Deforestation in the Paraguayan Chaco: how can banks manage risks from financing the cattle sector?
Comments and queries

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About SCRIPT

SCRIPT (Soft Commodity Risk Platform, available at www.script.finance) is a new freely-available system to help financial institutions understand and mitigate the business risks associated with financing companies in soft commodity supply chains. The platform provides tools and guidance for financial institutions to establish a robust sustainable financing policy and screen their portfolios to determine the companies and issue areas that pose the greatest risk to their institution.

About Global Canopy

Global Canopy is an innovative environmental organisation that targets the market forces destroying tropical forests. Since 2001, we have been testing new approaches to tackling deforestation, and guiding companies, investors and governments worldwide to think differently about our planet’s forests.

Funding

This work is part of the Conservation and Financial Markets Initiative, a collaboration among Ceres, the World Business Council for Sustainable Development, World Wildlife Fund and the Gordon and Betty Moore Foundation that seeks to leverage the power of mainstream financial markets in order to help drive the food sector away from practices that degrade natural ecosystems, particularly the production of commodities such as beef, soy, and farmed and wild-caught seafood that contributes to the loss of forests, grasslands, oceans, mangroves, and other habitats. The initiative is developing mechanisms and incentives that help companies and financial markets make better informed business and capital allocation decisions. For more information see www.moore.org.
Key takeaways

• Expansion of cattle farming has been the primary cause of high deforestation rates in the Paraguayan Chaco, with more than a million hectares cleared over the last four years. The growth of the cattle sector in the region has been linked to cases of forced labour, child labour, displacement of indigenous peoples, and illegal deforestation.

• There is growing awareness of these risks due to NGO campaigns targeting the private sector, as evidenced by recent reports exposing companies that are clearing forest without environmental licenses, and companies linked to forced labour practices.

• Ambitious plans to expand beef exports suggest these risks will increase, particularly as none of the top eight companies, who together account for 95% of beef exports, has a public policy to protect forests in the Chaco.

• Companies associated with illegal and unsustainable operations could be exposed to fines, delayed or cancelled operations, loss of market access, and reputational damage — particularly if looking to expand exports to countries where there is market demand for more sustainably sourced commodities, for example in Europe. Financial institutions could be exposed to financial downsides as these business risks may result in reduced profitability for companies.

• Whilst financial institutions in Paraguay are already taking steps to manage risk in cattle supply chains, for example through the Roundtable for Sustainable Finance and Environmental and Social Risk Analysis System (SARAS), there are further actions they can take to more effectively mitigate risks arising from cattle operations.

• Out of 10 banks assessed on the Soft Commodity Risk Platform (SCRIPT) only one bank had a public policy addressing sustainability criteria for companies in the cattle sector. Financial institutions should develop robust policies that require the companies they finance to protect native vegetation, ensure Free Prior Informed Consent of indigenous and local communities, and ensure that key labour standards are met. These policies should be available for buyers and investors to see.

• The new policy benchmarking tool and guidance materials available on SCRIPT support banks in understanding the strength of their policies assessed against peers in Paraguay, and make recommendations for strengthening policies towards best practice.

1http://mades.gov.py
2Mongabay 2018, Investigation reveals illegal cattle ranching in Paraguay’s vanishing Chaco
3Repórter Brasil 2018, Brazilian meat industry encroaches on Paraguayan Chaco
4The Guardian 2018, Forced labour in Paraguay: the darkness at the bottom of the global supply chain
The Paraguayan Chaco is a part of the second largest forest area in South America, the Gran Chaco. This tropical dry forest, which is rich in unique biodiversity and stores vast amounts of carbon, has become a deforestation hotspot, due to expanding cattle ranching and increasing international demand for beef. Carbon emissions from land-use change in the Chaco have been shown to be comparable to other areas such as the Amazon Biome and tropical forest in Southeast Asia.

According to data from the register for the National Service for Animal Health and Quality (SENACSA) the livestock herd in the Chaco has grown from 4.5 million in 2010 to more than 6 million in 2017. Spread across more than 8000 farms, this represents 44% of Paraguay’s total livestock herd.

The Chaco constitutes 60% of Paraguay’s land area, and is home to a number of different indigenous groups. Cattle operations in the Chaco have been linked to risks of displacement of indigenous people, forced and bonded labour practices, and child labour. A recent UN report found that whilst there have been improvements in compliance with labour standards in the Chaco, there were still numerous cases of child labour, with indigenous people particularly vulnerable to exploitative labour practices, rooted in the historical sale of indigenous territory to large landowners without obtaining Free Prior and Informed Consent.

Growing awareness of the environmental and social impacts of cattle ranching among consumers, governments, downstream companies, and other stakeholders increases the pressure on companies to reduce deforestation in their cattle operations. The potential business risks associated with poor sustainability performance include regulatory risks, market risks, reputational risks and physical risks.

Climate change creates a range of risks that can impact livestock production, such as changes in the quality and availability of feed crop, water availability, changes in reproduction patterns, and more frequent periods of droughts and floods.

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4In this briefing defined by the departments Boquerón, Alto Paraguay, and Presidente Hayes.
5Baumann et al. 2016, Carbon emissions from agricultural expansion and intensification in the Chaco
6www.mag.gov.py/
7Oxfam 2016, Yvy Jára. Los dueños de la tierra en Paraguay
8WWF 2016, Social economic and environmental analysis of soybean and meat production in Paraguay
9UN 2018, Report of the Special Rapporteur on contemporary forms of slavery, including its causes and consequences, on her mission to Paraguay
10Rojas-Downing et al. 2017 Climate change and livestock: Impacts, adaptation, and mitigation
Paraguay is a major player in the global beef market, exporting beef with a total value of US$1.2 billion in 2017. Over 60% of beef produced in Paraguay is projected to be exported in 2019. While there are currently few incentives to improve environmental and social performance, the government is looking to expand The Forestry Law in Paraguay requires that rural properties over 20 hectares in forest zones maintain 25% as natural forest, in addition to requirements to maintain riparian forest areas and protective barriers of natural forest between areas of cleared land. The National Forestry Institute (INFONA) estimates that as much as 24% of the deforestation that took place in the Chaco between August 2017 and August 2018 was carried out without environmental licences - an investigation is underway to verify whether this deforestation was illegal. INFONA has increasingly been detecting illegal deforestation in recent months. In January 2019 alone it carried out operations on several farms in the Chaco, detecting over 10,000 hectares of illegal deforestation. The sanctions faced by companies includes fines and the cancellation of previously approved land-use change permits. According to a recent statement by INFONA, it will soon be able to detect illegal deforestation and prosecute more efficiently, thanks to a new platform developed with Global Forest Watch that can monitor land use change almost in real time. Companies linked to or sourcing from farms involved in illegal forest clearance are likely to be at greater risk of fines, delays to or cancelled operations, restoration costs, heightened reputational risk and loss of access to certain markets.

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Regulatory risks

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Market risk

During drought periods in Paraguay in 2008 and 2009 it is estimated that livestock production suffered from 25% lower birth rates and 20% reduction in meat output. Floods in the Chaco can also have large impacts on cattle operations in the region because of slow water absorption rates in the clay soils. Heavy rainfall in 2012 affected 180,000 heads of cattle, resulting in loss of cattle, animals being lower in weight on average, and increases in transport and pasture rental costs.

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the industry, increasing the national herd from 14 million to 20 million cattle by 2020.

Improving the environmental and social sustainability of the industry could help increase access to higher value export markets, for example in Europe, where there is growing demand for products that are deforestation-free. A number of European governments have made commitments to remove deforestation from their supply chains, with European retailers and manufacturers at the forefront of developing policies to only source sustainably raised beef. Exports to the EU currently account for just two percent of beef exports by volume, but this represents four percent of the value, indicating the potential financial upsides of trading to a premium market.

Indeed, the Paraguayan market has already been affected by the shift towards sustainably sourced beef as global retailers and manufacturers are increasingly adopting commitments on deforestation under consumer pressure.

For example, McDonalds has a company-wide deforestation commitment that means that all beef sold in the company’s restaurants needs to be sustainably raised by 2020. In order to implement this in Paraguay, McDonalds is cooperating with WWF, Frigorifico Guarani and Neuland Cooperative to establish a monitoring system that can verify that the beef complies with their deforestation commitment.

Another example is the Paraguayan government together with the World Bank recently signing an agreement to develop a pilot traceability system. The project aims to improve competitiveness of the beef sector and provide added value for international markets by ensuring greater incorporation of socio-environmental factors in beef supply chains.

Many of the companies operating in Paraguay have projects or activities related to sustainability, and some have policies to deal with the social and environmental challenges from cattle operations. However, none of the eight largest exporters have publicly published commitments to exclude production or procurement of cattle products from intact forest landscapes and other areas of forest and native vegetation that are important for biodiversity (see Table 1) overleaf. It is important that companies are transparent in the way they deal with risk, publicly detailing their approach allowing buyers...
and financial institutions to independently assess mitigation strategies and track progress.

Companies with operations in the Chaco, such as Minerva\textsuperscript{26}, the Chortitzer, Fernheim and Neuland cooperatives\textsuperscript{27}, should have forest policies in place and available for all to see, due to the heightened risk of deforestation exposure in the region.

<table>
<thead>
<tr>
<th>Company</th>
<th>Trade volume (2013-2017)\textsuperscript{28}</th>
<th>Public policy to protect forest in the Chaco\textsuperscript{29}</th>
</tr>
</thead>
<tbody>
<tr>
<td>Frigorifico Concepcion S.A.</td>
<td>537,470t</td>
<td>No policy</td>
</tr>
<tr>
<td>JBS Paraguay S.A./Minerva\textsuperscript{30}</td>
<td>370,968t</td>
<td>No policy*</td>
</tr>
<tr>
<td>Frigorifico San Pedro S.A.\textsuperscript{31}</td>
<td>339,436t</td>
<td></td>
</tr>
<tr>
<td>Cooperativa Colonizadora Multiactiva Fernheim Ltda.</td>
<td>179,567t</td>
<td>No policy</td>
</tr>
<tr>
<td>Cooperativa Chortitzer Ltda.</td>
<td>170,448t</td>
<td>No policy</td>
</tr>
<tr>
<td>Frigorifico Guarani S.A.C.I.</td>
<td>118,213t</td>
<td>No policy</td>
</tr>
<tr>
<td>Cooperativa Multiactiva Neuland Limitada</td>
<td>78,725t</td>
<td>No policy</td>
</tr>
</tbody>
</table>

Table 1: Top eight exporters of Paraguayan beef identified by Trase showing tonnes of beef exported from Paraguay between 2013-2017. \textsuperscript{*}Minerva has a zero deforestation policy for its beef supply chain in the Amazon Biome, but has yet to extend it to its operations in Paraguay.

\textsuperscript{26}Minerva Food 2016, Cattle policy
\textsuperscript{27}Oxfam 2016, Yvy Jára. Los dueños de la tierra en Paraguay
\textsuperscript{28}https://trase.earth/
\textsuperscript{29}https://www.company-action.org/
\textsuperscript{30}JBS Paraguay S.A. was bought by Minerva in 2017.
\textsuperscript{31}Frigomerc S.A. was bought by Minerva in 2012.
\textsuperscript{32}Frigorifico San Pedro S.A. has not been operating since 2015.
There has been increased global awareness of issues linked to cattle ranching in the Chaco in the last year, with cattle ranching linked to deforestation, encroachment on indigenous lands, forced labour, and child labour. Companies that are not making the effort to transition to legal and sustainable operations risk reputational damage, which in turn can result in profit loss. For example, some of the world’s largest car firms suffered reputational damage, after they were linked to leather supplies from a company operating in the Chaco where an individual was convicted of trafficking in 2016, after 35 people were found to be working in slave labour conditions.

Such activities can lead downstream buyers to drop suppliers if they are exposed to unsustainable practices. This could have huge impacts on Paraguayan leather exports as nearly 60% of leather from Paraguay, worth $70 million, was exported to Italy in 2017.

Another example of how a failure to act on these issues can also bring reputational risks is the Brazilian company Minerva, which has faced criticism after failing to mitigate risks linked to sourcing in the cattle sector, after receiving a $85 million loan from the International Finance Corporation (IFC) for business expansion in Paraguay. The IFC classified the loan as high risk due to the risks of deforestation, encroachment on indigenous peoples’ land, and child/forced labour. The company missed its deadlines to develop a supply chain verification system and map regions and suppliers more likely to allow forced and child labour. By extension the IFC and the World Bank have also faced criticism for granting a high risk loan without strict conditions, and for not ensuring Minerva implemented the necessary measures to operate responsibly in the Chaco.

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33 Repórter Brasil 2018, Brazilian meat industry encroaches on Paraguayan Chaco
34 The Guardian 2018, Forced labour in Paraguay: the darkness at the bottom of the global supply chain
35 Resource Trade Earth
36 USAID 2017, Monitoring Report International Finance Corporation Minerva Beef Project - Brazil/Paraguay
37 IFC Project Information Portal - Minerva Beef
38 ITUC 2018, World Bank leaves door open to slavery in Paraguay
What financial institutions can do to more effectively mitigate these risks

The main business risks from cattle operations identified in this brief are deforestation, unresolved indigenous land claims, and harmful labour practices. Financial institutions in Paraguay are already taking steps to manage these risks, for example through their involvement in the Roundtable on Sustainable Finance and UNDP Green Commodity Platform, implementation of Roundtable on Sustainable Finance good practice guidance for financing livestock, and Environmental and Social Risk Analysis Systems (SARAS).

However, a recent assessment of the sustainability policies of banks in Paraguay by SCRIPT shows that there are gaps in their public policies to address environmental and social risks associated with financing of the cattle sector. For example, just one of the 10 Paraguayan banks assessed in the SCRIPT policy benchmarking tool had a public policy that included detailed sustainability criteria for companies in the cattle sector. Going forwards, financial institutions should develop robust public policies for their financing. This should include requiring companies in their portfolio to prevent the loss of forests in the Chaco, protect the rights and livelihoods of local communities, and ensure that key labour standards are met. A breakdown of key policy expectations can be found on the next page.

Once banks have a policy in place, they should establish clear systems for engaging with the companies they finance and ensuring compliance with the bank’s policy.

A new policy benchmarking tool and guidance materials for soy and cattle has been launched by the SCRIPT platform. The tool supports financial institutions in understanding the strength of their policies assessed against peers in Paraguay, and makes recommendations for stronger policies towards best practice. The tool can be accessed at www.script.finance.
Key policy expectations

• **Publicly available** — Policies should be publicly available and easily accessible.

• **Proof of legality** — Banks should require proof from companies in their portfolio that their operations comply with all applicable local, national, and international regulations.

• **Protects sensitive forest** — Require companies to have a commitment to protect globally important forests such as intact forest landscapes, areas of high conservation value, high carbon stock areas, primary and/or natural forests.

• **Timebound** — Banks should impose a deadline on their portfolio companies to comply with the banks’ policies or require that the companies’ forest policies are timebound.

• **Minimise emissions** — Require companies to monitor and report emissions, and have a timebound commitment in place to reduce emissions associated with the production and procurement of cattle and associated product supply chains.

• **Free Prior and Informed Consent** — Require companies to have policies that ensure that the rights and livelihoods of local communities are protected, including comprehensive stakeholder engagement to achieve Free Prior Informed Consent.

• **Labour rights** — Require companies to have policies ensuring that their business operations meet key labour standards, covering areas such as child labour, forced labour, freedom of association, discrimination, and other principles in ILO core conventions, and the Universal Declaration of Human Rights.

• **Gender equality** — Require companies to have policies that address gender related workers’ rights and encourage the inclusion of women in cattle supply chains on equal terms.

• **Small businesses and farmers** — Require companies to have policies to encourage and/or increase small-scale farmer participation in cattle supply chains.

• **Scope of policy** — Banks policies should apply to all of their operations and financial services provided, all deals and companies regardless of size, and to all companies regardless of their position in the supply chain.

• **Implementation, monitoring and reporting** — Banks should have a clear public process to identify and deal with policy non-compliance, and report progress against their policy.

• **Financial solutions** — Banks should offer incentives to companies linked to their sustainability performance. Examples of incentives are preferential loan rates or project finance for sustainable innovations.