

**Report No. 53280-PG.**

**The Inspection Panel**



**Report and Recommendation**

**PAPUA NEW GUINEA:  
Smallholder Agriculture  
Development Project (SADP)  
(IDA Credit No. 43740-PNG)**

**March 10, 2010**

**The Inspection Panel**  
**Report and Recommendation**

**On**

**Request for Inspection**

**Re: INDEPENDENT STATE OF PAPUA NEW GUINEA: Smallholder Agriculture  
Development Project (IDA Credit No. 43740-PNG)**

**A. BACKGROUND**

1. On December 8, 2009, the Inspection Panel (the “Panel”) received a Request for Inspection (the “Request”) related to the Papua New Guinea: Smallholder Agriculture Development Project (the “Project” or SADP) financed by the International Development Association (IDA).<sup>1</sup> The Request was submitted by the Center for Environmental Law and Community Rights (CELCOR), an NGO from Papua New Guinea (PNG), acting as a representative of the Ahora/Kakandetta Pressure Group, affected customary land owners from the Oro Province and affected smallholders in one of the three Project areas (the “Requesters”). The Requesters state that they have suffered, and are likely to suffer, serious harm from the design and implementation of the Project. The Requesters have asked that their identities be kept confidential and that CELCOR act as their designated representative.
2. The Panel registered the Request on December 17, 2009; Management received an extension from IDA’s Board of Executive Directors and submitted its response (the “Management Response”) on February 8, 2010.
3. As provided in paragraph 19 of the 1993 Resolution establishing the Inspection Panel (the “1993 Resolution”),<sup>2</sup> the purpose of this report is to determine the eligibility of the Request and make a recommendation to the Executive Directors as to whether the matters alleged in the Request should be investigated.

**B. 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 “in-filling”<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 three areas in Oro and West New Britain (WNB) provinces over five years.<sup>4</sup>

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<sup>1</sup> For the purpose of this Report, IDA is sometimes referred to as “the Bank”.

<sup>2</sup> International Development Association, Resolution No. IDA 93-6, dated September 22, 1993 (the “1993 Resolution”).

<sup>3</sup> Infilling refers to new blocks of oil palm being planted between established blocks of oil palm along existing access roads in the Nucleus Estate Scheme (NES) areas.

<sup>4</sup> Project Appraisal Document (PAD), Report No: 38558-PNG, dated November 19, 2007, p.3.

5. According to the Financing Agreement, the Project 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>
6. These objectives are to be achieved through three components:<sup>6</sup>
- **Component 1: Smallholder Productivity Enhancement (US\$18.9 million IDA).** This component supports: (a) smallholder oil palm development on 9000 hectares (ha) of vacant land along existing access roads through infilling; (b) upgrade 550 kms of existing roads and establish Road Maintenance Trust Funds (RMTF) in the three project areas; and (c) provide agricultural extension services through the Oil Palm Industry Corporation (OPIC).
  - **Component 2: Local Governance and Community Participation (US\$3 million IDA).** This pilot component supports the improved 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 (US\$5.6 million IDA).** This component supports OPIC’s efforts aimed at overall Project management by strengthening its capacity and improving its ability to provide extension services to growers, assisting it to contract a management agency responsible for implementing Component 2, and the strengthening of the smallholder oil palm sector (growers associations and PNG Oil Palm Research Association), and the financing of studies (Fresh Fruit Bunch<sup>7</sup> price formula review and design of RMTFs<sup>8</sup>) and overseas master courses.
7. The total Project cost is US\$ 68.8 million with IDA financing US\$ 27.5 million, which is equivalent to Special Drawing Rights (SDR) 17.7 million. Co-financiers of the Project are the PNG Sustainable Development Program (PNGSDP) providing US\$ 10.2 million, the Provincial Government of West New Britain Province providing US\$ 7.2 million, the Provincial Government of Oro Province providing US\$ 3.5 million, Palm Oil Milling Companies providing US\$ 5.7 million, and Smallholders<sup>9</sup> providing US\$ 7.3 million.<sup>10</sup>
8. The IDA Credit was approved by the IDA Board of Directors on December 18, 2007 and became effective on January 28, 2009. The expected Project Closing Date is December 31, 2012. According to the Management Response, the delay in initiating Project activities is due to delays in signing the Credit, achieving effectiveness and starting implementation.

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<sup>5</sup> Financing Agreement (Smallholder Agriculture Development Project) between Independent State of Papua New Guinea and International Development Association, dated July 9, 2008.

<sup>6</sup> PAD, p.4.

<sup>7</sup> The Fresh Fruit Bunch (FFB) is the primary unit of measure for oil palm sales.

<sup>8</sup> The Road Maintenance Trust Fund is a user pay based funding mechanism for road maintenance.

<sup>9</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>10</sup> Management Response – Request for Inspection of the Papua New Guinea: Smallholder Agriculture Development Project (IDA 43740-PNG), February 8, 2010, p. 10

9. According to the Project Appraisal Document (PAD)<sup>11</sup>, the PNG oil palm sub-sector is based on the nucleus estate system, in which there a well-established relationship among the three entities involved - the private sector palm oil milling companies with their own plantations and mills who also provide credit, agricultural inputs, and fruit collection service to the smallholders; the smallholder growers; and the OPIC. The Project area has three oil palm development 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 where growers sign a Customary Land Usage Agreement which provides them with security of tenure and usage rights of the land on which they farm two or four ha of oil palm. LSS blocks are those where migrants from different parts of PNG have settled on blocks of approximately six ha of which some or all is devoted to oil palm.
10. The Project is to be implemented by the OPIC. A Project Steering Committee (PSC) has been established to oversee Project implementation and provide guidance on policy matters. It will be chaired by the Secretary of the Department of National Planning and Monitoring (DNPM) and will comprise 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 PNG Sustainable Development Program.

### C. THE REQUEST

11. What follows is a summary of the Request for Inspection. The Request is attached to this Report as Annex I.
12. According to the Request, the Project was identified in 2003 as a follow-up to the previous World Bank-financed PNG: 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.
13. According to the Requesters, the credit facility under the first component of the Project, which will provide loans to smallholders who wish 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*”. 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 add that the Project has identified approximately 9,000 hectares of “*vacant*” land for new planting, rather than promoting more productivity on existing blocks.
14. The Requesters identify an overarching concern with oil palm development, which in their opinion, is that oil palm production does not result in poverty reduction for smallholders. Moreover, they state that other negative impacts of oil palm production are rarely disclosed to smallholders, including (a) land clearance and associated loss of forestland, which has important implications

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<sup>11</sup> PAD, p. 19.

including for erosion, topsoil depletion, and siltation of rivers, and (b) chemical and biological pollution of waterways.

15. In particular, the Requesters identify the following sets of harm or potential harm which they claim to be caused by the Project:

- (i) **Poverty 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”*. They point to the Social Assessment 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.”* The Requesters add that the same study *“recognizes that the fall in living standards is paradoxical”* as the cash income of oil palm smallholders is considerably higher than that of other cash crop producing smallholders.

The Requesters claim that under the Project, the farmers will be unable to *“enhance their living standards”* given their *“dependent relationship”* and *“unfair revenue sharing arrangement”* with the estate mill, and that the Project will *“reinforce”* the Fresh Fruit Bunch (FFB) pricing system which, in their view, favors the milling companies over the smallholders. They also believe that promoting oil palm as the *“single primary income generating activity for Indigenous Peoples in the three project areas”* leads to mono-cropping which *“is in direct contradiction with the World Bank’s own assessments on the importance of income diversification in the smallholder areas”* and prevents smallholders from using their land for supplemental income generating activities. Moreover, they state that in addition to the multiple levies smallholders have to pay to produce oil palm, they will have to pay an *“additional levy to support the Road Maintenance Trust Fund”* 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”*.

- (ii) **Information Disclosure and Consultation.** The Requesters state that *“World Bank and project sponsor have not consulted with claimants and other locally affected communities”* and *“project 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”*. 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 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”*. The Requesters state that despite their requests, they have not been provided records of the consultations which the Bank claims it has conducted during the design phase, and that the *“lack of transparent consultation records calls into question whether there has been achievement of broad community support”* for the Project, leading them to conclude that any consultations undertaken were *“limited”* and *“did not allow for informed participation”*.

- (iii) **Project Sustainability.** The Requesters raise concerns about the sustainability of the Road Maintenance Trust Fund (RMTF) and 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 are in poor condition due to a variety of planning and construction problems. 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 Government agencies and the oil palm industry. The Requesters claim 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 and make the Project unviable.

Moreover, the Requesters add that PNG taxpayers, by paying for the roads built by the previous World Bank project, then for this Project, and finally by paying user fees, will effectively be paying for the same roads thrice. The Request states that under the previous World Bank Oro Smallholder Oil Palm Development Project *“approximately 180 km of roads were not constructed and many smallholders were left without road access.”* The Request also notes an emergency AusAid fund which was 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 km undergoing minor reconstruction.

- (iv) **Environmental Impacts.** 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. They also believe the Environmental Assessment has *“major gaps”* as it does not use reliable sources of information, lacks an assessment of effluent treatment, and does not provide mitigation measures for Project impacts on high value forests. With regards 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 the OPIC which 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 believe deforestation will occur because *“OPIC officers lack the capacity to classify forests”* correctly according to the site survey criteria and because of an incentive system which 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.

16. In summary, the Requesters claim that the Project *“violates”* several World Bank policies and will:
- (a) 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, (b) cause water pollution, (c) cause forest degradation, (d) be unsustainable and ineffective, and (e) cause additional economic hardship by requiring growers to pay for road maintenance fees.
17. The Requesters note that they have raised their concerns with the World Bank on a number of occasions, and attach 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”*.

18. Moreover, the Requesters ask 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”.
19. Based on the foregoing, the Requesters ask that the Inspection Panel conduct an investigation of the matters described in the Request for Inspection.
20. The above claims may constitute, *inter alia*, non-compliance by the Bank with various provisions of 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

#### **D. MANAGEMENT RESPONSE**

21. What follows is a brief summary of the Management Response<sup>12</sup>, a complete copy of which is attached to this Report as Annex II.
22. **Context.** According to the Management Response, the World Bank has been involved with oil palm projects in PNG since 1969 when the first WB-financed oil palm project went into effect. The WB has financed four oil palm projects prior to the SADP.<sup>13</sup> Management notes that when the World Bank re-engaged with PNG in 2005 following a two year hiatus due to the suspension of the PNG Forestry and Conservation Project (2001)<sup>14</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 PNG oil palm industry contributes significantly to the improvement of rural livelihoods, brings favorable returns to smallholders in comparison to other cash crops, and is the second highest employer in the country

<sup>12</sup>Management Response – Request for Inspection of the PNG: Smallholder Agriculture Development Project ((IDA Credit No. 4374-PNG), February 8, 2010.

<sup>13</sup> These are New Britain Smallholder Development Project 1969-1973 (Phase 1) and 1970-1976 (Phase 2); Popondetta Smallholder Oil Palm Development Project (1976-1984); Nucleus Estate and Smallholder (Milne Bay) Project (1985-1992); and, Oro Smallholder Development Project (1992-2001).

<sup>14</sup> Note on Cancelled Operation - Independent State of Papua New Guinea Forestry and Conservation Project, October 13, 2006.

after the public sector.<sup>15</sup> Moreover, palm oil (the oil derived from the fruit of the oil palm tree) is the dominant contributor to the PNG 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 PNG oil palm sector is small in global terms, at 1 percent of global output.

23. **World Bank Group Moratorium.** Management also notes that the World Bank Group<sup>16</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>17</sup> However, 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.
24. Management states that the SADP supports the Government of PNG'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>18</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. Given restrictions on the use of IDA funds prior to project effectiveness, the Project co-financier PNGSDP extended financing for the repair of 35kms of roads.
25. **Project Risk.** Management acknowledges that the Project was considered to be ambitious and "high risk" at appraisal as it sought to address the issue of poorly maintained agricultural access roads through the introduction of 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.<sup>19</sup> Moreover, though a 2008 Quality Assurance Group (QAG) review concluded that the SADP was an *"essential"* and *"appropriate"* operation for PNG, it also opined 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>20</sup>
26. **Project Status.** Management also acknowledges that the PAD *"failed to identify the risk of slow implementation start-up including the time needed to establish OPIC's project management capacity."*<sup>21</sup> 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*

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<sup>15</sup> The Management Response states that Oil Palm smallholders earn 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).

<sup>16</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>17</sup> Management Response, p. vii.

<sup>18</sup> Management Response, p. 10.

<sup>19</sup> Management Response, p. 11.

<sup>20</sup> Management Response, p. 12.

<sup>21</sup> Management Response, p. 11.



quarter of 2010.”<sup>22</sup> However, Management believes substantial progress has been made in “*Oro emergency road repair program, infilling component, mobilization of Project funds, and preparatory arrangements for OPIC capacity building.*”<sup>23</sup>

27. **Poverty Reduction.** Management believes WB investment in the oil palm sector in PNG 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>24</sup> In Management’s view, the annual income of a Village Oil Palm (VOP) grower of about Kina (K) 5,586 from a two ha 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 ha block) and provides a guaranteed income with a fortnightly harvest.<sup>25</sup> Management agrees income diversification is an important consideration and states that existing data suggests VOP households in the Project area, as opposed to LSS households that are land-constrained, already have diverse income sources which the Project will support through improved roads and Component 2.
28. 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 explains this phenomenon as primarily being the consequence of high consumptive expenditure, 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 exacerbates 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 amongst each other, makes them particularly dependent on diverse sources of income and subsistence food production.
29. 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>26</sup> will have an overall positive impact on women in particular, and on the household in general.

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<sup>22</sup> Management Response, p. 8.

<sup>23</sup> Management Response, p. 14.

<sup>24</sup> Management states the returns to oil palm at current prices are about K2,793/ha and K130/day worked, compared to about K1,136/ha and K21/day worked for cocoa and K2,058/ha and K13/day worked for coffee.

<sup>25</sup> Management Response, p. 17.

<sup>26</sup> The Mama Lus Frut Scheme (MLFS) is aimed at women in the smallholder areas. Collecting loose fruit is considered women’s work but as women would not receive money from loose fruit collection, they preferred growing and selling vegetables. The MLFS provides women with harvest nets and a payment card known as the “mama card” which records their sales proceeds and deductions. Women now have an alternate source of income through the MLFS.

30. Management also believes investment in rural access roads will have an overall positive impact as it will improve access to services such as health and education. Moreover, Component 2 of the Project, which finances small-scale community level economic infrastructure, livelihood activities, trainings, and technical assistance through grants enables communities to undertake such 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.<sup>27</sup>
31. **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>28</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, and the most recent review was carried out in 2001 by independent experts under the WB-financed Oro Smallholder Development Project. The FFB price is calculated monthly and all mill companies follow it. The farmgate price paid to smallholders deducts smallholder costs of production (including all fixed and variable costs including labor costs for land clearing, planting and maintenance, material costs including seedlings, fertilizers and equipment) and a number of levies such as the PNG Oil Palm Research Association (PNGOPRA) levy, the OPIC levy, the FFB transport costs, the Sexava levy<sup>29</sup>, 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 (where applicable).<sup>30</sup>
32. Management agrees that the FFB price formula setting should involve all stakeholders<sup>31</sup> and states that the pricing formula will be reviewed under the Project as it is likely there have been 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>32</sup>
33. **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>33</sup> Management believes improved roads will reduce costs of production because of lower transportation costs, and also enable better access to social services thereby contributing to poverty reduction. The RMTF levy, like other levies, will be deducted from smallholders prior to the farmgate price and Management believes an understanding has been reached on the principle of cost sharing (25% smallholder, 25% mill company, 50% provincial government).<sup>34</sup> Management states that *"although 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*

<sup>27</sup> Management Response, p. 21.

<sup>28</sup> Management Response, p. 21.

<sup>29</sup> The Sexava Hopper is an oil palm pest whose spread is controlled through a centralized effort by mill companies.

<sup>30</sup> Management Response, p. 22.

<sup>31</sup> Management Response, p. 62.

<sup>32</sup> Management Response, p. 22.

<sup>33</sup> Management Response, p. 66.

<sup>34</sup> Management Response, p. 30.

*improved roads will outweigh the additional incremental cost.*<sup>35</sup> Management also states that the PAD describes the general principles pertaining to the RMTFs and its design has not been finalized yet as attested by Schedule 1 of the Financing Agreement, which only refers to supporting *“the design of Road Maintenance Trust Funds.”*<sup>36</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>37</sup> once road maintenance work starts.<sup>38</sup> Management expects this study to commence in mid-2010.

**34. Free Prior and Informed Consultations (FPIC) 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>39</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 PNG 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 which, following local tradition, were informed about the Project verbally and no documentation was provided. Management believes there was, and continues to be, strong support in the Project area for the Project as documented 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>40</sup>

**35. 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>41</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>42</sup>

**36. Information Disclosure:** Management states that the *“Social Assessment, the EA, and related documentation were publicly disclosed”* in English in Port Moresby at the PNG Public Information Center (PIC) and in Washington at the InfoShop on February 22, 2007. Management believes the

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<sup>35</sup> Management Response, p. 33.

<sup>36</sup> Management Response, Footnote 25, p. 8.

<sup>37</sup> Management Response, p. 64.

<sup>38</sup> Management Response, p. 23.

<sup>39</sup> Management Response, p. 25.

<sup>40</sup> Management Response, p. 27.

<sup>41</sup> Management Response, p. 31.

<sup>42</sup> Management Response, p. 32.

disclosure of information practiced under the Project was “fully consistent with the Bank’s Policy on Disclosure of Information.”<sup>43</sup>

37. **Project Sustainability.** Management agrees project sustainability is a priority and that road maintenance leading to reliable FFB collection is key 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>44</sup> Moreover, learning from the previous Oro Project (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>45</sup> and that clear contract management mechanisms need to be in place. In Management’s view, the Project provides a remedy for this situation in the form of the Road Maintenance Trust Funds (RMTF) which will operate under the principle 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 underperformance in road maintenance.
38. 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>46</sup> According to Management, this is because only 79% of the funds allocated for rural roads and 2% of funds allocated for main roads were actually spent. Also, some of the roads financed by the Oro Project have been repaired from AusAid funds and the remaining 105 kms will be reconstructed using grant money from the PNGSDP (75 kms) and IDA funds (30 kms).
39. 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” whose task will be 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>47</sup> as “an overall increase in smallholder production through more accessible roads, improved extension services, infilling and yield increases”<sup>48</sup> will increase the associated OPIC levy of K4/FFB (four Kina per 1MT FFB per farmer).
40. 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. In Management’s view, 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 who wish to plant them.
41. **Environmental Impacts:** Management states that consultations were carried out in the Project areas and in Port Moresby as part of the environmental assessment process. Besides smallholders,

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<sup>43</sup> Management Response, p. 33.

<sup>44</sup> Management Response, p. 34.

<sup>45</sup> Ibid.

<sup>46</sup> Management Response, p. 35.

<sup>47</sup> Ibid.

<sup>48</sup> Management Response, footnote 62, p. 35.

other civil society actors and local government authorities were also consulted. However, *“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>49</sup> and that further consultations will be undertaken as part of upcoming Project activities.

42. Management agrees that *“there was insufficient detail in the EA on the matter of effluents”*<sup>50</sup> and that *“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.”*<sup>51</sup> 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 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>52</sup> And though the EA, the EMP and the 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>53</sup>
43. With regard to High Value Conservation Forest (HVCF), Management believes *“the Project’s design includes adequate measures to minimize and manage risks of deforestation of areas of high conservation value.”*<sup>54</sup> Moreover, Management states that *“no significant conversion or degradation of critical forest areas or related critical natural habitats is planned under the Project.”*<sup>55</sup> Management stresses that screening processes already in place in both Components 1 and 2, and the proposed forest and wildlife mapping, will ensure there is no negative environmental impact on forests or regenerating forests. Also, OPIC extension officers are trained in identifying HCVF, 3 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 BP4.36 (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, the PNG logging code of practice and national environmental laws will also be followed.<sup>56</sup>
44. 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.
45. **Management Response and Actions.** Management believes it has made *“diligent efforts to apply its policies and procedures and to pursue concretely its mission statement in the context of the Project”*<sup>57</sup> and that *“the Requesters’ rights or interests have not been adversely affected by a*

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<sup>49</sup> Management Response, p. 28.

<sup>50</sup> Management Response, p. 36.

<sup>51</sup> Ibid.

<sup>52</sup> Management Response, p. 7.

<sup>53</sup> Ibid.

<sup>54</sup> Ibid.

<sup>55</sup> Management Response, p. 37.

<sup>56</sup> Management Response, p. 38.

<sup>57</sup> Management Response, p. 39.

*failure of the Bank to implement its policies and procedures.*"<sup>58</sup> That said, Management notes several areas for improvement. These are:

- (i) Acknowledging that no documents were translated into local languages, the Bank will ensure that key documents are translated and made available by OPIC in the Project areas and that OPIC radio programs communicate key aspects of the Project to smallholders. Routine translation of relevant Project documents will be discussed with Government and the Bank will encourage the Borrower to have relevant translated materials made available in the Project areas by July 1, 2010.
- (ii) Management recognizes that documentation of the consultation process in the Social Assessment should have been more detailed and complete.
- (iii) Management agrees that there was insufficient detail in the EA on the matter of effluents. Based on the review, an analysis of the impact of increased effluents due to Project activities will be undertaken.

46. Management also presents several actions to address the areas highlighted for improvement. These are:

- (i) Management will ensure that inconsistencies between the PIM and the EMP are addressed and amendments to the Project documents are discussed with OPIC.
- (ii) To ensure all environmental and land-related provisions are adhered to, Management will discuss with OPIC that the OPIC environment and land officers will both sign-off on the Oil Palm Planting Approval Form.
- (iii) Measures to further strengthen the consultation process for major activities during implementation, including the demand-driven Component 2, will be discussed with OPIC.
- (iv) Management undertakes to provide inputs to OPIC to ensure: (a) the design of the RMTFs is done in a consultative way with the objective of ensuring sustainability; (b) that the process of collecting and analyzing data and revising the FFB pricing formula continues to involve smallholders, through their representatives, and OPIC as well as the milling companies; (c) that provisions in the Road Reconstruction Sub-Manual, the Environmental Management Plan and the Resettlement Policy Framework are reexamined in light of the fact that IDA will be financing some of the incomplete roads in Oro province which were previously to be financed by PNGSDP; (d) that adequate provisions are made for the independent social and environmental audits; and (e) that the grievance mechanisms under the Project are strengthened.

## **E. ELIGIBILITY**

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<sup>58</sup> Management Response, p. 40.

47. The Panel must determine whether the Request satisfies the eligibility criteria set forth in the 1993 Resolution establishing the Panel and the 1999 Clarifications,<sup>59</sup> and recommend whether the matters alleged in the Request should be investigated.
48. As part of this process, the Panel has carefully reviewed the Request and the Management Response. Moreover, Panel Member Eimi Watanabe, together with Deputy Executive Secretary Dilek Barlas and Operations Officer Mishka Zaman visited Papua New Guinea from February 16, 2010 through February 20, 2010. During its visit, the Panel team met with CELCOR, Government officials, Bank staff, and representatives of the Oil Palm Industry Corporation. 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 affected people. 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 wishes to express its appreciation to everyone mentioned above for sharing their views and exchanging information and insights with the Panel.
49. The Panel also wishes to thank the World Bank Country Office in Port Moresby for providing relevant information and assisting with logistical arrangements, and the World Bank Project team based in Sydney for visiting Port Moresby to brief the Panel team on relevant aspects of the Project.
50. The Panel is satisfied that the Request meets all of the eligibility criteria set forth in the 1993 Resolution and Paragraph 9 of the 1999 Clarifications.
51. During the visit, the Panel confirmed that the Requesters are legitimate parties under the Resolution to submit a Request for Inspection to the Inspection Panel. The Requesters are affected parties who have common interests and common concerns, and reside in the Borrower's territory. The Request therefore satisfies item (a) of the said Paragraph 9.
52. The Panel confirms that the Request "*assert[s] in substance that a serious violation by the Bank of its operational policies and procedures has or is likely to have material adverse effect upon the requesters,*" as per the requirement of Paragraph 9(b).
53. The Requesters assert that the Project, with its current design, will harm them because of the negative economic, social and environmental impacts of increasing palm oil production. They believe that the Project will limit their economic opportunities and will force them to produce oil palm even though oil palm has not, and will likely not, improve their livelihood standards. The Requesters claim that infilling activities supported under the Project will cause additional water pollution in their area and degrade forests. In addition, the Requesters assert that the Road Maintenance Trust Fund will unfairly force smallholders to pay for road maintenance leading to increased levies and reduced income and will not be sustainable.
54. The Panel confirmed that the World Bank was aware of the concerns of the Requesters considerably in advance of the Request for Inspection. The Requesters corresponded with Bank Management and met with Bank staff on several occasions prior to the submission of the Request for Inspection. However, the Requesters indicate that they are not satisfied with the response

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<sup>59</sup> Conclusions of the Board's Second Review of the Inspection Panel (the "1999 Clarifications"), April 1999.

received from Management. The Panel is therefore satisfied that the Request “*does assert that the subject matter has been brought to Management’s attention and that, in the Requesters’ view, Management has failed to respond adequately demonstrating that it has followed or is taking steps to follow the Bank’s policies and procedures.*” Hence, the Request meets the requirement of Paragraph 9(c).

55. The Panel notes that the subject matter of the Request is not related to procurement, as required by Paragraph 9(d).
56. The Credit closing date is December 31, 2012. As of the date the Request was filed, about 2.6 % of the Credit had been disbursed. The Request therefore satisfies the requirement in Paragraph 9(e) that the related Loan has not been closed or substantially disbursed.
57. Furthermore, the Panel has not previously made a recommendation on the subject matter of the Request. Therefore, the Request satisfies Paragraph 9(f).

## F. OBSERVATIONS

58. At the outset, the Panel acknowledges the significance of the Project which includes activities intended to improve community participation in local development. The Panel also acknowledges the importance of palm oil in PNG’s overall economy as a dominant contributor to the country’s agricultural foreign exchange earnings. On the other hand, the Panel would like to underscore the gravity of the claims presented by this Request, and especially of the claims related to livelihood impacts of oil palm production on the smallholders. The Panel has carefully reviewed the Management Response and other relevant Project documents, which describe the Project, the context in which it came about and the Bank’s engagement in the palm oil sector in Papua New Guinea, which dates back to 1969. The Panel appreciates Management’s acknowledgement of some weaknesses in Project preparation and its identification of steps to address the same.
59. **Poverty Impact:** During its visit to Popondetta, the Panel met with several communities that are growing oil palm.<sup>60</sup> The Panel team met with smallholders living in Village Oil Palm blocks, Land Settlement Scheme blocks, and Land Tenure Conversion (LTC) blocks. All of the smallholders that the Panel team met stated that growing oil palm has not improved their livelihoods although most of them have been involved in growing oil palm over the past 30-35 years. During its visit the Panel team observed the poor living conditions of the smallholders who live in houses built from bush materials and lack basic infrastructure such as clean water and sanitation. The Panel also observed overcrowding and large numbers of family members dependent on income from one oil palm block, which appeared to be a consequence of population increase especially in the LSS areas, with very limited option to acquire new land. The Panel was informed that these pressures are leading to disputes within the families.
60. All of the smallholders that the Panel team met complained of the multiple levies deducted from the Fresh Fruit Bunches (FFB) pricing. They claimed that such levies, together with their loan repayments, which are directly deducted from their fortnightly payments, often account for more

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<sup>60</sup> The Panel tried to meet, courtesy OPIC, with smallholders that were not signatories to the Request; however this meeting could not be held.



than 50 percent of their pay. As evidence, some of the smallholders shared their payment cards with the Panel team. The smallholders indicated that while they are dependent on the milling company for their income, there are no means for them to provide their inputs in negotiating the FFB pricing and levies applied. The Smallholders claimed that they face levies that are unilaterally introduced or increased arbitrarily. The smallholders also claimed that they do not benefit from the services for which they pay levies. Several smallholders indicated that they would rather not replant their oil palm trees, and switch to a different crop. However, they indicated that their lack of financial resources and the absence of adequate extension and support services for other cash crops prevent them from making such a switch.

61. During its visit, the Panel team also met with women in the communities who are involved in the Mama Lus Frut Scheme (MLFS), which is an important source of income for women in smallholder blocks from loose oil palm fruit collection. They noted that their income under the MLFS was at first free of levies when the MLFS was started. However, they claimed that a change was made in 2002 and deductions, similar to the levies applied on FFB pricing, were also introduced on MLFS payments. The women told the Panel team that they spend most of their income on school fees, foodstuffs, and basic household necessities. They said they feel “*hopeless*” upon learning further levies will be introduced for road maintenance under the RMTF.
62. The communities met reiterated the importance of additional measures to improve their livelihoods. They noted the importance of improvement of local infrastructure and introduction of other income generating activities, which may be addressed under Component 2 of the Project. However, the communities claimed that they had not been consulted on the kind of activities that can be financed under Component 2 and on the needs of their communities.
63. In its Response, Management notes that the oil palm industry generates significant employment and contributes substantially to rural incomes in the oil palm growing areas. However, Management acknowledges the “paradox” of relatively high cash incomes of oil palm producers but deteriorating living standards reflected by some key indicators of poverty such as housing, access to clean water and health services. According to Management, high consumptive expenditures, lack of effective savings mechanisms, social and traditional obligations of the smallholders to share their incomes with friends and relatives, as well as extreme population pressure in the LSS areas, are the factors contributing to this paradox.
64. Management in its Response, states that an update of the pricing formula is much needed, and adds that funds have been allocated under the Project to review and update the existing FFB pricing formula, which will revise the methodology and assumptions used in calculating prices and shares between the smallholders and the mills. Management Response also notes that Component 2 of the Project, which focuses on local governance and community participation, will have an impact on welfare and living standards in the Project areas. At the time of the visit, the Panel was informed that the Project is in the process of selecting the management agency for this component.
65. During its visit to Popondetta, the Panel team met with the OPIC field representatives and the management of the POPGA together with some oil palm growers. OPIC representatives showed the Panel team a list of approximately one thousand people applying for infilling credits under the Project as an indication of further demand for growing oil palm. POPGA representatives discussed the importance of the oil palm industry for the area and how it has contributed to local development and improvement in the law and order situation. The POPGA representatives

explained how past efforts with coffee and cattle and other cash crops had failed, stating that oil palm is the only crop that brings high income to the area.

66. **Environmental Impacts:** During its visit, the Panel team met with a community living downstream from the mill. The community explained to the Panel team the negative impacts of effluent discharge from palm oil on the river and streams which causes skin diseases, reduction in fish life, change in soil structure leading to lower productivity, and bad odors. The community expressed its concern with the Project which they claim will increase palm oil production and effluent discharge. The community claimed that the mill company is not complying with the Roundtable on Sustainable Palm Oil guidelines and discharges effluents at night.
67. Management, in its Response, agrees that there was insufficient detail in the Environmental Assessment on effluents and an analysis of the impact of increased effluents due to Project activities will be undertaken. Management plans to discuss the arrangements for this analysis with the Borrower during the supervision mission in March 2010.
68. The Panel noted conflicting claims raised by the Requesters and Management on the Project's impact on forests. The Requesters with whom the Panel team met in Popondetta noted their concern on the impact of the Project's infilling activities on the High Conservation Value Forests and Primary Forests. They contended that OPIC does not have sufficient capacity to implement the screening process and will be under pressure to sign off the "Oil Palm Planting Approval Form." They claimed that the possibility of growing oil palm in infilling areas will increase the pressure on the smallholders to clear more forest areas for kitchen gardens, which is essential for their food security.
69. In its Response, Management notes that the Project includes adequate measures to minimize and manage risks of deforestation of areas of high conservation value. Management indicates that a thorough screening mechanism has been put in place to ensure that no planting takes place in critical habitats and primary forest areas. Management states that some inconsistencies were identified between the Environmental Management Plan and Project Implementation Manual in the division of labor between OPIC extension officers, the environment officers and land officers, and necessary amendments will be made in Project documents to clarify the division of labor for the site sensitivity screening.
70. **Information Disclosure and Consultation:** During the Panel team's visit, the communities said that their major concern was the lack of consultation and disclosure of information in the Project area before Project approval. They believed proper consultations may have led to Project design that included financing mechanisms for alternative crops and revenue generation opportunities for the smallholders. They contend that, as in the case of RMTF, deductions are introduced on the FFB pricing without their knowledge. They claimed that they already pay high transport costs and they do not understand why they should be required to contribute the same amount to RMTF as the mill companies. Although they noted the importance of the roads for their livelihood, they felt that the percentage of contribution for RMTF allocated to smallholders is not fair.
71. The Management Response states, however, that free, prior and informed consultations had taken place during Project preparation, and that broad community support for the Project exists in the Project areas. Management states that the design of the RMTF will be finalized through a detailed design study during implementation. Management further notes that while the principle of cost

sharing between the Provincial Government (50 percent), the milling companies (25 percent) and the smallholders (25 percent) constitutes the basis of understanding reached among the parties, important aspects of the RMTF, including the level of the smallholder road levy, are still to be designed in a consultative way.

72. The Panel observed the challenging nature of consultations and information sharing, because of the variety of languages spoken among different communities, as well as the low literacy levels. In addition, some of the smallholders believe that POPGA has not been effective in representing their interests in various consultative forums.
73. **Project Sustainability:** The smallholders shared their concerns with the Panel team regarding the sustainability of the Project. They contended that the Provincial Government does not have any revenue sources to contribute its share of funds to the RMTF to ensure a sustainable road maintenance mechanism. They claim that despite the additional levy, the poor state of road maintenance will not improve. In addition, the smallholders claimed that the Project will not be sustainable due to limited institutional capacity of OPIC. They claimed that the extension services that OPIC provides are not effective as smallholders already possess that knowledge which is passed within the family. In addition, they contend that due to OPIC's poor quality of extension services the mill company is providing such services to the smallholders.
74. In its Response, Management notes that the Project includes funds to strengthen OPIC's extension capacity. As noted above, Management also notes that the design of RMTF will be done with the objective of ensuring sustainability.
75. The Panel is not in an investigation stage and according to its procedures "*will not report on the Bank's failure to comply with its policies and procedures or its resulting material adverse effect*" during its eligibility phase.<sup>61</sup> Accordingly, the Panel at this time cannot draw conclusions about the claims and events described above or their possible connection to the Project.
76. Bank Management noted in its Response that the moratorium on new public sector investments in oil palm development announced by the World Bank in November 2009, did not apply to the Project as the Project was already effective and its design addresses the multiple social and environmental concerns that have been raised with regards to the sector at large. Management indicated that the Project will be reviewed in the context of the new oil palm strategy and changes will be made if required. The Panel was informed that this Project is the only one that IBRD/IDA is currently financing in the oil palm sector.
77. The issues described above illustrate the serious nature of the claims and concerns of the smallholder oil palm growers affected by the Project. The Panel also notes that there are important questions of compliance and harm raised by the Request, and differences in the claims made by the Requesters and Management on some of the key concerns, which could only be evaluated as part of an investigation.

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<sup>61</sup> 1999 Clarifications to Panel Resolution, Paragraph 7. This paragraph further provides that "*any definitive assessment of a serious failure of the Bank that has caused material adverse effect will be done after the Panel has completed its investigation.*"

## **G. CONCLUSION**

78. The Requesters and the Request meet the eligibility criteria set forth in the Resolution that established the Inspection Panel and the 1999 Clarifications.
79. The Panel notes that there are conflicting assertions and differing views on issues of harm and compliance with policies and procedures raised in the Request for Inspection, as evidenced by the various statements made in the Request, in the Management Response, and in the Panel's meetings with affected people and with Bank staff. In order to ascertain compliance or lack thereof with Bank policies and procedures in the design and implementation of the Project, the Panel must conduct an appropriate review of all relevant facts and applicable policies and procedures. This can be done only in the course of an investigation.
80. In light of the observations noted above, the Panel recommends that an investigation be carried out on the issues raised by the Request. The Panel's investigation will also report on steps and actions taken by Management during the course of the investigation to address the issues of compliance and the concerns raised by the Requesters.