

**Report No. 64458-PG**

**The Inspection Panel**



## **Investigation Report**

**INDEPENDENT STATE OF  
PAPUA NEW GUINEA:  
Smallholder Agriculture  
Development Project  
(IDA Credit No. 4374-PNG)**

**September 19, 2011**

## About the Panel

The Inspection Panel was created in September 1993 by the Board of Executive Directors of the World Bank to serve as an independent mechanism to ensure accountability in Bank operations with respect to its policies and procedures. The Inspection Panel is an instrument for groups of two or more private citizens who believe that they or their interests have been or could be harmed by Bank-financed activities to present their concerns through a Request for Inspection. In short, the Panel provides a link between the Bank and the people who are likely to be affected by the projects it finances.

Members of the Panel are selected “*on the basis of their ability to deal thoroughly and fairly with the request brought to them, their integrity and their independence from the Bank’s Management, and their exposure to developmental issues and to living conditions in developing countries.*”<sup>1</sup> The three-member Panel is empowered, subject to Board approval, to investigate problems that are alleged to have arisen as a result of the Bank having failed to comply with its own operating policies and procedures.

The Panel’s work embraces the fundamental principles of independence, integrity, and impartiality. These cornerstone principles enable the Panel to respond to the issues raised and to provide technically sound, independent assessments to the Bank’s Board.

## Processing Requests

After the Panel receives a Request for Inspection, it is processed as follows:

- The Panel decides whether the Request is *prima facie* not barred from Panel consideration.
- The Panel registers the Request—a purely administrative procedure.
- The Panel sends the Request to Bank Management, which has 21 working days to respond to the allegations of the Requesters.
- The Panel then conducts a short 21 working-day assessment to determine the eligibility of the Requesters and the Request.
- If the Panel recommends an investigation, and the Board approves it, the Panel undertakes a full investigation, which is not time-bound.
- If the Panel does not recommend an investigation, the Board of Executive Directors may still instruct the Panel to conduct an investigation if warranted.
- Three days after the Board decides on whether or not an investigation should be carried out, the Panel’s Report (including the Request for Inspection and Management’s

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<sup>1</sup> IBRD Resolution No. 93-10; IDA Resolution No. 93-6.

Response) is publicly available through the Panel's website and Secretariat, the Bank's Info Shop and the respective Bank Country Office.

- When the Panel completes an investigation, it sends its findings and conclusions on the matters alleged in the Request for Inspection to the Board as well as to Bank Management.
- The Bank Management then has six weeks to submit its recommendations to the Board on what actions the Bank would take in response to the Panel's findings and conclusions.
- The Board then takes the final decision on what should be done based on the Panel's findings and the Bank Management's recommendations.
- Three days after the Board's decision, the Panel's Report and Management's Recommendation are publicly available through the Panel's website and Secretariat, the Bank's Project website, the Bank's Info Shop and the respective Bank Country Office.

## **Acknowledgements**

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Finally, the Panel wishes to convey its gratitude and appreciation to members of its Secretariat, in particular Dilek Barlas, Deputy Executive Secretary, and Mishka Zaman, Operations Officer, for their resourceful handling of this investigation.

## **Abbreviations and Acronyms**

AusAID	Australian Agency for International Development
BCS	Broad Community Support
CAS	Country Assistance Strategy
CDC	(British) Commonwealth Development Corporation
CDD	Community Driven Development
CELCOR	Center for Environmental Law and Community Rights
CLUA	Clan Land Usage Agreement
CPB	Customary Purchase Blocks
CPO	Crude Palm Oil
CSTB	Central Supply and Tender Board
DEC	Department of Environment and Conservation
DNPM	Department of National Planning and Monitoring
DOW	Department of Works
DPLGA	Department of Provincial and Local Government Affairs
EA	Environmental Assessment
ECMMP	Environmental Control Measures and Monitoring Programs
EMP	Environmental Management Plan
ERR	Economic Rate of Return
ESCR	Economic, Social, and Cultural Rights
ESMF	Environmental and Social Management Framework
FFB	Fresh Fruit Bunch
FIRR	Financial Internal Rate of Return
GoPNG	Government of Papua New Guinea
ha	Hectare
HCVF	High-Conservation Value Forest
HIV/AIDS	Human Immunodeficiency Virus and Acquired Immunodeficiency Syndrome
HOP	Higaturu Oil Palm Limited
IBRD	International Bank for Reconstruction and Development
ICCC	Independent Consumer and Competition Commission
ICESCR	International Covenant on Economic, Social, and Cultural Rights
ICR	Implementation Completion Report
IDA	International Development Association
IEE	Initial Environmental Examination
IPP	Indigenous People's Plan
LLG	Local Level Government
LPC	Local Planning Committee
LSS	Land Settlement Schemes
NBPOL	New Britain Palm Oil Development Limited
NIWG	National Interpretation Working Group
NES	Nucleus Estate Scheme
M&E	Monitoring and Evaluation
MOU	Memorandum of Understanding
MLFS	Mama Lus Frut Scheme
MTDS	Medium-Term Development Strategy

NGO	Non-governmental Organization
NPV	Net Present Value
OPIC	Oil Palm Industry Corporation
OPID	Oil Palm Infrastructure Development Unit
PAD	Project Appraisal Document
PCD	Project Concept Document
PIC	Public Information Center
PIM	Project Implementation Manual
PKO	Palm Kernel Oil
PNG	Papua New Guinea
PNGOPRA	Papua New Guinea Oil Palm Research Association
PNGSDP	Papua New Guinea Sustainable Development Program
POPGA	Popondetta Oil Palm Growers Association
PPM	Parts Per Million
PSC	Project Steering Committee
QABB	Queen Alexandra Birdwing Butterfly
QAG	Quality Assurance Group
QER	Quality Enhancement Review
RMTF	Road Maintenance Trust Fund
RPF	Resettlement Policy Framework
RSPO	Roundtable on Sustainable Palm Oil
SA	Social Assessment
SADP	Smallholder Agriculture Development Project
SDR	Special Drawing Rights
VOP	Village Oil Palm
WDC	Ward Development Committee
WNB	West New Britain

**Note: All dollar figures used in this report refer to US dollars**

## Overview

This Investigation Report was prepared in response to a Request for Inspection related to the Papua New Guinea: Smallholder Agriculture Development Project (SADP, or the “Project”). The Request was submitted on December 8, 2009, by the Ahora/Kakandetta Pressure Group, affected customary land owners from Oro province and smallholders in one of the three Project areas (the “Requesters”). The Requesters designated the Center for Environmental Law and Community Rights (CELCOR), a non-governmental organization (NGO) from Papua New Guinea, to act as their representative.

The Project is being implemented in three areas in Oro and West New Britain (WNB) provinces. It seeks to increase the income and improve the livelihoods of smallholders involved in oil palm production by enabling them to plant additional oil palm through “infilling”. Infilling refers to new blocks of oil palm being planted between established blocks and along existing access roads in the Nucleus Estate and Smallholder Scheme areas. The Project also aims to rehabilitate and maintain rural access roads, improve local service provision and infrastructure through a local governance and community-participation component, and provide institutional support for Project management. This Project follows a long history of World Bank involvement in oil palm in Papua New Guinea which started in 1969; the Bank was also instrumental in initiating commercial oil palm cultivation in Oro province in 1976.

### Key Claims Presented to the Panel

The Requesters believe that the Bank has failed to comply with several of its Operational Policies and Procedures in the design, appraisal, and implementation of the Project. They believe that these failures have caused, or are likely to cause, harm to their community and environment.

**Information Disclosure, Consultation, and Broad Community Support:** The Requesters are concerned about inadequate consultation with community members in Project areas and timely and culturally appropriate disclosure of documents. They claim that despite the fact that they are Indigenous People and customary landowners, they were not given the opportunity to provide input about the Project’s scope, purpose, and activities. The Requesters call into question whether broad community support for the Project was achieved.

**Poverty and Livelihood Impacts:** The Requesters claim decades of oil palm production has not reduced poverty for smallholders nor improved their living standards, for three reasons. They explain this firstly as a consequence of the smallholders’ dependent relationship and revenue-sharing arrangement with the estate mill, in which the Fresh Fruit Bunch (FFB) pricing system distorts the price ratio in favor of the mill companies. Second, the Requesters point to the high number of levies imposed on smallholders as another reason preventing them from improving their living standards; they also maintain that in addition to the existing multiple levies, they will have to pay an extra levy to support the Road Maintenance Trust Fund (RMTF) set up under the Project, which will reduce their income even further. Finally, they believe that the Project promotes the mono cropping of oil palm, whereas income diversification to supplement earnings from oil palm, is a vital livelihood strategy for smallholders.

**Environmental Impacts:** The Requesters state that the Project will cause several environmental harms because of the inadequacy of the Environmental Assessment. The consequences of the Project's "infilling", which the Requesters claim is a deceptive term for oil palm expansion, include soil erosion, pollution of waterways and deforestation, and conversion of land that currently provides vital social, economic and cultural resources for the communities. The Requesters believe that the Environmental Assessment misses critical Project impacts including the effects of increased mill effluent discharge. They also state that mitigation measures with respect to High Conservation Value Forests are inadequate.

**Institutional Sustainability:** While acknowledging the importance of a road maintenance system, the Requesters question the sustainability of the Road Maintenance Trust Fund (RMTF) and the institutional capacity of the Oil Palm Industry Corporation (OPIC), the implementing entity. The Requesters claim that the RMTF will not be sustainable owing to the unreliability of the required financial contributions from the provincial governments and the mill companies. They believe the sustainability of Project benefits will be further undermined by the limited capacity of OPIC, which will hinder the delivery of effective extension services.

## **Panel Findings**

The focus of the Panel's investigation was to establish whether the Bank complied with its own policies and procedures in the design, appraisal, and implementation of the Project, and whether, if instances of noncompliance were found, they caused, or were likely to cause, the harm or potential harm alleged by the Requesters. In undertaking this investigation, the Panel was guided by the fact that the smallholders, for whom the Project has been developed, are all members of indigenous communities, and drew on the Indigenous Peoples Policy (OP 4.10) for much of the compliance analysis. Given that midway through the Project period none of the major Project activities have been initiated on the ground, much of the focus of the investigation pertained to the design, planning and appraisal phases. The Panel identified the following issues where Bank policy was not complied with and where policy compliance could have helped mitigate the harms.

**Information Disclosure, Consultation, and Broad Community Support:** The Panel reviewed the Social and Beneficiaries Assessments in detail, as key instruments in the consultation process, and found that the analysis of the legal and institutional framework of customary law, leadership, decision-making and dispute-resolution processes, and the gathering of baseline information on indigenous communities, fell short of requirements, which may have affected consultation processes. Management also failed to provide relevant information prior to consultations in a culturally appropriate manner, form, and language. Further, the Panel was unable to find in Project documents, including the Social and Beneficiaries Assessments, any information documenting how broad community support was reached. The Panel finds that this is not in compliance with OP 4.10. These shortcomings in the process of consultation with the smallholders are likely to have affected the design of the Project. The Panel noted that the Management Response indicates that Management intends to strengthen the consultation process during implementation.

**Poverty and Livelihood Impacts:** The Panel found that while the Project aims to increase the income of smallholders, in compliance with Bank Policy on Poverty Reduction, it was not in compliance with the Indigenous Peoples Policy which requires the Bank “*to ensure that the Indigenous Peoples receive social and economic benefits that are culturally appropriate and gender and intergenerationally inclusive.*” It is the Panel’s view that the Project design should have made provisions to respond to the significant differences among the Project areas. Further, Management did not conduct a review of the mill companies’ institutional and financial viability, thus leaving the Project without a sound basis for revenue-sharing, which has consequences for both the FFB pricing review and the RMTF. In addition, the Project did not include measures to promote an effective savings mechanism or diversify income of smallholders, which had been identified as critical means of improving smallholder livelihoods in the Social Assessment. The Panel confirmed that higher incomes have not uniformly led to corresponding improvements in smallholders’ living standards.

**Environmental Impacts.** While appreciating the Requesters claims on environmental harms given the history of deforestation, pollution of waterways and other negative environmental impacts from past oil palm production, the Panel found the Project to be mainly in compliance with the Bank’s Policy on Environmental Assessment, except for the issue of mill effluents. The Panel agrees with Management’s view that the lack of adequate analysis in the Environmental Assessment of impacts from mill effluent did not comply with Bank policy, and appreciates that the Agreed Action Plan provided in the recent Effluent Study addresses the issue of potential negative effects from mill effluent and, when implemented, could bring the Project into compliance.

**Institutional Sustainability.** The Panel recognizes and agrees with Management’s view that establishing a system for the regular maintenance of the road network is critical for smallholders and the industry. However, the Panel found Management left the design of this essential element of the Project to the implementation phase, and the proposal of 25% contribution by the smallholders was arrived at without fully assessing the smallholders’ ability to pay. Given that there is no way of assuring contributions into the RMTF from the provincial governments and mill companies, the Panel was concerned that the burden of risk fell entirely on the smallholders. The Project includes a capacity development component for the Oil Palm Industry Corporation (OPIC), having recognized OPIC’s capacity gaps, which was in compliance with policy requirements. However, the significant delays in Project implementation indicate that, as the Bank shifts from supervision to “implementation support”, it becomes even more incumbent upon Management to increase its own capacity to promptly identify problems with a view towards their early resolution.

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## EXECUTIVE SUMMARY

The Inspection Panel has prepared this Investigation Report in response to a Request for Inspection related to the Papua New Guinea: Smallholder Agriculture Development Project (SADP, or the “Project”). The Request was submitted on December 8, 2009, by the Ahora/Kakandetta Pressure Group, affected customary land owners from Oro province and smallholders in one of the three Project areas (the “Requesters”). The Requesters asked that their identities be kept confidential and that the Center for Environmental Law and Community Rights (CELCOR), a non-governmental organization (NGO) from Papua New Guinea, act as their designated representative. The Requesters state they have suffered, and are likely to suffer, serious harm from the Project’s design and implementation.

The Panel’s report is presented in seven chapters. Chapter 1 covers the Request, Management Response and the Investigation Process, and Chapter 2, the Project Context. Chapters 3 to 6 are the substantive chapters, covering the issues raised by the Requesters related to Information Disclosure, Consultation, and Broad Community Support; Poverty Reduction and Livelihood Impacts; Environmental Impacts; and Institutional Sustainability, respectively. The final chapter addresses Systemic Issues. Each of the chapters is summarized briefly below.

### **Chapter 1: The Request for Inspection, Management Response, and Investigation Process**

#### ***The Project***

The Project seeks to increase the income and improve the livelihoods of smallholders already involved in oil palm production. It attempts to do so by enabling smallholders to plant additional oil palm through “infilling” (that is, the planting of new blocks of oil palm between established blocks and along existing access roads in the Nucleus Estate and Smallholder Schemes areas), rehabilitating and maintaining rural access roads, improving local service provision and infrastructure through a local governance and community-participation component, and providing institutional support for Project management. The Project is implemented in three areas in Oro and West New Britain (WNB) provinces in Papua New Guinea (PNG).

#### ***The Request for Inspection***

The Requesters believe that the Bank has failed to comply with several of its Operational Policies and Procedures in the design, appraisal, and implementation of the SADP. They believe that these failures have caused, or are likely to cause, harm to their community and environment.

**Information Disclosure, Consultation, and Broad Community Support.** The Requesters are concerned about inadequate consultation with community members affected by the Project and lack of disclosure of documents. They claim that despite the fact that they are Indigenous People and customary landowners, they were not given the opportunity to provide input about the Project’s scope, purpose, and activities. Project information was not disseminated before Project approval and is still not available, nor was it ever delivered in any language other than English. The Requesters call into question whether broad community support for the Project was achieved, because of the lack of transparent consultation records.

**Poverty and Livelihood Impacts.** The Requesters believe that oil palm production does not reduce poverty for smallholders nor improves their living standards. The Requesters offer three main reasons to explain why they believe living conditions in the Project area have not improved despite decades of oil palm production. First, they note the smallholders' dependent relationship and revenue-sharing arrangement with the estate mill. They claim that the Fresh Fruit Bunch (FFB) pricing system distorts the price ratio in favor of the mill companies. Secondly, the Requesters maintain that in addition to the multiple levies smallholders have to pay to produce oil palm, they will have to pay an extra levy to support the Road Maintenance Trust Fund (RMTF) set up under the Project, which will reduce their income even further. Finally, they believe that the Project promotes the monocropping of oil palm, whereas income diversification is a vital livelihood strategy for smallholders.

**Environmental Impacts.** The Requesters state that the Project will cause several environmental harms because of the inadequacy of the environmental assessment. The consequences of the Project's "infilling", which the Requesters claim is a deceptive term for expansion, include soil erosion, pollution of waterways and deforestation, and conversion of land that currently provides vital social, economic and cultural resources for the communities. The Requesters also believe that the Environmental Assessment is flawed, and misses critical impacts of the Project including the effects of increased effluent discharge attributable to increased oil palm planting under the Project, and the Project's impact on forests and grasslands. They also charge that mitigation measures with respect to high conservation value forests are inadequate.

**Institutional Sustainability.** While acknowledging the importance of a road maintenance system, the Requesters question the sustainability of the Road Maintenance Trust Fund (RMTF) and the institutional capacity of the Oil Palm Industry Corporation (OPIC). The Requesters claim that the RMTF will not be sustainable owing to the unreliability of the required financial contributions from the provincial governments and the mill companies. They believe the sustainability of Project benefits will be further undermined by the limited capacity of OPIC, which will hinder the delivery of effective extension services.

The Requesters conclude by asking that Project authorities incorporate poverty reduction in the Project design, develop other economic livelihood options, undertake a comprehensive environmental assessment of effluent treatment and a forest inventory, change the design to ensure sustainability, and conduct proper consultations to ensure that communities give their free, prior, and informed consent to all Project components.

### ***Management Response***

**Information Disclosure, Consultation, and Broad Community Support.** Management states that the Social Assessment, and other necessary steps taken, have ensured broad community support at all major stages of the Project and that this support continues. The Management Response also states that OP 4.10 on Indigenous Peoples regarding '*broad community support*' does not require consent from all affected individuals or groups. Although Management believes that the findings of the consultation process were properly documented, it "*recognizes that documentation of the consultation process in the Social Assessment should have been more detailed and complete. The documents should have elaborated further on several aspects of the*

*consultation process, including what information was provided on the Project, how the information was conveyed, and how locations and participants were selected.”*

**Poverty and Livelihood Impacts.** Management acknowledges that the Project was considered a “*high-risk undertaking*.” However, Management believes that World Bank investment in the oil palm sector in PNG has had an overall positive impact and that the Project will continue to provide benefits in an environmentally and socially sustainable manner. Management believes that the “*paradox*” of high cash incomes and low standards of living is a national phenomenon and not confined to oil palm producers or the Project area *per se*. Management also holds that investment in rural roads will have a positive impact by improving access to such services as health and education. Moreover, Management states that the community development and local governance activities under the Project will have a positive impact on living standards in the Project areas.

**Environmental Impacts.** Management believes that Project documents identified the potential impacts on the environment and included appropriate mitigating strategies. However, Management acknowledges that, “... *there was insufficient detail in the EA on the matter of effluents,*” and “... *a more comprehensive analysis of the impacts of increased production at the oil palm mills and effluents should have been undertaken in accordance with the requirements of OP/BP 4.01.*” Furthermore, Management states that the Project includes adequate mitigation measures to manage the risks of deforestation in high value forests. Management also states that “[n]o significant conversion or degradation of critical forest areas” will take place under the Project.

**Institutional Sustainability.** Management agrees that the absence of an effective institutional arrangement for road maintenance is the main reason for poor road conditions in Project areas. Management believes that improved roads would reduce production costs for the smallholders by lowering transportation costs, which would outweigh the additional costs borne by them for road maintenance. Management also states that the RMTF mechanism is only in draft form and that the final RMTF formula has yet to be calculated. To calculate the “*level of the smallholder road levy*” for the RMTF mechanism, Management states that it intends to carry out a detailed consultative study in mid-2010.

Management states that contrary to the Requesters’ assertion, there is no planting target-based staff evaluation system in place at OPIC. Management also states that though the Project “*failed to identify the risk of slow implementation start-up including the time needed to establish OPIC’s project management capacity*”, the Project includes a component specifically designed to strengthen OPIC’s capacity.

Although Management believes diligent efforts were made to apply its policies and procedures and that the Requesters’ rights or interests have not been adversely affected, it does acknowledge several areas for improvement, on which action is being taken. These include translating Project documents into Tok Pisin; using OPIC radio programs to communicate key aspects of the Project; commissioning a study on oil palm effluent discharge; removing inconsistencies between Project documents; reviewing the FFB pricing formula involving smallholder representatives; strengthening the consultation process for major activities during

implementation, including the design of the RMTF; re-examining the Road Reconstruction Sub-Manual, Environment Management Plan, and Resettlement Policy Framework; commissioning independent social and environmental audits; and strengthening Project grievance mechanisms.

### ***Eligibility of the Request and Board Decision***

In its Eligibility Report, the Panel determined that the Request met the eligibility requirements for an investigation and recommended that an investigation be carried out. On March 25, 2010, the Board approved, on a no-objection basis, the Panel's recommendation. In its investigation, the Panel assessed whether the Bank had complied with OP/BP 4.10 on Indigenous Peoples, OP 1.00 on Poverty Reduction, OP 10.00 on Investment Lending, OMS 2.20 on Project Appraisal, OP 10.04 on Economic Evaluation of Investment Operations, OP 4.01 on Environmental Assessment, OP/BP 4.36 on Forests, OP/BP 4.04 on Natural Habitat, and OP/BP 13.05 on Project Supervision.

## **Chapter 2: Project Context**

Papua New Guinea's indigenous population is one of the most diverse in the world, an indicator of which is the number of distinct languages spoken -- some 841 indigenous languages.

Most of the Requesters belong to the Orokaiva ethnic group, which constitutes the majority of the inhabitants of Oro province. The Orokaiva are patrilineal, and each clan traces its origin to a common ancestor. The Orokaiva social structure is centered on the village/family unit to which people owe their greatest allegiances and which bind them in a system of reciprocal obligations commonly known by the Tok Pisin/Melanesian Pidgin term "*wantok*" (from "one talk"). Under the *wantok* system, anyone who speaks the same language has reciprocal social and economic obligations toward one another. The obligations under the *wantok* system have been identified as a partial explanation of the 'paradox' of high cash incomes and low standards of living in the Project areas.

The land tenure system in the Project areas of Hoskins, Bialla, and Popondetta consists of a mixture of indigenous customary land and state land, the latter being acquired prior to PNG's independence. The oil palm estates and subsequent land settlement schemes (LSS) are located on state land, while village oil palm blocks (VOP) occupy portions of the customary land belonging to various local clans and sub-clans.

The development of oil palm has been an important feature of the government's program to implement its rural development objectives. The continued transition from a subsistence economy to a market economy is presenting significant development challenges for PNG, and oil palm is one of the key vehicles for this change. While the introduction of cash crops has allowed subsistence farmers to diversify their income sources and participate in the export market, it has also made rural producers dependent on mill companies and unreliable markets and impacted subsistence farming, with socio-economic consequences.

The transition from subsistence farming to cash cropping has also altered PNG's traditional land tenure system. Customary land tenure generally means that the land is communally owned by

kinship groupings, which does not include individual ownership or inheritance. This flexible and communal nature of customary land tenure has been modified by the long-term, usufruct rights of the land for cash cropping associated with oil palm development

The Project follows a long history of World Bank involvement in oil palm in PNG, which started in 1969. The most recent project in Oro Province was the Oro Smallholder Oil Palm Development Project (1992-2001), which largely met its goals, but identified the need for maintenance of the access road network. While preparation of the current Project began in 2002, it was not until 2009 that the Project became effective.

### **Chapter 3: Information Disclosure, Consultation, and Broad Community Support**

The Requesters claim that the Project may cause harm to their community or the environment partly because they and other communities were not adequately consulted nor was Project information widely disseminated prior to Project approval. Hence, potentially affected indigenous communities were deprived of an opportunity to provide input into the Project. The Panel's own observations were inconclusive on the extent of consultations in the field, but confirmed that knowledge of the Project was limited. Further, while there was widespread interest in growing oil palm, there were also many concerns about what this involved. The majority of smallholders are neither literate in English and Tok Pisin, and Orokaiva was the most commonly spoken language in the Oro Province, thus limiting access to written documents. In the context of this claim, the Panel analyzed Management's compliance with relevant World Bank operational policies and procedures, namely OP 4.10 (Indigenous Peoples) and OP 4.01 (Environmental Assessment). This analysis covered two main dimensions: the initial socioeconomic and cultural fact-finding, and free, prior, and informed consultation and broad community support.

#### ***Socioeconomic and Cultural Fact-finding***

**Review of the Legal and Institutional Framework Applicable to Indigenous Peoples.** The first element of a Social Assessment, under Annex A of OP 4.10, is the review of the "*legal and institutional framework applicable to Indigenous Peoples.*" The Beneficiaries Assessment states that "*Clan leaders still command considerable respect and authority in their communities and without their active support, it is unlikely that SAMP-supported activities will succeed or gain the support of the broader community*", recommending that "*SAMP personnel should identify the local clan leaders and involve them in decision making regarding SAMP activities.*"

This notwithstanding, the Social and Beneficiaries Assessments offer little further discussion or information on the identification of customary leadership, decision-making structures, and dispute-mediation and conflict-resolution processes applicable to Project-affected indigenous peoples, nor on how these might differ between various ethnic groups. **The Panel finds that the analysis of the legal and institutional framework of customary law, leadership, decision-making and dispute-resolution processes, and the variations (if any) of these practices among different ethnic groups, fell short of the requirements of Annex A of OP 4.10, and thus did not comply with Bank Policy.**

**Gathering Baseline Information.** The Project documents identify one large ethnic and cultural group, the Orokaiva, in Oro Province. The Project documents identify a far more diverse

composition of ethnic groups in West New Britain province with seven major ethnic/tribal groups speaking some 25 languages. Although the Beneficiaries Assessment notes that land tenure and social structure in the Popondetta area of Oro province is “*strongly patrilineal*” and in WNB province it is “*predominantly matrilineal*,” it concludes that overall, in both provinces “*...the indigenous ethnic/language groups are relatively homogenous in terms of culture, social organization and land tenure systems.*”

The Panel found that in stating that the ethnic groups are relatively homogeneous, the Beneficiaries Assessment ignores the differences arising from patrilineal and matrilineal lineage systems. These differences may have consequences for the SADP in terms of ownership and management of land and customary decision-making processes.

**The Panel could not find adequate evidence and information in the Social or Beneficiaries Assessments to support the conclusion about the relative homogeneity of various affected indigenous groups. It is the Panel’s view that a more thorough treatment of the extent to which different communities rely on alternative livelihood sources (e.g., cash crops, gardens for home and local market, fishing, hunting), as well as maps delineating the areas inhabited by different ethno-linguistic groups, would have been helpful and appropriate.**

**The Panel is of the view that a more thorough analysis of the characteristics of the various Project-affected ethnic groups, especially with regard to key issues affecting the Project (e.g., land tenure and inheritance, customary decision-making processes, practices regarding food gardens) should have been included in the Social and Beneficiaries Assessments before concluding that these groups were “*relatively homogenous*.” The absence of key baseline information is a shortcoming of these assessments, which the Panel finds not to be in compliance with OP 4.10.**

**Identification of Project Stakeholders and Elaboration of a Consultation Process with Indigenous Peoples.** The Social Assessment identifies various stakeholder categories to be consulted, although not in terms of specific indigenous communities. **The Panel finds that the Social and Beneficiaries Assessments elaborate a consultation process to be conducted at each stage of the Project as required by OP 4.10.** However, **the Panel finds that the Consultation Framework is not culturally appropriate given the shortcomings in the review of the legal and institutional framework and gathering of baseline information on indigenous communities, and therefore does not comply with OP/BP 4.10.**

**Assessment of Effects of the Project on Indigenous Peoples.** The Social Assessment identifies potential problems associated with the introduction or incentivizing of cash crop farming. These are also raised in the Request for Inspection and include the pressure on subsistence gardens, ways in which cash is interpreted and distributed within communities, gambling, heavy alcohol use, prostitution, and domestic violence. **The Panel finds that the Social Assessment identified potential adverse and positive effects of SADP in accordance with OP/BP 4.10.** However, the general identification of the potential adverse effects and the recommended measures for their mitigation could have been more specific had the baseline information and consultation been adequate.

**Identification of Measures to Avoid Adverse Effects and Ensure that Indigenous People Receive Culturally Appropriate Benefits.** The Social Assessment discusses alternative sources of livelihoods, especially the critical importance of food gardens. It then recommends detailed measures to minimize and mitigate adverse effects of oil palm development, mainly through measures to lessen financial hardship caused by loan repayments and the introduction of a savings mechanism. **The Panel finds that the Social Assessment does identify some measures to avoid, minimize, and mitigate adverse effects and to ensure that indigenous people receive culturally-appropriate benefits under the Project.** However, consultations with the relevant stakeholders about the adequacy and appropriateness of the proposed Project design were not carried out in compliance with Bank policy. The Panel is concerned that adequate consultations may have revealed other effects and possible mitigating measures.

### ***Free, Prior, and Informed Consultation and Broad Community Support***

Although the Project was originally intended to include both oil palm infilling and replanting, a shift in focus resulted in exclusive support for infilling. The Panel finds no record of consultation concerning the Project's removal of replanting as a component, despite the apparent interest in replanting expressed by the groups consulted early on in the Project cycle. By the time of the Social Assessment, infilling was a key Project component, and not replanting, and consultations were carried out on this premise. **The Panel finds that the absence of consultation with smallholders on the change in Project design signified by the shift in Project emphasis from both infilling and replanting to only infilling, did not comply with OP 4.10.**

The Panel also finds that Project documents are unclear about how consultations involved clan and sub-clan leaders, despite the importance of consultations with them as identified in the Beneficiaries Assessment. **The Panel could not find evidence in Project documents that the consultations, when conducted, specifically sought the input of clan leaders other than the ones represented in the modern leadership groups (particularly Local Level Groups).**

Management acknowledges that the only information shared with stakeholders during consultations for the Environmental Assessment was in verbal form. **The Panel finds that none of the documentation associated with the Environmental Assessment indicates whether any relevant material was provided in a timely manner prior to consultation and in a form and language understandable and accessible to the groups being consulted, as required by OP 4.01.**

Management also acknowledges that *"no documents were translated into local languages,"* although they were subsequently translated and made available at the World Bank's InfoShop on February 22, 2007. **Furthermore, while the EA and related documentation were publicly disclosed in Port Moresby and Washington on February 22, 2007, and while formal notification to the public announcing where the documents were disclosed was published by OPIC in the press on the same day, the documents were made available only in English, and not in a form and language understandable and accessible to the groups being consulted. This does not comply with the free, prior, and informed consultation requirement of OP/BP 4.10.**

**In sum, the Panel thus finds significant shortcomings in the consultation process. In particular, Management failed to provide relevant information prior to consultations in a culturally appropriate manner, form, and language. This does not comply with OP 4.10 and OP 4.01.**

In the Panel's view, the widespread community interest in growing oil palm cannot be equated with broad community support for the Project. "*Broad Community Support*" can only be confirmed on the basis of free, prior, and informed consultation, as noted by OP 4.10. **The Panel was unable to find in Project documents, including the Social and Beneficiaries Assessments, any information documenting how broad community support was reached. The Panel finds that this is not in compliance with OP 4.10.**

#### **Chapter 4: Poverty and Livelihood Impacts**

In investigating the Requesters' claim that growing oil palm has not reduced poverty or improved smallholder livelihoods, the Panel concluded that growing oil palm has undoubtedly generated increased income. However, the Panel also confirmed the paradox, noted by the Requesters and Management. The Panel observed that higher incomes have not uniformly led to corresponding improvements in smallholders' living standards. The Panel analyzed this claim in view of relevant Bank policies that have a bearing on the design of projects aiming at improving livelihoods and reducing poverty, namely OP 1.00 on Poverty Reduction, OP 10.04 on Economic Evaluation of Investment Operations, and OP 4.10 on Indigenous Peoples.

##### ***Poverty Reduction***

Given the historical profitability of oil palm, the Panel finds that the Project is justified as a means to increase the income of smallholder palm-oil producers. Furthermore, the Project is consistent with the Papua New Guinea Country Assistance Strategy for reducing poverty. The Project's objective to strengthen road maintenance is also consistent with the Country Assistance Strategy's emphasis on improved transport as a way to reduce poverty and improve livelihoods. **The Panel finds that the Project aims at increasing the income of smallholders and thus complies with Bank Policy on Poverty Reduction OP 1.00.**

##### ***Economic Assessment and Analysis of Profitability***

Based on Project documents, the Panel notes significant economic, financial, and institutional differences among Project areas. This is especially evident in the differences in smallholder net oil palm income in the two provinces. These differences have not been adequately reflected either in the Project design or addressed in the implementation stage. **It is the Panel's view that the Project design should have made provisions to respond to the differences among the Project areas, so that the smallholders receive appropriate economic, social, and cultural benefits from the Project. The Panel finds this not to be in compliance with OMS 2.20 and OP/BP 4.10.**

The PAD notes the broad and crucial role of private milling companies in the success of the Project. Despite this, the Panel finds no evidence of any assessments of the profitability (or

otherwise) of the companies involved in the oil palm industry in the Project area—nor of their role in milling, transport, seedling production, input supply, credit/debt management, replanting, or their large financial contributions to OPIC and the Papua New Guinea Oil Palm Research Association (PNGOPRA). Neither is there analysis of the relative returns to smallholders, estates and milling companies, either from an historical perspective or under the Project.

**Considering the decades of work supported by the Bank in the oil palm sector in Papua New Guinea, in partnership with oil palm companies, and the companies’ important role in implementing the Project and their direct impact on smallholder income, the Panel finds that Management did not conduct appropriate due diligence of the companies’ institutional and financial viability. The Panel finds this not to be in compliance with OMS 2.20 and OP/BP 10.04.**

### *Improving Livelihoods: Savings and Income Diversification*

OP/BP 4.10 requires that “*Bank-financed projects include measures to (a) avoid potentially adverse effects on the Indigenous Peoples’ communities; or (b) when avoidance is not feasible, minimize, mitigate, or compensate for such effects.*” The Panel notes that Project documents as early as 2002 identified measures needed to assist smallholders’ transition to a cash economy. One such measure, recognized in the Social Assessment, is to develop a saving mechanism. However, SADP did not include any activity to promote savings for smallholders. The Panel appreciates the early efforts that Management made to explore the possibility of establishing a savings mechanism. Nonetheless, given that the introduction of an effective savings mechanism was a critical recommendation from the Social Assessment as well as earlier Project preparation work, and since such a mechanism relates directly to the issue of improving smallholder livelihoods, Management should have continued to give priority to promoting the importance of identifying effective means of savings.

Similarly, Management acknowledges income diversification to be an essential part of livelihood strategies for smallholders. The Panel notes, however, that nothing in the Project explicitly addresses income diversification among smallholders, nor does the Project give incentives to smallholders to grow crops other than oil palm or pursue other income-generation options. The Project’s approach has been to assume that income diversification would result as a spin-off from improving roads and building some (limited) community infrastructure. The Panel observes that although improved roads will increase a range of income-generating opportunities, because of easier transportation of other cash crops either for export or for local markets in addition to improved transportation of oil palm FFBs, relying only on such indirect effects would likely not reach the more vulnerable and less entrepreneurial households.

Saving and income diversification are key measures identified and recommended in the Social Assessment for avoiding potentially adverse effects on the indigenous peoples’ communities. **Since the Project did not incorporate measures recommended in the Social Assessment aimed at avoiding and mitigating adverse impacts on indigenous smallholders growing oil palm, the Panel finds that Management did not comply with OP/BP 4.10.**

## Chapter 5: Environmental Impacts

The Requesters' claim concerning environmental harm centers on the consequences of "infilling," erosion, pollution of waterways, and deforestation. The Panel believes that the Requesters' concerns about environmental and ecological harm arose partly because of the experiences in Oro province with the earlier World-Bank-financed projects. Since at the time the Request was submitted the SADP had not started infilling activities, to which most of the environmental harm is ascribed, the Panel views the Requesters' claims within the purview of potential harm, which may result from a violation of Bank policies and procedures during project design, appraisal, and implementation.

As to the adverse consequences of oil-palm cultivation, international attitudes and approaches to environmental and social aspects of oil-palm development have changed dramatically in the last decade. In Papua New Guinea, changes are being brought about with the accreditation process in the ISO14000 management systems, and the certification process under the Roundtable on Sustainable Palm Oil (RSPO). The Panel is of the view that the attempts to have the Project's key instruments comply with RSPO standards is a major step forward in minimizing adverse environmental impacts. Notwithstanding, given the extent of deforestation, pollution from mill effluents, and other negative environmental consequences that resulted from past oil palm activities, the Panel fully recognizes the validity of the concern of the Requesters.

The Panel's Investigation Report has addressed the Environmental Assessment, Infilling, Erosion, Pollution of Waterways and Deforestation. The Panel's analysis focused on compliance with OP 4.01 on Environmental Assessment, OP 4.04 on Natural Habitats, and OP 4.36 on Forests.

**Environmental Assessment.** The Requesters raise the concern that the Project's Environmental Assessments were inadequate. The Management Response states that the Environmental Assessment (EA), Environmental Management Plan (EMP) and Environment and Social Management Framework (ESMF) for the Project identify environmental impacts and include appropriate mitigation strategies. The EMP concludes with a series of Environmental Control Measures and Monitoring Programs (ECMMPs). The ECMMPs describe the approach needed to assess new blocks proposed for planting oil palm by determining a site sensitivity status that considers the block itself and adjacent areas. The approaches described in the ECMMPs are operationalized through the OPIC "*SADP Oil Palm Infilling Planting Approval Form*." The Panel notes that the EA reflects accepted good practice for environmental management. In addition, the Panel did not identify any unreliable sources in the Environmental Assessment, as the Requesters claimed, nor did it receive from the Requesters any specific examples of such sources. Through a provision for biannual independent environmental and social audits added to the PIM, Management has also opened itself up to constructive comment from stakeholders. **The Panel finds that the inclusion of environmental management and mitigation tools and the reliability of sources used in the Environmental Assessment comply with OP 4.01.**

**Infilling vs Expansion.** The Requesters maintain that the term "infilling" was used deceptively in the Project and that the Project's method of increased oil palm planting is better characterized

as expansion. **It is the view of the Panel that the term infilling has not been used by Management to deliberately obfuscate oil palm expansion.**

While the Requesters are concerned about the possible impact on livelihoods if infill blocks are developed in areas that “*provide economic and social services for local communities including household gardens*”, the Panel notes that the revised planting form of May 2011 does not allow conversion of subsistence gardens to infill blocks if these gardens are the only ones available to the applicant.

**Erosion, Topsoil Depletion, and Siltation.** Management recognizes the potential for erosion and stream sedimentation to occur at the time of establishing new oil palm blocks. The EA, EMP, and ECMMP include measures to minimize any adverse impacts from land erosion, topsoil depletion, and siltation. Collectively, these measures will minimize surface-soil erosion and the movement of soil into water courses. That said, given past experiences with OPIC capacity, Management needs to ensure that OPIC extension staff receive the proper training, support, and supervision to enable Project implementation as envisaged. **The Panel finds that the Project includes mitigation measures related to land erosion, topsoil depletion, and siltation and complies with OP 4.01.**

**Pollution of Waterways.** The Requesters raise a concern about chemical and biological pollution of waterways as a result of oil palm development. The mills carry out regular stream monitoring for chemical pollution and the potential for chemical pollution of natural waters, including eutrophication, is mentioned in the EA and the EMP. The ECMMPs and the OPIC Infilling Planting Approval Form also include guidelines to minimize the movement of chemicals into natural waters. **It is the Panel’s view that Management recognizes the potential for chemical pollution associated with oil palm development and has taken all reasonable steps in the design of the Project to ensure that any adverse impacts from fertilizer runoff are minimized. The Panel finds that these measures comply with OP 4.01.**

The Requesters also claim that the Environmental Assessment does not consider the critical impact of increased effluent discharged from mills on rivers, fish, and people. The Requesters claim that harm is still occurring as a result of effluent outflow into streams, specifically into the Ambogo River and the headwaters of the Mambare River. Management, in its Response to the Requesters’ claim, agreed there was insufficient detail in the EA on the issue of mill effluent and committed to conduct an analysis of the impacts of increased effluent due to Project activities.

Management commissioned a Study, referred to as the “*Effluent Study*”, in 2010, which resulted in an Agreed Action Plan, identifying measures for obtaining commitments from mill companies for adopting corrective action and assisting in the updating of the Papua New Guinea Code of Practice for the Palm Oil Industry.

**The Panel agrees with Management’s view that the lack of adequate analysis of impacts from mill effluent does not comply with OP 4.01. The Panel notes and appreciates that the Agreed Action Plan provided in the Effluent Study addresses the issue of potential negative effects from mill effluent and, when implemented, could bring the Project into compliance with OP 4.01. Given the challenges in implementing environmental regulations in Papua**

**New Guinea, as noted in the Effluent Study, the Panel notes that Management should have undertaken the study much sooner.**

**Risk of Deforestation of High Conservation Value Forests.** The Requesters believe that the Project poses a risk of deforestation in high-value forests. While the forest cover in Oro Province has undergone significant change over the past several decades as a result of changing agricultural and land use practices.

Management has recognized the capacity gaps in OPIC and has put in place institutional mechanisms to address these gaps and build the capacity of OPIC extension staff to ensure that oil palm operations are carried out in conformance with defined environmental and social standards. **The Panel finds that the Project’s approach in its design to building the capacity of OPIC extension staff conforms to the requirements of OP 4.04 on Natural Habitats.**

Management also recognizes the importance of preserving critical forest areas and has developed operational, site-level approaches in the PIM to exclude from oil palm planting any forest areas other than “*impacted and non regenerating forest*.” However, the Project does not have access to an inventory of critical forest areas at a spatial scale that, along with a map of high-conservation-value forests, show “*no go*” and “*caution*” areas. These would be useful complements to existing management tools and would help OPIC officers assess different categories of forests that are often difficult to classify. **It is the Panel’s view that Management did not fully comply with OP/BP 4.36 in ensuring that the Borrower provided the Bank with an assessment of the adequacy of land use allocations for the management, conservation, and sustainable development of forests which includes an inventory of critical forest areas. Nevertheless, Management has included measures in the Project to prevent conversion or degradation of critical forest areas or related critical habitats; the Panel finds Management to be in compliance with the objective of OP/BP 4.36 in this respect.**

## **Chapter 6: Institutional Sustainability**

The Requesters raise concerns about the sustainability of two key features of the Project which are critical to the achievement of Project objectives, namely the Road Maintenance Trust Fund (RMTF) and OPIC’s capacity as the implementing agency.

The RMTF is a user-pay based fund which will be established in each Project area under the Project. The proposal is for 25% of the required funds for annual road maintenance to be contributed by smallholder oil palm growers, 25% by the palm oil milling companies and 50% by the provincial governments. It is the Requesters view that smallholders might be adversely affected by the proposed financing mechanism for the RMTF. While a mandatory levy on smallholders can easily be enforced, there is no assurance of contributions from the milling companies and provincial governments, thus putting into question the sustainability of the mechanism, as well as putting undue risk on the smallholders. Similarly, smallholders might be affected by the lack of capacity of the OPIC extension officers to carry out their functions effectively, including its extension services. The Panel reviewed these claims in the context of OMS 2.20 on Project Appraisal and OP 13.05 on Project Supervision.

### *Sustainability of RMTF*

The Panel concludes that Management was, and remains, aware of the importance of road maintenance for the sustainability of smallholder productivity. However, the design of the SADP did not include institutional and funding arrangements for road maintenance and left these arrangements to be finalized during the Project's implementation. **The Panel finds that Management failed to comply with OMS 2.20 by leaving the design of this essential element of the Project, critical to ensuring the achievement of Project objectives, to the Project's implementation.** In addition, the Panel finds that Management's proposal of 25% contribution by the smallholders to the RMTF was arrived at without fully assessing smallholders' ability to pay, and most importantly without consultation with the smallholders.

### *Sustainability of OPIC Extension Activities*

The Requesters express concerns with "...OPIC's limited capacity to deliver appropriate extension services". The Panel notes that Management is aware of the limitations of OPIC as an organization and the capacity of its extension officers. These limitations are being addressed in two ways under the Project: (a) measures are being put in place to build the capacity of OPIC as an institution and, particularly, of its extension officers; and (b) the OPIC procedural systems, as spelled out in the PIM, ECMMPs and associated management tools, provide instructions to ensure that extension activities are carried out effectively, and to minimize any adverse environmental or social impacts.

The Panel also understands that Management tried to address OPIC's capacity gaps by requiring the establishment and staffing of the OPIC Project Office and the OPIC Road Engineering Unit as a specific disbursement condition. **The Panel appreciates that, within the limits of Management's staffing structure in support of this Project, Management complied with the requirements of OP 13.05 on Project Supervision, paragraph 2b, namely, "*Identify problems promptly as they arise during implementation and recommend to the borrower ways to resolve them.*"**

However, as the Bank shifts from supervision to "implementation support", it becomes even more incumbent upon Management to increase its own capacity to promptly identify problems with a view towards their early resolution, especially in situations where there are major capacity issues in the main implementing agency.

## **Chapter 7: Systemic Issues**

The Panel's investigation yielded observations on systemic issues in two areas, namely in applying the Indigenous Peoples Policy to projects where indigenous people are the main beneficiaries, and in managing risks associated with weak capacity of implementing institutions. In addition, the investigation generated some insights that might contribute to the follow-up to the WBG Framework on Engagement in the Palm Oil Sector.

### ***Applying the Indigenous Peoples Policy to Projects Where Indigenous People Are the Main Beneficiaries***

The Panel notes that Management did not prepare an Indigenous Peoples Plan (IPP) for the Project since the Project in its entirety benefits indigenous communities. The objective of OP 4.10 on Indigenous Peoples is to ensure that projects “*include measures to (a) avoid potentially adverse effects on the Indigenous Peoples’ communities; or (b) when avoidance is not feasible, minimize, mitigate, or compensate for such effects. Bank-financed projects are also designed to ensure that the Indigenous Peoples receive social and economic benefits that are culturally appropriate and gender and intergenerationally inclusive.*” The Panel is concerned that staff may become less focused on the latter part of this set of objectives (i.e., ‘*social and economic benefits*’) in projects where ‘*adverse effects*’ are not obvious and there is no need to develop an IPP.

A key concern is the consultation process; whether it adequately meets the standards of ‘*free, prior and informed consultation*’, whether ‘*broad community support*’ by indigenous communities has been obtained, and whether consultations also focus properly on ‘*benefits*’. The Panel’s investigation found the consultations deficient in scope, content, and form, as well as in not taking adequate account of customary structures and lacking documentation of broad community support. The investigation also found that the Project design does not adequately reflect the findings and recommendations of the Social Assessment.

OP 4.10 requires that consultation with communities takes place throughout implementation, for which the continuous involvement of well-trained staff is critical. The Panel found that Management’s attentiveness to this policy gradually diminished as the Project moved into the concrete design phase and, subsequently, to implementation and supervision. Hence it might be useful to formulate clearer guidelines for application of OP 4.10 to projects where a self-standing IPP is not warranted. The Panel acknowledges that projects in Papua New Guinea pose a unique challenge for the Bank as the population is almost entirely composed of indigenous peoples belonging to more than eight hundred distinct ethnic groups, triggering OP 4.10 for every project, with its higher bar in terms of safeguards.

### ***Managing Risks Associated with Weak Capacity of Implementing Institutions***

The Panel notes significant delays in implementing the Project, which highlight two systemic issues relevant for Management: First, how did Management assess the risks associated with weak counterpart capacity in view of the complexity of project design? And second, did Management mobilize resources commensurate with these risks in supervising the Project?

Management recognized the capacity issue in its design of Component 3, which specifically addresses OPIC’s capacity development. Yet in the fourth year of the Project, neither the RMTF and community development component have been designed, let alone implemented. SADP was flagged in May 2007 by OPCS as a “*high risk project*” owing to “*project complexity*”. Thus the need to keep the Project “*straightforward and simple*”, as recommended for projects in the Pacific Region in the Quality Enhancement Review in 2008, may have been even more applicable for SADP than anticipated. Keeping it simple and focused should not, however, be

understood to mean that risks should not be taken. Indeed, the Panel has applauded Management for trying to set up a permanent and sustainable mechanism for road maintenance, which is critical for continued oil palm cultivation. Nonetheless, a key issue for risk management is to ensure that the burden of risk does not fall on the poor. The Panel is concerned that in the RMTF, as initially conceived, the financial burden and risk fall disproportionately on the smallholders.

While the Panel was uniformly impressed by the caliber of individual staff members who were engaged with the Project, greater capacity is needed to respond to challenges that are certain to arise during project implementation in complex and challenging settings such as in Papua New Guinea.

### ***Lessons Contributing to Follow-Up of the WBG Framework on Engagement in the Oil Palm Sector***

The Request for Inspection was received shortly after the November 2009 World Bank Group moratorium on new oil palm projects. Given that the SADP had already been launched, the moratorium did not apply. Subsequently, in March 2011, the World Bank Board of Executive Directors approved a WBG Framework for Engagement in the Palm Oil Sector.

This investigation brought out three issues for the WBG as it moves forward with the Framework: (i) the implementation capacity of borrower institutions and the Bank's own capacity for implementation support; (ii) recognizing and ensuring diversification as key livelihood strategy for smallholders; (iii) addressing the structural inequalities in the sector, and the relationship between smallholders and mill companies.

# **Chapter 1: The Request for Inspection, Management Response and Investigation Process**

## **A. Organization of the Report**

1. This report presents the Inspection Panel's analysis and findings on issues raised by the Request for Inspection (the "Request") relating to Papua New Guinea: Smallholder Agriculture Development Project (hereinafter "the "Project").
2. The report has seven chapters. This Chapter describes the Project, summarizes the claims of the Requesters and the Response of Bank Management to these claims, and describes the Panel's investigation process and design. Chapter 2 provides a contextual description of the context within which the Project is taking place; Chapter 3 focuses on issues connected to disclosure and consultation and indigenous people; Chapter 4 discusses the fundamental question of whether increased oil palm production results in poverty reduction and livelihood improvements for smallholders; Chapter 5 deals with the environmental harms alleged in the Request; Chapter 6 addresses the concerns raised in the Request about institutional sustainability of the Oil Palm Industry Corporation (OPIC) and the Road Maintenance Trust Fund (RMTF); and Chapter 7 ends with systemic issues noted by the Panel.
3. In line with its mandate, the Panel investigation focuses solely on the issues raised by the Request that relate to allegations of violations of the World Bank's operational policies and procedures, and related harm, linked to the Project.

## **B. Brief Description of the Project**

4. The Project seeks to increase the income and improve livelihoods of smallholders already involved in oil palm production by enabling them to plant additional oil palm through "infilling"<sup>2</sup> on 9,000 hectares,<sup>3</sup> rehabilitating and maintaining rural access roads, and improving local level service provision and infrastructure through community participation. The Project will be implemented in select districts of Oro and West New Britain (WNB) provinces over five years.<sup>4</sup>
5. According to the Financing Agreement, the Project's objective is *"to increase, in a sustainable manner, the level of involvement of targeted communities in their local development through increasing oil palm revenue and local participation."*<sup>5</sup>

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<sup>2</sup> Infilling refers to new blocks of oil palm being planted between established blocks and along existing access roads in the Nucleus Estate and Smallholder Schemes areas.

<sup>3</sup> Of the total 9,000 hectares (ha) of new oil palm being planted, the Project Appraisal Document (PAD) states that 3,500 ha will be at Hoskins, 1,240 ha at Bialla, and 4,000 ha at Oro, thereby increasing oil palm cultivation by 13%, 9%, and 28%, respectively. PAD, p. 28.

<sup>4</sup> Project Appraisal Document (PAD), Report No: 38558-PNG, dated November 19, 2007, p.4, ¶ 14. Management has subsequently informed the Panel that the project areas are Ijivitari and Sohe districts in Oro province and Talasea district in WNB province.

<sup>5</sup> PAD, p. 3, ¶ 11.

6. These objectives are to be achieved through three components:<sup>6</sup>

- **Component 1: Smallholder Productivity Enhancement** (\$18.9 million from the International Development Association (IDA). This component supports: smallholder oil palm development on 9,000 hectares (ha) of vacant land along existing access roads through infilling; upgrading 550 kilometers of existing roads and establishing Road Maintenance Trust Funds<sup>7</sup> (RMTF) in the three Project areas; and providing agricultural extension services through the Oil Palm Industry Corporation (OPIC).
- **Component 2: Local Governance and Community Participation** (\$3 million IDA). This pilot component supports better provision of local services and infrastructure in the two project provinces of Oro and West New Britain through participatory processes (Community-Driven Development).
- **Component 3: Project Management and Institutional Support** (\$5.6 million IDA). This component supports OPIC's efforts to improve overall project management by strengthening its capacity and improving its ability to provide extension services to growers, helping it contract with a management agency to implement Component 2, strengthening the smallholder oil palm sector (growers associations and Papua New Guinea Oil Palm Research Association), and financing studies (Fresh Fruit Bunch<sup>8</sup> price formula review and design of RMTFs) and overseas master courses.

7. According to the Management Response, the Project is “*fully consistent*” with Pillar II of the Papua New Guinea Country Assistance Strategy (CAS) (2008-11) namely, “*Improving livelihoods and service delivery, especially for the rural poor,*”<sup>9</sup> and the government has prioritized oil palm development within its National Agriculture Development Plan, 2007-16.

8. The total Project cost is \$68.8 million, with IDA financing \$ 27.5 million--equivalent to Special Drawing Rights (SDR) 17.7 million. Co-financiers of the Project are the Papua New Guinea Sustainable Development Program (PNG SDP) (\$10.2 million), the Provincial Government of West New Britain province (\$7.2 million), the Provincial Government of Oro province (\$3.5 million), Palm Oil Milling Companies (\$5.7 million), and Smallholders<sup>10</sup> (\$7.3 million).<sup>11</sup>

9. The Management Response states that the Project was first identified in November 2002 but that processing was delayed owing to the suspension and subsequent cancellation of the

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<sup>6</sup> PAD., pp. 4-5.

<sup>7</sup> The Road Maintenance Trust Fund is a user-pay based funding mechanism for road maintenance.

<sup>8</sup> The Fresh Fruit Bunch (FFB) is the primary unit of measure for oil palm sales.

<sup>9</sup> Management Response, p. 6, Footnote 18.

<sup>10</sup> According to the PAD p. 5, the bulk of the smallholder financial contribution for the Project is their share of the proposed Road Maintenance Trust Fund levy.

<sup>11</sup> Management Response -Request for Inspection of the Papua New Guinea: Smallholder Agriculture Development Project (IDA 43740-PNG), February 8, 2010, p. 10, ¶ 30.

Bank-funded Forestry Conservation Project. Project preparation efforts were resumed after the September 2005 World Bank Annual Meetings.<sup>12</sup>

10. The IDA credit was approved on December 18, 2007 and became effective on January 28, 2009. The expected Project Closing Date is December 31, 2012, although this may change subject to the outcome of discussions between Management and the Government of Papua New Guinea regarding Project restructuring and a possible two-year extension.<sup>13</sup> According to the Management Response, the delay in initiating Project activities after Project approval is due to delays in signing the Credit, reaching Project effectiveness, and starting such preparatory activities as procurement and recruitment.
11. The Project Appraisal Document (PAD) states that the Papua New Guinea oil palm sub-sector is based on the nucleus estate system. In this system, there is a well-established relationship among the three entities involved: the private-sector palm-oil milling companies with their own plantations and mills which also provide credit, agricultural inputs, and fruit collection service to the smallholders; the smallholder growers; and OPIC. The Project area has three oil palm Nuclear Estate Schemes: Popondetta in Oro province and Hoskins and Bialla in West New Britain province. All three areas have estate plantations plus Village Oil Palm (VOP) blocks and Land Settlement Scheme (LSS) blocks. VOP blocks are those where growers sign a Customary Land Usage Agreement that gives them secure tenure and usage rights of the land on which they farm two or four hectares of oil palm. LSS blocks are those where migrants from different parts of Papua New Guinea have settled on blocks of approximately six hectares of which some or all is devoted to oil palm.
12. The Project is to be implemented by the OPIC. A Project Steering Committee (PSC) has been established to oversee implementation and provide guidance on policy matters. The Committee is chaired by the Secretary of the Department of National Planning and Monitoring (DNPM) and will consist of representatives from government departments and agencies, including the Departments of Treasury, Agriculture and Livestock, Environment and Conservation, Works, Provincial and Local Government Affairs, Community Development; Provincial Governments, and the Papua New Guinea Sustainable Development Program.

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<sup>12</sup> Management Response, ¶36.

<sup>13</sup> Papua New Guinea: Smallholder Agriculture Development Project (IDA 43740-PNG), Final Aide Memoire, Fifth Implementation Support Mission: April 15-19, 2011, ¶34.



**Picture 1: Oil Palm Fresh Fruit Bunch (FFB) ready for collection**

### **C. Events Leading to the Investigation**

13. On December 8, 2009, the Inspection Panel received a Request for Inspection<sup>14</sup> related to the Papua New Guinea: Smallholder Agriculture Development Project financed by the IDA.<sup>15</sup> The Request was submitted by the Ahora/Kakandetta Pressure Group, affected customary land owners from Oro province and smallholders in one of the three Project areas (the “Requesters”). The Requesters asked that their identities be kept confidential and that the Center for Environmental Law and Community Rights (CELCOR), a non-governmental organization (NGO) from Papua New Guinea, act as their designated representative. The Requesters state they have suffered, and are likely to suffer, serious harm from the Project’s design and implementation.
14. The Panel registered the Request on December 17, 2009. Management received an extension from the Board of Executive Directors and submitted its response (the “Management Response”) on February 8, 2010.
15. On March 10, 2010, the Panel submitted its Report and Recommendation<sup>16</sup> to the Executive Directors. In the report, the Panel recommended an investigation of matters raised by the Request for Inspection. On March 25, 2010, the Board approved, on a non-objection basis, the Panel’s recommendation to conduct an investigation into the matters alleged in the Request for Inspection.
16. This Investigation Report presents the Inspection Panel’s findings and conclusions in response to the Request.

<sup>14</sup> Request for Inspection, December 17, 2009.

<sup>15</sup> For the purpose of this Report, IDA is sometimes referred to as “the Bank.”

<sup>16</sup> Inspection Panel Report and Recommendation, Papua New Guinea – Smallholder Agriculture Development Project, March 10, 2010, p. 19, ¶80.



Picture 2: A village in Oro province

#### D. The Request for Inspection

17. The Requesters believe that the Bank has failed to comply with several of its Operational Policies and Procedures in the design, appraisal and implementation of the Project and has caused or is likely to cause harm to their community. The following paragraphs briefly summarize the Request for Inspection.
18. According to the Request, the Project was identified in 2003 as a follow-up to the previous World Bank-financed Papua New Guinea: Oro Smallholder Oil Palm Development Project (1992-2001). However, the Project was put "*on hold*" and preparation did not begin until 2006. The Requesters believe that the Project concept was revised during this period from an oil palm expansion project to an "*infilling*" and road maintenance project.
19. The Requesters identify an overarching concern with oil palm development, which in their opinion is that oil palm production does not reduce poverty of smallholders. They claim the project will "*limit their economic opportunities and essentially force them to produce oil palm even though they feel that participation in oil farming has not and will likely not increase their standard of living.*"<sup>17</sup> Moreover, they state that other negative impacts of oil palm production are rarely disclosed to smallholders, including: land clearance and associated loss of forestland, which has important implications including for erosion, topsoil depletion, and siltation of rivers; and chemical and biological pollution of waterways.
20. According to the Requesters, the credit facility under the first component of the Project, which will give loans to smallholders wanting to plant oil palm adjacent to existing access roads that have no oil palm development (known as '*infilling*'), is a "*deceptive term*" and the Project actually is an "*expansion project.*" They add that the Project has identified approximately 9,000 hectares of "*vacant*" land for new planting, rather than promoting more productivity on existing blocks.
21. In particular, the Requesters identify the following sets of harm or potential harm, which they claim the Project causes:

<sup>17</sup> Request for Inspection, p.2., available at [www.inspectionpanel.org](http://www.inspectionpanel.org).

22. **Information Disclosure, Consultation and Community Support.** The Requesters state that *"World Bank and project sponsor have not consulted with claimants and other locally affected communities"* and *"[p]roject information was not broadly disseminated prior to project approval and is still not available, nor was it ever delivered in any language other than English."*<sup>18</sup> The lack of disclosure of information and consultations in the Project area before Project approval is described by the Requesters as *"one of their major concerns."* The Requesters add that despite the fact that they are Indigenous People and customary landowners, the World Bank did not give them the opportunity to have input into the *"scope, purpose and activities"* of the Project, or discuss with them the *"additional road levy that will be imposed on them"* under the Project. The Requesters believe consultations may have led to proposals about alternative sources of revenue generation and negotiations on the *"user fee."* The Requesters state that despite their requests, they have not been provided records of the consultations, which the Bank claims to have conducted during the design phase. This *"lack of transparent consultation records calls into question whether there has been achievement of broad community support"* for the Project, leading the Requesters to conclude that any consultations undertaken were *"limited"* and *"did not allow for informed participation."*<sup>19</sup>
23. **Poverty and Livelihood Impacts.** The Requesters state that *"despite the significant level of investment"* by the World Bank in the oil palm industry over the years, these investments *"have done little to provide material improvement in smallholders' lives."*<sup>20</sup> They point to the Social Assessment<sup>21</sup> conducted under the Project, which states that *"living conditions have deteriorated and key indicators of poverty such as housing, access to clean water and health services show life quality has declined."*<sup>22</sup> The Requesters add that the Social Assessment *"recognizes that the fall in living standards is paradoxical"*<sup>23</sup> as the cash income of oil palm smallholders is considerably higher than that of other cash-crop-producing smallholders.
24. The Requesters claim that under the Project, farmers will be unable to *"enhance their living standards"*<sup>24</sup> given their *"dependent relationship"*<sup>25</sup> and revenue-sharing arrangement with the estate mill. They also maintain that the Project will *"reinforce"* the Fresh Fruit Bunch (FFB) pricing system, which, in their view, favors the milling companies over smallholders. The Requesters also believe that promoting oil palm as the *"single primary income generating activity for Indigenous Peoples in the three project areas"* leads to monocropping, which *"is in direct contradiction with the World Bank's own assessments on the importance of income diversification in the smallholder areas"*<sup>26</sup> and prevents smallholders from using their land for supplemental income-generating activities.

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<sup>18</sup> Request for Inspection, p. 2.

<sup>19</sup> Ibid, pp. 6-7.

<sup>20</sup> Ibid, p. 5.

<sup>21</sup> Curry, G.N., Koczberski, G., Omuru, E., Duigu, J., Yala, C., and Imbun, B. Social Assessment Report for the Smallholder Agriculture Development Project (SADP), Papua New Guinea, 2007.

<sup>22</sup> Request for Inspection, p. 5.

<sup>23</sup> Ibid, p.5

<sup>24</sup> Ibid, p.5.

<sup>25</sup> Ibid, p.5.

<sup>26</sup> Ibid, p. 6.

Moreover, they state that on top of the multiple levies smallholders must pay to produce oil palm, they will have to pay an *"additional levy to support the Road Maintenance Trust Fund"*<sup>27</sup> set up under the Project. Thus, in their view, by *"embedding"* these dependent relationships and raising levies, the Project will not enable smallholders to *"lift themselves out of poverty."*<sup>28</sup>

25. **Environmental Impacts.** The Requesters state that the *"environmental assessments conducted are particularly poor and miss critical impacts,"*<sup>29</sup> such as the impact of increased effluent discharge from the mills on rivers, fish, and people. They believe the Environmental Assessment<sup>30</sup> has *"major gaps"* as it does not use reliable data, does not assess effluent treatment, and does not provide mitigation measures for Project impacts on high-value forests.
26. With regard to high-value forests, the Requesters believe the Project poses a risk of deforestation in high-value forests because of the use of a *"site sensitivity survey"* by OPIC that seeks to guide OPIC officers to classify forest land suitable for oil palm planting, and the setting of internal oil palm planting targets. The Requesters state that their forests *"provide economic and social services for local communities including household gardens."*<sup>31</sup> They believe deforestation will occur because *"OPIC officers lack the capacity to classify forests"*<sup>32</sup> correctly, according to the site survey criteria, and because of an incentive system that evaluates them according to how much oil palm is planted. The Requesters propose a number of measures to prevent deforestation, including undertaking a high-value forest inventory before new planting begins.
27. **Institutional Sustainability.** The Requesters raise concerns about the sustainability of the Road Maintenance Trust Fund (RMTF) and the institutional capacity of OPIC, which according to them are the *"two key features of the project."* They believe both features are poorly designed and will not be maintained once the Project ends. The Requesters state that roads in the Project area are already degraded, and that roads built in the Province by the previous World Bank Oro Smallholder Oil Palm Development Project (1992-2001) are in poor condition. In their view, the roads to be constructed under the Project will not be sustainable because of the unreliability of the required financial contributions from provincial governments and from the oil palm industry. The Requesters argue that another issue likely to hamper sustainability is the limited capacity of OPIC and a skewed extension officer-grower ratio, which will prevent the delivery of effective extension services, making the Project unviable.
28. Moreover, the Requesters add that Papua New Guinea taxpayers will effectively be paying for the same roads thrice, by paying for the roads built by the previous World Bank project, then for this Project, and finally by paying user fees. The Request states that under the

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<sup>27</sup> Request for Inspection.p.5.

<sup>28</sup> Ibid, pp. 5-6.

<sup>29</sup> Ibid, p. 9.

<sup>30</sup> Douglas Environmental Services. Environmental Assessment, Smallholder Agriculture Development Project, 2007, OPIC.

<sup>31</sup> Request for Inspection, p. 3.

<sup>32</sup> Ibid, pp. 9, 10.

previous World Bank Oro Smallholder Oil Palm Development Project (1992-2001), *"approximately 180 km of roads were not constructed and many smallholders were left without road access."*<sup>33</sup> The Request also cites an emergency AusAID fund, mobilized to construct the *"left over"* roads from the Oro project. They claim that the Project will upgrade the same AusAID-funded roads with over 100 kilometers undergoing minor reconstruction.

29. In sum, the Requesters claim that the Project *"violates"* several World Bank policies and will: limit their economic opportunities and pressure them to produce oil palm even though they believe oil palm farming will not raise their standard of living; cause water pollution; degrade forests; be unsustainable and ineffective; and cause additional economic hardship by requiring growers to pay for road maintenance fees.
30. The Requesters note that they have raised their concerns with the World Bank on a number of occasions, and provide a list of correspondence to demonstrate this, but state they *"have not received any satisfactory response on how the project will ensure that the potential harms listed above will be prevented."*<sup>34</sup>
31. Moreover, the Requesters asked that the Project be put on hold until: *"(a) poverty reduction is incorporated into the project design; (b) other economic livelihood options are presented; (c) a comprehensive environmental assessment is undertaken, including assessment of effluent treatment and forest inventory; (d) the project design is changed to ensure project sustainability; and (e) proper consultation is undertaken to ensure communities give their free, prior, and informed consent to all components of the project."*<sup>35</sup>



Picture 3: A village in West New Britain province

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<sup>33</sup> Request for Inspection, p. 11.

<sup>34</sup> Ibid, p. 2.

<sup>35</sup> Ibid, p. 17.

## E. Management Response and Bank Actions

32. On February 8, 2010, Management submitted its Response to the Request for Inspection.<sup>36</sup> The Response addresses the key issues raised by the Requesters and includes four annexes and three maps. The Management Response is summarized below.
33. The Management Response states that the World Bank has been involved with oil palm projects in Papua New Guinea since 1969 when the first Bank-financed oil palm project went into effect. The Bank has financed four oil palm projects prior to the SADP.<sup>37</sup> Management notes that when the World Bank re-engaged with Papua New Guinea in 2005, following a two-year hiatus owing to the suspension of the Papua New Guinea Forestry and Conservation Project (2001),<sup>38</sup> oil palm was identified as the best vehicle to improve rural livelihoods. To avoid adverse environmental impacts associated with new oil palm development, the World Bank decided to focus on smallholders in existing oil palm areas by raising their productivity and improving their access to the mill companies and local-level services through the rehabilitation of rural roads. Management highlights that the Papua New Guinea oil palm industry contributes significantly to the improvement of rural livelihoods, brings favorable returns to smallholders relative to other cash crops, and is the second highest employer in the country after the public sector.<sup>39</sup> Moreover, palm oil (the oil derived from the fruit of the oil palm tree) is the dominant contributor to Papua New Guinea's economy, having experienced steady growth over the past three decades and rapid acceleration in the past five years. However, Management states that despite its contribution to the national economy, the Papua New Guinea oil palm sector is small in global terms, at 1% of global output.



Picture 4: Aerial view of oil palm blocks in West New Britain province

<sup>36</sup> Management Response -Request for Inspection of the PNG: Smallholder Agriculture Development Project (IDA Credit No. 4374-PNG), February 8, 2010. Available at [www.inspectionpanel.org](http://www.inspectionpanel.org)

<sup>37</sup> These are New Britain Smallholder Development Project 1969-73 (Phase 1) and 1970-76 (Phase 2); Popondetta Smallholder Oil Palm Development Project (1976-84); Nucleus Estate and Smallholder (Milne Bay) Project (1985-92); and, Oro Smallholder Development Project (1992-2001).

<sup>38</sup> Management Response, ¶36.

<sup>39</sup> The Management Response states that oil palm smallholders earn K2,793/ha and K130/day worked, compared with other cash crops such as cocoa (K1,136/ha and K21/day worked) and coffee (K2,058/ha and K13/day worked). Management Response, Executive Summary, p. vii.

34. **World Bank Group Moratorium.** Management also notes that the World Bank Group<sup>40</sup> moratorium on oil palm announced in November 2009 does not apply to SADP as the Project was already effective at this time and "*...its design is meant to address the multiple social and environmental concerns that have been raised with regards to the sector at large.*"<sup>41</sup> But Management believes that the Project can be reviewed and changes made in light of the outcomes of the proposed new comprehensive oil palm strategy for the World Bank Group. This strategy, "*The World Bank Group Framework and IFC Strategy for Engagement in the Palm Oil Sector,*" was finalized and publicly released in March 2011.<sup>42</sup>
35. Management states that the SADP supports the Government of Papua New Guinea's Medium-Term Development Strategy (2005-2010) and it incorporates lessons drawn from the Bank's long association with the oil palm subsector, especially from the Oro Smallholder Oil Palm Development Project, which closed in 2001.<sup>43</sup> Though implementation delays have pushed back the commencement of main Project activities, the Project did extend emergency road reconstruction assistance in the wake of Cyclone Guba, which hit Oro Province in 2007.
36. **Project Risk.** Management acknowledges that the Project was considered to be ambitious and a "*high-risk undertaking*"<sup>44</sup> at appraisal because it sought to address the issue of poorly maintained agricultural access roads by introducing the RMTF and because of the weak institutional capacity of Project counterparts. However, Management believes several conditions of effectiveness have been put in place to ensure these issues are addressed. Moreover, a 2008 Quality Assurance Group (QAG) review concluded that the SADP was an "*essential*" and "*appropriate*" operation for Papua New Guinea, though it also stated that the preparation process, driven by the window of opportunity to resume lending, was rushed and would have "*benefited from a more complete preparation of the arrangements for the operation of the RMTFs and finalization of the Terms of Reference (TOR) for the consultancies under the Project.*"<sup>45</sup>
37. **Project Status.** Management states that two years after Board approval "*...key Project activities including road reconstruction and maintenance, infill planting and provision of local services and infrastructure through CDD have not commenced, and are only expected to start around the third quarter of 2010.*"<sup>46</sup> However, Management believes substantial progress has been made in the "*Oro emergency road repair program, infilling component, mobilization of Project funds, and preparatory arrangements for OPIC capacity building.*"<sup>47</sup> Management acknowledges that the PAD "*failed to identify the risk of slow*

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<sup>40</sup> For the purpose of this Report, World Bank Group is the International Development Association (IDA), the International Bank for Reconstruction and Development (IBRD), the International Finance Corporation (IFC), and the Multilateral Investment Guarantee Agency (MIGA).

<sup>41</sup> Management Response, Executive Summary, p. vii.

<sup>42</sup> World Bank, WBG Oil Palm Framework and IFC Strategy for Engagement in the Palm Oil Sector, March 31, 2011.

<sup>43</sup> Management Response, p. 8, ¶ 26.

<sup>44</sup> Ibid., ¶32.

<sup>45</sup> Ibid, p. 12, ¶ 35.

<sup>46</sup> Ibid., p. 11, ¶ 34 .

<sup>47</sup> Ibid, p. 14, ¶ 41.

*implementation start-up including the time needed to establish OPIC's project management capacity.”<sup>48</sup>*

38. **Poverty Reduction.** Management believes that World Bank investment in the oil palm sector in Papua New Guinea has had an overall positive impact and that the Project will continue to provide such benefits in an environmentally and socially sustainable manner. Management states that the industry provides significant employment and *"oil palm currently provides smallholders with higher returns to their land and labor than most other agricultural commodities, and contributes substantially to household incomes.”<sup>49</sup>* In Management's view, the annual income of a Village Oil Palm (VOP) grower of about kina (K) 5,586 from a two-hectare block compares favorably with the annual income of a full-time minimum wage worker who earns about K3,200 at the prevailing minimum wage. Management notes that oil palm is less labor intensive relative to other crops (43 days a year for a two-hectare block) and provides a guaranteed income with a fortnightly harvest.<sup>50</sup> Management agrees that income diversification is an important consideration and states that existing data suggest VOP households in the Project area, as opposed to land-constrained LSS households, already have diverse income sources that the Project will support through improved roads and Component 2, which finances small-scale, community-level economic infrastructure, livelihood activities, training, and technical assistance.
39. Management believes the paradox of high cash incomes and low standards of living is a national phenomenon and not confined to oil palm producers or the Project area per se. Management attributes this phenomenon mainly to high consumption, low savings, and social obligations that require households to share their income with extended family and friends. This, coupled with the *"mixed performance"* of government service delivery in rural areas, further worsens the situation. Moreover, population density in LSS households--with up to three generations of extended families living off the same LSS block in some areas and rotating the oil palm harvest among themselves--makes them particularly dependent on diverse sources of income and subsistence food production.
40. According to Management, the established relationship of oil palm growers with the mill company facilitates easier access to credit and farm inputs than any other cash crop. Loan repayments and deductions for farm inputs are made by the mill company at the time payment is made to individual growers, effectively guaranteeing repayment. Management emphasizes, however, that the availability of credit does not imply smallholders will be forced into growing oil palm as the infilling activity is purely voluntary provided certain environmental criteria are met. Furthermore, Management believes the strengthening of the existing Mama Lus Frut Scheme (MLFS)<sup>51</sup> will have an overall positive impact on women in particular, and on the household in general.

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<sup>48</sup> Ibid., p. 11, ¶ 34.

<sup>49</sup> Management states the returns to oil palm at current prices are about K2,793/ha and K130/day worked, compared with about K1, 136/ha and K21/day worked for cocoa and K2,058/ha and K13/day worked for coffee. Management Response, p. 17, ¶ 47.

<sup>50</sup> Management Response, p. 17, ¶ 47.

<sup>51</sup> The Mama Lus Frut Scheme (MLFS) was introduced by NBPOL in the Hoskins area and is aimed at women in smallholder areas; 85% of women in all three SADP Project areas have their own harvesting card. Collecting loose

41. Management also believes investment in rural access roads will have an overall positive impact by improving access to such services as health and education. Moreover, Component 2 of the Project will enable communities to undertake investments through a participatory approach. In Management's view, this too will have a positive impact on welfare and living standards in the Project areas.
42. **Fresh Fruit Bunch (FFB) Pricing Formula.** Management explains that the FFB *"...pricing formula is based on an assessment of the relative costs of production of smallholders and milling companies. The payout ratio is calculated as the ratio of the industry average smallholder cost of production per ton of FFB (from the field to the mill gate) to the total industry average cost of production (from the field to saleable palm products ready to ship at the wharf)."*<sup>52</sup> According to Management, the FFB formula has been always been a contentious issue between the smallholders and the milling companies. The formula is periodically reviewed, most recently in 2001 by independent experts under the World Bank-financed Oro Smallholder Development Project (1992-2001). The FFB price is calculated monthly and all mill companies follow it. The farm-gate price paid to smallholders is derived from the mill-gate price by deducting the FFB transport costs and the various levies (Papua New Guinea Oil Palm Research Association levy, the OPIC levy, FFB transport costs, the Sexava levy<sup>53</sup>).<sup>54</sup>
43. Management agrees that the FFB price formula setting should involve all stakeholders and states that the pricing formula will be reviewed under the Project given the likelihood of changes in the industry cost structure since the 2001 Review. Management expects this review to be conducted in mid-2010 and anticipates it *"...will update and revise the methodology and assumptions used in calculating prices and shares between the smallholders and the mills."*<sup>55</sup>
44. **Road Maintenance Trust Fund (RMTF):** Management explains that the *"RMTF is a mechanism aimed at guaranteeing the funding of smallholder access road maintenance, through contributions from end-users of the network, including smallholders, milling companies and the Provincial Governments that represent the general population using and benefiting from the access roads."*<sup>56</sup> Management believes improved roads will reduce costs of production because of lower transportation costs and enable better access to social services, thereby helping reduce poverty. The RMTF levy, as other levies, will be deducted from smallholders. Management states that *"While the principle of sharing the costs of road maintenance between the Provincial Governments (50 percent), the milling companies (25 percent) and the smallholders (25 percent) constitutes the basis of the understanding reached with the three parties as well as GoPNG, other im-portant aspects, such as the RMTFs' governance, financial management and operational arrangements,*

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fruit is considered women's work, but as women would not receive money from it, they preferred growing and selling vegetables. The MLFS provides women with harvest nets and a payment card known as the "mama card" that records their sales proceeds and deductions. Women now have an alternate source of income through the MLFS.

<sup>52</sup> Management Response, p. 21, ¶ 61.

<sup>53</sup> The Sexava Hopper is an oil palm pest whose spread is controlled through a centralized effort by mill companies.

<sup>54</sup> Management Response, ¶63.

<sup>55</sup> Ibid, p. 22, ¶ 64.

<sup>56</sup> Ibid, Annex 1, p. 66.

*and the level of the smallholder road levy, are still to be designed in detail discussed and agreed with all stakeholders".*<sup>57</sup>

45. Management states that "[a]lthough smallholders will face higher costs due to the road maintenance levy; the economic and financial analysis for the SADP indicates that the benefits accruing from the improved roads will outweigh the additional incremental cost."<sup>58</sup> Management also states that the PAD describes the general principles pertaining to RMTFs, but its design has not yet been finalized as seen in the Financing Agreement's Schedule 1, which refers only to supporting *"the design of Road Maintenance Trust Funds."*<sup>59</sup> Management reiterates that the RMTF mechanism is in draft form, and that the *"level of the smallholder road levy"* and the final RMTF levy amount will be calculated and agreed upon through a detailed consultative study<sup>60</sup> once road maintenance work starts. Management expects this study to commence in mid-2010.



Picture 5: Oil Palm Block with mature trees

46. **Free Prior and Informed Consultations and Broad Community Support (BCS):** Management believes *"...free, prior and informed consultations resulting in broad community support for the Project were undertaken during Project preparation."*<sup>61</sup> Management states that a vast majority of the population living in the Project area is considered indigenous, as per Bank policy, and the Government of Papua New Guinea undertook a Social Assessment and other necessary steps to ensure free, prior, and informed consultations resulting in broad community support at all major stages of Project development. The Social Assessment, led by a team of consultants fluent in Tok Pisin, began in June 2006 and, in Management's view, numerous consultations involving a wide range of stakeholders were conducted in the three Project areas and in Port Moresby. Management states more than 550 individuals were consulted through focus-group discussions and one-on-one meetings and were informed about the Project verbally (following local tradition), with no documentation provided. Management believes there was, and continues to be, strong support in the Project area for the Project as documented

<sup>57</sup> Management Response., p. 30, ¶ 96.

<sup>58</sup> Ibid., p. 23, ¶ 66..

<sup>59</sup> Ibid, Footnote 25, p. 8.

<sup>60</sup> Ibid., p. 30, ¶ 96.

<sup>61</sup> Ibid, p. 23, ¶ 68.

in the Social Assessment and Beneficiaries Assessment. Though Management believes the findings of the consultation process were properly documented, it *"recognizes that documentation of the consultation process in the Social Assessment should have been more detailed and complete. The documents should have elaborated further on several aspects of the consultation process including specifying what information was provided on the Project, how the information was conveyed, and how locations and participants were selected."*<sup>62</sup>

47. Furthermore, Management *"strongly believes that broad community support for the Project exists in the three oil palm growing areas targeted under the Project and that the Project design reflects the concerns of the beneficiaries."*<sup>63</sup> Management notes that the requirements under OP 4.10 regarding *"broad community support"* and *"free, prior and informed consultations"* are *"not meant to require unanimity of views or to condition a Bank project on the receipt of consent from all affected individuals or groups."*<sup>64</sup>
48. **Information Disclosure:** Management states that the *"Social Assessment, the EA, and related documentation were publicly disclosed"* in English in Port Moresby at the Papua New Guinea Public Information Center (PIC) and in Washington at the World Bank's InfoShop on February 22, 2007. Management believes the disclosure of information practiced under the Project was *"fully consistent with the Bank's Policy on Disclosure of Information."*<sup>65</sup>
49. **Project Sustainability:** Management agrees project sustainability is a priority and that road maintenance leading to reliable FFB collection is central to ensuring smallholders translate their harvest into cash income and better access to social services. Management highlights the difficult task of road maintenance in a high-rainfall climate and believes *"it is the absence of an effective institutional arrangement for emergency and routine maintenance of the road network used by smallholder oil palm growers that is at the heart of the current situation."*<sup>66</sup> Moreover, drawing lessons from the previous Oro Project (1992-2001), Management states that *"even the programming of funds for maintenance into provincial budgets is no guarantee that such maintenance will actually take place"*<sup>67</sup> and that clear contract management mechanisms need to be in place. In Management's view, the Project remedies this situation with the RMTFs, which will operate under the principles of cost sharing and participatory management. Furthermore, the creation of a Road Engineering Unit under the Project and the expansion of OPIC's infrastructure department will, in Management's opinion, curtail the risk of insufficient road maintenance.
50. Management also states that *"PNG taxpayers did not pay for 150 kilometers of roads that were not completed under the previous Oro project, so they will not be paying multiple times for these roads when they are completed."*<sup>68</sup> According to Management, this is because only 79% of the funds allocated for rural roads and 2% of funds allocated for main

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<sup>62</sup> Management Response, p. 27. ¶ 83.

<sup>63</sup> Ibid., p. 31, ¶ 99.

<sup>64</sup> Ibid., p. 32, ¶ 101.

<sup>65</sup> Ibid., p. 33, ¶ 105.

<sup>66</sup> Ibid., p. 34, ¶ 110.

<sup>67</sup> Ibid.

<sup>68</sup> Management Response., p. 35, ¶ 113.

roads were actually spent. Also, some of the roads financed by the Oro Smallholder Project have been repaired using funds from the Australian Government's Overseas Aid Program (AusAID) and the remaining 105 kilometers will be reconstructed using grant money from the Papua New Guinea Sustainable Development Program (PNGSDP) (75 km) and IDA funds (30 km).

51. Management states the PAD acknowledged that OPIC capacity needed improvement and money is provided under the Project to address this issue. OPIC will hire an *"extension consultant"* to develop an approach to working with smallholders so as to address constraints to smallholder welfare and productivity. Moreover, *"improved smallholder productivity will also contribute to OPIC's financial sustainability"*<sup>69</sup> as *"an overall increase in smallholder production through more accessible roads, improved extension services, infilling and yield increases"*<sup>70</sup> will increase the associated OPIC levy of K4/FFB (four Kina per IMT FFB per farmer).
52. Furthermore, Management states that OPIC does not have a policy of rewarding or penalizing staff for planting new oil palm blocks and that it does not have a target-based staff evaluation system. Management believes that the only measure that could be called a target is OPIC's responsibility, based on estimates, to ensure seedlings (which have to be planted a year in advance) are available for smallholders wishing to plant them.
53. **Environmental Impacts:** Management states that consultations were carried out in the Project areas and in Port Moresby as part of the environmental assessment process. Apart from smallholders, other civil society actors and local government authorities were also consulted. Nonetheless, *"Management acknowledges that the requirements of OP 4.01 were not fully met, in that the only information shared with stakeholders during consultations for the EA was in verbal form"*<sup>71</sup> and that further consultations will occur as part of upcoming Project activities.
54. Management agrees that *"there was insufficient detail in the EA on the matter of effluents"*<sup>72</sup> and that *"In addition to monitoring of milling company ISO 14001 and RPSO certification, a thorough analysis of the impact of increased effluents due to Project activities will be undertaken."*<sup>73</sup> The Management Response explains that the *"ISO 14001 is an international standard for environmental management and a framework for lessening a company's footprint on the environment."* Management explains further that the Roundtable on Sustainable Palm Oil (RSPO) *"is a global coalition of industry, NGOs, financial institutions, environmental and conservation groups, retailers and consumer product companies that have come together since 2004 to develop a structured way forward for the production and use of sustainable oil palm."*<sup>74</sup> And though the Environmental Assessment (EA), the Environmental Management Plan (EMP) and the Environmental and Social

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<sup>69</sup> Ibid., ¶ 114.

<sup>70</sup> Ibid., footnote 62, p. 35.

<sup>71</sup> Ibid., p. 28, ¶ 85.

<sup>72</sup> Ibid., p. 36, ¶ 117.

<sup>73</sup> Ibid.

<sup>74</sup> Management Response, p. 7, ¶ 23.

Management Framework (ESMF) identify potential environmental impacts of the Project and include appropriate and effective mitigation strategies, in light of the Request, Management *"agrees that a more comprehensive analysis of the impacts of increased production at the oil palm mills and effluents should have been undertaken in accordance with the requirements of OP/BP 4.01."*<sup>75</sup>

55. With regard to High-Conservation Value Forest (HCVF), Management believes *"the Project's design includes adequate measures to minimize and manage risks of deforestation of areas of high-conservation value."*<sup>76</sup> Moreover, Management states that *"[n]o significant conversion or degradation of critical forest areas or related critical natural habitats is planned under the Project."*<sup>77</sup> Management stresses that screening processes already in place in both Components 1 and 2, and the proposed forest and wildlife mapping, will ensure against negative environmental impact on forests or on regenerating forests. Also, OPIC extension officers are trained in identifying HCVF, three new Environment Officers will be recruited, and further training will be provided under the Project. Management believes that the lack of a forest inventory does not violate BP 4.36 (Forests) as paragraph 4 of the Policy refers to an inventory of critical forest areas and not to a forest inventory. Finally, in the absence of an oil palm code of practice, the Papua New Guinea logging code of practice and national environmental laws will also be followed.<sup>78</sup>
56. Management observes that some inconsistencies in describing the division of labor between the various OPIC officers were identified during the preparation of the Management Response, and these will be addressed.
57. **Management Response and Actions:** Though Management believes diligent efforts were made to apply its policies and procedures and that the Requesters' rights or interests have not been adversely affected, it did acknowledge several areas for improvement.<sup>79</sup> These are the translation of key Project documents into Tok Pisin, routine translation of Project documents, as well as communication about the Project through OPIC radio programs; commissioning a study on effluent emissions; acknowledging that documentation of the social assessment process could have been more detailed and complete; removing inconsistencies between various Project documents; coordinating between OPIC land and environment officers on planting approval forms; strengthening the consultation process, especially for Component 2, the design of the RMTF, FFB pricing formula review; re-examining provisions in the Road Reconstruction Sub-Manual, the Environmental Management Plan, and the Resettlement Policy Framework given that IDA will be financing some of the incomplete roads in Oro province that were previously to be financed by Papua New Guinea SDP; making adequate provisions for the independent social and environmental audits; and strengthening the grievance mechanisms under the Project.

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<sup>75</sup> Ibid.

<sup>76</sup> Ibid., p. 7, ¶ 23.

<sup>77</sup> Ibid., p. 37, ¶ 124.

<sup>78</sup> Ibid., p. 38, ¶ 125.

<sup>79</sup> Ibid., pp. 39-41, ¶ 129-130.

## **F. Eligibility of the Request and Board Decision**

58. As established in its founding Resolution,<sup>80</sup> the Panel determined whether the Request for Inspection met the eligibility criteria set forth in the Resolution and in its subsequent 1999 Clarification.<sup>81</sup> To do so, the Panel reviewed the Request and Management's Response and visited the Project area.
59. Panel Member Eimi Watanabe, together with Deputy Executive Secretary Dilek Barlas and Operations Officer Mishka Zaman, visited Papua New Guinea during February 16-20, 2010. During its visit, the Panel team met with CELCOR, government officials, Bank staff, and OPIC representatives. The Panel team also visited Popondetta in Oro province, where the Requesters live, and met with the signatories of the Request for Inspection and other oil palm smallholders. The Panel team also met with a representative of the local administration in Popondetta, the representatives of the OPIC field office, and representatives of the Popondetta Oil Palm Growers Association (POPGA). The Panel team wishes to express its appreciation to everyone mentioned above for sharing their views and exchanging information and insights with the Panel.
60. On March 10, 2010, the Panel submitted its Report and Recommendation<sup>82</sup> to the Executive Directors in which the Panel recommended an investigation of matters raised by the Request for Inspection.
61. On March 25, 2010, the Board approved, on a no-objection basis, the Panel's recommendation to conduct an investigation into the matters alleged in the Request for Inspection. The Request, Management Response, and the Panel's Report and Recommendation were made public shortly after the Board approval.

## **G. The Investigation Process and Key Questions**

62. The purpose of the investigation was to establish whether the World Bank complied with its own policies and procedures in the design, appraisal, and implementation of the Project, and if instances of non-compliance were found, whether they caused, or were likely to cause, harm to the Requesters. Panel Member Eimi Watanabe served as the Lead Inspector for the Panel's investigation.
63. The Panel conducted a two-part investigation. The first part involved detailed research into Bank records related to the Project, interviews with Bank staff in Washington, D.C. and Sydney, and a review of relevant documents. The second part took the form of an in-country fact finding visit. To assist in the investigation, the Panel retained four internationally-recognized expert consultants: Dr. Donald Gilmour, who specializes in forestry; Professor Lesley Potter, who specializes in human geography and has extensive

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<sup>80</sup> International Bank for Reconstruction and Development (IBRD), Resolution No. IBRD 93-10, September 22, 1993 (the "1993 Resolution").

<sup>81</sup> Second Review of the Resolution Establishing the Inspection Panel (1999 Clarification).

<sup>82</sup> Inspection Panel Request for Inspection, Papua New Guinea – Smallholder Agriculture Development Project, Report and Recommendation, March 10, 2010.

experience in researching oil palm smallholders; Mr. Bruce Carrad, an economist; and Dr. Paul Michael Taylor, an anthropologist. (See Annex 4 for Biographies of the Expert Consultants.)

64. Panel Member Eimi Watanabe, Operations Officer Mishka Zaman, and the expert consultants<sup>83</sup> visited Papua New Guinea during October 1-10, 2010. During the visit, the Panel team met with the Requesters, Government authorities, OPIC officials, Papua New Guinea Oil Palm Research Association's (PNG OPRA) Chief Executive, and Bank staff in Port Moresby and Sydney. The Panel team also visited Project areas in West New Britain and Oro provinces and met with the representatives of growers associations, oil palm mill company executives, local government officials, local OPIC staff, local NGOs, and smallholders in general.
65. In its investigation, the Panel identified and carefully reviewed all documents relevant to the case that the Requesters, Bank staff, and other sources provided to the Panel. The Panel also analyzed other evidence gathered during the field visits or otherwise in its research, including scholarly literature.
66. The Panel would like to note that though the Project covers three areas in the two provinces of Oro and WNB, the investigation focused primarily on the Project area in Oro province, as the Requesters are from Oro province. The Panel team did however visit the Hoskins Project area in WNB province so as to get a better understanding of the Project, and has included observations regarding its perceptions of the differences and similarities between the two Project areas in this Report.
67. Also, the Panel's investigation did not examine issues relating to LSS smallholders. This is because only VOP smallholders are eligible for in-filling under the Project. However, the Panel notes with concern the difficulties facing the LSS smallholders, especially due to greater population growth, limited land availability and insecurity of land tenure, as elaborated in the Social Assessment.
68. **Applicable operational policies and procedures.** With respect to this Project, the Panel assessed whether the Bank complied with the following Operational Policies and Procedures:

*OP 1.00* Poverty Reduction  
*OP/BP 4.01* Environmental Assessment  
*OP/BP 4.10* Indigenous Peoples  
*OP/BP 4.36* Forests  
*OP/BP 4.04* Natural Habitats  
*OP/BP 10.00* Investment Lending  
*OP/BP 13.05* Project Supervision  
*OMS 2.20* Project Appraisal

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<sup>83</sup> Dr. Taylor did not participate in the field visit and Mr. Carrad participated in only part of the visit.

69. **Key Questions for the Investigation.** As noted earlier, the focus of the Panel's investigation has been on establishing whether the Bank complied with its policies and procedures in the design, appraisal, and implementation of the Project, and if instances of noncompliance were found, whether they caused, or were likely to cause, harm or potential harm alleged by the Requesters.
70. Given that as of the date of this Report, implementation of SADP activities on the ground is still limited, much of the harm claimed by the Requesters relates to the consequences of smallholder oil palm production during the past decades, with or without World Bank involvement, and Requesters' fear that such harm may continue to emanate from the SADP. The Panel's analysis of compliance therefore focuses mainly on measures taken by Management in the design, appraisal, and implementation of the Project in the context of World Bank policies and procedures.
71. Key issues of compliance and related harm, analyzed in detail in Chapters 3, 4, 5, and 6, include:
- **Information Disclosure, Consultation, and Community Support:** Was there free, prior, and informed consultation resulting in broad community support by the affected indigenous oil palm smallholders for the Project? Does the Project provide social and economic benefits that are culturally appropriate and gender- and inter-generationally-inclusive to indigenous oil palm smallholders?
  - **Poverty and Livelihood Impacts:** Does the Project as designed and implemented provide economic benefits to indigenous oil palm smallholders? If the choice of palm oil was appropriate, was the Project design appropriate and adequate for ensuring sustainable improvement in living standards and livelihoods of smallholders? Did the Bank conduct adequate analysis on profitability and sustainability of oil palm for the smallholders? Does the Project design provide for adequate alternative livelihood choices for smallholders consistent with the Bank Policy on Indigenous Peoples?
  - **Environmental Impacts:** Did the Project adequately assess the environmental risks and provide mitigation measures, in accordance with applicable Bank policies and procedures? Were the environmental screening procedures for oil-palm-infilling activities, and for any project that could be considered under Component 2 of the Project, adequate and consistent with the applicable Bank policies and procedures?
  - **Institutional Sustainability:** Was the design of the Road Maintenance Trust Fund, including its funding mechanism and operations, sustainable, adequate, and consistent with relevant Bank policies and procedures? Did Management properly assess OPIC's capacity to ensure implementation of Project activities?

## Chapter 2: The Project Context

### A. Overview

72. This chapter provides background for the interpretation of the social and environmental safeguard policies applicable to the Project and for the Panel's findings of compliance. Most of the chapter describes the geographic, cultural, historic, and political context of the Project within Papua New Guinea.<sup>84</sup> This includes a description of indigenous communities in the Project areas and their land tenure systems as well as of provincial and local governance, an overview of oil palm in Papua New Guinea's development, and a brief review of the literature on the transition of smallholders from a subsistence economy to a cash economy. The chapter ends with a brief history of World Bank oil palm projects in the country.

### B. Indigenous Peoples in Papua New Guinea

73. Papua New Guinea, with a population of 6.7 million (2010 estimate), occupies an area of 462,840 square kilometers on the eastern half (53%) of the "mainland" island of New Guinea and on nearby islands (including New Britain, New Ireland, and Bougainville) of the South Pacific, north of Australia. To the west it shares a border with Indonesia, whose easternmost Papuan provinces (formerly called Irian Jaya) occupy the western 47% of the island of New Guinea and constitute the least populous and most ethnically diverse part of Indonesia.<sup>85</sup>
74. Overall the New Guinea region is one of the two most culturally diverse regions in the world (along with the Amazon basin), as measured, for example, by the number of distinct languages spoken. Of the world's approximately 6,000 languages, one widely-used standard for counting languages<sup>86</sup> lists 841 indigenous languages spoken in Papua New Guinea alone (including the 11 that in 2005 no longer had any known speakers and have apparently become extinct).<sup>87</sup>
75. Papua New Guinea's indigenous population is one of the most heterogeneous in the world, as measured by the number of languages and other cultural traits. This is partly attributable to the lengthy period of its inhabitation (at least 60,000 years), and also to the island's mountainous and difficult terrain, which encouraged the separate development of numerous isolated populations, social organizations, and cultural groups. Divided by language, custom, and tradition, some of Papua New Guinea's communities had engaged in low-scale tribal conflict with their neighbors for millennia, prior to the sustained efforts to eradicate

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<sup>84</sup> Officially known as the Independent State of Papua New Guinea.

<sup>85</sup> Taylor, Paul Michael 1996 "Irian Jaya The Land and its People." pp. 28-33 in Konrad, G. and U. Konrad, eds., *Asmat: Myth and Ritual, the Inspiration of Art*. (Venezia: Erizzo). Koentjaraningrat (1991) *Irian Jaya: Membangun Masyarakat Majemuk* (Jakarta: Djambaan).

<sup>86</sup> Slightly different figures for the number of languages are given in the Management Response and elsewhere, because the boundary distinguishing two dialects of one language, vs. two distinct languages, can be defined differently.

<sup>87</sup> *Ethnologue* Raymond G. Gordon. Dallas: SIL International 15<sup>th</sup> ed. 2005.

such low-scale conflicts and create a modern state society.<sup>88</sup> The isolation created by the mountainous terrain was so great that many highland groups were, until recently, unknown to coastal groups or even to some neighboring highland populations.

76. In a study conducted for the World Bank, the political scientist Francis Fukuyama wrote:

*The extreme ethnolinguistic fragmentation of the country is noted by every observer of PNG, and is obviously the root cause of the failure to generate strong collective action at a national level. It is not just that the society is fragmented; the underlying social groups are very strong and cohesive compared to traditional social structures in other developing societies. The acid of modernization that has dissolved traditional social structures and driven millions of people from countryside to cities or abroad in much of Latin America and Africa is much less evident in Papua New Guinea...Papua New Guinea is arguably one of the most inherently democratic societies in the world. Villages and other local communities generate consensus through prolonged discussion and deliberation. Leadership—in the form of “big men”—is achieved rather than ascribed. It has to be demonstrated over time, and is constantly subject to challenge and change.*<sup>89</sup>

77. Today, about 96% of the population is Christian, with all the major churches under indigenous leadership. A small minority (3.3%) of the population still adheres to indigenous beliefs.<sup>90</sup>

### **C. Indigenous Peoples Communities in the Project Areas**

78. The Project is being implemented in the Talasea district of West New Britain province and Ijivitari and Sohe districts of Oro province. Oil palm infilling activities, under Component 1 of the Project, are confined to the catchment area of the three mill companies—that is, New Britain Oil Palm Limited and Hargy Oil Palm Limited in Talasea district in West New Britain province and Kula/Higaturu Oil Palm Limited<sup>91</sup> in the Ijivitari and Sohe districts in Oro province. Community development initiatives, under Component 2 of the Project, could be located in any of the 15 Local Level Governments (LLGs) in the three SADP Project districts provided they meet the required criteria.<sup>92</sup>

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<sup>88</sup> This summary of history and population characteristic is drawn partly from the US State Department’s August 10, 2011, Background Note on Papua New Guinea. <http://www.state.gov/r/pa/ei/bgn/2797.htm>.

<sup>89</sup> Fukuyama, Francis. (2007) Governance Reform in Papua New Guinea. Retrieved July, 2011 at: <http://unpan1.un.org/intradoc/groups/public/documents/un-dpadm/unpan044622.pdf>. p. 9-10. The author notes that the opinions expressed are his own, not those of the World Bank.

<sup>90</sup> CIA. The World Factbook: Papua New Guinea. <https://www.cia.gov/library/publications/the-world-factbook/geos/pp.html>. Based on the 2000 census.

<sup>91</sup> Higaturu Oil Palm Limited (HOP), the mill company operating in Oro province was bought by New Britain Palm Oil Group in April 2010 and renamed Kula Palm Oil. For the purposes of this Report, the mill company in Oro is referred to as Kula/Higaturu Oil Palm Limited.

<sup>92</sup> Management Response, ¶70 and Footnote 2; subsequent clarification requested by the Inspection Panel and received from Management on August 3, 2011.

79. ***Wantok and the Culture of Reciprocity.*** Although Papua New Guinea's indigenous cultures vary widely, many scholars<sup>93</sup> point to some common characteristics of traditional Papua New Guinea social structures. These generally include productive agricultural subsistence economies; a strong communal attachment to the land; and an emphasis on acquired rather than inherited status, but with a strong recognition of obligations owed to those who share bonds of kinship or to those who share membership in a local unit.
80. This obligation is often referred to by the Tok Pisin/Melanesian Pidgin term "*wantok*," which is also used in Project documents. It refers to the system of reciprocity found in a clan, family, or village, as defined by each indigenous group – that is, anyone who speaks the same language ("one talk") and to whom one has reciprocal social and economic obligations. As in the rest of Papua New Guinea, the *wantok* system prevails in the Project areas.
81. Some observers view *wantok* as a traditional social security system that ensures that everyone is cared for, while others regard it as a way of life that stifles individual productivity and success, since one must share one's wealth with one's *wantoks*. Some also feel that the underlying value and utility of the *wantok* system works well in traditional Papua New Guinea society, but that it can become an instrument of abuse when practiced in more modern settings, which is beginning to happen more frequently in Papua New Guinea.
82. Moreover, some observers hold a positive, perhaps even idealized, image of the *wantok*. They see Papua New Guinea's national parliament as a kind of extended version of the *wantok*, as though the Papua New Guinea nation was a place where every citizen could help and rely on every other.<sup>94</sup> This image differs from the vision of the role of *wantok* in development documents, including those associated with this Project. The Management Response, for example, notes that part of the reason for the "*paradox*" of high cash incomes and low standards of living (considered by Management to be a national phenomenon) is the "*significant social and traditional obligations placed upon smallholders*" to share cash income within the *wantok*.<sup>95</sup> Francis Fukuyama, in a paper produced for the World Bank,<sup>96</sup> argues that socioeconomic modernization is unlikely to break down social structures such as the *wantok* in the near future.<sup>97</sup> To Fukuyama, this means that modalities must be sought that can be reconciled with the existing social systems, but with the longer-term goal of making them more inclusive, less discriminatory, and less controlled by local elites.<sup>98</sup>

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<sup>93</sup> See, for example, Sillitoe, Paul (1998) *An Introduction to the Anthropology of Melanesia: Culture and Tradition* (Cambridge U. Press); Moore, Clive (2003) *New Guinea: Crossing Boundaries and History*. Honolulu: U. of Hawaii Press.

<sup>94</sup> See, for example, Waiko (1993), p. 15.

<sup>95</sup> Management Response, ¶50.

<sup>96</sup> Fukuyama, Francis. (2007), *Observations on State-Building in the Western Pacific*. Retrieved April, 2011 at: [http://fukuyama.stanford.edu/files/working\\_papers/WP\\_State-Building.doc](http://fukuyama.stanford.edu/files/working_papers/WP_State-Building.doc). The author notes that the opinions expressed are his own, not those of the World Bank.

<sup>97</sup> *Ibid.*, p. 16.

<sup>98</sup> *Ibid.*, p. 19.

83. The Social Assessment describes obligations of individuals toward their *wantoks* but also notes that people held positive views of arrangements such as the Bialla Growers Fund. This Fund, established in 2001,<sup>99</sup> increased the deduction rate from payments to smallholders for their oil palm harvests, thus enabling them to set aside money for such special purposes as school fees or housing. “[T]he reason for the scheme’s success is that a component of smallholder income is isolated from the demands of immediate consumption and the pressure of *wantoks* to redistribute income through the traditional economy. For growers, they are absolved from the responsibility of not distributing funds to *wantoks* because it is locked away in special purpose accounts that cannot be drawn upon for other purposes.”<sup>100</sup>
84. In fact, traditional obligations within the *wantok* have strict limits, and the Bialla Growers Fund appears to be (within that specific group in that part of West New Britain province) a successful example of how an asset like cash (which would have been classified within the category of objects/assets that must be redistributed upon request) was converted to another traditional class of objects/assets--namely, the kind (like certain family heirlooms reserved to be passed down on special occasions) that others cannot ask a person to give away.
85. Indigenous (including clan-based) decision-making structures, which vary considerably among Papua New Guinea’s ethnic groups, long pre-dated Papua New Guinea’s independence, and in all areas clan-based or village-based decision making structures continue. Such decision-making structures in the Oro province have been well described in recent literature on Binandere decision-making (an ethnolinguistic group considered by anthropologist Ira Bashkow to be one of Orokaiva’s subgroups, and classified linguistically as close to the Orokaiva language speakers of the Oro province; see below).<sup>101</sup> According to this literature, the “*arapa*” or village/family unit to which people most intently owe their allegiance, has the same name as the village space where *arapa* members come together to reach communal decisions.<sup>102</sup> (See Box 1 for extracts from this description.)

**Box 1: Binandere Communal Decision-Making Structure**

*The Binandere people [in the Popondetta area] see themselves as located within a family and among a small group with whom they have built strong bonds...The roots of the Binandere are anchored at the **arapa** of their hamlets, where they grew up and to which they make conscious and constant reference in later life.*

*The **arapa** [area between the Men’s House and Women’s House in a village] is also a formal gathering place where men come together to discuss issues of general concern. Formal feasts and major ceremonies are conducted in this area, where the sponsors are received, entertained, and fed, and from which the distribution of pig meat and vegetables takes place. In times of disputes or conflicts, the parties stay put on their own **arapa** and speeches are delivered from them. Decisions are handed down*

<sup>99</sup> Social Assessment, p. 58.

<sup>100</sup> Ibid, p. 58.

<sup>101</sup> Both the Orokaiva and the Binandere languages are classified as Trans-New Guinea phylum languages, both are within the so-called “Proper Binanderean” subgroup of the Binanderean group of the eastern group of the “Main Section” of Trans-New Guinea languages (see *Ethnologue* (Raymond G. Gordon, editor), Dallas: SIL International 15<sup>th</sup> ed., 2005, p. 593).

<sup>102</sup> See *A Short History of Papua New Guinea*, Professor John Dademo Waiko, 1995.

*here after the 'big men' have made their public statements. Formal negotiation about marriage and bride price also occur on the arapa, as well as the exchange of bride wealth. Late in the evenings, two elders might meet to discuss sorcery. Nowadays, village committees and councillors use the arapa to discuss community matters and business concerns.*

*A well-known feature of the society has to do with the manner in which discussions are conducted, decisions reached, and recommendations carried out. The arapa provides the forum for both private conversation and the public debate to arrive at a consensus with which the majority of people present feel comfortable. A decision reached collectively can hold together those present, at least temporarily, until the decision is implemented. If agreement cannot be reached, then at least this forum contains the basis for any further debate.*

*In the absence of the state, the ethical system of the Binandere emphasized the importance of reciprocity among people. The cultivation of sympathy and co-operation must begin in the family, as defined by arapa, and then extend by degrees into the village, clan, and to the tribe. Relationships could expand from the nuclear family along definite kin lines to include the extended family bounded by the charter of the arapa, and through which candidates could channel their bids for election as a member of a council, a provincial, or national government. This, in many ways, in fact, it is possible to think of parliament as a national arapa.*

Source: Waiko, John (1993) , pp. 13, 14, 15

86. Of the 100,000 inhabitants of Oro province, the largest ethnic group—the Orokaiva<sup>103</sup> numbers about 60,000. Most of the Requesters belong to this ethnic group. The Orokaiva speak several languages, the most dominant, with 35,000 speakers, is also called Orokaiva.<sup>104</sup> The name “Orokaiva” was reportedly first used by colonial officers who explored the area in the late 1800s and early 1900s.<sup>105</sup> (See Box 2 for more background on the Orokaiva.)

**Box 2: The Orokaiva**

*“Orokaiva speak several languages of the non-Austronesian Binandere language family. The largest of these, which has some 35,000 speakers, is also called Orokaiva; the others are its neighbors Notu, Hunjara, Aeka, and Binandere.”*

*Source: Bashkow, 2006, p. 27.*

*“Linguists conventionally divide the Binandere language family into fourteen languages, all of which are spoken in Oro Province...”*

*Source: Bashkow, 2006, p. 263, footnote. 2.*

*“Existing studies do not represent ‘the Orokaiva’ as a homogenous group, but instead, to the contrary, they have highlighted the wide variation that exists among local communities in details of social organization, ritual, diet, arts, and traditional knowledge. [...] At the same time, however, there are basic similarities in morality and culture throughout the Orokaiva regional world. Orokaiva societies are characterized by a distinctive set of variations on common Melanesian cultural themes, such as the centrality of gift exchange in sociality, the spirit of ‘eclecticism’ and ‘opportunism’ [...], the fluidity of leadership and land tenure, a subsistence economy based on shifting agriculture, and highly autonomous notions of the person.”*

<sup>103</sup> Bashkow, Ira. *The Meaning of Whitemen: Race and Modernity in the Orokaiva Cultural World*, 2006 (Chicago: University of Chicago Press), esp. p. 27 and Chapter 2, Footnote 1.

<sup>104</sup> Ibid, p.27.

<sup>105</sup> B4Ibid., pp.29-32.

Source: Bashkow, 2006, pp.31-32

*“Throughout the Orokaiva region, a primary focus of community life is the cultivation of taro, a root crop grown in swidden gardens that are invested with great social, ritual, and spiritual significance. Along with pigs and other garden produce, taro is also a major object of exchange. The fact that people grow their own food (and can use their own forest material to build houses) means that in practice they enjoy remarkable independence from the cash economy, and over time individual households tend to move in and out of participation in it.*

Source: Bashkow, 2006, p. 32.

*In comparison with many indigenous peoples, Orokaiva have been quite successful in maintaining the vitality of their vernacular culture and traditional economy, but over the last decade these have become increasingly imperiled by the large-scale loss of lands which were formerly used for subsistence gardening but are now dedicated to commodity cash-cropping, an activity spurred on by people’s increasing need for cash and by the expansion of a development project for the cultivation of oil palm funded by the World Bank”.*

Source: Bashkow, 2006, p.2.

87. **Ethnic Groups in Project Areas.** The Panel’s compilation of the ethnic groups in the Project areas is shown in Table 1; the information is from the Beneficiaries Assessment<sup>106</sup> and the Environmental Assessment.

**Table 1: Tribes and Language Groups in Project Areas<sup>107</sup>**

Project Area (province)	Tribe/Ethnic Group	Language Group	Beneficiaries Assessment	Environmental Assessment
Oro	Orokaivans	Orokaiva	Orokaiva has several dialects.	
West New Britain, Hoskins area	Bakovi	Bola	Extends over most of the Talasea Peninsula south of the Bula language area and east of Gaungo Village.	13,746 speakers in the Talasea District.
		Bula	Occupies the northern part of the Talasea Peninsula.	
	Nakani	Bebeli	Occupies the area between Gaungo VOP and Hoskins to the east.	1,050 speakers in the Talasea District.
		Nakanai	Extends from Hoskins eastward to just past Biälla.	13,000 speakers in the Hoskins District.
West New Britain, Biälla area	Aigon	Aigon	Occupies the mountains south of the Bebeli language group.	
	Kol	Kol	In the mountains east of the project area with the Meramera and Mengens on their northern and western borders respectively; nearly all of their territory is in	

<sup>106</sup> Koczberski, G., and Curry, G.N. Beneficiaries Assessment Report for Smallholder Agriculture Development Project (SADP), Papua New Guinea, 2007.

<sup>107</sup> The table is organized according to the Project document that offers information about the groups’ geographical location and population size. Because the Social Assessment does not reference any of these tribes or languages, it is not included as a source document here.

			ENB.	
	Mamusi	Mamusi	Occupies the mountains south of central Nakanai and extending through to south coast; most of their territory is in ENB.	
	Manseng/ Mangseng	Manseng/ Mangseng	Occupies the mountainous area south of the central Nakanai; most of their territory is in ENB.	2,500 speakers in the Bialla District (coastal).
	Mengen	Mengen	Occupies the land east from Bialla to around Navo and extends through to the south coast.	
	Meramera	Meramera	Extends from a little west of Ulamona Village over the provincial border into ENB.	2,000 speakers in the Bialla District (coastal).
	Pele Ata	Pele Ata	Occupies the mountainous area south of eastern Nakanai.	1,900 speakers in the Bialla District (inland).

88. The Beneficiaries Assessment describes the indigenous people in the Project area in Oro province, where the Requesters live, as *“one large cultural and ethnic group known as the ‘Orokaivans’”* (emphasis in original). The Orokaiva are patrilineal and each clan and sub-clan traces its origin to a common ancestor. The Beneficiaries Assessment also notes that typically there are no *“major cultural, ethnic, or resource conflicts between the Orokaivan tribes or clans, and people identify very strongly with being ‘Orokaivan.’”*<sup>108</sup>
89. The ethnic mix of indigenous people in WNB Province is far more diverse than Oro province, of which the Beneficiaries Assessment states that “[w]hilst there are minor differences in the subsistence and agricultural systems of the various ethnic and language groups, they share similar social and cultural systems.”<sup>109</sup> In both provinces, the Beneficiaries Assessment concludes that *“the indigenous ethnic/language groups are relatively homogenous in terms of culture, social organization and land tenure systems.”*<sup>110</sup> (This report will cover the issue of “relative homogeneity” in Chapter 3.)
90. Each of the ethnic groups has its own language,<sup>111</sup> although Tok Pisin and English are widely understood, especially for those who have been schooled (reported literacy is around 24% in Tok Pisin and 36% in English in Oro province, and 44% and 33% respectively in WNB province).<sup>112</sup>

<sup>108</sup> Beneficiaries Assessment, p. 8.

<sup>109</sup> Ibid., p. 9.

<sup>110</sup> Ibid., p. 8.

<sup>111</sup> As noted above Bashkow (2006) uses “Orokaiva” to refer to a large group of culturally similar peoples who speak languages of the Binandere language family, only one of which is the “Orokaiva” language; while other sources such as Ethnologue (Gordon, 2005) use the term only to refer to speakers of the Orokaiva language.

<sup>112</sup> Percentages are based on literacy rates referenced in the Environmental Assessment (p. 42) and population figures presented in the 2000 census data.

91. In addition to the ethnic groups identified in Table 1, large numbers of settlers from the overpopulated areas of Highlands, Sepik, Morobe, and Gazelle Peninsula now reside in both provinces. These groups were brought over to cultivate oil palm under previous World Bank-assisted projects as well as other cash crops, thus adding to the heterogeneity of the populations. WNB has a particularly high proportion of settlers, with some 22,000 in-migrants from other parts of the country, out of a total population of 184,000.<sup>113</sup>

#### **D. Land Tenure in the Project Areas**

92. The Project documents make several references to the nature of communal land tenure within the Project areas. These describe the relationship between the farmers, who obtain use rights or permission (sometimes by taking turns with other family members) to work and harvest an area of land, and their land-holding family groups (such as the clan noted for Orokaiva or Binandere, as noted in quotes above), which traditionally holds rights to land.
93. As Papua New Guinea Oil Palm Research Association (OPRA) notes, “*customary land generally refers to land that is under the communal ownership of traditional society and kinship groupings likes tribes, clans, sub-clans, and lineages. The introduction of commodity crops like oil palm has been accompanied by alterations to customary land tenure.*”<sup>114</sup> The Note goes on to explain that “*customary land tenure regimes in Papua New Guinea were characterized by two general sets of principles. First, exclusive individual land ownership and inheritance were almost unknown as all land was vested in land-holding groups, usually kinship groupings such as clans and sub-clans*” and the “*second set of principles related to the flexible and pragmatic nature of customary land tenure. Rights to land were often modified to accommodate changing socio-political, demographic and environmental situations.*”<sup>115</sup>
94. The customary land tenure principles applicable to subsistence production have had to be modified to accommodate cash cropping associated with oil palm. Modifications have been made to customary rules of land tenure because the land is under individual control for much longer than for subsistence food gardens in swidden systems, where short cultivation periods are interspersed with much longer fallow periods.
95. The Social Assessment<sup>116</sup> states that the main land tenure arrangements under which smallholder oil palm is cultivated in Papua New Guinea are:
- Agricultural State leasehold land on Land Settlement Schemes (LSS);
  - Village oil palm (VOP) holdings on customary land by major and minor clans;
  - Land Tenure Conversion blocks; and
  - Customary Purchase Blocks (CPBs) on customary land.

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<sup>113</sup> UNRISD, Ethnic Structure, Inequality and Governance of the Public Sector in Papua New Guinea, Ray Anere, 2004.

<sup>114</sup> The OPRActive Word, Technical Note 17, August 2010, PNG OPRA.

<sup>115</sup> The OPRActive Word, 2010.

<sup>116</sup> Social Assessment, p. 7.

96. The different land tenure arrangements, according to the Social Assessment, are important to understand as they “sometimes influence smallholder productivity, attitudes to replanting and infill, investment levels in farm inputs and other assets, the oil palm production strategies of smallholders, the livelihood strategies pursued by smallholders, and the welfare/quality of life of smallholder families.”<sup>117</sup>
97. The land tenure system in the Project areas of Hoskins, Bialla, and Popondetta consists of a mixture of indigenous customary land and state land, the latter acquired before Papua New Guinea independence. The oil palm estates and subsequent land settlement schemes are located on state land, while village oil palm blocks (VOP) occupy portions of the customary land belonging to various local clans and sub-clans.
98. The Social Assessment states that VOP plantings in Popondetta increased substantially in the late 1990s under the previous Oro oil palm project, with 74% of the total smallholder area planted with village oil palm.<sup>118</sup>
99. Oil palm cultivated on village land is subject to the rules and regulations of customary law and land-tenure principles. Clan agreements to the planting of individual oil palm holdings are either informal social contracts or are outlined in a Clan Land Usage Agreement (CLUA). A CLUA is a signed agreement between a clan and an individual acknowledging the latter's right under native law and custom to have access plant oil palm on the land. The road access requirement for oil palm means that landowner groups without a feeder road on their land must depend on the generosity of other landowner groups (clans or sub-clans) for access to land for oil palm. The road network is an important determinant of the income potential of different landowning groups within villages.
100. The Management Response notes that Oro province has a long history of a land dispute.<sup>119</sup> The Social Assessment states that “...local [Orokaivan] landowners constantly remind LSS leaseholders that their presence is resented” and the “Oro for Oro” campaign of the 1990s was designed to force settler farmers to vacate their land.<sup>120</sup> The Social Assessment notes that “...the conflict between customary landowners and settlers from other provinces has shifted to one between customary landowners and settlers from other parts of Oro Province. The uncertain tenure of Popondetta settlers discourages them from making long-term investments in their blocks and some LSS growers expressed anxieties about replanting. They were worried that re-investment and development of their blocks would attract the attentions of local landowners and were fearful that they would become targets of landowner anger. In summary, Oro-for-Oro sentiments still run deep at Popondetta, and as a consequence many LSS growers are unsure about replanting, making other long-term investments in their blocks or establishing small businesses. In fact, several LSS growers claimed that they under-harvested FFB during high crop periods because they thought that customary landowners would demand money from them.”<sup>121</sup>

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<sup>117</sup> Social Assessment, p. 7.

<sup>118</sup> Social Assessment, p. 14.

<sup>119</sup> Management Response, p. 26, ¶ 81.

<sup>120</sup> Social Assessment, p. 11.

<sup>121</sup> Social Assessment, p. 11.

## **E. Provincial and Local Level Governance**

101. Papua New Guinea has three levels of government - national, provincial, and local. Bank documents and staff interviews indicate that provincial governments have had a mixed record in managing development projects. The PAD notes that *“the overall local governance environment continues to be characterized by a limited downward accountability of public institutions to communities, a poor transparency in the use of public funds, a low level of public access to information (especially with regard to the possible use and application of public funds), and a misuse of public funds either for private personal gain (corruption) or through misdirection of resources to non-priority uses (elite capture).”*<sup>122</sup>
102. Following the independence of Papua New Guinea in 1975, major policy reforms were introduced including decentralization through the creation of 19 Provincial Governments (in 1976), which were given authority over local councils. These have subsequently evolved into what are now known as Local-level Governments (LLGs), in a continuing decentralization of government activities. The 1995 Organic Law on Provincial and Local-level Governments (LLGs) was passed in a bid to improve service delivery at the local level.

## **F. The Role of Oil Palm in Papua New Guinea’s Development**

103. The oil palm, *Elaeis guineensis*, was first introduced to Papua New Guinea’s Northern District (now Oro province) in about 1923 when several small blocks were planted near Popondetta. The results were poor owing to the quality of seed and swampy conditions. In 1966, trials began at 12 selected sites and, together with observations on existing plantings, provided the foundation for oil palm research. This was nine years before the establishment of the Independent State of Papua New Guinea in 1975.<sup>123</sup>
104. Commercial oil palm development began in 1967 on a site near Hoskins with the establishment of New Britain Palm Oil Development Limited (NBPOL), a joint venture owned equally by the Government and Harrisons and Crosfield (Australian and New Zealand) Limited.
105. The development of oil palm has been an important feature of the Government’s program to achieve its rural development objectives: to foster the geographic spread of development, to increase opportunities for earning cash incomes by Papua New Guineans, to diversify agriculture, and to increase export earnings. This was done by introducing the nucleus estate scheme (NES) concept. The NES develops smallholder areas adjacent to the estate to expand employment and provide livelihoods for settlers from other parts of the country that did not have adequate access to good agricultural land.

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<sup>122</sup> PAD, p. 23, ¶ 17.

<sup>123</sup> Asian Development Bank, 1991. Smallholder Oil Palm Productivity Study. Main Report. ADB TA 790 PNG, p. 16.

106. The NES concept was developed and promoted by the World Bank in partnership with the Government of Papua New Guinea. Over the course of the next four decades, the role of oil palm in the Papua New Guinea economy expanded to include five NES oil palm schemes – near Hoskins and Bialla in West New Britain province, near Popondetta in Oro province, at Gurney and Sagarai in the Milne Bay province and near Kavieng in New Ireland province. During this period, the Papua New Guinea Government was involved on both sides of the NES partnership. It assumed the role of shareholder in the company, with its holding traditionally set at up to 50% ownership. It also assumed the role of regulator of the companies' activities by monitoring compliance with environmental standards and reviews of prices paid to smallholders. The Government also provided services to smallholders--including extension services, credit, and subsidies on production inputs--and undertook community development at the NES schemes by providing infrastructure, including roads, health services, education, and policing. The Government's overall policy, however, stayed focused on smallholders, and the role of the estates in NES projects was to deliver modern technology, including milling, marketing, and management support.
107. The Project Appraisal Document (PAD) for the SADP states that by 2007, *“the agricultural sector in PNG, although underperforming, is central to the livelihood of the population and remains critical to development and poverty reduction.”*<sup>124</sup> The Management Response states that oil palm was identified by the World Bank as the best vehicle for improving rural livelihoods when it re-engaged with the country in 2005.<sup>125</sup>

**Box 3: Oil Palm in Papua New Guinea's Economy**

*“PNG's palm oil industry, while representing only one percent of global production, contributes substantially to rural incomes in the country. At current prices, oil palm provides smallholders with very favorable returns to their land and labor (K2,793/ha and K130/day worked), compared to other cash crops such as cocoa (K1,136/ha and K21/day worked) and coffee (K2,058/ha and K13/day worked). The industry is second only to the public service in terms of formal employment, with around 16,000 people working for the six milling companies. Approximately 18,500 smallholders supply the mills with fruit. Palm oil has become the dominant contributor to PNG's agricultural foreign exchange earnings, representing 43.2 percent of agricultural export values in 2008.”*

Source: Management Response, p. vi.

**G. Smallholder Livelihoods and the Transition from a Subsistence Economy to a Cash Economy**

108. The transition from a subsistence economy to a market economy is one of the key development challenges for the whole country, and is very much the context of the SADP.
109. Some observers believe that subsistence agriculture underpins the Papua New Guinea cash economy. They maintain that even though the production and sale of cash crops is an important source of income at both the national and household levels, cash crops should not

<sup>124</sup> PAD, p. 18.

<sup>125</sup> World Bank engagement with PNG was temporarily suspended in 2003 after the cancellation of the Forest Conservation Project; activities were resumed in 2005.

replace the subsistence sector.<sup>126</sup> This is because subsistence agriculture provides most of the food consumed in the country – “*an estimated 83 percent of food energy and 73 percent of protein*”.<sup>127</sup> Indeed, the term “*subsistence affluence*” was coined in the 1960s to describe Melanesian society’s system of production in which customary needs are met with modest levels of land and labor utilization.<sup>128</sup>

110. The World Bank’s Country Assistance Strategy (2008-11)<sup>129</sup> for Papua New Guinea describes its economy as being “*highly dualistic*” with an “*enclave-based formal sector focused mainly on the large-scale export of natural resources, and an informal sector dominated by the subsistence and semi-subsistence activities of the majority rural population.*” Eighty-five percent of the population lives in rural areas and depends on agriculture and informal activities for its livelihood.<sup>130</sup>
111. There are varying views on the effects on farmers of a transition from a subsistence economy to a cash economy. The changes Lawrence Grossman (1984) describes, based on his study of the Highlands region beginning in the 1980s, are still largely applicable to the Project areas. The study<sup>131</sup> notes that farmers growing cash crops for export often do not see an improvement in living conditions. Grossman compiles examples of adverse effects that have been noted in development literature, stating that the “*impact on the natural environment, subsistence, and social relationships – all interrelated elements of rural production systems – can be dramatic and deleterious.*”<sup>132</sup> Noting that effects on the natural environment (caused, for example, by forest clearing, monocropping, mechanization, and use of pesticides or fertilizers) have been widely acknowledged, his study documents the social impacts caused by “*the conflict between subsistence and cash cropping*” at the village level.<sup>133</sup>
112. The first area of major adverse impact that Grossman describes involves the disruption to subsistence patterns and the increased dependence on an unreliable market. He notes that:

*Where land is scarce, commercial activities can reduce the area for local food crops. The encroachment of cash cropping on subsistence is potentially detrimental for villagers for several reasons. Once tied to commercial activities rural producers are at the mercy of fluctuating commodity prices on national and international markets. At the same time, the terms of trade often work to their disadvantage, with the rate of inflation in the price of imported goods higher than that for the primary products sold ... Furthermore, even if increasing commodity production leads to higher cash incomes, there is no assurance*

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<sup>126</sup> Bourke, R. Michael and Harwood, Tracy (eds). Food and Agriculture in Papua New Guinea, ANU E Press, 2009, p. vii.

<sup>127</sup> Ibid, p. 6.

<sup>128</sup> Jones, Luke Trebor and McGavin, P.A. Labour Resources Utilization in Melanesia, Asia Pacific Printers, 1997.

<sup>129</sup> Country Assistance Strategy for Papua New Guinea for the Period 2008-2011, November 20, 2007, Report No. 41571-PG, p. 1.

<sup>130</sup> Management Response, p. 2, ¶ 9.

<sup>131</sup> Grossman, Lawrence S. Peasants, subsistence ecology, and development in the highlands of Papua New Guinea, Princeton University Press, 1984.

<sup>132</sup> Grossman (1984), p. 8.

<sup>133</sup> Ibid.

*that nutritional levels will also improve because purchased foods, which are often refined carbohydrates, may not be as nutritious as the subsistence items they replace (Nietshmann 1973; Dewey 1981).<sup>134</sup>*

113. Others corroborate this view and state that most smallholders “*face major constraints in moving to a more commercial form of production that delivers agricultural products that meet market requirements.*” This, according to them, is because “*Social norms, jealousy, factionalism, and obligations within the village greatly inhibit the time available for surplus production and the motivation to achieve high incomes to a greater or lesser degree for different groups. Access to adequate areas of good agricultural land, inputs supply, and marketing services are also major factors affecting the response to agricultural opportunities. Taken together, these factors generate a wide range of diversity in the agricultural sector. Some individuals and groups demonstrate a remarkable capacity to respond to new challenges and opportunities; most do not.*”<sup>135</sup>
114. Others disagree and believe “*that monetization resulting from participation in the cash economy (even in such a peripheral role as a primary producer of a tropical crop) can result in improved food security for those who have cash. The availability of cash may provide a new buffer against sporadic shortages in food supply resulting from drought, frost, and other natural disasters.*”<sup>136</sup>
115. The availability of cash income from a diversity of sources can also protect smallholders against increased competition from a growing population. One study finds that, “*continued population growth in the absence of a corresponding growth in income opportunities is likely to lead to greater social instability, especially if population growth were to fuel disputes between customary landowners and settlers. However, if a broadening of the economic base is promoted and it generates new income opportunities in line with population growth, then social instability is less likely to occur.*”<sup>137</sup>
116. All of the phenomena described above--regarding a transition from a subsistence economy to one dominated by cash crops--are relevant for the Orokaiva as well. In addition to the ways in which social relationships may be threatened (as described above), the transition to cash crops may also affect the availability of land to grow crops for home consumption and the local market. In particular, the consequences of a reduced capacity to cultivate taro is critical. Bashkow writes that “*the Orokaivas’ identify as people who are rooted in lands and in the culture of taro*” and that this is “*an enduring fundamental reference point in Orokaiva cultural life.*”<sup>138</sup>

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<sup>134</sup> Grossman (1984), p. 8-9.

<sup>135</sup> Bob McKillop, R. Michael Bourke and Valentine Kambori, Policy Making in Agriculture in Policy Making and Implementation: Studies from Papua New Guinea, May, R.J. (ed), 2009, E Press, p. 71.

<sup>136</sup> Heywood, Peter F. and Hide, Robin L. Nutritional effects of export-crop production in Papua New Guinea: A review of the evidence.

<sup>137</sup> Koczberski, G. & G. Curry. (2003, May). Sustaining Production and Livelihoods Among Oil Palm Smallholders: A socioeconomic study of the Bialla smallholder sector. Curtin University of Technology. p. 101.

<sup>138</sup> Bashkow (2006), p. 182.

117. The trend from subsistence agriculture to cash-crop production has been under way in both Oro and West New Britain provinces for several decades. And oil palm (with copra, coffee, cocoa, and rubber playing less important roles) has been the major crop that has facilitated this change. An important aspect of the transition from subsistence to market economy in Papua New Guinea is that oil palm expansion in the early 1990s occurred at a time “...when the Papua New Guinea government was increasingly introducing the “user pays” system into the delivery of its services such as health and education” and “To put it more succinctly, the general populace needed cash to survive, and oil palm was the most reliable source of a regular cash income, on the Popondetta Plain.”<sup>139</sup>

118. Bashkow, who did field work in Agenehambo village in Oro in the 1990s, describes the transition brought about by World Bank-financed oil palm projects as follows:

*“...the cash it introduces into the local economy has undoubtedly contributed to the viability of Orokaiva village existence in modern times. Because of the project Orokaiva are less compelled to leave their villages to gain access to money, as are many other Papua New Guinea villages...(oil palm’s) success relative to other big development schemes that have been tried in the region (e.g., coffee, cocoa, and cattle ranching) led to an expansion of the project in the mid-1990s that has more than doubled the land area devoted to oil palm.....virtually all of the new land planted by smallholders was customary land, much of it gardenland, in the close environs of villages. The project expansion also extended the road network. Bringing oil palm plantings to many new parts of Orokaiva country, including new areas around Agenehambo. Oil palm has now come to occupy a considerable proportion of Agenehambo villagers’ lands, including virtually all land suitable for gardening that is close to the roads...The threat of the expanding oil palm industry intensifies land pressures already being felt due to the growth of the local population and the use of land to grow other, less agriculturally disruptive and less externally regimented cash-crops such as coffee and cocoa. The permanent withdrawal of large tracts of land from the swidden gardening system has meant a shortening of the periods during which rotational garden lands are left fallow...When presented with an opportunity to participate in the oil palm project, Orokaiva individuals can hardly afford not to accept the huge sums the project pays participants upfront in loans for tools, seedlings, and so on, and they find the promise of a regular cash income an overpowering incentive... The threat to Orokaiva lands and the way of life they support is thus the most serious issue for the continued vitality of Orokaiva culture. Further large-scale diversion of garden lands for oil palm farming would have grave material and cultural consequences for Orokaiva people’s lives...”<sup>140</sup>*

119. The situation Bashkow describes with respect to the inherent conflict between land for home gardening (important for food security and cultural purposes) and land for oil palms (vital for engaging in the wider national economy) is relevant in appreciating the background of this Request.

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<sup>139</sup> Tom Diwai Vigus (2001) Environmental impact review of current project and recommendations for consideration in any future development. Study of Oro Smallholder Oil Palm Development Project (Ln. 3485-PNG), p. 39.

<sup>140</sup> Bashkow (2006), pp.237-39.

## H. History of Bank's Involvement in Papua New Guinea's Palm Oil Sector

120. The World Bank has been engaged with Papua New Guinea since 1963<sup>141</sup> when the Australian government asked the Bank to prepare a development policy for what was then called the Territory of Papua and New Guinea.<sup>142</sup>
121. Prior to the SADP, the World Bank had financed four oil palm projects in Papua New Guinea (Table 2)

**Table 2: World Bank Oil Palm Projects in Papua New Guinea**

Project Title	Project Period	Project Cost
New Britain Smallholder Development Project	1969-73 (Phase 1) 1970-76 (Phase 2)	\$ 3.35 million (Phase 1) \$ 4.95 million (Phase 2)
Popondetta Smallholder Oil Palm Development Project	1976-84	\$ 18.5 million
Nucleus Estate and Smallholder (Milne Bay) Project	1985-92	\$ 68.3 million
Oro Smallholder Oil Palm Development Project	1992-2001	\$ 36.3 million

122. The first of these projects, the New Britain Smallholder Development Project,<sup>143</sup> consisted of two implementation phases. Phase 1 focused on the settlement of families in an area to cultivate oil palm and the provision of the necessary infrastructure to support smallholders.<sup>144</sup> Phase 2 of the project focused on increasing the number of people living in the settlements in order to expand the cultivation of oil palm and the construction of a wharf to facilitate the export of palm oil/kernels and other goods.<sup>145</sup>
123. The main lessons the Bank drew from this two-phased project were that they had to review developments at the mills as intently as developments on the farm and that settlement on a remote frontier for similar nucleus estate tree crop projects can be successful if preceded by the development of the estate by two years.<sup>146</sup>

<sup>141</sup> "Current Economic Position and Prospects for the Territory of Papua and New Guinea," World Bank, Report No. AS129, August, 1967, p. ii.

<sup>142</sup> "The Economic Development of the Territory of Papua and New Guinea," Report of a Mission Organized by the International Bank for Reconstruction and Development at the Request of the Government of the Commonwealth of Australia World Bank, Report No. 11153, 1965.

<sup>143</sup> Management, Bank. "Management Response to Request for Inspection Panel Review of the Papua New Guinea Smallholder Agriculture Development Project (IDA 43740-PNG)." p. 5. 2010.

<sup>144</sup> IBRD/IDA. "Papua and New Guinea New Britain Smallholder Development Project Staff Appraisal Report." 1968, p. 5,6.

<sup>145</sup> Independent Evaluation Group. Papua New Guinea - New Britain Smallholder Development Group. <http://wbln1023.worldbank.org/oed/oeddoclib.nsf/DocUNIDViewForJavaSearch/059702890693E71852567F5005B930D?opendocument>.

<sup>146</sup> IBRD/IDA. "Papua and New Guinea New Britain Smallholder Development Project Staff Appraisal Report." Highlights.

124. The second of these projects was the Popondetta Smallholder Oil Palm Development Project. This project, similar to the New Britain Smallholder Development Project, sought to establish a smallholder settlement for oil palm production at Popondetta in the then-Northern Province of Papua New Guinea, to establish an oil palm factory company to process both smallholders' and nucleus estate production, and to upgrade infrastructure services to reach the Government's standards for rural areas.<sup>147</sup>
125. Although the project was considered an overall success, the new and existing settlers and villagers did not equally benefit from the exploitation of their oil palm blocks, owing to different yields achieved. It was felt that the extension approach had to be adapted for the villagers in future smallholder projects in order to account for their reduced labor availability attributed to their social obligations in the village. The villagers' yields could then be raised and differences with the settlers reduced, better integrating the different population groups.<sup>148</sup>
126. The Popondetta Smallholder Oil Palm Development Project demonstrated that tree crop production could be technically successful and economically profitable when managed or supported by efficient private or commercial companies.<sup>149</sup> This success was due largely to commercially-oriented institutions as the Higaturu Oil Palm Plantation Company (HOP) established by the Government and the British Commonwealth Development Corporation (CDC).
127. The third of these projects was the Milne Bay project, which also had a similar aim. Its goal was to increase the annual exports of cocoa and palm oil and kernel by developing oil palm and cocoa nucleus estate plantations, smallholder oil palm blocks, and associated processing facilities. The project also involved the construction of houses and bridges and upgrades in infrastructure in the project areas.
128. Although the project achieved many of its goals, the projected prices for palm oil and kernel did not materialize; indeed, prices fell dramatically. This meant that, although technically sound, the oil palm project was in financial difficulty mainly because of the high debt-to-equity ratio, which was the result of optimistic commodity price assumptions.<sup>150</sup>
129. The fourth of these projects was the Oro Smallholder Oil Palm Development Project. Among the past World Bank-financed oil palm projects, this one is most similar to SADP and particular attention should be paid to the lessons learned from it. The Oro Smallholder Oil Palm Development Project was aimed at increasing agricultural production and exports, creating jobs, generating incomes for poor farmers, maintaining the incomes of existing smallholders supported under the previous Bank-assisted oil-palm smallholders

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<sup>147</sup> Projects Department East Asia and Pacific Region. "Papua New Guinea: Appraisal of the Popondetta Smallholder Oil Palm Development Project." i. 1976.

<sup>148</sup> Operations Evaluation Department. "Project Performance Audit Report Papua New Guinea Popondetta Smallholder Oil Palm Development Project." 29. 1987.

<sup>149</sup> Ibid., p. 8.

<sup>150</sup> Agriculture Operations Division Country Department III East Asia and Pacific Regional Office. "Project Completion Report Papua New Guinea Nucleus Estate and Smallholder (Milne Bay) Project." 1993. p.21.

development project, and protecting the habitat of the endangered Queen Alexandra Birdwing Butterfly (QABB).

130. The project actions included: planting of oil palm in two areas of Oro province; strengthening extension services; building and maintaining agricultural roads and social infrastructure; upgrading and maintaining national road sections; providing protection to an endangered butterfly species and its associated ecosystem; strengthening the capacity of the Department of Agriculture and Livestock to formulate policy and prepare projects in the tree crop subsector; the management of the Oil Palm Industry Corporation (OPIC); and oil palm research.
131. Although the project achieved most of its major objectives, the shortcomings of the project included: the access road infrastructure component, which performed poorly and accounted for more than 50% of total project cost; main road construction, which was not undertaken during the project; the replanting of oil palm in the area of the earlier Popondetta scheme; and the failure to fully utilize a management information system.
132. The Implementation Completion Report (ICR) emphasized that once constructed, maintenance of the access road network was essential if it was to serve its purpose of enabling economic palm oil production. The ICR stated that, in hindsight, greater emphasis could have been given to this element of the project. Despite the obvious priority for maintenance of the total oil palm investment (in agricultural development, services, and the road network) once the capital expenditure had been incurred, the Government did not make the required budgetary allocation. Maintenance was a responsibility of provincial governments, but their funding was highly inadequate and allocation for road maintenance was insignificant. In the absence of allocations by the provincial government, OPIC filled the void by doing emergency maintenance using their own funds. The limited nature of this program, however, meant that in times of extreme weather conditions, requirements could not be handled, leading to large sections of road being impassable.<sup>151</sup>
133. **Preparation of the Smallholder Agricultural Development Project (SADP).** According to the Management Response, the preparation for a new project in Oro was scheduled to start in mid-2003. While technical visits took place and some background studies were commissioned, however, project preparation was put on hold during the suspension of another project. Only after the 2005 World Bank Annual Meetings did the Government of Papua New Guinea agree to the official restart of Project preparation activities. The Project was approved by the World Bank Board in December 2007 and the Credit was signed in July 2008.
134. In November 2007, Oro province was devastated by cyclone Guba, which destroyed large sections of the infrastructure and caused significant damage to the oil palm sector. At the request of the national and provincial governments, therefore, adjustments were made to the Project to help the province conduct emergency road repairs. This also meant that the

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<sup>151</sup> Implementation Completion Report: Papua New Guinea Oro Smallholder Oil Palm Development Project, 2002. p. 11.

Project launch workshops took place only in March 2009, some eight years after the completion of the previous project in Oro.

## Chapter 3: Information Disclosure, Consultation and Community Support

### A. Introduction

135. This chapter reviews the Requesters' claim that Management did not adequately consult with claimants and other affected communities and that Project information was not widely disseminated prior to Project approval, which deprived them of the opportunity to provide input into the Project. The Requesters' claim and the corresponding Management Response are presented first. Thereafter, the Panel's observations on the harms claimed by the Requesters are presented. The chapter concludes with the Panel's analysis of Management's compliance with relevant World Bank operational policies and procedures, namely OP 4.10 (Indigenous Peoples) and OP 4.01 (Environmental Assessment).

### B. Requesters' Claims

136. The Requesters state that *"World Bank and project sponsor have not consulted with claimants and other locally affected communities"* and that any consultations undertaken were "limited" and "did not allow for informed participation."<sup>152</sup> Furthermore "[p]roject information was not broadly disseminated prior to project approval and is still not available, nor was it ever delivered in any language other than English."<sup>153</sup> The lack of disclosure of information and consultations in the Project area before Project approval is described by the Requesters as *"one of their major concerns,"* and the *"lack of transparent consultation records calls into question whether there has been achievement of broad community support"* for the Project. The Requesters cite OP 4.10 and add that despite the fact that they are Indigenous People and customary landowners, the World Bank did not provide them with an opportunity to input into the *"scope, purpose and activities"* of the Project, or discuss with them the *"additional road levy that will be imposed on them"* under the Project. They believe consultations may have led to proposals about alternative sources of revenue generation and negotiations on the *"user fee."*
137. The Requesters further cite OP 4.01<sup>154</sup> to substantiate their claim that consultations were inadequate. They claim that *"...for meaningful consultation to take place between OPIC and the smallholders, as required under the OP 4.01 Environmental Assessment policy, the smallholders must have been provided with relevant material prior to consultation in a 'form and language' that is 'understandable and accessible.' This has not occurred. The smallholders have not received any materials, in English or otherwise, nor have they received information in spoken form. Therefore, there was no meaningful consultation as required in OP 4.01."*<sup>155</sup>

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<sup>152</sup> Request for Inspection, pp. 6- 7.

<sup>153</sup> Ibid., p. 2.

<sup>154</sup> OP 4.01, ¶ 15.

<sup>155</sup> Request for Inspection, p. 14.



Picture 6: Panel team talking with villagers in Hoskins area

### C. Management Response

138. Management believes "*...free, prior and informed consultations resulting in broad community support for the Project were undertaken during Project preparation.*"<sup>156</sup> According to Management, the bulk of the population living in the Project area is considered indigenous. In accordance with Bank policy, the Government of Papua New Guinea undertook a Social Assessment and other necessary steps to ensure free, prior, and informed consultations that would generate broad community support at all major stages of Project development. Management states more than 550 individuals were consulted through focus group discussions and one-on-one meetings at which, following local tradition, affected persons were informed about the Project verbally but no documentation was provided.
139. Management's Response also notes that for this Project, consultations with entire communities did not occur, stating that "*Including entire communities in consultations was not practical*". However, extensive consultations took place with community members and with organizations representative of diverse community interests, including different church groups, NGOs, and community-based organizations in the affected areas.<sup>157</sup> Management stated that the reason churches were chosen was that they are affiliated with youth and women.<sup>158</sup> In addition to these formal organizations, informal community and village-based groups were consulted.<sup>159</sup>
140. Although Management believes the findings of the consultation process were properly documented, Management "*recognizes that documentation of the consultation process in the Social Assessment should have been more detailed and complete. The documents should have elaborated further on several aspects of the consultation process including*

<sup>156</sup> Management Response, p. 23, ¶ 68.

<sup>157</sup> Management Response p. 24, Social Assessment, p. 72.

<sup>158</sup> Social Assessment, p. 73.

<sup>159</sup> Ibid., p. 75.

*specifying what information was provided on the Project, how the information was conveyed, and how locations and participants were selected.”*<sup>160</sup>

141. With respect to consultation related to environmental concerns, required by OP 4.01, Management noted that “*numerous consultations*”<sup>161</sup> were undertaken as part of the Environmental Assessment, beginning during the review of the Oro Smallholder Development Project in 2001.<sup>162</sup> Management goes on to state that “*The EA commenced with a broadly advertised notification of a public meeting in the nation’s capital, Port Moresby, and this was followed up with field visits and meetings (including smallholders and representatives of growers associations) in the two SADP-affected provinces in July 2006*” (Emphasis in original).<sup>163</sup> Management further reports that consultations for the EA were conducted in Tok Pisin.<sup>164</sup> The Management Response concludes by stating “*Management acknowledges that the requirements of OP 4.01 were not fully met, in that the only information shared with stakeholders during consultation for the EA was in verbal form.*”<sup>165</sup> However, despite these acknowledged deficiencies, Management believes that “*...the Requesters’ rights or interests have not been adversely affected by a failure of the Bank to implement its policies and procedures.*”<sup>166</sup>
142. Furthermore, Management “*strongly believes that broad community support for the Project exists in the three oil palm growing areas targeted under the Project and that the Project design reflects the concerns of the beneficiaries.*”<sup>167</sup> Management notes that OP 4.10’s requirements regarding “*broad community support*” and “*free, prior and informed consultations*” are “*not meant to require unanimity of views or to condition a Bank project on the receipt of consent from all affected individuals or groups.*”<sup>168</sup>
143. While the Requesters raise the concern that they were not provided the opportunity to provide input on Project design, the Management Response states that “*The Project design benefited from the long association of the Bank with the oil palm subsector and incorporated the lessons drawn from earlier investments, and particularly from the Oro Smallholder Oil Palm Development Project, which closed in 2001.*”<sup>169</sup>
144. Management states that the “*Social Assessment, the EA, and related documentation were publicly disclosed*” in English in Port Moresby at the Papua New Guinea Public Information Center (PIC) and in Washington at the World Bank’s InfoShop on February 22, 2007. Management believes the disclosure of information practiced under the Project was “*fully consistent with the Bank’s Policy on Disclosure of Information.*”<sup>170</sup>

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<sup>160</sup> Social Assessment., p. 27, ¶ 83.

<sup>161</sup> Management Response, p. 29, ¶ 90.

<sup>162</sup> Ibid., p. 27, ¶ 84.

<sup>163</sup> Ibid., p. 27, ¶ 85.

<sup>164</sup> Ibid., p. 28, ¶ 85.

<sup>165</sup> Ibid.

<sup>166</sup> Ibid, p. 40, ¶ 129.

<sup>167</sup> Ibid., p. 31, ¶ 99.

<sup>168</sup> Ibid., p. 32, ¶ 101.

<sup>169</sup> Ibid., p. 8, ¶ 26.

<sup>170</sup> Ibid, p. 33, ¶ 105.

#### **D. Panel's Observations on Harms Alleged in the Request**

145. The Panel notes that Management's documentation made no reference to consultations with either specific communities of indigenous peoples or their leadership, despite the fact that Papua New Guineans identify themselves first and foremost in terms of their ethnic group and clan or family structure.
146. Chapter 2 noted that Oro is a majority English-speaking province, with 48,493 (36%) literate in English and 32,023 (24%) literate in Tok Pisin, whereas West New Britain is a majority Tok Pisin-speaking province, with 80,946 (44%) literate in Tok Pisin and 61,007 (33%) literate in English.<sup>171</sup> The Panel team was informed that most people who can read Tok Pisin can also read English; hence, a significant proportion of the above are literate in both languages. But this leaves perhaps a majority in both provinces not literate in either language. The Project documents also note the widespread use of the closely-related Orokaiva languages (or dialects) in Oro province, as well as 11 vernacular languages in West New Britain (as described in Chapter 2).
147. During the field visit, the Panel team met with many community members who were conversant neither in English nor Tok Pisin. On several occasions, the Panel team's questions and smallholder replies had to go through two translators, English into Tok Pisin, then Tok Pisin into the local language and vice versa. In one extreme case, the wife in one family had come from another ethnic group and the husband had to translate additionally from the local language into her language. The Panel emphasizes *that the diversity of languages presents a unique challenge for consultation and communication*.
148. For the Environmental Assessment, the consultants engaged by OPIC conducted a stakeholder workshop (that included NGOs, government agencies, commercial oil palm growers, governors of oil palm-growing provinces, and aid agencies) in Port Moresby on July 18, 2006 to "...allow them to express any concerns they may had (sic.) with regards to the existing and potential social and environmental impacts of the project."<sup>172</sup> A full report of this workshop, including the issues raised by each of the groups, is included as Appendix 3 in the Environmental Assessment, although there is no mention of the number of people who participated in the workshop. During the field visits associated with carrying out the Environmental Assessment, additional people were consulted in West New Britain and Oro provinces, and these people (51 in total) are listed in Appendix 2 of the Environmental Assessment. However, only six of these 51 were block holders or land owners, although the members of growers' associations (10) and some of the women's representatives consulted (4) could be oil palm block owners.
149. The Panel team visited 16 oil palm growing villages in both WNB and Oro during its Eligibility and Investigation visits; in some instances, smallholders from surrounding villages also attended these meetings. While it was not possible to select the villages on any representative basis, the Panel team requested both CELCOR (the NGO representing

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<sup>171</sup> Percentages are based on literacy rates referenced in the Environmental Assessment (p. 42) and population figures presented in the 2000 census data.

<sup>172</sup> OPIC (n.d.) Environmental Assessment, p. 76.

the Requesters) and OPIC to organize separate visits in both provinces to ensure that the Panel team was exposed to different perspectives. None of the smallholders met by the Panel team recalled participating in consultative processes, even in villages listed in the Social Assessment as those where consultations had taken place or from where participants had traveled to attend consultations in another location. That said, the Panel team recognizes that this is not conclusive evidence that there had not been consultation, as the persons who had attended consultations may simply not have been present in the village when the Panel team visited. The Panel team could confirm, however, some limited knowledge of the Project, as some of the smallholders expressed dissatisfaction with having to pay more levies for RMTF; however, most were not aware of the RMTF.



Picture 7: Panel team in discussion with villagers in Oro province

150. While a few smallholders stated that they did not want to grow more oil palm, the majority of smallholders with whom the Panel team spoke expressed interest in, or at least accepted, oil palm as the most viable means for gaining cash income. Nevertheless, nearly all complained about non-transparent and one-sided imposition of levies, a lack of opportunities for income diversification, irregular FFB collection, and a failure to receive their fair share of profit because of the pricing formula, among other things. The Panel notes that Management also stated that, during the consultations for the Social Assessment, unreliable pickup of FFB was one of the most common areas of dissatisfaction. OPIC, the palm oil milling companies, and contract transport came under scathing criticism for what was perceived as very poor pick-up rates and unreliable transport schedules.
151. This notwithstanding, the Panel team's perception is of widespread interest among the smallholders it met to grow more oil palm if the conditions were made more favorable for them. Similarly, at the OPIC office in Popondetta, the Panel team was shown a pile of more than one thousand application forms for infilling, which the Panel team considers to be indicative of some knowledge of, and demand for, the Project.
152. Some of the consultations with smallholders were conducted with the representatives of the Oil Palm Growers Association. During its field visit, the Panel team was informed repeatedly by smallholders in various communities that even though they had selected the

representatives of the Growers Association themselves, they did not have faith in them, nor did they view the Association as representing their interests or speaking on their behalf. Thus, from the perspective of many smallholders, consultations should go beyond the Association and involve smallholders themselves, including women, and their customary leaders in order to adequately gauge their views.

153. In sum, the Panel also could not confirm that there was widespread understanding of, or broad support for, the Project and its components among smallholders. However, the Panel's perception is that of widespread interest among smallholders in growing more oil palm under the right conditions. This will be examined further in the following analysis of compliance on the consultation process.
154. The Panel shares the Requesters' concern that lack of proper consultation may have affected the Project in ways not beneficial to the smallholders.

## **E. Applicable Bank Policies and Procedures**

153. This section describes World Bank policies relevant to the claims made by the Requesters regarding consultation and disclosure of information.

### **1. Indigenous Peoples Policy OP/BP 4.10**

155. The SADP triggered the Indigenous Peoples Policy, OP/BP 4.10, because most of the population in the Project area is indigenous. The Requesters also raised OMS 2.20 on Project Appraisal, in the context of the International Covenant on Economic, Social, and Cultural Rights (ICESCR), to which Papua New Guinea is a signatory. This Treaty commits its parties to work toward the granting of economic, social, and cultural rights (ESCR) to individuals, including, among others, the right to an adequate standard of living. OMS 2.20 requires that, when international agreements are applicable to a project, the Bank "*should be satisfied that the project plan is consistent with the terms of the agreements.*"<sup>173</sup> However, since OP/BP 4.10 covers, and is consistent with, the Treaty's main objectives related to social and cultural rights (insofar as those objectives pertain to indigenous peoples), the Panel's analysis of compliance is focused solely within the parameters of OP/BP 4.10.
156. OP/BP4.10 requires that if Indigenous Peoples are present in the project area, then the Bank must undertake a Social Assessment.
157. In deciding whether to proceed with the project, the Borrower ascertains, on the basis of the Social Assessment (paragraph 9) and the free, prior, and informed consultation (paragraph 10), whether the affected Indigenous Peoples' communities provide their broad support to the project. The communities' broad support must be properly documented, and the Bank reviews the process and the outcome of the consultation carried out by the Borrower to satisfy itself that the affected Indigenous Peoples' communities have provided their broad support to the project. The Bank pays particular attention to the Social Assessment and to

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<sup>173</sup> OMS 2.20, ¶24.

the record and outcome of the free, prior, and informed consultation with the affected Indigenous Peoples' communities to ascertain whether such support exists. The Bank does not proceed further with project processing if it is unable to determine the existence of such support (paragraph 11).

158. Consultation must take place not just during the Social Assessment, but OP 4.10 requires *“a process of free, prior and informed consultation with the affected Indigenous Peoples communities at each stage of the project, and particularly during project preparation, to fully identify their views and ascertain their broad community support for the project”*<sup>174</sup> [emphasis added].
159. BP 4.10 describes *“free, prior and informed consultation as consultation that occurs freely and voluntarily, without any external manipulation, interference, or coercion, for which the parties consulted have prior access to information on the intent and scope of the proposed project in a culturally appropriate manner, form and language,”*<sup>175</sup> and that *“consultation approaches recognize existing Indigenous Peoples Organizations (IPOs) including councils of elders, headmen, and tribal leaders, and pay special attention to women, youth and the elderly”*<sup>176</sup>--and stresses the need to start the consultation process early.<sup>177</sup> The Policy also requires that *“a record of the consultation process is maintained as part of the project files.”*<sup>178</sup> Thus when a project affects Indigenous Peoples, Bank policy requires an extensive process of community consultation as well as determining broad community support for the project.

## **2. Environmental Assessment OP 4.01**

160. With regard to consultation, OP 4.01, Environmental Assessment requires that: *“...during the EA process, the borrower consults project-affected groups and local nongovernmental organizations (NGOs) about the project's environmental aspects and takes their views into account.”*<sup>179</sup> It also requires that *“The borrower initiates such consultations as early as possible.”*<sup>180</sup>
161. The disclosure requirements under OP 4.01 state that *“For meaningful consultations between the borrower and project-affected groups and local NGOs on all Category A and B projects”*<sup>181</sup> *proposed for IBRD or IDA financing, the borrower provides relevant material in a timely manner prior to consultation and in a form and language that are understandable and accessible to the groups being consulted.”*<sup>182</sup> Moreover, the Policy requires that *“Any separate Category B report for a project proposed for IDA financing is made available to project-affected groups and local NGOs. Public availability in the*

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<sup>174</sup> OP 4.10, ¶6(c).

<sup>175</sup> Ibid., ¶2(a).

<sup>176</sup> Ibid.

<sup>177</sup> Ibid., ¶2(c).

<sup>178</sup> Ibid., para 2(d).

<sup>179</sup> OP 4.01 – Environmental Assessment, ¶ 14.

<sup>180</sup> Ibid.

<sup>181</sup> SADP is a Category B project.

<sup>182</sup> OP 4.01, s. 15.

*borrowing country and official receipt by the Bank of ... any Category B EA report for projects proposed for IDA funding are prerequisites to Bank appraisal of these projects*”<sup>183</sup> and that EA reports for Category B projects are made publicly available at the InfoShop after the Bank receives them.

## **F. Panel’s Analysis of Compliance with Bank Policies**

162. This section presents the Panel’s analysis of Management’s compliance with applicable Bank policies, as summarized in the previous section. It addresses three broad sets of issues: socioeconomic and cultural fact finding supporting Project design; free, prior, and informed consultation; and evidence of broad community support. The first part analyses compliance of the Social and Beneficiaries Assessments with the requirements of Annex A of OP 4.10. The second part analyses the elements of free, prior and informed consultations, and the last part includes an analysis of evidence of broad community support. This section concludes with final reflections of the Panel.

### **1. Socioeconomic and Cultural Fact Finding Supporting Project Design**

163. The Social Assessment Report and the Beneficiaries Assessment Report, both dated January 2007, include summaries of different measures suggested for ensuring benefits and mitigating negative impacts of the Project for each category of smallholders based on their land tenure status.<sup>184</sup> The Social Assessment and Beneficiaries Assessment were undertaken by two leading scholars specializing in Papua New Guinea, with particular expertise in the oil palm sector, and fluent in Tok Pisin. Since the Beneficiaries Assessment accompanies the Social Assessment and summarizes some of the information required under OP 4.10, the adequacy of the two documents is considered together below.

164. Annex A of OP 4.10 lists the five detailed requirements for the Social Assessment:

- (a) *A review, on a scale appropriate to the project, of the legal and institutional framework applicable to Indigenous Peoples.*
- (b) *Gathering of baseline information on the demographic, social, cultural, and political characteristics of the affected Indigenous Peoples’ communities, the land and territories that they have traditionally owned or customarily used or occupied, and the natural resources on which they depend.*

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<sup>183</sup> OP 4.01, s. 17.

<sup>184</sup> The objectives of the Social Assessment include: increasing opportunities for optimising social development outcomes through the identification of the project beneficiaries and their needs, ideas, and expectations; verifying the validity and outcomes of the consultation process and examine possibilities for effective community participation; minimizing adverse social impacts which might be caused by SADP; mitigating unavoidable adverse social impacts and social costs of the Project; proposing guidelines for adopting a socially sustainable project design; preparing key socio-economic and social indicators for project monitoring and evaluation. Social Assessment Report (Jan 2007) and G. Koszberski and G.N. Curry. (2007). Beneficiaries Assessment Report for the Smallholder Agricultural Development Project (SADP). Papua New Guinea.

- (c) *Taking the review and baseline information into account, the identification of key project stakeholders and the elaboration of a culturally appropriate process for consulting with the Indigenous Peoples at each stage of project preparation and implementation (see paragraph 9 of this policy).*
- (d) *An assessment, based on free, prior, and informed consultation, with the affected Indigenous Peoples' communities, of the potential adverse and positive effects of the project. Critical to the determination of potential adverse impacts is an analysis of the relative vulnerability of, and risks to, the affected Indigenous Peoples' communities given their distinct circumstances and close ties to land and natural resources, as well as their lack of access to opportunities relative to other social groups in the communities, regions, or national societies in which they live.*
- (e) *The identification and evaluation, based on free, prior, and informed consultation with the affected Indigenous Peoples' communities, of measures necessary to avoid adverse effects, or if such measures are not feasible, the identification of measures to minimize, mitigate, or compensate for such effects, and to ensure that the Indigenous Peoples receive culturally appropriate benefits under the project.*<sup>185</sup>

#### **a. Review of the Legal and Institutional Framework Applicable to Indigenous Peoples**

165. The first element of a Social Assessment (under Annex A of OP 4.10) is the review of the *“legal and institutional framework applicable to Indigenous Peoples.”*<sup>186</sup> The Social and Beneficiaries Assessments explain the various categories of land tenure, and existing and potential conflicts that can occur around ownership and use issues. The Assessments offer concrete and useful recommendations to address issues for each of the categories.
166. The recommended actions are mainly to be undertaken by OPIC, the Department of Lands and Physical Planning, and Provincial Lands Offices, often in consultation with customary landowner groups. The Beneficiaries Assessment refers to the key role of clan leaders in controlling the allocation of land,<sup>187</sup> and recognizes the importance of having community meetings facilitated by *“respected community leaders.”*<sup>188</sup> The Beneficiaries Assessment goes on to say that *“Clan leaders still command considerable respect and authority in their communities and **without their active support, it is unlikely that SADP-supported activities will succeed or gain the support of the broader community** [emphasis added].”* It recommends that *“SADP personnel should identify the local clan leaders and involve them in decision making regarding SADP activities.”*<sup>189</sup>

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<sup>185</sup> OP 4.10, Annex A.

<sup>186</sup> OP 4.10, Annex A.

<sup>187</sup> Beneficiaries Assessment, p. 11.

<sup>188</sup> Ibid., p. 36.

<sup>189</sup> Koszberski and Curry 2007, p. 11.

167. Despite this recommendation, there is little further discussion or information in the Social and Beneficiaries Assessment on the identification of customary leadership, decision-making structures, and dispute-mediation and conflict-resolution processes applicable to Project-affected Indigenous Peoples, nor of how they might differ across various ethnic groups.
168. Such information is likely to be key, for example, in addressing the question of who decides, how, when, and whether specific families choose to cultivate more oil palm, either to re-plant, or to go for the infilling option; on which piece of customary land; and which land can be made available to other clans/sub-clans, settlers or mini-estates for oil palm cultivation. One recommendation in the Beneficiaries Assessment is for OPIC extension officers to develop skills in “*surveying and the use of maps, recording genealogies and clan structures, and customary land dispute mediation.*”<sup>190</sup> Thus, the importance of recording genealogies and clan structures, as part of the process of addressing land tenure issues, and the existence of customary dispute-mediation mechanisms, is recognized. But there is no further elaboration in the Social and Beneficiaries Assessments.
169. This absence of analysis in the Social Assessment does not correspond to the terms of reference of the Social Assessment, which specifies that it should “*Gather anthropological information (primarily socio-political) on significant variations (if any) between or among the various indigenous groups in the project areas of West New Britain and Oro regarding the local political economy leadership, political competition, decision making, representation, and relations/linkages with LLGs.*”<sup>191</sup>
170. As noted in OP 4.10, the identification of the legal and institutional framework, including customary leadership and decision-making processes, is critical for consultation and for gaining community support. **The Panel finds that the analysis of the legal and institutional framework of customary law, leadership, decision-making and dispute-resolution processes, and the variations (if any) of these practices among different ethnic groups, fell short of the requirements of Annex A of OP 4.10, and thus did not comply with Bank Policy.**

#### **b. Gathering Baseline Information**

171. While the Social Assessment and Beneficiaries Assessment contain a wealth of information on social and economic issues affecting oil palm growers in the various Project areas, it does not include sufficient “*social, cultural, and political characteristics of the affected Indigenous Peoples,*”<sup>192</sup> as required by Annex A of OP 4.10, to complete an ethnographic baseline. The Beneficiaries Assessment identifies the major ethnolinguistic groups in the two Project provinces. The indigenous inhabitants of the Project area in Oro province (as well as most of the Requesters) are from one large ethnic and cultural group, the Orokaiva, comprised of seven tribes--each with several patrilineal clans and sub-clans--with a high degree of cultural uniformity. The Beneficiaries Assessment identifies their language as

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<sup>190</sup> Beneficiaries Assessment, p. 39.

<sup>191</sup> Terms of Reference, p. 138.

<sup>192</sup> OP 4.10, Annex A, ¶ 2(b).

Orokaiva, which has several dialects.<sup>193</sup> The population of West New Britain province is far more diverse, with seven major ethnic/tribal groups speaking some 25 languages,<sup>194</sup> about whom the Beneficiaries Assessment notes that “*whilst there are minor differences in the subsistence and agricultural systems of the various ethnic and language groups, they share similar social and cultural systems.*”<sup>195</sup> In addition, in both Oro and WNB, a large number of settlers were brought in to cultivate oil palm and cacao. Many came from some of the overpopulated areas of the Highlands, Sepik, Morobe, and Gazelle Peninsula, thus adding to the heterogeneity of the population as noted in the Beneficiaries Assessment.<sup>196</sup>

172. Nonetheless, the Beneficiaries Assessment concludes that in both provinces “*the indigenous ethnic/language groups are relatively homogenous in terms of culture, social organization, and land tenure systems.*”<sup>197</sup>



Picture 8: Panel team at a village in Oro province

173. For the most part, the analyses of indigenous groups in the social and environmental assessment documents support the conclusion of relative homogeneity. Both largely reside in villages that are organized “*based on kinship in which the component clans and sub-clans can trace their genealogies to a common ancestor.*”<sup>198</sup> However, one important difference emerges from the social organization of indigenous groups in Oro versus those in WNB. The Beneficiaries Assessment notes that while land tenure and social structure in Popondetta are “*strongly **patrilineal** [emphasis added] with men inheriting the tenure rights of their fathers, and women moving to their husband's village after marriage,*” clans in northern West New Britain are “*predominantly **matrilineal** [emphasis added] with access through the mother's lineage so that a man has primary rights over his mother's property,*

<sup>193</sup> Beneficiaries Assessment, p. 8. The differences among these communities of speakers are classified as different but closely related “languages” by some authors (including Gordon 2005, Bashkow 2006) and as different “dialects” of one language in the Beneficiaries Assessment.

<sup>194</sup> Ibid., p. 8.

<sup>195</sup> Ibid., p. 9.

<sup>196</sup> Beneficiaries Assessment, p. 6.

<sup>197</sup> Ibid., p. 8.

<sup>198</sup> Beneficiaries Assessment, p. 9.

*and these rights pass on to his sisters' sons after his death (rights vested in his eldest sister's eldest daughter)."*<sup>199</sup>

174. The differences between patrilineal and matrilineal societies are significant. For example, *"In the matrilineal societies of northern WNB, an important distinction is made between land under export cash crops like oil palm and land used for subsistence food production. Oil palm blocks are usually inherited by a man's children while the land used for garden production is still governed by matrilineal principles and so passes to his sisters' sons on his death."*<sup>200</sup> The difference between matrilineal and patrilineal societies goes further than just relating to property inheritance: *"In WNB, the position of clan leader is tied to particular matrilineages, with men inheriting the status from their maternal uncles."*<sup>201</sup> Furthermore, the Beneficiaries Assessment notes that *"In the matrilineal societies of WNB it is important to involve female clan leaders who **tend to be less public in their leadership roles than men but who nevertheless exercise authority behind the scenes** [emphasis added]."*<sup>202</sup>
175. These differences arising from lineage systems may have consequences for SADP in terms of ownership and management of land and customary decision-making processes. Furthermore, while Orokaiva constitute the majority in Oro, the population of WNB is far more diverse, with seven major ethnic/tribal groups speaking some 25 languages.
176. Also, as mentioned in Chapter 2, some scholars hold the view that the Orokaiva are not a homogenous group and have noted the *"wide variation that exists among local communities in details of social organization, ritual, diet, arts, and traditional knowledge"*. That said, it is also acknowledged that there are some "basic similarities" within Orokaiva society which include variations of some Melanesian cultural themes such as the centrality of gift exchange in sociality, the spirit of 'eclecticism' and 'opportunism' [...], *the fluidity of leadership and land tenure, a subsistence economy based on shifting agriculture, and highly autonomous notions of the person*".<sup>203</sup>
177. The terms of reference for the Social Assessment state that, *"This assessment shall give special attention to significant variations (if any) among various indigenous groups by identifying the various communities, consulting with them and undertaking social assessments to assess potential impacts, both positive and adverse."*<sup>204</sup> As will be discussed later in this chapter, this analysis would have been essential for conducting adequate consultations with affected indigenous groups.
178. Annex A of OP 4.10 also requires that baseline information is gathered on, *"the land and territories that they have traditionally owned or customarily used or occupied, and the natural resources on which they depend."*<sup>205</sup> The Beneficiaries Assessment describes the

<sup>199</sup> Beneficiaries Assessment, p. 10.

<sup>200</sup> Social Assessment Report (January 2007), p. 32.

<sup>201</sup> Beneficiaries Assessment, p. 11.

<sup>202</sup> Ibid.

<sup>203</sup> Bashkow, 2006, p. 31-32.

<sup>204</sup> Terms Of Reference, p. 137.

<sup>205</sup> OP 4.10 Annex A, ¶ 2(b).

land area and natural resources<sup>206</sup> and refers briefly to hunting and fishing, and more extensively to food gardens. However, the Assessment notes that these practices are homogenous among Project-affected indigenous groups. **The Panel could not find adequate evidence and information in the Social or Beneficiaries Assessments to support the conclusion about the relative homogeneity of various affected indigenous groups. It is the Panel's view that a more thorough treatment of the extent to which different communities rely on alternative livelihood sources (e.g., cash crops, gardens for home and local market, fishing, hunting), as well as maps delineating the areas inhabited by different ethno-linguistic groups, would have been helpful and appropriate.**

179. **The Panel is of the view that a more thorough analysis of the characteristics of the various Project-affected ethnic groups, especially with regard to key issues affecting the Project (e.g., land tenure and inheritance, customary decision-making processes, practices regarding food gardens) should have been included in the Social and Beneficiaries Assessments before concluding that these groups were “relatively homogenous.” The absence of key baseline information is a shortcoming of these assessments, which the Panel finds not to be in compliance with OP 4.10.**

**c. Identification of Project Stakeholders and Elaboration of a Consultation Process with Indigenous Peoples**

180. The Social Assessment identifies various stakeholder categories to be consulted, although not in terms of specific indigenous communities.<sup>207</sup> The Beneficiaries Assessment contains an elaborate framework, entitled “Beneficiary Participation Framework,” for each of the three SADP components (Tables 6.1 to 6.3) identifying action to be taken by various stakeholders. This framework emphasizes three areas: to consult with, and promote the dissemination of information to all stakeholders; to ensure that vulnerable groups such as women, youth, and blockholders with insecure landholdings are benefitted by the Project; and to move decision-making to the local and community level. An example of proposed actions under this framework is *“In VOP areas identified for infill, community meetings should be held during planning stage to discuss and decide optimum location for feeder roads (to reflect distribution of clan land holdings) and to plan for the future needs of youths from landowning clans for access to land for oil palms. Community meetings to be facilitated by respected community leaders. Village facilitator to maintain close collaboration with OPIC.”*<sup>208</sup>
181. **The Panel finds that the Social and Beneficiaries Assessments elaborate a consultation process to be conducted at each stage of the Project as required by OP 4.10. However, the Panel finds that the Consultation Framework is not culturally appropriate given the shortcomings in the review of the legal and institutional framework and gathering of baseline information on indigenous communities, and therefore does not comply with OP/BP 4.10.** Whether and how consultation was actually undertaken in the course of

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<sup>206</sup> Beneficiaries Assessment, pp. 8-12.

<sup>207</sup> Social Assessment, pp. 71-72.

<sup>208</sup> Beneficiaries Assessment, p. 36, Table 6.1.

planning and implementation will be discussed at length in the next section, “Free, Prior, and Informed Consultation.”

#### **d. Assessment of Effects of the Project on Indigenous Peoples**

182. Annex A of OP 4.10 requires “An assessment, based on free, prior, and informed consultation, with the affected Indigenous Peoples’ communities, of the potential adverse and positive effects of the project. Critical to the determination of potential adverse impacts is an analysis of the relative vulnerability of, and risks to, the affected Indigenous Peoples’ communities given their distinct circumstances and close ties to land and natural resources, as well as their lack of access to opportunities relative to other social groups in the communities, regions, or national societies in which they live.”<sup>209</sup>
183. The Social Assessment identifies some of the potential problems associated with the introduction of incentives for cash crop farming, which are also raised in the Request for Inspection. The Assessment refers to cash-crop farming and the competition it provides for subsistence gardens, and to the ways in which cash is interpreted or distributed within particular social systems.
184. The Social Assessment also identifies the issue of adverse consequences from cash income. Although the negative consequences associated with oil palm production were not widely acknowledged in the past, they had become apparent by the end of the Oro Smallholder Oil Palm Project (1992-2001). The Social Assessment correctly identifies the problems faced by the communities, particularly on oil palm paydays, which included gambling, heavy alcohol use, prostitution, and family violence. The Social Assessment also notes that women felt particularly affected by these problems, as they suffered the brunt of the violence, maintained the integrity of the family, kept food on the table, and saved sufficient money for family health needs and children’s education. The Social Assessment also identifies the potentially devastating consequences of the prevalence of Human Immunodeficiency Virus/Acquired Immune Deficiency Syndrome (HIV/AIDS).
185. The Assessment analysed at length the critical issue accounting for the paradox of income not resulting in improved living standards, namely, “the absence of an effective savings mechanism to isolate a component of cash earnings from the demands of the traditional exchange economy and other competing demands on income, which is seen by growers as a major constraint on their ability to accumulate savings.”<sup>210</sup> The Assessment also elaborates on the example of the Bialla Growers Fund, a special purpose saving fund, much in demand by the Bialla smallholders, as a successful example of a mechanism that has managed to isolate savings from such competing demands. However, there is no further examination of culturally appropriate ways in which income can be isolated in ways that prevent *wantok* members from making a claim.<sup>211</sup>

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<sup>209</sup> Annex A, OP. 4.10, ¶ 2 (d).

<sup>210</sup> Social Assessment, p.76.

<sup>211</sup> See Nimal Fernando, *Informal Finance in a Semi-Subsistence Economy: The Case of Papua New Guinea*, National Research Institute Discussion Paper, Number 62, 1991, for examples of informal savings and credit groups in Papua New Guinea. One example of an informal and culturally appropriate savings and credit scheme existing in

186. **The Panel finds that the Social Assessment identified potential adverse and positive effects of SADP in accordance with OP/BP 4.10.** However, it is the Panel's view that, had the legal and institutional framework been analysed in full, including conducting and providing robust baseline information and carrying out an adequate consultation process, the identification of potential adverse and positive effects may have been more thorough.

**e. Identification of Measures to Avoid Adverse Effects and Ensure that Indigenous People Receive Culturally Appropriate Benefits**

187. Annex A of OP 4.10 requires *“The identification and evaluation, based on free, prior, and informed consultation with the affected Indigenous Peoples’ communities of measures necessary to avoid adverse effects, or if such measures are not feasible, the identification of measures to minimize, mitigate, or compensate for such effects, and to ensure that the Indigenous Peoples receive culturally appropriate benefits under the project.”*<sup>212</sup>
188. The Social Social Assessment describes at length the socioeconomic circumstances of the smallholders, particularly of LSSs (whose living conditions are strained by population growth and land pressure), and the negative consequences of the availability of large amounts of cash within a society with strong social obligations to share. The Assessment discusses alternative sources of livelihoods, especially the critical importance of food gardens. It then recommends detailed measures to minimize the adverse effects, mainly through measures to lessen the financial hardship on loan repayments, and it describes a savings mechanism desired by the Bialla community. (The analysis on livelihoods in the next chapter will discuss the measures recommended in the Social Assessment.)
189. **The Panel finds that the Social Assessment does identify some measures to avoid, minimize, and mitigate adverse effects and to ensure that indigenous people receive culturally-appropriate benefits under the Project. However, as noted above and discussed further below, consultations with the relevant stakeholders about the adequacy and appropriateness of the proposed Project design were not carried out in compliance with Bank policy.** Adequate consultations and literature review would likely have resulted in greater attention to the importance of non-cash crop gardening and could also have identified ways to mitigate the problems associated with cash payments in the Oro region.

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rural Papua New Guinea cited in the Paper is the “Wok Meri” group which is based on kinship. “Wok Meri is the Tok Pisin term for “women’s work” and each group “engages in savings under the leadership of one or two ‘big women’ ...She organizes a new group, establishes and maintains ties with big women from other groups, arranges meetings and ceremonies...the big women also encourage their group to save more money.” (p.9). Also, “Wok Meri groups have a savings system they say is similar to banking. Each woman deposits her money into an account and a record is kept in her small notebook, which is labeled her passbook. Her money is kept in her own cloth bundle or mesh bag and all the members’ bundles of money are stored together in the leader’s house. Money is deposited at meetings in the evening of a market day. So, the women can save some of their money, before they are tempted to spend it or are asked for money by spouses and children.” (p. 9-10), and “The Wok Meri groups...also operate in the informal credit market in addition to their savings function. These groups have inter-group transactions.” (p. 11), and “The Wok Meri is undoubtedly a more complex system of savings and credit ... and involves a fairly long-term commitment of the members. The savings phase itself ranges from five to nine years.” (p. 12)

<sup>212</sup> OP 4.10, Annex A, ¶ 2(e).

190. The issue of whether the measures identified and recommended in the Social Assessment were included in the Project design will be discussed in chapter 4.

#### **f. Summary of Findings on Compliance**

191. The Panel finds that the Social and Beneficiaries Assessments were in compliance with OP 4.10 in including sections with concrete recommendations on measures to avoid adverse effects, and responding to potential negative consequences of oil palm production. The Panel finds, however, deficiencies in the way potential beneficiaries and Project affected people were involved in discussing the adequacy and appropriateness of these recommendations. Moreover, the Panel finds that the Social Assessment did not adequately cover information on customary laws, leadership, decision making and dispute resolution processes, with potential consequences for the consultation process as well as the design of the Project. Further, the Social Assessment did not adequately explore the diversity of indigenous groups in the Project areas before reaching the conclusion of relative homogeneity. These gaps, had they been addressed, would have brought the Assessments more in accordance with the intent of the Indigenous Peoples Policy.

### **2. Free, Prior and Informed Consultation**

192. Free, prior, and informed consultation is one of the most important elements of the Indigenous Peoples Policy. According to OP 4.10, the following is required to ensure such consultation:

*(a) establishe[s] an appropriate gender and intergenerationally inclusive framework that provides opportunities for consultation at each stage of project preparation and implementation among the borrower, the affected Indigenous Peoples' communities, the Indigenous Peoples Organizations (IPOs) if any, and other local civil society organizations (CSOs) identified by the affected Indigenous Peoples' communities;*

*(b) use[s] consultation methods appropriate to the social and cultural values of the affected Indigenous Peoples' communities and their local conditions and, in designing these methods, give[s] special attention to the concerns of Indigenous women, youth, and children and their access to development opportunities and benefits; and*

*(c) provide[s] the affected Indigenous Peoples' communities with all relevant information about the project (including an assessment of potential adverse effects of the project on the affected Indigenous Peoples' communities) in a culturally appropriate manner at each stage of project preparation and implementation.<sup>213</sup>*

193. The following sections present the Panel's analysis of the Project's compliance with the principles of OP 4.10's free, prior and informed consultation requirement.

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<sup>213</sup> OP 4.10

### a. Documentation of Consultation

194. In its Response, Management notes that, “free, prior and informed consultations were undertaken during Project preparation and that broad community support for the Project exists in the Project areas.”<sup>214</sup> The Management Response continues by stating that “[t]he Social Assessment and the Beneficiaries Assessment thoroughly document the findings of the consultations that were held. But Management recognizes that there was insufficient documentation of the consultation process in the Social Assessment. The Social Assessment report does not discuss what information was systematically shared with participants during various consultations, how information was conveyed or how locations and participants were selected.”<sup>215</sup> Furthermore, Management acknowledges that “...the requirements of OP 4.01 were not fully met, in that the only information shared with stakeholders during consultations for the EA was in verbal form.”<sup>216</sup>
195. Although the Beneficiaries Assessment proposes a framework, which is also included as an annex in the Project Implementation Manual (PIM) that emphasizes the importance of consultation including with smallholders at each stage of project preparation and implementation, the Panel could not find evidence that such a framework was elaborated on and applied at each stage of Project preparation and implementation.<sup>217</sup>
196. The Panel notes that many of the consultations occurred very early in the Project’s design, when it was expected that the successor to the Oro Smallholder Project (1992-2001) would follow within a relatively short period of time.<sup>218</sup> Management stated that “The Project design benefited from the long association of the Bank with the oil palm subsector and incorporated the lessons drawn from earlier investments, and particularly from the Oro Smallholder Oil Palm Development Project, which closed in 2001.”<sup>219</sup>
197. As discussed in Chapter 2, however, there was a long gap, during which the smallholder oil palm sector, particularly in Oro province, suffered because of relative neglect. The sector was further devastated by Cyclone Guba in 2007,<sup>220</sup> and the global price of palm oil suffered a steep decline in late 2008. As explained in Chapter 2, the success of the earlier project raised expectations, but the long period where project support was absent led increasingly to a decline in services, and thus to unmet expectations and frustration.<sup>221</sup> These changing circumstances warranted intense consultation with the smallholders, even before the Social Assessment, as the Assessment was already predicated on the SADP plan. Therefore, the possibility of significant changes in the Project design was limited.
198. For example, take the issue of infilling versus replanting. The PAD identifies that although the Project intended originally to include both infilling and replanting, there was a shift

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<sup>214</sup> Management Response, p. 42.

<sup>215</sup> Ibid.

<sup>216</sup> Management Response, ¶ 85.

<sup>217</sup> Beneficiaries Assessment.

<sup>218</sup> PAD, ¶ 4, Footnote 2

<sup>219</sup> Management Response, p. 8, ¶. 26.

<sup>220</sup> Ibid., p. 34, ¶ 110.

<sup>221</sup> Management Response, p. 26, ¶ 80.

resulting in exclusive support for infilling.<sup>222</sup> The Panel notes that when the Project was conceived after the completion of the 1992-2001 project, “it was aimed at ensuring the long-term sustainability of the smallholder oil palm sub-sector, mainly with regard to financing the replanting of old palms, road maintenance, smallholder productivity and institutional capacity.”<sup>223</sup> The Project Concept Document (2003)<sup>224</sup> and Management’s Identification Update Mission Final Aide Memoire (2005)<sup>225</sup> defined the proposed objectives as: replanting about 6,500 hectares of aging oil palm blocks and developing financing mechanisms to meet future replanting needs; and, establishing about 6,000 hectares of new village oil palm on vacant blocks alongside existing roads.

199. The PAD, however, states that “A replanting program exists in each scheme but would not be included in the project as they are part of the oil palm production system. The palm oil milling companies have agreed to continue their support for the replanting program into the project period and beyond by carrying the associated smallholder loans themselves.”<sup>226</sup> Similarly, the September 20-October 7, 2010, Mid-Term Review-Final Aide Memoire makes it clear that the SADP does not fund replanting and generally identifies infilling as a major Project component.<sup>227</sup>
200. The Panel could not find evidence of consultation with the smallholders or with oil palm growers’ associations while this “change of emphasis” occurred. On the contrary, the consultations that did occur before the shift showed a preference for replanting. Early consultations, during November 25-December 8, 2001, with oil palm growers’ association members in Popondetta revealed that the members wanted the Project to support smallholder replanting and that a replanting fund should be considered.<sup>228</sup> Similarly, the oil palm growers’ association in Bialla indicated that one of its priorities was the poisoning of aged oil palm to allow for replanting.<sup>229</sup> This continued to be a primary concern on May 10, 2006, during consultations with the oil palm growers’ association in Popondetta.<sup>230</sup>
201. The Panel finds no record of consultation concerning the Project’s removal of replanting as a component, despite the apparent interest in replanting expressed by the groups consulted early on in the Project cycle. Although some consultations did occur after the shift with the oil palm growers’ associations, it is unclear whether this shift in Project focus was clarified.

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<sup>222</sup> PAD, p. 16, ¶ 51. “The change of emphasis of the proposed project (from replanting 6,500 ha and new planting 6,000 hectare (“infilling” along existing roads), to infilling of up to 9,000 ha with no replanting) was discussed with the relevant DEC officials. DEC confirmed that its letter of May 23, 2006, would remain valid so long as the principle of “infilling” along existing roads was maintained and the provisions in the DEC letter adhered to.”

<sup>223</sup> Papua New Guinea Smallholder Agriculture Development Project, Minutes Of PCD Review Meeting, June 25, 2003.

<sup>224</sup> Project Concept Document, 2003, p.5.

<sup>225</sup> Papua New Guinea Proposed Smallholder Agriculture Development Project, Identification Update Mission Final Aide Memoire, October/November 2005.

<sup>226</sup> PAD, p. 30, ¶ 9.

<sup>227</sup> October 7, 2010 Mid-Term Review-Final Aide Memoire, ¶ 18.

<sup>228</sup> Management Response, Annex 2 Summary of Consultation, p. 70.

<sup>229</sup> Ibid., p. 72.

<sup>230</sup> Ibid., Annex A, p. 75.

By the time of the Social Assessment, infilling--and not replanting--was a key Project component and, thus, consultations were carried out on this premise.<sup>231</sup>

202. The Panel also notes that New Britain Palm Oil Group, which took over the management of Higaturu Oil Palm Limited in Oro province in April 2010, has reservations about the infilling program<sup>232</sup> and is giving priority in allocating seedlings and other supplies to replanting rather than infilling under the Memorandum of Agreement for Infilling Credit Component.<sup>233</sup> This adds to the concern about the adequacy of consultation over the issue of infilling versus replanting. **The Panel finds that the absence of consultation with smallholders on the change in Project design signified by the shift in Project emphasis from both infilling and replanting to only infilling, did not comply with OP 4.10.**

#### **b. Consultation with Customary Leaders**

203. As noted earlier, the Panel found that the Social Assessment did not adequately identify the customary leadership and decision-making structures. Project documents are also unclear about how consultations have involved clan and sub-clan leaders, despite the Beneficiaries Assessment noting their importance. **The Panel could not find evidence in Project documents that the consultations, when conducted, specifically sought the input of clan leaders other than the ones represented in the modern leadership groups (particularly LLGs).**
204. The Project Implementation Manual (PIM) for the Community Development component, for example, makes no reference to clan leaders and customary decision-making processes. For example, the Manual states:

*The key to improving the effectiveness of the WDCs (ward development committees) will be the participation of informal groups and individuals at the community level to ensure genuine representation and to augment the currently limited capacity and resources of the WDC.*<sup>234</sup>

*The current WDCs may not be fully inclusive of all community interests. Therefore, open meetings, and a more broadly-based and community-selected planning groups at the ward level are methods that will be employed to encourage more inclusive participation.*<sup>235</sup>

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<sup>231</sup> Ibid., Annex 2 Summary of Consultations, pp. 70-79.

<sup>232</sup> Aide Memoire, Fifth Implementation Support Mission: April 15 – April 19, 2011 ¶ 5 and Footnote 2. Also, in a meeting with the Panel team, Kula/Higaturu Oil Palm management emphasized that the Project should focus on increasing yields on existing blocks rather than increasing oil palm production through infilling. This observation was made in light of the Company's view that there were not enough young people in Oro to manage oil palm blocks as most go to Port Moresby to work. Therefore, there is "need based" harvesting in Oro, and blocks are not well managed by the older generation, which is unable to tend a typical two-hectare block.

<sup>233</sup> Memorandum of Agreement between PNG Microfinance Limited and Oil Palm Industry Corporation and Higaturu Oil Palms Ltd and PNG Sustainable Development Program Limited in Relation to Implementation of the Infilling Credit Component of the Government of PNG, Smallholder Agricultural Development Project, s. 3.3.2.

<sup>234</sup> PIM, p. 5.

<sup>235</sup> PIM, p. 6.

205. Thus, even when addressing the need for effectiveness and inclusiveness of the Ward Development Committees, no mention is made of customary leadership. This oversight would be even more significant in matrilineal societies where female clan leaders are likely to not have been well represented among those holding modern leadership positions.

**c. Sharing of Information in Appropriate Form and Language**

206. The diversity of languages spoken in WNB, and the fact that most may lack literacy in English or Tok Pisin, has already been noted. Management acknowledges that “*no documents were translated into local languages.*”<sup>236</sup> Furthermore, “*all focus group discussions with oil palm smallholders and non-oil palm growing households were held in Tok Pisin.*”<sup>237</sup> That is, not in Orokaiva in the case of Oro, or one of the vernacular languages in WNB in which a greater number of smallholders may have been more fluent.
207. As noted above, the Management Response states that the Social Assessment does not discuss what information was shared during the various consultations. As a result, the Panel could not assess whether the indigenous communities had any access to information prior to the consultations. In describing “*free, prior and informed consultation,*” the Policy notes that such consultation must involve “*prior access to information on the intent and scope of the proposed project in a culturally appropriate manner, form and language.*”<sup>238</sup>
208. On disclosure, Management acknowledges that “*...no documents were translated into local languages*”<sup>239</sup> but they were subsequently made available at the World Bank InfoShop on February 22, 2007.
209. As to consultation for the Environment Assessment, the Management Response notes that two meetings on environmental issues were held with NGOs in Port Moresby, on January 31, 2004, and May 25, 2006. Both of these meetings were held at the request of the World Bank and, judging from the notes recorded in Annex 3 of the Management Response, the Bank held these meetings to inform the NGOs about certain aspects of the coming consultation and design process, i.e., they seemed to have a prime purpose of information dissemination.
210. The consultants who carried out the EA did consult with some Project-affected groups. Furthermore, Management did take note of some of the environmental (and social) concerns expressed by those consulted, and consequently included a provision for bi-annual independent environmental and social audits in the Project design (as included in the PIM).<sup>240</sup>
211. None of the documentation associated with the EA indicates whether the EA consultants provided any “*...relevant material in a timely manner prior to consultation and in a form*

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<sup>236</sup> Management Response, p. 40.

<sup>237</sup> Ibid., p. 43.

<sup>238</sup> BP4.10, 2(a).

<sup>239</sup> Management Response, p. 40, ¶ 129.

<sup>240</sup> PIM, p. 24.

*and language that are understandable and accessible to the groups being consulted,*<sup>241</sup> as required by OP 4.01. Management acknowledges that the only information shared with stakeholders during consultations for the EA was done verbally.<sup>242</sup> The report on the EA workshop with Project-affected groups in Port Moresby is silent on this issue, but a reading of the report suggests that no material was distributed before the event. The same conclusion applies in relation to consultations carried out in West New Britain and Oro provinces during the subsequent field visits (i.e., no material in any language was distributed prior to the consultations).

212. **The Panel finds that none of the documentation associated with the Environmental Assessment indicates whether any relevant material was provided in a timely manner prior to consultation and in a form and language understandable and accessible to the groups being consulted, as required by OP 4.01.**
213. **Furthermore, while the EA and related documentation were publicly disclosed in Port Moresby and Washington on February 22, 2007, and while formal notification to the public announcing where the documents were disclosed was published by OPIC in the press on the same day, the documents were made available only in English, and not in a form and language understandable and accessible to the groups being consulted. This does not comply with the free, prior, and informed consultation requirement of OP/BP 4.10.**

#### d. Summary of Findings on Compliance

214. **The Panel thus finds significant shortcomings in the consultation process. In particular, Management failed to provide relevant information prior to consultations in a culturally appropriate manner, form, and language. This does not comply with OP 4.10 and OP 4.01.**
215. The Panel recognizes, however, the considerable effort that Management is making to strengthen communication activities by encouraging OPIC to undertake various forms of consultations, namely face-to-face meetings, radio broadcasts, field days, and newsletters.<sup>243</sup> The Management Response also states (paragraph 86) that “*Additional consultations are planned for various Project activities throughout implementation to ensure informed participation.*”
216. Going forward, the Panel notes that the Project will be undertaking key activities that involve stakeholder consultation, namely the RMTF study and FFB Pricing Study. The Panel hopes that such consultations will be conducted in accordance with the intent of OP 4.10 (Indigenous Peoples)--that is, with special attention to soliciting the views of the indigenous smallholders, and with due reference to the customary decision-making

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<sup>241</sup> OP 4.01, ¶ 15.

<sup>242</sup> Management Response, p. 49.

<sup>243</sup> Papua New Guinea: Smallholder Agriculture Development Project (Credit No. 4374-PNG), Aide Memoire, Mid-Term Review, ¶20.

structure of each of the indigenous peoples--and go beyond merely transmitting Project information.

### 3. Evidence of Broad Community Support

217. As noted above, the objective of the consultative process, in accordance with OP 4.10, is to ensure “*broad community support*” for Bank-financed projects involving indigenous peoples.<sup>244</sup> The Panel’s independent observation confirms a broad community interest in growing oil palm as the most viable option for earning cash income. But the Panel also observed frustrations about the negative aspects of oil palm, namely multiple levies, unreliable pickup of FFB, fluctuating prices, and a perception of an unfair payout ratio.
218. Management states that “*There is very strong support for the Project in all project areas and during the consultations people expressed high expectations of what the Project would deliver.*”<sup>245</sup> However, Management’s own more recent assessment, quoted above, is that the Project “*is poorly understood by many of its beneficiaries (including the growers association).*”<sup>246</sup> Based on this statement, the Panel questions whether broad community support can be established if understanding of the Project is lacking.
219. In the Panel’s view, the widespread community interest in growing oil palm cannot be equated with broad community support for the Project. “*Broad Community Support*” can only be confirmed on the basis of free, prior, and informed consultation, as noted by OP 4.10. Furthermore, **the Panel was unable to find in Project documents, including the Social and Beneficiaries Assessments, any information documenting how broad community support was reached. The Panel finds that this is not in compliance with OP 4.10.**

### 4. Final Reflections

220. In summary, the Panel believes that adequate consultation, respecting customary structures and languages and allowing prior access to Project information, would have had a significant impact on the design and implementation of the SADP. With such consultation at each stage of the Project, indigenous smallholders would have had the opportunity to express their concerns about the Project components and their views on alternative approaches. This process would have yielded constructive improvements in Project design and implementation. In particular, inadequate consultation may have undermined the potential benefits that smallholders were expecting from the Project with regard to improving livelihoods and design of the road maintenance mechanism. These issues will be explored in chapters 4 and 6.

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<sup>244</sup> OP 4.10, ¶11 lists the requirements of documenting “*broad community support*”; these include (among others) documenting the findings of the social assessment, documenting the process of free, prior, and informed consultation, formal agreements reached with Indigenous Peoples’ communities and/or the IPOs.

<sup>245</sup> Management Response, p. 25.

<sup>246</sup> Aide Memoire following conclusion of SADP MTR, October 18, 2010, p. 5, ¶20.

## Chapter 4: Poverty and Livelihood Impacts

### A. Introduction

221. This chapter reviews the Requesters' claim that growing oil palm has not reduced poverty for smallholders, and, more generally, that doing so does not deliver significant livelihood benefits. The Requesters' claim and the corresponding Management Response are first presented, followed by the relevant operational policies and procedures. The main body of the chapter deals with the Panel's observations on harms claimed by the Requesters and Management's compliance with Bank policies and procedures.



Picture 9: Panel team meeting villagers in WNB province

222. Given that as of mid-2011, implementation of the SADP activities on the ground remains very limited, much of the harm claimed by the Requesters relates to the consequences of smallholder oil palm production during the past decades--with or without World Bank involvement--and their fear that such harm may continue under the SADP. Therefore, the Panel's analysis on compliance will focus mainly on measures taken by Management in designing, appraising, and implementing the Project to *"ensure that the Indigenous Peoples receive social and economic benefits that are culturally appropriate and gender and intergenerationally inclusive, and, avoid potentially adverse effects on the Indigenous Peoples' communities, or when avoidance is not feasible, minimize, mitigate, or compensate for such effects,"*<sup>247</sup> according to the requirements of the Indigenous Peoples Policy (OP/BP 4.10).
223. As the great majority of the SADP's beneficiaries are indigenous people, a separate Indigenous Peoples Plan was not prepared. Instead, the overall Project design was intended to reflect the principles expressed in OP 4.10. This chapter will therefore examine whether the Project was designed meet the requirements of OP4.10, including ensuring that the indigenous smallholders affected by the Project receive culturally-appropriate social and

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<sup>247</sup> OP 4.10, ¶ 1.

economic benefits and/or whether adverse effects were avoided, minimized, or compensated. In particular, the analysis will focus on savings and income diversification.

224. In Chapter 3, the Panel concluded that had adequate consultation been undertaken respecting customary structures and languages so that indigenous smallholders were provided with full information on the Project, and additionally, had the Social Assessment been in full compliance with OP 4.10, the design as well as implementation of SADP would have been improved. In this chapter, the possible impact of these earlier shortcomings on the poverty reduction and livelihoods dimensions of the Project, as well as gaps in translating the recommendations on mitigation of adverse consequences into Project design, are examined.
225. The Panel's review establishes that some of the indigenous smallholders who are intended beneficiaries of this Project do legitimately fear harm from it (however unintended that harm may be), and that this comes as a result of the Bank's failure to follow the safeguards embodied in the Indigenous Peoples Policy.

## **B. Requesters' Claims**

226. Citing evidence from the Project's Social Assessment, the Requesters claim that "*despite the significant level of investment, introduction of oil palm has done little to provide material improvement in smallholders' lives.*"<sup>248</sup> The Requesters also claim that the Project will not reduce poverty but will limit economic choices, giving smallholders few opportunities to improve their living conditions.<sup>249</sup> The Requesters attribute these concerns first to the fact that mill companies have the exclusive power to set the price for FFB (and therefore for smallholder incomes from oil palm), thus locking smallholders into a dependent relationship with the estate mill.<sup>250</sup> This pricing procedure, the Requesters maintain, "*distort[s] the price ratio in favour of the companies by undervaluing smallholder costs and the value of customary land, while recognizing the commercial salaries and capital depreciation of the oil palm mills.*"<sup>251</sup> Second, the Requesters point to the high number of levies imposed on smallholders as another reason preventing them from improving their living standards. Between loan payments deducted by the mill companies (typically 30%)<sup>252</sup>, levies for state services (more than 44%)<sup>253</sup>, other levies (growers association dues, transport levy, OPIC levy, OPRA levy, Sexava levy)<sup>254</sup>, and a levy to

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<sup>248</sup> Request for Inspection, p. 5; citing findings of the Project's Social Assessment (January 2007, p. 46) that "*Living conditions have deteriorated and key indicators of poverty such as housing, access to clean water and health services show life quality has declined*" in oil palm growing areas. In fact, however, the Social Assessment of 2007 (p. 46) had also noted that the education had greatly improved in the oil palm growing areas, despite the "paradoxical" decline in these other quality-of-life indicators.

<sup>249</sup> Ibid., p. 5, ¶ B.3.

<sup>250</sup> Ibid.

<sup>251</sup> Ibid.

<sup>252</sup> Request for Inspection, p. 5, ¶ B.3.

<sup>253</sup> Ibid.

<sup>254</sup> Sexava is a type of insect which are the principal pests of oil palm for which treatment is provided by the mill companies.

support the Road Maintenance Trust Fund, “*smallholders will be progressively burdened and unable to lift themselves out of poverty,*”<sup>255</sup> note the Requesters.

227. Finally, the Requesters express concern that the Project promotes oil palm as the single primary income-generating activity for Indigenous Peoples, which the Requesters claim directly contradicts the Bank’s own assessments on the importance of income diversification among smallholders. The Requesters observe that “*smallholders who wish to access loans for other agricultural purposes [are driven] into growing oil palm.*”<sup>256</sup> The Requesters emphasize that income diversification to supplement oil palm incomes is a vital livelihood strategy for smallholders. They claim that incorporating small businesses and employment training does not adequately address the need for economic diversification in the Project area.<sup>257</sup>

### C. Management Response

228. Management notes that “*investments in the oil palm industry in PNG have had an overall positive impact on rural welfare.*”<sup>258</sup> Management claims that oil palm production reliably provides smallholders with higher returns to their land and labor than other commodity crops, comparing favorably to the income of a full-time laborer paid minimum wage.<sup>259</sup> Despite significant levies on oil palm relative to other crops, Management maintains that infill planting of oil palm is still a good investment for smallholders because of its high return rate.<sup>260</sup> Management also recognizes, however, that “*living conditions have deteriorated... [and] on some key indicators of poverty such as housing, and access to clean water and health services, life quality has declined,*”<sup>261</sup> a finding that is paradoxical when noted in context of the income increase that oil palm smallholders have experienced relative to other cash-crop producers. This paradox, according to Management, is not confined to oil palm smallholders alone, and may be attributed to such other factors as high consumption spending, the lack of saving mechanisms, the significant social and traditional obligations to share one’s income with friends and family, and poor service delivery owing to underdevelopment (e.g., in education, health, and infrastructure).<sup>262</sup>
229. Management agrees with the Requesters about the importance of income diversification in helping protect smallholders from international commodity-price fluctuations.<sup>263</sup> Management stresses that the SADP does support further income diversification through investment in rural road infrastructure and through Component 2 of the Project (Local Governance and Community Participation).<sup>264</sup> In response to the Requesters’ related claim

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<sup>255</sup> Request for Inspection, pp. 5-6.

<sup>256</sup> Ibid.

<sup>257</sup> Request for Inspection, p. 6, ¶ B.3.

<sup>258</sup> Management Response, p.17, ¶ 47.

<sup>259</sup> Ibid., p. 17, ¶ 47.

<sup>260</sup> Ibid., p. 63, ¶19.

<sup>261</sup> Curry, G.N., Koczberski, G., Omuru, E., Duigu, J., Yala, C., and B. Imbun. (January 2007). Social Assessment Report for the Smallholder Agriculture Development Project (SADP). Papua New Guinea. p. 46, ¶ 3.8.

<sup>262</sup> Management Response, p. 18, ¶ 50.

<sup>263</sup> Ibid., p. 17, ¶ 48.

<sup>264</sup> Ibid., p. 17, ¶ 48.

that the Project will force smallholders who wish to access loans for other agricultural purposes to be driven into growing oil palm, Management maintains that participation in the SADP is completely demand driven and voluntary, and that “*the fact that credit is available for oil palm infilling does not mean that any smallholder is forced into growing oil palm.*”<sup>265</sup>

230. On the specific topic of the FFB price setting (which Requesters claim as one of the factors that encourages dependency on the mills), Management recognizes that the issue is contentious but funds are provided under the SADP to review and update the existing FFB pricing formula.<sup>266</sup>

#### **D. The Panel’s Observations on Harms Alleged in the Request**

231. This section includes the Panel’s observations of actual and potential harm caused by producing oil palm, as claimed by the Requesters. The issues are particularly vexing in a case like this one where Management, the Requestors, and other persons affected by the Project have different perceptions about the Project’s benefits and impact on the livelihood of the indigenous smallholder farmers. Furthermore, this issue is highlighted by the Project documents, which state that it is “*paradoxical*” that increased incomes from oil palm growing have often not led to improved living conditions.<sup>267</sup>
232. The Requesters claim that the Project will not reduce poverty and will limit economic choices, and that under the Project, the smallholders will have few opportunities to enhance their living standards, and that oil palm has not reduced poverty.<sup>268</sup> In contrast, “*Management believes that there was adequate attention to poverty reduction...in the Project’s design.*”<sup>269</sup> Management also claims that the Project is consistent with the Bank’s policy OP/BP 10.00 on Investment Lending.
233. The Panel has noted that both the Requesters and Management use the terms “poverty reduction” and “livelihoods” interchangeably, and not always precisely, according to accepted definitions. Sometimes “poverty reduction” is used to mean increasing income; at other times, it is interpreted more broadly. The term “livelihoods” is also used in places to mean living conditions, and at other times, to mean making a living. OP 1.0 on Poverty Reduction defines poverty as a “*lack of opportunities (including capabilities), lack of voice and representation, and vulnerability to shocks.*”<sup>270</sup> There is, however, no specific World Bank policy definition of livelihoods. Livelihood is defined in some academic literature as “*the capabilities, assets (including both material and social resources) and activities required for a means of living. A livelihood is sustainable when it can cope with and recover from stresses and shocks, maintain or enhance its capabilities and assets, while not*

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<sup>265</sup> Management Response, p. 19, ¶ 54.

<sup>266</sup> Ibid., p. 21, ¶ 61.

<sup>267</sup> Social Assessment Report (January 2007), p. 38, ¶ 3.8 and Management Response, p. 17, ¶ 46.

<sup>268</sup> Request for Inspection, p. 4-5.

<sup>269</sup> Management Response, p. 56.

<sup>270</sup> OP 1.00, ¶ 1.

*undermining the natural resource base.*”<sup>271</sup> Both terms clearly encompass much more than the issue of income, and incorporate concepts of capabilities as well as vulnerability to shocks.

234. This Report, therefore, uses the term “income” in addressing the financial aspects of poverty reduction, and the term “livelihood” to indicate means of living, whereas “living conditions” will indicate the circumstances of living.
235. The following sections present the Panel’s observations about four dimensions of harm stated in the Request for Inspection and embodied in the concept of poverty reduction and livelihoods. These are related to issues connected with income from oil palm, living conditions, savings and adverse consequences of cash income.

## 1. Income from Oil Palm

236. In terms of its contribution to the national economy, there is no doubt that palm oil is important, constituting 43.2% of agricultural export values (2008). The industry is second only to the public service sector in total number of employees, according to the Management Response.<sup>272</sup> Furthermore, “*Oil palm provides among the highest returns for smallholders in terms of income per hectare and per day worked in PNG’s agricultural sector.*”<sup>273</sup> The Management Response states that “*...investments in the oil palm industry in PNG have had an overall positive impact on rural welfare.*”<sup>274</sup> (Emphasis in original.) The Management Response goes on to describe the significant employment generated in oil-palm-growing areas and the relatively high cash income flowing into oil palm smallholders’ households. The Management Response also outlines other advantages of oil palm production, including relatively low labor inputs compared with most other crops; regular cash payments from the milling companies, and better access to financing than most other cash-crop farmers.<sup>275</sup>
237. During its visit to Oro province, the Panel team was informed that oil palm was the largest employer and generator of income in the province. The Panel also understood that the province transformed from subsistence to a cash-based economy mainly because of the oil palm industry. There is no doubt that over the decades, oil palm production has generated cash income for the smallholders of Oro, uneven as it may be, and that oil palm smallholders have had a level of cash income significantly above those of other smallholder cash crop producers for a long period of time, as stated in the Social Assessment.<sup>276</sup>
238. The Country Assistance Strategy (CAS) for Papua New Guinea prepared in 2007 notes that “*...in PNG, poverty is defined as a lack of access [which] includes the inability to take advantage of basic public services and infrastructure, as well as a lack of access to income*

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<sup>271</sup> Scoones, I. (1998). Sustainable Rural Livelihoods: A Framework for Analysis. *Institute of Development Studies, Working Paper 72*.

<sup>272</sup> Management Response, p.2-3.

<sup>273</sup> Ibid., p. 3, ¶ 14.

<sup>274</sup> Ibid., p. 17, ¶ 47.

<sup>275</sup> Management Response, pp. 18-22.

<sup>276</sup> Social Assessment Report (Jan 2007), p. xv.

*and income-earning opportunities.”*<sup>277</sup> While access to basic public services and infrastructure remains an issue for smallholders, they would not be considered in “poverty,” according to this definition, in terms of access to income.

239. It is noted, however, that there are significant differences between Oro and WNB in terms of smallholder profitability, and therefore earnings. Data from the PAD indicate that average annual net income for Hoskins will be 25%, and for Bialla 10%, above that of Oro. The difference in the projected yield between the provinces averaged from the fourth year of planting to the twenty-third year is projected at 18.4 tons of FFB per hectare for Hoskins, whereas Bialla and Oro are projected to yield 17 tons of FFB per hectare.<sup>278</sup>
240. The differences are due to a combination of factors, including the history of the industry in the respective provinces as well as socioeconomic and cultural factors. There are other indications that smallholder oil palm production was in a better state in WNB than in Oro province. The Panel team was informed in Oro that since the conclusion of the Bank-financed Oro Smallholder Project in 2001, and until the takeover by the new company Kula/Higaturu in 2010, there has not been any replanting nor has fertilizer been distributed; in contrast, in the two Project sites in WNB province, the company continued to replant and distribute fertilizer. In addition, the Panel was informed that some 10% or so of smallholders’ oil palm hectares in Oro were abandoned, whereas in Hoskins and Bialla, none of the smallholder plantings were abandoned.
241. During discussions with the Panel, the management of Kula/Higaturu Oil Palm expressed their concern for the smallholder sector in Oro province which they felt was in dire and urgent need of renewal. As mentioned earlier, in a meeting with the Panel team, Kula/Higaturu Oil Palm management stressed the need to focus on increasing yields by replanting and managing existing blocks better, rather than developing new blocks through infilling. The company’s concern was expressed as recently as January 2011 in OPIC’s Implementation Progress Report on the Project, in which they state that the smallholder sector should concentrate on replanting rather than infilling in Oro.<sup>279</sup>
242. Some of the adverse impacts attributed to oil palm production, as experienced in Oro, may be accentuated for Oro-specific, historical reasons. According to its Project Completion Report, the Oro Smallholder Project (1992-2001) *“has had more generalized benefits in the province of Oro. With the major increase in cash incomes from palm fruit deliveries, consumer demand has substantially increased over the project period. A national supermarket chain has been attracted to Popondetta, the provincial capital. Annual movement of containers at the wharf increased by 30% from 1997 to 2000 (all merchandise comes by sea). The cash income from palm fruit has provided diversification of income and more secure household economies.”*<sup>280</sup> In the intervening eight years since the completion of the previous project and the launching of the SADP, the smallholder oil palm sector

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<sup>277</sup> Country Assistance Strategy for Papua New Guinea for the period FY08-11, Report No. 41571-PG, November 20, 2007, page 7, ¶. 22.

<sup>278</sup> Project Appraisal Document (November 2007), p. 86, Annex 9, Table 3.

<sup>279</sup> OPIC Implementation Progress Report, January 2011, p. 6.

<sup>280</sup> Implementation Completion Report, Oro Smallholder Oil Palm Development Project (June 2002), p. 5.

deteriorated, with no replanting or new plantings, no distribution of fertilizer, and minimal road maintenance.

243. Oro province was also devastated by Cyclone Guba in 2007 (1,800 to 2,000 homes were destroyed and about 9,500 people displaced, and infrastructure was hurt badly, with over 56 bridges and culverts washed away or severely damaged), which further hindered the production and collection of oil palm. With the delayed implementation of the SADP, the expectations of increased benefits from palm oil production, which were heightened by the previous project, were not been fulfilled by the current project.
244. As noted earlier, productivity among smallholders varies widely “*due to a range of underlying factors from land tenure security to intra-household relationships.*”<sup>281</sup> While some smallholders apply technologies and maximize outputs, others prefer to invest more in other crops or other livelihood strategies.<sup>282</sup> Most of the smallholders met by the Panel team during its visits commented positively about growing oil palm; this is confirmed by the fact that more than one thousand applications for infilling had been received by OPIC in Oro when the Panel team visited in September 2010. But a large number of smallholders told the Panel team that they had serious concerns about the deductions, price fluctuations, the heavy work involved, and environmental issues related to the industry.

## **2. Living Conditions**

245. In terms of living conditions, Management concurs with the Requesters, in recognizing the “*paradox*” that despite the significant cash income of smallholders, their living conditions have deteriorated and key indicators of poverty such as housing, access to clean water and health services show life quality has declined adding that this not a phenomenon confined to oil palm smallholders or areas with oil palm production in the SADP.<sup>283</sup>
246. Management explains the paradox as follows: “*High consumptive expenditures, a lack of effective savings mechanisms, and the very significant social and traditional obligations that smallholders have to share their incomes with friends and relatives contribute to this phenomenon. The general mixed performance of government in rural service delivery (education, health, and infrastructure) further compounds the situation.*”<sup>284</sup>

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<sup>281</sup> Vermeulen, S. and N. Goad. (2008). Towards Better Practice in Smallholder Palm Oil Production. *International Institute for Environment and Development*. p. 25.

<sup>282</sup> Ibid.,p. 25.

<sup>283</sup> Social Assessment Report (January 2007), p. 46, ¶ 3.8.

<sup>284</sup> Management Response, p. viii.



Picture 10: View of a village in Oro province

247. The Social Assessment further states that *“In all three project areas, the familiar refrain from focus groups with smallholders and the LLGs, was how little material improvement there had been in their lives following the introduction of oil palm. Aside from education, where tremendous gains have been made over the years as evidenced by the senior positions in industry and government occupied by second generation oil palm growers, living conditions, particularly on the land settlement subdivisions, have deteriorated through time. This fall in living standards is paradoxical considering that oil palm smallholders have for a long period (38 years at Hoskins, the oldest scheme) had levels of cash income significantly above those of other smallholder cash crop producers.”*<sup>285</sup>
248. The Panel team’s impression of living conditions was varied; many smallholders lived in houses made exclusively of locally available bush material, while others used more durable materials such as corrugated metal.



Picture 11: View of an "oil palm" house and more traditional house in WNB province

249. The Panel team also encountered entrepreneurial smallholders running small businesses, some even with motor vehicles. Given that the Panel did not undertake field-based studies

<sup>285</sup> Social Assessment Report (January 2007), p. 46, ¶ 3.8.

of social and economic indicators, the Panel is unable to make conclusive statements about the linkages between smallholders' oil palm income and living conditions. Nonetheless, the Panel shares the view of the Requesters and Management with regard to the “*paradox*.”

250. The Requesters cite three underlying reasons for why “*Under SADP, smallholders will have few opportunities to enhance their living standards.*”<sup>286</sup> These are:

- (a) Farmers are locked into a dependent relationship with the estate mill;
- (b) Smallholders are expected to pay multiple levies for producing oil palm (including a new road maintenance levy); and
- (c) Smallholders will have limited choices for income diversification.<sup>287</sup>

251. The following paragraphs address each of these issues.

#### **a. Relationship with Estate Mills**

252. Under the nucleus estate and smallholder scheme (NES), the relationship between the milling company and smallholders is monopsonistic, that is, there is only one buyer and many sellers. In each of the Project areas, the sole milling company and smallholders enter into a business relationship in which the former supplies the seedlings, fertilizer and tools on credit, collect the harvest of oil palm, and then pays the smallholders according to their yield, deducting for the credit for items supplied, and levies for OPRA, OPIC and Sexava and for transport costs. Companies extend interest-free, short-term, in-kind credit repayable at 50% of gross Fresh Fruit Bunch income over three months (for tools), one year (for fertilizer), or two years (for seedlings).<sup>288</sup> Under such a scheme, while smallholders have a choice of not planting oil palm, once they do so, they depend completely on the company for supplies and for collection.

253. In a review of the oil palm industry in Papua New Guinea, some argue that there are three factors that impact the economic benefit for smallholders, these factors being that smallholders are at the end of a large grower market with little influence over market price, that they are at a disadvantage to the dominant mill company in the nucleus estate and smallholder model, and that they are at the bottom of a very long value chain.<sup>289</sup>

254. The Fresh Fruit Bunch pricing formula, which determines smallholder remuneration, reflects the relationship between the companies and the smallholders. The buying price of FFBs fluctuates according to the global price of Crude Palm Oil (CPO) and Palm Kernel Oil (PKO). The formula is based on the FOB value of the primary palm products (CPO and PKO) produced from one ton of Fresh Fruit Bunch. This value is then divided through a payout ratio (derived from the relative production costs of the smallholder and milling

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<sup>286</sup> Request for Inspection, p. 5, ¶ B.3.

<sup>287</sup> Ibid

<sup>288</sup> Vermeulen, S. and N. Goad. (2008). Towards Better Practice in Smallholder Palm Oil Production. *International Institute for Environment and Development*. p. 21.

<sup>289</sup> Anderson, T. (2006). *Oil Palm and Small Farmers in Papua New Guinea*. University of Sydney. Report for the Centre for Environmental Law and Community Rights on the economic prospects for small farmers in PNG's oil palm industry, p. 3.

company and their relative break-even points) between the smallholders and the milling company. Since the selling price is determined by global fluctuations in commodity prices, and deductions and levies are fixed costs, smallholder earnings are basically determined by this payout ratio, which is established by the FFB review process and is reviewed every few years. Previous reviews of the pricing formula took place in 1990, 1996, 1998, and 2001, and another one is planned under the SADP.

255. In the Requesters' view, the FFB reviews have distorted "*the price ratio in favour of the companies by undervaluing smallholder costs and the value of customary land, while recognizing the commercial salaries and capital depreciation of the oil palm mills.*"<sup>290</sup> An independent analysis of these reviews carried out by the Panel's expert consultant found that in the past (1970-1990) the FFB formula was biased in favor of the companies, regardless of the market price for crude palm oil--which has undermined smallholder trust in the milling companies and the formula. More recently, however, farm-gate prices and mill charges have been more equitable and less exploitative. However, the Management Response states that in the 2001 FFB Pricing Formula Review "*the milling companies...questioned the data used by the consultants to calculate the smallholder costs of production, and only agreed to the payout ratio of 57%*" to the smallholders instead of the 59% recommended in the Pricing Review.<sup>291</sup>
256. Management also recognized that the FFB review is a highly contentious issue. The SADP is supporting an FFB price formula review, and the terms of reference have been finalized. This review will "*recommend changes that would improve the operation of the pricing formula, with the aim of ensuring that a transparent and equitable pricing formula is in place and applied by each palm oil milling company. Furthermore, since the FFB price is calculated by the FFB buyer, it must therefore be subject to periodic independent verification, and it is proposed that subsequent to this review of the formula annual audits of the FFB price paid to smallholders will be implemented.*"<sup>292</sup>
257. Despite these problems with the FFB prices, the independent analysis conducted by the Panel consultant also concluded that there was ample evidence--especially for WNB smallholders but also for some in Oro--that oil palm has been profitable for many smallholders.

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<sup>290</sup> Request for Inspection, p. 5.

<sup>291</sup> Management Response, paragraph 61 states that "*To arrive at the current payout ratio of 57 percent, a detailed analysis of both smallholder and milling company costs of production was undertaken as part of the 2001 review of the FFB pricing formula. The calculation of smallholder costs of production included all fixed and variable costs including labor costs (for land clearing, planting and maintenance), material costs (including seedlings, fertilizers and equipment), the PNGOPRA levy, the OPIC levy, the FFB transport costs, the Sexava levy, 45 land rent (for all LSS blocks), growers association membership fees, the cost of borrowing (interest payments and bank fees) and the construction costs of smallholder housing.*<sup>46</sup> The 2001 FFB pricing review recommended minor amendments to the pricing formula that existed at the time and an increase in the smallholder payout ratio from 55 percent to 59 percent to reflect the respective small-holder and milling company fixed and variable costs of production and the smallholder break-even prices for sales of FFB. The milling companies, however, questioned the data used by the consultants to calculate the smallholder costs of production, and only agreed to an increase of the payout ratio to 57 percent for the smallholders."

<sup>292</sup> Terms of Reference, FFB Price Review and Audit (November 2010).



Picture 12: Panel team meeting villagers in Oro province

258. The Panel also notes that under the Roundtable on Sustainable Palm Oil (RSPO) process, and particularly since the establishment of a Smallholder Task Force in 2006, increasing attention is being paid to enhancing smallholders' circumstances. This was also the Panel's impression when it met the management of Kula/Higaturu Oil Palm, the company that has taken over in Oro. The moves toward greater protection of smallholder interests are to be welcomed, but as long as the monopsonistic relationship remains, smallholders' dependency on the mill companies cannot be denied. Thus, the critical issue is the extent to which the Project, which purports to improve smallholder livelihoods, may help level the playing field. The Panel also underscores its concern about the latest developments regarding the FFB review, which, according to Management, has been postponed for reasons beyond Management's control.<sup>293</sup>
259. One of the recommendations for smallholders emerging from the World Bank Group review of its oil palm investments is to *"improve the negotiating capacities of the smallholder representatives and smallholder cooperatives. Smallholder associations play an important role in negotiating deals with oil palm companies."*<sup>294</sup> In all of the Panel team's encounters with smallholders, they uniformly indicated that they had no faith in their Growers Association and felt that the associations did not represent their interests, even though they had elected them to office.
260. Thus, the Panel observes that while the relationship between the mill companies and smallholders has improved over the years, the issues of smallholder dependency and vulnerability, within the broader construct of the oil palm industry, persists. Indeed, the Panel came away with the impression that the smallholder's living situation will not

<sup>293</sup> According to Aide Memoire of the Fifth Implementation Support Mission: April 15–19, 2011, ¶ 28-29, OPIC has informed the Bank that the *"FFB Price Formula Review has been suspended due to notification received from the Independent Consumer and Competition Commission (ICCC) alleging contravention of the ICCC Act if OPIC goes forward with the FFB Price Review study. The allegation is that OPIC is participating in a price fixing arrangement. OPIC has had discussions with the ICCC but the issue is yet to be resolved"* and that *"OPIC does not wish to be embroiled in litigation and it was agreed (by the PSC Chairman and the OPIC Chairman) that the review would be put on hold pending resolution of the matter by DAL and the ICCC."*

<sup>294</sup> The World Bank Group Framework and IFC Strategy for Engagement in the Palm Oil Sector, p. 24.

improve if adequate measures are not taken to strengthen the negotiating position of smallholders and their representatives.

#### **b. Levies and Deductions**

261. Smallholders are subject to multiple levies and deductions for company credits for the cost of planting, fertilizer, and tools, and the Inspection Panel heard from practically every smallholder complaints about the negative effect this had on their income. They argued that the heavy burden of these levies and deductions absorbed an excessively large proportion of their earnings, and also objected to the lack of transparency on how deductions were made. Some complained that despite paying a levy for OPIC, they received little in return in terms of extension services. In one instance, a smallholder indicated that her earnings were still being deducted for a housing loan that she took out more than twenty years ago, which she was certain she had repaid in full. It turned out that the relevant records held by the loaning bank had been destroyed in a fire some years ago, but that deductions continued to be made automatically, despite the likelihood of full repayment. When the Panel discussed this with OPIC, it was informed that the situation would be remedied. This may well be an extreme case, but nonetheless a real one, of a nontransparent and unjust deduction.
262. The Social Assessment notes that *“It is also probable that high repayment rates (at 50% of monthly income) act as a disincentive to repay loans, particularly when repayments coincide with low oil palm prices and high cash demands (e.g., school fees or customary obligations).”*<sup>295</sup> There is no doubt that smallholders felt a strong sense of reduced well-being that heightened their perception of stagnant living standards. Indeed, the WBG review of oil palm investments also mentions that *“Smallholders are often unaware of the terms of contracts that they sign with companies and sometimes these terms are not clear leading to future conflict. Contracts need to be especially clear and equitable on issues related to land transfer and debt terms.”*<sup>296</sup>
263. In this context, the proposal for yet another levy for the Road Maintenance Trust Fund becomes a highly contested issue for the smallholders. This issue will be discussed in Chapter 6.

#### **c. Alternatives and Choices: Income Diversification**

264. The planting of oil palm requires considerable commitment of time and resources for smallholders. The total cost for planting oil palm on two hectares, excluding the cost of labor, is K3165, taken as credit from the mill company.<sup>297</sup> Once seedlings are planted, oil palm can be harvested for up to twenty five years, but smallholders must wait three years before they can start harvesting, during which time they need other sources of livelihood. Once established, the land cannot easily be converted to produce other cash crops or put to other polyculture uses. Unlike other cash crops, oil palm can be harvested every two weeks,

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<sup>295</sup> Social Assessment Report (January 2007), p. 53, ¶ 3.9.

<sup>296</sup> The World Bank Group Framework and IFC Strategy for Engagement in the Palm Oil Sector, p. 24.

<sup>297</sup> Project Appraisal Document, p. 85.

thus providing a regular source of income, although prices fluctuate in accordance with world prices.

265. The Social Assessment indicates that most oil palm smallholders in Oro were engaged in producing other cash crops (25% coffee and 32% cacao).<sup>298</sup> It explains that “*VOP smallholders view cash crop diversity as a form of income security against fluctuating commodity prices, and they will adjust their labour and investment inputs into different cash crops according to relative prices and returns on their labour.*”<sup>299</sup> While alternative cash crops are being produced, there is no support infrastructure such as credit, extension services, or collection systems, as in the case of oil palm.
266. A 2001 study on the oil palm sector in Papua New Guinea<sup>300</sup> found that “*the wide variation in productivity among individual smallholders was due to a range of underlying factors from land tenure security to intra-household relationships. While some smallholders put a great deal of effort into applying technologies and maximising outputs, others prefer to invest more in other crops or other livelihood strategies. For large plantation companies, production of oil palm is the ‘core business,’ but for smallholders oil palm is just one of an array of agricultural and non-agricultural means of making a living.*”<sup>301</sup>
267. The authors of the 2001 study note further that in the case of Papua New Guinea smallholders, “[a]cceptance that smallholders have rational priorities other than yield maximization” is an innovation and solution in responding to the issue of low productivity and quantity among smallholders.<sup>302</sup>
268. Apart from export-oriented cash crops, all smallholders interviewed by the Panel engaged in food garden production, which, according to the Social Assessment “*is a fundamental component of the livelihood strategies of the vast majority of LSS and VOP smallholders, particularly women ...The long-term viability of the smallholder sector depends to a considerable extent on the food and income security provided by access to gardening land.*”<sup>303</sup>

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<sup>298</sup> Social Assessment Report (January 2007), p.44.

<sup>299</sup> Ibid.

<sup>300</sup> Koczberski, G., Curry, G. and Gibson, K. (2001). Improving Productivity of the Smallholder Oil Palm Sector in Papua New Guinea: a socio-economic study of the Hoskins and Popondetta schemes. Research Unit for the Study of Societies in Change, Curtin University of Technology, Perth, Western Australia.

<sup>301</sup> Vermeulen and Goad (2008), p. 25.

<sup>302</sup> Ibid.,p.33, Table 6.

<sup>303</sup> Social Assessment Report (January 2007), pp. xiii-xiv.



Picture 13: Panel team visiting a food garden in Oro province

269. The Social Assessment further emphasizes that *“Food gardening is a primary focus in the lives of smallholders, particularly for women, and most smallholder households remain heavily dependent on subsistence food production for their daily needs. Most LSS and VOP smallholders grow sufficient food to meet most of their food requirements, and garden food production for sale at local markets provides LSS women with an important source of income.”*<sup>304</sup> Food gardens are evidently central for food security, especially on the LSS blocks where households are far more dependent on gardens than VOP producers. Food gardens also provide an important buffer against oil palm price fluctuation.<sup>305</sup>
270. The excerpts from Bashkow’s study on Orokaiva culture, quoted in Chapter 2, suggest that *“the most critical factor for its continued vitality is the continued availability of ancestral garden lands that yield the food that Orokaiva not only subsist on but also use to create their social selves through feasting and exchange with others.”*<sup>306</sup> Since the Social Assessment does not discuss the social and cultural significance of food gardens for the Orokaiva, the SADP needs to pay special attention to land for gardens for VOP Orokaiva and not just for settler ethnic groups that live on the Land Settlement Schemes (LSSs). Chapter 5 discusses how this is being achieved in the design of infilling forms in SADP.
271. All of the smallholders that the Panel team met during its field visit confirmed their ownership of gardens, although some were apparently quite distant from their residences, requiring several hours to reach. The Panel also confirmed that for many smallholders, especially women, the garden was their main occupation and source of food and income, with income from oil palm seen as supplementary. Some experts in Papua New Guinea

<sup>304</sup> Social Assessment Report (January 2007), p. 42.

<sup>305</sup> Anderson (2006) also comments that *“...customary land has important subsistence value, as well as alternative cash crop potential. This is noted in practical surveys, though usually not given a monetary value. Koczberski et al. note that about 80% of the diet of Kavui and Popondetta LSS farmers was from garden food, and that most women (100% on LSS blocks and 52% on VOP blocks) regularly sold market food, many relying on the market as their main source of income (Koczberski, Curry & Gibson 2001: 50 & 57-58).”*

<sup>306</sup> Bashkow, I. (2006). *The Meaning of Whitemen: Race and Modernity in the Orokaiva Cultural World*, p. 236.

referred to the “foraging mentality” of some smallholders toward oil palm production, that is, they harvest when there is need for the extra income, such as to pay for school expenses.



Picture 14: Panel team visiting a food garden in Oro province

272. The Social Assessment recommends that “...the development of supplementary income sources should also be encouraged”<sup>307</sup> and that “...the promotion of supplementary income sources should not be confined to blocks undergoing replanting, but rather be an integral part of OPIC's general extension strategies.”<sup>308</sup> The Assessment cites the limited acknowledgment in the oil palm industry of the importance of non-oil-palm activities to the livelihoods of smallholders and views such activities as distractions.<sup>309</sup> The Assessment identifies the challenge as consolidating and building on these income trends through policies that strengthen linkages between the smallholder sector and the broader regional economy.<sup>310</sup>
273. The Panel also notes that the issue of ensuring land availability for food gardens has been addressed in the Project through the Infill Planting Sub-manual and the Infill Planting Approval Form. These allow for infill planting in existing home gardens only if (i) the applicant has another block of a similar size that could be used for food gardens, or (ii) if the applicant has food gardens that already provide for the entire household's consumption needs.<sup>311</sup>

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<sup>307</sup> Anderson (2006) makes a plea for smallholders to be encouraged to engage in diversified cropping systems following his analysis of two pilot studies, one in Madang and one near Popondetta, where he found that “*The highest returns of the two groups did not go to the oil palm farmers, but to those in Madang who had successfully marketed three or four cash crops, usually two domestic crops (such as peanut, buai and select fruit or vegetables), which gave best returns when the growers also directly sold their produce (at market or roadside); and one or two supplementary export crops (such as cocoa and vanilla), which expanded their markets. Two of these groups earned 14,000 and 16,000 Kina per year. The highest returns for oil palm farmer were around half this. While oil palm was the best cash earner for farmers in the Popondetta area, there does seem to be a ceiling on small farmers' returns on oil palm.*”

<sup>308</sup> Social Assessment Report (January 2007), p. 63.

<sup>309</sup> Ibid., p. 45.

<sup>310</sup> Ibid..

<sup>311</sup> OPIC SADP Oil Palm Infilling Approval Form, Questions 7.3a and 7.3 b.

274. Management points out that road improvements under the SADP will help diversify income since better roads can be used to transport other crops and products in addition to oil palm. Management also notes that some of the community-driven development efforts undertaken under Component 2 may be income-diversification projects.<sup>312</sup> Improved roads will undoubtedly contribute to a range of community benefits, including a potential increase in income-generating opportunities owing to the easier transport of other cash crops (including subsistence food crops) for sale, in addition to improved transport of oil palm FFBs.
275. Less certain is whether the activities under the Project's Component 2 will increase income-generating opportunities, although improved community infrastructure may materialize in some areas. Component 2 is, nonetheless, only a relatively small pilot and therefore unlikely to have a direct impact on many smallholders.<sup>313</sup> However, nothing in these two initiatives (improved roads or Component 2's community-driven development projects) explicitly addresses income diversification among smallholders. This indirect method of addressing income diversification appears to be an inadequate approach to a Project that seeks "...to increase and sustain agricultural output and productivity in smallholder oil palm production in the country's three largest NES" and a development objective to "...increase, in a sustainable manner, the level of involvement of targeted communities in their local development through measures aimed at increasing oil palm revenue and local participation."<sup>314</sup>

### 3. Savings Mechanisms

276. The prevalence of the *wantok* system, whereby Papuans exercise reciprocal social and economic obligations with anyone who speaks the same language, was described in Chapter 2. In explaining the difficulties faced by smallholders in saving money, they "...identify three related barriers to savings. First, the social pressure to be generous to relatives is great. Traditionally, social status and the reputations of individuals and groups were very much bound up with the redistribution of wealth through social and kinship networks. Status, prestige and respect were not associated with accumulating wealth for personal consumption or personal investment purposes, but in redistributing this wealth through social networks or group projects that had the effect of enhancing the status of the giver and associated group members. These values and thinking remain very strong amongst LSS and VOP growers, especially amongst the latter where customary events are often timed to coincide with oil palm pay-days to allow people to contribute part or all of their pay to the group activity. Also, there is a cultural obligation on blockholders to redistribute a significant proportion of their income amongst the extended family group, and blockholders are often accompanied by relatives to town when they go to cash their pay cheques or withdraw cash from the bank if their pay is paid directly in to a bank account. Indeed, for a blockholder to resist the demands of the extended family on his oil palm payment is to risk social censure and damage to his reputation."<sup>315</sup>

<sup>312</sup> Management Response, p. 17, ¶ 48.

<sup>313</sup> Update Component 2, likely to be restructured.

<sup>314</sup> Management Response, p. 8, ¶ 26-27.

<sup>315</sup> Social Assessment Report, p. 51, ¶ 3.9.

277. The Panel team did encounter women smallholders in WNB who had opened bank accounts, with the agreement of their husbands, to save, to build a house, and to send children to university. But the great majority of smallholders, especially the women, complained about the inability to save, with income from oil palm being spent on, for example, drinking, gambling, and prostitution (see next section), or in catering to extended family members who come to visit and stay for years. In many cases, whatever is needed for children's school and bus fees, and household expenses, are paid out of earnings from the Mama Lus Fruit Scheme.
278. The Social Assessment therefore emphasizes that “...*the absence of an effective savings mechanism to isolate a component of cash earnings from the demands of the traditional exchange economy and other competing demands on income is seen by growers as a major constraint on their ability to accumulate savings. The absence of an effective savings mechanism is an important factor explaining the lack of material progress on many oil palm blocks...*”<sup>316</sup>

#### 4. Adverse Consequences of Cash Income

279. A related issue is the adverse consequences of cash income. The Social Assessment makes several recommendations to address the many socioeconomic problems identified during the assessment. The PIM discusses some of these as a series of “...*actions and strategies to help ensure the success of the SADP and to avoid negative environmental and social consequences from the SADP activities*”<sup>317</sup> (see Table 2.1 in the PIM<sup>318</sup>).
280. The negative consequences associated with oil palm production were not widely acknowledged in the past, although they began to become apparent by the end of the Oro Smallholder Project in 2001. The current claim goes much further in specifying the problems and their causes. Here we focus especially on the negative effects of the sudden availability of larger amounts of cash within a society with strong social obligations for giving cash away; and particularly the consequent temptation for a person who receives cash to consume it quickly since there is no good alternative means of saving the cash other than giving it away within a system of reciprocity within a large (and often needy) family.
281. These adverse consequences are not universally experienced by oil palm growers. In 2001, Vigus states that “*The positive socio-economic effects of the smallholder scheme are the reason why many blocks have been established in the first place and include income generation, employment and probably most important, construction and maintenance of roads.*”<sup>319</sup> Vigus does cite, however, some negative effects of the land settlement scheme that led some settlers from other provinces to flee Oro during the 1990s, a time of political agitation. Vigus also notes that among the positive socioeconomic effects is the improvement in the law and order situation, particularly in rural areas, by the planting of

<sup>316</sup> Social Assessment Report (January 2007), p. 52.

<sup>317</sup> Project Implementation Manual (August 2007), Main Document, p. 10, ¶ 2.2.

<sup>318</sup> Ibid., p. 11.

<sup>319</sup> Vigus, T.D. (2001) Environment impact review of current project and recommendations for considerations in any future development. Study of Oro Oil Palm Development Project (Ln. 3485-PNG), p. 29.

smallholder blocks. This was presumably because new block owners became involved in income-generating activities and ceased anti-social behaviour.<sup>320</sup> The Panel team heard a personal account from a previous self confessed “raskol” who had given up armed robbery and other such things after planting an oil palm block in 2001 and becoming gainfully employed. However, already in 2001, ADS (Papua New Guinea) reported that “*Negative impacts of oil palm include increases in alcohol consumption in the project areas with associated social problems corresponding to the time of receipt of payment for sales of FFB. Poker machines introduced into some oil palm provinces have exacerbated gambling problems brought about, in part, by oil palm development.*”<sup>321</sup>

282. Additionally, during the field visits in both West New Britain and Oro, the Panel members heard many complaints, particularly from women, of the social problems associated with cash income derived from oil palm. The problems were said to be particularly severe on the days when oil palm cheques were available, and included gambling, heavy alcohol use, prostitution and family violence. These problems were not isolated occurrences but had become a regular feature of life in oil-palm-growing areas. They were mentioned quite openly during all discussions in villages. Women felt they were particularly affected by these problems, as they suffered the butt of the violence, but had to maintain the integrity of the family, keep food on the table, and save enough money for family health needs and children’s education.
283. The Social Assessment documents many such socioeconomic problems encountered by smallholders; some are directly attributed to oil palm production, some not. The Assessment also highlights the potentially devastating consequences of the prevalence of HIV/AIDS: “*Based on trends from 1997-2003, Sales (2004) predicts that over 17% of the oil palm population in WNB could be HIV positive by 2017 (equivalent to the current level in South Africa), with devastating effects on worker productivity (p.53),*” citing poverty and high risk behavior as contributing factors.<sup>322</sup>
284. In conclusion, many of the actual or potential socio-economic adverse consequences described by the Requesters and in the Social Assessment, and also observed by the Panel, are serious, though not specific to the SADP or even oil palm in general, but are associated with the macro economic transition from subsistence to cash cropping. It is part of the process of the indigenous communities adapting to cash crops and the introduction of cash, while also preserving traditions and customary forms of livelihood alongside their integration into a market economy.

## **E. Summary of Panel’s Observations on Harms**

285. In sum, in relation to the overarching claim of the Requesters that growing oil palm has not reduced smallholder poverty or improved livelihoods, the Panel observes that as far as income is concerned, growing oil palm has undoubtedly generated increased income.

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<sup>320</sup> Ibid., p. 29.

<sup>321</sup> ADS (PNG). (May 2001). Study of the smallholder oil palm sector, Achievements and potential for future development. Oro Smallholder Development Project. p. 27.

<sup>322</sup> Social Assessment Report (January 2007), p. 53, ¶ 3.10.

However, the Panel notes that the structure of the industry, limiting the bargaining power of smallholders and their representatives, deprives smallholders of a fair share of the values created by the industry. The Panel also agrees with the Requesters and Management that the higher income has not often yielded corresponding improvements in the smallholders' standard of living, owing to many factors, and especially to the smallholders' sociocultural background, the insufficient mix of livelihood strategies, and the lack of an appropriate savings mechanism available in Project areas.

## **F. Applicable Bank Policies and Procedures**

286. This section briefly summarizes the applicable policies and procedures which relate directly to the socio-economic impacts claimed by the Requesters. These are Indigenous Peoples Policy (OP/BP 4.10); Poverty Reduction (OP 1.00); Investment Lending (OP 10.00); OMS 2.20 on Project Appraisal and Economic Evaluation of Investment Operations (OP/BP 10.04).

287. Analysis of compliance with each of the above policies will be reviewed in more detail in the sections below, with the Indigenous Peoples Policy as the overall framework of the analysis.

### **1. Indigenous Peoples Policy (OP/BP 4.10)**

288. As described in Chapter 2, the SADP triggered the Indigenous Peoples Policy OP/BP 4.10 because most of the population in the Project area is considered indigenous. The policy requires that Bank-financed projects affecting indigenous people “*are designed to ensure that the Indigenous Peoples receive social and economic benefits that are culturally appropriate and gender and intergenerationally inclusive.*”<sup>323</sup> Furthermore, such projects must also “*include measures to (a) avoid potentially adverse effects on the Indigenous Peoples' communities; or (b) when avoidance is not feasible, minimize, mitigate, or compensate for such effects.*”<sup>324</sup> Thus, OP/BP 4.10 requires that the SADP be designed to provide social and economic benefits, avoid potentially adverse effects, and/or minimize, mitigate, or compensates for adverse effects.

### **2. Poverty Reduction (OP 1.00)**

289. This policy provides a broad framework for the Bank's operations, stating that “The Bank's mission is sustainable poverty reduction. Poverty encompasses lack of opportunities (including capabilities), lack of voice and representation, and vulnerability to shocks. The Bank's support for poverty reduction is focused on actions, consistent with its mandate, to increase opportunity, enhance empowerment, and strengthen security. Within this broad framework, a critical priority is promoting broad-based growth, given its proven importance in reducing poverty”<sup>325</sup>

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<sup>323</sup> OP 4.10, ¶ 1.

<sup>324</sup> Ibid.

<sup>325</sup> OP 1.00, ¶ 1.

### 3. Project Appraisal (OMS 2.20)

290. OMS 2.20 notes that sociological elements are among the six aspects of a project's design to be appraised. In discussing the sociological aspects, OMS 2.20 states that the "*project design is based on a sound understanding of the social organization of productive activities: (a) how the intended beneficiaries have access to, make use of, and exercise control over productive resources available in the area; (b) how the structure of the household and of the family systems prevalent in the area affects the development potential and constraints, labor availability and ownership patterns...*"<sup>326</sup> OMS 2.20 also notes that "*In many projects, an important aspect of the financial appraisal is the evaluation of the impact on the final beneficiaries and incentives for their participation in project implementation and operation. An examination should be made of the ability of final beneficiaries to pay for goods and services...*"<sup>327</sup> and that "*In many agricultural projects, typical farm budgets are prepared to analyze the farmers' incentive to participate and their capacity to meet the debt service burden of farm credit.*"<sup>328</sup>
291. OMS 2.20 also notes that appraisal requires a review of "*...the marketing arrangements and the probable prices to be obtained; and of the comparison of costs and revenues to determine the commercial viability to the entity, which could be either an individual farmer, a private entrepreneur, or a private or public enterprise, depending on the nature of the project...*"<sup>329</sup> OM 2.20 adds that "*...marketing arrangements necessary to ensure the project's efficient operation may include (a) the transport, processing, storage and trading of the project output; [and] (b) the market information system concerning supplies, demand and prices so that buyers and sellers can make intelligent decisions...*"<sup>330</sup>

### 4. Economic Evaluation of Investment Operations (OP 10.04)

292. This policy aims to ensure that all Bank-funded projects promote the development goals of the borrower country. For every investment project, the Bank must conduct an economic analysis to determine whether the project creates more net benefits to the economy than other mutually exclusive options for the use of the resources in question. The consideration of alternatives is thus a core requirement. The economic evaluation of projects integrates financial, institutional, technical, sociological, and environmental considerations.
293. Projects must be assessed with respect to economic, financial, institutional, and environmental risks. The main purpose of this analysis is to identify the scope for improving project design, increasing the project's expected value, and reducing the risk of failure.

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<sup>326</sup> OMS 2.20 – Project Appraisal, January 1984, ¶. 58.

<sup>327</sup> OMS 2.20 – Project Appraisal, January 1984, ¶. 43.

<sup>328</sup> Ibid.

<sup>329</sup> Ibid., ¶. 53.

<sup>330</sup> Ibid., ¶. 54.

## G. Panel's Analysis of Compliance with Bank Policies

294. The following section includes the Panel's analysis of Management's compliance with above noted Bank Policies. It examines the Requesters' claim that oil palm farming does not lead to poverty reduction and an improvement in their livelihoods. The first part includes the Panel's analysis at a macro level, the second part reviews the Project's economic assessment and its profitability analysis for smallholders, and the last part includes analysis of measures to improve livelihoods of smallholders, specifically savings and income diversification. This section concludes with the Panel's final reflections on these issues.

### 1. Poverty Reduction

295. The SADP is aimed at reducing poverty, through “(a) road improvements; (b) raising household incomes of smallholders growing oil palm (on existing oil palm blocks) through improved productivity and lower marketing costs; (c) raising incomes of smallholders planting new oil palm through infilling; (iv) strengthening various sector initiatives focused on improving smallholder welfare (such as the MLFS); and (v) improving access to critical social and economic infrastructure under Component 2 of the Project.”<sup>331</sup>

296. The Management Response emphasizes that the Project will not limit economic choices and that it will improve incomes, increase smallholder productivity, and reduce transport and marketing costs. The Project's fundamental design is aimed at improving cash crop productivity among rural smallholders and transport networks for rural farmers. These are important components of previous and the current Papua New Guinea Country Assistance Strategies,<sup>332</sup> and therefore also conform with the Bank's policy (OP/BP 1.00) on Poverty Reduction.

297. The Panel concurs that the Project is fundamentally designed to increase the income of smallholder oil palm producers who choose to participate in the Project. In doing so, the Project has opted for a method of poverty reduction consistent with the Papua New Guinea Country Assistance Strategy for reducing poverty. Furthermore, the Project's goal of improving transportation by maintaining the road network is also consistent with the CAS's encouragement of increased transport as a means of reducing poverty and improving livelihoods. **The Panel finds that the Project aims at increasing the income of smallholders and thus complies with Bank Policy on Poverty Reduction OP 1.00.**

298. While the SADP was designed to increase smallholder income through the design and implementation of the Project components-- whether the Project ensures smallholders receive “social and economic benefits that are culturally appropriate and gender and intergenerationally inclusive” (as required in OP 4.10)--is a separate issue and will be examined in the following sections.

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<sup>331</sup> Management Response, p. 57.

<sup>332</sup> Ibid., p. 6, ¶ 21.

## 2. Economic Assessment and Analysis of Profitability

299. OP requires Management to ensure the sustainability of projects: *“To obtain a reasonable assurance that the project's benefits will materialize as expected and will be sustained throughout the life of the project, the Bank assesses the robustness of the project with respect to economic, financial, institutional, and environmental risks.”*<sup>333</sup>
300. There is considerable evidence from the design stage of the Project that the economic, financial, and institutional risks in different Project sites, namely between Oro and WNB, are highly diverse. These major differences should have been adequately analyzed and reflected, either in the project design, or dealt with in the implementation stage. This issue is further discussed in the next section.
301. While oil palm has increased income for smallholders, the Panel notes that their share of earnings has not previously been equitable because of the FFB pricing system and deductions that increased the pressure on smallholders' income. (Annex 9 of the PAD presents the Project's economic and financial analysis.) The Panel's expert notes the following regarding this analysis:
302. **Financial Internal Rate of Return (FIRR).** According to Annex 9 of the PAD, oil palm new planting (termed “infilling”) is estimated to be financially viable for smallholders. The FIRR for Hoskins, Bialla and Oro are estimated at 27%, 24% and 22% respectively. These base case FIRRs are high, and show the high estimated profitability of oil palm due to low costs and high yields.
303. **Oil Palm Incomes.** According to the PAD, once established, *“smallholder oil palm net incomes (excluding labor) average (over the three schemes) K1,800/2 ha (\$643) in years 4 to 10 and K5,000 (\$1,785) in years 11 to 23 of production.”*<sup>334</sup> This represents *“K90/day (USD \$32/day) worked (before debt service) in contrast to the K5.5 (USD \$1.96/day) minimum wage.”*<sup>335</sup> As suggested by the above FIRRs, the Bialla and Oro net-oil-palm-income results are less than the Hoskins scheme. The results for Oro are also significantly less than Bialla (Table 3). Averaging the figures, as the PAD does, does not show clearly the differences in incomes by scheme. Oro lags behind Hoskins by 25% and Bialla by 10% in years 4 to 10, and then by 16% and 9%, respectively, in years 11 to 23 (Table 2).

**Table 3: Average Annual Net Incomes by Scheme**<sup>336</sup>

Scheme	Av:Yr 4-10	Compared to Oro: Yr 4-10 (%)	Av:Yr11-23	Compared to Oro:Yr 11-23 (%)
Hoskins	K2,045	+25%	K5,341	+16%
Bialla	K1,802	+10%	K5,023	+9%
<b>Oro</b>	<b>K1,633</b>		<b>K4,595</b>	

<sup>333</sup> OP 10.04, ¶ 5.

<sup>334</sup> Project Appraisal Document, p. 79.

<sup>335</sup> Ibid.

<sup>336</sup> Project Appraisal Document, p. 85, Annex 9, Table 2.

304. Although the main economic differences (such as FFB production, kilometers of access roads, and smallholders' share of production)<sup>337</sup> between schemes are identified, the causes of these differences are not. Some of these include traditional and cultural aspects, ineffective smallholder-mill liaison, industrial disputes, and an "arms-length" relationship with smallholders by the company relative to that in Hoskins, and compounded by many years of grievances over prices. Moreover, measures to improve farm-level productivity and working relationships in Oro province are not proposed.
305. The average labor profile assumed in the PAD (not a scheme-specific estimate) differs from other studies commissioned by the World Bank. For example, in ADS 2001 (the FFB price formula review), labor profiles for Village Oil Palm and LSS blocks were reported for Hoskins, Oro, and Bialla and show higher labor inputs at Hoskins.<sup>338</sup> The PAD labor assumptions (two hectare) are far below all two-hectare models reported in ADS 2001.<sup>339</sup> Furthermore, the OPIC analysis of the Credit Component and Financial Analysis, prepared for the SADP, features a labor profile (Annex Table 1) that estimates labor requirements for one hectare of oil palm in years 4-23 when harvesting is under way, which exceeds the PAD's assumptions for two hectare of oil palm.<sup>340</sup> These alternative estimates cast doubt on the reliability of the returns per day worked as reported in the PAD.
306. **Debt Servicing.** According to the PAD, a cash flow analysis "*indicates that a loan of K1,900 at 8% interest, with a grace period of 3 years, would take 7 years of monthly repayments to clear the debt, with repayments set at 30% of the monthly payment amounts due the grower for FFB sold to the mill.*"<sup>341</sup> The PAD notes that based on the cash flow analysis, "servicing the debt is well within the means of smallholders and allows sufficient cash flow after debt repayment for their livelihood requirements and other obligations."<sup>342</sup>
307. The detailed credit component and cash flow analysis by OPIC shows that repayment for new planting ("infilling") is more than eight years, not seven years as stated in the PAD.<sup>343</sup> The PAD claims to reflect the "with project" situation through an average model of the three schemes. However, the FFB yields used in the analysis are for Hoskins only<sup>344</sup> and during the debt-servicing period are about 13% higher than the yields assumed for the other two schemes. Using the yields for Bialla/Oro and prices for Oro, debt for 2 hectares of new oil palm is fully serviced at Oro in 11 years--4 years longer than suggested in the PAD--which is based on the OPIC model. Moreover, the FFB prices in the OPIC model, Table 11 ("actual prices paid to farmers") are different from those used in the PAD Annex 9, Table 2, so the income results are not comparable, which creates further confusion. In Oro

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<sup>337</sup> Ibid., p. 21, Table A1.1

<sup>338</sup> ADS (May 2001), Annex 6, Tables 2 and 3.

<sup>339</sup> PAD, p. 84-85, Tables 1 and 2.

<sup>340</sup> Cuddihy, W. *Credit Component and Financial Analysis*, Revised Final, 30 December 2006. Prepared for OPIC/PHRD. Annex Table 1, page 19.

<sup>341</sup> PAD, p. 79

<sup>342</sup> Ibid.

<sup>343</sup> OPIC/Cuddihy, William (2006). SADP Credit Component and Financial Analysis. December. The FFB yields used in the two-hectare model for new blocks are based on Hoskins only, and these exceed the other two locations by about 13% during the repayment period.

<sup>344</sup> See Table 11 of the OPIC/Cuddihy (2006) compared with PAD, Annex 9, Table 2.

especially, oil palm is not as affordable as presented as it takes four years longer than estimated to service the debt.

308. **FFB Yields.** The PAD presents the current without project smallholder or estate yield profile only for Hoskins, and not for Bialla or Oro. This omission calls into question the basis for the yield estimates in Bialla and Oro and whether these are not overoptimistic when compared to actual performance.
309. The Implementation Completion Report<sup>345</sup> for the Oro Smallholder Project (1992-2001) flagged the problem of overestimating yields in the earlier project:

*“On the **new blocks**, analysis of individual block yields according to year of planting reveals that, on average, they are up to 50% less than anticipated at appraisal in early years, with less deficit (about 12%) in later years. The appraisal assumed that yields would start at 5 tonnes in the third year and rise to 12, 16, 18 and 19 tonnes/ha in successive succeeding years. The relatively high yields were based on trends exhibited in the earlier Popondetta scheme in the mid-1980s before the major drop in palm oil prices of the late-1980s... Over the last 10 years annual average yields have been between 9.5 and 13 tonnes/ha planted, or between 11 and 14.5 tonnes/ha harvested, with the figures over the last six years being higher than the earlier years when the worst effects of the anti-settler campaign were evident. This compares with an expectation of about 15 tonnes.”*<sup>346</sup>

310. The PAD mentions “smallholders in existing scheme areas generally are producing at far below their potential,” without specifying the extent.<sup>347</sup> A more recent statement by the New Britain Palm Oil Development Limited (NBPOL) gives an indication: “...while NBPOL’s estates produced around 26 tons per hectare and their existing smallholders were producing 19 tons per hectare (referring to West New Britain), the newly incoming ones (referring to the Oro area newly acquired by NBPOL) **yielded five tons per hectare. Smallholders were in dire need of technical support.**”<sup>348</sup> (emphasis added).
311. The agronomic potential of smallholder oil palm is not in question, as it has always been high in Papua New Guinea and is sometimes achieved. But it is not a good basis for estimating the baseline assumptions for a project, especially when previous experience indicates that it is rarely achieved, especially in Oro, until the roads are fully upgraded and better extension services are in place. More practical assumptions based on a percentage of the potential yield would have been prudent.
312. Based on the above analysis, the Panel’s expert concludes that the analysis shown in Annex 9 of the PAD is broadly consistent with the type of analysis usually developed for

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<sup>345</sup> World Bank, 2002. *Implementation Completion Report* on a Loan in the Amount of US\$27 million to the Government of Papua New Guinea for the Oro Smallholder Oil Palm Development Project

<sup>346</sup> Implementation Completion Report, p. 8

<sup>347</sup> PAD p. 8, ¶ 24.

<sup>348</sup> *Improving the Livelihoods of Palm Oil Smallholders: The Role of the Private Sector*. Prepared by FSG Social Impact Advisors (commissioned by World Bank Group, 2010). p. 12.

smallholder oil palm projects financed by the World Bank, as well as with the type of financial modeling analysis done for the preceding World Bank-financed Papua New Guinea projects. The modeling in Annex 9, however, is based on average productivity across the three schemes, with adjustments for scheme-specific farm gate FFB prices and yields. Specific models for each scheme are not presented. Specific debt-servicing models for each scheme are also not presented. Labor inputs in the two-hectare smallholder model in the PAD were well below other estimates prepared with World Bank financing, for example, ADS 2001 (FFB pricing study) and in the OPIC study for the credit component and financial analysis of the SADP.

313. High base-case financial internal rates of return (FIRRs) reflect the high productivity and low cost assumptions. But these seem to be too high, especially for Oro, as they are not backed up by actual data to support the assumptions for oil palm FFB yields. Thus, if the FFB yields in the SADP for Oro (and Bialla) are overestimated, the projected FIRR, net income and debt recovery estimates in the PAD are overestimated. Based on the evidence provided by previous experience at Oro, in particular, and the lack of actual data to support the assumptions for oil palm FFB yields, it is reasonable to assume that the PAD overstates the FFB yields and the resulting financial projections for the base case in Oro.
314. Based on the above analysis, there are significant economic, financial, and institutional differences in the different Project areas, as in the case of Oro and WNB. **It is the Panel's view that the Project design should have made provisions to respond to the differences among the Project areas, so that the smallholders receive appropriate economic, social, and cultural benefits from the Project. The Panel finds this not to be in compliance with OMS 2.20 and OP/BP 4.10.**
315. With respect to the role of private companies in the SADP, the PAD states that *“the palm oil milling companies (a) provide the milling capacity for the FFB from their own estates and from smallholder outgrowers; (b) collect FFB from roadsides in the smallholder supply areas at fortnightly intervals, mostly using their own transport fleet; (c) supply essential production inputs such as seedlings (for planting and replanting), fertilizer and tools; and (d) pay growers for deliveries either fortnightly or monthly, and maintain an accounting system that enables deductions from each grower's FFB payment to meet repayments due on development and/or production input loans from the concerned lending entity.”*<sup>349</sup> Despite the broad range of responsibilities of the companies, however, the PAD provides no quantitative information to assess the profitability (or lack thereof) of the companies involved in any of these operations in milling, transport, seedling production, input supply, credit/debt management, replanting, and in their large financial contributions to OPIC and PNGOPRA.
316. Neither is there analysis of the relative returns to smallholders, estates and milling companies, either from an historical perspective or under the Project. Thus there is no analysis of “capacity to pay” for the costs of road maintenance, for example, when it is proposed to be shared amongst the key stakeholders. This raises the issues of the FFB pricing formula, costs of production, transport, employment, value added margins at each

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<sup>349</sup> PAD, p. 20, ¶ 8.

stage of the value chain (smallholders, estates, CPO mills – the format for gathering these data has been given to the IP for on-forwarding to Papua New Guinea) including the processing efficiency and CPO/PKO oil extraction rates at the domestic mills. The PAD repeatedly mentions the close relationship of smallholders, OPIC and the milling companies but is silent on corporate governance, past performance of the companies, their role on smallholder debt and services, profitability, and their future potential.

317. The company situation in West New Britain over the years has been more stable than in Oro, where company ownership has changed hands several times over the years.<sup>350</sup> In Oro, the smallholder debt situation and record keeping and accounting, has been “*less than satisfactory*,” according to the Requesters.<sup>351</sup> This is an additional reason to differentiate the Project design in Oro.
318. The Panel was informed that neither OPIC nor the Bank has any information on returns to company estates and mills. **Considering the decades of work supported by the Bank in the oil palm sector in Papua New Guinea, in partnership with oil palm companies, and the companies’ important role in implementing the Project and their direct impact on smallholder income, the Panel finds that Management did not conduct appropriate due diligence of the companies’ institutional and financial viability. The Panel finds this not to be in compliance with OMS 2.20 and OP/BP 10.04.**
319. In this context, the Panel notes that the terms of reference for the FFB Pricing Study states that the study “*would improve the operation of the pricing formula, with the aim of ensuring that a transparent and equitable pricing formula is in place and applied by each palm oil milling company.*”<sup>352</sup> Accordingly, the selected consultant will be reviewing both smallholder and company data pertaining to the actual costs of production in coming up with a recommendation. The Panel welcomes this attempt to ensure a transparent and equitable formula, based on the review of both smallholder and company production data. But the Panel notes that the FFB study is currently on hold until legal issues between the Independent Consumer and Competition Commission (ICCC) and OPIC are resolved.<sup>353</sup>

### 3. Improving Livelihoods: Savings and Income Diversification

#### a. Savings

320. The prevalence of the *wantok* system of reciprocal social and economic obligations with anyone who speaks the same language, is described in Chapter 2.<sup>354</sup> Such a society, where

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<sup>350</sup> The Commonwealth Development Corporation (CDC), the original developer of Higaturu Oil Palms Pty. Ltd., initially owned Pacific Rim Plantations Limited (PacRim) in partnership with the State. In addition, Cargill-Temasek (Cargill in JV with the Singapore Government’s sovereign wealth fund) and now New Britain Palm Oil Group have been involved in company ownership.

<sup>351</sup> Scott, M. Panel meeting with OPIC. September 2, 2010.

<sup>352</sup> Terms of Reference, FFB Price Formula Review and Audit (2010), p. 3.

<sup>353</sup> Aide Mémoire, Implementation Support Mission, April 15-19 2011.

<sup>354</sup> In explaining the difficulties faced by smallholders in saving money, they “...identify three related barriers to savings. First, the social pressure to be generous to relatives is great. Traditionally, social status and the reputations of individuals and groups were very much bound up with the redistribution of wealth through social and

cash, food, and other material goods are shared, and where there is no tradition of saving, may be one in which some people react to an increase in the availability of cash by immediate consumption.

321. The Panel notes that Project documents as early as 2002<sup>355</sup> clearly indicated that developing systems to promote savings by smallholders was an element of the Project and that suitable institutions and mechanisms were needed to implement this. The 2003 Identification Mission stated that *“In the long term smallholder self-financing of the re-development of their blocks will be strongly linked to their ability to save. The challenges in developing a savings culture amongst smallholders, given the important societal obligations in PNG are considerable, nor is it currently much encouraged by the institutional environment.”*<sup>356</sup>
322. Moreover, at the Project Concept Document (PCD) Review Meeting held in June 2003, a peer reviewer commented about the need to *“insulate”* oil palm income from the non-productive outlets that males use it for, which have negative social consequences. The “pre-social assessment” also noted that the lack of savings and entrepreneurship capacity had *“possible social implications”* and called for developing a savings mechanism as part of the Project.<sup>357</sup> This report suggested that this (i.e., the development of a savings mechanism) be made part of the Social Assessment’s terms of reference.
323. The Social Assessment emphasizes that *“...the absence of an effective savings mechanism to isolate a component of cash earnings from the demands of the traditional exchange economy and other competing demands on income is seen by growers as a major constraint on their ability to accumulate savings. The absence of an effective savings mechanism is an important factor explaining the lack of material progress on many oil palm blocks...”*<sup>358</sup>
324. After having identified an effective saving mechanism as an issue affecting the Project’s ability to improve smallholder livelihoods and ostensibly help enable the reversal of the income “paradox”, the Social Assessment recommends that a mechanism similar to the one developed by the Bialla Growers Fund might be implemented. This Fund functioned by

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*kinship networks. Status, prestige and respect were not associated with accumulating wealth for personal consumption or personal investment purposes, but in redistributing this wealth through social networks or group projects that had the effect of enhancing the status of the giver and associated group members. These values and thinking remain very strong amongst LSS and VOP growers, especially amongst the latter where customary events are often timed to coincide with oil palm pay-days to allow people to contribute part or all of their pay to the group activity. Also, there is a cultural obligation on blockholders to redistribute a significant proportion of their income amongst the extended family group, and blockholders are often accompanied by relatives to town when they go to cash their pay cheques or withdraw cash from the bank if their pay is paid directly in to a bank account. Indeed, for a blockholder to resist the demands of the extended family on his oil palm payment is to risk social censure and damage to his reputation.”* Social Assessment Report (January 2007), p. 51.

<sup>355</sup> Aide Memoire, Identification Mission, Proposed Smallholder Agricultural Development Project, November 2002, p. 3.

<sup>356</sup> Ibid., March-April 2003, p. 4, ¶17.

<sup>357</sup> COWI. (June 2003). Smallholder Agricultural Development Project (SADP) Identification Mission: Assessment of Social Issues, Safeguard Policies, Identified Stakeholders and TOR for Social Assessment, p. 13.

<sup>358</sup> Social Assessment (January 2007), p. 52.

placing a levy on production that was deducted at a fixed rate per ton of FFB from the growers' payments. The growers later exchanged their contributions to the Fund for certain goods. This allowed the income from oil palm to be transformed into a productive physical asset that could contribute directly to improving their quality of life.

325. The PIM also mentions the issue of savings and recommends implementation of "... *long term strategies to lessen the financial hardship of loan repayments for smallholders undertaking replanting, including investigating the possibility of introducing a replanting levy and new savings mechanisms.*"<sup>359</sup> It also cites the existing Bialla Growers Fund as a possible example.<sup>360</sup>
326. The Panel understands that Management considered the establishment of a savings mechanism during the design of the SADP, but concluded it would not have a good chance of success given the lack of existing capacity in the area. Moreover, Management received indication that Papua New Guinea SDP Micro Finance would begin lending and savings operations in the Project areas (beyond their involvement in the credit mechanism for the infilling component). Management further cited local governance and participation as requirements that merited higher priority during the Project preparation. For these reasons, Management decided not to include a savings mechanism as a Project component.
327. The Panel appreciates the efforts Management made to explore the possibility of establishing a savings mechanism. Nonetheless, given that the introduction of an effective savings mechanism was a critical recommendation from the Social Assessment, as well as earlier Project preparation work, and since it relates directly to the issue of improving smallholder livelihoods, in the Panel's view, Management should have continued to give priority in promoting the importance of identifying effective means of savings.

#### **b. Income Diversification**

328. The Panel notes that the purpose of preparing the Social Assessment, in addition to examining the Project's potential positive and adverse effects on the Indigenous Peoples, is "*to examine project alternatives where adverse effects may be significant.*"<sup>361</sup>
329. The Social Assessment defines its objective as presenting an outline of the SADP and seeking inputs on how it might be more effective. Given that SADP, as designed, was the starting point, there was no examination of project alternatives.
330. The Social Assessment did however recommend that the Project develop strategies for income diversification. "*Non-oil palm activities are sometimes viewed as distractions drawing smallholders' time and energy away from oil palm production. Rather than ignoring income diversification, the challenge for extension services and smallholder development policies is to consolidate and build on these income trends through policies that strengthen linkages between the smallholder sector and the broader regional*

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<sup>359</sup> PIM August 2007, Main document, p. 13, Table 2.1.

<sup>360</sup> Ibid., p. 13.

<sup>361</sup> OP 4.10, ¶ 9.

economy.”<sup>362</sup> Recommended measures include skills training for unemployed youth, for example, provided by other organizations but coordinated by OPIC.

331. The Management Response states that the “*SADP will support further diversification through investments in improving rural roads and through Component 2 of the Project (Local Governance and Community Participation)*.”<sup>363</sup> Management thus acknowledges income diversification as an essential part of livelihood strategies for smallholders. The Project approach, however, has been to assume that income diversification will result as a spin-off from improving roads and building some (limited) community infrastructure. Improved roads will undoubtedly contribute to a range of community benefits, including a potential increase in income-generating opportunities owing to the easier transportation of other cash crops either for export or for local markets, as well as improved transportation of oil palm FFBs. It is harder to see the link between the activities foreseen under Component 2--which will, in any case, be on a limited scale--and additional income-generating opportunities. Moreover, the Panel understands that Management will be deciding in the next few months whether to “maintain” Component 2 or to restructure it.<sup>364</sup> Regardless of this, the Panel notes that nothing in either of these two initiatives (improved roads and Component 2’s community-driven development projects) explicitly addresses income diversification among smallholders, nor gives incentives to smallholders under the Project, other than focusing on growing oil palm.<sup>365</sup>

332. As noted earlier, savings and income diversification are key measures for avoiding potentially adverse effects on the indigenous communities--as recommended in the Social Assessment. OP/BP 4.10 requires that “*Bank-financed projects include measures to (a) avoid potentially adverse effects on the Indigenous Peoples’ communities; or (b) when avoidance is not feasible, minimize, mitigate, or compensate for such effects.*”<sup>366</sup> **Since the Project did not incorporate measures recommended in the Social Assessment aimed at avoiding and mitigating adverse impacts on indigenous smallholders growing oil palm, the Panel finds that Management did not comply with OP/BP 4.10.**

## H. Final Reflections

333. While production of oil palm generated increased income for the smallholder, the Project as designed did not adequately meet the requirements of Bank’s Indigenous Peoples Policy

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<sup>362</sup> Social Assessment Report (Jan 2007), p. xiv.

<sup>363</sup> Management Response, p. 17, ¶ 48.

<sup>364</sup> Aide Memoire, Implementation Support Mission, April 15-19, 2011. p. 6, ¶ 30.

<sup>365</sup> During its field visit, the Panel team came across two interesting examples--one from OPIC and the other from the mill company (NBPOL)--in which smallholders were being helped with income diversification, without additional resources. In one case, an OPIC extension officer was helping organize cacao and coffee producers’ cooperatives for oil palm smallholders who were also producing these other cash crops, thus facilitating their marketability. The other case was NBPOL management who had negotiated with a European chocolate manufacture (for whom the mill was processing palm oil) to buy cacao from the oil palm smallholders who were also producing cacao.

<sup>366</sup> OP 4.10, ¶ 1.

that it is “*designed to ensure that the Indigenous Peoples receive social and economic benefits that are culturally appropriate and gender and intergenerationally inclusive.*”<sup>367</sup>

334. The inadequate analysis in the Social Assessment of customary laws and institutions, and of how the consultations are carried out, also meant inadequate attention to key livelihood issues in Project design and implementation, specifically in not recognizing the vital importance of diversification of livelihoods and savings. In the Panel’s view, the application of Indigenous Peoples Policy calls for consistent application of its principles, namely, ensuring social and economic benefits; continuous free, prior, and informed consultation; and avoidance of potentially adverse effects or the minimization, mitigation, or compensation for such effects when they are unavoidable. Undoubtedly, this makes the task of Project design, supervision, and implementation support more demanding and challenging.
335. The Panel considers that had Management paid more attention to the differences between the provinces and thus ensured different responses, Project design and implementation could have led to better outcomes for the smallholders.
336. In the Panel’s view, a thorough analysis of actual production costs (based on company data) may have resulted in a more equitable and sustainable design of RMTF, and may have been critical going forward for the FFB Pricing study.
337. The Panel also recognizes the challenges Management faces given the capacity constraints that are regularly discussed in Management’s Mission Reports. The Report will revert to this issue in Chapter 6. One recent positive change in the environment of SADP, however, is the new management of the mill company in Oro Province. While the Panel has commented on the inadequacy during the Project design phase with regards Management’s effort to analyze mill company data needed to address the issues of smallholder earnings, the strong commitment of the company to RSPO principles is to be welcomed.

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<sup>367</sup> OP 4.10, ¶ 1.

## Chapter 5: Environmental Impacts

### A. Introduction

338. This Chapter focuses on claims relating to environmental concerns. The Requesters state that the Project will cause several environmental harms owing to the inadequacy of the environmental assessment and consequences from “*infilling*,” erosion, pollution of waterways, and deforestation. Throughout the Request for Inspection, several environmental concerns are raised. They include:

- 1) inadequacies in the Environmental Assessment (particularly the lack of reliable sources);<sup>368</sup>
- 2) deceptive connotations of the term “*infilling*”;<sup>369</sup>
- 3) consequences of complete land clearance, including erosion, topsoil depletion, and siltation;<sup>370</sup>
- 4) inadequate assessment of mill effluent<sup>371</sup> and potential chemical and biological pollution of waterways (agro-chemicals);<sup>372</sup>
- 5) inadequate mitigation measures in the Environment Management Plan (EMP) with regard to preservation of high conservation value forests;<sup>373</sup> and
- 6) lack of consultation with claimants and Project-affected persons and inadequate disclosure of information.

339. Each of these issues, except for consultation and disclosure, which has already been discussed in Chapter 3, is discussed separately below. These issues share common elements, particularly regarding how they are addressed in the EMP, the Project Implementation Manual (PIM), and the PAD, and their overall compliance with Bank safeguard policies.

340. Although the Requesters concerns regarding harm from oil-palm planting pertain to Oro province, no new oil palm blocks have been established since 2001. Therefore the harms alleged are prospective and reflect experience from the oil-palm expansion that occurred in previous decades and financed by the World Bank.<sup>374</sup>

### B. Requesters’ Claims

341. According to the Requesters, the Project will cause several environmental harms because of the inadequacy of the environmental assessment. The harms include lack of disclosure and consultation, and the consequences of “*infilling*,” which include soil erosion, pollution of waterways, and deforestation. The Requesters state that the credit facility under the

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<sup>368</sup> Request for Inspection, p. 9.

<sup>369</sup> Ibid., pp. 2-3.

<sup>370</sup> Ibid., p. 4.

<sup>371</sup> Ibid., pp. 4, 9.

<sup>372</sup> Ibid., p. 4.

<sup>373</sup> Request for Inspection, p. 10.

<sup>374</sup> Oro Smallholder Oil Palm Development Project, 1992-2001.

Project's first component--which gives loans to smallholders wanting to plant oil palm adjacent to existing access roads that don't currently have oil palm--is actually an 'expansion project,' rather than 'infilling,' which they believe is a 'deceptive term.'

342. The Requesters claim that the Project "*will extend oil palm onto blocks that currently contain forests, degraded forests and grassland that, despite being located within oil palm blocks, still provide economic and social services for local communities including household gardens.*" The Requesters go on to note that local communities "...*depend on these forests and grasslands, often managed under the community's traditional law, for their subsistence and cash income, as well as for cultural and religious practices.*"<sup>375</sup> They also draw attention to the much greater biodiversity contained in primary rainforest than in oil palm plantations.<sup>376</sup> In discussing the Project's harms, the Requesters state that forests and grasslands that might be converted to oil palm under the Project provide "*ecological*" and "*socio-economic and cultural functions.*"<sup>377</sup>
343. The Requesters state that the "*environmental assessments conducted are particularly poor and miss critical impacts,*" such as the impact of increased effluent discharge from the mills on rivers, fish, and people.<sup>378</sup> They also believe the Environmental Assessment exhibits "*major gaps,*" as it does not use reliable sources of information, does not assess effluent treatment, and does not provide mitigation measures for Project impacts on high-value forests.<sup>379</sup>
344. In their overview of the effects of oil palm, the Requesters note that "...*oil palm cultivation requires complete land clearance which has important implications for erosion, topsoil depletion, and the siltation of rivers.*"<sup>380</sup> While noting that the Environmental Assessment evaluates impacts on soils and surface water, the Requesters consider it inadequate.<sup>381</sup>
345. The Requesters also claim that "...*oil palm development often leads to chemical and biological pollution of waterways. In many plantations and smallholder plots, fertilizer is extensively used to maintain soil nutrients and tree productivity. Improper use of agro-chemicals and run-off during periods of heavy rainfall can cause pollution of the water table and river systems, resulting in algae blooms and damage to natural biological processes.*"<sup>382</sup>
346. The Requesters fear the Project will destroy high value forests through the OPIC's establishment of internal oil-palm-planting targets and because of a "*site sensitivity survey,*" which seeks to guide OPIC officers to classify forest land suitable for oil palm planting.<sup>383</sup> The Requesters believe deforestation will occur because "*OPIC officers lack*

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<sup>375</sup> Request for Inspection, p. 4.

<sup>376</sup> Request for Inspection, p. 4.

<sup>377</sup> Ibid

<sup>378</sup> Ibid., p. 9.

<sup>379</sup> Ibid

<sup>380</sup> Ibid., p. 4.

<sup>381</sup> Request for Inspection, p. 9.

<sup>382</sup> Ibid., p. 4.

<sup>383</sup> Ibid., p. 10.

*the capacity to classify forests,” according to the site survey criteria and because of an incentive structure that rewards increased oil palm planting.<sup>384</sup> The Requesters propose a number of measures to prevent deforestation, including undertaking a high-value forest inventory before new planting begins.*

### **C. Management Response**

347. The Management Response notes that “[t]he terminology of infill planting has been used consistently in all Project documentation to refer to planting of oil palm along existing access roads in Papua New Guinea’s three largest NES. It is very clear from all Project documentation that the SADP will support an expansion in oil palm area of up to 9,000 hectares on smallholder VOP blocks.”<sup>385</sup> The Response also notes that “...infilling was an unfamiliar concept. Detailed explanations of the infill component were frequently accompanied by maps, on paper or on the ground, to show how infill planting might proceed and how this might lead to improved efficiencies in the use of transport and road infrastructure.”<sup>386</sup>
348. The Management Response specifies that infilling does not mean that any smallholder is forced into growing oil palm: “Participation in infill planting under the SADP is completely demand driven and whether or not VOP smallholders decide to participate in infilling is entirely up to them, as long as their blocks meet the various social and environmental screening criteria for infill planting”<sup>387</sup> and “[i]t was explained that infill planting was voluntary, would only proceed at the discretion of the customary landowners, and would not be permitted on land subject to disputes.”<sup>388</sup>
349. Management agrees that “...there was insufficient detail in the EA on the matter of effluents”<sup>389</sup> and that “In addition to monitoring of milling company ISO14001 and RSPO certification, a thorough analysis of the impact of increased effluents due to Project activities will be undertaken.”<sup>390</sup> The Management Response explains that the “ISO14001 is an international standard for environmental management and a framework for lessening a company’s footprint on the environment” and the RSPO “...is a global coalition of industry, NGOs, financial institutions, environmental and conservation groups, retailers and consumer product companies that have come together since 2004 to develop a structured way forward for the production and use of sustainable oil palm.”<sup>391</sup> In addition, although the EA, the EMP, and the Environmental and Social Management Framework (ESMF) identify potential environmental impacts of the Project and include appropriate and effective mitigation strategies, Management “...agrees that a more comprehensive

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<sup>384</sup> Request for Inspection, p. 10.

<sup>385</sup> Management Response, p. 9, ¶ 29.

<sup>386</sup> Ibid., pp. 25-26, ¶ 79.

<sup>387</sup> Management Response, p.19, ¶ 54.

<sup>388</sup> Ibid., p. 26, ¶ 79.

<sup>389</sup> Ibid., p. 36, ¶ 117.

<sup>390</sup> Ibid.

<sup>391</sup> Ibid., p. 7, ¶ 23.

*analysis of the impacts of increased production at the oil palm mills and effluents should have been undertaken in accordance with the requirements of OP/BP 4.01.”*<sup>392</sup>

350. With regard to the High Conservation Value Forest (HCVF), Management believes “...*the Project’s design includes adequate measures to minimize and manage risks of deforestation of areas of high conservation value.*”<sup>393</sup> Moreover, Management states that “[n]o significant conversion or degradation of critical forest areas or related critical natural habitats is planned under the Project.”<sup>394</sup> Management stresses that screening processes are already in place in both Components 1 and 2, and the proposed forest and wildlife mapping will prevent any negative environmental impact on forests or on regenerating forests. Also, OPIC extension officers are trained in identifying HCVF. Three new Environment Officers will be recruited and further training will be provided under the Project. Management believes that the lack of a forest inventory is not a violation of BP 4.36 (Forests) as “...*paragraph 4 of BP 4.36 (Forests) refers to an inventory of critical forest areas and not to a forest inventory per se.*” Lastly, in the absence of an oil palm code of practice, Management assures that the PNG logging code of practice and national environmental laws will also be followed.<sup>395</sup>

#### **D. Panel’s Observations on Harms Alleged in the Request**

351. The Panel notes that the Requesters believe that due to inadequacies in the Environmental Assessment and infilling activities supported under the Project which will considerably expand oil palm farming and lead to land clearance, their land will be degraded from erosion, top soil depletion, and siltation. They also state that their water sources will become polluted from mill effluent, thus leading to a decline in the local fish stock, and their forests and home gardens will not be protected under the Project. Consequently, they believe they will be deprived of the “*critical ecological, socio-economic and cultural functions*” provided by their forests as they “*depend on these forests and grasslands...for their subsistence and cash income, as well as for cultural and religious practices.*”<sup>396</sup>
352. As was noted above, the Project had not started infilling activities at the time the Request for Inspection was submitted.<sup>397</sup> Therefore, there was no specific harm that could be attributed solely to the Project. However, as stated in the Panel Resolution and subsequent 1999 Clarification,<sup>398</sup> the harms expressed in the Request anticipate adverse material effect/s that may occur as a result of an omission or violation of the Bank’s operational policies and procedures in the design, appraisal and/or implementation of SADP. The Panel believes that the Requesters’ perceptions of environmental and ecological harm arose partly because of the experiences in Oro province with the World-Bank-financed Popondetta Smallholder Oil Palm Development Project (1976-84) and the more recent Oro

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<sup>392</sup> Ibid., p. 36, ¶ 119.

<sup>393</sup> Ibid., p. 36, ¶ 117.

<sup>394</sup> Ibid., p. 37, ¶ 124.

<sup>395</sup> Management Response, p. 38, ¶125, 126, and 127.

<sup>396</sup> Request for Inspection, p. 4.

<sup>397</sup> According to the most recent OPIC Implementation Progress Report of July 21, 2011, infill planting will begin once an MOA regarding the POME Management Action Plan is signed by the parties.

<sup>398</sup> Inspection Panel Resolution (¶16) and 1999 Clarification (¶ 9b).

Smallholder Oil Palm Development Project (1992-2001).<sup>399</sup> As the SADP had not started infilling activities, to which most of the environmental harm is ascribed, the Panel views the Requesters' claims within the purview of potential harm, which may result from a violation of Bank policies and procedures during Project design, appraisal, and implementation.

353. As to the adverse consequences of oil-palm cultivation, international attitudes and approaches to environmental and social aspects of oil-palm development have changed dramatically in the last decade. In Papua New Guinea, this has been marked by the adoption of two approaches to environmental management by oil-palm-milling companies. The first is accreditation with the ISO14000 management systems approach of continual improvement in achieving and demonstrating sound environmental performance. The second is certification under the RSPO, which adopts a more operational approach to sustainable oil-palm production and includes stakeholders.

354. The Management Response notes that *"In 2005, all palm oil milling companies in PNG had achieved ISO14001 accreditation. ISO14001 is an international standard for environmental management and a framework for lessening a company's footprint on the environment. ISO14001 accreditation is independently audited and the certification authority conducts regular annual compliance audits."*<sup>400</sup>

355. The RSPO was formed in 2004 amid global concerns about the environmental responsibility and sustainability of the oil-palm sector. The stated objective of RSPO is *"promoting the growth and use of sustainable oil palm through credible global standards and engagement of stakeholders."*<sup>401</sup> A certification scheme was established, consisting of 8 Principles and 39 Criteria. Both NBPOL (WNB Hoskins) and Hargy (WNB Bialla), have earned RSPO certification, and Kula/Higaturu Oil Palm Limited (HOP) is seeking certification by 2012.<sup>402</sup> Papua New Guinea is a party to the RSPO and has established a representative National Interpretation Working Group (NIWG) to, in part, interpret the RSPO Criteria to ensure they adequately describe sustainable management of oil palm in Papua New Guinea.<sup>403</sup> Principle 4 of the RSPO Principles relates to *"Use of appropriate best practices by growers and millers"*<sup>404</sup> and addresses, among other things, soil fertility

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<sup>399</sup> See Environmental Impact Review of Current Project and Recommendations for Consideration in any Future Development. Study of Oro Smallholder Oil Palm Development Project (Ln. 3485-PNG) Tom Diwai Vigus (2001), Oil Palm Industry Corporation.

<sup>400</sup> Management Response, p. 7, ¶ 23.

<sup>401</sup> RSPO Website, <http://www.rspo.org/?q=page/9> Accessed March 31, 2011.

<sup>402</sup> Roundtable on Sustainable Palm Oil. 2010. "New Britain Palm Oil Report 2010," RSPO Annual Communication of Progress.

<http://www.rspo.org/sites/default/files/17.%20New%20Britain%20Palm%20Oil%20annual%20report%202010.pdf>. The Panel was informed during its September 2010 visit by Kula/Higaturu Management that it withdrew the company's application for RSPO certification voluntarily after it took over because the original RSPO application did not include the smallholder sector. At the time, the Panel was informed that HOPL would re-apply in a few months.

<sup>403</sup> Oil Palm Sector Situation and Perception Assessment, Papua New Guinea (Draft Report). Peter McCrea (2009). The World Bank and Oil Palm Industry Corporation. p. 17.

<sup>404</sup> RSPO Principles and Criteria for Sustainable Palm Oil Production, Public Release Version, October 17, 2005, p. 12.

and erosion issues. Principle 5 relates to “*Environmental Responsibility and Conservation of Natural Resources and Biodiversity*”<sup>405</sup> and addresses, among other things, biodiversity conservation. Both of these Principles are relevant for the following discussion on environmental impacts of the SADP.

356. As companies accept RSPO compliance standards, they are expected to become more environmentally and socially responsible. This is usually reflected in the growing and processing practices of company estates and company-linked smallholders. Standards and practices (which are still evolving) are very different from those that applied in the last oil palm expansion in the mid to late 1990s. New ownership of some of the companies, as in the case of Kula/Higaturu (HOP), has also facilitated the adoption of these new approaches to environmental management.
357. The NIWG found that the procedures applied under the SADP and the OPIC Planting Approval Form (which mainly assesses environmental issues but includes some livelihood issues) largely comply with RSPO requirements.<sup>406</sup> Reference to the RSPO Principles and Criteria by the SADP and attempts to have the Project’s key planning instruments comply with RSPO standards is a major step forward in ensuring that oil palm plantings are carried out in a way that minimizes adverse environmental impacts.
358. The Panel recognizes the concern of the Requesters given the extent of deforestation, pollution from mill effluents, and other negative environmental consequences associated with past oil palm activities in Papua New Guinea.

## **E. Applicable Bank Policies and Procedures**

359. The section below provides a description of Bank policies that are relevant to the claims raised in the Request for Inspection against which the Panel is assessing compliance.

### **1. Environmental Assessment (OP 4.01)**

360. The operative Bank policy for addressing environmental issues is OP 4.01: Environmental Assessment, which aims to “...ensure that [projects] are environmentally sound and sustainable...”<sup>407</sup> It describes the Environmental Assessment:

*“EA is a process whose breadth, depth, and type of analysis depend on the nature, scale, and potential environmental impact of the proposed project. EA evaluates a project's potential environmental risks and impacts in its area of influence; [footnote omitted] examines project alternatives; identifies ways of improving project selection, siting, planning, design, and implementation by preventing, minimizing, mitigating, or compensating for adverse environmental impacts and enhancing positive impacts; and includes the process of mitigating and managing adverse environmental impacts*

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<sup>405</sup> RSPO Principles and Criteria for Sustainable Palm Oil Production, 2005, p. 21.

<sup>406</sup> Oil Palm Sector Situation and Perception Assessment, p. 19.

<sup>407</sup> OP 4.01: Environmental Assessment, ¶ 1

*throughout project implementation. The Bank favors preventive measures over mitigatory or compensatory measures, whenever feasible.*”<sup>408</sup>

361. OP 4.01 requires that the “EA takes into account the natural environment (air, water, and land); human health and safety; social aspects (involuntary resettlement, indigenous peoples, and physical cultural resources); and transboundary and global environmental aspects.”<sup>409</sup>
362. The policy on Forests OP 4.36 states in one of its core provisions that the “Bank does not finance projects that, in its opinion, would involve significant conversion or degradation of critical forest areas or related critical natural habitats.”<sup>410</sup> In addition, BP 4.36 (Forests) requires that “...[d]uring project preparation, the TT [task team leader] ensures that the borrower provides the Bank with an assessment of the adequacy of land use allocations for the management, conservation, and sustainable development of forests, including any additional allocations needed to protect critical forest areas. This assessment provides an inventory of such critical forest areas, and is undertaken at a spatial scale that is ecologically, socially, and culturally appropriate for the forest area in which the project is located.”<sup>411</sup>
363. The Bank’s Policy on Natural Habitat, OP 4.04, states that the “...conservation of natural habitats.... is essential for long-term sustainable development” and the Bank “supports the protection, maintenance, and rehabilitation of natural habitats and their functions”.<sup>412</sup> The Policy also states that “In deciding whether to support a project with potential adverse impacts on a natural habitat, the Bank takes into account the borrower’s ability to implement the appropriate conservation and mitigation measures. If there are potential institutional capacity problems, the project includes components that develop the capacity of national and local institutions for effective environmental planning and management.”<sup>413</sup>

## **F. Panel’s Analysis of Compliance with Bank Policies**

### **1. Adequacy of the Environmental Assessment**

364. The Environmental Assessment notes that the SADP satisfies the definition of a Category B project and the Requesters do not contest this. According to OP 4.01, a project is classified as Category B “...if its potential adverse environmental impacts on human populations or environmentally important areas-including wetlands, forests, grasslands, and other natural habitats-are less adverse than those of Category A projects. These impacts are site-specific; few if any of them are irreversible; and in most cases mitigatory measures can be designed more readily than for Category A projects.”<sup>414</sup> According to OP

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<sup>408</sup> OP 4.01, ¶ 2.

<sup>409</sup> OP 4.01, ¶ 3.

<sup>410</sup> OP 4.36 – Forests, ¶ 5.

<sup>411</sup> BP 4.36 ¶ 4.

<sup>412</sup> OP 4.04 – Natural Habitats, ¶ 1.

<sup>413</sup> Ibid., ¶ 6.

<sup>414</sup> OP 4.01 – Environmental Assessment, January 1999, ¶ 8.

4.01, “[t]he scope of EA for a Category B project may vary from project to project, but it is narrower than that of Category A EA. Like Category A EA, it examines the project’s potential negative and positive environmental impacts and recommends any measures needed to prevent, minimize, mitigate, or compensate for adverse impacts and improve environmental performance.”<sup>415</sup>



Picture 15: A view of NBPOL Nursery, Hoskins, WNB.

365. The Requesters raise the concern that the Project’s Environmental Assessments were inadequate. The Management Response states that “*The EA, EMP and ESMF identify the potential environmental impacts of the Project and include appropriate and effective mitigation strategies for these.*”<sup>416</sup>
366. In examining this claim, the Panel notes that OPIC commissioned an Environmental Assessment (completed in 2007) followed by an Environmental Management Plan (also in 2007). These were accompanied by an Environmental and Social Management Framework (also in 2007) that addresses issues associated with Component 2 of the Project.<sup>417</sup>
367. The Panel also notes that the EA is a relatively generic document that indicates “what” needs to be done, while the EMP tends to indicate “how” to address the environmental issues outlined in the EA. The EMP concludes with a series of Environmental Control Measures and Monitoring Programs (ECMMPs) that aim to “...*provide concise instructions on how to conduct the avoidance strategies and implement the mitigation measures.*”<sup>418</sup> These essentially make the measures outlined in the EA and the early chapters of the EMP more operationally relevant.
368. The ECMMPs describe the approach needed to assess new blocks proposed for planting oil palm by determining a site sensitivity status that considers the block itself and adjacent areas (up to 100 meters beyond the block boundaries). This assessment aims to determine

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<sup>415</sup> Ibid., ¶ 8(b).

<sup>416</sup> Management Response, p. 51, Annex 1.

<sup>417</sup> Component 2 has since been suspended (OPIC Progress Report, July 2011), and may be dropped owing to Project restructuring (update this before issuing report).

<sup>418</sup> OPIC (2007) Environmental Management Plan, p. 37.

“...whether development of the block poses a risk to any environmentally sensitive areas or areas which may contain critical habitats or conservation values.”<sup>419</sup>

369. The approaches described in the ECMMPs are operationalized via the OPIC “*SADP Oil Palm Infilling Planting Approval Form*.” This is the essential management tool designed for use by OPIC officers to determine the site-sensitivity status of new oil palm blocks and to assess key environmental issues (as well as some land tenure and livelihood-related ones). It is also the tool used by Extension Officers to decide about whether planting can proceed or not and, if so, under what conditions. These forms (which first appeared in the PIM in August 2007)<sup>420</sup> have been revised several times, with the latest version dated July 2010.
370. The Panel also notes that another important management tool, not currently used in the Project, is landscape-level mapping. Such mapping could clearly show HCVPs and thereby help OPIC reach more informed decisions related to the designation of Infill blocks. The mapping could complement the Infilling Planting Approval Form and would ensure that OPIC Environment and Extension Officers are aware of HCFV or Wildlife Management Areas that may be adjacent to potential blocks.
371. Regarding the issue of reliability of sources used in the EA raised by the Requesters, the EA itself is a rather generic document and tends to develop its proposals on the basis of *a priori* arguments, rather than referring to specific literature. This is particularly the case with soil and biological impacts and, to a lesser extent, with fauna. The EMP adopts a similar approach. But having said this, the positions finally arrived at are essentially sound in that they reflect accepted good practice for environmental management.
372. The Panel did not identify any unreliable sources in the Environmental Assessment, as the Requesters claimed, nor did it receive from the Requesters any specific examples of such sources. Through a provision for biannual independent environmental and social audits added to the PIM, Management has also opened itself up to constructive comment from stakeholders.<sup>421</sup> Therefore, **the Panel finds that the inclusion of environmental management and mitigation tools and the reliability of sources used in the Environmental Assessment comply with OP 4.01.**

## **2. Infilling vs. Expansion and its Consequences**

373. The Requesters allege that “infilling” is a term that is used deceptively. They note that “*The claimants and CELCOR consider such plantings to fall within the definition of expansion.*”<sup>422</sup> The Management Response states that “*the terminology of infill planting has been used consistently in all Project documentation to refer to planting of oil palm along existing access roads in PNG’s three largest NES. It is very clear from all Project*

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<sup>419</sup> Ibid., p. 39.

<sup>420</sup> PIM, August 2007, Infill Planting Sub-Manual, pp. 9-20.

<sup>421</sup> PIM, August 2007, p. 43

<sup>422</sup> Request for Inspection, p. 3.

*documentation that the SADP will support an expansion in oil palm areas of up to 9,000 hectares on smallholder VOP blocks.”<sup>423</sup>*

374. The Panel notes that the stated intention of the Project is to support an expansion of the total area under oil palm through infilling along the existing road network. **It is the view of the Panel that the term infilling has not been used by Management to deliberately obfuscate oil palm expansion.**
375. The stated intention of the Project is to support an expansion of the total area under oil palm, but this will be done by infilling along the existing road network. OPIC staff in Oro province provided the Inspection Panel with details of approximately 1000 applications received from smallholders (mainly during 2006-08) for establishing new oil palm blocks. None of these requests were assessed for suitability for oil-palm planting by OPIC extension staff under the current assessment guidelines, and they may not all meet the criteria for support. (Picture 16 shows the current Popondetta Plain, where infilling may be carried out along an existing road.)



Picture 16: Aerial view of kunai grassland near Popondetta

376. Both the original and revised PIM Infill Planting Sub-manual emphasizes that:

*“Development of an infill block will only be considered if it meets all the OPIC, DEC and SADP environmental and social safeguard requirements. These include social and socio-economic issues, topographic considerations, measures related to proximity to watercourses, preservation of protected flora or fauna, and status of impacted forest at each site. Primary forest cannot be developed. Further, an impacted forest site can only be eligible for smallholder oil palm development if it is certain that, in the absence of oil palm development, existing human pressure would not allow regeneration of primary forest. Even though a parcel of land identified for oil palm infill meets environmental guidelines, development of that land under SADP will not be permitted if this development results in relocation of household gardens into areas that would normally be excluded on the same environmental grounds.”<sup>424</sup>*

<sup>423</sup> Management Response, p. 9, ¶ 29.

<sup>424</sup> PIM, August 2007, Infill Planting Sub-Manual, p. 6.

And that

*“Project participants with limited power and status, such as women, youth, caretakers and CPB owners will require specific attention to ensure they are equitably involved in Project decision-making processes.”*<sup>425</sup>

377. As described earlier, the selection of infill blocks is operationalized through the SADP “*Oil Palm Infilling Planting Approval Form*.” The Panel notes that the proper application of this management tool, given OPIC’s capacity, needs to be carefully monitored to ensure selection is handled as intended.
378. Furthermore, the Panel notes that the Requesters’ concern is that infilling might “*extend oil palm onto blocks that currently contain forests, degraded forests and grasslands that, despite being located within oil palm blocks, still provide economic and social services for local communities including household gardens. Infilling these blocks will extend the total planted area of oil palm and will displace important services.*”<sup>426</sup>
379. Thus, the Requesters’ concern is not only about the environmental impact of infill planting but also its livelihood impacts if infill blocks were developed in areas that “*provide economic and social services*”. The Panel notes that the draft “Oil Palm Planting Approval Form” of June 2007 may have prompted the Requesters concern as this allowed for infill blocks to be developed in “*Impacted and non-regenerating*” forests even if this area had “*subsistence gardens, other cash crops,...*”.<sup>427</sup> The revised planting form of May 2011, however, has removed this provision and does not allow conversion of subsistence gardens into infill blocks if these gardens are the only ones available to the applicant.<sup>428</sup>



Picture 17: A potential infill block next to a road in Popondetta

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<sup>425</sup> Ibid.

<sup>426</sup> Request for Inspection, p. 2-3.

<sup>427</sup> Annex 1 (Infill Planting Form, version 2.1, June 2007) of PIM, Infill Planting Submanual, August 2007 p. 17.

<sup>428</sup> Annex 1 (Infill Planting Form, Revised, May 2011), Sections 7.3, p. 14

380. Management’s assertion that no smallholder is forced to plant oil palm was corroborated during the Panel’s field visits. Given the right conditions (fair prices and equitable distribution of profits between mill companies and smallholders), a vast majority of community members interviewed by the Panel indicated that they would plant more oil palm, even if they had other concerns about the Project. A key message from these meetings was that there was no fundamental concern with oil palm in and of itself, even if there were concerns with some aspects of the oil palm operations.
381. The planting of oil palm in West New Britain and Oro provinces is not new, and most community members have some knowledge of the trade-offs involved in moving to cash crops in general and to oil palm in particular. The fact that there is a demand for more oil palm blocks is demonstrated by the more than 1,000 applications already received by OPIC for infilling in Oro province. The Panel can only assume that these applicants have assessed the positive and negative aspects associated with their decision.

### 3. Land Erosion, Topsoil Depletion and Siltation

382. The Requesters note that “...oil palm cultivation requires complete land clearance which has important implications for erosion, topsoil depletion, and the siltation of rivers.”<sup>429</sup> They claim that the Assessments do not consider the “ecological, socio-economic and cultural functions...” that the clearing of land has on affected communities.
383. The Management Response does not address potential erosion, topsoil depletion, and siltation explicitly but states that “*The EA, the EMP and the ESMF identify the potential environmental impacts of the Project and include appropriate and effective mitigation strategies for these.*”<sup>430</sup> The Management Response also notes that “***In addition to the systems described, the SADP has built in the provision of an independent bi-annual environmental audit.***”<sup>431</sup> (emphasis in original).
384. The Panel outlines at the beginning of this chapter how the hierarchy of the EA, EMP (including the ECMMPs), and OPIC infilling-planting approval forms progresses along a trajectory: from a generic statement that identifies the potential for erosion and stream sedimentation to describing what needs to be done to minimize the impact, and finally to using a specific management tool to apply in the field.
385. The EA outlines the potential environmental impacts on soils. These include:
- “loss of soil from exposed surfaces through erosion by water and wind, and the subsequent sedimentation of downstream waters;
  - the contamination of soils by wastes and other materials (including excessive amounts of fine silts resulting from erosion).”<sup>432</sup>

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<sup>429</sup> Request for Inspection, p. 4.

<sup>430</sup> Management Response, p. 36, ¶ 119.

<sup>431</sup> Management Response, p. 37, ¶ 122.

<sup>432</sup> OPIC (2007) Environmental Assessment, p. 52.

386. The EA goes on to note that “*land clearance either for oil palm planting or for road reconstruction leaves the bare soil susceptible to erosion if not revegetated quickly.*”<sup>433</sup> These points are repeated in the Environmental Management Plan (EMP), which goes on to state that “[e]rosion from exposed soil surfaces during block clearance must be minimised by mulching with the cleared vegetation and prompt re-planting of fast-growing ground cover species.”<sup>434</sup>
387. The EMP also defines buffer zone requirements (drawn from the Papua New Guinea Forest Authority Code of Practice).<sup>435</sup> These requirements seek to minimize the transport of surface soil from a cleared block to a permanent stream and the requirements are repeated in Environmental Control Measures and Monitoring Programs (ECMMP) 2. The EMP also notes that “*the clearance of new blocks will generate large amounts of plant waste which will be composted as mulch over the exposed soil surface to protect the top soil from erosion and promote the recycling of nutrients.*”<sup>436</sup>
388. The ECMMP 2 describes the methods to adopt in order to “...avoid or minimize the risk of off-site environmental impacts from the clearance of vegetation and the preparation of ground on new blocks.”<sup>437</sup> It specifies that “*The new block area will be cleared in stages to minimise the area of exposed soil at any one time and reduce the risk of soil erosion.*”<sup>438</sup> It requires each new block owner to prepare a block clearance plan that “...will provide for a 10 meter buffer zone of undisturbed natural vegetation to be retained around the block boundaries,”<sup>439</sup> and that there should be “[i]mmediate back-covering of exposed soil with a mulch of soft vegetation to reduce exposure and potential erosion” and “[p]rompt planting of ground-anchoring protective vegetation to stabilise the soil surface.”<sup>440</sup> Picture 18 shows a Class 1 stream (i.e. a stream which requires a buffer zone of 50 meters) with a home garden to the left, cleared to the edge of the stream, whose owner has applied for an infill block.

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<sup>433</sup> Ibid., p. 52.

<sup>434</sup> OPIC (2007) Environmental Management Plan, p. 9.

<sup>435</sup> Ibid., p. 17.

<sup>436</sup> Ibid., p. 25.

<sup>437</sup> OPIC (2007) Environmental Management Plan, ECMMP 2, p. 46.

<sup>438</sup> Ibid.

<sup>439</sup> Ibid.

<sup>440</sup> Ibid.



Picture 18: “Class 1 stream” in Hoskins area

389. In summary, these requirements seek to limit oil palm planting to slopes less than 25°, minimizing the area of bare soil exposed at any one time; establishing ground cover plants to cover bare soil as quickly as possible; and establishing buffer zones where the blocks are adjacent to permanent streams. Collectively, these measures will minimize surface soil erosion and the movement of soil into adjacent water courses. They are comprehensive and it is hard to see what additional actions could be taken. OPIC’s challenge will be to ensure that these measures are enacted on the ground. The OPIC extension, environmental, and lands officers have crucial roles to play in applying these measures. They require a thorough understanding of a wide range of agronomic, environmental, and social issues. Monitoring the effectiveness of these measures will be the responsibility of the independent biannual environmental audits.<sup>441</sup>
390. Most oil palm planting in both West New Britain and Oro is done on relatively flat land, so any surface water flow generated by local saturation during periods of heavy rain will flow at a very slow rate, and thus have little capacity to initiate soil erosion. The OPIC planting guidelines limit new planting and replanting to sites with a slope of less than 25°,<sup>442</sup> a requirement that will ensure that steep slopes, where the potential for soil erosion is greatest, cannot be used for planting.
391. During the Panel’s field visit to Oro province in September 2010 examples were seen of legume cover crops, still persisting in well-established blocks, which were set up at the time of block clearance to minimize surface erosion.

<sup>441</sup> PIM, Procurement Manual, TOR for Environment and Social Auditor, pp. 442-49.

<sup>442</sup> OPIC (July 2010) SADP Oil Palm Infilling Approval Form, and OPIC - SADP (August 1, 2010) Oil Palm Planting Approval Form – Replant, p. 4.



Picture 19: Legume ground cover to minimize soil loss

392. Management recognizes the potential for erosion and stream sedimentation to occur at the time of establishing new oil palm blocks. The EA, EMP, and ECMMP include measures to minimize any adverse impacts from land erosion, topsoil depletion, and siltation. Collectively, these measures will minimize surface-soil erosion and the movement of soil into water courses. That said, given past experiences with OPIC capacity, Management needs to ensure that OPIC extension staff receive the proper training, support, and supervision to enable Project implementation as envisaged. **The Panel finds that the Project includes mitigation measures related to land erosion, topsoil depletion, and siltation and complies with OP 4.01.**

#### 4. Chemical and Biological Pollution of Waterways

393. The Requesters claim that “...oil palm development often leads to chemical and biological pollution of waterways. In many plantations and smallholder plots, fertilizer is extensively used to maintain soil nutrients and tree productivity. Improper use of agro-chemicals and run-off during periods of heavy rainfall can cause pollution of the water table and river systems resulting in algae blooms and damage to natural biological processes.”<sup>443</sup>
394. The Requesters state that the “environmental assessments conducted are particularly poor and miss critical impacts,”<sup>444</sup> such as the impact of increased effluent discharge from the mills on rivers, fish, and people.
395. OP 4.01 requires that the “EA is a process whose breadth, depth, and type of analysis depend on the nature, scale, and potential environmental impact of the proposed project. EA evaluates a project's potential environmental risks and impacts in its area of influence.”<sup>445</sup>

<sup>443</sup> Request for Inspection, p. 4.

<sup>444</sup> Ibid., p. 9.

<sup>445</sup> OP 4.01, ¶2



Picture 20: View of Ambogo River in Oro province, alleged to have received palm oil mill effluent

396. Management states that “...there was insufficient detail in the EA on the matter of effluents”<sup>446</sup> and “agrees that a more comprehensive analysis of the impacts of increased production at the oil palm mills and effluents should have been undertaken in accordance with the requirements of OP/BP 4.01.”<sup>447</sup> The Management Response does not address potential chemical and biological pollution of waterways explicitly, apart from its discussion of mill effluent, but states that “The EA, the EMP and the ESMF identify the potential environmental impacts of the Project and include appropriate and effective mitigation strategies for these.”<sup>448</sup>
397. **Chemical Pollution.** Chemical fertilizers are applied by the palm oil milling companies in their estates at rates and frequencies that follow recommendations provided by OPRA. OPRA recommendations are based on research findings and are designed to optimize growth, and, as fertilizer is expensive, it is unlikely that rates in excess of those recommended would be applied (Table 4).

**Table 4: Recommended Fertilizer Rates for 2010**

Fertilizer Type	Rounds / year	Rate (kg)/ palm	Total rate (kg) / palm / year
Muriate of Potash (MOP)	2	1.00	2.00
Sulphate of Ammonia (SOA)	1	1.75	1.75
Kieserite	1	1.00	1.00
Sodium Borate	1	0.50	0.5
Ammonium Chloride (A/C)	1	1.00 – 2.50	1.00 – 2.50 (different blocks for diff. rate due to soil leaf analysis-recommendation from OPRA)

Source: NBPOL data.

398. The major elements that could cause chemical pollution if entering streams or ground water would be potassium and nitrogen in their various forms. These could both lead to algal blooms and eutrophication if present at high levels.

<sup>446</sup> Management Response, p. 36, ¶ 117.

<sup>447</sup> Ibid., p. 36, ¶ 119.

<sup>448</sup> Management Response, p. 36, ¶ 119.

399. Many smallholders told the Panel team during its visit that they used little or no fertilizer, a major barrier to increasing the generally low productivity of smallholder blocks. Increases in smallholder productivity will require improved agronomic practices, especially applying more fertilizer--a clearly stated goal of the SADP and the milling companies. Outside of the SADP, OPIC has independently stated that it aims to boost FFB yields in the smallholder sector from 10-15 tons per hectare a year to greater than 25 tons per hectare a year by teaching smallholders how to use fertilizer.<sup>449</sup> Thus, if agronomic practices can be improved, total fertilizer application on smallholder blocks could increase in the future.
400. During its field visits, the Panel team found that fertilizer bags were occasionally left in the field, but there is no evidence that this is a common occurrence. Where this does occur, it could result in local point sources of pollution, which could have local impact but it is unlikely to have serious downstream consequences.
401. High rainfall is experienced in all oil-palm-growing areas, so that there will inevitably be periods when saturation overland flow occurs during intense rainfalls (despite the highly permeable volcanic soils in most of the Project areas).<sup>450</sup> This could result in some flow of chemicals into streams either as direct overland flow or by being leached through the soil profile before they are absorbed by the vegetation. This is unlikely to cause significant local or downstream chemical pollution, however, owing to relatively low total fertilizer application rates (when considered across the landscape) and to massive dilution effects caused by high stream flows caused by the regular high rainfall.<sup>451</sup>
402. None of the Requesters or other smallholders interviewed could cite instances of algal blooms or eutrophication in surface waters, which would be expected if stream were heavily polluted owing to the accumulation of nitrogen and/or potassium in surface waters.
403. The PAD reported that “...a detailed study was carried out to look at the impact of existing oil palm activities on quality of freshwater and stream health in the project areas by a specialist freshwater ecologist. The results of this study (in project files) indicated that existing oil palm operations are having no discernable adverse effect on freshwater quality in these two provinces.”<sup>452</sup>
404. The mills regularly monitor streams for chemical pollution, but no information was provided to assess whether background chemical levels of surface streams are elevated at any time. The potential for chemical pollution of natural waters, including eutrophication,

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<sup>449</sup> PNGOPRA-2009 Annual Report, p. iv, 1-1.

<sup>450</sup> Bonell, M., Gilmour, D. A. Cassells, D.S. (1983). “Runoff generation in tropical rainforests of North Queensland, Australia, and the implications for land use management.” In *Hydrology of Humid Tropical Regions of Agriculture and Forestry Practice* (proc. of the Hamburg Symposium, August 1983) I.A.H.S. Publ. No. 140, pp. 287- 297.

<sup>451</sup> Bonell, M, Gilmour, DA and Cassells, DS. (1991). “The links between synoptic climatology and the runoff response of rainforest catchments on the wet tropical coast of north-eastern Queensland.” In G. Werren and P. Kershaw (eds), *The Rainforest Legacy* (Vol 2) ; “Flora and fauna of the rainforests.” Australia Government Pub. Serv. pp. 27-62.

<sup>452</sup> PAD, p. 93, ¶ 8.

is mentioned in the EA<sup>453</sup> and the EMP.<sup>454</sup> Many of the approaches taken to mitigate surface soil erosion and stream sedimentation (discussed in the previous section) will also be effective in minimizing the movement of chemicals into natural waters. These include maintaining vegetation cover on soils, limiting planting to slopes below 25°, and using buffer zones along the edges of permanent streams. These guidelines are covered in the ECMMPs and the OPIC Infilling Planting Approval Form.

405. **It is the Panel's view that Management recognizes the potential for chemical pollution associated with oil palm development and has taken all reasonable steps in the design of the Project to ensure that any adverse impacts from fertilizer runoff are minimized. The Panel finds that these measures comply with OP 4.01.** Management would need to ensure that OPIC provides the proper training, support, and supervision of its extension workers to be certain that the design and tools put in place in the Project are implemented as intended.
406. **Biological Pollution.** The effects of mill effluent were omitted from the Project analysis, as recognized in the Management Response. The Requesters claim that harm is still occurring as a result of effluent outflow into streams, specifically the Ambogo River and the headwaters of the Mamba River. Two studies were conducted in Oro to substantiate these claims. An Initial Environmental Examination (IEE) of the impacts of oil palm activities in Popondetta (which employed two environmental consultants) was commissioned in February 2006 by the Australian Conservation Foundation for CELCOR and the Ahora/Kakandetta Peoples Foundation. The key objective of the IEE was *"to collect and assess scientific evidence that could be used to support claims for compensation by villages located downstream of the oil palm milling operations."*<sup>455</sup> The second study was carried out in the Mamba area by 'Friends of Mamba' in November 2009 and it criticized the Higaturu mill for allegedly continuing pollution.<sup>456</sup>
407. In the IEE report, the authors emphasized that their fieldwork was preliminary but carried out in a scientific manner. Sampling was undertaken along the Ambogo River (three samples, plus one during the night) and the Seiha Creek (four samples). The most significant finding at the Ambogo River was *"the consistently reduced dissolved oxygen levels at the discharge site--a mean concentration of 81% dissolved oxygen"*--suggesting that *"a constant flow of POME [Palm Oil Mill Effluent] discharge occurred throughout the night."*<sup>457</sup> Samples from the Seiha Creek displayed positive signs for fecal coliforms at all sites, perhaps caused by *"heavy rainfall transporting the contents of local septic tanks via ground and surface runoff to the Creek."* The latter results were described as *"concerning"*<sup>458</sup> as the Seiha Creek water is used for cooking and drinking.

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<sup>453</sup> Environmental Assessment (January 2007) p. 56.

<sup>454</sup> Environmental Management Plan (January 2007) p. 22.

<sup>455</sup> Impacts of Oil Palm Activities in the Kokoda and Popondetta Catchments: An Initial Environmental Examination. February/March 2006. S2/1.

<sup>456</sup> Friends of Mamba/CELCOR 27 November 2009. 'Comments on RSPO Certification of CTP (PNG) Limited Trading as Higaturu Oil Palm Limited in the Oro province Oro province PNG' submitted to BSI Management Systems, Singapore.

<sup>457</sup> Impacts of Oil Palm, S3/9.

<sup>458</sup> Impacts of Oil Palm, S3/8.



Picture 21: An effluent pond of Kula/Higaturu Oil Palm at the time of Panel team's Investigation visit

408. The IEE report notes that *“the waterways in the Popondetta catchment were regularly contaminated with oil palm mill effluent and human sewage, though levels of oil and grease in the Ambogo River from the discharge point were not measured to be excessively high (6ppm) Dissolved oxygen levels were depressed within the discharge plume throughout the four-day sampling regime and during the overnight sampling regime.”*<sup>459</sup>
409. The IEE report took place before the construction of the oil palm mill at Mamba, near Kokoda. The water quality in the upper catchment of the Kokoda (Madi and Mambare Rivers) was of a very high standard,<sup>460</sup> and it was suggested that an Environmental Impact Assessment (EIA) be carried out there to provide a baseline for future evaluations.<sup>461</sup>
410. According to the IEE report, anecdotal evidence suggested widespread loss of fish species throughout the river systems downstream of the Popondetta catchment. The IEE report suggested that this species loss could be attributed to *“a number of natural and man-made factors including sedimentation..., pesticide use, direct input of POME from the HOPPL mill and potential wood preservative waste input from the Ambogo saw mill.”*<sup>462</sup> Popondetta's garbage tip, located on the river bank, could have been a source of *“toxic leachates from residues from containers of domestic, agricultural and industrial chemicals.”*<sup>463</sup> The Report also notes that *“There have been reports of workers washing out spraying equipment in waterways and using chemicals to stun fish and prawns.”*<sup>464</sup> Large-scale fish kills have commonly been reported after heavy rainfall, particularly in the mid-1980s.
411. The Environmental Manager of Kula/Higaturu Oil Palm mill agreed that the current system was incapable of handling heavy rainfall and controlled discharges were made to prevent

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<sup>459</sup> Impacts of Oil Palm, S3/1.

<sup>460</sup> Ibid., S3/14.

<sup>461</sup> Ibid., S1/2.

<sup>462</sup> Ibid., S3/15.

<sup>463</sup> Ibid., S4/10.

<sup>464</sup> Ibid., S4/13.

the retention pond from breaking its banks. He said that releases of oils and greases did not exceed two parts per million (ppm), although six ppm was found even with dilution by heavy rain.<sup>465</sup>

412. Management notes in its Response that “*the requirements of OP 4.01 (Environmental Assessment) were not fully met, in that there was insufficient detail in the EA on the matter of effluents and the only information shared with stakeholders during consultations for the EA was in verbal form.*”<sup>466</sup> However, it is clear from a letter from the Country Director for Papua New Guinea, dated June 10, 2004, that the Bank was made aware of the potential effluent pollution and had reassured stakeholders that it would address this concern during Project preparation. The letter, addressed to the Executive Director of CELCOR, states, “[s]hould a decision be made to proceed with the proposed project, rest assured that, in accordance with World Bank policies, the concerns of the Ahora/Kakandetta Pressure Group about potential environmental damages and water pollution, as well as the use of land, would be addressed during detailed project preparation.”<sup>467</sup> Thus, when Management states in its Response that “*a thorough analysis of the impact of increased effluents due to Project activities will be undertaken, in addition to monitoring ISO14001 and RPSO certification of the milling companies,*”<sup>468</sup> this action was fulfilling a commitment first made more than five years earlier.
413. A study referred to as the “*Effluent Study,*”<sup>469</sup> was commissioned by Management in 2010. The Inspection Panel received the draft report, on February 18 and the final report on July 29, 2011. The Effluent Study showed that some sites have experienced operational issues that have influenced discharge performance. The study also noted challenges with the quality of regulatory monitoring, and noted that some sites would benefit from additional monitoring.<sup>470</sup> Due to the lack of clarity of permits, limited availability of data, and constraints of the study preparation, the study did not make a categorical statement about full legal compliance for all the mills, although it did note that most, if not all, mills are legally compliant.<sup>471</sup> There was no mention of how this determination was made, due to the extensive constraints and uncertainties noted in the study.
414. The study mentions that “*greater use of flow meters will enable design or operational modification to reduce the risk of pond flooding; and more targeted and timely in pond quality monitoring will give greater understanding of the biological processes taking place and subsequently enable actions to optimize pond performance.*”<sup>472</sup> In addition, the study cites data quality issues and notes that the definition of full compliance with water quality standards could be more precise.<sup>473</sup> The study also points to discrepancies between the

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<sup>465</sup> Ibid., S5/3.

<sup>466</sup> Management Response, p. 28, ¶ 85.

<sup>467</sup> World Bank Letter, June 10, 2004, p. 1.

<sup>468</sup> Management Response, p. ix.

<sup>469</sup> Papua New Guinea Smallholder Agricultural Development Project ‘Effluent Study’ July 25, 2011.

Commissioned by the World Bank. J Barrett, Hebee Ltd.

<sup>470</sup> Effluent Study, p. 25.

<sup>471</sup> Ibid., p. 50.

<sup>472</sup> Ibid., p. 25.

<sup>473</sup> Effluent Study, p. 51.

World Bank Group Environmental Health and Safety Standards for Vegetable Oil Processing (2007) and existing national regulations, as well as a number of specific operational issues that need to be further investigated and addressed at different mills in the Project area.

415. The study findings conclude that “*given that all the mills are or will shortly be certified to ISO 14001 and RSPO principles and criteria, which have commitments for continuous improvement, the necessary practices, capabilities and controls should be in place to treat the increase in POME due to the SADP.*”<sup>474</sup> However, Bank Management, in the overview to the Effluent Study and Action Plan, acknowledges that the study “*is not fully conclusive.*” The Panel agrees with this analysis and commends Management’s efforts to undertake “*further in-depth technical analysis of each mill’s capability to treat liquid waste.*”<sup>475</sup>
416. The Agreed Action Plan for the Effluent Study identifies three broad items to be addressed. These are:<sup>476</sup>
- (1) Obtain commitment in writing from the project area milling companies to: (i) establish baseline information for each project area mill, and (ii) conduct one follow-up environmental audit of these mills. Depending on the results of the follow-up audit and the perceived efficacy of the concurrent RSPO surveillance audits, additional follow-up audits will be considered.*
  - (2) Undertake specific measures at the following mills that have been identified to present high environmental risks: (i) Sangara Mill owned by Higaturu/Kula Palm Oil, (ii) Hargy and Navo Mills owned by Hargy Oil Palm Ltd., and (iii) Mosa Mill owned by New Britain Palm Oil (NBPOL);*
  - (3) Assist Government (DEC) and industry to produce an updated Draft PNG Code of Practice for the Palm Oil [Processing] Industry, which will be used as the basis for regulation, to improve the quality and scope of effluent-related environmental monitoring, provide greater guidance on the design and operation of palm oil wastewater treatment systems in PNG, and better define “targets” and “limits” for discharge of treated palm oil wastewater to surface waters and land.*
417. **The Panel agrees with Management’s view that the lack of adequate analysis of impacts from mill effluent does not comply with OP 4.01. The Panel notes and appreciates that the Agreed Action Plan provided in the Effluent Study addresses the issue of potential negative effects from mill effluent and, when implemented, could bring the Project into compliance with OP 4.01. Given the challenges in implementing environmental regulations in Papua New Guinea, as noted in the Effluent Study, the Panel notes that Management should have undertaken the study much sooner.**

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<sup>474</sup> Ibid., p. ix.

<sup>475</sup> Forward to Agreed Action Plan, July 25, 2011.

<sup>476</sup> PNG Smallholder Agriculture Development Project Palm Oil Mill Effluent Management Agreed Action Plan, July 25, 2011.

## 5. Risk of Deforestation of High Conservation Value Forests

418. The Requesters believe the Project poses a risk of deforestation in high-value forests because “*OPIC officers lack the capacity to classify forests*” correctly. Management states that “*the Project’s design includes adequate measures to minimize and manage risks of deforestation of areas of high conservation value.*”<sup>477</sup> Management stresses current practices will ensure no negative environmental impact on forests or on regenerating forests. Management notes that OPIC extension officers have been trained in identifying forests and are scheduled to receive more training. Management believes that the lack of a forest inventory does not violate BP4.36 (Forests). Finally, in the absence of an oil palm code of practice, Management states that the Papua New Guinea logging code of practice and national environmental laws will also be followed.<sup>478</sup>
419. The forest cover in Oro province has undergone significant change over the past several decades as a result of changing agricultural and land use practices. These include the incorporation of various cash crops (coffee, cocoa, rubber, coconut, and oil palm) into the agricultural systems at different times, all of which have affected the natural forest. The expansion of commercial logging in the recent past has been particularly important..
420. Oro province contains 1,555,545 hectares of rainforest, including degraded forest, which constitutes 69% of its total land area. As of 2002, nearly 6% (90,087 ha) of total rainforest cover in Oro was classified as degraded. Between 1972 and 2002, as much as 14.9% of the old-growth forests were lost in Papua New Guinea from all forestry activities.<sup>479</sup> Approximately 6,771 hectare of forest were cleared for oil palm and rubber plantations in Oro; in West New Britain, 58,467 hectares of forest were cleared for plantations in the past thirty years, amounting to 3.2% of the 1972 forest cover.<sup>480</sup>
421. All of these land use changes have had the effect of converting high-value forest to various forms of degraded and disturbed forest, much of which still has significant environmental, social, and economic value for local communities. The landscape in the Popondetta area is also characterized by extensive areas of *kunai* grassland and associated clumps of remnant trees. Much of the deforestation, forest degradation, and alteration to the original high-value forest currently evident in Oro province occurred in the decades before the development of the SADP, and no proposals under the SADP could cause additional deforestation.
422. The following Panel observations are grouped under four categories based on the Requesters’ claim:
- OPIC is a target-run organization and OPIC extension officers are evaluated on their achievement of oil-palm-planting targets;

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<sup>477</sup> Management Response, p. 36, ¶ 117.

<sup>478</sup> Ibid., p. 38, ¶ 125.

<sup>479</sup> Friends of the Earth Japan. (2011, June). Evaluation of Social and Environmental Risks Accompanying the Procurement of Timber from Papua New Guinea. Global Environment Forum Publication.

<sup>480</sup> Shearman, P.L., Bryan, J.E., Ash, J., Hunnam, P., Mackey, B., and B. Lokes. (2008). The State of the Forests of Papua New Guinea. Mapping the extent and condition of forest cover and measuring the drivers of forest change during 1972-2002. University of Papua New Guinea, 2008.

- OPIC extension officers are not equipped to apply the site-sensitivity analysis in the Infill Planting Approval Form;
- The Bank is not in compliance with OP 4.36 (Forests) because it has not undertaken an inventory of High Conservation Value Forests; and
- The combination of the above factors will lead to forest conversion and degradation. As a result, the mitigation measures outlined in the EMP with regard to preservation of High Conservation Value Forests are inadequate.

423. At the outset of this discussion, it is important to note that has been no new oil-palm planting since 2001. Consequently, perceptions of OPIC's internal culture and management systems, particularly setting planting targets, require an analysis of practices during the period prior to 2001.

424. **OPIC and Evaluation of Extension Officers.** A review of the previous Oro Smallholder Oil Palm Development Project (1992-2001) noted that "*OPIC extension officers have had to manage their workload, which included an annual target for oil palm plantings for each extension officer, in hindsight yet another obstacle to sound environmental management, and at the same time try to balance protection of the environment with excessive demands from landowners for development sponsorship.*"<sup>481</sup> Panel interviews indicated that prior to 2001, OPIC in Oro (but not in West New Britain) was rigidly organized and extension officers had targets for oil palm planting. It was emphasized, however, that this is no longer the case. The Panel team looked at the forms used by OPIC management for annual staff performance appraisals and found that staff members being evaluated are asked to list four or five key areas as "*high priority targets*" that could include such activities as organization of field days or assessment of blocks for planting oil palm. This approach is common in many organizations and there is nothing here to suggest that planting targets will be imposed on extension officers by OPIC management. In fact, senior members of OPIC strongly denied that such targets exist or had existed in recent years. Follow-up discussions with individual extension officers confirmed that there was no internal culture in OPIC that put pressure on officers to achieve planting targets. They all emphasized that no planting had taken place for many years and that planting targets were no longer enforced or relevant.

425. The targets for infill planting (listed on page two of the PIM Infill Planting Sub-Manual) should reasonably be read as indicative targets to allow budgeting and project planning to take place. They should not be read as targets that must be achieved and that will be allocated to individual extension officers. It is inconceivable that a Project such as the SADP could be planned and implemented without some mention of indicative areas to be planted.

426. **Capacity of OPIC Extension Officers.** The Requesters are concerned that the Project may cause environmental harm since "[m]any *OPIC officers lack the capacity to classify forests*

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<sup>481</sup> Environmental Impact Review of Current Project and Recommendations for Consideration in any Future Development. Study of Oro Smallholder Oil Palm Development Project (Ln. 3485-PNG) Tom Diwai Vigus (2001), p. 39, Oil Palm Industry Corporation.

*within the correct forest criteria of primary forest, impacted forest, regenerating and non regenerating forest, the criteria being clearly described in the Survey Form.”*<sup>482</sup>

427. A review of the previous Oro Smallholder Oil Palm Development Project (1992-2001) commissioned by OPIC cited several instances of forest areas being converted to oil palm, including clearing more than half of the proposed Lejo Wildlife Management Area (WMA) by the milling company.<sup>483</sup> The review cited one instance in which rainforest regenerating after selective logging had been cleared for VOP planting, and another where “*In the first phase of the project from its inception in 1992, until the AusAID project commenced in 1995, some rainforest areas containing QABB habitat were cleared by villagers for VOP blocks.*”<sup>484</sup> It was emphasized, however, that “*...this is not a common occurrence, there is no rational for this except for pressure from landowners...*”<sup>485</sup>
428. The review also noted that “*...although a few mistakes have been made in the past, they are getting fewer and fewer as time goes by.*”<sup>486</sup> The study cited instances where OPIC extension officers “*...rejected VOP applications on the basis of environmental concerns...*”<sup>487</sup>
429. For the SADP, OPIC appointed three environment officers around April 2010 and all three were met during the course of the Panel’s investigation visit. They all come with strong credentials in environmental management. Field discussions took place between the Panel’s expert consultant on forestry and two of the environment officers (in Hoskins and Oro) in the company of extension officers and a lands officer in Oro. In each case they were asked to “*talk through*” the completion of the Oil Palm Infilling Planting Approval Form in a typical site and discuss the relevant issues. They all recognized the difficulties associated with categorizing forest land, especially when the site fell on the boundary between two classifications. But they were sensitive to the relevant environmental and social issues. In each case, they demonstrated the capacity to apply effectively the Infill Planting Approval Form.
430. The Panel recognizes the challenge of building the capacity of all OPIC extension officers to the same level of understanding and competence demonstrated by the environment officers, but does not see it as impossible. The SADP has allocated funds to improve the capacity of OPIC extension officers, and the Management Response states that “*OPIC’s extension officers have been trained in identifying primary forest areas;*”<sup>488</sup> But the Panel notes that while numerous training courses have already been held, none have covered environmental issues.
431. Based on its discussions in Papua New Guinea, the Panel came to see that overall environmental awareness had increased considerably during the past decade among all key

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<sup>482</sup> Request for Inspection, p. 10.

<sup>483</sup> Environmental Impact Review, p. 9.

<sup>484</sup> Ibid., p. 33.

<sup>485</sup> Ibid., p. 35.

<sup>486</sup> Ibid., p. 41.

<sup>487</sup> Environmental Impact Review, p. 41.

<sup>488</sup> Management Response, p. 39, ¶ 127.

stakeholders: OPIC, milling companies, smallholders, and the World Bank. This led to an expectation of higher standards of planning and implementation throughout. For example, the Bank's environmental safeguard policies are now much more demanding than in the 1990s. Similarly, the milling companies, through ISO 14000 accreditation and the pursuit of RSPO compliance, have demonstrated a commitment to lifting environmental and social standards. And OPIC is increasing its awareness of environmental and social issues and improving its capacity to address these issues in the field (although much more needs to be done with focused training). Management systems under the SADP are now designed to much higher environmental and social standards than in earlier projects. For example, ECMMP 1 in the EMP describes in detail the steps required "...to ensure that no critical habitats or forest areas are disturbed or damaged by establishment of new oil palm blocks..."<sup>489</sup> Increased environmental awareness and the resulting higher operational standards mean that, while there is still some way to go toward changing the institutional culture of OPIC and toward building staff capacity to operate in the new setting, the overall trend is positive. OPIC management recognizes the challenges, however, and steps are being taken to improve the situation before infill planting begins.

432. The Management Response also points to the significant modification to the Project design aimed at addressing some of the general environmental and social concerns. These include: "...the provision of bi-annual independent environmental and social audits..."<sup>490</sup> These will assist in monitoring all environmental and social aspects of the Project and, with the appropriate feedback, will allow necessary modifications to field practice to be made.
433. **Inventory of High Conservation Value Forests.** The OPIC-sponsored environmental impact review of the Oro Smallholder Oil Palm Development Project (1992-2001) notes the need for a map that clearly delineates all rainforest areas and all existing and proposed Wildlife Management Areas (WMAs). It states that "*This map would be a key instrument for OPIC extension officers in their negotiations with landowners.*"<sup>491</sup> In arguing for such a planning instrument, the study acknowledged the difficulty in assessing different categories of forest and comments that "...it is neither realistic nor reasonable to expect OPIC extension officers to make decisions on the state of rainforest, especially when experts are not always able to differentiate between remnant rainforest and 'bush, secondary bush', etc."<sup>492</sup> These arguments reinforce the importance, outlined in OP 4.36, of having access to an inventory of critical forest areas at a spatial scale that is ecologically, socially, and culturally appropriate for the forest area in which the Project is located.<sup>493</sup>

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<sup>489</sup> OPIC (2007) Environmental Management Plan, ECMMP 1, p. 42.

<sup>490</sup> Management Response, p. 32, ¶ 103.

<sup>491</sup> Environmental Impact Review, p. 23.

<sup>492</sup> Ibid.

<sup>493</sup> BP 4.36 (Forests), ¶ 4 requires that "During project preparation, the TT ensures that the borrower provides the Bank with an assessment of the adequacy of land use allocations for the management, conservation, and sustainable development of forests, including any additional allocations needed to protect critical forest areas. This assessment provides an inventory of such critical forest areas, and is undertaken at a spatial scale that is ecologically, socially, and culturally appropriate for the forest area in which the project is located."

434. The study reports on the development of a GIS mapping system in the late 1990s that delineated “no go” and “caution” areas in Oro province.<sup>494</sup> Investigations during the course of the Inspection Panel visit indicated that this mapping system had not been operationalized. It has, however, been reported that “*Higaturu Oil Palm P/L have used the GIS, especially the “no go” map to reject eight proposals for mini-estates.*”<sup>495</sup> The “no go” map is apparently no longer used regularly. Also, OPIC no longer has the capacity to operate the GIS mapping system.
435. The Management Response indicates that the requirements of OP 4.36 (Forests), in terms of providing an inventory of critical forest areas, is addressed in two ways: first, by the field application of the Oil Palm Infill Planting Approval Form by OPIC extension officers where “...*a site specific inventory of critical forest areas will be undertaken through a screening process...*”<sup>496</sup>; and second, by the preparation of a High Conservation Value Forests (HCVF) map by the milling companies as part of their RSPO certification. The *a priori* assumption of the first of these approaches is that it “...*provides an inventory of such critical forest areas, and is undertaken at a spatial scale that is ecologically, socially, and culturally appropriate for the forest area in which the project is located,*”<sup>497</sup> as required under OP/BP 4.36 (Forests). An inventory by definition is a “*detailed list.*”<sup>498</sup> Nothing in the Oil Palm Infill Planting Approval Form will result in the compilation of a detailed list of critical forest areas. The second approach to addressing the requirements of OP 4.36 (Forests)—that is, the mapping of HCVFs by the milling company—lacks the potential to provide a detailed list of critical forest areas, as required under OP 4.36 (Forests). But this has yet to be carried out and was not done during Project preparation as required under OP 4.36 (Forests).
436. The Management Response also notes that the “*Oil Palm Planting Approval Form...has been in use since 2007 in all locations that have OPIC extension officers.*”<sup>499</sup> But no new oil palm plantings have occurred since 2001, and the extension officers in Oro informed the Panel during the investigation visit that they had never seen the form. The Panel members gave the Environment and Extension Officers copies so that they could copy them and use them during field discussions. The extension officers in the Hoskins project area were using the earlier version of the form, the one contained in the 2007 PIM Infill Planting Sub-Manual, for assessing the infill applications they received.
437. **Mitigation Measures to preserve High Conservation Value Forests.** In judging whether the mitigation measures in the EMP are sufficient to ensure the preservation of HCVFs, it is first necessary to consider how the institutional environment in OPIC might hinder the preservation of HCVFs. As noted above, the Panel has concluded that: (a) while OPIC in Oro in the period prior to 2001 was a target-run organization, this no longer prevails; (b) while raising the capacity of OPIC extension officers to a satisfactory level is a major challenge, it is possible, and the signs are encouraging; and (c) while an inventory of

<sup>494</sup> Environmental Impact Review, p. 25.

<sup>495</sup> Ibid.

<sup>496</sup> Management Response, p. 39, ¶ 126.

<sup>497</sup> Ibid., p. 55.

<sup>498</sup> The Concise Oxford Dictionary (1976) Sixth Edition, Oxford at the Clarendon Press.

<sup>499</sup> Management Response, p. 39, ¶ 127.

critical forest areas has not been carried out, the comprehensive assessment of forest areas at the level of the planting site is a reasonable guarantee that critical forest areas will not be converted to oil palm once planting gets under way. However, a map of high-conservation-value forests, particularly showing “no go” and “caution” areas, would be a useful addition to existing management tools, particularly in helping the environment officers supervise the extension officers.

438. Future smallholder plantings in West New Britain are unlikely to affect any high-conservation-value forests as there are few remaining in the area that are likely to be available for planting. But care will be needed with land in or adjacent to WMAs, as there are reports of some landowners wishing to convert their land within the WMAs to oil palm.
439. Many of the potential planting sites in the Popondetta area of Oro are covered by *kunai* grass and planting them is unlikely to have any significant impact on critical forests. But smallholders in the Kokoda area of Oro are likely to apply pressure to convert some areas of regenerating forest. This will be a challenge for the OPIC extension officers in making an appropriate judgment about forest categories when completing the Infill Planting Approval Form and deciding whether or not to approve planting.
440. OP 4.04 on Natural Habitats notes that *“If there are potential institutional capacity problems, the project includes components that develop the capacity of national and local institutions for effective environmental planning and management. The mitigation measures specified for the project may be used to enhance the practical field capacity of national and local institutions.”*<sup>500</sup> Management has recognized the capacity gaps in OPIC and has put in place institutional mechanisms to address the gaps and build the capacity of OPIC extension staff to perform the tasks necessary to ensure that oil palm operations are carried out in conformance with defined environmental and social standards. **The Panel finds that the Project’s approach in its design to building the capacity of OPIC extension staff conforms to the requirements of OP 4.04 on Natural Habitats.**
441. Management also recognizes the importance of preserving critical forest areas and has developed operational approaches in the PIM to apply at the site level to exclude from oil palm planting any forest areas other than *“impacted and non regenerating forest.”*<sup>501</sup> The Project is thus highly unlikely to result in the conversion or degradation of critical forest areas or related critical habitats.
442. **It is the Panel’s view that Management did not fully comply with OP/BP 4.36 in ensuring that the Borrower provided the Bank with an assessment of the adequacy of land use allocations for the management, conservation, and sustainable development of forests which includes an inventory of critical forest areas. Nevertheless, Management has included measures in the Project to prevent conversion or degradation of critical forest areas or related critical habitats; the Panel finds Management to be in compliance with the objective of OP/BP 4.36 in this respect.**

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<sup>500</sup> OP 4.04 – Natural Habitats (June 2001), ¶ 6.

<sup>501</sup> SADP Oil Palm Infilling Approval Form (July 2010), p. 5.

## **G. Final Reflections**

443. In summary, as to claims relating to environmental concerns raised in the Request, the Panel arrives at the following conclusions:

- (a) with reference to the claim pertaining to the adequacy of the Environmental Assessment, the Panel does not find lack of compliance with OP 4.01 associated with the alleged lack of reliable sources used in the Environmental Assessment.
- (b) regarding the issue of infilling vs expansion, the Panel notes that the term infilling has not been used by Management to deliberately obfuscate oil palm expansion.
- (c) as to the claim that the Project may cause land clearance leading to erosion, top soil depletion, and siltation of rivers, the Panel does not find lack of compliance with OP 4.01.
- (d) as to the claim related to the potential pollution of waterways from agro-chemicals, the Panel finds that the Project complies with OP 4.01. The Panel's view is that Management recognizes the potential for chemical pollution associated with oil palm development and has taken all reasonable steps in designing the Project to minimize any adverse effects of fertilizer runoff. As to the claim that the Project may cause biological pollution, the Panel finds that the Project does not comply with OP 4.01 with regard to impacts of mill effluent. The Panel notes that Management acknowledged this shortcoming in its Management Response and commissioned an Effluent Study. The Panel believes the Agreed Action Plan provided in the Effluent Study addresses the potential negative effects from mill effluent and, when implemented, could bring the Project into compliance with OP 4.01.
- (e) with reference to the claim that the Project poses a risk of deforestation of high-value forests, the Panel's view is that Management did not fully comply with the requirements of OP/BP 4.36 (Forests). During Project preparation, Management did not ensure that the Borrower gave the Bank an assessment of the adequacy of land use allocations for the management, conservation, and sustainable development of forests. Moreover, the assessment did not provide an inventory of critical forest areas. The Panel finds that the Project's design for building the capacity of OPIC extension staff conforms to the requirements of OP 4.04 (Natural Habitats).

444. It is the Panel's view that while Management has complied with OP/BP 4.01, the concerns of the Requesters about harm to forests and the environment are valid based on past history. Therefore, it is critical that the measures designed to avoid adverse consequences are fully implemented. And given the capacity constraints in OPIC (to be discussed in the next chapter), Management continues to remain vigilant, as it is with regard to the effluent study. In this context, the Panel notes that the greater commitment of mill companies to RSPO standards bodes well for the future.

## Chapter 6: Institutional Sustainability

### A. Introduction

445. This Chapter focuses on claims raised by the Requesters about the sustainability of the SADP. The Requesters state that they are “...concerned about the sustainability of two key features of this project, namely, the road maintenance fund and the activities of the OPIC extension officers. The project is dependent on these elements however both are poorly designed and will not be maintained after project completion.”<sup>502</sup> The first claim relates to the sustainability of the Road Maintenance Trust Fund (RMTF), and whether broad community support existed for the additional levy proposed under the RMTF. The second claim relates to the sustainability of OPIC as an institution, including aspects of its internal culture and the quality of its extension services and the capacity of OPIC extension officers to carry out their functions effectively.

### B. Requesters’ Claim

#### 1. Road Maintenance Trust Fund

446. The Requesters acknowledge the importance of a sound and well maintained network of roads in the area. They point to the harm that poor road conditions can cause by stating that the lack of road access “...affects the standard of health care and education accessible to the smallholders, as well as increasing transport levies...”<sup>503</sup> In testimony to the Panel team during its field visits, many smallholders complained that their Fresh Fruit Bunches (FFBs) often remained uncollected for days. As company trucks navigated the roads to reach collection points, the FFBs lost weight and consequently lost value.

447. The Requesters note that “Under SADP, the World Bank is proposing an end user fee pay system, with smallholders funding their infrastructure improvement to a road maintenance trust fund (RMTF) to make the road network more sustainable.”<sup>504</sup> While acknowledging the merits of this goal, they express concern that “...the road maintenance will again be unsustainable”<sup>505</sup> and that “by further embedding smallholder dependency on the mills and increasing levies, smallholders will be progressively burdened and unable to lift themselves out of poverty.”<sup>506</sup>

448. They further note that “According to the SADP PAD, page 35, the RMTF will be funded in the following way: 25% of the fund will be derived from the Provincial Government, 25% from the National Government, 25% from the oil palm companies and the final 25% from the growers.”<sup>507</sup> They go on to say that “In order for this to be sustainable all participants need to contribute their allocated funds. There is a high risk however that the Provincial

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<sup>502</sup> Request for Inspection, p. 7.

<sup>503</sup> Request for Inspection, p. 7.

<sup>504</sup> Ibid.

<sup>505</sup> Request for Inspection, p. 8.

<sup>506</sup> Ibid., p. 6.

<sup>507</sup> Ibid., p. 8.

government will be unable to make their contribution to the fund regularly.”<sup>508</sup> This was recognized early on in the project design and was listed in the Project Information Document (PID) as one of the largest challenges faced in the previous projects: “[T]he Provincial government could not be relied on to provide funds for maintenance of the access road network.”<sup>509</sup>

449. The Requesters note that *“The claimants also have concerns that the industry will not contribute their funds in a timely manner.”*<sup>510</sup> Finally, the Requesters assert that *“This maintenance mechanism, without contributions from either the provincial, national or oil palm companies, will not be sustainable and roads access will decline. The SADP has a high risk of being unsustainable.”*<sup>511</sup>



Picture 22: Company Truck collecting FFB along Popondetta-Kokoda National Highway

450. The Requesters also state that they were not consulted about the road levy. They write that *“Importantly, the claimants were not consulted about the additional road levy that will be imposed on them under the SADP nor were they consulted on the strategy for them to pay for this additional levy through opening additional oil palm blocks. If claimants had been consulted, they would have proposed alternative income generating opportunities and would have negotiated on the new road ‘user fee.’”*<sup>512</sup>
451. Thus the Requesters believe they are harmed by poorly maintained roads, or a lack of access to roads in general, in a number of ways. Their quality of life is affected because poor road conditions impede their ability to access timely and quality healthcare and affordable education. Moreover, the Requesters feel that poor roads affect them financially as they have to pay a higher Transport Levy when Company vehicles experience higher repair and maintenance costs, and because an additional RMTF levy will be deducted from them without any assurances that other stakeholders in the enterprise (the Company and Government) pay their share.

<sup>508</sup> PAD risk assessment, p. 62.

<sup>509</sup> Request for Inspection, p. 8; PID, p.6.

<sup>510</sup> Request for Inspection, p. 8.

<sup>511</sup> Ibid.

<sup>512</sup> Request for Inspection, p. 6.

## 2. OPIC Extension Activities

452. The Requesters are also concerned that “...*OPIC's limited capacity to deliver appropriate extension services*”<sup>513</sup> will limit the Project’s sustainability. They state that “...*the ratio of officers to growers clearly remains above 1:300, ensuring that the project will not be viable in the long term and growers will be left with the burden of growing oil palm without any support. Considering that other critical components of the project, such as productivity increase, HIV/AIDS awareness and land tenure strengthening are tightly linked with extension officer activities, these components will suffer and will not achieve their targets.*”<sup>514</sup>
453. They also note that “*An increase in production means ... an increase in smallholders or number of oil palm hectares. Currently OPIC officers are 1:300, the Project will increase the number of growers bringing this ratio to 1:400. Given the current management structure and resources of OPIC, we don't think OPIC can handle the project effectively, unless internal issues at the agencies are sorted out.*”<sup>515</sup>

## C. Management Response

### 1. Road Maintenance Trust Fund

454. The Management Response indicates that “*Road maintenance is especially challenging given the tropical, high-rainfall climate inherent in oil palm growing areas*” and that “...*it is the absence of an effective institutional arrangement for emergency and routine maintenance of the road network used by smallholder oil palm growers that is at the heart of the current situation...even the programming of funds for maintenance into provincial budgets is no guarantee that such maintenance will actually take place.*”<sup>516</sup>
455. The Management Response emphasizes that “...*successful road reconstruction and maintenance depends heavily on strong and clear mechanisms for contracting and contract management...the SADP has included a Road Engineering Unit in its design, as well as the strengthening and expansion of OPID (OPIC’s infrastructure department). These measures will substantially mitigate the risk of underperformance in the area of road reconstruction.*”<sup>517</sup>
456. The Management Response goes on to mention that “*During preparation, initial analysis of the financial feasibility of the RMTFs was undertaken. This included an analysis of cost sharing options and funding mechanisms...the final design study of the RMTFs will be undertaken as part of Project implementation.*”<sup>518</sup> The Management Response also reported on the findings of a Quality Assurance Group (QAG) Quality Enhancement Review (QER)

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<sup>513</sup> Request for Inspection, p. 8.

<sup>514</sup> Ibid., p. 9.

<sup>515</sup> Letter from CELCOR to Ms Eimi Watanabe, Inspection Panel, on February 19, 2010.

<sup>516</sup> Management Response, p. 34, ¶. 110.

<sup>517</sup> Management Response, p. 34, ¶. 112.

<sup>518</sup> Ibid., p. 34, ¶. 111.

conducted in 2008, which found that “...the preparation process...would have benefited from a more complete preparation of the arrangements for the operation of the RMTFs.”<sup>519</sup>

457. Management notes that seed capital of K3.1 million<sup>520</sup> for the creation of the three provincial RMTFs would be provided as a grant by the Papua New Guinea Sustainable Development Program, a Project co-financier, if it is satisfied with the design.<sup>521</sup>
458. The Management Response acknowledges that “*The Project was considered to be a ‘high risk’ undertaking at appraisal. The Project was understood to be ambitious because it sought to address the critical issue of poorly maintained agricultural access roads—which affect not only the oil palm sector, but also all rural areas in PNG--through introducing an innovative, user pay based funding mechanism for effective road maintenance.*”<sup>522</sup>
459. The Management Response goes on to note that “*The PAD Critical Risks assessment (Section C, paragraph 5) rated the overall risk as “substantial.” The Critical Risks matrix of the PAD identifies three risks that are directly relevant to this Response. These risks relate to the road reconstruction and maintenance activities to be carried out under the SADP and are: (a) that Provincial Governments may not provide the required funding for road maintenance; (b) that there could be leakage from the RMTFs due to the design of fund flow arrangements; and (c) that there may be an insufficient number of local contractors with the capacity to perform work in the Project areas. The identified risks relating to the RMTF financing arrangements will be addressed through the detailed design of the RMTFs, which is expected to start in 2010, while road works implementation arrangements will take into account the actual local contracting capacity.*”<sup>523</sup>
460. The Management Response emphasizes that “*Sustainability is a priority in the SADP*”<sup>524</sup> and goes on to note that “*Discussions with representatives of the growers associations during preparation indicated that it would be difficult to reach an agreement on the road levy without the roads first being rehabilitated.*”<sup>525</sup>
461. In addressing the formula for the contribution of different stakeholders to the levy, the Management Response states that “*While some of the text of the Project documents may give the impression that the RMTFs are fully designed and complete, this was not the intended message, as the design of the RMTFs was always intended to be finalized through a detailed design study during implementation.*”<sup>526</sup>
462. In response to the Requesters claim that the RMTF levy did not have broad community support, nor was it extensively consulted on, Management responds that “*The establishment of RMTFs and the introduction of an additional levy for road maintenance*

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<sup>519</sup> Ibid., p. 12, ¶. 35.

<sup>520</sup> PAD, p. 36, ¶. 31.

<sup>521</sup> Management Response, p. 30, footnote 57.

<sup>522</sup> Ibid., p. 11, ¶. 32.

<sup>523</sup> Management Response, p. 11, ¶. 33.

<sup>524</sup> Ibid., p. 34, ¶. 109.

<sup>525</sup> Ibid., p. 29, ¶. 95.

<sup>526</sup> Ibid., p. 30, ¶. 96.

*have been discussed extensively by the Bank and representatives of the growers associations in all three Project areas, starting from November 2001 and all throughout Project preparation, appraisal and the long process of achieving Project effectiveness. OPIC's managers were also liaising with the growers associations on the subject of the road maintenance levy and were collecting feedback from growers on different levels of levies. Consultation with the growers associations was in recognition of the fact that they are a representative body of the growers and an interlocutor between the growers and other bodies. In addition, in the context of the road maintenance levy they are the group that will be affected.”*<sup>527</sup>

463. And although “*Management agrees that there could have been broader consultation within the grower community on the road maintenance levy during preparation,*” it “*notes that further consultations are planned as part of the RMTF design study.*”<sup>528</sup>

464. Given the concerns raised in the Request for Inspection, Management agrees that “*Inputs will be provided to OPIC to ensure...that the design of the RMTFs is done in a consultative way with the objective of ensuring sustainability.*”<sup>529</sup>

## **2. OPIC Extension Activities**

465. The Management Response further notes that Papua New Guinea’s weak institutional capacity was recognized, and thus “*...several conditions of effectiveness to address this weakness were made part of the Project.*”<sup>530</sup> Among the measures were the development of the Smallholder Oil Palm Infill Planting Sub-Manual, the Road Reconstruction Sub-Manual, and the establishment and staffing of the OPIC Project Office.<sup>531</sup>

466. Management also acknowledges that “*The PAD, however, failed to identify the risk of slow implementation start-up including the time needed to establish OPIC’s project management capacity.*”<sup>532</sup>

## **D. Panel’s Observations on Harms Alleged in the Request**

### **1. Road Maintenance Trust Fund**

467. **Stalled Road Reconstruction.** According to the Project Implementation Manual (PIM) Roothing Sub-Manual,<sup>533</sup> there are 2,770 kilometers of access roads in the three oil palm

<sup>527</sup> Management Response, p. 29, ¶ 94.

<sup>528</sup> Management Response, p. 31, ¶ 97.

<sup>529</sup> Ibid., p. 40, ¶ 130.

<sup>530</sup> Ibid., p. 11, ¶ 32. The PAD (p. 14) states that “*Specific conditions of effectiveness would include: (a) the execution of the Subsidiary Agreement between GoPNG and OPIC; (b) the execution of the Co-financing Agreement among GoPNG, PNGSDP and OPIC; (c) the establishment of the PSC with composition acceptable to IDA; (d) the adoption of (i) the PIM, including the EMP and RPF by GoPNG and OPIC; and (ii) the Smallholder Oil Palm In-fill Sub-Manual and the Road Reconstruction Sub-Manual by PNGSDP; and (e) the establishment and staffing of the OPIC Project Office.*”

<sup>531</sup> Management Response, p. 11, ¶ 32.

<sup>532</sup> Ibid., p. 11, ¶ 34.

schemes in Oro, Hoskins, and Bialla. The aim of the road sub-component of the Project is to upgrade and restore 550 kilometers (or 20%) of access roads and develop and implement a maintenance system to cover the entire smallholder access road network and to have a sustainable funding mechanism. These 550 kilometers include a parcel of 105 kilometers of roads that could not be completed under the 2002 AusAid-funded PNG Incentive Fund.<sup>534</sup> OPIC's engineering unit, the Oil Palm Infrastructure Development (OPID) unit, is responsible for maintaining the road network. According to the PIM, OPID's operating costs will initially be financed by contributions from the national development budget, and later by levies paid by smallholders and by contributions from the milling companies.

468. The table below taken from the PIM summarizes the anticipated schedule of repair and reconstruction of the roads.

**Table 5: Road Reconstruction Schedule**

Scheme	2008 km	2009 km	2010 km	2011 km	2012 km	Total km
<b>Hoskins</b>						
Major Reconstruction	15	20	20	20	15	90
Minor Reconstruction	15	20	20	20	15	90
Bridges				1 bridge	1 bridge	
<b>Bialla</b>						
Major Reconstruction	19	26	28	0	0	73
Minor Reconstruction	6	9	9	0	0	24
Bridges			1 bridge	1 bridge		
<b>Oro</b>						
Major Reconstruction	30	32	32	28	0	122
Minor Reconstruction	10	12	12	9	0	43
Minor PNGSDP	50	35	20	0	0	105
Bridges			1 bridge	1 bridge		
<b>Total</b>						
Major Reconstruction	64	78	80	48	15	285
Minor Reconstruction	81	76	61	29	15	262
Bridges			2 bridges	3 bridges	1 bridge	6 bridges
<b>Total Reconstruction</b>	<b>145</b>	<b>154</b>	<b>141</b>	<b>77</b>	<b>30</b>	<b>547</b>

Source: Project Implementation Manual, Roading Sub-Manual, Table 6.1.

469. Management's Mid-term Review reported no progress on road reconstruction as of October 2010 and estimated that only one-third of the projected 550 kilometers would likely be completed by the Project closing date of December 2012 if OPIC did not improve its capacity.<sup>535</sup> The April 2011 Implementation Support Mission mentions "*a shortfall in counterpart funding*" as another impediment to the road reconstruction program and the future of the RMTF.<sup>536</sup>

<sup>533</sup> Project Implementation Manual Roading Sub-Manual for the Smallholder Agriculture Development Project, August 2007.

<sup>534</sup> PAD, p. 36, ¶ 32.

<sup>535</sup> Papua New Guinea Smallholder Agriculture Development Project (IDA Credit NO. 4374-PNG) Mid-Term Review: September 20 -October 7, 2010 Final Aide-Memoire Mid-Term Review, p. 5, ¶ 23.

<sup>536</sup> Ibid., Fifth Implementation Support Mission: April 15– 19, 2011, Final Aide-Memoire, ¶ 6.

470. **Poor State of Roads and Need for Regular Maintenance.** During Panel discussions with villagers in both West New Britain and Oro provinces, the poor state of the roads was cited as the single biggest issue that needed to be addressed. The general consensus was as follows:

- a. Smallholders are already paying several levies, including a transport levy. Thus, an additional levy for road maintenance will be a severe financial burden;
- b. Smallholders recognize that they need to contribute to road maintenance but want their contributions to be equitably determined through consultation with them as one of several sources of finances for road repair;
- c. Smallholders want to see some visible sign that roads are being improved before they would consider any sort of levy; and
- d. The Provincial government cannot be relied on to contribute funds, and thus the sustainability of the RMTF (and consequently improved roads) cannot be assured.



Picture 23: Panel team travelling through a wet crossing between Popondetta-Kokoda National Highway

471. The Panel team travelled widely in both WNB and Oro provinces, experiencing the road conditions first hand. Although it was the dry season, many parts of the major and minor access roads were in a serious state of disrepair and difficult to drive on even in 4 x 4 vehicles. Pictures 21-22 show the difficulties associated with traversing even the national highway between Popondetta and Kokoda in Oro province during the dry season. Bridges that were washed away during Cyclone Guba have not been repaired, and thus vehicles must drive across riverbeds in up to three feet of water. The Panel was told that some of the road works and bridge construction planned under the 1992-2001 Oro Smallholder Oil Palm Development Project were never undertaken. This despite the fact that smallholders planted oil palm at the encouragement of that Project and with the expectation that adequate facilities for FFB collection would be developed.<sup>537</sup> In one instance, the Panel team saw villagers crossing the Mambare River near Butue village on a rubber tube; the Panel was informed that villagers regularly transport their FFB in the same manner on

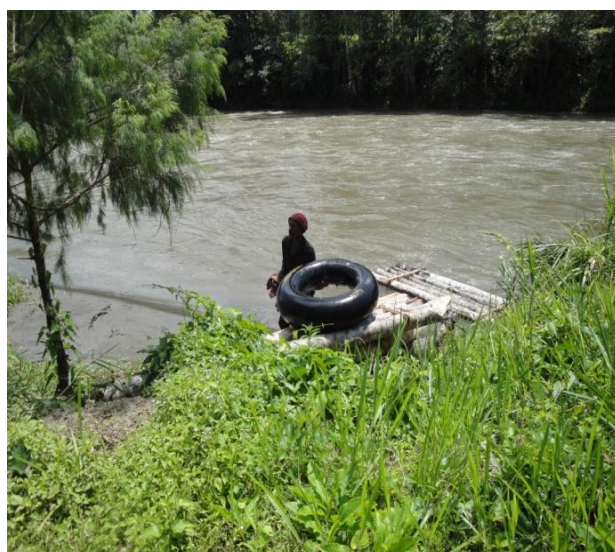
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<sup>537</sup> Implementation Completion Report, Oro Smallholder Oil Palm Development Project, states that the original objective of the Project was to construct 450 kilometers of access roads. This target was revised to 350 kilometers at the loan extension stage (p. 3). The "Borrowers Comments" section of the ICR states that an assessment carried out in 2000 estimated that "an additional 181km of roads were needed to service 870 blocks not on existing or planned roads" (p. 28).

makeshift rafts using tire tubes, after carrying them in wheel barrows for a couple of days to bring them to the river bank. Improving road conditions in the Project area is undoubtedly a priority if productivity is to be increased and the general well-being of the smallholders improved.



Picture 24: Washout on the Kokoda National Highway



Picture 25: Man crossing Mambare River on a tyre tube

472. **Creation and calculation of the RMTF.** The PAD notes that the Social Assessment “...highlighted problems of...the deteriorating state of the provincial roads and associated problems as major concerns by communities... The SA confirmed that the reconstruction and sustainable maintenance of the provincial access road network along with the proposed oil palm infilling activities of the project can especially benefit women and youth and can, together with component 2 activities, positively impact the community as a whole.”<sup>538</sup>

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<sup>538</sup> Project Appraisal Document (November 19, 2007) p. 93, ¶ 6.

473. The PAD, Annex 4, states that “*The **proposal** is for 25% of the required funds for annual maintenance to be contributed by smallholder oil palm growers, 25% by the palm oil milling companies and 50% by the provincial governments...*”[emphasis added]<sup>539</sup> A footnote in the PAD states that “*Although the general organization and operation of the RMTF have been drafted and appear in the PIM, SADP provides for a consultancy at the start of the project to establish the legalities of the RMTF instrument and of the measures necessary to ensure accountability and transparency. The RMTF is expected to be in operation from July 2008, to enable the implementation of the proposed maintenance program and its funding from that date.*”<sup>540</sup> The Table of Critical Risks and Possible Controversial Aspects in the PAD also notes that the design of the RMTF “...will be carried out during project implementation...”<sup>541</sup>”
474. The Roding Sub-Manual of the PIM confirms that all maintenance will be financed by an RMTF, one for each scheme, which will be supported by end-users of the network. The Sub-Manual states that “*Twenty five percent of the required funds for annual maintenance will be contributed by a smallholder oil palm grower levy, 25 percent by the palm oil milling companies and 50 percent by the provincial governments **and/or GoPNG*** [emphasis added].” A footnote further explains this additional provision: “*It is possible that one or both of the provincial governments would not completely meet their obligations to the RMTF. To the extent that either of the provincial government’s does not meet its obligation, the GoPNG will underwrite those costs. It will therefore be important for the General Secretary (OPIC) to monitor this situation closely and to make timely submissions to the DNPM for funding under the national development budget each year.*”<sup>542</sup> The Sub-Manual also notes that “*Seed capital, provided by a PNGSDP grant, will provide a funding cushion that should prevent any disruption to the maintenance programs.*”<sup>543</sup>
475. According to the PAD, the proposed RMTF contribution is based on the projected annual cost of road maintenance divided by the anticipated FFB delivered to the mills as a result of improved roads (i.e., maintenance costs will be “*approximately K5.5 million at Hoskins, K2.9 million at Bialla, and K4.1 million in Oro. These amounts imply contributions by smallholders at the rate of approximately K4 per ton of FFB delivered in Hoskins and Bialla, and K5.5 per ton of FFB delivered in Oro in the early years of the project.*”<sup>544</sup> The PAD references financial models and smallholder cash-flow models to substantiate the proposal that smallholders, although initially unwilling, will not suffer “*unreasonable impact on the net cash return from FFB deliveries*” after paying the proposed 25% contribution assigned to them. Elsewhere in the PAD, slightly different per kina figures are provided as a proposed RMTF levy. Annex 9 states that “*Smallholders would pay one-quarter of the levy and preliminary estimates indicate that Hoskins and Bialla smallholders would pay a levy of K5/ton FFB and Oro smallholders would pay K6/ton FFB.*”<sup>545</sup>

<sup>539</sup> Ibid., Annex 4, p. 35, ¶ 28.

<sup>540</sup> Ibid., ¶ 28, footnote 39.

<sup>541</sup> Ibid., Table 5, p. 13.

<sup>542</sup> PIM Roding Submanual, p. 10, footnote 6.

<sup>543</sup> Ibid., p. 11.

<sup>544</sup> PAD, p. 35, ¶ 29.

<sup>545</sup> Ibid., Annex 9, Economic and Financial Analysis, p. 78, ¶ 11.

476. The two groups with a strong vested interest in seeing the roads well maintained are the milling companies and the smallholders. The Panel team notes that the milling companies in both West New Britain and Oro are the only organizations carrying out any road maintenance at present. They clearly have a vested interest in ensuring that roads are sufficiently well maintained to transport FFB to the mills. Thus, it does not seem plausible that they would not “*contribute their funds in a timely manner*”<sup>546</sup> to an RMTF as the Requesters suggest. Their milling operation would cease to function effectively if they did not. Indeed, Management was aware beginning as early as 2006 that RMTF “*Cost-sharing with the mills does not seem to be a problem but provincial government is unlikely to be unable to (sic) provide a reliable share and alternative arrangements need to be considered.*”<sup>547</sup>



Picture 26: Company Trucks Repairing Sections of Kokoda National Highway

477. Indeed, in a letter addressed to the Panel, the Popondetta Oil Palm Growers Association (POPGA) wrote “*We know that everyone has to work together to get the roads fixed. The roads are important to us and new growers under SADP. Without roads we cannot get our fruits to market and we don't make any money. We need the road so we can go to town for shopping and for hospital and education of our children. The Government never maintains our roads. Only OPIC and Higaturu Oil Palms try their best to keep the roads open. With SADP we understand that the growers might have to pay some of the road maintenance cost but if we do then the Government and Higaturu will have to pay too.*”<sup>548</sup>

478. **Smallholder and Company Contribution.** The Panel notes that it has not been able to determine from available Project documentation<sup>549</sup> how Management arrived at the proposed smallholder contribution of 25%, or one quarter of the annual RMTF operating costs. The only reference to a calculation appears in a 2006 Technical Note that states, in

<sup>546</sup> Request for Inspection, p. 8.

<sup>547</sup> Cuddihy, William. Credit Component and Financial Analysis REVISED FINAL, Report for OPIC/PHRD, December 30, 2006.

<sup>548</sup> Letter to Inspection Panel by Popondetta Oil Palm Growers Association (POPGA), February 9, 2010, p. 1.

<sup>549</sup> Papua New Guinea Proposed Smallholder Agriculture Project Access Roads Program in Target Oil Palm Areas, Institutional Aspects, Working Paper 1; Papua New Guinea Proposed Smallholder Agriculture Project Access Roads Program in Target Oil Palm Areas, Technical Aspects, Working Paper 2; and SADP Access Road Maintenance Technical Note, May 2006.

the context of annual maintenance costs, that *“the implication of this calculation is that if the growers were to pay for one quarter of the costs of maintenance, the mills one quarter, and the province one half, the growers would have to pay a levy of K4.16, K 4.27 and K5.60 per tonne delivered in the early years of the project, and K3.2, K 3.6 and K4.9 per tonne of ffb delivered in the later years, respectively, in Hoskins, Bialla and Oro.”*<sup>550</sup> This suggests a simplistic formula for dividing the annual maintenance costs between the four stakeholders (smallholders, the company, and provincial government underwritten by national government), which led to a quarter of the cost assigned per stakeholder.<sup>551</sup>

479. In addition, the Panel cannot find any indication in the documentation made available to it that Management factored in smallholder costs of production per FFB tonnage to assess smallholder “capacity to pay” before proposing they pay a quarter of the levy similar to the other three stakeholders. Project documents do not analyze the relative returns from oil palm revenue to smallholders, estates, and milling companies, either from an historical perspective or under the Project. Thus, there is no analysis of “capacity to pay” for the costs of road maintenance when it is proposed to be shared among the key stakeholders. Management was requested to provide such data on the value chain analysis but the Panel was informed that Management did not have the data as it was confidential information maintained by the companies.
480. Similarly, the Panel notes that Management did not assess the respective profitability of the smallholder and estate sectors. This raises the issues of the FFB pricing formula, costs of production, transport, employment, value added margins at each stage of the value chain (smallholders, estates, CPO mills), including the processing efficiency and CPO/PKO oil extraction rates at the domestic mills. The PAD repeatedly mentions the close relationship of smallholders and OPIC and the milling companies but is silent on corporate governance, past performance of the companies, their role on smallholder debt and services, profitability, and their future potential. Without having analyzed such data, Management could not have been in a position to determine the appropriate share of RMTF levy proposed for the smallholders.
481. Moreover, neither is there indication in the project documents of the extent to which improved road maintenance through the RMTF might reduce the current transport levy of kina 35 per FFB for Oro smallholders.
482. The Panel observes that: (i) understanding the relative capacity to pay of the smallholders and estate companies in each scheme is important in negotiating their relative shares of road maintenance costs; and (ii) had Management carried out (a) calculations of a cost of production per FFB tonnage along with (b) profitability estimates for both smallholders and the estate companies and reviewed these against the annual road maintenance costs, it may

<sup>550</sup> SADP Access Road Maintenance Technical Note, May 2006, ¶ 33.

<sup>551</sup> The SADP Credit Component and Financial Analysis (Revised Final, December 2006) states in relation to the road maintenance levy: “A levy of K4/ton FFB is equivalent to a price reduction of the same amount. The effect of the imposition of such a levy, using historical prices, is relatively minor since K4/ton FFB is equivalent to a price fall of only 4% at a low price of K100/ton FFB. ...Cost-sharing with the mills does not seem to be a problem but provincial government is unlikely to be able to provide a reliable share and alternative arrangements need to be considered” pp. 16-17.

have arrived at a more clearly justified proposal for their shares of RMTF contributions. Similarly an analysis was needed of each provincial government's capacity to pay its stated 50% share of the annual road maintenance costs, as discussed below.

483. **Provincial Government Contribution.** Moreover, Management states in the PAD that *"The sustainability of the trust funds depends on contributions from Provincial government that have a poor track record in supporting provincial road infrastructure; this risk is to be addressed by having a fall back obligation on the national government in the event of the provincial governments not meeting the annual commitments to the road maintenance fund and possible earmarking of tax receipts."*<sup>552</sup> The Panel notes that Management did not carry out the necessary due diligence to assess how provincial governments had spent tax revenues derived from export grants in the past, nor did it examine whether provincial governments would be committed to apply these tax payments to their proposed RMTF contributions in the future.
484. Virtually everyone the Panel met with was concerned about the Oro provincial government's ability to contribute funds to an RMTF--especially after the Project ended--as the Government of Papua New Guinea would no longer underwrite those costs. Many felt that the WNB provincial government might be able to make payments, but that the Oro provincial government would not. Most informants felt that counterpart funds could possibly be counted on to flow to the provincial government from Government of Papua New Guinea during the life of the Project, but not once the Project ends. During the Panel's meeting with the Provincial Administrator in Oro, he confirmed to the Panel that they simply had no resources to pay into the RMTF even if they wanted to. The PAD notes the possibility that provincial governments may not provide the required funding for road maintenance, which the PAD cited as one of the three risk factors leading to the *"substantial risk"* rating for the Project.<sup>553</sup>
485. The Panel therefore observes that while the method for collecting a regular end-user fee was clear from the very beginning for the smallholders (i.e., through a levy charged on FFB tonnage and collected at the farm gate), the same assurance regarding regular collection through a definite system was not provided for the other two major stakeholders (i.e., the estate/milling companies and the provincial governments). The road maintenance contributions and methods of collection for emerging non-smallholder producers, such as new mini-estates, are also not clear. The Requesters raise this issue when they state *"Growers, in contrast, are compulsorily required to contribute to the OPIC levy and will be forced to contribute to the road maintenance levy if they wish road access to improve."*<sup>554</sup>
486. **Smallholder Consultation and Free, Prior, Informed Consent.** As far as smallholders are concerned, Management has been aware that *"an initial negative reaction to any levy from a significant proportion of growers must be anticipated"* but that this could be buffered by *"favorable financial return in additional FFB delivered"* when road conditions improve. During its visit, the Panel team was struck by the strong resentment smallholders

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<sup>552</sup> PAD, p. 55, ¶ 11.

<sup>553</sup> PAD, p. 55, ¶ 11.

<sup>554</sup> Request for Inspection, p. 8.

had toward the companies for the multiple levies deducted from their pay-slips. In their view, this was done in a non-transparent and unilateral manner. Thus, when the Panel team asked about the possibility of further deductions for RMTF, the response was overwhelmingly negative.

487. Management's supposition that the negative reaction may be buffered by favorable financial returns in additional FFB delivered does not address the fact that Management did not plan for the impact that Project start-up delays would have on smallholder attitudes toward the road levy and RMTFs.
488. The Panel appreciates Management's recognition that "*there could have been broader consultation within the grower community on the road maintenance levy during preparation*", and thus Management plans to provide inputs to OPIC to ensure "...*that the design of the RMTFs is done in a consultative way with the objective of ensuring sustainability.*"<sup>555</sup>
489. **RMTF Implementation.** The RMTF is a key aspect of the Project design. Without it, many of the major outputs of the Project would not be sustained in the long term. The Management Response states that important aspects of the RMTFs such as governance, financial management and operational arrangements, and the level of the smallholder road levy, are still to be designed in detail, discussed and agreed with all stakeholders.<sup>556</sup>
490. The Project was approved more than three years ago, and the terms of reference for the design of an RMTF were advertised in August 2010. In addition, the outline of a trust fund may not become clear before the end of 2012; further delay is then likely until the Trust Fund (or other modality) becomes operational. Hence, RMTFs are not likely to become operational before 2013, a long way from the estimate of July 2008 as given in the PAD.<sup>557</sup>
491. The QAG Quality Enhancement Review of 2008 concluded that the Project preparation process "...*would have benefited from a more complete preparation of the arrangements for the operation of the RMTFs.*"<sup>558</sup> The Panel agrees and questions the wisdom of leaving so many of the key institutional and financial elements of the design of this critical component to the implementation stage, which itself is subject to continued delays.

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<sup>555</sup> Management Response, p. 40, ¶. 130.

<sup>556</sup> Management Response, p. 30, ¶96.

<sup>557</sup> PAD, 35, Footnote 39 and p. 36, ¶30.

<sup>558</sup> Management Response, p. 12, ¶35.

## 2. OPIC Extension Activities

492. Many smallholders told Panel members that OPIC extension officers rarely sat down with them for meaningful discussions about oil palm extension issues, and they would welcome such opportunities. Many smallholders said that they do not see any benefits accruing to them from the existing OPIC levy that they pay. Senior OPIC staff acknowledged to the Panel that many of the extension staff were not well trained. But they added that this could be improved if the OPIC Board is prepared to support changes.
493. The effective functioning of OPIC is central to the success of the SADP as it is responsible for the management, coordination, and performance of all Project components. The Panel believes that Management was, and remains, aware of OPIC's limitations in carrying out its activities. The PAD notes that "*Project implementation experience in PNG has often revealed a limited performance at the operational level in most public sector institutions, government's limited capacity to provide for operational costs other than salaries in these institutions, and government's inability to make timely and adequate appropriation of counterpart funding.*"<sup>559</sup> The PAD also states "*The OPIC extension system is less than fully effective in enhancing productivity, in part because of an incapacity to utilize its management information system and to analyze and address grower attitudes to improved productivity measures.*"<sup>560</sup> Indeed, the Project will increase the existing workload of the extension officers with the addition of a further 9,000 hectares of smallholder oil palm blocks, which is likely to involve 4,500 additional smallholders.
494. The Panel notes that Management was aware of OPIC's capacity gaps. This was the reason Component 3, which focuses on strengthening OPIC capacity through various institutional development measures, was included in the Project. That said, the Project Mid-Term Review of October 2010 highlights that "*unsatisfactory implementation progress*" owing to weak project management has led to "*key project activities including road reconstruction, infill planting, and community development*" to not commence.<sup>561</sup> Moreover, citing the seriousness of this delay, Management informed the Government that its request for a two-year project extension would be considered only if OPIC reported satisfactory progress on procurement and project management issues by January 15, 2011.
495. OPIC reported "*good progress*" in its January 2011 Implementation Progress Report. The report states that of the four conditions outstanding at the time the Project took effect, only one remains to be completed,<sup>562</sup> although major Project components (e.g., the establishment of the RMTF and Project staffing remain) are substantially delayed. Of the 47 Project positions in OPIC, 9 have been filled and 38 remain to be filled.<sup>563</sup> The RMTF consultancy, with more focus on "*education, consultation and discussion,*" is slated for completion in 2011.<sup>564</sup>

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<sup>559</sup> PAD, p. 6, ¶ 18.

<sup>560</sup> Ibid., p. 7, ¶ 18.

<sup>561</sup> Management Letter for Mid-Term Review, October 18, 2010, p. 1.

<sup>562</sup> OPIC Implementation Progress Report, January 21, 2011, p. 5.

<sup>563</sup> Ibid., Table 3, p. 12.

<sup>564</sup> Ibid., p. 10.

496. The Project Midterm Review also states “*The SADP was approved in December, 2007 and became effective in January 2009. Following the long effectiveness delay, Project start-up has been extremely slow. It took close to a year to establish OPIC's project management structure. The Project Coordinator and Procurement Specialist commenced work in Oct/Nov. 2009, but OPIC is still recruiting consultants for other key positions including the Road Engineering Unit, the Management Agency for Component 2 on Local Governance and Community Participation, the Extension Specialist and the Baseline/M&E Consultants. During the past year, procurement delays have become a severe impediment to project implementation. To date, key activities including road reconstruction, infill planting, and community development activities have not commenced. As it currently stands, SADP will not meet its Development Objectives by the project's closing date of December 31, 2012.*”<sup>565</sup>
497. The Panel notes that during the past year, weak project management and procurement delays have severely impeded Project implementation. Indeed, the “*complex, lengthy process of establishing OPIC project management capacity*” was identified early on by Management as the main cause of slow Project start-up<sup>566</sup> and in May 2007 SADP was flagged by OPCS as a “*high risk project*” owing to “*project complexity.*”<sup>567</sup> Consequently, four years after Project approval and two years since the Project took effect, key Project activities have not started.
498. The Project relies on a sustainable RMTF financing mechanism to ensure roads are maintained after the Project ends. This would allow for timely FFB collection. If this component remains incomplete, poor road maintenance will continue to hamper smallholder output and reduce the corresponding OPIC levy charged on FFB per tonnage. The Panel also notes with concern the statement in the January 2011 OPIC Implementation Progress Report that infill planting in Oro may not begin for another one or two years, owing to the mill company (Kula/Higaturu) expressing “*high concern*” regarding any new planting in Oro and indicating a preference for replanting rather than infill planting. The mill company, OPIC reports, was of this view as “*they feel that the smallholder replant is a much higher priority and resources will be too stretched if infill planting is implemented*”.<sup>568</sup>
499. The Mill Company subsequently agreed to participate in the infilling component, as indicated by Management in the Aide Memoire for the latest Implementation Support Mission,<sup>569</sup> but it leads to two observations: one, that the mill company in Oro is concerned about OPIC’s capacity to deliver extension services for new planting and would like instead to focus on replanting in existing blocks, and two, that the RMTF’s establishment

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<sup>565</sup> Papua New Guinea Smallholder Agriculture Development Project (IDA Credit No. 4374-PNG) Mid-Term Review: September 20-October 7, 2010 Final Aide-Memoire, Mid-Term Review, p. 1.

<sup>566</sup> September/October 2009 World Bank Review Mission, Final Aide-Memoire, p. 1.

<sup>567</sup> World Bank, Papua New Guinea: Smallholder Agriculture Development Project (P079140), EAPCO Quality Assurance Review, November 26, 2007

<sup>568</sup> Smallholder Agriculture Development Project, Project ID-P079140, IDA Credit No. 4374-PNG, Implementation Progress Report, Status as of January 21, 2011, OPIC, p.6.

<sup>569</sup> Papua New Guinea Smallholder Agriculture Development Project (IDA Credit No. 4374-PNG), Fifth Implementation Support Mission: April 15-19, 2011, Final Aide-Memoire, ¶ 5.

will be jeopardized in Oro if the anticipated income gains from new infill planting--with which the smallholders were to be motivated to pay the additional RMTF levy--do not materialize. Thus although the PAD recognizes that the mill companies' support is needed for new planting and smallholder productivity enhancement activities,<sup>570</sup> the Panel notes that Management did not anticipate, nor plan, for the possibility of a different planting approach by the mill companies during the life of the Project, and what this might imply for the Project.

## **E. Applicable Bank Policies and Procedures**

500. In this section, we briefly summarize the policies and procedures relating directly to the sustainability of RMTF and OPIC extension activities. The relevant policies include: OMS 2.20 on Project Appraisal, and the Indigenous Peoples Policy (OP/BP 4.10).

### **1. Project Appraisal (OMS 2.20)**

501. OMS 2.20 states that the aim of appraisal is *“to examine and evaluate the economic and social objectives which a project is designed to meet, to assess whether the proposed project is likely to meet these objectives efficiently, and to recommend conditions that should be met to ensure that the purposes of the project will be achieved.”*<sup>571</sup> Financial aspects are among the six aspects of a project's design to be appraised. In discussing the financial aspects, the policy states that *“The financial appraisal always includes a review of the reliability of the project's financial plan and of the adequacy of the accounting and auditing arrangements.”*<sup>572</sup> OMS 2.20 also notes that *“In many projects, an important aspect of the financial appraisal is the evaluation of the impact on the final beneficiaries and incentives for their participation in project implementation and operation. An examination should be made of the ability of final beneficiaries to pay for goods and services...”*<sup>573</sup> and that *“In many agricultural projects, typical farm budgets are prepared to analyze the farmers' incentive to participate and their capacity to meet the debt service burden of farm credit.”*<sup>574</sup>

### **2. Indigenous Peoples Policy (OP/BP 4.10)**

502. As described in Chapter 2, the SADP triggered the Indigenous Peoples Policy OP/BP 4.10, because the great bulk of the population in the Project area is considered indigenous, as per Bank policy. This policy requires that Bank-financed projects affecting indigenous peoples *“are designed to ensure that the Indigenous Peoples receive social and economic benefits that are culturally appropriate and gender and intergenerationally inclusive.”*<sup>575</sup> Furthermore, the policy requires that such projects involve *“a process of free, prior, and informed consultation with the affected Indigenous Peoples' communities at each stage of*

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<sup>570</sup> PAD, p.10, ¶ 29.

<sup>571</sup> OMS 2.20 – Project Appraisal, January 1984, ¶ 7.

<sup>572</sup> Ibid., ¶ 38.

<sup>573</sup> Ibid., ¶ 43.

<sup>574</sup> OMS 2.20 – Project Appraisal, January 1984, ¶ 43.

<sup>575</sup> OP 4.10, ¶ 1.

*the project, and particularly during project preparation, to fully identify their views and ascertain their broad community support for the project.”<sup>576</sup> The policy notes that the borrower must also “provide[...] the affected Indigenous Peoples’ communities with all relevant information about the project (including an assessment of potential adverse effects of the project on the affected Indigenous Peoples’ communities) in a culturally appropriate manner at each state of project preparation and implementation.”<sup>577</sup>*

## **F. Panel’s Analysis of Compliance with Bank Policies**

### **1. Road Maintenance Trust Fund**

503. The Panel acknowledges Management’s attempt to set up a sustainable financial mechanism for road maintenance. Such a mechanism would address a critical issue without which the smallholder oil palm industry cannot be sustained, and Management merits due recognition for taking up this challenge in a difficult environment. Management is also aware of the limitations associated with having regular and appropriate financial contributions for a road maintenance fund from the provincial governments, and the reluctance of smallholders to pay an additional roads levy. Governance in Papua New Guinea is widely acknowledged as being in urgent need of strengthening, and the RMTF could be seen in this wider developmental context. Hence, any attempt to develop an innovative approach to sustainable funding for maintenance of such critical infrastructure as roads should be applauded, even if it is high risk.
504. The Panel notes that the smallholders are concerned with three main issues regarding the RMTF: (i) that the smallholder contribution of 25% is an additional financial burden; (ii) that this percentage was arrived at without due consultation with smallholders and they believe it to be unfairly calculated; and (iii) that the other stakeholders, especially provincial governments, will not contribute their share of the RMTF levy.
505. **Project Design.** The Panel notes that the Implementation Completion Report (ICR) of the predecessor to the SADP (the Oro Smallholder Oil Palm Development Project (1992-2001)), states that *“Once constructed, maintenance of the access road network is essential if it is to serve its purpose in enabling economic palm oil production..... However, the institutional arrangement for this maintenance did not receive special attention. In hindsight, greater emphasis could have been given to this element of the project.... Maintenance was a provincial government responsibility, but the province normally had very scarce funds available and did not allocate any significant amount to access road maintenance”*.<sup>578</sup> In its “Lessons Learned” section, the ICR says that *“As access roads to allow collection of fresh fruit are critical for success, the institutional and funding arrangements to enable their timely construction and subsequent maintenance must receive high priority.... Because of the substantial expenditure involved in both construction and maintenance, the road distance per smallholder block serviced must be minimized. This is ensured by maximizing the oil palm development along any access road....Provision for*

<sup>576</sup> OP 4.10, ¶ 6(c).

<sup>577</sup> Ibid., ¶ 10(c).

<sup>578</sup> Implementation Completion Report, Oro Smallholder Oil Palm Development Project, p. 11-12.

*access road maintenance is as essential as the construction of the network. The preparation report on the Oro project specified that annual provision would be made through the central government budget. This did not occur.”*<sup>579</sup>

506. The Panel concludes that Management was, and remains, aware of the importance of roads and road maintenance for the sustainability of the Project and for smallholder productivity; 70% of SADP financing is intended for the roads component. Smallholder productivity enhancement through better roads can be seen as its most vital component, without which Project success would be difficult to guarantee. The “Lessons Learned” notes above clearly state the need to give high priority to the institutional and funding arrangements to enable timely construction and maintenance of roads for the Project to succeed. Moreover, the Bank was also aware of the scarcity of funds at the provincial level and the unreliability of funding from the central government budget.
507. Although the PAD notes some of the lessons learned, the design of the SADP failed to include institutional and funding arrangements of RMTFs, leaving these to be finalized during project implementation. The QAG review notes this issue and the Management Response also acknowledges it.
508. The Panel notes that RMTF performance is most closely tied, and is most sensitive, to implementation delays as these erode the confidence of its most skeptical and vulnerable stakeholders (the smallholders). The Panel understands that Management is helping government initiate the design process of the RMTF and hopes that this design will ensure sustainable contributions from all RMTF stakeholders.
509. **The Panel finds that Management failed to comply with OMS 2.20 by leaving the design of this essential element of the Project, critical to ensuring the achievement of Project objectives, to the Project’s implementation.**
510. **RMTF Calculation.** While it may appear from a general reading of the PAD that the percentage contribution to the RMTFs is fixed, the Panel believes a careful reading of the PAD shows that the percentage contribution was provided as a proposal and the precise structure and modality of a funding mechanism for road maintenance is yet to be determined. This was apparently the intention at the Project’s design stage. But a reader could justifiably draw a different conclusion from reading the PIM Roding Sub-Manual, which portrays the percentage contribution formula as fixed and determined.<sup>580</sup> Indeed, Figure 3 in the Sub-Manual (“Funding Arrangements for each Road Maintenance Trust Fund”) substantiates this impression by illustrating the category-wise percentage allocations. The Requesters, therefore, have grounds to conclude that the road levy contribution of 25% was pre-determined.
511. **The Panel finds that Management’s proposal of 25% contribution by the smallholders was arrived at without fully assessing smallholders’ ability to pay, and most importantly without consultation with the smallholders.** Determining the appropriate

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<sup>579</sup> Implementation Completion Report, Oro Smallholder Oil Palm Development Project, p. 23.

<sup>580</sup> PIM Roding Sub-Manual, p. 11.

share of the RMTF levy proposed for the smallholders needed to be based on an analysis of such data and consultations.

## **2. OPIC Extension Activities**

512. **OPIC Extension Activities.** The Panel agrees with Management’s acknowledgement that it *“failed to identify the risk of slow implementation start-up including the time needed to establish OPIC’s project management capacity.”*<sup>581</sup>
513. The Panel notes that Management is aware of the limitations of OPIC as an organization and the capacity of its extension officers. These limitations are being addressed in two ways: (a) measures are being put in place to build the capacity of OPIC in general and its extension officers in particular, and (b) the OPIC procedural systems, as spelled out in the PIM ECMMPs and associated management tools, provide concise instructions to ensure that extension is carried out as effectively as possible, and to minimize any adverse environmental or social impacts.
514. Moreover, the Panel understands that Management tried to address OPIC’s capacity gaps by adding a specific institutional development component (Component 3) in the Project and requiring the establishment and staffing of the OPIC Project Office and the OPIC Road Engineering Unit as a specific disbursement condition.
515. **The Panel appreciates that, within the limits of Management’s staffing structure in support of this Project, Management complied with the requirements of OP 13.05 on Project Supervision, paragraph 2b, namely, “Identify problems promptly as they arise during implementation and recommend to the borrower ways to resolve them.”**
516. As the Bank shifts from supervision to *“implementation support,”* however, it becomes even more incumbent upon Management to enhance its capacity to promptly identify problems with a view to their early resolution. This is especially true where there are major capacity issues in the main implementing agency, and in a challenging program environment, or, to keep the Projects *“straightforward and simple,”* as per the recommendation of the 2008 QAG Review.

## **G. Final Reflections**

517. The Panel appreciates Management’s attempt to tackle the road maintenance issue, which is critical for preserving the viability of oil palm production in the Project areas and for ensuring the achievement of Project goals. But the Panel is concerned that the risks associated with the instances of non-compliance listed earlier, including the delay in designing this essential element during the Project’s implementation, the failure to fully assess smallholders’ ability to pay into the RMTF, and the inadequacy of consultations, together with the challenging Project implementation environment, places an unacceptable proportion of the risks on smallholders.

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<sup>581</sup> PIM Roding Sub-Manual, p. 11, ¶ 34.

## Chapter 7: Systemic Issues

518. This chapter discusses systemic issues relevant to the Bank's compliance with its operational policies and procedures in the context of the investigation of this Project. Specifically, three systemic issues identified by the Panel in the course of this investigation are highlighted: applying the Indigenous Peoples Policy to Projects where indigenous people are the main beneficiaries, applying this Policy during implementation, and managing risks associated with weak capacity of implementing institutions. In addition, in view of the recent approval by the Executive Board of the World Bank Group Framework and IFC Strategy for Engagement in the Palm Oil Sector, this chapter includes some observations by the Panel on lessons learned from this investigation that might contribute to the follow up to this Framework.

### A. Applying the Indigenous Peoples Policy to Projects Where Indigenous People are the Main Beneficiaries

522. In undertaking this investigation, the Panel was guided by the project title, the Smallholder Agricultural Development Project, and the fact that the smallholders involved are members of indigenous communities. Thus, the focus was on the agricultural development of smallholders, and the investigation on harm and compliance took particular note of the policy framework provided by the World Bank policy on Indigenous Peoples (OP 4.10).

523. The Panel notes that Management decided not to prepare an Indigenous Peoples Plan (IPP) for the Project because the Project in its entirety would benefit indigenous communities. In a recent Panel case, the Panama Land Administration Project, Management made a similar judgment based on the fact that an entire project component would address indigenous peoples' land right issues. In both the Panama investigation and this investigation, the Panel finds a lack of compliance with OP 4.10, and in both cases the most serious concern relates to consultations with indigenous communities.

524. The Panel further notes that OP 4.10 does allow for not preparing an IPP under the circumstances noted above: *"When Indigenous Peoples are the sole or the overwhelming majority of direct project beneficiaries, the elements of an IPP should be included in the overall project design, and a separate IPP is not required. In such cases, the Project Appraisal Document (PAD) includes a brief summary of how the project complies with the policy, in particular the IPP requirements."*<sup>582</sup> While the guidance on preparing an IPP is quite specific in the Policy, it is less explicit on what would be required in the absence of an IPP.

525. The objectives of the Policy are to ensure that projects *"include measures to (a) avoid potentially adverse effects on the Indigenous Peoples' communities; or (b) when avoidance is not feasible, minimize, mitigate, or compensate for such effects. Bank-financed projects are also designed to ensure that the Indigenous Peoples receive social and economic benefits that are culturally appropriate and gender and intergenerationally inclusive."*<sup>583</sup>

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<sup>582</sup> OP 4.10, ¶12.

<sup>583</sup> Ibid., ¶1.

The Panel is concerned that staff may become less focused on the latter part of this set of objectives (i.e., ‘social and economic benefits’) in projects where ‘adverse effects’ are not obvious and there is no need to develop an IPP. According to the Policy, an IPP is meant to set out “*the measures through which the borrower will ensure that (a) Indigenous Peoples affected by the project receive culturally appropriate social and economic benefits; and (b) when potential adverse effects on Indigenous Peoples are identified, those adverse effects are avoided, minimized, mitigated, or compensated for.*”<sup>584</sup> The explicit focus on being ‘affected’ and ‘adverse effects’ may divert attention away from a focus on how to ensure culturally appropriate benefits. A key concern in this regard appears to be the consultation process; whether it adequately meets the standards of “*free, prior and informed consultation,*” whether “*broad community support*” by indigenous communities has been obtained, and whether consultations also focus properly on “*benefits*”.

526. The Panel’s investigation found the consultations wanting in scope, extent, and form in addition to not taking adequate account of customary decision-making structures. The process should have been better documented, not least with respect to evidence of broad community support. The investigation also found that the Project design did not adequately reflect the findings and recommendations of the Social Assessment that could have directly affected the livelihoods of indigenous communities, such as setting up a savings mechanism and diversification of livelihoods. The absence of an IPP, with its two explicit objectives, may have influenced this lack of policy compliance.
527. Previous Panel investigations have also revealed noncompliance in application of the Bank’s Policy on Indigenous Peoples. Again, a significant issue has been shortcomings in consultations with the affected populations, and in particular, failure to adequately account for local structures of representation (for example, Honduras Land Administration Project and DRC forest operations). The findings of noncompliance in these instances go beyond issues of consultation, however, and have included instances of noncompliance in relation to the preparation of Indigenous Peoples’ Development Plans.
528. Hence, it might be useful to formulate clearer guidelines for the application of OP 4.10 to projects where a self-standing IPP is not warranted. The emphasis is on the appropriateness of benefits intended under the project and community support for the project as a whole.

## **B. Applying the Indigenous Peoples Policy during Implementation**

529. OP 4.10 requires that consultation of communities takes place not only at the project design stage, but throughout implementation, and the continuous involvement of appropriately trained staff is critical. In its review of Project documents, the Panel found that Management had been attentive to OP 4.10 requirements at the early planning stage (i.e., the Social Assessment and Beneficiaries Assessment), but that references to this Policy gradually diminished as the Project moved into the concrete design phase and subsequently into implementation and supervision.

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<sup>584</sup> OP 4.10, ¶12.

530. In the Panama Land Administration Project investigation, the Panel made a similar observation: that is, that “*the proper implementation of the Bank’s IP policy hinges on not only strong and clear foundations during Project preparation, but also appropriate allocation of resources for supervision, in particular to engage the services of staff and consultants with specialized training in indigenous peoples’ issues and participatory development.*”<sup>585</sup> The Panel considers that this conclusion also applies for the SADP. Resources for supervision of the IP policy become even more important with the Bank’s new emphasis on implementation support. The Panel is pleased to note the Management letter (dated March 8, 2011)<sup>586</sup> announcing its next mission as an ‘implementation support’ rather than a ‘supervision’ mission, in line with the ongoing corporate reform process.
531. The Panel thus acknowledges that projects in Papua New Guinea pose a unique challenge for the Bank, in that the population is almost entirely composed of indigenous peoples from over eight hundred distinct ethnic groups; this triggers OP 4.10 for every project. Project areas, such as for the SADP, tend to be ethnically complex and particular attention to the Indigenous Peoples Policy during implementation is critical. This may call for clearer guidelines for staff in making OP 4.10 operational in Papua New Guinea.

### **C. Managing Risks Associated with Weak Capacity of Implementing Institutions**

532. The Panel cites significant delays in implementation of the Project, which has contributed to the frustration expressed by many smallholders. The causes of these delays are several, but Project experience highlights two systemic issues relevant for Management. First, how did Management assess the risks associated with weak counterpart capacity in view of the complexity of project design? And, second, did Management mobilize resources commensurate with these risks in supervising the Project?
533. Interestingly, the Quality Enhancement Review of the Pacific Islands reviewed the SADP design in June 2008 before the launch of the Project and concluded that it was an excellent example of the matching of capacity and complexity. At that stage, the Review considered that the SADP “*is focused, builds on known capacity (and a long relationship between the Bank and the Oil Palm Investment Corporation, the executing agency), while being innovative (with a road trust fund) and modestly experimental (a CDD program for communities outside the project area).*”<sup>587</sup> However, as a major overall conclusion, the Review identified “*the necessity for ensuring that project complexity matches local capacity as the principal lesson from IEG and QAG over many years. Projects in the Pacific Region need to be kept straightforward and simple.*”<sup>588</sup> In contrast, the SADP was flagged in May 2007 by OPCS as a “*high risk project*” owing to “*project complexity.*”<sup>589</sup>

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<sup>585</sup> Investigation Report, Panama: Land Administration Project (Loan No. 7045-PAN), September 16, 2010, ¶348.

<sup>586</sup> Management Letter, Papua New Guinea: Smallholder Agriculture Development Project (Credit No. 4374-PNG) – Implementation Support Mission.

<sup>587</sup> Pacific Islands Quality Enhancement Review, Volume 1, June 2, 2008, Quality Assurance Group, p.12.

<sup>588</sup> Ibid.

<sup>589</sup> World Bank, Papua New Guinea: Smallholder Agriculture Development Project (P079140), EAPCO Quality Assurance Review, November 26, 2007.

534. The Panel also notes significant counterpart capacity issues. This was well recognized by Management through the design of Component 3 specifically addressing OPIC's capacity development. Yet, the Project continues to suffer from major delays. According to the June 2011 Implementation Status and Results Report (ISR), *"weak project management and procurement capacity were identified as the main causes of the severe implementation delays."*<sup>590</sup> The key elements of the project (the Road Maintenance Trust Fund, and infilling on smallholder blocks) hinge on OPIC's delivery capacity, which in turn depends on recruitment of key personnel and setting up of the internal institutional structure. Lack of both in the first years of the Project is leading to implementation delays.
535. The fact that some of the key design work central to the Project was deferred to the implementation stage contributed to further delays in field-level operations. While the Panel was pleased to note that some of the bottlenecks were being resolved over the past year, the same ISR also refers to delays in road reconstruction: *"OPIC does not yet have sufficient counterpart funds for the Popondetta and Bialla packages. OPIC is following up with the Department of Treasury and the Department National Planning and Monitoring (DNPM) on the counterpart funding issue. If this counterpart funding issue is not resolved soon, it will also affect implementation of other activities."*<sup>591</sup>
536. Given that in the fourth year of the Project, neither the innovative nor the modestly experimental components (the RMTF and community development) have been designed let alone implemented, perhaps the need to be "kept straightforward and simple"<sup>592</sup> was more applicable for the SADP than anticipated in 2008. The Panel believes that the overall QER recommendation for the Pacific Islands thus applies to the SADP, the *"main lesson to improve the quality of lending is: Keep it simple! There is a clear correlation between project complexity and implementation problems. Conversely the simple, focused projects, regardless of size have tended to achieve satisfactory outcomes and there is evidence that these can have a strategic impact if designed in the context of good advisory work."*<sup>593</sup>
537. *"Keeping it simple and focused"* should not mean that risks should not be taken. Indeed, the Panel has applauded Management for trying to set up a permanent and sustainable mechanism for road maintenance, which is critical for sustaining oil palm cultivation. However, a key issue for risk management under the Project is to ensure that the burden of risk does not fall on the poor. This is a major concern raised in the Request. The Panel is of the view that in the RMTF, as initially conceived, the financial burden and risk fall disproportionately on the smallholders as there is no guarantee in funding from the other two sources of financing--the provincial governments and the mill companies--even though the companies have a clear vested interest in road maintenance.
538. With the delays in implementation, the government and Bank Management seems to be considering restructuring the Project, and possibly cancelling Component 2. This

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<sup>590</sup> Implementation Status and Results Report, June 2011, p. 2.

<sup>591</sup> Ibid, p. 2.

<sup>592</sup> Pacific Islands Quality Enhancement Review, Volume 1, June 2, 2008, Quality Assurance Group, para 33, bullet point 5.

<sup>593</sup> Pacific Islands Quality Enhancement Review, Volume 1, June 2, 2008, Quality Assurance Group, para 34.

Component involves, according to the Project Implementation Manual (PIM), launching an entirely new set of labor-intensive activities to be undertaken by an external agency under contract.

539. A similar issue, which calls for adjustments during implementation, is the significant differences in terms of the recent history of the oil palm sector within the project area. This is reflected in different levels of smallholder productivity, which has led to the decision by the same mill company to support infilling in one province, but to give it less priority in the other and instead place greater emphasis on replanting. The SADP's PIM does not respond to such differences in the field realities of the two provinces. Thus, it becomes even more incumbent during the implementation stage for the Project to apply a differentiated rather than a cookie-cutter approach in making progress toward achieving the Project objective.
540. While the Panel was uniformly impressed by the caliber of individual staff members who were engaged with the Project, greater capacity is needed to respond to challenges that are certain to arise during project implementation in complex and challenging settings such as Papua New Guinea.

**D. Issues to Note in the Follow-Up of WBG Framework on Engagement in the Oil Palm Sector**

541. This Request for Inspection was received shortly after the November 2009 World Bank Group moratorium on new oil palm projects. Given that the SADP had already been launched, the moratorium did not apply to it. Subsequently, a WBG Framework for Engagement in the Palm Oil Sector<sup>594</sup> was approved by the Executive Board in March 2011.
542. The Framework concludes as follows: *“While the crop's positive impact on employment, income generation and the poor is considerable, oil palm has long been criticized for being a major contributor to deforestation and emissions of greenhouse gases in some countries. It has also been criticized for inequitable benefit sharing with local communities and adverse impacts on indigenous peoples. This seems to suggest inherent trade-offs from oil palm expansion, but this is not necessarily the case. The net environmental and social impacts of oil palm depend on where and how it is developed. Problems arise when strong economic incentives for expansion are superimposed on a governance framework that has weak capacity for guiding the development of new oil palm plantations onto areas where the environmental and social impacts are minimized.”*<sup>595</sup>
519. The following focuses on three issues where this investigation may contribute to the follow up to the Framework. These issues are capacity for implementation and supervision, income diversification, and structural inequalities.

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<sup>594</sup> World Bank and IFC, *The World Bank Group Framework and IFC Strategy for Engagement in The Palm Oil Sector*, March 31, 2011

<sup>595</sup> Ibid, p. 4.

543. **Capacity for Implementation and Supervision.** It could be said that in the past there were significant negative environmental and social impacts from strong economic incentives being super imposed on a weak governance framework. However, under the current Project, with regard to deforestation, the Panel notes that the Project’s design and instruments include mitigating measures to avoid potential damage to the environment. With regard to pollution, the Panel notes that Management has recognized the need to enhance the treatment of mill effluents, which is currently being addressed. Furthermore, the mill companies now operating are demonstrating their commitment to upholding the required standards of environmental and social protection, including the rights of indigenous peoples.
544. An important lesson from this investigation, however, is that the implementation capacity of borrower institutions and the capacity of the Bank to carry out adequate implementation support determine whether the Project is implemented as designed and adequately prevents adverse social and environmental impacts. The WBG Framework does not explicitly point at such factors in its presentation of the need for strengthened early assessment (p.33) or in the new Good Practice Note for Staff.<sup>596</sup>
545. In addition, the investigation highlights two critical issues reflected in the Framework but, taking the lessons from the SADP into consideration, warrant more emphasis. The two issues are:
- the importance of income diversification and mixed livelihood strategies: and
  - the need to address structural inequalities in the sector.
546. **Income Diversification.** While the Framework cites among social concerns “*the mixed impacts of a move to dependence on cash crops and loss of autonomy gained from traditional subsistence practices*” and identifies “*depriving local people of the benefits derived from mixed livelihood strategies*” as one of the potential negative impacts of oil palm expansion on smallholders,<sup>597</sup> the list of Possible Solutions for Improving Social Impacts of Oil Palm Development (section 3.5), is primarily about enhancing smallholder productivity and gains from the oil palm industry. As this Report discusses, for many smallholders in Papua New Guinea, oil palm is one among a range of livelihood strategies thus pointing to the need to enhance mixed livelihood strategies.
547. **Structural Inequalities.** The Framework recognizes that the “*structure of the relationship between smallholders and the plantation companies and/or mills that buy their fruits is a major determinant of smallholder conditions.*”<sup>598</sup> Being in a monopsonic situation, smallholders usually have weak influence over pricing. The Framework mentions among “Solutions for Improving Impacts of Oil Palm Development” the need to strengthen the negotiating capacities of smallholder representatives and smallholder cooperatives. This

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<sup>596</sup> World Bank, WBG Oil Palm Framework and IFC Strategy for Engagement in the Palm Oil Sector, March 31, 201, Annex VII: Applying World Bank Safeguards and IFC Performance Standards: A Good Practice Note for WBG Staff

<sup>597</sup> The World Bank Group Framework and IFC Strategy for Engagement in The Palm Oil Sector , p.20.

<sup>598</sup> Ibid, p.22.

investigation has confirmed that the lack of influence over the pricing policy and determination of revenues levied on smallholders, combined with lack of confidence in their formal representatives, are legitimate concerns that the Project has not been able to address adequately.

## ANNEX 1

### Table of Findings

ISSUE	MANAGEMENT RESPONSE	PANEL'S FINDINGS
<b>Information Disclosure, Consultation and Broad Community Support</b>		
<b>Socioeconomic and Cultural Fact Finding</b>  <b>a. Review of Legal and Institutional Frameworks Applicable to Indigenous Peoples</b>	<p>Management states in its Response that the Borrower conducted a detailed Social Assessment and a Beneficiaries Assessment.</p> <p>Management states that the Social Assessment details the socio-economic and political context of the Project areas and includes an assessment of the institutions in each of the areas, including local community organizations, NGOs, community and village-based groups, LLGs, oil palm growers associations, and industry bodies.</p>	<p>The Panel finds that the analysis of the legal and institutional framework of customary law, leadership, decision-making and dispute-resolution processes, and the variations (if any) of these practices among different ethnic groups, fell short of the requirements of Annex A of OP 4.10, and thus did not comply with Bank Policy.</p>
<b>b. Gathering Baseline Information</b>	<p>Management states in its Response that the Social Assessment includes baseline data from a housing and water survey.</p>	<p>The Panel could not find adequate evidence and information in the Social or Beneficiaries Assessments to support the conclusion about the relative homogeneity of various affected indigenous groups. It is the Panel's view that a more thorough treatment of the extent to which different communities rely on alternative livelihood sources (e.g., cash crops, gardens for home and local market, fishing, hunting), as well as maps delineating the areas inhabited by different ethno-linguistic groups, would have been helpful and appropriate.</p>

		<p>The Panel is of the view that a more thorough analysis of the characteristics of the various Project-affected ethnic groups, especially with regard to key issues affecting the Project (e.g., land tenure and inheritance, customary decision-making processes, practices regarding food gardens) should have been included in the Social and Beneficiaries Assessments before concluding that these groups were “<i>relatively homogenous</i>.” The absence of key baseline information is a shortcoming of these assessments, which the Panel finds not to be in compliance with OP 4.10.</p>
<p><b>c. Identification of Project Stakeholders and Elaboration of a Consultation Process with Indigenous Peoples</b></p>	<p>The Management Response states that a Beneficiaries Participation Framework was prepared on the basis of the Social Assessment and outlines ways in which beneficiary communities could participate throughout the Project. Aspects of this Framework have been incorporated into the Project’s design.</p> <p>Management also states that as documented in the Social Assessment and Beneficiaries Assessment, a wide range of consultations were held with oil palm smallholder households, non-oil palm communities directly affected by the Project, Local Government institutions, CBOs (including women’s and youth groups), NGOs, church groups and oil palm organizations (including oil palm</p>	<p>The Social Assessment identifies various stakeholder categories to be consulted, although not in terms of specific indigenous communities.</p> <p><b>The Panel finds that the Social and Beneficiaries Assessments elaborate a consultation process to be conducted at each stage of the Project as required by OP 4.10. However, the Panel finds that the Consultation Framework is not culturally appropriate given the shortcomings in the review of the legal and institutional framework and gathering of baseline information on indigenous communities, and therefore does not comply with OP/BP 4.10.</b></p>

	<p>growers associations).</p> <p>Management states that participation in the consultations was voluntary and the format of the consultations was culturally appropriate. All focus group discussions with oil palm smallholders and non-oil palm growing households were held in Tok Pisin.</p> <p>Management states that groups of smallholders were invited to participate in the consultations by OPIC extension officers. Focus group meetings with community groups from the two LLGs which formed part of the institutional assessment included in the Social Assessment, were arranged with the assistance of OPIC and LLG representatives (this information is based on recent communication with the consultants that carried out the Social Assessment).</p>	
<b>d. Assessment of Effects of the Project on Indigenous Peoples</b>	<p>Management states in its Response that the Borrower conducted a detailed Social Assessment and a Beneficiaries Assessment.</p>	<p><b>The Panel finds that the Social Assessment identified potential adverse and positive effects of SADP in accordance with OP/BP 4.10.</b> However, it is the Panel's view that, had the legal and institutional framework been analysed in full, including conducting and providing robust baseline information and carrying out an adequate consultation process, the identification of potential adverse and positive effects may have been more thorough.</p>
<b>e. Identification of Measures to Avoid Adverse Effects and</b>	<p>Management states that the Social Assessment documented concerns about socio-economic issues. Concerns were raised</p>	<p><b>The Panel finds that the Social Assessment does identify some measures to avoid, minimize, and mitigate adverse effects</b></p>

<p><b>Ensure that Indigenous People Receive Culturally Appropriate Benefits</b></p>	<p>about housing and water supply. Land issues were also raised but were particularly important at Popondetta where there has been a history of land disputes. The Beneficiaries Assessment consolidates the expected benefits and adverse impacts as envisioned by respondents during the consultations. The Beneficiaries Assessment also provides recommendations for maximizing benefits and mitigating adverse impacts</p>	<p><b>and to ensure that indigenous people receive culturally-appropriate benefits under the Project. However, consultations with the relevant stakeholders about the adequacy and appropriateness of the proposed Project design were not carried out in compliance with Bank policy.</b></p>
<p><b>Free, Prior and Informed Consultation</b></p> <p><b>a.</b></p> <p><b>Documentation of Consultation Process</b></p>	<p>The Management Response states that the Social Assessment and the Beneficiaries Assessment thoroughly document the findings of the consultations that were held. Management recognizes, however, that there was insufficient documentation of the consultation process in the Social Assessment and that the Social Assessment report does not discuss what information was systematically shared with participants during various consultations, how information was conveyed or how locations and participants were selected.</p> <p>Furthermore, Management acknowledges that the requirements of OP 4.01 were not fully met, in that the only information shared with stakeholders during consultations for the EA was in verbal form.</p>	<p>Although the Beneficiaries Assessment proposes a framework, which is also included as an annex in the Project Implementation Manual (PIM) that emphasizes the importance of consultation including with smallholders at each stage of project preparation and implementation, the Panel could not find evidence that such a framework was elaborated on and applied at each stage of Project preparation and implementation.</p> <p>For example, according to the PAD, the Project intended originally to include both oil palm infilling and replanting but there was a shift resulting in exclusive support for infilling. The Panel finds no record of consultation concerning the Project's removal of replanting as a component, despite the apparent interest in replanting expressed by the groups consulted early on in the Project cycle.</p> <p><b>The Panel finds that the</b></p>

		absence of consultation with smallholders on the change in Project design signified by the shift in Project emphasis from both infilling and replanting to only infilling, did not comply with OP 4.10.
<b>b. Consultation with Customary Leaders</b>	The Management Response states that including entire communities in consultations was not practical, therefore GoPNG sought to consult extensively with community members and with organizations representative of diverse community interests. The majority of consultations occurred within the Project area, defined as the districts where Project activities would occur.	<b>The Panel could not find evidence in Project documents that the consultations, when conducted, specifically sought the input of clan leaders other than the ones represented in the modern leadership groups (particularly Local Level Groups).</b>
<b>c. Sharing of Information in Appropriate Form and Language</b>	Management acknowledges that the only information shared with stakeholders during consultations for the Environmental Assessment was in verbal form. The consultations with smallholders were held in Tok Pisin and no Project documents were translated into Tok Pisin. However, English language documents were subsequently disclosed in PNG in February 2007.	<p><b>The Panel finds that none of the documentation associated with the Environmental Assessment indicates whether any relevant material was provided in a timely manner prior to consultation and in a form and language understandable and accessible to the groups being consulted, as required by OP 4.01.</b></p> <p><b>Furthermore, while the EA and related documentation were publicly disclosed in Port Moresby and Washington on February 22, 2007, and while formal notification to the public announcing where the documents were disclosed was published by OPIC in the press on the same day, the documents were made available only in English, and not in a form and language understandable and accessible</b></p>

		<p>to the groups being consulted. This does not comply with the free, prior, and informed consultation requirement of OP/BP 4.10.</p> <p>The Panel thus finds significant shortcomings in the consultation process. In particular, Management failed to provide relevant information prior to consultations in a culturally appropriate manner, form, and language. This does not comply with OP 4.10 and OP 4.01.</p>
<b>Evidence of Broad Community Support</b>	<p>It is Management's view that free, prior and informed consultations were undertaken during Project preparation and that broad community support for the Project exists in the Project areas.</p> <p>Management states that the Borrower conducted a detailed Social Assessment and a Beneficiaries Assessment. As documented in these reports, numerous consultations were held to inform the assessments and to elicit feedback from key stakeholders on various Project design choices and activities. Based on a review of these documents, and the consultations undertaken by the Bank during the long identification and preparation phase of this Project, the Bank ascertained that the Borrower had obtained broad community support.</p> <p>Management states that the policy's references to <i>"free, prior and informed</i></p>	<p>The Panel was unable to find in Project documents, including the Social and Beneficiaries Assessments, any information documenting how broad community support was reached. The Panel finds that this is not in compliance with OP 4.10.</p>

	<p><i>consultation” and “broad community support” are not meant to require unanimity of views or to condition a Bank project on the receipt of consent from <u>all</u> affected individuals or groups.</i></p>	
<b>Poverty and Livelihood Impacts</b>		
<b>Poverty Reduction</b>	<p>The Project is designed to contribute to poverty reduction in the three Project areas through multiple pathways including: (a) road improvements; (b) raising household incomes of smallholders growing oil palm (on existing oil palm blocks) through improved productivity and lower marketing costs; (c) raising incomes of smallholders planting new oil palm through infilling; (iv) strengthening various sector initiatives focused on improving smallholder welfare (such as the MLFS); and (v) improving access to critical social and economic infrastructure under Component 2 of the Project.</p>	<p><b>The Panel finds that the Project aims at increasing the income of smallholders and thus complies with Bank Policy on Poverty Reduction OP 1.00.</b></p>
<b>Economic Assessment and Analysis of Profitability</b>	<p>A robust economic and financial analysis for the Project was undertaken as part of preparation. The overall Project ERR was estimated to be 16.7 percent. Further, the analysis indicated that FRRs to smallholders participating in the infilling activities ranged between 22 percent and 27 percent, depending on the Project area, which represented a considerably higher rate of return compared to other alternative investments.</p>	<p><b>It is the Panel’s view that the Project design should have made provisions to respond to the differences among the Project areas, so that the smallholders receive appropriate economic, social, and cultural benefits from the Project. The Panel finds this not to be in compliance with OMS 2.20 and OP/BP 4.10.</b></p> <p><b>Considering the decades of work supported by the Bank in the oil palm sector in Papua New Guinea, in partnership with oil palm companies, and the companies’ important role</b></p>

		<p>in implementing the Project and their direct impact on smallholder income, the Panel finds that Management did not conduct appropriate due diligence of the companies' institutional and financial viability. The Panel finds this not to be in compliance with OMS 2.20 and OP/BP 10.04.</p>
<p><b>Improving Livelihoods: Savings and Income Diversification</b></p>	<p>Management believes strongly that the Project does not limit economic choices.</p> <p>Existing data indicate that the livelihoods of oil palm smallholders in the three SADP Project areas are quite diversified and a range of different activities contribute to household incomes for oil palm smallholders. The SADP will support further diversification through investments in improving rural roads and through Component 2 of the Project (Local Governance and Community Participation).</p> <p>Management states that oil palm smallholders are better off compared to most other farmers, as the milling companies supply smallholders with farm inputs such as seedlings, fertilizer and tools on credit. The Project does not in any way force small holders who wish to access loans for other agricultural purposes to be driven into growing oil palm. Participation in infill planting under the SADP is completely demand driven and whether or not VOP smallholders decide to participate in infilling is entirely up to them, as long as their</p>	<p>Savings and income diversification are key measures for avoiding potentially adverse effects on the indigenous communities--as recommended in the Social Assessment.</p> <p><b>Since the Project did not incorporate measures recommended in the Social Assessment aimed at avoiding and mitigating adverse impacts on indigenous smallholders growing oil palm, the Panel finds that Management did not comply with OP/BP 4.10.</b></p>

	<p>blocks meet the various social and environmental screening criteria for infill planting. Smallholders themselves hold local knowledge on oil palm, specifically the possible returns and family labor requirements as oil palm has been part of the landscape for decades. In deciding whether or not to grow oil palm, smallholders have access to local re-sources that can reasonably inform their choices.</p> <p>While intercropping is not currently practiced on oil palm blocks in PNG, mono cropping does not necessarily limit opportunities to diversify household income. In VOP areas, data indicate that perhaps as many as two-thirds of households grow other cash crops including coffee, cocoa, copra and vanilla, depending on the area. LSS smallholders, who are usually more land constrained, have tended to diversify into small businesses and to seek off farm employment.</p>	
<b>Environmental Impacts</b>		
<b>Adequacy of the Environmental Assessment</b>	<p>Management states that the EA, EMP and ESMF identify the potential environmental impacts of the Project and include appropriate and effective mitigation strategies for these. The EA provides data on the volume of effluents and the amount of effluent that is treated and discharged. In the EA, a judgment was made that ISO14001 certification provided assurances of the integrity of milling company environmental</p>	<p>The Panel did not identify any unreliable sources in the Environmental Assessment, as the Requesters claimed, nor did it receive from the Requesters any specific examples of such sources. Through a provision for biannual independent environmental and social audits added to the PIM, Management has also opened itself up to constructive comment from stakeholders.</p> <p><b>The Panel finds that the</b></p>

	management practices and associated controls. In light of the current Request, however, Management agrees that a more comprehensive analysis of the impacts of increased production at the oil palm mills and effluents should have been undertaken.	<b>inclusion of environmental management and mitigation tools and the reliability of sources used in the Environmental Assessment comply with OP 4.01.</b>
<b>“Infilling” versus “Expansion” and its Consequences</b>	Management states in its response that the terminology of infill planting has been used consistently in all Project documentation to refer to planting of oil palm along existing access roads in PNG’s three largest NES. It is very clear from all the Project documentation that the SADP will support an expansion in oil palm area of up to 9,000 hectares on smallholder VOP blocks. The average infill block is about two hectares in size. The terminology of infilling was used to clarify that there will be no expansion of oil palm area beyond that already covered by existing access roads in the three NES areas. Infilling improves overall production efficiency by maximizing use of existing infrastructure and increasing delivery of FFB in existing oil palm scheme areas. Infilling responds to smallholder demand and enables consolidation of production in an existing oil palm scheme area thereby avoiding the potential environmental impacts associated with developing new scheme areas for oil palm production.	<p><b>It is the view of the Panel that the term infilling has not been used by Management to deliberately obfuscate oil palm expansion.</b></p> <p>The Panel notes the Requesters’ concern is not only about the environmental impact of infill planting but also its livelihood impacts if infill blocks were developed in areas that “<i>provide economic and social services</i>”. The revised Infill Planting Approval Form of May 2011, however, does not allow conversion of subsistence gardens into infill blocks if these gardens are the only ones available to the applicant.</p>
<b>Land Erosion,</b>	<b>The Management Response</b>	<b>The Panel finds that the</b>

<b>Topsoil Depletion and Siltation</b>	states that the EA, EMP and ESMF identify the potential environmental impacts of the Project and include appropriate and effective mitigation strategies for these.	<b>Project includes mitigation measures related to land erosion, topsoil depletion, and siltation and complies with OP 4.01.</b>
<b>Chemical and Biological Pollution of Waterways</b>	<p>Management agrees that there was insufficient detail in the EA on the matter of effluents. In addition to monitoring of milling company ISO14001 and RPSO certification, a thorough analysis of the impact of increased effluents due to Project activities will be undertaken.</p> <p>In light of the current Request, however, Management agrees that a more comprehensive analysis of the impacts of increased production at the oil palm mills and effluents should have been undertaken.</p>	<p><b>It is the Panel's view that Management recognizes the potential for chemical pollution associated with oil palm development and has taken all reasonable steps in the design of the Project to ensure that any adverse impacts from fertilizer runoff are minimized. The Panel finds that these measures comply with OP 4.01.</b></p> <p><b>The Panel agrees with Management's view that the lack of adequate analysis of impacts from mill effluent does not comply with OP 4.01. The Panel notes and appreciates that the Agreed Action Plan provided in the Effluent Study addresses the issue of potential negative effects from mill effluent and, when implemented, could bring the Project into compliance with OP 4.01. Given the challenges in implementing environmental regulations in Papua New Guinea, as noted in the Effluent Study, the Panel notes that Management should have undertaken the study much sooner.</b></p>
<b>Risk of Deforestation of High Conservation Value Forests</b>	No significant conversion or degradation of critical forest areas or related critical natural habitats is planned under the Project, and in Management's	<b>The Panel finds that the Project's approach in its design to building the capacity of OPIC extension staff conforms to the requirements</b>

	<p>view the Project includes adequate measures (consistent with OP/BP 4.36) to minimize and manage risks of deforestation of areas of high conservation value. The Project also incorporates measures to avoid risks to critical habitats in line with the requirements of OP/BP 4.04.</p> <p>Adequate provisions have been made in the Project to ensure OPIC's capacity is strengthened, including with regard to its capacity to implement the EMP, which is designed to ensure that the SADP complies fully with the requirements of environmental and conservation legislation in PNG and with the Bank's environmental safeguards.</p>	<p><b>of OP 4.04 on Natural Habitats.</b></p> <p><b>It is the Panel's view that Management did not fully comply with OP/BP 4.36 in ensuring that the Borrower provided the Bank with an assessment of the adequacy of land use allocations for the management, conservation, and sustainable development of forests which includes an inventory of critical forest areas. Nevertheless, Management has included measures in the Project to prevent conversion or degradation of critical forest areas or related critical habitats; the Panel finds Management to be in compliance with the objective of OP/BP 4.36 in this respect.</b></p>
<b>Institutional Sustainability</b>		
<b>Road Maintenance Trust Fund (RMTF)</b>	<p>Sustainability is a priority in the SADP as reflected in Project design. The proposed RMTF to be established under the Project will ensure sustainability of the investments made in road reconstruction in the Project areas.</p> <p>The SADP was part of a QAG learning review in 2008. Overall the assessment of quality at entry was favorable. The review did note, however, that some aspects of Project design would have benefited from more complete preparation, mentioning in particular the RMTFs, QAG also noted that the preparation time was accelerated due to the window of opportunity to resume lending in PNG.</p>	<p><b>The Panel finds that Management failed to comply with OMS 2.20 by leaving the design of this essential element of the Project, critical to ensuring the achievement of Project objectives, to the Project's implementation.</b></p> <p><b>The Panel finds that Management's proposal of 25% contribution by the smallholders to the RMTF was arrived at without fully assessing smallholders' ability to pay, and most importantly without consultation with the smallholders.</b></p>

	<p>Management agrees that there could have been broader consultation on the road maintenance levy within the grower community during preparation. However, Management notes that further consultations are planned as part of the RMTF design study.</p>	
<b>OPIC Extension Activities</b>	<p>Management believes that there was adequate attention to poverty reduction and sustainability in the Project's design.</p> <p>Management also believes that there has been due diligence in Project supervision.</p> <p>Management states that the PAD recognized that OPIC's extension capacity needed to be improved and funds are allocated under the Project to strengthen this capacity.</p> <p>The Project design also addresses the importance of enhancing the quality, effectiveness and sustainability of research and extension services for the smallholder oil palm sector.</p> <p>The Management response also states that expectations are that an overall increase in smallholder production through more accessible roads, improved extension services, infilling and yield increases under the SADP, combined with the extensive program of smallholder oil palm replanting that the oil palm milling companies are</p>	<p><b>The Panel appreciates that, within the limits of Management's staffing structure in support of this Project, Management complied with the requirements of OP 13.05 on Project Supervision, paragraph 2b, namely, <i>"Identify problems promptly as they arise during implementation and recommend to the borrower ways to resolve them."</i></b></p> <p>However, as the Bank shifts from supervision to "implementation support", it becomes even more incumbent upon Management to increase its own capacity to promptly identify problems with a view towards their early resolution, especially in situations where there are major capacity issues in the main implementing agency.</p>

undertaking, will generate a substantial increase in FFB production and in the associated OPIC levies of K4 per FFB. This will in turn enhance the sustainability of the existing OPIC service system.

## ANNEX 2: SADP TIMELINE

<b>2002</b>	<i>Nov. 18 - 29, 2002</i>	<i>Identification mission</i>
<b>2003</b>	Mar. 4 – Apr. 4, 2003	Detailed identification mission
	June 25, 2003	Concept note review meeting
	July 17, 2003	PID and ISDS to InfoShop
<b>2006</b>	<i>Apr. 25 – May 26, 2006</i>	<i>Preparation mission</i>
	Oct. 23 – Nov. 16, 2006	Pre-appraisal mission
<b>2007</b>	Jan. 28 – Feb. 28, 2007	Appraisal mission
	Feb. 22, 2007	Decision meeting, authorization of negotiations
	<i>Feb. 23, 2007</i>	<i>Begin appraisal</i>
	Mar. 1, 2007	Updated PID to InfoShop
	Apr. 30, 2007	Begin negotiations
	May 16, 2007	Updated ISDS to InfoShop
	May 17, 2007	Environmental assessment received by InfoShop
	Oct. 10, 2007	Conclusion of negotiations
	<i>Dec. 18, 2007</i>	<i>Board approval of credit</i>
<b>2008</b>	July 9, 2008	Signing of Financing Agreement and Project Agreement
<b>2009</b>	<i>Jan. 28, 2009</i>	<i>Project effectiveness</i>
	March 5 - 19, 2009	Project launch mission
	Sept. 17 – Oct. 7, 2009	Supervision mission
	<i>Dec. 17, 2009</i>	<i>Request for Inspection Registered by Inspection Panel</i>
<b>2010</b>	March 15 - 31, 2010	Implementation Support Mission
	<i>March 25, 2010</i>	<i>Board of Executive Directors approve investigation</i>
	Sept. 20 – Oct. 7, 2010	Mid-term Review Mission
<b>2011</b>	Apr. 15 – 19, 2011	Implementation Support Mission

### Applying World Bank Safeguards and IFC Performance Standards: A Good Practice Note for WBG Staff<sup>a</sup>

In 2011 the World Bank Group (WBG) completed a review of the palm oil sector and lessons learned from WBG investments in palm oil. The review was catalyzed by stakeholder concerns regarding negative environmental and social impacts of the sector together with recognition of the recent rapid expansion in the sector and the potential for developmental benefits, particularly for the rural poor.

Stakeholders highlighted concerns regarding good governance, land tenure, deforestation and biodiversity loss, smallholder inclusion, and productivity differentials; but also the sector's ability to boost economies, improve food security and create jobs. While perspectives on preconditions for reengagement differed, there was a clear view that the WBG could and should play a positive role in promoting sustainability in the sector.

As a result, and responding to requests from counterparts, the WBG has determined that a qualified reengagement in the sector would enable the Group to support palm oil cultivation that is sustainable, that benefits the poor, and does not degrade the environment.

This note provides advice to staff in the application of the existing, extensive social and environmental safeguards and performance standards to activities in the palm oil sector. The intention is to facilitate decision making and encourage good practice.

**Approach:** All projects will be subject to the following: (i) a Joint WB-IFC early assessment to identify opportunities and challenges in the sector (Country Situation Analysis); (ii) identification of opportunities for joint WB-IFC engagement; and (iii) for IFC projects, application of the Risk Screening and Assessment Tool.

**Applicable policies:** As in all World Bank operations, the Bank's environment, social and legal safeguard policies and consultation processes apply, or where an IFC project is under development, IFC performance standards apply. The following criteria are intended to assist staff in the application of existing policies to palm oil projects.

All projects will be consistent with appropriate national policy, legal and regulatory mechanisms. And as appropriate, capacity

building to strengthen accountability mechanisms will be a priority.

**Criterion 1.** There are demonstrated economic benefits for poor rural populations: the WB will give priority to projects that benefit smallholders and to rehabilitation of existing degraded plantations (and degraded plantations of other tree crops which are being converted to oil palm) that benefit smallholders and new smallholder groves; IFC will support plantations and companies in the supply chain that benefit rural communities while giving priority to projects that also benefit smallholders and that use degraded lands.

Impact: increased incomes from palm oil production, marketing or processing, smallholder organizations strengthened.

Monitoring indicators: increase in employment; increase in incomes; increase in value added; increase in productivity; benefits for local communities; evidence of smallholder empowerment.

**Criterion 2.** Smallholders and palm oil companies have recognized land use rights for oil palm and WB supports documentation and arbitration processes where appropriate.

Impact: transparent land use rights improve enabling environment for investments, access to financial services and further livelihood enhancement.

Monitoring indicators: land title or user rights documentation; investments sustained; increase in access to financial services; arbitration processes successfully followed.

**Criterion 3.** Direct impacts of oil palm development on natural and/or critical habitats are limited. When possible alternative scenarios have been explored and impacts are unavoidable, mitigation measures are put in place. Priority will be given to rehabilitating existing plantations to enhance their productivity. In the event that projects support the establishment of new plantations, priority would be given to plantations that are developed on degraded lands. Palm oil plantations that result in significant conversion or degradation of high carbon stock or high conservation value habitats will be avoided.

Monitoring indicators: land and vegetation maps and surveys, productivity data.

**Criterion 4.** In addition, where significant quantities of palm oil are exported, systems of traceability and certification are in place; where they are not, support is provided for the development of appropriate accountability systems, and for the WB, investment is limited to smallholder programs.

Impact: Systems are in place (or under development) and independently monitored; products are eligible for purchase by organizations with requirements on sustainability.

Monitoring indicators: systems in place (or under development) and independently monitored.

<sup>a</sup>This Annex is taken from *The World Bank Group Framework and IFC Strategy for Engagement in the Palm Oil Sector, March 31, 2011, p. 66.*, available at:  
[http://intresources.worldbank.org/INTARD/Resources/PalmOil\\_strategy\\_eng.pdf](http://intresources.worldbank.org/INTARD/Resources/PalmOil_strategy_eng.pdf)

## Annex 4

### Biographies

#### Panel Members

**Mr. Roberto Lenton** (Argentina) was appointed to the Panel in September 2007 and became its chair in November 2009. He earned a civil engineering degree from the University of Buenos Aires and a Ph.D. from the Massachusetts Institute of Technology (MIT). A specialist in water resources and sustainable development with more than 30 years of international experience in the field, he serves as chair of the Water Supply and Sanitation Collaborative Council and member of the board of directors of WaterAid America, and served until July 2009 as chair of the technical committee of the Global Water Partnership. Mr. Lenton is a coauthor of *Applied Water Resources Systems* and coeditor of —Integrated Water Resources Management in Practice,<sup>ll</sup> and a lead author of *Health, Dignity and Development: What Will it Take?*, the final report of the United Nations Millennium Project Task Force on Water and Sanitation, which he co-chaired. Earlier, Mr. Lenton was director of the Sustainable Energy and Environment Division of the United Nations Development Programme in New York, director general of the International Water Management Institute in Sri Lanka, and program officer in the Rural Poverty and Resources program of the Ford Foundation in New Delhi and New York. He has served as adjunct professor in the School of International and Public Affairs at Columbia University and assistant professor of civil and environmental engineering at MIT.

**Mr. Alf Jerve** (Norway) was appointed to the Panel in November 2008. Mr. Jerve brings to the Panel close to three decades of work in the field of development. A social anthropologist by training, he has been engaged in a wide range of development activities, including extensive field research in Africa and Asia. Among his assignments was a three-year posting to Tanzania with the Norwegian Agency for Development Cooperation as coordinator of a rural development program. From 1993 to 1995, he was responsible for resettlement and rehabilitation issues with projects in Bangladesh during an assignment with the World Bank. In 1995, he became Assistant Director, and served as Director in 2005 and 2006, at the Christian Michelsen Institute in Norway, an internationally recognized development research institution, where he has also devoted his energies and expertise to research and analysis of a wide variety of policy and program issues affecting people in developing countries. Over the years, Mr. Jerve has led and participated in numerous independent evaluations commissioned by bilateral and multilateral development agencies, and served as a member of the Roster of Experts for the Asian Development Bank's Inspection Function. He earned his magister degree in social anthropology from the University of Bergen, and his bachelor's degree is in the areas of environmental science and biology. His publications have focused on rural development, decentralization, and poverty reduction and most recently on issues of ownership in development aid cooperation.

**Ms. Eimi Watanabe** (Japan) was appointed to the Inspection Panel on November 1, 2009. Throughout her career, Ms. Watanabe has demonstrated a commitment to applying analytical as well as participatory approaches to development programs, and a strong track record of working collaboratively with civil society organizations, governments, and other development organizations. A sociologist by training, she has been involved in a wide range of substantive

areas, at both the project and policy levels, including poverty reduction, governance, gender, child health and nutrition, capacity development, environment, and international migration. Ms. Watanabe earned a M.Sc. and Ph.D. from the London School of Economics and received a B.A. in sociology from the International Christian University in Tokyo. From 1998 to 2001, she served as assistant secretary general and director of the United Nations Development Programme (UNDP) Bureau for Development Policy. Prior to that, she was UN resident coordinator and UNDP resident representative in Bangladesh, and UNICEF Representative in India. Recently she has served as a member of the Strategic and Audit Advisory Committee of the United Nations Office for Project Services. Ms. Watanabe brings to the Panel more than 30 years of experience in the field of development.

### **Expert Consultants**

**Bruce Carrad** ([brucecarrad@gmail.com](mailto:brucecarrad@gmail.com)) is an economist and agribusiness specialist who lived in Papua New Guinea from 1978 to 1986, and more recently from mid 2008 to December 2009. Between these periods he was Director of Evaluation Section at AusAID; Director, Agricultural Development Services (a Southeast Asia based consultancy and business management firm specializing in agricultural commodities, including oil palm); and held various positions as a staff member at the Asian Development Bank from 1994 to retirement in 2007, including 3 years based in Beijing, China. Mr. Carrad was a member of an expert panel for a recent CAO compliance audit of IFC's lending to Wilmar International, one of the world's largest palm oil traders and processors. He is currently based in Hanoi, Vietnam and is working on livelihoods development for poor and mostly ethnic minority communities in the Northern Mountains region.

**Donald Allan Gilmour** ([don.gil@bigpond.com](mailto:don.gil@bigpond.com)) holds a PhD from James Cook University of North Queensland and a MSc from the Australian National University. He currently works as a private consultant, and has extensive work experience in developing countries, mainly in Asia and Africa. He was Head of the Forest Conservation Programme of IUCN, the International Union for the Conservation of Nature, based in Switzerland during the mid-1990s; he spent eight years in Nepal working on a community forestry project in the 1980s, and he has 18 years previous experience in forestry education and forest hydrology research in the wet tropics of northern Australia. He was a founding member, Vice Chair and Chair of the Board of Trustees of the Center for People and Forests (RECOFTC) in Bangkok. He is a member of several of IUCN's scientific commissions (on ecosystem management, environmental economics and social policy and protected areas). He is also a member of the editorial advisory boards of two scientific journals. Dr Gilmour has authored or co-authored several books and monographs on community forestry, forest rehabilitation and forest hydrology, and is author/co-author of more than 150 other scholarly publications covering a range of policy and practical aspects of forestry and land management.

**Lesley Potter** ([lesley.potter@anu.edu.au](mailto:lesley.potter@anu.edu.au)) is a Human Geographer by profession and a specialist in smallholder agriculture. Her career spans four decades of work in developing countries, particularly Indonesia, Malaysia and Guyana. She has undertaken extensive academic research and has been involved in consulting for a range of international development agencies. She has had experience in academic teaching and training in Guyana, Singapore, New Zealand and Australia. Her most recent academic positions have been at the University of Adelaide and the

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**Paul Michael Taylor** ([halmahera@gmail.com](mailto:halmahera@gmail.com)) holds a Ph.D. in Anthropology from Yale University, 1980. Mr. Taylor is a cultural anthropologist based in Arlington, Virginia. He served while on leave from his position as research anthropologist and Director of the Asian Cultural History Program (Department of Anthropology), Smithsonian Institution. He has produced seven books and numerous other scholarly publications on the ethnography, ethnobiology, and languages of Asia and the Pacific; he has also curated eighteen museum exhibitions and served as the Director of Ethnographic Film Development for twelve ethnographic films. The recipient of numerous international grants and awards, he has served on the Board of Directors of the Association for Asian Studies, and currently serves on the Advisory Board of the US-Indonesia Society. His research on rural social and ecological issues has included living for over three years in rural village or tribal communities of Southeast Asia (including western New Guinea). Dr. Taylor also served as consultant for social and resettlement issues for previous Inspection Panel investigations in China, Paraguay/Argentina, Cambodia, and the Democratic Republic of Congo.