

The World Bank Group Framework and IFC Strategy for Engagement in the Palm Oil Sector

March 31, 2011



THE WORLD BANK



IFC

**International
Finance Corporation**
World Bank Group

The World Bank Group Mission

The World Bank Group mission is to:

- Fight poverty with passion and professionalism for lasting results
- Help people help themselves and their environment

And this is achieved by providing resources, sharing knowledge, building capacity, and forging partnerships in the public and private sectors.

How the World Bank Group Works

The World Bank Group (WBG) consists of the International Bank for Reconstruction and Development (IBRD), which works in middle-income and creditworthy-poorer countries; the International Development Association (IDA), which focuses on the world's poorest countries (collectively the World Bank); the International Finance Corporation (IFC), which invests and advises in support of private sector development; the Multilateral Investment Guarantee Agency (MIGA), which provides political risk insurance and guarantees to the private sector; and the International Centre for the Settlement of Investment Disputes (ICSID).

The Group's work program is broadly determined by its 187 member country shareholders, the needs and priorities of the client countries in which it operates, international conventions and agreements, and a broad community of stakeholders, including civil society and the private sector.

All WBG lending, grants, and advice are regulated by operational policies and Performance Standards.

Each WBG institution shares a common mission of fighting poverty and promoting environmentally and socially sustainable development.

How the World Bank Works

Governments, the clients of the World Bank, are the key drivers behind the strategic priority setting in Country Assistance Strategies (CASs) for low-income countries, or Country Partnership Strategies (CPSs) for middle-income countries.

The design of these strategies is led by the relevant host country government and reflects the input of a diverse range of stakeholders obtained through a formal engagement and consultation process. *Poverty Reduction Strategies* are papers that define a country's macroeconomic, structural, and social policy goals and external financing needs. CASs and CPSs lay out a selective program of WBG support for a particular country and take as a starting point the country's own long-term vision for development. They also take into account the World Bank's comparative advantages in the context of programs and projects supported by others. In practice this means that the World Bank can engage in a sector only if the government of the country requests such engagement. More information on Country Strategies and the World Bank Project Cycle can be found in Annex I.

How IFC Works

IFC fosters sustainable economic growth in developing countries by financing private sector investment, mobilizing capital in the international financial markets, and providing advisory services to businesses and governments.

IFC offers an array of financial products and services to its clients and continues to develop new financial tools that enable companies to manage risk and broaden their access to foreign and domestic capital markets. A company or entrepreneur seeking to establish a new venture or expand an existing enterprise can approach IFC directly by submitting an investment proposal. After this initial contact and a preliminary review, IFC may proceed by requesting a detailed feasibility study or business plan to determine whether or not to appraise the project. Like other private sector investors and commercial lenders, IFC seeks profitable returns, prices its finance and services in line with the market, and fully shares risks with its partners.

IFC also offers a range of advisory services in support of private sector development in developing countries. IFC's advisory work is organized into four business lines: Access to Finance, Investment Climate, Sustainable Business and Public-Private Partnerships.

The World Bank Group Framework and IFC Strategy for Engagement in the Palm Oil Sector

This Framework for Engagement is informed by and should be read together with extensive additional analysis including the following:

- *The World Development Report 2008: Agriculture for Development* that demonstrates investment in agriculture is three times more effective in raising incomes of poor people than growth generated from other sectors;

- *The World Bank Group Agricultural Action Plan FY2010-2012* that defines raising agricultural productivity especially for smallholders, linking farmers to markets, reducing risk and enhancing sustainability as fundamental for agricultural development;
- *The World Bank Group's Strategic Framework on Development and Climate Change* that provides guidance for supporting sustainable development as climate risks rise;
- *The World Bank's Gender Action Plan* that requires staff to increasingly disaggregate impacts by gender and target gender-informed design and gender-informed monitoring and evaluation; and
- The 2010 World Bank report, *Rising Global Interest in Farmland* that provides analysis and policy advice on strengthened land governance.

Implementation will also be consistent with the World Bank's Safeguards and IFC's Performance Standards.



THE WORLD BANK



IFC | **International
Finance Corporation**
World Bank Group

TABLE OF CONTENTS

EXECUTIVE SUMMARY	4
I. INTRODUCTION	9
II. THE GLOBAL CONTEXT OF PALM OIL	10
2.1. The Value of Agricultural Investment	10
2.2. The Global Significance of Palm Oil	10
2.3. Palm Oil and Other Vegetable Oils	11
2.4. Demand Outlook	13
2.5. Supply Outlook.....	13
2.6. Export Earnings.....	14
2.7. Employment and Income generation	14
2.8. Poverty Reduction	15
2.9. Food Security	15
2.10. The World Bank and IFC's Experience.....	16
III. ENVIRONMENTAL AND SOCIAL ISSUES: CONCERNS AND POSSIBLE SOLUTIONS	17
A. ENVIRONMENTAL	17
3.1. Environmental Concerns	17
3.1.1. Biodiversity	17
3.1.2. Oil Palm Production and the Emissions of Greenhouse Gases	17
3.1.3. REDD and the use of Degraded Lands.	18
3.2. Possible Solutions for Improving Environmental Outcomes of Oil Palm Expansion	19
B. SOCIAL	20
3.3. Social Concerns.....	20
3.3.1. Land Rights	20
3.3.2. Impacts on Culture and Livelihoods	20
3.3.3. Labor.....	21
3.4. Smallholders.....	21
Structure of Smallholder Relationships	21
3.5. Possible Solutions for Improving Social Impacts of Oil Palm Development.....	24
IV. WORLD BANK GROUP FRAMEWORK AND IFC STRATEGY.....	26
A. WORLD BANK GROUP FRAMEWORK	26
4.1. Pillars of the WBG Framework	26
4.1.1. Policy and Regulatory Environment.....	29
4.1.2. Mobilization of Private Sector Investment	30
4.1.3. Benefit Sharing with Smallholders and Communities	30
4.1.4. Codes of Sustainable Practice	31
4.2. Implementing the WBG Framework.....	33
4.2.1. Early Assessment	33
4.2.2. Integrated Approach.....	34



4.2.3. Good Practice Note for Staff Guidance.....	35
4.2.4. Revised Risk Screening and Assessment Tool (for IFC).....	35
4.2.5. Strengthened Collaboration with Stakeholders	35
4.2.6. Monitoring and Evaluation	35
<i>B. IFC STRATEGY</i>	39
4.3. Key elements of the IFC Strategy	39
4.4. Regional Approaches.....	40
4.5. Development Impact.....	41
4.6. IFC’s Revised Investment and Advisory Approach	42
4.7. Addressing Environmental and Social Concerns	45
4.8. IFC Engagement with Private Companies in the Palm Oil Value Chain	47
ANNEXES	50
Annex I: World Bank Country Strategies and Project Cycle.....	51
Annex II: Overview of the Consultation Process	53
Annex III: Production and Trade in Major Vegetable Oils.....	54
Annex IV: The World Bank Group’s Experience in the Palm Oil Sector	55
Annex V: Actors in the Palm Oil Sector	60
Annex VI: World Bank Safeguards Policies	64
Annex VII: Applying World Bank Safeguards and IFC Performance Standards: A Best Practice Note for WBG Staff.....	66
Annex VIII: WBG Approach to Monitoring and Evaluation	68
Annex IX: Examples of Ongoing WBG Partnerships in Support of Sustainability.....	69
Annex X: Recommendations of IFC’s Compliance Advisor/Ombudsperson and IFC’s Responses.....	71
Annex XI: Improving Livelihoods of Palm Oil Smallholders: The Role of the Private Sector ...	74
Annex XII: IFC’s Risk Screening and Assessment Tool	77
Annex XIII: IFC’s Sustainability Framework: Applications for Potential Environmental and Social Issues in Palm Oil Projects	80



LIST OF ABBREVIATIONS

BACP	Biodiversity and Agricultural Commodities Program
CAO	Compliance Advisor/Ombudsman
CAS	Country Assistance Strategy
CSA	Country Situation Analysis
CIRAD	International Cooperation Centre for Agricultural Research and Development (Centre de coopération internationale en recherche agronomique pour le développement)
CPS	Country Partnership Strategy
CSPO	Certified Sustainable Palm Oil
DOTS	Development Outcome Tracking System
E&S	Environmental and Social
ESAP	Environmental and Social Action Plan
ESMS	Environmental and Social Management System
ESRP	Environmental and Social Review Procedure
ESRS	Environmental and Social Review Summary
FEATI	Farmer Empowerment through Agricultural Technology and Information
FFB	Fresh Fruit Bunch
FI	Financial Intermediary
FIP	Forest Investment Program
FPIC	Free, Prior and Informed Consultation
GFP	Growing Forest Partnership
GHG	Greenhouse Gases
HCV	High Conservation Value
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IEG	Independent Evaluation Group
IFC	International Finance Corporation
IIED	International Institute for Environment and Development
IP	Indigenous People
NES	Nucleus Estates and Smallholders
NGO	Non-Governmental Organization
OECD	Organisation for Economic Cooperation and Development
PROFOR	Programme on Forests
PS	Performance Standard
P&C	Principles and Criteria
RSPO	Roundtable on Sustainable Palm Oil
REDD	Reducing Emissions from Deforestation and Forest Degradation
SAN	Sustainable Agriculture Network
WB	World Bank
WBG	World Bank Group
WWF	World Wildlife Fund



EXECUTIVE SUMMARY

The Global Significance of Palm Oil

The palm oil industry is an important driver for economic growth in Southeast Asia, Papua New Guinea, Central and Western Africa, and to a lesser extent tropical Latin America. Today, palm oil is the most important tropical vegetable oil in the global oils and fats industry in terms of production value and trade. The industry has played a significant role in generating employment and export earnings in key producing countries.

A key reason for palm oil's dominance in the vegetable oils market is the crop's inherent productivity and its competitive position compared to other vegetable oils. Oil palm is at least five times more productive in terms of vegetable oil per hectare than other oil bearing crops and has the lowest requirement for inputs of fuel, fertilizers and pesticides per tonne of production. About 80 percent of current world palm oil production is consumed in the form of food. Rising food demand coupled with growing demand for non-food uses is likely to sustain the continued rapid growth in demand for palm oil for the foreseeable future.

With a population increase of 11.6 percent and a 5 percent increase in per capita consumption, an additional 28 million tonnes of vegetable oils will have to be produced annually by 2020. Palm oil is well placed to meet this demand with the lowest requirement for new land. An additional 6.3 million ha would need to be planted for oil palm; in contrast if the increased demand were to be satisfied by soybean oil production, an additional 42 million hectares of land would need to be cultivated.

The palm oil sector employs an estimated 6 million people worldwide and generates more jobs per hectare than other large scale farming operations. The sector is largely driven by private sector investment and includes a large number of smallholder farmers. Smallholder farmers are involved in nearly 40 percent of Southeast Asia's area under oil palm cultivation and over 80 percent of Africa's area under oil palm cultivation. While income earned by smallholders can vary widely according to the form of engagement and market access, smallholders regularly report achieving more income from oil palm than alternative crops. This is causing increasing numbers of smallholders to enter the sector as global demand for palm oil continues to grow. Because of its extensive root system, oil palm grows well on uneven, leached

soils that are generally less well suited for growing annual crops such as cereals; there is thus less direct competition with these crops. Palm oil is also the cheapest major vegetable oil; as a result it is most commonly used by poorer households.

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.

Getting It Right

Sustainable benefits can be maximized through a policy framework that provides incentives for plantation development on non-forested lands with settled land claims and a supportive business environment. Improved spatial planning to better identify suitable land for sustainable oil palm cultivation where local people have an interest in developing palm oil plantations together with clear contractual arrangements and dispute resolution systems benefit both responsible investors and the local population. Improving the business enabling environment for developing low carbon and non-forested areas through incentives including possibly payment for environmental services under REDD+ would also enhance positive outcomes.

A focus on increasing the productivity of existing oil palm plantations, when combined with good governance, could limit pressure on expansion into forest lands, and most importantly, addressing the productivity differentials between large plantations and smallholdings could benefit the poor. Improving access to markets and finance for independent smallholders, and strengthening farmer extension services, would also deliver additional benefits to local populations. Finally, adoption of voluntary commodity-based environmental and social



standards that protect high-conservation value forests and promote equitable distribution of benefits is critical to the sustainable development of the sector.

Pause for New Analysis

It is these existing and potential benefits that motivated the WBG to invest in oil palm in the past, but a 2009 report from IFC's Compliance Advisor/Ombudsman on the handling of IFC downstream investments and concerns raised by civil society organizations on environmental and social sustainability of the sector prompted the WBG to pause new investments and reassess that engagement.

Stakeholder Review

During 2010, the WBG undertook a review of the global significance of the sector, including impacts on employment, income generation, export earnings and poverty reduction; environmental impacts including the sector's role as a driver of deforestation and contributor to greenhouse gas emissions, and the potential of the sector to bring development benefits to the rural poor and smallholders. Nine multi-stakeholder consultations reached over 2,500 stakeholders from 30 countries, and an interactive E-consultation, with participants from 51 countries, brought extensive practical expertise and additional analysis to the WBG's effort to assess the benefits and risks of the sector, and answer the question: could the WBG contribute to placing the sector on a more sustainable footing? The result is the *World Bank Group's Framework and IFC Strategy for Engagement in the Palm Oil Sector*.

A Framework for Engagement

The Framework reflects the WBG's conclusion that in light of continued growth in demand for palm oil and its comparative advantages compared to other vegetable oils, the potential to mitigate environmental and social risks, and the opportunities to deliver development benefits, there is a compelling need for concerted multi-stakeholder action to strengthen development impacts, mitigate negative consequences and build sustainability across the sector.

Broad group of actors needed to build sustainability

The palm oil sector can be viewed as a network of businesses involved in various segments of the supply chain, all working within a framework of governmental policies, laws, and regulatory systems. The government—through enhanced capacity and new forms of governance—addresses market failures, regulates

competition, and engages strategically in public-private partnerships to promote competitiveness in the agribusiness sector and further inclusion of smallholders and rural workers. Businesses in the primary supply chain include small producers (including smallholders), large multinational plantation companies, processors of the crude palm oil, manufacturers of consumer and industrial products using palm oil, and buyers, all linked by traders and transport companies. The sector also includes supporting businesses that provide a wide variety of goods and services needed by the industry, as well as industry and other associations representing the interests of groups of stakeholders. Multi-stakeholder fora, including the Roundtable on Sustainable Palm Oil (RSPO), offer opportunities for members to set principles and criteria in order to promote sustainability through certification.

Strengthening the sector as a whole, and ensuring that all of these parts work effectively together can have a significant development impact. Through collective action and partnerships among these actors, development of the sector can be scaled up and the benefits can be extended to reach more poor people and impact the wider economy.

Engagement and the World Bank Group's comparative advantage

The World Development Report 2008: Agriculture for Development demonstrated that growth originating in agriculture has been three times more effective in raising the incomes of people who are poor than growth generated from other sectors. While the WBG's investment in agriculture has increased dramatically in the last five years, estimates that US\$14 billion is required annually to meet agricultural investment needs in developing countries suggests that public sector investment alone cannot meet demand. Both public and private investments are required to boost economies and reduce poverty. Furthermore, the WBG's extensive analysis and experience of development, agricultural investments and forest management together with engagement with the private sector suggests that while with good governance, clear regulation, and recognized land tenure, large scale agriculture can deliver benefits, a focus on strengthening smallholders is critical in alleviating poverty and a focus on protecting standing forests is critical for environmental sustainability. The WBG is able to bring this broad experience of development to the palm oil sector, offer advice and share global best practice.



Four Pillars Define Re-Engagement

The World Bank Group's objective in engaging in the palm oil sector is to invest in the potential of the sector to reduce poverty by generating growth and incomes, and to contribute to food security while ensuring sustainable management of resources and the environment. While WBG strategy and work programs in individual countries are ultimately determined by host country government development priorities and private sector interest, the WBG has identified four pillars through which it could work with other stakeholders to strengthen the economic, social and environmental underpinnings of the sector.

- Policy and regulatory environment:** Issues regarding land acquisition, land tenure, and forest governance, and the rights of workers, communities, and indigenous peoples are at the root of much of the social and environmental problems in the sector. Where policies and regulations are in place, better implementation of land administration systems, land use planning, environmental impact assessment and regulations, labor regulations, and conflict resolution can assist in protecting biodiversity, mitigating climate change, protecting rights of workers and local communities. The WBG can offer advice and capacity building and share global best practice in many of these areas.
- Sustainable private sector investment:** Most investment in the palm oil sector has been undertaken by the private sector. Where government policies and regulations permit, private sector investors can ensure investment in the sector generates economic benefits in an environmentally and socially sustainable manner. The WBG can support sustainable investment by private sector actors using direct and indirect financing and advisory services.
- Benefit sharing** with smallholders and communities: palm oil can be a significant contributor to livelihood improvement and poverty reduction in many rural communities; and further promoting environmentally and socially sustainable models of oil palm development that improve the distribution of benefits to local communities and smallholders is a priority for many governments. Since 1970, large-scale agro industry has seen a transformation from more directly managed planning to more flexible methods where farmers can choose how best to engage. This approach offers real opportunities for

benefit sharing, but key questions around regulation and economies of scale continue to require further research. Integrating smallholders into growing global markets and supply chains is critical in addressing poverty. The WBG can help by identifying and scaling up inclusive business models, investing in infrastructure that enables smallholders to access markets, strengthening services to improve the productivity of smallholder farmers and developing innovative financial mechanisms to provide access to finance.

- Codes of sustainable practice:** The development, adoption, and implementation of commodity specific sustainability standards and codes of practice, including certification systems is, when accompanied by complementary regulatory requirements, an effective means for achieving sector-wide change in the industry. The WBG can support the development and accelerated adoption of such standards and practices.

A Revised Collaborative Approach to Implementation

Individual country strategies are ultimately determined by the host country government. Where a country wishes to incorporate palm oil in national strategies, the World Bank and IFC will collaborate to implement a revised approach to engagement consistent with the four interconnected pillars.

The form of engagement in individual countries will depend on country, sector and project level conditions, and host government priorities.

As in all operations, the Bank's environment, social and legal safeguard policies (see Annex VI on WB Safeguards Policies), and consultation processes apply, or where an IFC project is under development, IFC Performance Standards will apply.

Investments will be consistent with appropriate national policy, legal, and regulatory mechanisms. And, as appropriate, capacity building to strengthen regulatory and accountability mechanisms will be a priority.

The revised approach would be as follows:

- Early Assessment.** Where a country wishes to incorporate palm oil into its national strategy, interventions will be jointly assessed by World Bank and IFC country teams with external input as appropriate to identify the opportunities and challenges presented by the sector in the country concerned.



B. *Integrated Approach.* The WBG is committed to strengthening internal coordination and collaboration at the global, regional, and country levels. The early assessment would help identify opportunities for joint engagement in the sector such as joint sector analysis, country situational analysis in major producing countries or countries with potential to expand, and focused specific analytical initiatives in selected countries to pilot a more intensive effort. In designing this joint sector work, the WBG would take into account government demand, the potential to deliver global public goods, and existing knowledge products from the WBG and its partners. In addition, joint steps during the project cycle for standard WBG tasks would be mandated and joint working teams established.

C. *Good Practice Note for Staff Guidance.* In any engagement with palm oil, WBG staff will be guided by a good practice note in project selection and design that emphasizes benefits for rural communities, engagement with smallholders, limitation of development on natural habitats and systems of traceability for palm oil producers and certification (for investments in the palm oil supply chain).

D. *Risk Screening and Assessment Tool (for IFC).* In its assessment of new palm oil investments, IFC will utilize a new tailored country, sector and project risk assessment framework that takes into account the issues highlighted through the consultation process.

E. *Strengthened Collaboration* with stakeholders to mobilize investment in palm oil related research to enhance productivity, promote sustainability and benefit sharing.

F. *Monitoring and Evaluation* to enable measurement and reporting of the above priorities.

Safeguard and Performance Standards

As in all operations, the Bank's environment, social and legal safeguard policies, and consultation processes apply¹, or where an IFC project is under development, IFC Performance Standards² and WBG generic and sector-specific

¹ During the consultation calls were made for the WBG to adopt the practice of Free, Prior and Informed Consent (FPICConsent). The WBG's current approach is described in this paper. IFC is considering the adoption of FPICConsent as part of the ongoing review of its performance standards. The WB will similarly examine it during the recently initiated process of updating and consolidating its safeguard policies.

² IFC is currently revising and updating its Sustainability Framework, including the performance standards. Pending

Environmental, Health and Safety (EHS) Guidelines will apply. In addition, in accordance with its Disclosure Policy³, IFC discloses the Environmental and Social Review Summary (ESRS) and the Environmental and Social Action Plan (ESAP), which are respectively the due diligence report on the main E&S risks and impacts of the project and the key measures identified to mitigate those in a manner consistent with the Performance Standards and WBG EHS Guidelines.

The objective of these policies and standards is to prevent and mitigate undue harm to people and their environment in the development process. They provide guidelines for WBG and borrower staffs in the identification, preparation, and implementation of programs and projects. The safeguards on natural habitats and forests and Performance Standard 6 on Biodiversity Conservation and Sustainable Natural Resources Management are particularly relevant to advancing sustainable palm oil production.

On natural habitats, the World Bank promotes and supports natural habitat conservation and improved land use by financing projects designed to integrate with national and regional development, the conservation of natural habitats, and the maintenance of ecological functions.

On forests, the operational policy on forests applies to projects that (a) have or may have impacts on the health and quality of forests, (b) affect the rights and welfare of people and their level of dependence on or interaction with forests, or (c) aim to bring about changes in the management, protection, or utilization of natural forests or plantations, whether publicly, privately, or communally owned.

IFC strategy reflects the key role of the private sector

IFC has an important role to play in supporting and catalyzing sustainable private sector involvement and inclusive economic growth. IFC's strategy in the palm oil sector is driven by the broader WBG commitment to support client countries improve agriculture's contribution to food security, economic growth, incomes of the poor, and environmental and social sustainability.

approval by the Board, the revised performance standards will apply to all of IFC's projects.

³ This Policy will be renamed IFC's Access to Information Policy and, as such, will have much broader disclosure requirements which could include the ESRS, ESAP and an annual update on the ESAP's implementation progress and on the Development Outcomes Tracking System (DOTS).



As IFC is a relatively small provider of finance and advice within the sector, IFC will be best able to make a difference by (1) investing in relatively underdeveloped areas, such as in poorer countries or frontier regions, where projects will have a relatively larger positive impact (e.g., through direct employment or by supporting smallholders); (2) engaging selectively with key private sector partners throughout the industry's supply chain (producers, traders, and processors) who are able to demonstrate good management practices in environment and social sustainability and community and smallholder engagement; and (3) working with multi-stakeholder initiatives to develop voluntary industry-wide standards for sustainable development.

While interventions will be tailored to the country context, the strategy outlines IFC's approach in three major palm producing regions – East Asia and the Pacific Islands, Africa (West Africa Sub-region), and Latin America – and its approach for engaging with companies in the palm oil value chain.

East Asia and Pacific Islands

- Support multi-stakeholder-led development of industry-wide voluntary standards for sustainable investments (complementing possible engagement by the World Bank with governments);
- Support industry-wide and firm-level efforts to further engage with and support smallholders; and
- Selectively support companies in the palm oil value chain that commit to adopting industry good management practices for environmental and social performance.

Africa (West Africa Sub-region)

- Support private investments that foster economic growth and that benefit local communities (ideally in parallel with World Bank support for policy and regulatory support for governments);
- Support industry-wide and firm-level efforts to further engage with and support smallholders;
- Work to develop national interpretations of internationally recognized certification standards;
- Work with governments to identify and address factors that may be constraining private investment in the sector (complementing possible engagement by the World Bank with governments to strengthen the legal and regulatory environment); and

- Support South-South investments.

Latin America

- Support private investments that foster economic growth and that benefit local communities (ideally in parallel with World Bank support for policy and regulatory support for governments);
- Work to develop national interpretations of internationally recognized certification standards;
- Work with governments to identify and address factors that may be constraining private investment in the sector (complementing possible engagement by the World Bank with governments to strengthen the legal and regulatory environment); and
- Support South-South investments.

IFC's Environmental and Social Risk Assessment Approach

IFC has revised its risk assessment approach and environmental categorization procedure to reflect the recommendations of its CAO and the feedback from the consultation process. Further revisions to IFC's performance standards are being considered as part of a separate regular update process. IFC Strategy section describes the revised risk assessment approach and also how IFC's performance standards are applied to protect the rights of affected communities and indigenous peoples.

With regards to projects in critical habitats, IFC uses a risk based analysis that results in go or no-go decisions. This analysis would take into account the degree of criticality, the level of adverse impacts, and the client's ability to mitigate and manage the issues. IFC's investment portfolio is broad, and industry-related impacts vary significantly. As an example, IFC would not support any oil palm plantation project that would convert high-carbon-stock peatlands, due to their ecosystems services, as well as high carbon and/or biodiversity value. Similar considerations would apply to high-carbon-stock primary tropical forest.

Moving Forward

Monitoring and evaluation is a critical part of World Bank Group operations. Where this new approach can be applied, we will continue to learn from analysis and experience and share best practice among stakeholders.



I. INTRODUCTION

This document presents the WBG Framework and IFC Strategy for Engagement in the Palm Oil Sector (“the Framework”).

The Framework reviews the global significance of palm oil, its role in promoting economic growth and poverty reduction, its environmental and social impacts, and the different stakeholders active in the sector, as a basis for determining the proposed areas of focus and the recommended approach by the WBG. It highlights the importance of a collective approach to enhance environmental and social sustainability in the sector. Finally, it proposes selective engagement by the WBG that is responsive to the needs of its client countries, takes into account the WBG’s comparative advantages, and reflects a revised integrated approach for World Bank and IFC activities in the sector.

The Framework reflects the WBG’s commitment to support client countries improve agriculture’s contribution to food security, raise the incomes of the poor, facilitate economic transformation and provide environmental services⁴. It draws on related WBG research and initiatives in the agriculture sector, including the WBG’s *World Development Report 2008: Agriculture for Development*, and the *Agriculture Action Plan 2010–2012* (See Box 1). The Framework is consistent with The 2004 *World Bank Forest Strategy* the central element of which is to *harness the potential of forests to reduce poverty*, and the WBG’s *Strategic Framework on Development and Climate Change* (SFDCC), approved in 2008. The SFDCC provides guidance for the WBG in (1) effectively supporting sustainable development and poverty reduction in developing countries as climate risks and climate-related economic opportunities arise, and (2) facilitating global action and interactions among all countries. Finally, the Framework is informed by WB research and sector analysis including the 2010 publication, *Rising Global Interest in Farmland: Can it Yield Sustainable and Equitable Benefits?*, together with continuing project evaluations.

WBG Moratorium and Re-engagement Approach

While recognizing the impact of palm oil production on poverty reduction, concerns over potential negative environmental and social

effects prompted the WBG to declare an interim moratorium for new investments in palm oil.

The WBG has carried out an extensive, transparent, and inclusive global consultation process to inform the development of a new framework for engagement (See Annex II for an Overview of the Consultation Process). While stakeholders highlighted concerns regarding good governance, land tenure, climate change, deforestation and biodiversity loss, smallholder inclusion, and productivity differentials, the sector’s ability to lift people out of poverty, and contribution to economic growth was also emphasized. Furthermore, although perspectives differed on preconditions for reengagement, there was broad agreement that the WBG could and should play a positive role in promoting sustainability by engaging in the sector.

Following a reassessment of its approach in the sector, and reflecting the feedback from stakeholders during the consultation process, the WBG has developed this Framework under which the WBG would selectively re-engage in the sector. This approach reflects the important role that the sector can play in fostering economic growth and poverty reduction, the challenges as well as the opportunities for ensuring that development in the sector takes place in an environmentally and socially sustainable manner, and the alignment of these issues with the WBG’s mandate and expertise.

⁴ Implementing Agriculture for Development: The WBG Agriculture Action Plan: 2010-2012



II. THE GLOBAL CONTEXT OF PALM OIL

2.1. The Value of Agricultural Investment

The World Development Report 2008: *Agriculture for Development* notes that 75 percent of the world's poor live in rural areas and most of them are farmers. The report concludes that growth originating in agriculture has been three times more effective in raising the incomes of the poor than growth generated from other sectors. Recent analysis demonstrates that the additional agricultural investment required to meet the Millennium Development Goal of halving poverty by 2015 is estimated to be to be US\$14 billion annually for developing countries⁵. These conclusions have generated increased public sector investment in agriculture. The WBG is committed to a significant increase in support to agriculture from a baseline in 2008 of US\$4.1 billion to between US\$6.2 and US\$8.3 billion annually by 2012.⁶ However, public sector investment alone is unlikely to be sufficient. Innovative approaches to inclusive public-private partnerships will be crucial for generating investment, reducing poverty, and delivering growth.

Rising food demand (by 2050 there will be 9 billion people to feed worldwide) and climate change are placing additional pressures on rural livelihoods and the environment. Substantial productivity growth will be needed to meet demand and reduce the risks of further environmental degradation. In this context, the Action Plan guides the WBG's agricultural investment, and smallholder farmers are at the center of each pillar (See Box 1).

2.2. The Global Significance of Palm Oil

Palm oil, which is produced from the fruit of the African oil palm (*Elaeis guineensis*), has become a major global agricultural commodity that is used in a host of food and non-food products. The oil palm is cultivated entirely in developing countries in the humid tropics, where it often forms an important basis for local economies, as an export, as a raw material for local industry, and as a locally consumed food.

The oil palm is an increasingly important driver for economic growth in Southeast Asia, including Papua New Guinea, Central and Western Africa, and to a lesser extent tropical Latin America.

Today, palm oil is the most important tropical vegetable oil in the global oils and fats industry in terms of production and trade. The industry has played a significant role in generating export earnings and reducing poverty in the producing countries.

Box 1: On Implementing Agriculture for Development: World Bank Group's Agriculture Action Plan for Fiscal Years 2010-2012

The World Bank Group's Agriculture Action Plan for Fiscal Years 2010-2012 (Agriculture Action Plan) is a summary of the World Bank Group's proposed work program for the sector. The Agriculture Action Plan is the follow-up for the World Bank Group to the broad consensus represented by World Development Report 2008 (WDR 2008), *Agriculture for Development*.

The drafting of the WDR 2008 involved broad multi-stakeholder external collaboration, as well as extensive consultation with stakeholders in both developed and developing countries. It was the first WDR on agriculture since 1982, and became a widely praised strategic assessment of what needed to be done by governments and other stakeholders to create the policy environment and public goods investments necessary to ensure private--including smallholder farmer--supply response.

The Agriculture Action Plan is organized around five focal areas:

- Raise agricultural productivity – including support to increased adoption of new technology (e.g., seed varieties, livestock breeds), improved agricultural water management, tenure security and land markets, and strengthened agricultural innovation systems.
- Link farmers to market and strengthen value addition – including investments in transport infrastructure, strengthened producer organizations, improved market information, and access to finance.
- Reduce risk and vulnerability – continued support for safety nets, for better managing national food imports, protection against catastrophic loss, and reduced risk of major livestock disease outbreaks.
- Facilitate agricultural entry and exit and rural non-farm income – including improved rural investment climates, and upgraded skills.
- Enhance environmental services and sustainability – including better managed livestock intensification, improved rangeland, watershed, forestry and fisheries management, and support to link improved agricultural practices to carbon markets (e.g., through soil carbon sequestration).

⁵ Fan and Rosegrant, 2008

⁶Implementing Agriculture for Development: The WBG Agriculture Action Plan: 2010-2012



Originally used in crude form for cooking, palm oil has evolved into an international commodity with many food and nonfood applications. More recently, it has been promoted as a feedstock for the production of biofuels. About 80 percent of current world palm oil production is consumed in the form of food as cooking oil and as an ingredient in packaged foods, such as margarine, ice cream, cookies, and chocolates.

Nonfood uses of palm oil and palm kernel oil are also becoming increasingly important, contributing to the greater demand and higher prices for palm oil. Usage in soaps, detergents and surfactants, cosmetics, pharmaceuticals, nutraceuticals, and some household and industrial products has been growing because of the move away from petroleum-based products, which has opened the way to nontraditional applications for palm and palm kernel oils. The global desire to substitute at least a small portion of fossil fuel use with renewable fuels has also given rise to increased demand. Global brands such as Flora, KitKat, Dove, and Persil contain ingredients derived from palm oil.

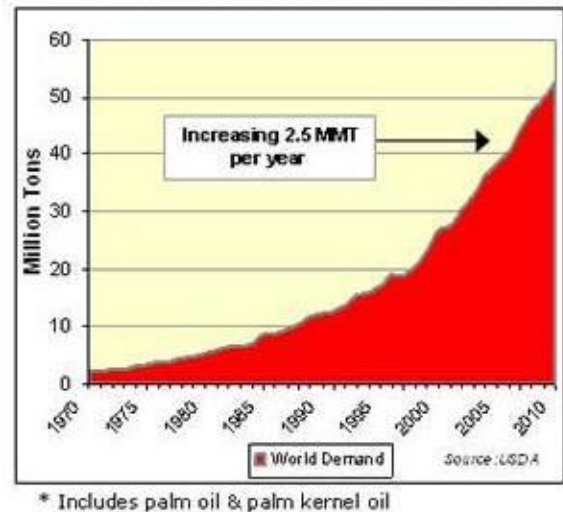
2.3. Palm Oil and Other Vegetable Oils

Of the total global production of about 133 million tonnes of vegetable oils in 2009, the palm oil sector produced about 45 million tonnes of palm oil (34 percent of the world's total) and more than 5 million tonnes of palm kernel oil as a valuable by-product for industrial and food uses (4 percent). In comparison, production of soybean oil and rapeseed oil totaled about 36 and 22 million tonnes, respectively. The growth of the palm oil sector in the past three decades has been phenomenal, with the planted area for the crop increasing from about 1.55 million hectares in 1980 to about 12.2 million hectares in 2009, nearly an eightfold increase. During that period, production increased 10-fold, from 4.5 million tonnes in 1980 to about 45 million tonnes in 2009 (Figure 1).

Among the major vegetables, palm oil is the most widely traded globally; the volume of palm oil exported has increased from 3.8 million tonnes in 1980 to 36.2 million tonnes in 2009, representing almost a 10-fold increase. Indonesia and Malaysia are the world's largest exporters of palm oil, accounting for nearly 90 percent in 2009. Almost three-fourths of the 45 million tonnes of global production is traded. The largest importers of palm oil are India, China, and the EU-27, accounting for 18.8 percent (6.8 million tonnes), 18.2 percent (6.6 million tonnes), and 16 percent (5.8 million tonnes) of

global imports, respectively.⁷ The dependence on imported vegetable oils among the major consumers has continued to surge and a linear trend in imports of palm oil is seen in EU-27, India, and China as well as in Russia and Ukraine in the last 10 years.⁸

Figure 1: Global Palm Oil Demand 1970-2010



Annex III shows the data on production and trade in major vegetable oils by country. Growth in production, consumption, and market share of palm oil is to a large extent due to its cost competitiveness vis-à-vis other vegetable oils and animal fats. Palm oil, cheaper than soybean oil, rapeseed oil, and sunflower seed oil, has effectively captured new markets and made inroads into markets that have traditionally been dominated by other oils. Palm oil is also very versatile, with many processing applications and a long shelf-life. Concerns over the health hazards associated with trans-fatty acids (TFAs) and genetically modified organisms (GMOs) have also raised demand. Palm oil, which requires little or no hydrogenation for the production of margarine, bakery shortenings, and confectionery fats, is a widely accepted substitute for other vegetable oil, which need hydrogenation to provide these products.

Another key reason for palm oil's dominance in the vegetable oils market is its inherent productivity compared with the oil seeds. Oil palm produces on average four tonnes per hectare of palm oil, in comparison to other competitor seeds (soybean, sunflower and

⁷ *Oil World*. 2010. www.oilworld.de

⁸ Basiron, Y. 2010. "Glimpse of 2011: Pointers for 2011 on Global Oils & Fats Trade." Paper presented at the Third International Palm Oil Trade Fair & Seminar, Kuala Lumpur.



Box 2: Oil Palm and the Poor in Africa

Oil palm is native to Africa and is widely grown and consumed in the humid lowland forests of West and Central Africa. In Liberia, the Democratic Republic of Congo, and the Ivory Coast, palm oil accounts for over half of the intake of dietary fats, and is a significant source for over 20 percent of dietary fat in 13 other countries. It has especially important impacts on the poor via three pathways. First, it is largely a subsistence crop produced through harvesting wild palms in intercropped fields, and processed on farm for household consumption and small cash sales, largely by women. Second, commercial production is important in some countries providing incomes to rural households through smallholder outgrower schemes and through plantation employment. It is estimated that 1.8 million people in Nigeria are involved in oil palm production (Ayodele, 2010). Finally, given its importance in consumption expenditures, prices of palm oil and its derivatives can be especially important to the welfare of the urban poor.

Yet, Africa and its smallholders who originally domesticated oil palm have been left behind in the dramatic global development of the industry. Yields have stagnated around 0.5 tonnes per hectare of oil, only a bit more than 10 percent of the world average. Low yields partly reflected the fact that much of the production is from wild thinly dispersed trees that have not been selected for oil yields. Low yields also reflect the inefficiency of home processing methods that are not only onerous but also extract less than half of the available oil. Even yields on smallholder commercial plantations are often less than half of that of comparable smallholders in Southeast Asia. As a result, sub-Saharan Africa has switched from being a net exporter of palm oil in 1980 to a net importer today.

Low productivity in turn reflects the lack of investment in the industry. Price policies and exchange rates have traditionally highly taxed the industry until recently. This together with parastatal dominance of plantations and milling infrastructure and difficulty of accessing contiguous land parcels strongly discouraged private investors. Investment in public research and development needed to enhance productivity has also declined in about half of African countries.

With good policies and coordinated public and private investments, Africa has the opportunity to gain a share of expanding world markets, as well as meet its own rapidly increasing demand. It has large non-forested land areas that are suited to oil palm production estimated at 4.5 million hectares in DRC, 1.2 m ha in Republic of Congo, 0.4 m ha in Liberia, and 0.3 million ha in Gabon (World Bank, 2010). Other countries, such as Nigeria, Ghana and Ivory Coast have large areas under low productivity oil palm where production could be intensified through use of improved varieties and management practices. For smallholder subsistence production, improved processing technologies represent a major opportunity to expand output. Small manually operated mechanical presses have been successfully introduced into some countries such as Camerouns that effectively double the oil extraction rate and increase labor productivity by four times. Small efficient mills could also be employed for commercial smallholder production to reduce their harvest coordination problem with large mills. In some cases, such as in Liberia, foreign investors from Southeast Asia are taking over abandoned plantations, and if they follow responsible investment practices, they have the potential to create badly needed jobs in rural areas.

Sources: Ayodele, Thompson, 2010. *African Case Study: Palm Oil and Economic Development in Nigeria and Ghana; Recommendations for the World Bank's 2010 Palm Oil Strategy*, Institute for Public Policy Analysis, Lagos. Poku, J. A. and Felix A. Asante. 2008. "Palm Oil Production in Ghana." Accra: GTZ.
World Bank, 2010. Rising global interest in farmland: Can it yield sustainable and equitable benefits. Washington DC: Agricultural and Rural Development Dept.

rapeseed; oils) that yield less than 0.8 tonnes per hectare⁹ (Table 1).

In terms of land utilization, of the total land area dedicated to oil crops, of 229 million ha, oil palm required about 12.2 million ha (or 5.3 percent) for its production in 2009 while soybean oil required 98.0 million ha (or 42.7 percent of the total land area). Other advantages of palm oil over oil seeds include energy efficiency through utilization of its own biomass as fuel for power and steam generation in palm oil mills, and the lowest requirement for inputs of fertilizers and pesticides.¹⁰

Table 1: Typical Yield of Palm Oil against Other Oils

Oil	Tonnage per hectare
Soybean oil	0.37
Sunflower oil	0.5
Rapeseed oil	0.75
Oil Palm	4.09

Source: Oil World 2010

⁹ Oil World, 2010, "Oil World Annual 2010", Hamburg, Germany

¹⁰ Teoh, C. H. 2004. "Selling the Green Palm Oil Advantage?" *Oil Palm Industry Economic Journal* 4: 1.



2.4. Demand Outlook

Strong demand for vegetable oils has been reflected in the rising prices of palm oil since 2000. Palm oil has become the staple food oil in Malaysia and Indonesia, joining much of West Africa in this respect. The current price of crude palm oil at over US\$1,200 per ton (CIF Rotterdam) is still 183 percent above the long run price trend.¹¹

Worldwide demand for vegetable oils is expected to increase by 36 percent from 2007 to 2017, with biofuels accounting for one-third of the increase.¹² Demand for palm oil for edible use is expected to continue to rise due to population growth, increased per capita consumption, and movement of the developed world away from saturated animal fats.

While the per capita consumption of oils and fats during 2008–09 in the EU-27 and the United States was 59.3 kg and 51.7 kg, respectively, the consumption in developing countries such as India, Pakistan, and Nigeria was 13.4 kg, 19.9 kg, and 12.5 kg, respectively. As the developing world aspires to a better quality of life, a further leap in production of vegetable oil will be required to meet the future demand.¹³

Assuming a population increase of 11.6 percent (based on the World Bank's world population projection of 7.58 billion in 2020) and a 5 percent increase in per capita consumption, an additional 27.7 million tonnes of vegetable oils will have to be produced annually by 2020. Given its superior productivity, oil palm is well placed to meet this demand with the lowest requirement for new land. An additional 6.3 million ha would need to be planted for oil palm, assuming a 10 percent improvement in productivity per hectare. If the increased demand were to be satisfied by soybean oil production, an additional 42 million hectares of land would have to be cultivated.

In the biofuels sector, countries have set national biodiesel blending targets varying from 1 percent in the Philippines to 10 percent in the EU by 2020. If the expected mandates materialize, it is estimated that an additional 4 million hectares of oil palm would need to be planted to meet the requirements of the EU,

with another 1 million hectares needed to satisfy China's demands.¹⁴

2.5. Supply Outlook

Indonesia and Malaysia are the world's largest producers of palm oil, accounting for about 38.5 million tonnes or nearly 90 percent of global production. Smaller and other significant producers are Cameroon, Colombia, Costa Rica, Cote d'Ivoire, Ghana, Guatemala, Honduras, Nigeria, Papua New Guinea, and Thailand.

Indonesia is expected to continue to be the leading producer with further expansion of the sector. The government has announced its objective that Indonesia produce 40 million tonnes of palm oil by 2020, 50 percent for food and 50 percent for energy while becoming the "best sustainable palm oil producer in the world".

To achieve this national production would have to double over the next 10 years with up to 300,000 ha of new land devoted to oil palm annually¹⁵. The expansion of oil palm production in Malaysia is expected to slow in view of the limited land availability. However, the Sarawak state government has announced that it is opening large tracts of land for oil palm cultivation. This will increase the national land area for oil palm from 4.67 million ha to 5.4 million ha.¹⁶

Planted areas in tropical countries in Africa and Latin America are also expected to expand to meet rising local and global demand. Considering that Africa's average per capita consumption of oils and fats is only about 11 kg, compared to the world average of about 24 kg, and the wide discrepancy in production and consumption between palm oil and vegetable oils, Africa presents a significant opportunity for future expansion of global palm oil production both for regional supply and the supply the EU.

Several African and Latin American countries, in pursuit of economic growth and reduced dependence on imported edible oils are attracting Asian and European companies to invest in the sector. These include Brazil, Cameroon, Democratic Republic of Congo, Ghana, Ivory Coast, and Liberia.

¹¹ LMC, December 2010.

¹² FAO/OECD Agricultural Outlook 2008–2017.

¹³ Bek-Nielsen, C. 2010. "A Perspective on Palm Oil and Its Sustainability." Paper presented at the Palm Oil and Lauric Oils Conference POC2010, Kuala Lumpur.

¹⁴ Sheil, D., Casson, A., Meijaard, E., van Noordwijk, M. Gaskell, J., Sunderland-Groves, J., Wertz, K., and Kanninen, M. 2009. "The Impacts and Opportunities of Oil Palm in Southeast Asia: What Do We Know and What Do We Need to Know?" Occasional Paper 51. CIFOR, Bogor, Indonesia.

¹⁵ Greenpeace. 2009. *Forest Destruction, Climate Change and Palm Oil Expansion in Indonesia*. Amsterdam: Greenpeace International.

¹⁶ Wong, J. (2010). "Sarawak: A Hotspot for Palm Planters." StarBiz 8 (March 2010), B1.



In the immediate future, expansion of the industry will most likely continue to be centered in Southeast Asia, where governments are supportive of the palm oil sector; there is a well-established supply chain to both internal and external markets, and there are large areas of new plantings that will come into production over the next few years. In Southeast Asia, with increased government focus on sustainable development and where eco-standards in the form of the Roundtable on Sustainable Palm Oil (RSPO) certification system are gaining traction, it is expected that planting will gradually shift away from forested areas with High Conservation Value (HCV) to existing agricultural land or areas designated as degraded. Globally, concerned stakeholders are exploring incentives that encourage this critical shift.

2.6. Export Earnings

The palm oil sector has also been a major contributor to the export earnings of the producer countries. In Malaysia, the export value of palm oil and its derivatives rose from RM 2.98 billion (US\$903 million), to RM 45.61 billion (US\$13.8 billion) in 2007. During the Asian financial crisis of 1997–98, palm oil was the top foreign exchange earner, exceeding the revenue derived from crude petroleum and petroleum products and forestry by a wide margin. The palm oil sector is also a major export earner in Indonesia, contributing about US\$7.9 billion in 2007¹⁷. Indonesia and Malaysia reported US\$27 billion in combined sales in 2007.

2.7. Employment and Income generation

Due to low levels of mechanization, large oil palm plantations are labor intensive and generate up to 30 times more employment per unit area than other large scale farming, such as soybeans. In 80 percent of palm oil plantations in Africa and the 40 percent in South East Asia, where smallholders are involved, income generation is higher than other competing crops (see Box 3 on Nigeria Example). While incomes earned by smallholders vary widely and are impacted by market access, international pricing, and the form of smallholder engagement, many smallholders in Indonesia and Papua New Guinea report their income from oil palm cultivation is significantly higher than income from subsistence farming or from competing cash crops, including cocoa or coffee^{18,19}. In addition, in Africa, the plants are

intercropped with other crops and effectively used to diversify sources of livelihood. Currently, smallholders are entering the industry in increasing numbers.

In Malaysia, the number of people employed in the sector grew from 92,352 in 1980 to about 570,000 in 2009²⁰. It is estimated that another 290,000 are employed in downstream operations. In Malaysia, the sector also provides employment for migrant workers from Bangladesh, Indonesia, and Thailand, who provide substantial remittances to their home countries. Estimates of the number employed in the palm oil sector in Indonesia vary considerably, but it is estimated that 2-3 million people are involved in the industry.

Box 3: Palm oil and Increasing Smallholder Productivity: Nigeria

Over 80 percent of Nigeria's palm oil is produced by smallholders, and a new generation of locally-manufactured technologies is increasing profits, raising returns to labor, and lowering the costs of processing – a development that is particularly significant for rural women, who throughout West Africa are principally responsible for the processing and sale of farm produce (FAO 2002; Olagunju and Akintola 2008).

The development of these technologies has been driven by local smallholders who demand more sophisticated, efficient, and reliable machines. Replacing the traditional practice of manually pounding the oil palm fruit has been especially important in overcoming the low returns to labor that had given people disincentives to engage in processing.

This exemplifies the kind of “productivity revolution in smallholder farming”, which the 2008 World Development Report prescribes for farming to assume its pivotal role in driving economic growth and reducing mass poverty and food insecurity in agriculture-based countries.

In both Indonesia and Malaysia, oil palm based agricultural development has been a major driver of development and agricultural diversification. Prior to the 1960s, Indonesia and Malaysia were the world's largest producers of

¹⁷ World Bank, 2009

¹⁸ World Bank Inspection Panel Report No. 53280-PG. 10 March 2010. Report and Recommendation. Papua New Guinea:

Smallholder Agriculture Development Project (SADP) (IDA Credit No. 43740-PNG). p. 8. and Annex II. Management Response to Request for Inspection Panel Review of the Papua New Guinea Smallholder Development Project (IDA 43740-PNG). pp.vi-vii.

¹⁹ Rising Global Interest in Farmland: Can it Yield Sustainable and Equitable Benefits? Conference Edition. p.20

²⁰ Ministry of Plantation Industries & Commodities, 2009



rubber. However, following the slump in rubber prices and thus national earnings, Malaysia embarked on a conversion and diversification program that drove the large-scale development of the palm oil sector. The decision to diversify resulted in the establishment of the Federal Land Development Authority (Felda) in July 1956 with the dual objectives of resettling the poor and landless, and diversifying away from rubber. The first Felda scheme involving the oil palm was started in 1961. Today, Felda supported smallholders are the largest producers of palm oil in Malaysia, with 720,000 ha of oil palm established and 112,635 landless families resettled²¹.

In the case of Brazil, the potential of palm oil to benefit poor farmers has been well established beginning in 2002, when the Agropalma company and the state government of Pará introduced a new program for poor rural farmers, many of them women. Between 2002 and 2005, the state government awarded 150 10 hectare parcels close to land on which Agropalma produced palm oil directly. The initial challenge the participants faced was the need to wait for three years before harvesting could begin, but inputs and equipment were covered by loans by a state-managed regional development bank, the Banco da Amazônia. Some 90 percent of the farmers who have participated in the program have been successful, and achieve higher yields than the plantations on which Agropalma produces directly. After 25 years, ownership of the parcels will revert to the farmers, who can decide whether or not to continue cultivating oil palm.

2.8. Poverty Reduction

The recent rapid expansion of oil palm activity in Indonesia is associated with significant poverty reduction. For example, in 2005 and 2008, reported national headcount poverty rates in Indonesia were roughly equal at 15.7 and 15.4 percent, while districts with increases in palm oil production saw significant poverty declines over the same period (World Bank Staff Estimates). Regressions at the district level, controlling for initial levels of palm oil activity (also predictive of poverty reduction), indicate that a 1 percent increase in the hectares in oil palm production contribute to a reduction of between 0.15 to 0.25 percentage points of those in poverty. With increases of 50 percent or more in production of oil palm in many districts, the effects on poverty

are correspondingly large. The analysis²² also confirms that the poverty-reduction effects of smallholder activity are much greater than the effects of increased private or State Owned Enterprises activity. Furthermore, the poverty-reduction effects of oil palm production by smallholders are greater for districts where poor households are concentrated in agriculture.

Palm oil is the cheapest major vegetable oil. Historically, palm oil has traded at a discount to soybean oil, the second most traded vegetable oil, and to others such as rapeseed, sunflower, etc. Because of its low cost and availability relative to alternatives, palm oil is mostly used by poorer households, especially in developing countries, and for the production of lower cost food products such as instant noodles and bakery items.

2.9. Food Security

Overall, with population expected to increase to 9 billion by 2050, food production will need to increase by 70 percent by 2050 to feed the world's people. Demand for edible oils is "income elastic" and is therefore expected to increase faster than demand for basic cereals and starches. Palm oil, as one of the most productive and cost effective oils, will continue to play a major role in meeting this growing demand. Yields per hectare of oil from oil palm are at least five times higher than that of the major oil-seeds. Furthermore, oil palm with its extensive root system, grows well on well drained, uneven, leached soils that are less well suited for growing annual crops such as cereals; there is thus limited direct competition for land use between oil palm and food crops. Cash from oil palm sales can provide smallholders with the income they need for economic diversification and enhancement of living standards, a key element in a broader food security strategy.

²² World Bank, Forthcoming. This analysis, while robust on measured poverty at the current poverty line, is not based on a full specification of the channels through which oil palm activity affects poor households. For example, the analysis does not provide evidence on the contribution that better governance, a healthier investment climate, or better land-titling procedures would contribute to improved poverty performance and increased economic activity. And, as with any regression, in the event of important omitted variables poverty impacts may be overstated. On the other hand, these estimates only allow districts where there is oil palm activity to have an impact on poverty thus excluding the effect on poverty in cities or rural areas near major oil palm production centers thus understating poverty impacts. Finally, reduced poverty or increased incomes are only one of many issues in the costs and benefits of oil palm activity.

²¹ Ahmad Tarmizi, 2009



Oil palm is not yet widely grown as a biofuel; although it has considerable potential as a cost-effective option compared with other feedstocks, costs of production are not competitive with fossil fuel and there is robust demand for palm oil as edible oil, especially as other oil seeds such as rapeseed are diverted to biofuels. Future demand will depend on policy priorities both from major biofuel producing countries and from importing countries, which may wish to substitute fossil fuels with biofuels. Because of its low cost of production and its relatively high yields, palm oil (like sugar-cane) is potentially an attractive feedstock for biofuels. Major palm oil producing countries such as Indonesia and Malaysia may choose (like Brazil for sugar-cane) to support use of biofuels as part of their low carbon development strategy. A focus on increasing productivity and yields on the one hand, and limiting area expansion to degraded lands on the other, together with pricing

regimes, which avoid distorting markets, will be key to minimizing potential trade-offs between production for biofuels or edible oil.

2.10. The World Bank and IFC's Experience

As indicated previously, in Malaysia, the World Bank-supported palm oil sector played a key role in rural poverty eradication through land and development agencies. Globally, IFC financed projects had significant impact on livelihoods of local communities, and estimates are that one job was created for each 5 hectares of plantation developed. World Bank portfolio evaluations suggest that impact on poverty reduction is determined at least in part on the degree to which projects address land tenure issues at the outset, the extent of integration of infrastructure into the projects, and the importance of management capacity particularly in public sector estates (See Annex IV for a description of WBG experience).



III. ENVIRONMENTAL AND SOCIAL ISSUES: CONCERNS AND POSSIBLE SOLUTIONS

A. ENVIRONMENTAL

3.1. Environmental Concerns

While the crop's positive impact on employment and income generation is considerable, palm oil has often been criticized for being a major contributor to deforestation and emissions of greenhouse gasses. This seems to suggest an inherent trade-off between oil palm expansion and the environment, but this is not necessarily the case. The net environmental impact of oil palm actually depends on where it is planted. 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 impact is minimized.

Forest loss can result in watershed degradation, drying and increased risk of fire, erosion and soil degradation, biodiversity loss, resource scarcity and greenhouse gas emissions²³. Oil palm plantations harbor significantly less biodiversity than natural forests, and generally do not provide the same level of environmental services, such as carbon storage, forest products (timber and non-timber), and soil benefits. Around 70 percent, or 4.2 million ha, of Indonesia's oil palm plantations are on land that was previously part of the Forest Estate²⁴. Over 56 percent of oil palm expansion between 1990 and 2005 occurred at the expense of forest cover²⁵. Similarly, about half of Malaysia's oil palm expansion in the same period has been at the expense of forests. While some of this area may have been cleared of trees previous to, and independent of, oil palm establishment, a portion of the area would have been cleared specifically to make way for the plantations.

With continuing global demand, expansion of oil palm cultivation is likely to extend to other regions such as Africa and South America. The Global Forest Resources Assessment 2010 showed that the rate of deforestation in South America and Africa continues to be high²⁶. The increasing interest in production in these regions could pose further threats to forest resources, but there are also examples of actions by governments and other stakeholders that can

help to reduce these pressures. These include better land use planning, regulations and incentives (such as REDD+) for the use of already degraded lands for new plantations and a focus on increasing the productivity of existing plantations, especially small holder plantations.

3.1.1. Biodiversity

Some palm oil-producing countries are also primary biodiversity centers. It is well established that biodiversity in oil palm plantations is much lower than in natural forests, essentially due to the reduced structural complexity of such plantations. The reduced habitat provides fewer niches for flora and fauna. Considerable attention has been focused on endangered species, such as the Sumatran tiger, the Asian elephant, and the orangutan. These and other species are particularly vulnerable to the clearing of forest areas, as the increased access leads to increased hunting, illegal logging, and opens areas to human settlement. Increased habitat fragmentation and access leads to more conflicts between humans and these species.

A central concern in regard to deforestation and biodiversity is that inadequate attention is given during the plantation planning phase to whether the area is of significant conservation value or biodiversity importance or is of HCV²⁷.

3.1.2. Oil Palm Production and the Emissions of Greenhouse Gases

Land use change and deforestation are the largest single contributors to greenhouse gas emissions in tropical countries such as Brazil and Indonesia. The oil palm sector can increase greenhouse gases (GHGs) through (1) clearing of carbon-dense tropical forest for new plantations, and the burning of the cleared biomass; (2) draining of peatlands, which results in carbon loss as the peat is oxidized; and (3) releasing of methane from effluent treatment ponds.

The most significant sources of GHG emissions associated with oil palm have been forest clearance and the use of fires for land clearing. Although the Association of Southeast Asian Nations (ASEAN) countries signed the ASEAN Agreement on Transboundary Haze Pollution in 2002 and have adopted a regional policy to

²³ World Bank, 2007

²⁴ Casson et al., 2007

²⁵ Koh and Wilcove, 2008

²⁶ FAO. 2010. "Global Forests Resources Assessment 2010: Key Findings." www.fao.org/forestry/gfra2010.

²⁷Per the definition adopted by the Forest Stewardship Council and RSPO.



implement zero burning²⁸, use of fire for clearing land for agriculture continues to contribute to air pollution in the region. This use of fires is a traditional agricultural practice among smallholders and farmers, who typically lack the access to heavy machinery to do otherwise.

Currently, in most countries, there are regulations in place that require the treatment of palm oil mill effluents before they are discharged into waterways. The most widely used system is the anaerobic digestion of the effluent through a series of ponds. However, the open ponds are a major source of GHG emissions as methane, which is significantly more potent than CO₂ in terms of global warming effect, is released through the digestion process. At present, most of the open pond treatment systems do not capture the methane released. Larger firms are moving to implement technology for the capture and use of methane, but this is often financially out of the reach for smaller operators. Under the Kyoto Protocol's Clean Development Mechanism, farmers could be paid for capture of the methane, but regulatory uncertainty and low prices for credits for carbon emission reductions have inhibited the suppression of methane emissions through the UN mechanisms of Kyoto.

3.1.3. REDD and the use of Degraded Lands.

A number of studies have pointed to the opportunity presented by degraded and abandoned lands as a way of reducing pressure on deforestation and loss of biodiversity. The threat of deforestation could be reduced if future expansion of oil palm is directed towards degraded land.

According to a compilation of estimates by the World Resources Institute, there are at least 6 million ha of degraded land in Indonesia—enough to support expected expansion by 2020.²⁹ In the early years of palm oil development in Indonesia, and in some cases still today, revenue from harvesting commercial timber on a site is sometimes used to pay for the subsequent palm oil plantation development costs.

²⁸ ASEAN. 2003. *Guidelines for the Implementation of the ASEAN Policy on Zero Burning*. Jakarta: ASEAN Secretariat.

²⁹ Wicke et al 2010 "Exploring land use changes and the role of palm oil production in Indonesia and Malaysia," in Land Use Policy.

Box 4: Examples of Country-Led Efforts on REDD and Degraded Lands

Indonesia: At the G20 meeting in September 2009, President Yudhoyono announced that Indonesia would reduce GHG emissions by 26 percent by 2020, and up to 41 percent with international support. Based on this commitment, the Government of Indonesia has mapped out a strong program of climate change action, including a REDD+ National Strategy. The Government of Indonesia is financing REDD Preparation activities funded under Forest Carbon Partnership Facility (FCPF), UN REDD, Global Environment Facility, and other sources. Indonesia is a pilot country for REDD investment activities under the Forest Investment Program (FIP) of the Climate Investment Funds*. The Government of Indonesia has also developed the Climate Change Reform Program with policy milestones on forestry, energy, adaptation and institutional development that is supported by Japan International Cooperation Agency, Agence Francaise de Developpment, the World Bank, and the Asian Development Bank.

Most recently, May 2010, the Government of Indonesia agreed with the Government of Norway on a bold, performance-based, policy-linked initiative to accelerate action on REDD+. The bilateral Letter of Intent (LOI) establishes a series of milestones and funding phases, focusing first on establishment of a REDD+ management agency, a monitoring, reporting and verification agency, a national REDD strategy, a pilot province, and a financing instrument.

Brazil: Brazil's experience in providing additional incentives to restrict oil palm cultivation to abandoned, degraded and long deforested lands demonstrates the potential of these approaches. In May 2010, former Brazilian President Lula da Silva announced the Program for Sustainable Production of Palm Oil that seeks to bring up to nearly 5 million hectares of abandoned and degraded land into production while prohibiting conversion of native forests. Oil palm plantations in the country employ one worker per 8 to 10 hectares, and are far more labor intensive than mechanized soybean farms and cattle ranching, which are the other leading agricultural production systems in the Brazilian Amazon. Enforcing compliance with this prohibition of deforestation will be greatly facilitated by the country's advanced satellite monitoring system.

* *The Climate Investment Funds (including FIP and CTF) and the FCPF are multi donor mechanisms with contributions from development partners including Australia, Canada, France, Germany, Japan, Netherlands, Norway, Spain, Sweden, Switzerland, United Kingdom and United States.*



As development has moved to secondary forest and agricultural lands, this source of revenue is often no longer available. However, REDD+ has potential to contribute to the protection of forest assets by providing financial incentives to avoid forest conversion. This can steer palm oil expansion to degraded/ converted lands. The Indonesian government has announced that the development of oil palm on degraded land will be part of the national REDD+ strategy to be developed under a US\$1 billion partnership with Norway.³⁰

In addition, recent research by WRI, the Prince's Rainforests Project, and agricultural economist Thomas Fairhurst indicate that many palm oil companies would rather expand onto non-forested land to lower set-up costs and avoid the lengthy process of getting a permit in forested areas. None of the interviewed companies for the research cited financing – and thus the need to cut timber to generate cash – as a factor restricting their expansion. Rather, they emphasized the importance of improved spatial planning as the main requirement to reach oil palm development targets as well as forest conservation goals in Indonesia.³¹ Research also shows that many of the degraded land areas have suitable soil for oil palm cultivation and can produce comparable yields relative to recently deforested land.³²

3.2. Possible Solutions for Improving Environmental Outcomes of Oil Palm Expansion

The impacts on forest and peatland ecosystems of an expanding palm oil sector are significant but largely avoidable. A policy framework that directs plantation development onto non-forested mineral soils and a supporting business environment would greatly improve the sector's environmental footprint. It is noteworthy that the following preliminary options apply broadly to land use allocation and are not sector specific.

- **Identify lands suitable for sustainable oil palm cultivation and areas which must be conserved.** There is a need for identifying non-forested areas and/or areas of low conservation value that are suitable

³⁰ <http://www.thejakartapost.com/news/2010/05/27/ri-honor-palm-oil-contracts-despite-forest-protection.html>

³¹ http://news.mongabay.com/2011/0103-wri_interview_hance_butler.html

³² T. Fairhurst and D. McLaughlin, "Sustainable Oil Palm Development on Degraded Land in Kalimantan." WWF, 2009; Indonesian National Development Planning Agency (BAPPENAS) "Reducing carbon emissions from Indonesia's peatlands," 2009.

for oil palm plantation. A key challenge is finding lands with the right physical attributes where there are either no claims by local people or where local people have an interest in developing oil palm plantations. Improvements in remote sensing technology need to be combined with on the ground verification to identify suitable sites.

- **Improve spatial planning efforts.** Improved spatial planning within the forest estate should improve monitoring of forest areas and prevent high value forests from being converted. Efforts should also be made to improve spatial planning outside of the forest estate to identify degraded lands that may be suitable for oil palm production.
 - **Provide incentives for protecting peatland areas.** With increased recognition of the value of carbon stored in peatlands, there is potential to provide financial incentives to the government as well as to private companies for not developing such areas. In the short term, grant mechanisms could be used to purchase carbon credits from peat soil conservation. For the longer term, this could be facilitated by inclusion of peatlands in the emerging REDD forest carbon market/payment mechanism.
- Applying REDD mechanisms successfully, however, requires that the rights of existing occupants on degraded lands be identified and benefits shared. Community mapping such as that carried out by the World Resources Institute and Sekala to identify degraded land that could be swapped for planned expansion in forest lands, would be an important component of a REDD initiative.
- **Improve the business-enabling environment for developing low carbon areas.** Improved spatial plans, clear delineation of property rights, settlement of conflicting land claims, and mechanisms for conflict resolution would help companies to develop plantations in areas that are already cleared, reducing the need for opening new areas.
 - **Increase the productivity of existing oil palm plantations.** By supporting replacement of ageing palms and low density plantings, which have passed their economic life with improved, higher yielding stock, and support husbandry techniques, which ensure that the higher yield potential will be obtained. The principle barrier to



overcome is “upfront financing”, especially to smallholders, to cover the eight year period before newly planted palms come into full production.

- **Develop and Adopt Voluntary Standards.** By developing and adopting verifiable practices, palm oil companies can protect HCV and high-carbon-stock forests. Other actors in the supply chain, including buyers, processors, and retailers, can also be effective in encouraging oil palm growers to adopt more robust standards.

B. SOCIAL

3.3. Social Concerns

Agricultural activities are the mainstay of rural households in most tropical countries and growth in the agricultural sector is a potent driver of poverty reduction³³. Oil palm expansion can yield positive socio-economic benefits to local people through employment opportunities, improved infrastructure, increases in land value, and income from cultivating oil palm. Oil palm expansion also yields indirect or national level poverty reduction benefits through government allocation of tax revenues and increased monetary stability through foreign exchange earnings. However, there are also potential negative impacts, including loss of access to land without adequate compensation, loss of the benefits of mixed livelihood strategies, and loss of environmental services from natural forests (e.g., water, game, medicinal plants) when these are replaced by plantations.

There are concerns that benefit sharing and conflict resolution for smallholders and local communities have been insufficient. Problems include lack of clarity regarding land rights and conflicts with indigenous peoples and local communities.

3.3.1. Land Rights

Tensions can arise in connection with land acquisition, and the recognition of local people’s rights to land during the establishment of industrial estates. When oil palm estates are established, compensation for lost land access can improve the distribution of benefits, but unclear land rights and lack of transparency can lead to inequitable outcomes. Indigenous peoples with traditional claims to land are particularly disadvantaged as formal recognition of such claims is limited. A large number of rural

poor depend on forests for a wide range of goods and services, and the conversion of forests may have adverse impacts on their livelihoods and culture.

Economies of scale in mills and the need to process fruits soon after harvest, require mills to have access to sizeable tracts of land that may be mono-cropped, depriving local people of the benefits derived from mixed livelihood strategies. When forests are replaced with palm plantations, communities lose access to timber for construction, rattan, and jungle rubber gardens³⁴. Also, communities may lose the autonomy and self-sufficiency associated with traditional subsistence practices and may become dependent on the market fluctuations of palm oil prices and the purchasing practices of palm oil mills.

Effective broad based community participation in land use planning is needed to address the wide range of issues presented when any large scale plantations interact with local communities. While challenges and opportunities are clearly context specific, they commonly include lack of clarity regarding land and water rights and their transfer (if any), lack of clarity regarding contractual arrangements between companies and smallholders and low capacity of local communities to negotiate equitable contracts, lack of publically available information about the proposal, lack of information of alternative models of community or smallholder engagement which offer different levels of benefits, and for some subsistence farmers, the mixed impacts of a move to dependence on cash crops and loss of autonomy gained from traditional subsistence practices.

While community participation in land use planning is critical, the ground rules, expectations, and recording procedures of the consultations are often deficient. Indigenous peoples can be particularly vulnerable when plantations are proposed. Where indigenous peoples practice shifting cultivation, and plantation companies prefer to hire workers with a background in sedentary agriculture, tension between companies and indigenous peoples can arise.

3.3.2. Impacts on Culture and Livelihoods

The basic notion of sustainability refers to taking future generations into account while living with the awareness that actions do have an impact on others and the world at large. Social sustainability takes the larger worldview into

³³ World Bank, 2007.

³⁴ Belcher et al., 2004, cited in Shell et al., 2009



consideration in relation to communities, culture and globalization. The recent WBG report, *Rising Global Interest in Farmland: Can it Yield Sustainable and Equitable Benefits*, points to examples where investment provided large and sustained benefits to local populations.

In many cases however, desired benefits were not achieved. Especially in Africa, investments often did not achieve their full potential in terms of productivity and poverty reduction because of:

- Weak land governance and a failure to recognize or protect local communities' land rights;
- Lack of country capacity to process and manage large-scale investments involving land acquisitions;
- Investor proposals that were insufficiently elaborated or technically non-viable; and
- Lack of a development strategy to determine whether large-scale investment can be instrumental in helping the host country to achieve its development objectives, and if it is suitable, where and how investment can contribute to those objectives.

Additionally, in many countries, a widespread lack of information makes it difficult for public institutions to properly do their jobs. Without addressing this lack of information, even the most progressive regulations will be difficult or impossible to enforce, corruption can flourish, and it will be difficult to attract serious investors. It will be critical to increase access to information and establish ways in which it can be used to enforce regulations and allow open debate to inform policies and regulations, in addition to strengthening governments' own structures and making data publicly accessible.

More emphasis on the culture and engagement of local communities in areas slated for new oil palm plantations is fundamental to mitigating conflict and facilitating peaceful, equitable processes of change.

3.3.3. Labor

While the sector is an important source of jobs, critics point to a lack of safe and decent work conditions in some cases. Women, casual laborers, and migrant laborers are particularly vulnerable. Areas of concern include occupational health and safety policies and practices, freedom of association, child labor, bonded labor and other forms of forced labor, and discrimination. Although minimum wages and job benefits are set either by relevant

government agencies or through collective agreements between employers and the workers' unions, consistent application of standard wages and benefits across the industry is an issue.

In particular, measures to address the treatment of women are often deficient. Impacts of the industry on women and men are typically different. Where decision making power resides with men, inclusion of women requires a proactive approach and the gender implications of employment, land use access, housing, education and health all require further analysis. For example, women may be employed in field operations such as weeding and the application of pesticides. Exposure to hazardous chemicals such as herbicides and fungicides in palm oil cultivation have been reported to cause health problems among women workers, and the risks exacerbated when pregnant women are exposed to pesticides.

3.4. Smallholders

The RSPO, defines oil palm smallholders as farmers controlling 50 hectares or less of cultivated land³⁵. This paper uses that definition and acknowledges that smallholder definitions are country specific. Furthermore there may be significant development opportunities associated with mid-size cultivators as well as workers on plantations who do not own land.

Table 2: Smallholder Production in Major Producer Countries³⁶

Country	Percentage of Area under Smallholders	Percentage of Production under Smallholders
Indonesia	44 percent	33 percent
Malaysia	41 percent	–
Nigeria	–	80 percent
PNG	42 percent	35 percent
Thailand	76 percent	–

Smallholders represent a significant portion of oil palm cultivation worldwide. Globally, three million smallholder heads of family are involved

³⁵ However, in the case of Nucleus Estate Smallholder schemes in Indonesia, the term refers to families that have been allocated much smaller areas of land (generally 2 Ha).

³⁶ Smallholder production data from Teoh 2010 and Vermeulen and Goad 2006. Comprehensive data on smallholder cultivation (by area and by total production) is not consistently available across countries; this table highlights the available data points in key producer countries



in the oil palm sector³⁷. While data collection on cultivated area is not consistently available everywhere, there is significant variation in key regions (see Table 2).

Structure of Smallholder Relationships

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. There are several main types of structures, though there is significant variability even within these types.

Independent smallholders are free to sell to any mill and thus may be able to pursue higher prices. However, their market access is not assured, and in any case there may not be enough of a diverse buyer base if mills are scattered. Independent smallholders are often less productive; studies have identified elements of inefficiency that include maintaining old oil palms too long, using smallholders' own (low-quality) seedlings, applying insufficient amounts of fertilizer, harvesting unripe fresh fruits bunches (FFBs), and not having strong data management systems³⁸.

In contrast, supported smallholders are generally tied to specific mills. The exact mechanism for this tie varies: it can include formal links in land titles or contractual relationships associated with loans. Generally, supported smallholders have access to some degree of support from plantation companies – through access to credit, technical assistance, FFB transport or other means.

Average income from oil palm cultivation is significantly higher than income from subsistence farming³⁹ or from competing cash crops. In 2006, annual returns to farmers from mature oil palm were around US\$980 per ha, compared to US\$410 from coffee, US\$580 from maize, and US\$150 from rubber⁴⁰. Field studies indicate that many villagers hope to enter the cash economy and see oil palm cultivation as an attractive option⁴¹. Often, such villagers have few alternatives to subsistence agriculture, which provides limited benefits without a regular source of cash income. In some areas, traditional livelihood activities, such as collection of rattan and eaglewood or small-scale logging, have become increasingly difficult, as over-harvesting and population pressures have led to

a decline in resources⁴². Due to low returns from existing land uses, farmers are often willing to sell land to oil palm companies for very low prices. Land prices have been shown to rise steeply in some areas following oil palm arrival, providing significant benefits to farmers who manage to retain land⁴³.

Governments, such as Indonesia have successfully supported smallholder developments through initiatives such as the Nucleus Estate Smallholder (NES) scheme. Total smallholder area in Indonesia grew by 16 percent per annum between 1997 and 2007, faster than the growth in State-Owned and Private Estate Plantations (Table 3).

Although smallholders produce 60 percent of the world's palm oil, they generally have significantly lower yields than estate or government owned plantations.

Raising the productivity of smallholders is a major challenge. The best estates in Southeast Asia produce more than 7 tonnes of oil /ha/yr, with some smallholders producing less than 0.5 t oil/ha/yr. The problem is more serious among independent smallholders: as supported or "scheme" smallholders operating under policies such as Fel'da in Malaysia, and NES and subsequent cooperative schemes in Indonesia typically have access to technical and financial support from the "parent" companies.

³⁷ Teoh, 2010.

³⁸ Ayat Rahman et al 2008

³⁹ Hardter et al, cited in Sheil et al., 2009

⁴⁰ Koh et al., forthcoming

⁴¹ Rist et al., forthcoming

⁴² Levang 2002

⁴³ Rist et al., forthcoming.



Box 5: Participation of small producers in oil palm and other agro-industries

Traditionally, in agro-industrial development projects, small holder participation would be in the form of out grower schemes or nucleus estate schemes, where an agro-industrial plantation or estate would be established, directly managed by the agro-industrial company (private, or often a parastatal), including the processing units (oil mills, sugar mills, rubber factory) and other infrastructure (villages for the workers, schools and health centers or hospitals) and out grower or small holder plantations would be established at the periphery. Often, these out growers were not indigenous populations but migrants and settlers who received a land allocation to establish their plantations and food crops. They were generally closely linked to – and dependent upon – the agro-industrial company, receiving not only the land allocations but also technical assistance in clearing the land and creating the plantation as well in accessing inputs (selected high-yielding planting material) and credit – the latter with the intermediation of some financial institution in a triangular arrangement for loan repayment based on proceeds from the delivery of their produce to the agro-industrial company. Typically, these out growers were also dependent on the agro-industrial estate for the purchase of their production (palm oil FFB, liquid or coagulated latex, cane crop) at pre-set prices, sometimes without any written contract given the fact that they had no other option than to deliver their production to the company. This model of agro-industrial development has been widely used for decades particularly in the 1970s and 1980s in various parts of South-East Asia (Malaysia and Vietnam) and Africa (Cameroon, Cote d'Ivoire, Ghana, Nigeria), and was supported and funded by various aid agencies including the World Bank. It was slowly phased out when the agro-industrial parastatals were privatized and when as a result World Bank lending to governments for this type of project declined (with some noticeable exceptions like Vietnam where such projects were still funded in the 1990s and 2000s).

It is important to underscore the fact that while the context has changed, as described above, so have the thinking and approaches to small holder development in tropical agro-industries. Over the years there has been a shift from this “integrated”, oligopsonic and state-driven model, to a more diffuse private-sector-led type of support to small holders and small agricultural enterprises, whereby farm units of different sizes are left to decide whether or not to grow an agro-industrial crop on their own land, and are provided support if needed from a range of local private providers such as input suppliers, traders and financial institutions. On the marketing side, arrangements can go from firm delivery contracts to a nearby agro-industrial company to leaving farmers to be free to decide where they want to deliver and sell their produce. There is a range of transition models from one to the other depending on country situations, but the trend is clearly toward the more open and competitive system, which also takes more into account pre-existing situations in terms of land ownership and local community involvement, as well as relies more on private provision of services to farmers and rural dwellers.

This (relatively) new approach offers huge opportunities for engagement at country level, because a number client governments and stakeholders have expressed interest in exploring these new avenues to stimulate growth and employment in rural areas while tapping into the potential of expansion offered by these agro-industrial crops. At the same time the challenges and trade-offs associated with this development model cannot be underestimated: how to maintain/achieve economies of scale and raw material aggregation to meet the requirements of these industries in terms of critical volumes and competitiveness? How to regulate these sub-sectors in a liberalized environment and avoid/limit side-selling and other practices that in the long run are detrimental to the respective industries? How to manage land use and geospatial development? In any case these are areas for development research and project piloting in which the WBG could get further involved in the future.

Major constraints to smallholder production include difficulty in securing capital to meet up-front expenses. Smallholders often lack the necessary collateral for bank financing, and access to good technical advice and market information. Obtaining a fair price for their produce is a key concern. Being in a monopsonic situation in the rural areas, they usually have weak influence over pricing. As the palm oil industry moves toward certified sustainable palm oil production according to the standards set by the RSPO and other organizations, smallholders risk losing market share if they do not improve production practices to meet the stringent certification requirements.

Research suggests that better access to improved plant materials, fertilizer and improved management practices lead to increased

benefits. For example, the Indonesian Oil Palm Research Institute has an active seed production and breeding program. The Brazilian experience based on a growing body of research is promising. In a Brazilian program designed for poor rural farmers, many of them women, 90 percent of farmers achieved higher yields than company plantations, and in Papua New Guinea, a recent study found that adjusting site specific fertilizer application, together with targeted technical extension services resulted in a 30 percent yield increase for smallholders. Strengthening demand driven smallholder extension and advisory services and innovative mechanisms to provide finance to smallholders is also a key for increasing productivity and benefits.



Table 3: Oil palm production area in Indonesia, 1997-2007

Oil Palm Area (Millions of Hectares)	1997	2007	1997-2007 average growth/yr	Palm Oil Production (Millions of Tonnes)	1997	2007	1997-2007 average growth/yr
Smallholders	0.81	2.57	12 percent	Smallholders	1.28	5.81	16 percent
State Owned	0.52	0.69	3.0 percent	State Owned	1.59	2.39	4 percent
Private Estates	1.59	3.06	6.7 percent	Private Estates	2.58	8.69	13 percent
Total	2.92	6.32	8.0 percent	Total	5.45	16.89	12 percent

Source: Data from Indonesia Palm Oil Board IPOB, 2008

3.5. Possible Solutions for Improving Social Impacts of Oil Palm Development

Clarify land use and access rights. Many of the conflicts between oil palm companies and local people revolve around the issue of land rights. Clear land rights would allow local people to resist expansion of oil palm companies in areas where this is not wanted, and would allow farmers to negotiate more favorable deals with companies where it is wanted. The clarification of land rights is in the interest of companies as well, because conflict stemming from unclear or overlapping land claims is a significant cost to business. Titles to land would have the added benefit of helping to facilitate smallholders' access to finance. However, individual titles are not the only form of land right recognition, and some traditional groups may not desire individual titles.

Support conflict resolution mechanisms. Conflicts can arise between companies and local people over land and there may be a role for intermediaries to improve outcomes in the short term. The World Agroforestry Center has developed and tested a Negotiation Support System and the Justice for the Poor program has tested models of conflict adjudication. Most voluntary certification systems also include conflict resolution mechanisms. These and other models could be evaluated for scaling up, but would need consideration of the institutional framework and sustainability of financing.

Reform and standardize negotiation processes and contracts between smallholders and companies. 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. Multi-stakeholder initiatives such as RSPO could play a role in developing standard contracts that are adapted or adaptable to local conditions⁴⁴.

Improve the negotiating capacities of smallholder representatives and smallholder cooperatives. Smallholder associations play an important role in negotiating deals with oil palm companies. Rural extension agencies and civil society groups can raise awareness of legal rights and options of smallholders and can help to increase the capacity of smallholder cooperatives to negotiate favorable agreements⁴⁵. Civil society groups could also focus on the corporate governance issues and internal transparency of cooperatives.

Promote smallholdings in further oil palm development. Local benefits are likely to be larger when farmers retain their land and participate in oil palm growing, than when they sell their land to estates. An option for achieving greater smallholder participation would be to increase the mandated area of the smallholder portion of new oil palm developments. This would need to be combined with policies that ensure that partnerships are beneficial to smallholders and that the rights of local people are considered in cases where smallholders are brought in from other regions.

Improve market access for independent smallholders. There is a need for consideration of options for promoting small-scale palm oil

⁴⁴ Rist et al, forthcoming

⁴⁵ Rist et al, forthcoming



mills and how these facilities could be financed, owned, managed, and maintained. Such facilities would need to meet environmental and social requirements, which is often difficult for such small-scale operations.

Strengthen farmer extension services to improve smallholder yields. Better access to improved seedlings, fertilizer, and improved management practices would lead to increased benefits for smallholders. The World Bank supported Farmer Empowerment Through Agricultural Technology and Information Project (FEATI) is part of the Government of Indonesia's effort to revitalize the agricultural sector and could be used to target oil palm smallholders. FEATI works on empowering farmers through improved information networks, community

agribusiness development, and enhanced linkages between research and extension.

The nature and degree of social and environmental concerns and challenges are specific to each country and production system. They have received the attention in the largest producer country, Indonesia, where the social and environmental aspects of land use change and related governance issues are at the core of concerns. In other countries and regions, notably Latin America, Papua New Guinea, and Sub-Saharan Africa, the challenges have been less acute, possibly due to the much slower rate of development of the sector. In Sub-Saharan Africa, the largest challenges are to improve productivity and competitiveness.



IV. WORLD BANK GROUP FRAMEWORK AND IFC STRATEGY

As the previous sections indicate, palm oil presents significant opportunities for economic growth, employment and poverty reduction, but it can also result in significant adverse environmental and social consequences. In light of the continued growth in demand for palm oil and its comparative advantages vis-à-vis other vegetable oils, there is a compelling need for concerted multi-stakeholder action to strengthen development impacts, mitigate negative consequences and build sustainability across the sector. Each stakeholder group has an important role to play in this regard (see Annex V for more information on actors in the Palm Oil sector).

Governments and private sector companies have primary roles. Governments establish enabling policy, develop appropriate regulatory frameworks and robust public information mechanisms and can address market failures. The private sector is the primary source of investments and employment in the sector and, subject to the regulatory requirements and enforcement capabilities, determines industry practices, including uptake of voluntary standards and codes of conduct. Large buyers of palm oil can significantly influence producer practices. Civil society organizations can provide local knowledge and technical expertise, educate local communities and hold governments and other actors accountable to national and international standards. Development institutions work with partners to invest in public and private sector programs designed to generate economic growth, alleviate poverty and ensure environmental and social sustainability. Multi-stakeholder fora including the RSPO offer opportunities for participants to generate collective action to set standards and promote sustainability.

In countries where there is interest in engagement, the WBG is committed to implement this Framework and stands ready to support the palm oil sector as part of a multi-stakeholder effort. It recognizes that collaborative action amongst all stakeholders is critical for environmental and social sustainability and considers that it can contribute to that process.

A. WORLD BANK GROUP FRAMEWORK

4.1. Pillars of the WBG Framework

As the basis for development of this Framework, the WBG has taken into account the feedback it has received from a wide range of stakeholders as part of the global consultation process (much of which is reflected in the previous sections). Based on these consultations, and its own experiences in the palm oil sector, the WBG has identified four central pillars on which successful development in this sector is contingent. The pillars are:

- An enabling policy and regulatory environment that promotes economically, environmentally and socially sustainable investments in the sector;
- Mobilization of sustainable private sector investment in palm oil producing countries;
- Benefit sharing with smallholders and communities;
- Sustainable codes of practice that can be adopted by producers and buyers of palm oil.

The application of these pillars will vary according to country, sector and project circumstances as will potential WBG engagement. Implementation of actions to support these pillars is the ultimate responsibility of national, provincial, and local governments and other stakeholders, including private companies, civil society and local communities. If requested, the WBG can work with partners to contribute to the design and establishment of appropriate policies and regulatory environments; provide financing to both the public and private sectors to further develop the sector; facilitate benefit sharing with smallholders and local communities; and support the development of codes of sustainable practice.

The WBG typically engages through the development of Country Assistance or Partnership Strategies. The strategies are increasingly jointly developed with the World Bank and IFC and are reviewed and updated on a three- to five-year basis. Subject to a government's interest in engagement and its development priorities, the review and/or formulation of new Country Assistance and Partnership Strategies serve as an opportunity



to develop programs that address the four pillars of a country palm oil framework.

- Policy and regulatory environment.** Achieving environmentally and socially sustainable investments in the palm oil sector can be challenging if the enabling policy and regulatory environment is weak. Issues regarding land acquisition, land tenure, and forest governance, and the rights of workers, communities, and indigenous peoples are at the root of many of the social and environmental problems in the sector. Where policies and regulations are in place, better implementation of land administration systems, land use planning, environmental impact assessment and regulations, labor regulations, and conflict resolution can assist in protecting biodiversity, mitigating climate change, protecting rights of workers and local communities, and enabling the implementation of sustainability standards and codes of good practice. In some instances, capacity building to strengthen good governance and regulatory and accountability mechanisms is necessary.
- Sustainable private sector investment.** Investment in or cooperation with a range of private sector actors along the value chain, using both direct and indirect financing and advisory services can support sustainability.
- Benefit sharing with smallholders and communities.** Oil palm can be a significant contributor to livelihood improvement and poverty reduction in many rural communities and further promoting environmentally and socially sustainable models of oil palm development that improve the distribution of benefits to local communities and smallholders is a priority. Integrating smallholders into growing global markets and supply chains is critical in addressing poverty. Identifying and scaling up inclusive business models, investing in infrastructure that enables smallholders to access markets, strengthening smallholder producer organizations and extension and advisory services, investing in innovative financial mechanisms to provide access to finance are essential for benefit sharing.
- Codes of sustainable practice.** The development, adoption, and implementation of voluntary sustainability standards and codes of practice, including certification systems is, when accompanied by complementary regulatory requirements, an effective means for effecting sector-wide change in the industry.

The following table and paragraphs summarize the roles and actions the WBG could undertake in support of a multi stakeholder approach.

Table 4: A Summary of Possible WBG Interventions under the Four Pillars and their Relation to Feedback from Consultations

Stakeholder feedback from consultations	Development Pillars for the palm oil sector			
	Policy/regulation	Private investment	Benefit sharing	Sustainability standards
Public policy/legal environment aspects, including governance issues, human rights issues, and regulatory concerns, especially land use planning	CAS/CPS planning process Land registration systems Strengthening environmental regulations Policy dialogue	Addressing constraints to investment	Policy dialogue Legal protection and enforcement capacity building in support of land rights and access	Policy dialogue Development and enhancement of accreditation and certification systems



Stakeholder feedback from consultations	Development Pillars for the palm oil sector			
	Policy/regulation	Private investment	Benefit sharing	Sustainability standards
Environmental concerns, including deforestation, biodiversity loss, greenhouse gas emissions, conversion of HCV and peat land	Building Environmental Impact Assessment (EIA) and institutional and enforcement capacity Building knowledge bases, GHG accounting, protection of forest and HCV assets, knowledge management	Application of Performance Standards Safeguard policies requiring certification Strengthening environmental management capacity Advisory services assistance	Extension services including training in farm management, RSPO or similar certification	Advisory services assistance (increase local auditing capacity)
Social and human rights issues regarding land acquisition and tenure, indigenous peoples' rights, conflict resolution	Policy dialogue Land tenure systems and enforcement Conflict management mechanisms Legal protection Gender issues	Community development programs Advisory services assistance Adoption of conflict avoidance and resolution procedures by firms	Community development programs, RSPO, or similar certification Broad Community Support	Advisory services assistance in support of community engagement
Smallholder concerns, including access to finance, markets, and inputs, need for yield improvement, access to land	Policy dialogue, institution of plasma or other third-party supplier schemes	Access to finance through larger processing companies and financial institutions Crop insurance Technical assistance and input support Provision of rural infrastructure	Promoting market access and attractive producer prices Strengthening producer organizations, third-party outgrower schemes Extension and agricultural input services Access to finance Yield improvement	Advisory services assistance Supporting smallholders in meeting standards (i.e., group certification)
Standards and certification, including the role of the RSPO, demand for CSPO	Policy dialogue Development of accreditation and certification systems in compliance with relevant regulatory framework. Standards development	Supporting harmonization and consistency in application Assisting clients to achieve certification	Supporting smallholder standards development, group certification	Multi-stakeholder involvement Advisory services assistance, including capacity support to RSPO and related standards



4.1.1. Policy and Regulatory Environment

Addressing policy and regulatory issues in palm oil is key but complex and multifaceted, involving the full spectrum of stakeholders. Dialogue, analysis and planning along with knowledge sharing are key components. The WBG has the capacity and experience to address these issues through facilitating:

Policy Dialogue, Analysis and Advanced Planning. The World Bank's engagement with governments provides an opportunity to facilitate dialogue on policy and regulatory issues at the national level⁴⁶. If governments are looking to adjust their policy and regulatory environments, the Bank can assist through its analytical work and advisory services. Upon their request, palm oil sector issues could be linked to policy dialogues with host governments. The objective of this engagement could include the improvement and implementation of the policy, institutional, and legal framework related to land and other natural resources, and to workers', communities', and indigenous peoples' rights. Additional analytical work in core countries could also be included in the Country Assistance and Partnership Strategies planning cycle, thereby providing advance planning for developing effective programs.

Public/Private Dialogue. Working in collaboration on areas such as investment climate diagnosis and reforms, the World Bank and IFC can support dialogue with public and private sector players as well as other partners, in order to inform strategic priority setting at the country level. In addition, IFC, with its primary connections to private sector clients, is well positioned to provide input to governments on constraints and incentives for private sector development.

Comprehensive Approach to Property Rights and Land Issues. Besides a sound policy and regulatory framework, secure property rights are fundamental to increasing local incentives for investment as well as protecting the rights of existing users and improving productivity. Programs to make land rights more secure, especially for poor farmers and communities and other vulnerable groups, have long been a major thrust of World Bank interventions⁴⁷. Improving the clarity of rights

⁴⁶ Plans to address these areas could also build on existing analysis from the WBG Agriculture Action Plan 2010–12, the Doing Business for Agriculture initiative, and the Responsible Agricultural Investment work program.

⁴⁷ As part of the Agricultural Action Plan, the WBG has taken a comprehensive approach to improving access to and security

would allow local people more say in negotiating the terms for making their land available for oil palm and reduce the costs for companies.

Social conflict surrounding oil palm expansion also derives from opaque or poorly understood contractual agreements, lack of consultation, and limited benefit sharing with local communities⁴⁸. Contracts are often unclear on the terms for transferring land, remunerating outgrowers, and employing local people⁴⁹. Establishing smallholder associations, greater clarity of contracts, and avenues for conflict resolution could help address these problems.

Forest Governance and Land Use Planning. Better forest governance is also at the heart of the challenge to achieve sustainable oil palm production. The WBG can support investments that address the drivers of deforestation and degradation such as incentives for community certification, transparent management of public forest lands, improving forest governance, expanding institutional capacity, and facilitating the flow of information. Land use planning requires particular attention in order to clearly designate HCV areas to be avoided in the expansion of oil palm production, and degraded lands that are agronomically suited to oil palm production with sufficient infrastructure to allow sustainable expansion. Brazil has pioneered such a system that could be a model for other countries. As part of its work with government agencies in this sphere, the WB could apply its experience in land use planning and development of local capacity to assist governments in regulating land use to advance knowledge in this critical area.

Communication and Knowledge Sharing. Difficulties in coordination in the oil palm sector often result from poor communication and deficient sharing and assessing of information. The WBG could integrate oil palm proposals into ongoing land initiatives in selected focus countries, and would seek to improve dialogue and coordination among its different sections (agribusiness, finance, land, forests, environment, legal, and social) and across different levels of government in its implementation. Recently developed WB forest governance assessment tools are also applicable

of land for agricultural development: including (1) establishing land policy and legal reforms, (2) increasing security of existing customary or informal land tenure, (3) modernizing land administration practices, (4) preventing or reducing land conflicts, and (5) addressing land issues in the context of investments in large-scale agriculture.

⁴⁸ World Bank 2009

⁴⁹ Colchester and others 2006



to the oil palm sector. They enable stakeholders to better assess the governance environment and formulate actionable interventions as well as monitoring progress.

Recent difficulties with the oil palm sector have arisen in part from lack of an adequate knowledge base on sector issues. The WBG will seek opportunities for continuing this work, especially in Sub-Saharan Africa, where there is a dearth of current information. More in-depth analytical work on specific issues such as land and forest governance and community rights may also be needed.

Assessments and Capacity Building. Social and environmental impact assessments for large-scale private investments in oil palm have generally been weak or nonexistent. Where they are mandated and carried out, the public sector generally has little capacity to evaluate them or monitor implementation. The WBG can integrate capacity building for public and private institutions operating in the oil palm sector into ongoing WB activities (e.g., through the World Bank Institute) where appropriate, and increase access to and share knowledge about modern monitoring systems. Specially designed pilot programs in selected oil palm producing countries can be explored. There may also be opportunities for IFC in developing small and medium-size enterprises (MSEs) for preparation of environmental and social impact assessments and for biodiversity assessment including ecosystem services.

4.1.2. Mobilization of Private Sector Investment

The WBG can support sustainable development of the palm oil sector through investment in or cooperation with a range of clients and stakeholders along the value chain, using both direct and indirect financing and advisory services. Specific goals would include the enabling of productive investment that contributes to economic growth and employment, benefit sharing with local communities and smallholders, adoption of improved environmental and social practices such as those reflected in the WBG's Safeguards and Performance Standards, promoting certification to established international sustainability standards such as that of RSPO, and increasing the proportion of CSPO in the marketplace.

Direct and indirect financing, along with associated advisory services for private sector

development, is IFC's core business⁵⁰. It draws on global reach and local delivery, its catalytic role as a leading financier, and its work as a recognized environmental and social standard setter. IFC can promote change by working with firms small to large across various segments of the economy (producers, traders, processors, and supporting services) that are committed to sustainable practices and can meet IFC Performance Standards.

4.1.3. Benefit Sharing with Smallholders and Communities

If requested, the WBG can support the identification and scaling up of sustainable and inclusive country-specific business models that could strengthen smallholder participation in the oil palm sector and maximize opportunities and benefits for smallholders, local communities, and indigenous groups. Most of such business models involve partnerships between larger plantations with mills and smallholders. IFC investments could include medium and larger companies, while the WB focus could be on strengthening smallholder organizations. Business models could be contingent on land tenure structures and the policy environment, as well as cultural, environmental and demographic considerations. WBG support would be centered on business models that promote legal and transparent contractual arrangements, equitable sharing of risks and rewards, gender inclusiveness, and sustainability.

Investing in infrastructure. Improved access to markets and resulting reduced transaction costs and risks are critical for the success of the sector in most areas. In selected oil palm countries, the WBG could promote investments in port facilities, telecommunications, and road networks in smallholder oil palm areas to support access to market and promote faster growth. Support could include investments in new infrastructure, upgrading of existing infrastructure, and support for institutional mechanisms for maintenance of infrastructure.

Strengthening smallholder producer organizations. The WBG has a strong record of support to producer and community organizations. Strengthening oil palm producer organizations would include technical assistance in developing management capacity and

⁵⁰ The IFC's financial products include loans, equity, trade finance, intermediated finance, guarantees and risk-sharing facilities, public-private partnerships and privatization vehicles, and funds. These are enhanced by a range of advisory services in areas such as supply chain linkages, investment climate, eco-standards, labor standards, cleaner production, access to finance, and community investment.



negotiating power, strengthening representativeness, and providing mechanisms to resolve conflicts. Encouraging them to organize and developing their capacity once they have become established is a prominent feature of World Bank-supported programs, together with helping governments to identify and scale-up inclusive business models that foster opportunities for smallholders.

Investing in financial mechanisms to provide access to finance for smallholders.

The WBG will investigate opportunities to improve access to finance for smallholders and smallholder organizations. This financing would look to establish appropriate risk sharing arrangements in collaboration with governments, larger palm oil producers, processors, traders and financial institutions. The focus for this financing would be to help smallholder farmers, and farmer organizations, access both short and longer term investment capital so they might improve their farming practices, increase yields, and adopt good environmental and social practices. In addition, advisory services could be provided to financial institutions in order to improve their lending processes and practices, while also supporting them to introduce and apply appropriate environmental and social risk assessments and decision making in their lending to the palm oil sector.

Strengthening smallholder extension and advisory services.

Smallholder oil palm plantations have significantly lower yields than estate- or government-owned plantations. Better access to improved seedlings, fertilizer, and management practices would lead to increased yields and benefits for smallholders. WBG support could focus on improving the relevance, responsiveness, and linkages of research and extension. The expansion of demand-driven extension services using the capacity of the public and private sectors together with producer organizations, the expansion in use of ICT to provide smallholders with better information, and the increased use of matching grants for technology adoption also require support.

Reducing risk and vulnerability. The WBG is developing innovative mechanisms such as IFC's Global Index Reinsurance Facility, which supports crop insurance for smallholders in developing countries. The World Bank also offers training courses in futures markets and hedging for commodity price risk management. In addition, WBG support could promote diversified farming systems of which oil palm is one

component. Most smallholders in Indonesia, for example, produce both rubber and oil palm, while smallholders in West Africa produce oil palm along with food crops.

Providing Related Interventions for the Benefit of Smallholders.

Historically, IFC's primary context of smallholder support has been when they are associated third-party suppliers to a larger plantation and/or processing company. IFC has additional capacity through its expanded advisory services, offering products that increase access to finance (and support group certification that can provide a more financially affordable means for smallholders to achieve certified status).

Providing Advisory Services. Other advisory services studies that IFC is undertaking in support of smallholders are:

- Characterization of smallholders, to better understand their needs;
- Cataloging input needs and management practices on smallholdings;
- Assessing potential means to increase access to finance;
- Providing instructional materials on better farm management practices, which would help smallholders to better prepare for certification.

By understanding smallholder production systems and their needs better, IFC will be better informed to work with sponsors to design advisory service projects that meet the needs of the growing population of oil palm smallholders. IFC would use these data to establish a more accurate baseline for different oil palm smallholder systems in order to track results at the smallholder level. This could include yield and related income figures of smallholder production, and also constraints and drivers for yield improvement. The baseline could serve to measure the benefits that smallholders should realize from certification and consider additional compliance costs. This information would help determine if there is a business case for the adoption of RSPO Principles and Criteria (P&C) standards or other certifications by smallholders.

4.1.4. Codes of Sustainable Practice

The development, adoption, and implementation of sustainability standards and codes of practice is, when accompanied by complementary regulatory requirements, an effective means for effecting sector-wide change in the industry. The WBG is committed to sustainable palm oil production. The WBG will work with partners to



encourage the development of appropriate international standards and codes of practice, including certification systems based on the standards. This will be informed by lessons from experience with certification in related sectors.

Concern about the environmental and social impacts of the palm oil industry triggered the development of an independent roundtable of concerned stakeholders to address these issues. In its seven years of existence, the RSPO has successfully developed a standard (its Principles and Criteria) and a certification system to certify that palm oil plantations are managed in a sustainable fashion. Notwithstanding the progress it has made, critics point to the need for the RSPO to continue to broaden its stakeholder representation and to strengthen its audit and enforcement capacity. IFC has supported the development of the RSPO, primarily through its Biodiversity and Agricultural Commodities Program (BACP) funded by the Global Environmental Facility. IFC will continue to engage with and strengthen the RSPO through membership, participation on technical committees, and support through the BACP or other programs.

While independent certification for sustainable management of oil palm plantations can be an effective way to promote sustainable production of palm oil, in practice, the comprehensive requirements in the RSPO certification scheme are likely to be well beyond the capacity of most smallholders, who thus may be significantly disadvantaged. This concern is being actively addressed by the RSPO, and it has proposed remedies such as the inclusion of smallholders in the certification process for larger plantations or separate certification of groups of smallholders. Revision of the standard to accommodate smallholder concerns is being discussed by the RSPO.

RSPO has requested IFC to assist in developing a smallholder development funding mechanism using funds it obtains from the premium on certified sustainable palm oil CSPO premium. IFC is meeting this request by (1) cataloging existing and known past practices of financial services provided to palm oil smallholders; (2) assessing potential means to support access to financial services; and (3) providing recommendations for possible new, more transparent financing models relevant to Indonesia.

While the RSPO is currently recognized as the only active certification system focusing exclusively on the palm oil sector, other systems are being developed and may play a supplementary role in the future. For example,

the Sustainable Agriculture Network (SAN)⁵¹ has developed a Sustainable Agriculture Standard for use in certifying a variety of agricultural crops under the trademark "*Rainforest Alliance Certified*", applied so far largely in Latin America. SAN has recently adopted an addendum to cover palm oil and is incorporating this into its general standard. The SAN standard differs from that of the RSPO in that it is more detailed in its criteria dealing with the conservation of natural resources and worker health and safety, among other priorities. Informal benchmarking of this standard against the RSPO is underway, and it is expected that the systems will complement each other.

With increasing interest in the use of biofuels other standards, such as the International Sustainability and Carbon Certification (ISCC), have been developed. The Roundtable on Sustainable Biofuels (RSB) is also currently testing the application of its certification system based on the RSB's Principles & Criteria, which define the level of social and environmental responsibility which RSB certified biofuels have to reach.

In addition, some countries are developing national level standards, such as the Indonesian Sustainable Palm Oil (ISPO) system.

IFC will continue to monitor application of these standards and determine if they could meet IFC's Performance Standard 6 criteria for appropriate certification systems⁵².

Supply Chains. Supply chain concerns can be addressed only through concerted action to examine the entire supply chain to identify at what stages issues may occur and where third parties, such as the WBG, have leverage to address these issues. IFC's Performance Standards require that supply chain-related risks (low-cost labor, including child/forced labor, and ecologically-sensitive resources used by the project) be examined and addressed as appropriate. Annex XIII provides additional discussion on key supply chain requirements for processors and traders.

While plantation-level certification can contribute to ensuring that palm oil is produced sustainably, other mechanisms are needed to track the certified sustainable palm oil through

⁵¹ SAN is a coalition of nine independent non-profit conservation organizations: Conservacion y Desarrollo (Ecuador), Fundacion Interamericana de Investigacion Tropical (Guatemala), Fundacion Natura (Colombia), ICADE (Honduras), IMAFLORA (Brazil), Nature Conservation Foundation (India), Pronatura Chiapas (Mexico), SalvaNatura (El Salvador), and Rainforest Alliance.

⁵² See Annex XIII for further details on these requirements.



the supply chain, to processors and to the ultimate consumers. Although in an early stage, mechanisms are being developed to track palm oil, which depends on consumer's/investor's awareness (GreenPalm and Utz Certified being two examples).

4.2. Collaborative Approach to Implementing the WBG Framework

As noted in the previous section, individual country strategies are ultimately determined by the host country government. Where a country wishes to incorporate palm oil in national strategies, the World Bank and IFC will collaborate to implement a revised approach to engagement consistent with the four interconnected pillars.

The form of engagement in individual countries will depend on country, sector and project level conditions, and host government priorities.

As in all operations, the Bank's environment, social and legal safeguard policies (see Annex VI on WB Safeguards Policies), and consultation processes apply, or where an IFC project is under development, IFC Performance Standards will apply (see Annex XIII on IFC Performance Standards).

Investments will be consistent with appropriate national policy, legal and regulatory mechanisms. In countries where the relevant policy, legal, and regulatory mechanisms need strengthening, the WBG will invest under the condition that World Bank Safeguards or IFC Performance Standards and certification requirements, as appropriate, can be met. Capacity building to strengthen regulatory and accountability mechanisms will be a priority in such circumstances and in partnership with willing host governments.

The revised approach would be as follows:

- A. Early Assessment.** Where a country wishes to incorporate palm oil into its national strategy, interventions would be jointly assessed by World Bank and IFC country teams with external input as appropriate to identify the opportunities and challenges presented by the sector in the country concerned.
- B. Integrated Approach.** The WBG is committed to strengthening internal coordination and collaboration at the global, regional, and country levels. The early assessment would help identify opportunities for joint engagement in the sector such as joint sector analysis, country situational analysis in major

producing countries or countries with potential to expand, and focused specific analytical initiatives in selected countries to pilot a more intensive effort. In designing this joint sector work, the WBG would take into account government demand, the potential to deliver global public goods, and existing knowledge products from the WBG and its partners. In addition, joint steps during the project cycle for standard WBG tasks would be mandated and joint working teams established.

- C. Good Practice Note for Staff Guidance.** In any engagement with palm oil, WBG staff will be guided by a good practice note in project selection and design that emphasizes benefits for rural communities, engagement with smallholders, limitation of development on natural habitats and systems of traceability and certification (for investments in the palm oil supply chain).
- D. Risk Screening and Assessment Tool (for IFC).** In its assessment of new palm oil investments, IFC will utilize a new tailored country, sector and project risk assessment framework that takes into account the issues highlighted through the consultation process.
- E. Strengthened Collaboration** with stakeholders to mobilize investment in palm oil related research to enhance productivity, promote sustainability and benefit sharing.
- F. Monitoring and Evaluation** to enable measurement and reporting of the above priorities.

The specific interventions within each of these areas follow:

4.2.1. Early Assessment

A.1 Country Situation Analysis for the Palm Oil Sector. The WBG will undertake focused country situational analyses in palm oil producing countries where there is demand and an agreement to engage.

There is a clear need for a more strategic approach to deciding on appropriate interventions in support of the palm oil sector, particularly at the country level. Therefore, IFC and the WB will, prior to commencing any new lending for palm oil in that country (i.e. projects that have not yet



been presented to the Board), carry out a Country Situation Analysis (CSA).

The objective of the CSA is to quickly and efficiently summarize current knowledge of the sector and identify issues, particularly those likely to significantly constrain future development. The CSA would take a holistic view of the sector in the country, the actors involved, and their current and future roles. In practice, considerable knowledge of the palm oil sector and the enabling environment already exists in most cases, particularly where the WB already has programs and IFC has existing investments in palm oil or other sectors. The CSA is a vehicle to formally pull all this information together in an accessible and practical format.

The CSA may recommend additional analysis, as well as specific background or baseline studies that would be valuable in informing future work. These could include application of the IFC Risk Screening and Assessment Tool, which has been developed specifically for this task (and which is discussed in detail in the IFC Strategy section of this report). If needed and appropriate in a specific country, this could also include other WBG risk assessment and management tools, such as Strategic Environmental Assessment (for which the WB has developed a practical toolkit).

The CSA is intended to be a flexible and practical instrument to provide a strategic overview of the sector, identify what the issues are, and what the WBG and other partners can do, and where they can have an effect. It would not substitute for the rigorous planning and analysis to be undertaken as part of the CAS/CPS process, or for the in-depth appraisal of IFC investments and advisory services projects. It would serve to inform the WB CAS/CPS process in terms of planning for programs to address the more long-term environmental, social, and governance constraints on the palm oil sector that can be addressed only through public sector interventions.

4.2.2. Integrated Approach

B.1 Systematic Collaboration through the Project Cycle

Collaboration in analytical work. The World Bank produces analytical work and technical assistance products while IFC provides advisory services for clients. To improve collaboration in the programming of these tasks, World Bank task teams will invite an IFC staff as a peer reviewer at the concept stage, and vice versa for IFC deliverables. This would promote upstream coordination as well as improved quality, based

on recognition of the different perspectives that each organization has to offer.

Collaboration in investment operations. While recognizing different approaches between investment operations of the World Bank and those of IFC, and given that the specific content of these operations will vary and are highly context specific, in both operations private investors, smallholder producers, and the policy and enabling environments are critical. Moving forward, at an early stage in the project cycle, IFC and WB will liaise to identify opportunities for complementary interventions and require that project concept review include staff from both IFC and the WB.

B.2 Specific analytical initiatives in selected countries to pilot a more intensive effort.

The WBG will launch joint WB-IFC initiatives in countries that seek to expedite on-the-ground collaboration. Potential candidates are:

- **Liberia**, where IFC is already active in advisory work and in lending, and the Bank has an expanding agriculture-related portfolio. Following a CSA as described above, a comprehensive oil palm sub-sector strategy review to be managed jointly by the WB and IFC will provide a comprehensive assessment of the potential of the sector, existing investor interest, opportunities for broad-based sector development (including out-grower schemes), environmental and social risks, a conflict sensitivity analysis and proposed roles for Bank and IFC lending moving forward.
- **Ghana**, where IFC is already supporting an existing oil palm plantation that includes an outgrower platform. At the same time, the World Bank is preparing a new operation to support commercial agriculture that will include a component to support new and scaled-up outgrower and contract farming schemes. Moving forward, the project team will work with IFC to examine the potential for leveraging both the existing business relationship and the new operation to augment the development footprint of the existing plantation.
- In **Indonesia**, the WB is currently financing the "Farmer Empowerment through Agricultural Technology and Information" (FEATI) project, which seeks to develop a demand-driven, market oriented research and extension system benefitting farmers for a range of crops. In addition, a Sustainable Management of Agricultural Research and



Technology Dissemination (SMART-D) project is under preparation that will further enhance the productivity and livelihoods of small farmers in Indonesia. Beyond these ongoing and planned investments in the agricultural sector, the WB is exploring opportunities for analytical work that can improve the social, environmental and economic outcomes of a number of crops including palm oil, coffee and cocoa. This work will complement IFC's Advisory Services program focusing on smallholder productivity gaps, smallholder sustainability certification and improvements in occupational health and safety practices in the palm oil sector.

4.2.3. Good Practice Note for Staff Guidance

A good practice note for palm oil investments (Annex VII) will guide WBG staff in project selection and design. In addition to summarizing the revised approach for palm oil investments, the note includes the following criteria:

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.

Criterion 2. Smallholders and palm oil companies have recognized land use rights for oil palm, and WB supports documentation and arbitration processes where appropriate.

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.

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.

4.2.4. Revised Risk Screening and Assessment Tool (for IFC)

In its assessment of new palm oil investments, IFC will utilize a new tailored risk screening and assessment tool that takes into account country, sector and project issues highlighted through the consultation process. Further details are provided in Annex XII.

4.2.5. Strengthened Collaboration with Stakeholders

E.1 Collaboration to mobilize investment in research

Ensuring that research responds to the needs and concerns of small and large producers, and ensuring access to research projects are important roles for public investment. Through partnerships with public research institutions including the CGIAR, CIRAD and EMRAPA, the WBG will advocate increased investment in research focused on productivity increases, ecological intensification and efficient farming systems, and promote dissemination.

E.2 Partnerships to promote sustainability and benefit sharing

Partnerships are playing an increasingly significant role in development financing and offer substantial opportunities to support this sector. Working through partnerships, the WBG Bank will mobilize support for analysis of socially and environmentally responsible oil palm development and strengthened community participation in planning processes through a number of ongoing collaborative programs such as the Forest Investment Program (FIP) and the Growing Forest Partnership (GFP) (See Annex IX for more information).

4.2.6. Monitoring and Evaluation

Table 5 summarizes the monitoring and evaluation approach that the WBG will adopt for evaluating progress in implementing this Framework. It describes for each pillar, the inputs and activities, the expected outputs and outcomes and how the information will be disclosed. For IFC, the project-level indicators are tracked as relevant through the IFC Development Outcome Tracking System (DOTS). These indicators represent the different forms of



support IFC can provide and would need to be tailored to the specific intervention. Many of these indicators are explicitly gender-disaggregated, such as relating to employment, training and ownership.

This framework will also assist in guiding objectives for new projects, to ensure that they are consistent within the broader strategy. Many indicators are applicable within the context of the respective World Bank and IFC investment or advisory methodology and monitoring and

evaluation (M&E) systems; this M&E framework unifies the strategy, but does not constitute an alignment of indicators across the WBG due to the different nature of possible interventions. This framework recognizes many of these differences and levels of intervention, providing robust capacity for M&E and reporting both at the level of individual projects and at the aggregate strategy level. Annex VIII provides a brief description of the WBG's approach to monitoring and evaluation.

Table 5: Monitoring and Evaluation

WBG inputs/activities	Inputs and outputs	Outcomes and Impacts ⁵³	Sources of information
Pillar 1: Policy and Regulatory Environments			
<i>WB Country Level:</i> Support governments in strengthening policy and regulatory environments for sustainable palm oil production and land use	Number of stakeholder consultations on policy and regulatory issues in target countries Number of WB engagements to support regulatory/policy improvements	Number of target countries that have undertaken agreed-upon activities such as environmental and social assessments Number of new improved or enhanced regulations on sustainable palm oil production ⁵⁴ Increase in amount of land with regulatory clarity (e.g., on land use, ownership rights, etc.)	WBG CAS/CPS documents and Completion Reports
Pillar 2: Mobilization of Sustainable Private Sector Investment			
<i>IFC Advisory Services/Investment:</i> Mobilize private sector participation in palm oil production	Number and volume (US\$) of IFC investments in sector Number of entities receiving IFC Advisory services	Volume of financing (US\$) facilitated by palm oil entities supported by IFC Investment and Advisory Services Number of new financial products launched ⁵⁵ Number of permanent employees in palm oil entities Number of MSMEs in value chain reached (upstream and downstream) Increase in value of SME contracts signed (US\$) Number of smallholder farmers reached (including holdings <	IFC Annual Report IFC Summary of Investment Information DOTS Project level information

⁵³ Where feasible, gender disaggregation will be sought for outcomes and impacts

⁵⁴ Governing land use, environmental risks, ownership, including indigenous rights, etc

⁵⁵ For interventions through FIs, thematically also tracking outstanding loans and volumes, where applicable to beneficiaries



WBG inputs/activities	Inputs and outputs	Outcomes and Impacts ⁵³	Sources of information
		50 Ha) Increase in farmer revenues (US\$) Increase in yield per Hectare (Metric Tons /Ha) Purchases from Local Suppliers (US\$)	
Pillar 3: Benefit Sharing with Smallholders and Communities			
<i>World Bank or IFC Project:</i> Promote sustainable models of palm oil development to improve distribution of benefits to local communities	Number of targeted smallholders and smallholder groups trained in sustainable production Number of strategic partnerships and local community organizations engaged	Number of smallholders adopting sustainable production practices ⁵⁶ Increase in farmer revenues (US\$) Number of beneficiaries of Community Development Programs (World Bank and IFC) Number of farmers benefiting ⁵⁷ Increase in yield per Hectare (Metric Tons /Ha)Support for local communities (IFC) ⁵⁸	Bank Implementation Completion Reports Summary of Investment Information - DOTS Project level information
<i>World Bank Project:</i> Develop risk management tools to reduce losses from price and weather volatility	Number of risk management instruments developed	Number of smallholders using the risk management instruments developed	Bank Implementation Completion Reports
<i>World Bank and IFC Projects:</i> Focus on strengthening smallholder producer organizations Support improved access to markets and infrastructure	Volume (US\$) of Community Development Outlays (IFC) Number of target beneficiaries who are members of a producer organization Number of new technologies demonstrated ⁵⁹	Number of beneficiaries with new/improved access to services and infrastructure ⁶⁰ (IFC) Benefits to smallholders (IFC) ⁶¹ Increase in farmer revenues (US\$) Increase in yield per Hectare (Metric Tons /Ha) Number of	IFC Annual Report Summary of Investment Information - DOTS Project level information World Bank Implementation Completion Reports

⁵⁶ Appropriate use of chemicals, fertilizers; maintenance of buffers, protecting HCV forests & habitats, etc

⁵⁷ Disaggregated number of farmers benefitting from community development programs, as compared to Number of Beneficiaries of Community Development Programs indicator

⁵⁸ As measured by number—and type—of infrastructure facilities built or upgraded within the local community, and may be linked to volume of community development outlays relating to construction or other expenditures on physical infrastructure

⁵⁹ Demonstration effects: use or introduction of new technology or techniques to improve production, sustainability or good practice with the objective of promoting the adoption and replication of the technology through demonstration. Indicator targets intention of replication and tracks observation of use outside target groups



WBG inputs/activities	Inputs and outputs	Outcomes and Impacts ⁵³	Sources of information
	Roads built/upgraded (km) (World Bank)	beneficiaries who are satisfied with agricultural services (World Bank, IFC) ⁶²	Independent Evaluation Group—World Bank evaluations
Pillar 4: Promoting the Use of Sustainability Codes of Practice			
<i>IFC Advisory and Investment Services:</i> Promote the use of Certified Sustainable Palm Oil among clients	<p>Number of people trained in environmental and social assessment</p> <p>Number of engagements (as national interpretations) to strengthen or implement internationally recognized standards</p> <p>Number of workshops, training events, seminars, etc, including number of participants</p>	<p>Number of IFC clients certified or in process of certification</p> <p>Land certified to internationally recognized standards (Ha)</p> <p>Relevant Environmental Social Governance performance measures to substantiate certification or IFC E&S standards, using standard IFC CES indicators⁶³</p>	IFC Annual Report Project Environmental and Social Review Summary

⁶⁰ Access to health facilities, education or vocational training; and infrastructure, such as water, electricity, sewage

⁶¹ Benefits from community development programs and improved access specifically reaching smallholder farmers

⁶² Beneficiaries of interventions participating in trainings, workshops, etc responding to surveys and indicating high levels of satisfaction with the training received or services provided. Survey data collection may also collect gender response rates, when possible

⁶³ Including GHG emissions, water effluent concentrations, resettlement and livelihood restoration, safety and labor standards, land claims and dispute resolution, etc



B. IFC STRATEGY

IFC's involvement in the palm oil sector is motivated by its potential for sustainable economic development and poverty reduction. As indicated in the document, the palm oil sector can play an important role in the overall economic development of certain countries. Given that the private sector has been and will continue to be the primary driver of growth in the palm oil sector, as the private sector arm of the WBG, IFC can play a role in supporting and catalyzing sustainable private sector involvement.

This section details IFC's strategy for supporting the sustainable development of the sector as part of the overall WBG approach. It also explains how IFC has revised its approach in response to the recommendations made by its Compliance Advisor/Ombudsman (CAO) following the complaint by civil society organizations in relation to four IFC investments in a large commercial palm oil trader and processor (Annex X outlines CAO's recommendations and the measures IFC has taken). Finally, it responds to requests from stakeholders to explain how IFC's current and revised environmental and social performance standards and practices protect affected communities and the environment.

4.3. Key elements of the IFC Strategy

IFC's strategy in the palm oil sector is guided by the broader WBG commitment to support client countries improve agriculture's contribution to food security, economic growth, incomes of the poor, and environmental sustainability.

As IFC is a relatively small provider of finance and advice within the sector, IFC will best make a difference by (1) investing in relatively underdeveloped areas, such as in poorer countries or frontier regions, where projects will have a relatively larger positive impact (e.g., through direct employment or by supporting smallholders) and where access to capital is constrained; (2) engaging selectively with key private sector partners throughout the industry's supply chain (producers, traders, and processors) who are able to demonstrate best practice in environment and social sustainability and community and smallholder engagement; (3) working with multi-stakeholder initiatives to develop voluntary industry-wide standards for sustainable development.

IFC will adapt its approach according to the country context as follows and will incorporate

all four elements of the broader WBG approach – holistic assessment, joint engagement (where feasible), increased focus on smallholders, and revised risk assessment and categorization procedures, in order to enhance sustainable development impact:

In countries with significant private sector investments in palm oil, IFC's approach will be to invest in and provide advice to:

- multi-stakeholder-led development of industry-wide voluntary standards for sustainable investments (complementing possible engagement by the World Bank with governments to strengthen the legal and regulatory environment);
- industry-wide and firm-level efforts to distribute the economic benefits of palm oil investments to local communities and smallholders;
- (on a selective basis) companies in the palm oil value chain that commit to adopting industry best practice for environmental and social performance.

In countries with strong potential for development of the palm oil sector, but with limited private investment in the sector, IFC would:

- support private investments that foster economic growth, promote good international environmental, health and safety practice, and that benefit local communities;
- in collaboration with the World Bank, work with governments to identify and address factors that may be constraining private investment in the sector;
- support multi-stakeholder-led development of industry-wide voluntary standards for sustainable investments (complementing possible engagement by the World Bank with governments to strengthen the legal and regulatory environment);
- support industry-wide and firm-level efforts to enhance distribution of the economic benefits of palm oil investments to local communities and small holders.

The key elements that have shaped IFC's strategy for engagement in the palm oil sector are:



- The potential for increased development impact through effective engagement with smallholders and communities;
- The growing demand for palm oil and its inherent attractiveness relative to potential substitutes as a means of meeting consumer demand and of contributing to economic growth and poverty reduction;
- The negative environmental and social consequences that can arise from investment in the sector in the absence of an effective policy and regulatory environment;
- The growing awareness and willingness of private companies to voluntarily develop and subscribe to good industry E&S practices and standards.
- support industry-wide and firm-level efforts to further engage with and support smallholders;
- selectively support companies in the palm oil supply chain, including the development of value added industries, that commit to adopting industry good management practices for environmental and social performance.

In Indonesia, this approach is consistent with the interest expressed by the Government (which would like support for smallholders, but does not see a need for financing from development finance institutions for larger companies) and by a number of private sector companies. As Box 6 indicates, IFC has developed a program of Advisory Services in Indonesia to identify opportunities for smallholders to improve productivity and sustainability, including through engagement with RSPO and sub-National governments.

4.4. Regional Approaches

This section outlines the approach IFC will take in the three major palm producing regions: East Asia and the Pacific Islands, West Africa, and Latin America, subject to private sector interest and host government priorities.

Asia and Pacific Islands. In the near future, private sector investment in palm oil is likely to remain centered in Southeast Asia, particularly Malaysia and Indonesia, where there is a long track record of investment by private companies in these countries, governments are supportive of the sector, there is a well-established supply chain to both internal and external markets, and there are large areas of new plantings that will come into production over the next few years. There are, however, well publicized concerns about the environmental and social impacts of the sector in these countries and growing recognition and efforts by governments and the private sector to address these concerns. There is also a well established base of independent and supported smallholders in the region, in Indonesia and Malaysia and also in Papua New Guinea and Thailand. Although large numbers of smallholders have benefitted from the opportunities presented by the sector, there are significant opportunities for improving smallholder productivity as well as the environmental and social sustainability of their operations. Although IFC's approach in individual countries is likely to vary, IFC's priorities in the region will be to:

- support multi-stakeholder-led development of industry-wide voluntary standards for sustainable investments (complementing possible engagement by the World Bank with governments);

Box 6: IFC Advisory Program in Indonesia

One component of IFC's work in Indonesia that is consistent with the proposed palm oil strategy, is an advisory services initiative to:

- Identify and analyze smallholder productivity gaps vis-à-vis plantation production and locations and develop prospective solutions to smallholder access to financial services, agricultural inputs and markets.
- Survey best practices from other multi-stakeholder commodity roundtables and other bodies to determine approaches for accelerating smallholder adoption of sustainability criteria so they can qualify for certification.
- Analyze the business case for RSPO certification by identifying the costs of certification for smallholders and calculating the prospective benefits.
- Utilize the preceding to assist the RSPO Smallholder Task Force to analyze access to finance options for smallholders, including the possible utilization of a portion of the funds RSPO receives from the sale of CSPO.

In Papua New Guinea, IFC would adapt its approach to reflect the greater challenges faced by private sector companies in securing financing and by smallholders with respect to enabling infrastructure.

Africa (West Africa Subregion). As noted in the Framework, Africa presents a substantial opportunity for future expansion of palm oil production. African governments like Ghana, Liberia, and Nigeria have expressed an interest



in developing the sector. The presence of suitable climates, low labor costs, rising local demand for palm oil, and incentives by governments, has attracted international investor interest (including by companies from South East Asia).

Box 7: IFC Investment and Advisory Service Project in Ghana

IFC's current work in Ghana is an example of how IFC investment and advisory is working together to enhance development outcomes. IFC has an existing US\$12.5 million investment in the Ghana Oil Palm Development Company Ltd. (GOPDC)

The project helped GOPDC expand its own operations, as well as increase demand from over 7,000 smallholders to supply FFB. Drawing on IFC's investment experience and work with GOPDC, IFC Advisory is now developing a project which will finalize a national interpretation of RSPO principles and criteria, test these principles, and develop local capacity of smallholders to implement best practices and achieve RSPO certification. IFC's Advisory work will benefit smallholders supplying GOPDC and throughout the country. In addition, the project will serve as a model to develop similar national interpretations in other West African countries.

Many African countries have significant smallholder participation in palm oil and opportunities also exist for the development of private sector-led smallholder support models. There is also demand and advisory support by the private companies who are interested in investing in the sector in many of these countries. Consequently, IFC's approach in these countries is likely to be to:

- support private investments that foster economic growth and that benefit local communities (ideally in parallel with World Bank support for policy and regulatory support for governments);
- support industry-wide and firm-level efforts to further engage with and support smallholders;
- work to develop national interpretations of internationally recognized certification standards;
- work with governments to identify and address factors that may be constraining private investment in the sector (complementing possible engagement by the World Bank with governments to strengthen the legal and regulatory environment);
- support South-South investments.

Latin America and Caribbean (LAC). Similar to countries in Africa, several Latin American countries in pursuit of economic growth and reduced dependence on imported edible oils are attracting Asian and European companies to invest in the sector. As in Africa, opportunities and challenges vary considerably by country and IFC's interventions would have to be adapted to the conditions on the ground. Environmental and social risks can be high in some countries whereas other countries have large tracts of degraded land (e.g. formerly used for cattle grazing). Unlike many African countries, countries in Latin America have less of a tradition of smallholder involvement in the sector. Private sector companies have expressed a need for financing in the region and also for support on environmental and social practices. Consequently, IFC's overall approach in the region is likely to be to:

- support private investments that foster economic growth and that benefit local communities, including smallholders (ideally in parallel with World Bank support for policy and regulatory support for governments);
- work to develop national interpretations of internationally recognized certification standards;
- work with governments to identify and address factors that may be constraining private investment in the sector (complementing possible engagement by the World Bank with governments to strengthen the legal and regulatory environment); and
- support South-South investments.

4.5. Development Impact

IFC will seek to maximize the impact of its interventions by pursuing a focused strategy that takes into account country context and conditions in the sector.

Although IFC's traditional client base consists of large- and medium-sized companies, it has been prioritizing engagements with companies that are able to associate with and support SMEs, including smallholders, in the palm oil sector. IFC has undertaken studies to help it shape its activities in this area (Annex XI summarizes the key recommendations of a July 2010 study on what private firms can do to improve the livelihoods of palm oil smallholders) and has developed a range of advisory products to assist its clients in this area. IFC will use these and related advisory services to assist in the realization of its development objectives at the project, sector and country levels as follows:



Project-level advisory: IFC is further developing its advisory capabilities to support clients that engage with smallholders in the palm oil sector. IFC assistance in this area is expected to include enhancing smallholder productivity by developing training materials and train-the-trainer approaches that help farmers adopt better agricultural practices. This assistance will also support training to farmers and others in the supply chain to improve their environmental and social related practices, primarily through the uptake and application of appropriate standards (with a view to improved sustainability of operations, broadening access to markets and/or market premia). IFC will also look for opportunities for capacity building to local financial institutions to increase their lending to small holders and improve their risk management practices in the palm oil sector, including better identification and management of environmental and social risks.

Sector-level Advisory: At the sector level, IFC's advisory work consists mainly of supporting multi-stakeholder initiatives (such as RSPO) for the development or national interpretation of industry-wide voluntary standards for sustainable investment. Multi-stakeholder initiatives take considerable time to develop and they often have limitations that can only be addressed by the dedicated efforts of the entire stakeholder group. IFC has been a member of RSPO since 2005, and has an active participation in the following working groups: (i) Biodiversity Technical Committee; (ii) New Plantings Working Group (completed); (iii) GHG Working Group; and (iv) Smallholders Task Force. IFC is also active in exploring and developing various projects to support RSPO,

such as through national interpretations, or accelerating smallholder access.

As the following Figure 2 indicates, IFC believes that the development of voluntary industry standards can complement IFC's own Performance Standards as well as policy and regulatory changes at the government level. They can play a role in increasing awareness of key environmental and social concerns and in accelerating the adoption of good environmental and social management practices by leading firms in the industry. IFC's own experience has been that companies that opt to obtain internationally recognized certification are better able to also adhere to IFC's environmental and social standards.

IFC will measure its progress in achieving its development objectives in the sector using the indicators detailed in Table 5 of the WBG Framework section. The development objectives will be measured on a project-by-project basis. The aggregate impact of IFC's program will depend on the types of projects IFC finances as well as the number.

4.6. IFC's Revised Investment and Advisory Approach

IFC's investment engagement is typically triggered by a private sector need and interest in IFC financing. Figure 3 details IFC's revised approach following such an expression of interest. This approach takes into account the recommendations from IFC's CAO following its 2009 audit and the feedback from the consultation process.



Figure 2: Two Pronged Approach to Promoting Standards

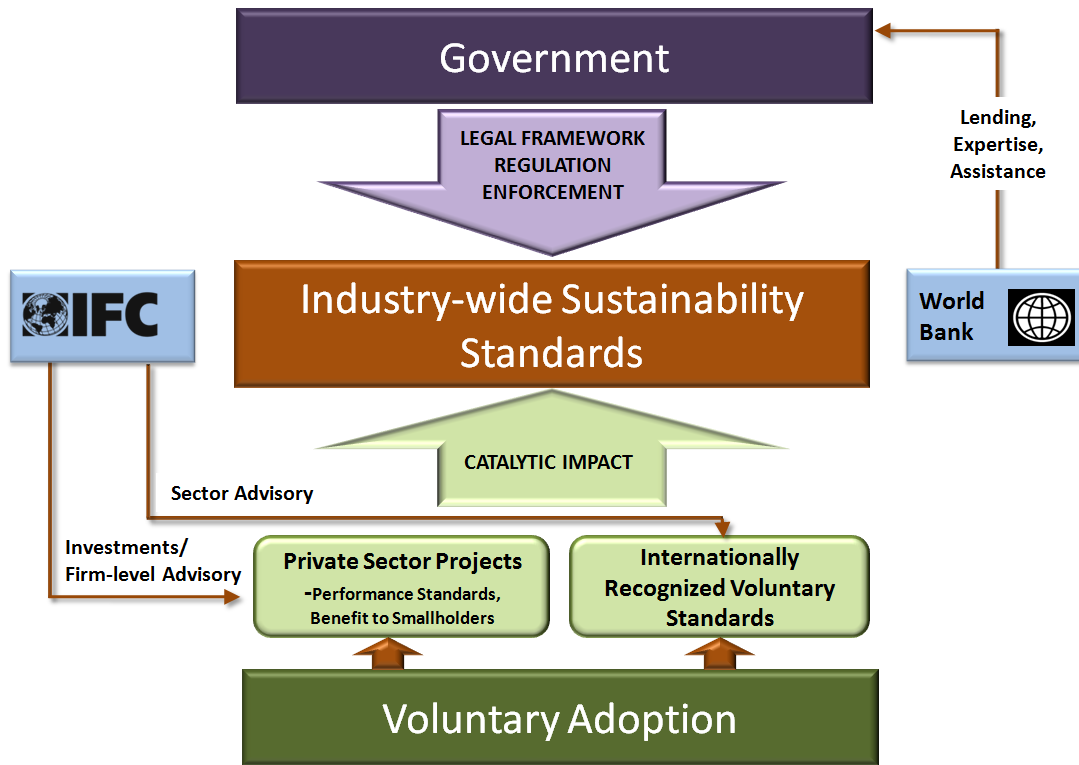
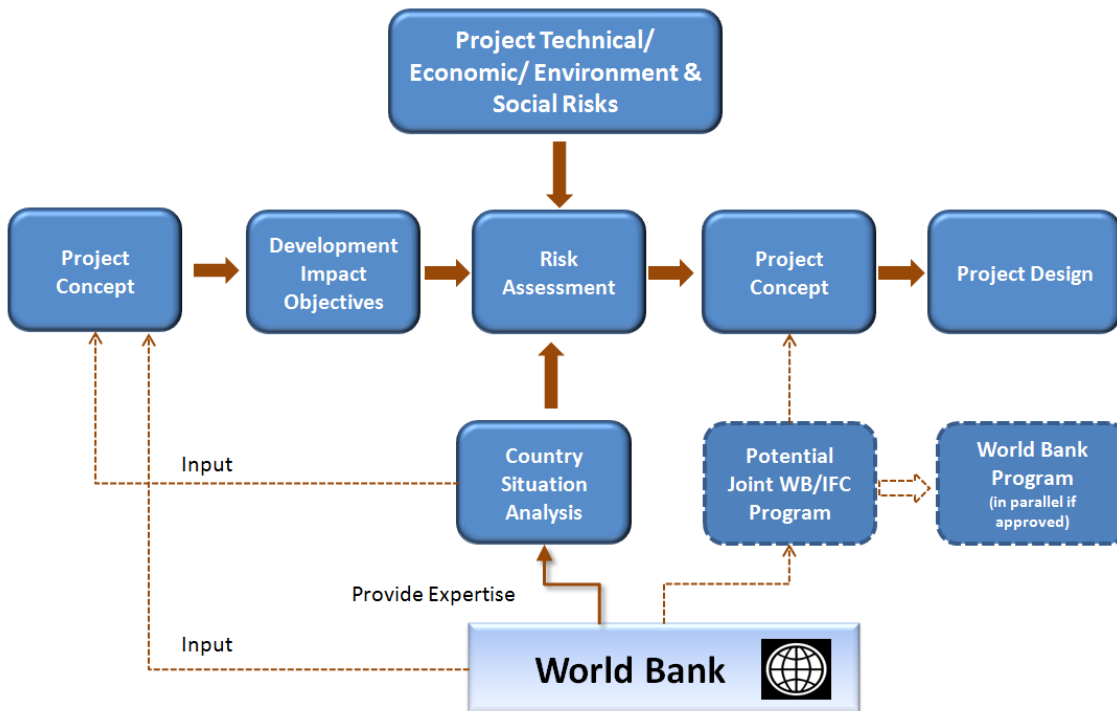


Figure 3: Simplified IFC Project Concept Approval Process



Early Country Situation Analysis (CSA)

Following a serious expression of interest from a private sector client for an IFC investment, IFC will engage with the World Bank to undertake a joint preliminary analysis of the key opportunities and risks in the sector/country (as indicated earlier in the paper, such an analysis could also be triggered by a potential interest in WB financing). In some circumstances IFC's advisory work may precede an IFC investment and could include country and sectoral analyses to determine how IFC advisory work might best promote standards for sustainable development. IFC's planned advisory work in Indonesia is an example of this. For a potential IFC investment, the joint analysis will consider the following and assist the WBG in developing its proposed engagement in the sector:

- the project's ability to foster sustainable development in the country in light of country/sector conditions on the ground (including any supply chain impacts);
- regulatory/policy factors, if any, that may limit the ability of projects in the sector to contribute to sustainable development;
- the opportunity for the project to deliver enhanced benefits to local communities and smallholders; and
- the opportunity for integrated WBG support at the country/sector/project level in order to broaden development benefits and/or strengthen environmental and social performance.

Based on the outcome from this assessment process, the WBG will make the following decisions with regard to the project and sector:

- the terms under which IFC may choose to engage on the project; and
- offers by the WBG to the client or local/national governments for enhancing the ability of the project/sector to contribute to sustainable development (in certain cases, the feasibility of a parallel WBG project would influence whether or not the Project Concept is approved).

IFC may decide, based on this early assessment, not to proceed with the financing of a project until identified regulatory/policy limitations are being worked on or have been addressed.

Ensuring Environmental and Social Sustainability

The early CSA will play a key role in ensuring that IFC has a full understanding of the likely

environmental and social impacts of the project. IFC will utilize the Risk Screening and Assessment Tool (see Annex XII) to assist in this process. This tool has been developed by IFC taking into account the feedback from the global palm oil consultations and the recommendations from the CAO. It utilizes a new approach to ensure that IFC review of proposed projects takes into account the country and sector context, as well as the environmental and social concerns that have been identified as part of the consultation process, including: (1) land use rights, allocation and management; (2) environmental concerns (deforestation, biodiversity loss, utilization of peat, GHGs, HCV land); (3) social and human rights concerns (land acquisition and tenure, indigenous peoples, conflict resolution, labor issues, and poverty reduction); (4) smallholder concerns; and (5) supply chain management, particularly in the areas of traceability and certification. In addition to drawing on internal World Bank and IFC knowledge of country and sector conditions, this tool will draw on information from external sources as appropriate to inform IFC's assessment of the project, sector and country.

Early E&S Risk Rating

In order to be approved, all project concepts must meet standard IFC criteria with respect to financial and economic rates of return, technical viability, sponsor integrity, corporate governance, and appropriate disclosure of E&S issues and development impact indicators. In addition to assessing a project's risk of financial, economic, technical, integrity and governance criteria, projects will also be rated with respect to E&S issues as low, medium, and high risk depending on the early risk assessment. The assessment will use the following approach. The scoring system will depend on both the probability of an adverse event occurring, as well as the perceived level of the E&S issue. Only projects with a low probability of any significant E&S adverse events occurring would be classified as low. This risk rating will in turn be a key input into IFC's environmental categorization of the project. Depending on country, sector, and project conditions, projects in the palm oil value chain are likely to be categorized as either Category A or Category B which would subject them to a higher degree of due diligence and environmental and social requirements where risks are identified.

For medium and high risk projects, this will 'trigger' additional procedures and actions which IFC staff will undertake. The steps in the decision process are as follows:



- **Step 1:** Determine Risk Level: The project will be rated low, medium or high
- **Step 2:** Risk Level Triggers: Depending upon the risk level, the project will have to undergo certain actions before formal concept approval, which may include pre-appraisal, consultation with the government, consultation with stakeholders and communities, and collaboration between IFC Advisory and Investment staff.
- **Step 3:** Decision criteria to proceed: The project concept will be approved based on defined criteria, which would include the project's development impact, the project's ability to meet IFC's performance standards, support from the government, and support from relevant stakeholders.
- **Step 4:** Project design: IFC will work with the client to ensure that the development impact of the project is enhanced (particularly with regard to benefits to workers, the community and smallholders), environmental and social risks are mitigated, a monitoring system is put into place, and that there is effective engagement with stakeholders.

Staff Training. To ensure that the strategy is followed through, all investment and E&S staff that may be involved in the palm oil sector will undergo a training course covering (1) the WBG Palm Oil Framework and IFC Strategy, (2) IFC's development objectives in the palm oil sector, (3) the Good Practice Note for WBG Staff, (4) the Country Situation Analysis, (5) the rationale for and use of the Risk Screening and Assessment Tool, and (6) the procedures that must be followed in processing any investments in the palm oil sector.

4.7. Addressing Environmental and Social Concerns

IFC believes that the palm oil risk screening and assessment approach at country/sector level, on one hand, and, on the other hand, its performance standards at investment-level provide adequate protections in relation to the key environmental and social concerns raised during the consultation process. Where compliance with these requirements is not feasible, IFC will not invest. A brief summary of IFC's approach is provided below and further detail of the relevant performance standards is provided in Annex XIII. The full set of performance standards is accessible at (www.ifc.org/ifcext/sustainability.nsf/Content/EnVocStandards).

IFC E&S Categorization: In addition to revising its categorization approach following the CAO audit⁶⁴, IFC is adopting the new risk screening and assessment tool to enhance its ability to identify E&S risks. This will inform initial categorization, and other subsequent due diligence, and finally any mitigation measures that may need to be undertaken by IFC's clients in the sector. In practice, projects in the palm oil value chain are likely to be classified as Category A or B which will subject them to a higher levels of due diligence.

As part of the on-going PS review, IFC is proposing to introduce a risk categorization system for financial intermediaries based on the environmental and social risks associated with their lending operations. Depending on country and sector circumstances, the provision of IFC financing for clients in the palm oil sector through financial intermediaries would likely be classified as either high or medium risk according to this approach.

Adequacy of Client' E&S Systems: Through its Performance Standard 1, IFC requires its clients to assess their projects for actual and potential E&S impacts taking into account the requirements of relevant IFC performance standards⁶⁵. It further requires clients to develop, implement and maintain a social and environmental management system that will enable them to avoid, manage or compensate for relevant E&S impacts.

Biodiversity Conservation and Sustainable Natural Resource Management: Performance Standard 6, Biodiversity Conservation and Sustainable Natural Resource Management, includes client requirements related to protection and conservation of biodiversity and ecosystems services. It is qualitatively similar to the concept of High Conservation Value (HCV) areas that is incorporated in various certification systems. IFC investments in palm oil producers require achieving certification according to such systems.

Clients are required to assess natural and modified habitat and determine if any such areas include critical habitat. Critical habitat includes

⁶⁴ This involved a change in the categorization process for a trade or working capital facility involving a single-commodity, single-company transaction. As a result, such investments are likely to be categorized as Category A or B.

⁶⁵ performance standards 2 through 8 cover labor and working conditions; pollution prevention and abatement; community health, safety and security; land acquisition and involuntary resettlement; biodiversity conservation and sustainable natural resource management; indigenous peoples; and cultural heritage.



areas necessary for the support of endangered and critically-endangered species, endemic and restricted range species, and migratory species, as well as areas having significant scientific value and areas of social, economic and/or cultural value to local communities. It is essential that competent biodiversity specialists from relevant technical disciplines be involved to ensure that thorough biodiversity analysis is undertaken, including consideration of ecosystem services and habitat functionality, and negative impacts avoided where possible.

With regards to projects in critical habitats, IFC uses a risk based analysis which results in go or no-go decisions. This analysis would take into account the degree of criticality, the level of adverse impacts, and the client's ability to mitigate and manage the issues. IFC may decide not to proceed with a project because of the potential adverse impact on critical habitat. As an example, IFC would not support any oil palm plantation project that would convert high-carbon-stock peatlands, due to their ecosystems services, as well as high carbon and/or biodiversity value. Similar considerations would apply to high-carbon-stock primary tropical forest.

Consistent with the requirements in Performance Standard 6, IFC will avoid investments in which primary tropical forest has been cleared specifically for the purpose of the palm oil expansion under consideration. In other cases where the area has suffered recent deforestation, IFC will also assess when the deforestation occurred in an area and the associated risks.

Affected Communities and Indigenous Peoples: IFC has specific requirements and protections in relation to affected communities and to indigenous peoples. Where projects may have a significant environmental or social impact on affected communities, or that may have adverse impacts on affected communities of indigenous peoples it must implement an elevated form of consultation described as Free, Prior and Informed Consultation (FPIConsultation)⁶⁶. In addition, with regard to indigenous peoples, if the client is going to locate the project on or commercially develop natural resources located within land under traditional or customary use by indigenous peoples, if project development requires

relocation of indigenous peoples, or if a project makes commercial use of indigenous peoples' cultural resources, the client is required to apply an elevated form of consultation called Good Faith Negotiation, in addition to FPI Consultation. When the client is required to engage in a process of FPI Consultation, IFC will conduct, as part of its due diligence, a process of determining broad community support. IFC reviews the client's documentation and engages with affected stakeholders to assure itself that the client's community engagement process is one that involves free, prior, and informed consultation and enables the informed participation of the affected community and leads to broad community support, before presenting the project for approval to IFC's Board. After Board approval of the project, IFC continues to monitor the client's community engagement process as part of project supervision.

Box 8: Free Prior and Informed Consent

During its on-going review of IFC performance standards, IFC has proposed adopting Free Prior and Informed Consent in the Version 2 draft of Performance Standard 7 on Indigenous Peoples. The final decision on this point is subject to Board approval. The draft language requires FPIConsent in special circumstances when projects: (i) are to be located on or make commercial use of natural resources on lands subject to traditional ownership and/or under customary use by indigenous peoples; (ii) require relocation of indigenous peoples from traditional or customary lands; or (iii) involve commercial use of indigenous peoples' cultural resources.

IFC has sought to clarify the definition of consent stating that FPIConsent will be established through good faith negotiation between the client and culturally appropriate institutions representing communities of indigenous peoples. The client will document the mutually accepted process between the client and indigenous peoples and evidence of agreement between the parties as the outcome of the negotiations.

Supply Chains: Performance Standard 1 states that the impacts associated with supply chains will be considered where the resource utilized by the project is ecologically sensitive or where low labor cost is a factor in the competitiveness of the item supplied. The Sustainability Policy recognizes that sometimes the client does not have control over the third party, which could be a supplier, and that the two should collaborate, where possible. For primary suppliers providing living natural resources, goods or materials essential to the core business function, the client

⁶⁶ IFC is assessing the possibility of changing its requirement in this area to one of Free, Prior and Informed Consent as part of the ongoing review of its performance standards. See box on p. 48.



should verify that natural and/or critical habitat is not being significantly adversely impacted and should give purchasing preference from suppliers that can demonstrate no significant conversion. The practice is for the client to conduct a mapping exercise that identifies the supply chain. For supplies growing in ecologically sensitive areas, the client should require its suppliers to avoid/minimize negative impact on natural and critical habitats. Where IFC's client cannot meet these requirements because it lacks leverage, the client is expected to change suppliers, where possible.

If an IFC client is sourcing from its own plantations, IFC requires the client to apply Performance Standard 6 to its facilities. If the client is a majority buyer from a supply chain supplier, IFC requires it to use its leverage to effect positive results. The complexity comes when the client does not have control over the supply chain—or when the client is positioned in the value chain after the commodities are comingled, making it impossible to identify the suppliers. In such cases, if the risk is considered high and non-mitigatable, IFC may not invest. Likewise, IFC would require clients to address child and forced labor in its supply chain as required in Performance Standard 2.

Greenhouse Gas (GHG) Emissions: IFC will review GHG emissions associated with prospective palm oil projects. For projects that are expected to or currently produce more than 100,000⁶⁷ tonnes of CO₂-equivalent annually, IFC requires its clients to implement technically and financially feasible and cost-effective options to reduce project-related GHG emissions during the design and operation of the project. Such measures will integrate the principles of cleaner production into product design and production processes with the objective of conserving raw materials, energy and water. Particular opportunities exist in palm oil processing and storage such as the collection of methane from effluent treatment ponds. Additionally, IFC requires its clients to report annually on the emissions from the project, as well as indirect emissions associated with the off-site production of energy used by the project. IFC would not support any palm oil plantations that would result in conversion of high-carbon-stock peatlands or primary tropical forests.⁶⁸ Research

⁶⁷ IFC is considering lowering this to 25,000 tonnes CO₂ equivalent per annum and requesting the client in demonstrating that the project design is as efficient as possible through benchmarking, when available, as part of the ongoing review of its performance standards.

⁶⁸ The proposed changes to PS3 will require clients to make the GHG calculation of their project, no matter what size it is

is underway to define agreed methodologies for assessing and measuring carbon stocks and defining thresholds.

Requirement for Certification: For clients involved in primary production of agriculture and related industries, IFC requires a further commitment by its clients to obtain independent certification to the appropriate standards for sustainable practices, where such standards exist. IFC's Performance Standard 6 and Guidance Note 6 provide additional guidance on the elements that define the appropriate certification system (more than one certification system may be acceptable to IFC in this regard). These requirements are summarized in Annex XIII.

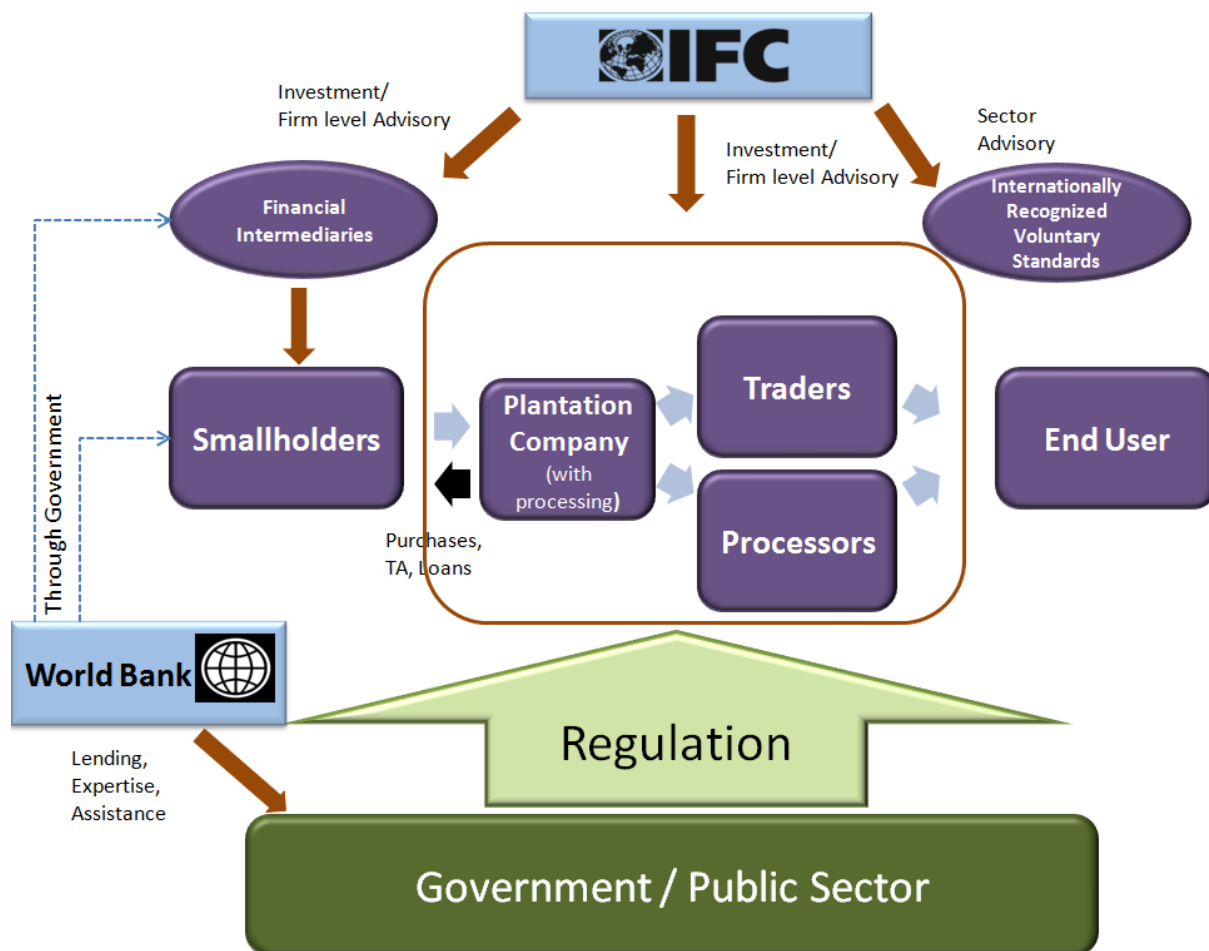
4.8. IFC Engagement with Private Companies in the Palm Oil Value Chain

The private sector is the dominant player in the palm oil industry. It encompasses large plantation companies, smallholders, processors, traders, and buyers/users of palm oil, in addition to a variety of supporting firms in the provision of inputs and services. Future developmental benefits from the palm oil sector will, in all likelihood, continue to derive from private investment in the sector. When undertaken in an environmentally and socially sustainable manner these investments can play an important role in supporting economic growth and poverty reduction in a number of developing countries.

and will include project-induced changes in soil carbon content or above ground biomass by using internationally recognized methodology and good practice (such as methodologies provided by the Intergovernmental Panel on Climate Change).



Figure 4: IFC Targeted Investments within a Simplified Palm Oil Value Chain



IFC can directly engage with plantation companies, refineries or processors, and traders. On occasion it may also support palm oil companies through financial intermediaries. IFC typically reaches smallholders through its investments in these entities and offers incentives and support for its clients to engage smallholders and local communities. Plantations and smallholders represent the 'Upstream' part of the supply chain, while refineries, processors and traders generally represent the 'Downstream' part.

Upstream companies can contribute to sustainable development by undertaking investments that create employment, local infrastructure, improved agricultural practices, benefits for associated outgrowers and local communities and improved environmental and social practices. Downstream companies and financial intermediaries can extend benefits to growers that are not associated with upstream

companies and can also assist in improving agricultural, environmental and social practices.

IFC would seek to support private sector companies in the palm oil value chain that:

- Undertake productive investments that contribute to economic growth and poverty alleviation;
- Support smallholders and local communities, as appropriate;
- Undertake investments on degraded lands or lands where E&S risks can be avoided or mitigated;
- Commit to complying with all local regulations and to meeting IFC Performance Standards;
- In the case of Upstream firms, commit to obtaining internationally recognized certification of their operations;



- In the case of downstream firms, ensure that they have the ability to assess the environmental and social risks in their supply chains and that they commit to meeting IFC's performance standards;
- In the case of financial intermediaries, ensure that they have the ability to assess the environmental and social risks associated with their investments and that they commit to meeting IFC's performance standards for financial intermediaries.

IFC's additionality: In addition to providing financing to these types of companies, IFC would seek to assist them in the following areas as appropriate:

- Adopt industry best practices for engaging with smallholders;
- Support the provision of technical assistance to smallholder suppliers;

- Help to broaden the smallholder base;
- Support the development of a company strategy to improve the sustainability of operations, including supply chain risk assessment and implementation planning;
- Help the company design appropriate community development projects (education, health, etc.);
- Assist clients in tracking and measuring GHG emissions and help them identify opportunities to reduce GHG emissions in the design and operation of their projects;
- Assist clients in identifying and integrating REDD+ activities into project design.



ANNEXES

- Annex I: World Bank Country Strategies and Project Cycle
- Annex II: Overview of the Stakeholder Engagement and Consultation Process
- Annex III: Production and Trade in Major Vegetable Oils
- Annex IV: The World Bank Group's Experience in the Palm Oil Sector
- Annex V: Actors in the Palm Oil Sector
- Annex VI: World Bank Safeguards Policies
- Annex VII: Applying World Bank Safeguards and IFC Performance Standards:
A Good Practice Note for WBG Staff
- Annex VIII: WBG Approach to Monitoring and Evaluation
- Annex IX: Examples of Ongoing Partnerships in Support of Sustainability
- Annex X: Recommendations of IFC's Compliance Advisor/Ombudsperson and IFC's Responses
- Annex XI: Improving Livelihoods of Palm Oil Smallholders: The Role of the Private Sector
- Annex XII: IFC's Risk Screening and Assessment Tool
- Annex XIII: IFC's Sustainability Framework: Applications for Potential Environmental and Social Issues in Palm Oil Projects



Annex I: World Bank Country Strategies and Project Cycle

1. WORLD BANK STRATEGIES

Poverty Reduction Strategies. The Poverty Reduction Strategy Paper (PRSP) describes a country's long term vision. The paper is prepared by low-income country governments in consultation with various stakeholders, such as civil society and the private sector. The paper sets out macroeconomic, structural, and social policy goals.

The paper also lays out a country's external financing needs for meeting those goals, such as loans and grants from the World Bank and other donors, that are meant to promote economic growth and reduce poverty. The Bank and other donor agencies line up their assistance with these countries' priorities and targets.

Countries have used PRSPs to address their investment climate and prescribe measures to foster private sector development, or to chart plans to improve governance and reduce corruption. Many concentrate on issues facing the agricultural sector and rural areas, and stress the need for investment in key basic services, particularly health and education in implementing their strategies.

The World Bank provides training and technical and financial assistance to support the design of national poverty-reduction strategies. For example, it helps countries improve their poverty analysis, public expenditure management, and service evaluation. It also offers Poverty Reduction Support Credits (PRSCs), annual programmatic loans, to support the implementation of these strategies.

Both the World Bank's International Development Association (IDA) and the International Monetary Fund (IMF) require a Poverty Reduction Strategy Paper in order for low-income countries to receive lower cost financial assistance from the Bank (through IDA) and the IMF (through its Poverty Reduction and Growth Facility).

Country Assistance Strategies. The Country Assistance Strategy (CAS) - also called in some cases Country Partnership Strategy or Joint Assistance Strategy - lays out a selective program of World Bank Group support for a particular country. This strategy is developed by Bank staff in meetings with government officials, in consultation with country authorities, civil society organizations, development partners, and other stakeholders. It takes as a starting point the country's own long-term vision for development and takes into account the Bank Group's comparative advantages in the context of other donor activities. The strategy is designed to promote collaboration and coordination among development partners in a country.

The CAS includes a comprehensive diagnosis - drawing on analytical work by the Bank, the government, and/or other partners - of the development challenges facing the country, including the incidence, trends, and causes of poverty. The CAS identifies the key areas where the Bank Group's assistance can have the biggest impact on poverty reduction. In its diagnosis, the CAS takes into account the performance of the Bank's portfolio in the country, the country's creditworthiness, state of institutional development, implementation capacity, governance, and other sectoral and cross-cutting issues. From this assessment, the level and composition of Bank Group financial, advisory, and/or technical support to the country is determined.

To track the implementation of the CAS program, the CAS is increasingly results-focused. It includes a framework of clear targets and indicators to monitor Bank Group and country performance in achieving stated outcomes.



2. WORLD BANK PROJECT CYCLE

How Project Cycle Works

1. Country Assistance Strategy

The World Bank proposes financial, advisory and technical services, to help countries identify their priorities and reach their main development goals.

6. Evaluation

After a Borrower completes a project, the Bank's Independent Evaluation Group (IEG) measures the outcomes against original objectives and assesses whether or not the project's results can be maintained over the long-term. A number of projects are further scrutinized in detailed impact evaluation reports.

5. Implementation and Completion

At the end of the loan or credit disbursement period (anywhere from 1 to 10 years), a completion report identifying project results, problems and lessons is submitted by operations staff to the Bank's Board of Executive Directors for information purposes.

2. Identification

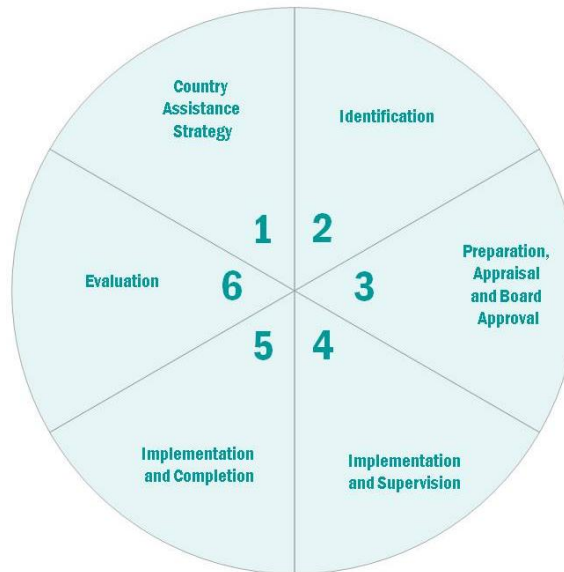
Ideas for creating meaningful change are discussed. Borrower and Bank representatives weigh development objectives and project impacts, risks, alternatives and timetable.

3. Preparation, Appraisal and Board Approval

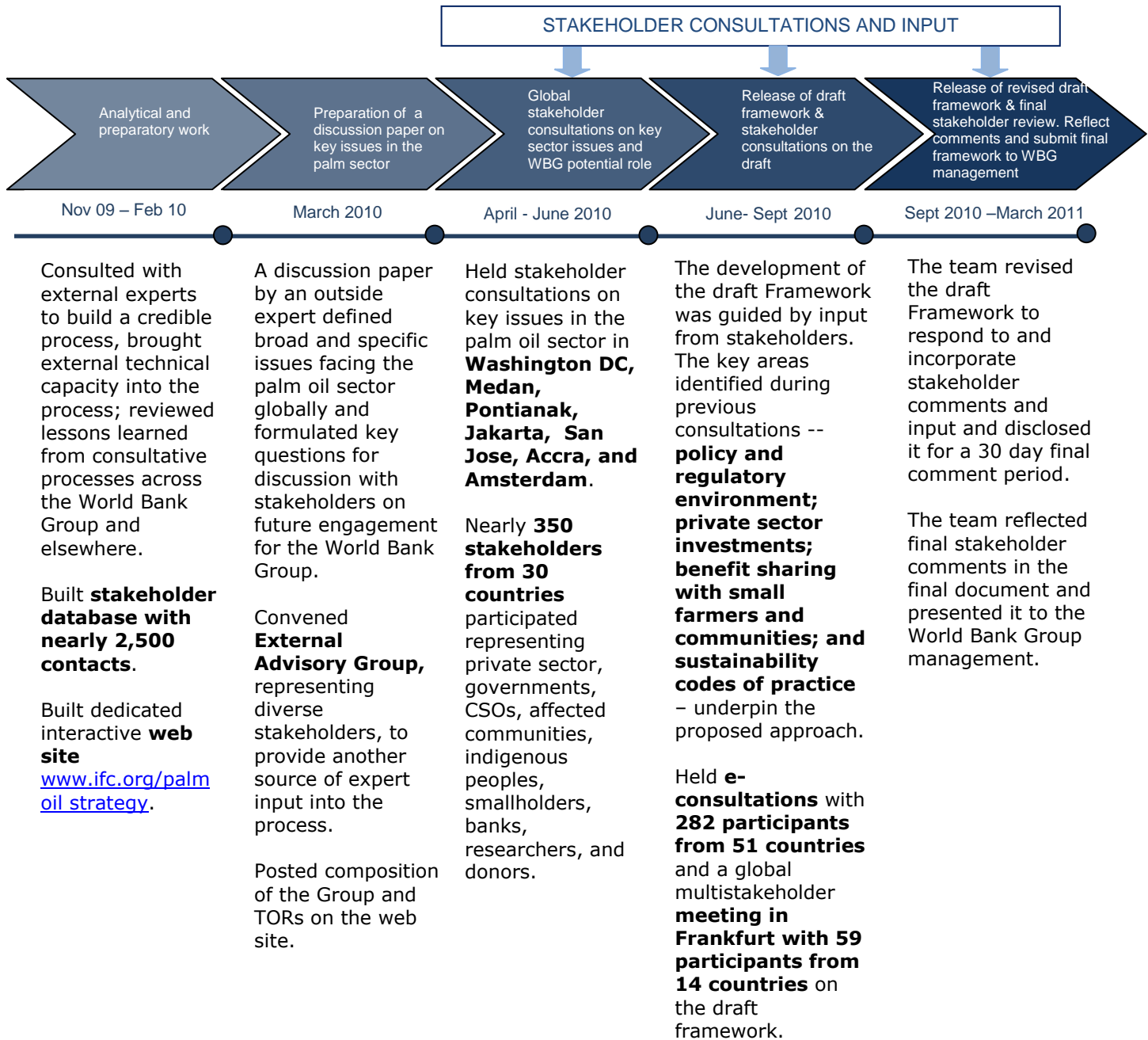
With advice and financial assistance from the Bank, the Borrower conducts studies and prepares detailed project documentation. The Bank assesses the economic, technical, institutional, financial, and environmental and social aspects of the project. When the Bank and the Borrower agree on the terms of the loan or credit, the project is presented to the Bank's Board of Executive Directors for approval.

4. Implementation and Supervision

The Borrower implements the project, issuing contracts through a competitive bidding process that follows the Bank's procurement guidelines. World Bank staff periodically supervises the project to make sure that the loan proceeds are used for intended purposes and with due regard for economy, efficiency, and effectiveness.



Annex II: Overview of the Stakeholder Engagement and Consultation Process



Annex III: Production and Trade in Major Vegetable Oils

By country ('000 tonnes)

	Production			Disappearance			Net Exports ¹		
	2008/09	2009/10	2010/11	2008/09	2009/10	2010/11	2008/09	2009/10	2010/11
Soybean Oil									
Argentina	5,914	6,445	7,525	1,425	1,912	2,242	4,704	4,400	5,355
Brazil	6,120	6,440	6,350	4,274	5,050	5,220	1,905	1,394	1,195
China	7,314	8,703	10,420	9,486	10,435	12,130	-2,411	-1,520	-1,930
EU	2,314	2,250	2,268	2,779	2,380	2,543	-394	-150	-250
India	1,287	1,265	1,415	2,300	2,710	2,720	-1,058	-1,498	-1,198
USA	8,503	8,870	8,609	7,378	7,235	7,773	954	1,492	1,082
Total	35,695	38,671	41,544	35,869	38,087	41,306	9,122	9,082	9,377
Rapeseed Oil									
Canada	1,679	1,868	2,104	395	400	425	1,416	1,609	1,760
China	4,700	5,158	5,219	4,853	5,478	5,909	-444	-715	-590
EU	8,472	9,370	9,090	8,679	9,665	9,565	-312	-330	-350
India	2,058	2,230	2,325	2,095	2,252	2,347	-41	-22	-22
USA	497	475	531	1,280	1,293	1,491	-801	-816	-970
Total	20,463	22,311	22,283	20,125	22,088	22,592	2,416	2,660	2,679
Sunflower Oil									
Argentina	1,342	1,035	1,450	378	387	392	853	760	1,050
EU	2,335	2,435	2,360	3,158	3,234	3,303	-864	-830	-900
India	319	255	283	731	852	730	-583	-550	-450
Russia	2,565	2,505	2,193	1,918	1,991	1,926	765	530	280
Ukraine	2,632	2,603	2,632	395	219	259	2,098	2,600	2,370
Total	11,872	11,462	11,531	10,673	11,134	10,964	4,588	4,678	4,583
Palm Oil									
China	0	0	0	5,618	6,320	6,977	-6,117	-6,349	-6,949
EU	0	0	0	4,993	5,024	5,388	-5,247	-4,990	-5,250
India	50	50	50	6,475	6,750	7,350	-6,867	-6,400	-7,200
Indonesia	20,500	21,275	23,450	4,677	4,685	4,935	15,949	16,685	18,060
Malaysia	17,259	17,764	18,297	3,229	3,697	3,800	14,438	14,280	14,850
Thailand	1,345	1,720	1,750	1,250	1,485	1,650	148	118	118
Total	43,702	45,416	48,234	42,440	45,065	47,987	34,573	35,487	37,520
COMBINED	111,732	117,860	123,592	109,107	116,374	122,849	50,699	51,907	54,159

Note: 1. Exports minus imports (except for world totals, which are exports). A negative number means a country is a net importer.

Sources: LMC estimates; Malaysian Palm Oil Board; Oil World; Solvent Extractors' Association; USDA.



Annex IV: The World Bank Group's Experience in the Palm Oil Sector

Overview of World Bank Investments

Since 1965, the World Bank (IBRD/IDA) has committed nearly US\$2 billion over 45 projects in the palm oil sector, in 12 countries in Africa, Latin America, and Southeast Asia. Many stand-alone projects focused on oil palm, while others included crops such as rubber, coconut, coffee, etc. Most of the oil palm projects were implemented in the 1970s and 1980s. Many were repeat or follow-on projects within countries. Regionally, most projects were based in West Africa and East Asia with only one project implemented in Latin America during this period. Three such projects are currently in implementation, while the balance has been completed and closed.

Countries	Total Committed Amount (mIn, US\$)*
Benin	4.6
Burundi	35
Cameroon	118.4
Congo, Democratic Republic of	9
Cote d'Ivoire	53.1
Ghana	43.6
Indonesia	618.8
Liberia	12
Malaysia	383.2
Nigeria	451.5
Panama	19
Papua New Guinea	100.6
Total	1848.8

*most of the projects were stand alone focusing on oil palm, however there were some which included other crops such as coconut, rubber and coffee. In addition, there are a few projects which may have very small amounts going towards oil palm.

Generally, the objective of these projects was to reduce poverty and promote economic growth by improving productivity in the palm oil sector through investments in planting and replanting oil palm over several thousand hectares of land. The World Bank supported public sector projects included construction of palm oil processing factories and mills and also included associated facilities, such as collection roads, buildings and other infrastructure (housing, medical and administrative buildings, store sheds, vehicles, and equipment, etc.). Projects often supported the establishment and operation of nucleus estates, provided funding for extension services and credit facilities to develop smallholder farms, and in some cases promoted out-grower schemes. Some third and fourth generation projects expanded their scope and settled landless families on prepared land, and created productive employment on the estates and in the palm oil mill to raise the incomes of smallholders and employees.

Selected Country Experience

Indonesia

Indonesia has been a central focus of World Bank lending for oil palm development projects, with more than a third of the total lending for the sector. Over the 1969 to 1983 period, eight projects were financed by the Bank. This was a period of considerable emphasis by the Government of Indonesia on developing the agricultural sector, and the government established a range of government-sponsored (public sector) operations in the palm oil and other sectors.

The eight Bank projects in Indonesia were generally deemed to have been successful in establishing new plantations and introducing smallholders to oil palm cultivation. Results achieved included:

- Nearly 100,000 ha of oil palm planted and replanted (total)
- 12,000 smallholder families (rubber and oil palm) benefited and 24,000 new jobs generated on the nucleus estates and smallholdings (*North Sumatra I*)
- 2.59 million tons of palm oil production (*North Sumatra II*)
- Rubber and oil palm components benefited about 10,000 poor smallholder families and



generated about 6,000 new jobs on the nucleus estates and smallholdings (*NES V*)

- 900 km of road improved/ built (*NES V*)

The projects were assessed by IEG, which found the first six projects to be satisfactory according to their internal rating scheme, while the last two, which were larger and more complex, were unsatisfactory due to the poor performance of the responsible agencies, and logistical and management difficulties. Land titling was identified as subject to delays. It was noted that in one case in West Java there were difficulties with competing land claims from local communities which did not want to participate in the project. Based, in part, on the disappointing performance of public agencies, the Government of Indonesia encouraged the private sector development of oil palm plantations.

Nigeria

Nigeria was the second largest recipient of the World Bank palm oil sector funding, with six projects over the 1975 to 2009 period. One project, in which palm oil is one of many possible technologies that smallholders can select, is still under implementation. Results achieved included:

- 42,658 ha of oil palm planted (total)
- 384 km of roads improved (*Eastern Central and Nucleus*)
- Two small mills with capacities of 1 ton and 3 ton FFB/hr were rehabilitated (*Tree Crops*)
- 30 tons/hour of milling capacity was installed (*Eastern Central and Nucleus*)

In its review of these projects, the Independent Evaluation Group rated only two of five to be satisfactory. Issues that were identified included poor management, high labor costs and questions over land use rights for smallholders.

Cameroon

From 1967 to 1982 the World Bank funded six palm oil projects in Cameroon. The main objective of these projects was to increase the production of palm oil in the western region and improve the financial efficiency of public enterprises. Results achieved included:

- 10,464 ha of oil palm planted and 4,682 ha felled and replanted resulting in a net increase of 5,782 ha (*Camdev I*)
- Successful institution building of the Camdev company
- 8,280 ha of oil palms planted (*Socapalm I*)

- 2,031 ha of oil palm planted (281 ha estate and 1750 ha smallholder) (*Camdev II and Socapalm II*)

Out of the six projects, four were rated satisfactory by IEG. The first two projects (*Camdev 1* and *Socapalm*) were satisfactory and their objective of increased production of palm oil was largely met. *Socapalm* was a new company and its management performed reasonably well. Despite their success, both projects faced financial difficulties. Follow-on projects (*Camdev II* and *Socapalm II*) financed by the Bank were unable to address the financial difficulties but introduced smallholder out-grower schemes. These new additional components did not perform well either and financial situation of both companies deteriorated further. Finally, the World Bank decided to suspend further investments in this sector due to questions of profitability and competitiveness of palm oil production in Cameroon.

Papua New Guinea

The World Bank has had six projects in Papua New Guinea over the 1969 to 2008 period, which primarily addressed oil palm. Five are closed while one project (*Smallholder Agriculture Development Project*) is still under implementation. Results of the first two projects included:

- 50,000 tons of palm oil produced in 5,583 ha of land benefiting 1517 smallholders (*Popondetta Smallholder Oil Palm*)
- 8,230 ha of oil palm planted in new blocks (8,230 ha) (*Oro Smallholder Oil Palm*)
- Access road of 345 km built (*Oro Smallholder Oil Palm*)

IEG's evaluations of the first four closed projects were rated as satisfactory, while the last project was moderately satisfactory. Success was attributed to good suitability of the area for cultivation of palm oil with regard to soil and climate, and good management by the project staff. There were difficulties in providing inputs (fertilizer) for cultivation which reduced productivity.

Malaysia

Malaysia is one the largest oil palm producer in the world and received significant Bank funding. From 1968 to 1994, seven projects were approved and all were rated as satisfactory by IEG. These projects are not discussed in the review because at the time of the research, the projects were missing from the Bank's



information depository (Business Warehouse) due to a problem with the internal sector coding system.

Lessons Learned

Lessons learned⁶⁹ from the World Bank's experience in the sector include the following:

Experience with nucleus estates and smallholder (NES) projects suggests that the prospects for success are improved if public sector agencies have well developed capacity for oversight of technical management and of the social and financial aspects of project development (as was the case for the earlier FELDA supported projects in Malaysia). Nucleus estates under private sector management (as in PNG, for example), are most likely to succeed if institutional mechanisms are in place for ensuring that participating local communities and small holder outgrowers receive an equitable share of project revenues.

Land tenure issues should be addressed at the outset of the project: In some countries, land tenure issues resulted in disputes which affected project implementation. At the outset of the projects, land for crop developments should have been secured legally, as well as through in-depth consultation with the project beneficiaries.

Management capacity of public sector estate companies affects project performance: As noted above, in some countries, public sector companies like FELDA (Malaysia) performed very efficiently, from both a technical and financial standpoint. As a result, Bank financed projects in Malaysia were categorized as successful. Alternatively, in countries where the public sector estate companies had financial management problems and were overstretched, the estate companies were unable to manage large commercial investments well.

Infrastructure components (i.e., Roads) need to be well integrated into the project: In projects that included access roads and which were given less attention, there were delays in their construction and maintenance. Projects that addressed all components in balance were able to avoid cost overruns and extension of closing dates. It also contributed towards achieving the overall success of the project.

Different approaches to out-grower/smallholder involvement have varying success: Various approaches were tried with varying success. Additional analysis is needed to evaluate which models of smallholder involvement offer the best

approach and it may vary depending upon the countries and involvement of public/private management.

Overview of IFC Investments

IFC has engaged extensively throughout the supply chain in the palm oil sector, with investments in plantations (Indonesia, Thailand, Ghana, and Nicaragua) as well as palm oil refining (Indonesia and Ukraine) and palm oil trading (Indonesia and Singapore). Since 1976, IFC has invested US\$311 million in 26 palm oil related projects. This compares to net commitments of US\$5.5 billion in the agribusiness sector over the same period, and US\$80.1 billion invested in total by IFC. A summary of these investments is provided in the table below.

IFC's early investments (1970s and 1980s) focused on smaller-scale processing as well as oil palm cultivation. Most of the investments in Africa were done through the Africa Enterprise Fund, which focused on small and medium-scale investments. These, and the project in Brazil, included investment in oil palm plantation development as well as expansion or upgrading of crude palm oil mills, palm kernel crushing, and associated facilities (bulk storage, effluent treatment). Environmental and social reviews of these investments were minimal, as these preceded any formal requirements by either IFC or the World Bank.

Subsequent investments, since the 1990s, have focused on larger plantation operations in Indonesia, with investments in operations in Bengkulu, West and South Kalimantan, and North and South Sumatra. These were located on existing agricultural lands (transmigration projects) or degraded lands (*Imperata* grasslands).

IFC Investments in the Palm Oil Sector

Other recent plantation investments have been in Nicaragua and Ghana, and further investments in Africa and Latin America are expected in the future.

⁶⁹ See additional examples of lessons at the end of this annex.



Country	Year	Committed Amount (mln US\$)*	Status
Brazil	1980	4.7	closed
	1982	6.1	closed
	1993	0.6	closed
Cameroon	1976	0.8	closed
	1978	0.4	closed
	1981	0.2	closed
	1985	1.9	closed
Cote d'Ivoire	1987	2.0	closed
	1993	4.7	closed
	1996	3.8	closed
Ghana	2007	12.5	active
Honduras	2009	30.0	active
Indonesia	1990	12.7	closed
	1996	35.0	closed
	2002	11.5	closed
	2003	14.0	closed
	2003	12.0	closed
	2004	33.3	closed
	2007	50.0	closed
Mexico	2006	1.0	closed
Nicaragua	2009	25.0	active
Philippines	1982	11.0	closed
Thailand	1987	4.7	closed
Ukraine	2006	17.5	active
	2008	45.0	active

Since 2004, IFC has been more active in moving down the palm oil supply chain, with substantial investments in trading (Wilmar Trading – short-term trade finance support) and in refining (Ukraine). These investments have resulted in criticism of IFC for insufficient attention to supply chain issues with regard to sustainability in trading and refining operations, which has in turn prompted this current strategy exercise for the palm oil sector.

IFC-financed companies generally performed well and were able to grow their businesses over time in spite of unexpected difficulties along the way with one investment (Brazil) failing after experiencing disease problems and then ceasing operations. The main challenges to implementing (palm plantation) projects and achieving the expected returns were (i) the long gestation of palm plantations and the heavy capital commitment that is required upfront; (ii) frequent claims over disputed lands; and (iii) economic and financial crises in the country of operation. Although land claims were generally resolved through local mechanisms, they often resulted in delayed planting and production. Economic crises had a negative impact on the financial performance of plantations because of the direct impact of devaluations, policies that lowered the revenue base (e.g., export tax), but also because governments were often unable to deliver on their budgeted commitments (e.g., to support financially the development of smallholder plantings); under these circumstances, private sector companies had to step in and fill the financial gap at a high additional cost.

Palm oil projects have had strong economic impacts on the countries involved. In Indonesia, they supported the emergence of private companies and smallholders that took over the development of palm oil production due to the mixed performance of state-owned estates (see World Bank experience above). Palm oil has also had a significant economic impact on the livelihoods of local communities with industry estimates that one job is created for each 5-hectare plantation developed. Common attributes for permanent workers have included housing, medical care, transport, water, and electricity.

A key component of some of the projects, particularly in Indonesia, was the transfer of land for the development of small oil palm holdings. Although the implementation of these schemes was sometimes delayed, and the economics was strongly impacted by economic crises, it eventually resulted in the establishment of a sector of smallholders who derived a decent livelihood from their production, while benefiting from their access to the nucleus's infrastructure and technical support.

Finally, IFC's engagement in the investment ensured that all investors adjusted their environmental and social policies and processes to the World Bank's guidelines and, from 2006 to IFC's Performance Standards.



Lessons Learned

While a number of generic lessons for all IFC investments would apply, palm-oil related projects differed particularly with regard to the following:

The need for careful selection of clients. IFC's investment experience shows that clients vary greatly in their capacity to understand and respond to environmental and social issues. In a sector such as palm oil, where there are a number of major issues of concern to stakeholders, clients need to have the capacity to deal with these issues as needed, or they need to be able to obtain or develop such capacity rapidly. It is important not to assume that the names and reputations of sponsoring companies will guarantee good management in any specific case—careful and regular monitoring is needed in every case in order to ensure that productivity and management are continuously benchmarked.

The need for careful attention to questions of land acquisition and land tenure. Questions in regard to land use and land ownership can arise in all countries in which IFC works, even in areas where land ownership may be relatively settled and codified. Where land use rights are being transferred from local communities to private sector companies, by government fiat, there is a particular need for care in ensuring that procedures meet local laws and regulations and do not disadvantage local peoples.

The need for careful attention to biodiversity issues. Although oil palm plantations today do not cover an overall area as large as other commodities, areas suitable for oil palm cultivation in the world are also the richest in terms of biological diversity. Concerns over loss of biodiversity are well known. The conversion of primary tropical forest to agriculture has been shown to result in major biodiversity loss. Lands that are planned for conversion to oil palm (or other crops) must be analyzed for their biodiversity and conservation value, and areas designated as being critical habitat (as per IFC's PS6) or of HCV (or similar designations) need to be protected.

The importance of working effectively with local communities to ensure that benefits are appropriately shared and issues properly managed. Especially in cases where communal lands have been transferred to private control, there is a need for companies to work with local communities both to build support for their business as well as to demonstrate that positive

development benefits can accrue to the community.

The value of developing appropriate partnerships with stakeholders, such as roundtables, in order to address sector-wide issues. Strengthening the private sector more broadly, beyond financing specific businesses, can be achieved through mechanisms such as roundtables, which bring together a variety of stakeholders to address issues. Roundtables provide a measure of internal governance for the private sector, and seek to transform the market through development of mutually-agreed standards for sustainability in the sector.

The value of working within a defined and agreed strategy for a sector. IFC recognizes the shortcomings of engaging on a transaction-by-transaction basis in the absence of an overarching strategy. Effectively targeting investment interventions is best accomplished through a thorough understanding of the sector and a comprehensive strategy for its development. Such a strategy should address how different investment products and advisory services⁷⁰ can be targeted to address local conditions—particularly those relating to environmental and social issues. The strategy needs to define how IFC will work, through both its investment and advisory services, with all components of the private sector as well as addressing certain regulatory issues.

The need for adequate attention to supply chains. Concerns over supply chains, particularly for agricultural commodities, have become much more pronounced in recent years. Consumer concerns over environmental and social issues in production, trade, and processing of commodities are now important risks that need to be addressed

The relevance of the policy and regulatory environment. Achieving environmentally and socially sustainable investments in the palm oil sector can be challenging if the enabling policy and regulatory environment is weak. Issues regarding land acquisition, land tenure, and forest governance, and the rights of workers, communities, and indigenous peoples are at the root of many of the social and environmental problems in the sector.

⁷⁰ IFC's Advisory Services are designed to complement traditional investment lending. Additional details are provided at <http://www.ifc.org/ifcext/about.nsf/Content/TAAS>.



Annex V: Actors in the Palm Oil Sector

The Palm Oil Supply Chain

The palm oil sector can be viewed as a network of businesses involved in various segments of the supply chain, all working within a framework of governmental policies, laws, and regulatory systems. The state—through enhanced capacity and new forms of governance—addresses market failures, regulates competition, and engages strategically in public-private partnerships to promote competitiveness in the agribusiness sector and further inclusion of smallholders and rural workers. Businesses in the primary supply chain include small producers (including smallholders) to large multinational plantation companies, processors of the crude palm oil, and manufacturers of consumer and industrial products using palm oil, all linked by traders and transport companies. The sector also includes supporting businesses that provide a wide variety of goods and services needed by the industry (e.g., agricultural inputs, business services, and financial services), as well as industry and other associations representing the interests of groups of stakeholders.

Strengthening the sector as a whole, and ensuring that all of these parts work effectively together, can have a significant developmental impact. Through collective action and partnerships among these actors development of the sector can be scaled up and the benefits can be extended to reach poor people and impact the wider economy.

Private Sector

The private sector is the dominant player in the palm oil industry, from both the producer and buyer/consumer standpoints. It encompasses large plantation companies, smallholders, processors, traders, and buyers/users of palm oil, in addition to a variety of supporting firms in transport, provision of inputs, and other service areas. The WBG supports companies committed to improving the sustainability of their industry. The private sector can play the following roles in support of positive changes in the sector:

- Implementing sound agricultural practices at the company and estate levels.
- In the case of large producer firms: (1) defining and establishing fair and equitable relationships with local communities, and (2) ensuring integration and equitable treatment of smallholder suppliers.

- Engaging with civil society (including direct partnerships) in support of better environmental and social performance.
- Committing to sustainable sourcing and then monitoring the sustainability of their supply chain.
- Establishing strong and effective environmental, social, and labor policies and practices, and improving management capacity and achieving certified status in these matters.
- Establishing and implementing sector-specific codes of conduct or sustainability protocols (e.g., the RSPO).

The private sector has been the key driver behind the exponential growth of the palm oil sector in the major producing countries since the 1960s. Currently, the top 10 plantation companies have a combined market capitalization of US\$79.1 billion (March 31, 2010) and own about 2.3 million ha of plantations producing 9.7 million tonnes.⁷¹ This is equivalent to about 22 percent of the world's palm oil production. Recent mergers and acquisitions have resulted in the emergence of several mega-plantations, such as Sime Darby Berhad and Wilmar International Ltd. Such corporations are vertically integrated, involved in upstream production, processing, and downstream manufacturing in the consuming countries of Europe and China, and elsewhere.

With regard to sustainability, the private sector, working in collaboration with civil society organizations, was instrumental in the establishment of the Roundtable on Sustainable Palm Oil (RSPO) in 2004 (discussed further below). Among the growers, since the adoption of the RSPO principles and criteria and the implementation of the RSPO certification system, many companies have adopted proactive and more structured approaches toward management for sustainability. Several companies have put in place departments or units headed by senior level management to drive initiatives in sustainability. Some corporations, such as Wilmar International Ltd., and Sime Darby Berhad, have put sustainability under the broader context of corporate commitment to social responsibility.⁷² However,

⁷¹ Bloomberg, March 31, 2010.

⁷² Teoh, C. H. 2009. "Malaysian Corporations as Strategic Players in the Southeast Asian Palm Oil Industry." Presentation at the Institute of Southeast Asian Studies Workshop on the



practices vary considerably within the industry and it will take a combination of voluntary actions by the private sector as well as improved government regulation and enforcement to address the issues highlighted in this report.

Governments

The state has a role in addressing market failures and in market development—providing core public goods, strengthening regulatory and transparency mechanisms, and improving the investment climate for the private sector—and in enhancing natural resources management by introducing incentives and assigning property rights.

Governments bear the primary responsibility for establishing the strategic, legal, and regulatory contexts for development of the palm oil sector. More specifically, the function of government is to:

- Define development policies and objectives relevant to the oil palm sector
- Establish the relevant legal and regulatory framework to support sustainable palm oil production
- Ensure nondiscriminatory enforcement of the operative legal and regulatory framework
- Identify and protect high-value environmental assets and services
- Protect the rights and access to livelihood of indigenous peoples and local communities
- Establish good governance practices

Civil Society Organizations

Civil society organizations are key actors in enhancing sustainability of the palm oil industry. Contributions of civil society organizations to development projects can include providing local knowledge and technical expertise, and leveraging social capital. Some examples are as follows:

- *Promoting public sector transparency and accountability* as well as contributing to the enabling environment for good governance
- *Promoting public consensus and local ownership* in support of reforms, national poverty reduction, and development strategies by building common ground for understanding and encouraging public-private cooperation

- *Bringing innovative ideas and solutions*, as well as inclusive approaches to solving local problems
- *Strengthening and leveraging development programs* by providing local knowledge, targeting assistance, and generating social capital at the community level
- *Providing professional expertise* and increasing capacity for effective service delivery, especially in environments with weak public sector capacity or in the post-conflict context

Communities, producer and other stakeholder organizations, and nongovernmental organizations (NGOs) can improve representation of the rural poor and, in so doing, achieve better governance. Producer organizations can give political voice to smallholders and hold policy makers and implementing agencies accountable by participating in agricultural policy making, monitoring the budget, and engaging in policy implementation. For example, in Senegal the Conseil National de Concertation et de Coopération des Ruraux, an umbrella organization of producers, is active in the development and implementation of national agricultural strategies and policies. Freedom of association, a free press, and investment in the social capital of rural organizations, including women's organizations, are important to such demand-side strategies for improving governance.⁷³

Development Finance Institutions

International Financial Institutions, including the WBG, play a supportive role in promoting a sustainable sector through policy dialogue, identifying critical research needs, generating and distributing research and analysis, investment lending, supporting development financing partnerships and supporting multi stakeholder processes.

Multi-stakeholder Fora

Roundtables have found increasing use in the field of forestry and agricultural commodities. They provide a formal structure in which a range of stakeholders can meet and work through common issues and concerns and find ways to jointly address them as well as discuss conflicting views. Most commodity roundtables are global and include key actors covering the entire supply chain of a given sector, from

Oil Palm Controversy in Transnational Perspective, Institute of Southeast Asian Studies, March.

⁷³ World Development Report 2008: Agriculture for Development, The World Bank, Overview, p. 23.



producers and processors to consumers, as well as financiers, civil society organizations, and a range of other supporting institutions. Governments per se generally are not included; the roundtables are seen as a mechanism for self-regulation of the private sector, which goes beyond the formal regulatory role of governments.

Most commodity roundtables have been formed in cases where there are concerns over environmental, social, and governance issues in the sector, and there is a desire by the participants to move the sector toward sustainability, through collective action. This is commonly done through actions to develop a voluntary standard that addresses market requirements for environmental and social responsibility and sustainability. Often these standards overlap with other, non-sector-specific standards for priorities such as quality, environmental management, occupational health and safety, and food safety; where relevant, the roundtable standard will use and refer to other, existing standards.

The success of a commodity roundtable can be defined by the portion of the global trade volume that has become certified under the agreed-on standard and, increasingly, by the evidence that the use of this standard has had the desired impact: improved the well-being of vulnerable groups, strengthened conservation of fragile habitats, reduced deforestation, and so on. The success depends on there being a balance of membership among producers, buyers, financiers, and environmental and social interests, all of which are committed to using the roundtable to address their issues. Of particular importance is ensuring the production capacity to match or exceed the demand from purchasers, in order to encourage the future uptake of the certified product.

There must be appropriate mechanisms for governance and for knowledge, cost, and risk sharing, so that the roundtable members can:

- Decide democratically on the main issues they need to address
- Set auditable standards and create traceability systems that they can all live with
- Agree on and identify means to ensure the integrity and quality of these systems
- Stand by their final standards and systems

Commodity roundtables drive collective and synergistic action and produce results that no

one member can accomplish alone. They differ from other standard-setting initiatives in that they attempt to set a baseline for all, step by step, as opposed to favoring, or segmenting, a subset of players according to a particular production or processing trait (or set of traits). Experience has shown, however, that multiple, interdependent certification systems are needed: one to set the basic tone and others to cater to different tastes and needs. In the end they can set mutual recognition agreements or push each other to improve.

The Roundtable on Sustainable Palm Oil (RSPO)

A number of commercial participants in the global palm oil value chain with the World Wildlife Fund (WWF) in 2004 formed the RSPO, a global multi-stakeholder roundtable. The intention of the RSPO is to improve the sustainability of palm related operations, partly in response to pressure from environmentally sensitive markets. So far the membership has expanded rapidly. The RSPO has gained most traction in the center of production and consumption, Asia, as well as North America and Europe.

The RSPO, with a secretariat in Kuala Lumpur, brings together stakeholders from seven sectors of the palm oil industry: palm producers, processors or traders, consumer goods manufacturers, retailers, banks and investors, environmental or nature conservation NGOs, and social or development NGOs. The RSPO's objective is to promote the growth and use of sustainable oil palm products through the development of a credible global standard and Code of Practice (known as the Principles and Criteria) and engagement of stakeholders. The Principles and Criteria (P&C) cover environmental and social aspects of principally upstream development. As of November 2008, the RSPO had implemented an auditable certification system based on the P&C, which provides independent certification that production is being managed in a sustainable fashion. About 7.5 percent (about 3.4 million tonnes) of global palm oil supply at present is certified as CSPO (certified sustainable palm oil). This has involved the auditing and certification by independent accredited certification bodies of 22 grower and 60 supply chain companies.

The RSPO plays an important role in setting standards that have impacts beyond the areas managed by its members, and is working on extending certification to smallholders. Although the RSPO is a voluntary, market-driven initiative, it plays an important role in defining



the nature and scope of necessary regulatory interventions. The RSPO's strength, visibility, and achievements so far have raised government awareness of key issues. This places pressure on public authorities to complement the RSPO's activities with improved policies. Market demand for sustainable palm oil is still limited and reduces incentives for some companies to join; but there are indications that demand for sustainable palm oil is emerging through a number of market instruments.

IFC is an active member of the RSPO, supporting several technical committees, biodiversity improvement, and the development of national interpretations of the P&C in Africa.

The RSPO is recognized by a broad range of stakeholders as being the most effective means by which improvements in sustainable production may be made. At present it is weak institutionally and stretched to meet multiple demands.



Annex VI: World Bank Safeguard Policies

A variety of World Bank environmental, social and legal safeguard policies apply to oil palm. The objective of these policies is to prevent or mitigate undue harm to people and their environment in the development process through improved decision-making, ensuring that project options under consideration are sound and sustainable, that potentially affected people have been properly consulted, and that safeguard documents are disclosed. Safeguard policies provide a platform for the participation of stakeholders in project design and have been an important instrument for building ownership among local populations. Policies that are frequently applied to oil palm projects are described below. For a full list of the World Bank's Safeguard policies, please visit: www.worldbank.org/safeguards

Environmental Assessment. Projects involving oil palm should anticipate being subject to the application of the World Bank's policy on environmental assessment. The World Bank screens all proposed projects to determine their potential environmental impacts and risks. Based on the type, location, sensitivity, and scale of the project and the degree of its potential environmental impacts, a project is placed in one of four categories. Oil palm-related projects in general are most likely to be classified in category A. This indicates that they are likely to have "significant adverse environmental impacts that are sensitive, diverse, or unprecedented" and "may affect an area broader than the sites or facilities subject to physical works"; their effects in short transcend the scope in time or space of the project itself. Environmental assessments are undertaken to compare alternatives, including the "without project" scenario to determine whether the proposed project is likely to do more harm than good. Alternative "with project" scenarios, involving opportunities to prevent, minimize, mitigate, or compensate for adverse impacts, are also weighed. Opportunities to improve the environmental performance of the assets and resources connected with the project are carefully examined as well.

Forests. The operational policy on forests applies to projects that (a) have or may have impacts on the health and quality of forests, (b) affect the rights and welfare of people and their level of dependence on or interaction with forests, or (c) aim to bring about changes in the management, protection, or utilization of natural

forests or plantations, whether publicly, privately, or communally owned. The management, conservation, and sustainable development of forest ecosystems and their associated resources are essential to lasting poverty reduction and sustainable development, in countries with abundant forests or in those with depleted or naturally limited forest resources. The policy is intended to assist borrowers in harnessing the potential of forests to reduce poverty in a sustainable manner, to integrate forests effectively into sustainable economic development, and to protect the vital local and global environmental services that forests provide. The World Bank has a clear interest in directing the expansion of oil palm plantations away from standing forests to degraded grasslands. Its estimates suggest that the available area under these degraded conditions is at least double the area needed to satisfy global demand over the next decade. A number of economically viable options and incentives for using these areas are available, the most important of which is the use of payments for environmental services and reducing emissions from deforestation and forest degradation in developing countries. Applying these mechanisms successfully, however, requires that the rights of occupants of degraded lands be identified and compensated.

Natural Habitats. The Bank promotes and supports natural habitat conservation and improved land use by financing projects designed to integrate with national and regional development, the conservation of natural habitats, and the maintenance of ecological functions. Furthermore, the Bank promotes the rehabilitation of degraded natural habitats. The Bank does not support projects that, in its view, entail significant conversion or degradation of critical natural habitats. Wherever feasible, Bank-financed projects are sited on lands already converted (excluding any lands that the Bank concludes were converted in anticipation of the project). The Bank does not support projects involving the significant conversion of natural habitats unless there are no feasible alternatives for the project and its siting, and comprehensive analysis demonstrates that overall benefits from the project substantially outweigh the environmental costs. If the environmental assessment indicates that a project would significantly convert or degrade natural habitats, the project must adopt mitigation measures acceptable to the Bank. Such mitigation



measures include strategic habitat retention and post-development restoration. They may also include establishing and maintaining an ecologically similar protected area. The Bank accepts other forms of mitigation measures only when they are technically justified.

Indigenous Peoples. In areas where local indigenous peoples are likely to be affected, the World Bank undertakes a screening process. If, based on the screening, the Bank determines that indigenous peoples are present in the project area or share a collective attachment to that area, the borrower must undertake a social assessment to evaluate the potential positive and adverse effects on the groups concerned. Where adverse impacts may be significant, alternatives to the project or within the project will be investigated. The borrower contracts social scientists that are endorsed by the World Bank to conduct the social assessment. The borrower then engages in 'free, prior, and informed consultation' with the indigenous peoples at every stage of project preparation and implementation. For a project to proceed, it must be determined that there is broad community support among the indigenous peoples. Special consideration is made to accommodate the concerns of indigenous women, youth, and children and to ensure their access to the development opportunities and benefits that accrue from the project. All relevant information about potentially adverse impacts is shared with the affected community.

Physical Cultural Resources. The operational Bank policy on physical and cultural resources applies in many of the same settings, although the potential impacts of a proposed project on these cultural assets are assessed in the course of the project's environmental assessment. Physical cultural resources are defined as movable or immovable objects, sites, structures, groups of structures, and natural features and landscapes that have archaeological,

paleontological, historical, architectural, religious, aesthetic, or other cultural significance. They may be located in urban or rural settings, and may be above- or belowground or underwater. Their cultural interest may lie at the local, provincial, or national level or within the international community.

Involuntary Resettlement. The Bank's operational policy on involuntary resettlement is triggered in situations involving involuntary taking of land and involuntary restrictions of access to legally designated parks or protected areas. The policy aims to minimize involuntary resettlement to the extent feasible, or to minimize and mitigate its adverse social and economic impacts. It promotes the participation of displaced people in resettlement planning and implementation, and its key economic objective is to assist displaced persons in their efforts to improve or restore their incomes and standards of living after displacement. The policy prescribes compensation and other resettlement measures and requires that borrowers prepare adequate resettlement planning instruments prior to Bank appraisal of proposed projects.

Pest Management. In assisting borrowers to manage pests that affect either agriculture or public health, the Bank promotes the use of biological or environmental control methods and reduced reliance on synthetic chemical pesticides. In Bank-financed projects, the borrower addresses pest management issues in the context of the project's environmental assessment. The Bank assesses the capacity of the country's regulatory framework and institutions to promote and support safe, effective, and environmentally sound pest management. As necessary, the Bank and the borrower incorporate into the project components to strengthen such capacity.



Annex VII: Applying World Bank Safeguards and IFC Performance Standards: A Good Practice Note for WBG Staff

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.



Annex VIII: WBG Approach to Monitoring and Evaluation

IFC projects are currently subject to regular supervision, monitoring, and evaluation, as specified in the operational procedures; these functions are based on existing good practice standards and documentation established by DFIs and donor organizations, and they will continue to be applied and reported as per current practices. These processes have been in place for five years, which is sufficient to allow inter-temporal monitoring of the progress of development results. These processes are independently audited annually by an external assurance provider, and are subject to oversight and audit by the Development Impact Department of IFC and by the WBG Independent Evaluation Group.

The World Bank relies on a combination of monitoring and self-evaluation and independent evaluation. Operational Policy (OP) 13.60 addresses Monitoring and Evaluation.

The designs of Bank operational activities incorporate a framework for M&E. The Bank monitors and evaluates its own contribution to results using this framework, relying on the borrower's M&E systems to the extent possible and, if these systems are not strong, assisting the borrower's efforts to strengthen them. For CASs and sector/thematic strategies, the Bank monitors and evaluates progress toward achieving the results identified in the strategy. For lending operations, the borrower monitors progress towards results during implementation and evaluates the achievement of results upon completion; the Bank reviews the borrower's

M&E reporting. For analytic and advisory services, the Bank monitors and evaluates results on completion.

In addition to working with borrowers, the Bank works with other development partners to agree on the results expected from development activities and to harmonize monitoring, reporting, and evaluation requirements.

Independent evaluation validates self-evaluation activities, verifies their results, and/or undertakes separate assessments of the relevance, efficacy, and efficiency of Bank operational activities and processes. Independent evaluation is carried out by the Independent Evaluation Group (IEG) under the oversight of the Director-General, Evaluation (DGE), who reports directly to the Board, which approves the DGE's mandate and IEG's terms of reference.

In both IFC and the World Bank, these processes require that quantifiable targets be set for each development outcome indicator at project outset, with results tracked annually or semi-annually. IFC's indicators are standardized to the greatest extent possible; however, the framework may undergo revision over time as projects and stakeholders find new requirements or the need to select from an expanded set of standard indicators. The existing M&E process provides the flexibility to systematically add or create indicators should the need arise. The World Bank's project documents specify selected indicators at the outset based on the project's development objectives.



Annex IX: Examples of Ongoing WBG Partnerships in Support of Sustainability

Partnerships playing an increasingly significant role in development financing

PROFOR (Programme on Forests). PROFOR is a multi-donor partnership pursuing the shared goal of enhancing the contribution of forests to poverty alleviation, sustainable development, and protection of environmental services. It has undertaken numerous analytical studies that are relevant to the design implementation and monitoring of private sector investments in forest- and agribusiness-related projects. It could play a useful role in scoping out investment opportunities for oil palm development of possible interest to a wide range of potential IFC client companies, donor agencies, and financial institutions, including the Bank and IFC.

Forest Carbon Finance Unit and Forest Carbon Partnership Facility. The World Bank Carbon Finance Unit (CFU) uses money provided by governments and companies in OECD countries to purchase project-based greenhouse gas emission reduction credits in developing countries and in transition countries. These are purchased through one of the CFU Carbon Funds (e.g., the Bio Carbon Fund or the Forest Carbon Partnership Facility on behalf of the contributor and within the framework of the Kyoto Protocol's Clean Development Mechanism (CDM) or Joint Implementation agreements). The World Bank acts as trustee and secretariat for the Forest Carbon Partnership Facility, a global partnership focused on reducing emissions from deforestation, and degradation (REDD+), forest carbon stock conservation, sustainable management of forests and enhancement of carbon stocks. These carbon-related programs could feasibly contribute to oil palm development—for example, as part of WBG support to governments such as those of Indonesia that have committed to avoiding forest conversion and instead are shifting toward planting on non-forest, non-peat lands.

Forest Investment Program (FIP). The Forest Investment Program, a targeted program of the Strategic Climate Fund (SCF) funded by multiple donors and implemented by multilateral development banks in close collaboration with other agencies, was created to support efforts to reduce emissions from deforestation and forest degradation (REDD+) by financing investments to address drivers of deforestation and forest degradation. It promotes programmatic investments aimed at transformational change in

the forest sector or sectors affecting forests. FIP investments also mainstream climate resilience considerations and contribute to multiple co-benefits, such as biodiversity conservation, protection of the rights of indigenous peoples and local communities, and poverty reduction through rural livelihood enhancements.

Through its Indigenous Peoples and Local Communities Dedicated Initiative, FIP could potentially provide funding and capacity building to allow local and marginalized communities to participate in national REDD+ strategy discussions in which land investment strategies, including palm oil development, might figure. Also, FIP could provide grant funding to help local communities plant palm oil on degraded lands to avoid pressure on forests. Indeed, FIP is designed to implement a small number of country-led and -owned pilot programs to support change in a number of areas, including investing outside the forest sector.

Target FIP countries as of October 2010 that have the potential to contribute to analysis and partial financing of possible Bank/IFC-supported palm oil projects include Indonesia, Brazil, Ghana, the Democratic Republic of Congo, and the Lao People's Democratic Republic.

Growing Forest Partnership (GFP). The Growing Forest Partnership is an initiative funded by the World Bank and currently involving the International Union for the Conservation of Nature (IUCN), the International Institute for Environment and Development (IIED), and the Food and Agricultural Organization (FAO) as implementing partners. GFP seeks to build alliances inclusive of local communities and indigenous peoples at the local, regional, and international levels to ensure that global discussions about forests include the real and current challenges that forest-dependent people and local forest managers are facing, by bringing the voices of local communities and indigenous peoples forward to influence decision-making.

Local forest-dependent people could potentially use GFP resources to make their voices heard during investment dialogues and national consultations. They could use GFP funds to mobilize and participate in the oil palm debate at the local, national, or international level if they consider it a relevant issue.

The GFP is active in Liberia, Ghana, Mozambique, Guatemala, and Nepal. Its



experience in Ghana could be especially relevant to future WBG engagement in oil palm.

The World Wildlife Fund. Through the GFP the Bank can help to mobilize input to oil palm development by engaging companies that are members of WWF's Global Forest and Trade Network (GFTN). This body supports private sector initiatives that embrace socially and environmentally responsible conservation and management principles that have been certified according to Forest Stewardship Council standards. As of September 2010 the GFTN had 272 member companies managing about 250 million ha of forest. In Indonesia, WWF has an opportunity to influence global oil palm development through its Forest Conversion Programme. WWF is an influential member of the RSPO.

The Global Partnership for Forest Landscape Restoration. The GLP is a consortium between the Bank/IUCN, the World Resources Institute, PROFOR, the University of South Dakota, and the U.K. Forestry Commission; its objectives are to mobilize finance and technical assistance for restoration of part of the more than 800,000 ha of degraded forest lands in the tropics. Its focus to date has been primarily on planting timber and pulpwood crops. Mobilizing GLP support for establishing

agroforestry tree crops such as oil palm, rubber, cocoa, coffee, tea, and coconut is a possibility that could be explored.

Company-Community Partnerships.

Through collaboration with the London-based Institute for Environment and Development (IIED), the Bank has the possibility of assisting potential IFC client companies and local communities to develop equitable pricing and benefit sharing arrangements with palm oil outgrowers. IIED's practical experiences in countries such as Ghana, Kenya, and South Africa provide positive lessons on which to build. IIED is supported by PROFOR through the so-called Forest Connect program.

Monitoring Forest Governance. Through its EU-funded Forest Law Enforcement Governance and Trade Programme (FLEGT) the Bank can assist IFC by bringing to bear its extensive experience in applying social, economic, and environmental indicators for monitoring and evaluating the impact of WBG-financed agriculture and forestry priorities, including oil palm projects. Such evaluations are already under way in Uganda and are about to be tested with Finnish aid support in five Latin American countries.



Annex X: Recommendations of IFC's Compliance Advisor/Ombudsperson and IFC's Responses

In July 2007, a group of CSOs filed a complaint with the CAO, focusing on environmental and social concerns with the palm oil sector in Indonesia and claiming that IFC's investments in the Wilmar Group were in violation of a number of IFC's own policies and procedures.

This complaint was subject to an audit by the CAO's compliance office. The CAO issued its audit findings on June 19, 2009. The main findings of the audit were as follows:

1. IFC had no specific strategy that provided guidance for its investments in the palm oil sector in dealing with recognized environmental, social, and governance issues.
2. IFC did not correctly categorize the trade facilities and hence failed to apply its performance standards.
3. IFC failed to adequately assess the supply chains for its downstream investments, as required by its performance standards.

The audit focused only on IFC's compliance with its own policies, standard and procedures. It did not address any of the CSO allegations against Wilmar, as these were outside the CAO's mandate.

IFC management welcomed the CAO's contribution as a basis for helping IFC to strengthen the development impacts of its investments on the ground, as well as reinforcing the importance of systematically assessing and managing risks and issues in higher-risk sectors and country contexts. IFC management acknowledged the need to improve its policies and procedures.

IFC, in consultation with the CAO, developed an Action Plan to address the CAO findings. The main items in the Action Plan and the current status of its implementation are presented in Table X-1.

Table X-1: IFC Action Plan—Response to CAO Audit

IFC Commitments	Planned Actions	Current Status
1. Develop a comprehensive strategy for the palm oil sector	<p>Strategy development in coordination with the World Bank</p> <p>Includes global consultations with stakeholders</p>	<p>Final document will include an overall Framework for the World Bank Group, laying out a common approach for the two institutions, and a Strategy for IFC's engagement in the palm oil sector</p> <p>New approaches included in the Framework/Strategy include a mechanism for a Country Situation Analysis, for joint scoping by IFC, and the World Bank, and the application of a newly-developed risk management tool to assist IFC investment staff in recognizing country-specific risks in the palm oil sector.</p> <p>Preparation ongoing, with target date of March 2011 for completion</p>
2. Assist in strengthening of the Roundtable on Sustainable Palm Oil (RSPO)	<p>Direct support of RSPO's Biodiversity Technical Committee, support of pilot projects through IFC's Biodiversity and Agricultural Commodities Program (BACP), IFC staff involvement in RSPO working groups, requirements for client adherence to RSPO Principles and Criteria,</p>	<p>Establishment of Biodiversity Technical Committee and hiring of Biodiversity Coordinator</p> <p>MOU under negotiation with Business and Biodiversity Offset Program (BBOP) for research on biodiversity conservation mechanisms</p> <p>IFC staff involved with Biodiversity Technical Committee (BTC), the Smallholder Taskforce (STF), and the New Plantings Working Group</p>



IFC Commitments	Planned Actions	Current Status
	support of regional RSPO meetings, support through Advisory Services programs, and other support to be developed through discussions with RSPO as required	<p>IFC staff involved with National Interpretation meetings in Ghana and Brazil</p> <p>Support ongoing (2009-2011) to 3 pilot projects with PanEco Foundation, Flora and Fauna International and Zoological Society of London for biodiversity programs. Other projects currently under review</p> <p>Draft IFC Strategy includes requirements for producer clients to achieve RSPO certification for sustainable oil palm plantation management, or equivalent</p>
3. Development and implementation of an Advisory Services program to address sector-wide issues	Development of Advisory Services programs, including smallholder programs, testing of certification criteria, development of business enabling environment programs and occupational health and safety programs (initially focusing on Indonesia, but replicable to other regions)	<p>Development of "Indonesia Palm Oil Sector Advisory Services Program" (including smallholder baseline, development of improvement programs, field test of RSPO smallholder certification criteria, etc.) currently underway</p> <p>"Indonesia Agricultural Business Enabling Environment Program" (identification of regulatory constraints, development of solutions) is under way, with internal approval 10/3/09. Local arrangements in process</p> <p>Development of "Improving Occupational Health & Safety (OH&S) Program" for the Indonesian Palm Oil Industry in final design stage. Includes OH&S data gathering at producer sites, identification of priority areas for improvement and creation of an OH&S audit tool relevant to palm oil sector</p>
4. Consideration of categorization issues in the Sustainability Policy and performance standards review and update process	Review of categories and process of determining categories	<p>Environmental and Social Review Procedure already updated (August 15, 2009) to revise categorization of single-commodity, single-company trade finance investments</p> <p>Draft Sustainability Policy update includes additional FI categories</p> <p>Completion of Sustainability Policy and performance standards review and update process expected by May 2011</p>
5. Consideration of supply chain issues in the Sustainability Policy and performance standards review and update process	<p>Consideration of what aspects of supply chains need particular attention, and how to address the specifics of these requirements in the performance standards and the guidance notes and possibly the environmental health and safety sectoral guidelines.</p> <p>Preparation of various</p>	<p>Supply chain mapping template designed and now in use for applicable agribusiness projects, not just for palm oil projects</p> <p>Field checklist based on IFC's performance standards has been developed for specific use for palm oil projects.</p> <p>A comparative analysis of IFC's performance standards compared to the RSPO P&C and the SAN standard, completed in November 2010.</p> <p>Training program for Investment Officers in</p>



IFC Commitments	Planned Actions	Current Status
	tools including: (i) field level appraisal checklist; (ii) supply chain mapping template, and; (iii) comparative analysis of IFC Performance standards with RSPO P&C and Sustainable Agriculture Network (SAN) standard	preparation and scheduled for Spring 2011. The program will encompass performance standards requirements, implementation of the risk matrix framework, and best practices in supply chain risk assessment Completion of Sustainability Policy and performance standards review and update process expected by May 2011
6. Review of Wilmar's Indonesian plantations to identify any remaining E&S issues which need attention, and follow-up on ongoing issues regarding community relations	Audit of Wilmar's Indonesian plantation operations	Environmental and social audit of representative sample of plantations being carried out by ProForest, with final report due by January 2011
7. Resolution of categorization and processing issues	Develop mechanisms to ensure that commercial pressure does not prevail over environmental and social requirements	Discussions between Environmental and Social Department and Agribusiness Department (September 21, 2009) resulted in agreement regarding improved internal procedures for project allocation and environmental and social due diligence
8. Improvements in due diligence related to CSO reports	Prepare response to CAO on improved mechanisms for due diligence	Formal response prepared for CAO which includes mechanisms to ensure that relevant background information is fully considered during the entire project appraisal process



Annex XI: Improving Livelihoods of Palm Oil Smallholders: The Role of the Private Sector

*An Executive Summary of a Report by FSG "Improving Livelihoods of Palm Oil Smallholders: The Role of the Private Sector"
(commissioned by IFC to inform development of the WBG framework for engagement in the palm oil sector)*

Purpose of This Report

This report provides an assessment of the private sector's efforts to improve the livelihoods of smallholder farmers engaged in oil palm production. Palm oil is the world's most traded vegetable oil and the industry employs millions around the developing world. At the same time, palm oil production has also resulted in significant controversy due to its potential effects on the environment, as well as various social challenges. The challenges faced by smallholder farmers – defined by RSPO as those controlling 50 hectares or less of cultivated land – are especially acute.

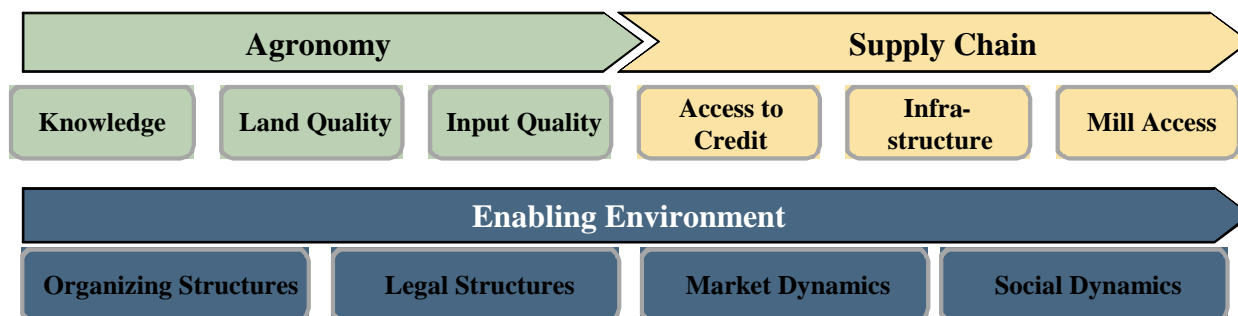
Addressing these challenges requires participation from the entire sector, including donors, civil society, governments, and corporations. We believe that corporations in the palm oil supply chain can play a crucial role in improving smallholder livelihoods, given the resources and expertise they bring. These efforts can both impact smallholder livelihoods and also benefit companies through greater

yields and improved quality – a significant opportunity to create shared value for the private sector.

This report was created to inform development of the WBG's framework for palm oil. Given the emphasis of the WBG framework on addressing smallholder needs, the findings of this report can serve as important guidelines for implementing future activities. Our research consisted of 28 interviews with a range of stakeholders, including representatives from companies, civil society organizations, industry associations, and multilateral agencies, as well as secondary research.

Factors Affecting Smallholder Livelihoods

While smallholder conditions and structures vary significantly across and even within regions, three major categories of factors affect smallholder livelihoods: agronomy, supply chain, and the enabling environment. Within each of these factors, there are significant needs to improve smallholder livelihoods.



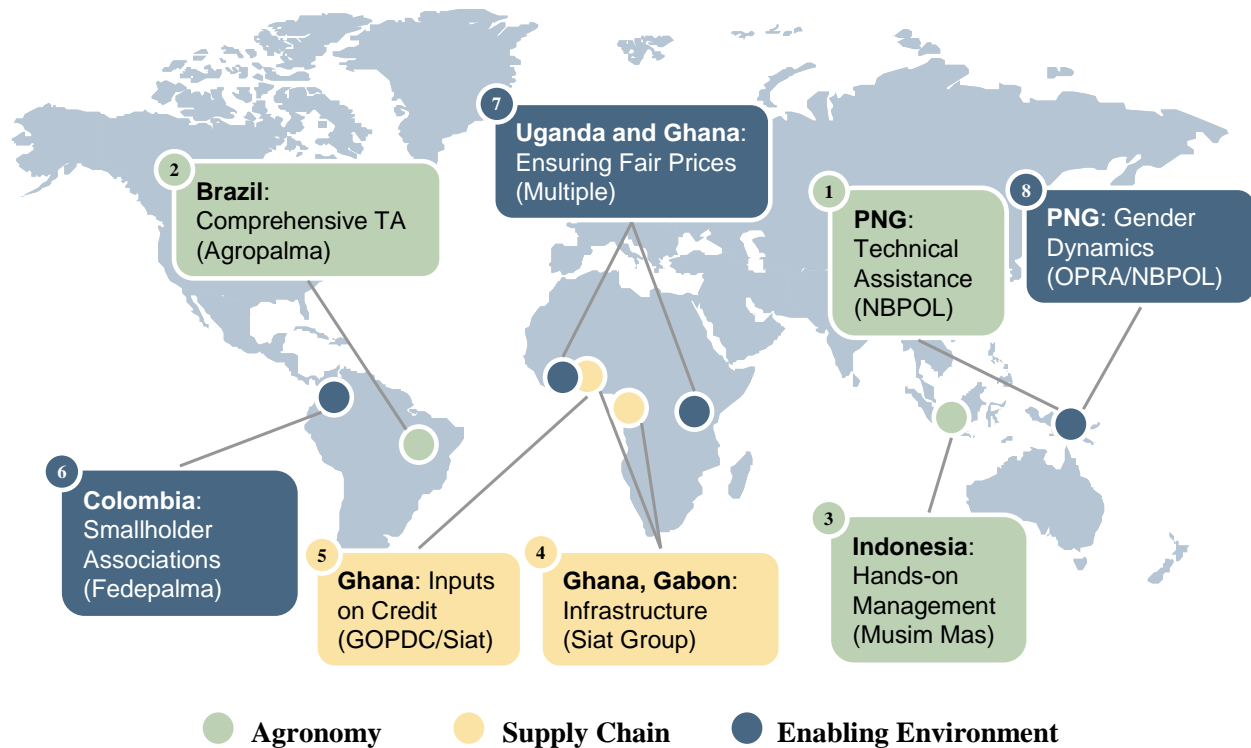
Profiles of Private Sector Efforts

Palm oil producing companies have substantial business interest in improving smallholder productivity and livelihoods, and our research identified several examples of private sector-led efforts. In many cases, companies focus on providing support on agronomy issues via technical assistance. For example, New Britain Palm Oil supports the provision of extension services to smallholders in Papua New Guinea in order to improve productivity. Other companies, such as Siat Group are involved in strengthening

supply chain conditions by improving the mechanisms for smallholders to access credit from oil palm mills. A few companies are attempting to address elements of the enabling environment for smallholder livelihoods: in Uganda, Bidco partnered with IFAD and the Ugandan government to develop a pricing policy that ensures a transparent and fair pricing mechanism for smallholders.

This paper profiles several smallholder development efforts, as depicted in the figure below.





Trends in Private Sector Efforts

Beyond the specific case examples of existing projects, our research identified several themes regarding the role of the private sector in promoting smallholder development:

- **More Is Needed:** *Despite important efforts by some companies, there is a need for significantly more engagement by the private sector in order to address smallholder livelihood challenges.* There is a continued substantial gap between the yields of smallholder farms and that of plantations, highlighting the need for a sustained focus on the development of smallholder farmers.
- **Leadership Vacuum:** *Stakeholders could not identify specific companies that are leaders in improving smallholder livelihoods in palm oil.* In some other corporate sectors, such as the pharmaceutical industry, multiple leading companies model best practice approaches to corporate social responsibility efforts. The palm oil sector does not have widely accepted leaders in Corporate Social Responsibility related to smallholders
- **Systems Matter:** *Few companies are working on enabling environment issues that can have large scale impact beyond their own smallholders.* Several companies work on enabling environment factors in a more

limited way, for example, by strengthening associations among their smallholders, or by addressing social issues in affected communities. However, few are working on broad enabling environment conditions, such as developing national institutional capacity related to extension and research. This theme stands in contrast to some other crops, such as cocoa, where several initiatives are under way that take systemic approaches to development.

- **Power of Partnering:** *Collaboration across sectors is a critical component of many existing efforts.* While companies can play an important role in directly improving livelihoods of their associated smallholders, there is significant potential for more systemic challenges to be addressed through multi-sectoral collaboration

Recommendations for Private Sector Engagement

Significant opportunities exist for corporations to commit to smallholder livelihood development in ways that link efforts more closely with their business expertise and priorities. As companies engage in future investments in improving smallholder livelihoods, they should consider the following recommendations:



1. *Identify opportunities for shared value creation* that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which it operates
2. *Prioritize issues that leverage the company's core capabilities* (e.g., providing technical assistance in improving yields is a core competency for agricultural companies, while investing in road construction does not use companies' core strengths)
3. *Partner with other actors to achieve collective impact*, working with governments, NGOs, donors, or other companies to develop shared strategies rather than only pursuing individual projects
4. *Take advantage of the existing momentum* in the field on certain issues (e.g., certification) so as to increase chances of success
5. *Consider the scale of impact* of the intervention, and focus on opportunities with large-scale benefits that can serve as models for replication
6. *Measure the results* of smallholder development efforts in order to learn effectively to inform future projects

Strategic Opportunities for the Private Sector

Stakeholders suggest several areas for corporations to improve smallholder livelihoods. These include:

- *Creating new incentive structures* that reward farmers for utilizing agronomy best practices (e.g., paying farmers based on appropriate fertilizer use)
- *Working with financial institutions to develop appropriately-designed financial products* for farmers (e.g., access to loans with deferred repayment which do not require land titles as collateral)
- *Incorporating productivity improvements* into steps taken toward certifying smallholders (e.g., incorporating stronger technical assistance into the monitoring required by RSPO standards)

Donors and development agencies, such as IFC, can provide incentives for the private sector to invest in innovative models and fund research efforts that encourage additional investments.

We hope that the opportunities presented here will catalyze the field to take action on the challenges faced by smallholders, leading to improved smallholder livelihoods in the oil palm sector.



Annex XII: IFC's Risk Screening and Assessment Tool

The risk assessment process will be performed in the context of IFC's investment strategy in the palm oil sector. The version presented in this document is specific to palm oil. In requiring a pro-active review of country, commodity/sector and project level risk, IFC aims to ensure early consideration of contextual and project level risk, assess options for mitigation through sector and/or project-level measures, with the World Bank and IFC's Advisory Services respectively, and thereby ensure that broader E&S issues are integrated into early decisions associated with investment applications. In compiling and using this tool, IFC will draw on the knowledge of the World Bank and research institutions, its own internal knowledge of country and sector conditions as well as information from external sources appropriate to support the assessment of the investment application.

The country level assessment is initiated at a high level and considers all the factors that may influence IFC investments in the country. These may include in the broadest sense, social, environmental and economic factors but seen in terms of more specific indicators that contribute to these, such as the countries' legal framework, infrastructure, internal policies related to IFC's performance standards

and other factors. The sector level assessment is again initiated at a high level but aimed at the specific sector under consideration. The aim here is to review all the factors that may influence IFC investments in the sector, within the previously identified country. The project level assessment is intended to be more comprehensive and completed on a case by case basis. While it again involves a rating process, the factors that may influence an IFC investment become site specific.

The early risk assessment process will inform the basis on which investment applications will be rated, both in terms of IFC's E&S categorization, as well as an additional internal rating of low, medium and high. The rating process provides the opportunity to identify areas of concern that may require a more detailed risk assessment before the project is categorized.

Typical country-level rating criteria are specified in the following table, which should only be seen as examples of the issues to be addressed and not as an exhaustive list. Further assessment of individual criterion will be guided by a checklist of questions.

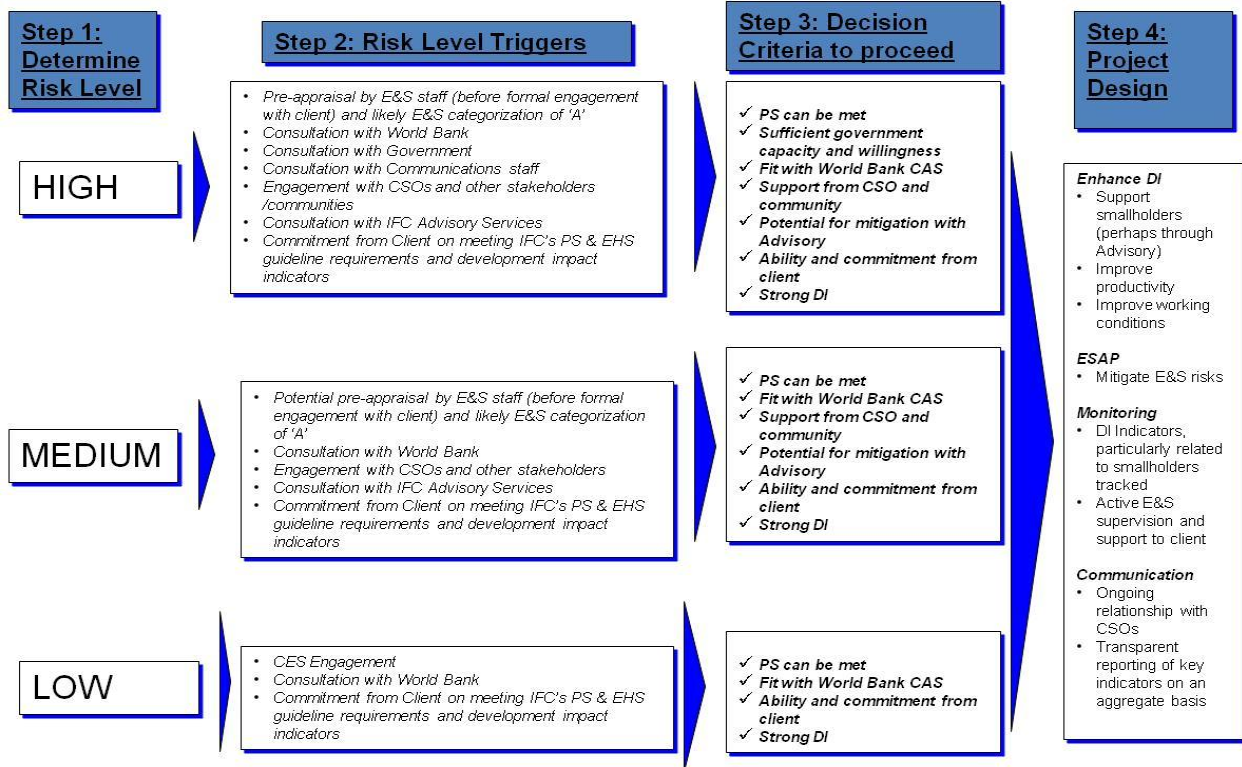
Rating category		Rating Criteria
Policy	International convention signatory	Signing of international treaties and conventions such as biodiversity.
	Sector policy (Agriculture)	Do national policies exist for this agricultural commodity: for example, national policies and programs supporting the development, production and marketing of the commodity, national food security policy, national forestry policy (including REDD+ programs), agriculture master plan.
Legal	National	Does a national legal framework exist?
	Social (including labor and working conditions)	Labor and Working Conditions – e.g. child labor, forced labor, freedom of association, etc.
	Environmental (including pollution prevention and abatement)	Pollution Prevention and Abatement – e.g.: environmental assessment, management, and reporting.
	Community health, safety and security	Community Health Safety and Security
	Land acquisition utilization and involuntary settlement	Land Acquisition and Involuntary Settlement, such as: involuntary displacement, compensation, customary rights.
	Smallholders	Are the needs of smallholders considered where



Rating category		Rating Criteria
		relevant? What relationship and terms exist between a potential IFC client and associated smallholders
	Indigenous peoples	Indigenous peoples - e.g. existence of national legal and regulatory framework for the respect of the indigenous peoples, enforcement level.
	Cultural heritage	Cultural Heritage - e.g., protection and preservation of cultural heritage.
	Conflicting land claims	Do conflicting land claims exist – e.g. existence of a conflict resolution mechanism?
	Compliance	What is the degree of compliance with laws, statues regulations and other contractual documents
Infrastructure	Overall	Is there a clearly developed infrastructure in place
	Health services	Are suitable health services in place for workers and their families, where applicable
	Education system	Is there an education system in place to provide for the development of a long term skills base
Workforce	Wages	Are the wages paid just and fair for the work done
	Working conditions and management of worker relationship	Are working conditions prescribed that meet national and international standards
	Protection of workforce	Is the workforce protected against child or forced labor
	Non-employee workers (Contractors)	Is the role of contractors acknowledged understood and managed effectively
	Supply chain	Is there a supply chain support structure in place
Threats (from or to the project)	Cultural barriers	Are there any known cultural barriers that could be related to this proposal
	Local land disputes	Are there local land disputes
	Local cultural barriers	Are there are any local cultural barriers to this commodity
	Reputational issues	Are there issues associated with this commodity that might impact the proposals viability
	Pollution	Will the proposal create pollution
	Biodiversity	Will there be an impact on biodiversity resulting from this proposal
Market	Certification	Is there a recognized certification scheme for this commodity
Client	Past history	Does the client have a past history of failed proposals
	Reputation	Does the client have a sound reputation
Community	Community resilience	Does the community have the resilience to recover if the proposal fails
	Indigenous peoples	Are indigenous peoples present and are there needs addressed in the proposal
	Social change	Will the proposal create unintended social change
	Local acceptance of project	Is their local acceptance of the proposal
Resources	Available land (agricultural/degraded)	Is adequate land available to support the growth and expansion of the commodity Is there a land conversion of edible crops
	Water	Are adequate water resources available



Depending upon the early risk assessment, this will 'trigger' additional procedures and actions as shown in the table below:



Annex XIII: IFC's Sustainability Framework: Applications of Potential Environmental and Social Issues in Palm Oil Projects

Introduction. The IFC Sustainability Framework⁷⁴ was adopted on April 30, 2006. The IFC Policy on Social and Environmental Sustainability (Sustainability Policy) and the IFC Policy on Disclosure of Information (Disclosure Policy) describe IFC's role and responsibilities, and the performance standards (PS) describes the outcomes that IFC clients should achieve on projects. IFC PSs have become the internationally recognized and adopted standards for private sector environmental and social (E&S) risk management in emerging markets.⁷⁵ The Sustainability Framework is strengthened by supporting documents, such as sector-specific WBG Environmental Health and Safety guidelines (WBG EH&S Guidelines)⁷⁶ and by Good Practice Notes.⁷⁷

The PSs are written to have global relevance across country-, sector-, and project-specific contexts. Their application varies depending on the specific risks and impacts of individual projects. IFC is currently revising the Sustainability Framework and estimates that Board approval will be secured by spring/summer 2011.⁷⁸

The eight performance standards are as follows:

PS1: Social and Environmental Assessment and Management Systems

PS2: Labor and Working Conditions

PS3: Pollution Prevention and Abatement

PS4: Community Health, Safety, and Security

PS5: Land Acquisition and Involuntary Resettlement

⁷⁴ The IFC Sustainability Framework includes the IFC Policy on Social and Environmental Sustainability, the IFC Policy on Disclosure of Information, and the IFC's performance standards. These can be found at <http://www.ifc.org/ifcext/sustainability.nsf/Content/EnvSocStandards>.

⁷⁵ For example, as adopted by the 67 financial institutions that have certified their lending against the Equator Principles. The Equator Principles are seen as the leading voluntary standard for managing social and environmental risk for project financing in emerging markets.

⁷⁶ Performance Standard 3 requires clients to utilize the WBG EH&S guidelines. These guidelines are technical reference documents with general- and industry-specific examples of Good International Industry Practice (GIIP). Specifically, for palm oil operations, applicable EH&S guidelines are those pertaining to General EH&S, Plantation Crop Production, and Vegetable Oil Processing.

⁷⁷ Good Practice Notes provide guidance to clients on a broad range of subjects, such as Retrenchment, Addressing Community Grievances, and HIV/AIDS in the Workplace.

⁷⁸ Refer to <http://www.ifc.org/policyreview> for information on the review and update processes.

PS6: Biodiversity Conservation and Sustainable Natural Resource Management

PS7: Indigenous peoples

PS8: Cultural Heritage

IFC's Environmental and Social Review Procedures (ESRPs) spell out the procedure IFC staff follow to implement the Sustainability Framework.⁷⁹ The ESRPs outline the S&E requirements that IFC follows for each of its investments through the entire project cycle, from appraisal and approval (including Project Design Summary [PDS], initial categorization, and E&S screening against applicable PSs) to Investment Review (including preparation of the Environmental and Social Review Summary [ESRS] and the Environmental and Social Action Plan [ESAP]) to Board paper. Assessing and managing social and environmental impacts in a manner consistent with PS requirements is the responsibility of the client. IFC's role and responsibility is to appraise the work of the client, identify opportunities to improve outcomes, and ensure consistency with policy requirements. If IFC determines that gaps exist, IFC may require the client to fix the gaps prior to taking the project to its Board for approval or for consideration of actions whose consequences are less serious. IFC will require specific actions to ensure that those gaps are closed and that there will be compliance with the PSs over time. These actions are outlined in the ESAP and are included in the investment documentation.

Categorization

The Sustainability Policy defines IFC's approach to project categorization, and detailed process requirements are included in the ESRPs. IFC uses a system of environmental and social categorization to communicate the magnitude of potential impacts, as assessed by the client and approved by IFC during the appraisal, and to specify IFC's institutional requirements toward disclosure of project information to the public prior to the client's presenting a project to the Board.

The project categories are:

- **Category A:** Projects with potential significant adverse social or environmental impacts that are diverse, irreversible, or unprecedented

⁷⁹ The ESRPs can be found at <http://www.ifc.org/ifcext/sustainability.nsf/Content/EnvSocStandards>.



- *Category B:* Projects with potential adverse social or environmental impacts that are limited or few, generally site-specific, largely reversible, and readily addressed through mitigation measures
- *Category C:* Projects with minimal or no adverse social or environmental impacts, including certain financial intermediary (FI) projects with minimal or no adverse risks
- *Category FI:* All FI projects that are not Category C projects

As an example, for vertically integrated trading companies the social and environmental categorization reflects the impacts of the operations, holdings, and activities, if known. Following the Wilmar audit report, IFC updated its ESRPs with specific language regarding these types of investments. Vertically integrated trading companies that exert control over several levels of the supply chain may pose greater risks, depending on the commodity, than investments in a pure commodity trader. As a result, such investments are likely to be categorized as Category A or B.

Environmental and Social Assessment and Management

IFC requires clients to assess their projects for actual or potential E&S impacts. Depending on the stage of the project at which IFC enters (i.e., planning, construction, operations, or expansion) and the potential issues, the assessment may be a comprehensive environmental and social impact assessment (ESIA); a limited or focused environmental and social assessment; an audit; or a straightforward application of environmental siting, pollution standards, design criteria, or construction standards. Regardless of the approach, the assessment has to encompass the relevant IFC performance standards (PS1 through PS8) and is expected to be commensurate with the actual and potential impacts of the project. Applicable national laws and regulations of the jurisdictions in which the project operates that pertain to social and environmental matters, including laws implementing host country obligations under international law, must be taken into account.

Based upon the E&S assessment, the client is required to incorporate the findings of the assessment into an integrated management system that focuses on managing social and environmental issues (including the areas of human resources and occupational health and safety) associated with the project with the aim

of avoiding them or, if that is not possible, minimizing or compensating for them. PS1 contains the requirements with regard to developing, implementing, and maintaining a social and environmental management system.

In addition to the summary provided in the body of the document, the following paragraphs summarize some of the performance standards that could apply to IFC investments in the Palm Oil sector:

Land Acquisition and Involuntary Resettlement

PS5, Land Acquisition and Involuntary Resettlement, addresses project acquisition or leasing of land where the possibility of expropriation exists. It is not applied to willing buyer-willing seller situations. The PS focuses on the process of land acquisition, the adequacy of compensation for land and assets, and the mitigation of physical or economic displacement. The application of PS5 is not dependent on the existence of (formal) title. It also applies to situations where customary land ownership is demonstrated. (Note, however, that PS7—indigenous peoples—addresses project development on indigenous peoples' lands and their relocation).

While avoidance of impacts is preferable, where they are unavoidable, projects must demonstrate that due process has been followed. Land transactions are scrutinized to (1) ascertain the process of acquisition (this may include the existence of a Compensation Framework) and (2) confirm the adequacy and timely payment of compensation for land and productive assets (including crops and infrastructure) and payment for prior land acquisition, existence of grievance mechanisms regarding compensation, and other requirements. Where involuntary land acquisition results in physical or economic displacement, IFC reviews the client support for the restoration of the livelihoods and standards of living of displaced persons. For projects where involuntary displacement is likely to occur in the future, IFC requires clients to develop a Resettlement Framework that entails the development of project-specific Resettlement Action Plans. PS5 outlines requirements for the management of physical and economic displacement, and supporting documents, such as Guidelines for Developing a Resettlement Action Plan, provide best-practice guidance.



Indigenous Peoples

The risk of a project's affecting indigenous peoples is addressed in PS7 and is ascertained at the start of the E&S appraisal process. Various sources of information, including client ESIA, WBG resources, literature, country contacts, and media are contacted and/or reviewed. Where clients are expanding their landholdings, IFC requires them to ensure that land assessment procedures include consideration of the risk of impacting indigenous peoples. IFC reviews the client's management of key indigenous peoples issues, including identification of indigenous peoples; appropriate and thorough assessment of indigenous peoples communities, including territorial claims, traditional ownership or customary use of lands and natural resources, livelihood activities, vulnerability, and similar concerns; appropriate mitigation, restoration, or compensation; and stakeholder engagement. IFC clients are required to recognize indigenous peoples' customary rights and usage of lands and resources according to PS5 and PS7.

Where needed, the development and implementation of mitigation measures may occur through community development plans applicable to all affected people, or through the development of an indigenous peoples Development Plan specific to the adversely impacted indigenous peoples. The client will also have to meet the PS consultation requirements (FPIC and Good Faith Negotiation).

Local Communities and Vulnerable Groups

Typically the client's assessment of E&S risks and impacts is focused on directly affected communities, although it may take into account secondary or induced impacts. IFC appraisal involves a review of the definition of the project-affected area and the assessment of E&S risks. Project social assessments are also required to consider vulnerable groups (such as the elderly, women, and female-headed households) and, where relevant, to ensure that appropriate mitigation measures are adopted for these groups. As part of the review, IFC E&S specialists visit a sample of the affected communities, meeting with various groups—including recognized representatives (both administrative and traditional), women, youth, and others—to discuss the project and its impacts, the livelihoods of affected peoples, the project stakeholder engagement process (including grievance mechanisms) and the project's avoidance, minimization, mitigation, restoration, and compensation measures. If needed, separate meetings with vulnerable

people will be conducted to ensure that all affected people have been consulted and engaged.

Cultural Heritage

The risk of a project's affecting cultural property is ascertained through the client's assessment. This assessment should consider several factors, including the nature of the project and the lands it is using, the occupation and use of lands by local and indigenous peoples, and the known presence of cultural heritage in the project area of operations. Field appraisal includes visits to affected communities, including local communities and indigenous peoples, if applicable, and inquiries about the existence of cultural property (which may include sacred rocks, trees, or groves; historical sites marking previous occupation; cemeteries; etc.). IFC will review the client's assessment and management system.

Human Rights

IFC's Sustainability Policy recognizes the increasingly important roles and responsibilities of the private sector in respecting human rights. Both the Sustainability Policy and the PSs incorporate many schemes of internationally recognized human rights, but phrased in project operational language. As an example, the rights to just and favorable conditions of work, freedom of association, and exclusion from being subject to slavery, servitude, or forced labor are addressed in PS2. The increased recognition of the role and responsibilities of the private sector with regard to human rights has also led to the development of the Guide to Human Rights Impact Assessment and Management, which includes sector-specific scenarios (including extensive agriculture) that facilitate the identification and assessment of possible human rights issues.⁸⁰

Gender

IFC expects its clients to minimize gender-related business activities risks and unintended gender differentiated impacts. The proposed revisions to PS1, 4, 5, 7 and 8 include increased emphasis on a gender-responsive approach and related requirements during project risk and impact assessment.

⁸⁰ The proposed revisions to IFC Performance Standard 1 and its accompanying guidance note include information on using human rights impact assessments as a voluntary risk management tool in high risk situations.



Biodiversity

PS6, Biodiversity Conservation and Sustainable Natural Resource Management. Further detailed in the main body of the paper.

Community Development

Through the Sustainability Policy, IFC puts into practice its commitment to S&E sustainability, of which one factor is the accrual of benefits to communities. Accordingly, IFC encourages the client to attain a social license to operate by addressing adverse impacts, promoting employment, and, where appropriate, becoming an active stakeholder in local development. IFC tracks development outcomes associated with its investment activities using its own Development Outcome Tracking System (DOTS), which often includes elements of community development.⁸¹

Labor

The PSs, specifically PS2, recognizes that the pursuit of economic growth through employment creation and income generation should be balanced with protection of the basic rights of workers. PS2 requires, among other things, that the client develop a human resource policy, enable workers to partake of organization and freedom of association, promote nondiscrimination and equal opportunity, refrain from employing children in an exploitative manner or using forced labor, and provide workers with a safe and healthy work environment. IFC reviews the information provided by the client, reviews country reports and labor laws, and assesses the sector's labor record to determine if there are issues needing particular attention. During the appraisal, IFC verifies the information provided by the client, observes the physical operations and site conditions, and interviews employees. For sectors with known use of or reliance on child or forced labor, seasonal labor, migrant labor, or use of a contractor workforce, field appraisal includes special efforts to review these situations to ensure that appropriate employment practices are being pursued.

Pollution Management and Natural Resource Use

PS3 requires a client to meet the WBG EHS guidelines when evaluating and selecting pollution prevention and control techniques for a project. Guidelines relevant to palm oil operations are the WBG EH&S Guidelines for Plantation Crop Production, Vegetable Oil

Processing, and the General EH&S Guidelines. These documents contain discussions of environmental and occupational health and safety issues pertinent to palm oil plantations and oil processing operations along with recommendations for their management.

With regard to the issue of water use and the water footprint of palm oil operations, the guidelines discuss issues regarding the quantity and quality of water used and disposal of contaminated water generated from plantations and production facilities. For example, the amount of water required to optimize yields (sample water use/yield ratios are provided) and the possible issues associated with limits to supply due to conservation of water resources are included. Issues of excess nutrient runoff from fields that may impact surface and ground water are also discussed. Figures on the water consumption required in the various stages of processing are provided in the Vegetable Oil Processing guidelines. These industry benchmarks are provided to assist the client to set targets and improve operating efficiency. Water inputs and process wastewater generated (i.e., in the processing of FFBs into crude palm oil and in further refining the product) and options to be considered in minimizing inputs and properly treating outputs before release into the environment are also discussed (including a list of process effluent guidelines) in the EH&S guidelines.

Client Consultation and Disclosure of Information

For all projects that may have a social or environmental impact, PS1 requires clients to engage with communities on an ongoing basis. The nature and frequency of this engagement will reflect the project's potential adverse impacts on the affected community. Part of this engagement should include disclosure of relevant information (e.g., Environmental and Social Action Plan) that helps the communities understand the risks, impacts, and opportunities associated with the project. Clients are required to provide periodic updates to the affected stakeholders, at least annually, on the implementation and progress on specific items that involve ongoing risks to or impacts on affected communities. As appropriate, where amendments and updates to such actions materially change the impacts on affected stakeholders, the client will disclose this to communities. In addition, information should be made available to affected stakeholders in response to community feedback or grievances and as a means to further involve the affected

⁸¹

www.ifc.org/ifcext/devresultsinvestments.nsf/Content/DOTS.



community in the social and environmental performance of the project. Further explanations on consultations for projects that may have significant environmental or social impacts on communities are included in the paper.

IFC Disclosure

In accordance with its Disclosure Policy, IFC discloses an ESRS, summarizing the findings of IFC's appraisal process, and the associated ESAP on the IFC Web site prior to Board consideration. For Category A Projects, disclosure is necessary a minimum of 60 days prior to Board consideration, versus a minimum of 30 days for Category B Projects.

Working with clients before a commitment is made

During a due diligence visit to a client, IFC identifies and assesses potential E&S impacts and issues, both adverse and beneficial, associated with the proposed investment and conduct a gap analysis to define areas of projects non-compliance with the requirements of IFC's performance standards and general and sector-specific Environmental, Health and Safety (EHS) Guidelines. Assessment of the commitment and capacity of the client to manage identified impacts and define remedial measures as well as to assess the quality and adequacy of the client's E&S management systems and practices to avoid, minimize, or mitigate, or offset/compensate for adverse impacts on workers, affected communities, and the environment is also done. Meetings with company, government authorities and stakeholders to discuss the E&S aspects of the project also take place.

Following the IFC due diligence, an Environmental and Social Review Summary (ESRS) documenting the findings of the gap analysis as well as an Environmental and Social Action Plan (ESAP) addressing all deficiencies and noncompliance discerned during the appraisal and containing specific tasks designed to close all significant gaps is designed. Identification of opportunities (e.g., cleaner production and energy efficiency, reduction of the water footprint) to improve E&S performance, and, where feasible, initiate contact between IFC Advisory Services (AS) and the client to realize these improvements is promoted.

The client reviews the ESRS and ESAP and agrees with the content. The client signs a release letter authorizing IFC to proceed with

the disclosure of its E&S project review, along with relevant sponsor E&S documentation, on the IFC website. The client is also requested to disclose project E&S assessment information locally. All projects should engage and consult with affected communities and local stakeholders to ensure their awareness and support of the project. For project with significant potential adverse social impacts on affected communities and projects involving indigenous peoples, IFC will also make a formal determination of the Free, Prior and Informed Consultation process leading to Broad Community Support (BCS) of, and support for, the project.

Once the Board of Directors of the WBG approves the project, the investment agreement is drafted, mutually agreed and finalized. The final agreement reflects the terms of the Environmental and Social Action Plan (ESAP) developed during the review process. The format of the project's Annual E&S Monitoring Report is attached to the investment agreement. Funds are disbursed once the client meets the disbursement conditions.

IFC Supervision

IFC supervision of the project begins once commitment is made. Any Social and Environmental Conditions of Disbursement must be met prior to disbursement of money, especially as they relate to the implementation status of the ESAP. Certain projects (Category A) require clients to implement additional monitoring measures, such as the retention of external experts to verify monitoring information. Clients are required to complete an Annual Monitoring Report (AMR), which is submitted to IFC for review and assessment. AMRs require reporting on a variety of EH&S issues, tailored to the nature of the risks and impacts of the project. IFC uses a risk-based approach with respect to determining the need and frequency for site supervisory visits to projects.

Independent Certification

In brief, the Performance Standards defined "an appropriate certification system as one that would be independent, cost-effective, based on objective and measurable performance standards and developed through consultation with relevant stakeholders, such as local people and communities, indigenous peoples, and civil society organizations representing consumer, producer and conservation interests. Such a system has fair, transparent and independent decision-making procedures that avoid conflicts of interest".



In addition, the Performance Standards provide additional guidance on what a certification system should be, including the following:

- "Be independent, cost-effective, and based on objective and measurable performance standards that are defined at the national level and are compatible with internationally accepted principles and criteria for responsible management and use
- Require independent, third-party assessment of management performance
- Have standards which are developed through a process of consultation and dialogue that included representatives from the private, public and civil society sectors
- Have decision-making procedures which are fair, transparent, independent, and designed to avoid conflicts of interest"

An over-riding objective of future engagement in the palm oil sector is to strengthen sector level performance which is why RSPO and other similar undertakings are so crucially important given that IFC will only ever directly impact a small percentage of producers through its direct investments. IFC's Performance Standards are written to have global relevance across various countries, sectors and project specific contexts. The multi-stakeholder process derived specific commodity standards (e.g., RSPO, Sustainable Agricultural Network (SAN)) are specifically developed with a clear focus on the palm oil sector's environmental and social issues. IFC, participating as one of many members in the RSPO and/or other commodity Roundtables, can certainly work to align and strengthen the associated P&C's but is not in a position to unilaterally impose its own E&S requirements on others who are not IFC clients.

Grievance Mechanism

IFC's Sustainability Policy and the Performance Standards and Guidance Notes reflect the centrality of stakeholder engagement and grievance mechanisms. In Performance Standard 1 (PS1), stakeholder engagement is identified as a key component of the Social and environmental Assessment and Management System while the need for project-level grievance mechanisms are specified. A grievance mechanism is a formal process for the systematic recording and resolution of grievances that are expressed by affected communities. Employees and contract workers should also have access to a grievance mechanism by which they can raise concerns regarding their terms of employment, working

conditions, etc. concerning the impacts of a project. The development and implementation of project-level grievance mechanisms emphasizes the direct relations between a project and its stakeholders and aims to provide the project and affected stakeholders with a means to rapidly address day-to-day issues, pre-empting the entry of claims into the formal judicial system and thereby ensuring that these issues do not affect the project's social license to operate.

While grievance mechanisms have to be designed to suit the project context, both the procedure and the underlying principles remain the same. The IFC Good Practice Note defines five key principles for grievance mechanisms:

- Proportionality – scaled to risk and adverse impact on affected communities
- Cultural Appropriateness – designed to take into account culturally appropriate ways of handling community concerns
- Accessibility – clear and understandable mechanism that is accessible to all segments of the affected communities at no cost
- Transparency and accountability – to all stakeholders
- Appropriate protection – a mechanism that prevents retribution and does not impede access to other remedies
- A typical grievance procedure will include:
 - Objectives - a statement of the intended aims and benefits of the grievance procedure
 - Scope - a clear statement of the types of grievances covered by the procedure
 - Responsibilities - who is responsible for the various components of the system
 - Mechanisms to ensure the affected population is aware of and understands the purpose of the mechanism and how it works
 - Procedures for collecting grievances via telephone, interpersonal engagement, electronic mail, etc.
 - Procedures for recording and acknowledgement of grievances/comments/complaints
 - A transparent methodology for investigation of grievances/comments/complaints
 - Acceptable, publicly stated, timescale targets for responding to complainants



- Procedures for further review of unresolved issues
- Monitoring and feedback, with targets for satisfactory complaint resolution
- How the procedure will be communicated to third parties
- Disclosure: how information about grievances/comments/complaints that have been lodged and/or resolved will be made publicly available.

1. A grievance is defined as 'a real or perceived cause for complaint'. It may be expressed formally (e.g. in writing) or informally (e.g. by telephone). In the context of development projects, grievances may relate to alleged or potential risks and adverse impacts associated with a project, an alleged non-compliance with a project commitment, or to matters concerned with employment and working conditions.

2. Employees and contract workers should also have access to a grievance mechanism by which they can raise concerns regarding their terms of employment, working conditions, etc.

Supply Chain

In accordance with the IFC Sustainability Framework adopted on April 30, 2006,⁸² and most specifically Performance Standard 1, "the impacts associated with supply chains will be considered where the resource utilized by the project is ecologically sensitive or where low labor cost is a factor in the competitiveness of the item supplied". In addition, PS2 specifies that "the client will inquire about and address child labor and forced labor in its supply chain."⁸³ Accordingly, where assessment of supply chain risks and impacts demonstrates that these requirements are applicable, the client's Social and Environmental Management System (SEMS) will include elements to manage its supply chain.

⁸² The IFC Sustainability Framework includes the IFC Policy on Social and Environmental Sustainability, the IFC Policy on Disclosure of Information, and the IFC's performance standards.

⁸³ IFC is currently revising its Sustainability Framework. As part of this review and update, on-going efforts are devoted to further define IFC's requirements as it relates to supply chains. In addition to existing requirements in PS2, IFC is tentatively proposing to widen the scope of supply chain requirements to include situations "where there is a high risk of significant safety issues related to workers employed by a primary supplier...". In addition, under PS6 (Biodiversity Conservation and Sustainable Management of Living Natural Resources), it is proposed that: "Where there is the potential for natural and/or critical habitats to be significantly adversely impacted by the clients' primary suppliers, the client should give preference to purchasing from suppliers that can demonstrate that they are not significantly adversely impacting these areas".

Specifically, when the client has control and/or leverage over its supply chain, IFC will require the client to manage the E&S risks and impacts of its supply chain. In order to achieve this, the Client will undertake a supply chain mapping and risk assessment of PS2 and PS6 associated with the production and trade of the agro-commodities in the area of influence of the project, especially as it relates to primary suppliers. Based on this, the client may be required to implement the following elements:

1. Integrate E&S Supply Chain Risk Assessment and Management Procedure into Social and Environmental Management System: As requested under PS1, the client's Social and Environmental Management System (SEMS) will include, as relevant, a supply chain component, including policy, mapping, risk assessment, corrective measures, training, monitoring and reporting. Risks and impacts in the trader's supply chain will be assessed and documented when there is the potential for child/forced labor, significant safety issues, and/or natural and critical habitats to be significantly adversely impacted by the client's primary suppliers.

2. Supply Chain Policy: A purchasing policy that includes the assessment and management of E&S risk and impacts in the supply chain, including a commitment to continuously increase the volume of PS compliant commodities purchased (as defined by industry specific codes of conduct (e.g. RSPO), or in the absence of such codes, according to an agreed sustainable purchasing criteria) as a percentage of total volume traded/processed over a reasonable period of time. The "policy" must indicate that it will promote compliance with the applicable IFC Performance Standards' requirements for its supply chain. The development of a Code of Conduct for the trader' primary suppliers could also be required.

3. Supplier Database: As part of the SEMS, a supplier database will be developed to collect information on suppliers in each of the countries or other locations where the client sources its material commodities. The supplier's database should include information on compliance with applicable IFC's Performance Standards requirements for supply chain. Within an extended supply chain concept, the database will help identify and classify suppliers according to E&S risk and performance (portfolio level) in order to (a) set future targets for traceability, (b) gradually increase the number of low-risk suppliers, and (c) phase out suppliers perpetually at the high-risk end from a labor, safety and ecological standpoint.



4. Mitigation and/or Risk Minimization: Where E&S supply chain risks and impacts are identified, IFC and the client will work on the development of an implementation plan for mitigating and/or minimizing the E&S risk in the supply chain. This may involve: (a) improving the traceability of the supply chain; (b) reduction and/or cessation of sourcing from high-risk areas or disreputable suppliers; (c) identification of alternative sources that are compliant with the applicable PS requirements for supply chain and preferentially procuring from these sources; (d) increasing the percentage and amount of PS compliant commodities purchased as a percentage of the total volume traded or processed in a given year, either through switching suppliers or influencing existing suppliers; (e) the development and implementation of mitigation measures focused on locations where monitoring results indicate adverse environmental and social conditions (hotspot areas), and; (f) if the trader has limited influence on its supply chain, recommendation to its primary suppliers in joining sectoral/multi-stakeholders initiatives to improve best E&S practices in commodity's supply chain area.

5. Training: The client will implement a training program for field staff to build in-house audit capacity to carry out environmental and social (labor/safety) reviews and determine the nature, scale, and importance of environmental and social issues in the supply chain at any given location. The training shall include sessions for

primary suppliers (farmers) on best agronomy practices and legal and regulatory compliance requirements as it applies to child labor, significant safety issues and biodiversity, and ensuring that suppliers are gradually advanced into higher environmental and social standards (low risk categories).

6. Supply Chain E&S Monitoring and Reporting: The Client will develop systems for continuous monitoring and periodic reporting of its supply chain's environmental and social information to senior management. For example, the supplier's database described above may serve as a tool to monitor the supply chain and could be expanded to incorporate broader country supply chain data. In certain circumstances, the Client may be required to implement annual independent monitoring of traceable product, especially as it relates to PS2 issues concerning child labour and significant safety issues, and PS6 monitoring of natural and critical habitats conversion. Monitoring will serve to identify necessary changes in the company's SEMS to improve supply chain risk assessment and management and/or reduce E&S risk within the supply chain.

This procedure will allow IFC to track: (a) the progress made by the clients in increasing traceability targets and quantifying compliance with applicable PSs requirements in its supply chain; (b) the implementation of monitoring tools, metrics, and methodologies to measure on-going performance assessment, and on-going update of supplier categorization dynamics.



2121 Pennsylvania Ave., NW, MSN 8P 807
Washington DC, 20433, USA
Tel. + 1 202 458 0430
Fax: + 1 202 974 4338
palmoilstrategy@ifc.org

www.ifc.org/palmoilstrategy



THE WORLD BANK



IFC | **International
Finance Corporation**
World Bank Group