure 3. Thirty-three ECA-supported projects in Indonesia. Sorted by Lead ECA, 1994-1997. (Only Lead ECAs shown.)

In addition to lead roles, ECAs may play secondary roles in project finance and are able to leverage significant additional project value in a supporting role – i.e. by providing additional guarantees or loans for a tranche led by another ECA, as in the above example of Canadian, Finnish, and Swedish support for the Hermes-led tranche for the \$1.3 billion finance package for PT. TEL. The table below demonstrates the total finance leveraged by ECAs acting as lead financiers and that leveraged by ECAs in their capacity as secondary financiers in the 33 Indonesia projects.

### ECAs and the "Extractive Industries" Sector: Mining, Oil, and Gas

Combined, the mining and oil and gas sectors make up the largest category of ECA-supported projects in our sample, followed by the power sector, also inextricably linked to the mining of coal and the extraction of petroleum products.

**ECA-Supported Mining/Oil/Gas Projects in Indonesia from sample of 34 projects, 1994 - 2002**  
 Does not include proposed Hermes support for PT. Aneka Tambang



**Indonesian Mining/Oil/Gas Projects supported by Export Credit Agencies.**

*(Please note that this is not intended to be a complete list and that the data on ECA involvement is still of a preliminary nature.)*

**Newmont's notorious Batu Hijau copper and gold mine in Sumbawa, Nusa Tenggara Barat.** Involved in the forced seizure of lands from the surrounding villages, the destruction of fishery resources and turtle habitat, increased militarization of the region apparently leading to shootings, the Batu Hijau mine is designed to dump its waste into the ocean (submarine tailings disposal), a heavily criticized process which can lead to contamination of the marine ecosystem by heavy metals and other toxins.

ECAs: JBIC, USEXIM. Additional funding provided by German development bank, KfW (which is not an ECA, but which often acts in tandem with ECA support).

**Pertamina Bontang LNG Plant, East Kalimantan.** Bontang has also been the site of significant conflicts with communities and environmental problems. ECA: JBIC

**PT. INCO nickel mining concessions, Sulawesi:** PT Inco has been involved in significant conflicts with local and indigenous communities as a result of land seizures, air and water pollution, forest destruction. ECAs: JBIC, EDC

**Unocal West Seno I and II, East Kalimantan:** Involved in significant conflicts with local communities, including blockades of Unocal transportation lines in 2000, Unocal has been accused of causing severe air and water pollution.<sup>15</sup> The Unocal deal, representing a return to financing large Indonesian projects on the part of the U.S. government, was apparently announced as an "instant reward" by the Bush Administration for President Megawati's "commitment to join the global war against terrorism."<sup>16</sup> ECA: OPIC, 2/2/02

#### **Proposed project:**

**PT. Aneka Tambang nickel mine, Pomalaa, Southeast Sulawesi.** The German Export Credit Agency, Hermes, is apparently close to approving support for the operations of PT. Aneka Tambang nickel mine which has also operated smelting plants in the region. Local communities have protested the pollution of their environment and destruction of their fishery resources for years. Under consideration by Hermes.

**Other projects:** There are a number of Pertamina projects, a gas-field project in Sengkang, South Sulawesi ECAs: USEXIM, JEXIM, ERG

## **ENDNOTE**

### **Deceived Again? The "War Against Terrorism", OPIC, and UNOCAL in East Kalimantan**

Indonesia's President Megawati Soekarnoputri was the second foreign leader to visit George Bush in the aftermath of the September 11, 2001 destruction of the New York World Trade Center buildings. According to media accounts at the time, she "reaped

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<sup>15</sup> JATAM letter to OPIC, Feb. 2002; various news clippings.

<sup>16</sup> Jakarta Post, 9.21.01, "U.S. Showers Indonesia with Promises"

instant rewards" as a result of assuring the U.S. that Indonesia opposed the terrorist attacks.<sup>17</sup>

During her U.S. visit, Megawati pitched the resumption of military ties with Indonesia in order to protect Indonesia's "territorial integrity and political sovereignty."<sup>18</sup> In order to "support President Megawati as leader of the world's largest Muslim democracy", the Bush administration announced that OPIC, US ExIm, and the US Trade and Development Agency would "provide a total of \$400 million to promote trade and investment, especially in the oil and gas sector."<sup>19</sup> The Bush Administration also pledged that the U.S. would lift its embargo on commercial sales of "non-lethal defense equipment" to Indonesia and removed duties on four types of plywood sheeting, copper ores and concentrates and 9 other Indonesian products.

In early 2002, the Indonesian Mining Advocacy Network, JATAM, presented OPIC with results of an analysis indicating substantial environmental and social problems associated with Unocal's operations in East Kalimantan. On February 8, 2002, however, following the passage of new oil and gas laws in Indonesia, OPIC announced the provision to Indonesia of \$350 million in loans for the construction of deep-water oil and gas production platforms, at least 40 production wells, and two 60 kilometer oil and gas pipelines for a Unocal project in East Kalimantan. OPIC's February press release stated that this would "nearly single-handedly fulfil a joint initiative of OPIC, the US Export Import Bank, and the U.S. Trade and Development Agency to provide \$400 million in loans and guarantees to finance U.S. investments in Indonesia. The initiative, announced last September, specifically targeted the oil and gas sector."<sup>20</sup>

This "War on Terrorism" initiative was approved despite the fact that local communities had apparently been deeply affected by pollution, loss of resource-dependent livelihood, and the climate of terror and intimidation associated with Unocal operations in East Kalimantan for decades, leading to a blockade of Unocal's operations by 300 people in the year 2000 and the subsequent shooting of seven people and the severe beating of sixteen people at the site.

As news of the impending OPIC deal reached Indonesia's Minister of Energy and Mineral Resources, Purnomo Yusgiantoro, the Minister warned that "OPIC will only be allowed to invest in Indonesia if it uses its own money, rather than loans or compensation claims."<sup>21</sup> He said that the government "would refuse if the fund for it came from the claim worth US\$260 million the government should pay to OPIC following the cancellation of the Dieng-Patuha geothermal project in 1997."<sup>22</sup>

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<sup>17</sup> ibid

<sup>18</sup> ibid

<sup>19</sup> ibid

<sup>20</sup> OPIC press release "Indonesian Projects Help Meet U.S. Investment Goal", Antara News, "OPIC supports oil and gas projects", 2/8/02p; ""OPIC may only invest in Indonesia using its own money: Minister," 2/6/02, Antara News

<sup>21</sup> ""OPIC may only invest in Indonesia using its own money: Minister," 2/6/02, Antara News

<sup>22</sup> ibid

The Minister Purnomo concluded, "The government will never agree with such an investment system. We do not want to be deceived again."