

FAIR COMPANY–COMMUNITY PARTNERSHIPS IN PALM OIL DEVELOPMENT



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LIST OF ABBREVIATIONS

CPO	Crude palm oil
CSR	Corporate social responsibility
FAIR	Freedom of choice, Accountability, Improvement and Respect for rights
FFB	Fresh fruit bunches
FPIC	Free, prior and informed consent
GHG	Greenhouse gas
HCS	High carbon stock
HCV	High conservation value
IDH	Sustainable trade initiative
ISCC	International sustainability & carbon certification
LCDA	Land Custody and Development Authority
NES	Nucleus estate schemes
NGO	Non-government organisation
PIR	Perusahaan Inti Rakyat (Nucleus estate and community)
PKO	Palm kernel oil
PTPN	Perseroan Terbatas Perkebunan (Nusantara) (State owned plantation company)
RSPO	Roundtable on Sustainable Palm Oil
SHARP	Smallholder Acceleration and REDD+ Programme

EXECUTIVE SUMMARY

Palm oil production can lead to greenhouse gas emissions, land grabs and exploitation. However, sustainable production, investment and sourcing can create benefits for the climate and communities. One evident opportunity is increased land efficiency and productivity on smallholder farms.

This report points to four key principles to design company–community partnerships: freedom of choice, accountability, improvement and respect for rights (FAIR). These principles for FAIR company–community partnerships provoke rethinking of current development models. While raising productivity and reducing agricultural emissions from land use change, smallholder income security can improve. At the same time, community land rights and food security should be recognised. In particular around replanting, the company–community engagement rules are reset for a long period. Most social, environmental and economic trade-offs are also determined at this early stage.

Respect for rights is the basic principle. Improvement should be the driving force to create shared value between a company and host communities, in terms of business relationships and climate-friendly and pro-poor impacts. The rules of engagement (including concepts such as voice, transparency and mutual responsibility) allow freedom of choice in balance with accountability.

The principles for FAIR partnerships should not be considered as a new standard, but should be seen as support for existing sustainability initiatives – such as the Roundtable on Sustainable Palm Oil (RSPO) – on pursuing to make sustainable production models the norm.

While each development model in palm oil has different opportunities to be climate-friendly, land-efficient and pro-poor, none is currently fulfilling the potential for smallholders and communities. Moreover, the success of, for example, land tenure arrangements or revenue models also depends on the intent, the implementation and the local regulatory context. High potential for land efficiency exist in the more centralised models where the company holds responsibility for development and management of the plantations and has access to farm inputs (high quality seedlings) and agronomic knowledge. These models, however, take land away from community members and leave them in the role of workers, not enabling them to be active as investors in the improvement and continuity of their farms.

Partnerships do not emerge in isolation, but depend on incentives from other stakeholders to trigger and sustain them:

- Trading companies, brands and investors should jointly work with suppliers to revitalise low-productive plantings, embracing smallholders as environmentally sound business partners.
- National and local governments are crucial for creating forest protection rules to effectively spare land and climate.
- Opportunities should be shared with the broader community and relevant voices – including women – and heard in community consultations, impact assessments and grievance mechanisms.

Investments which are well-integrated with the surrounding community are likely to be financially successful and have pro-poor impact, a recent World Bank survey found. But investors who left consultations to host governments faced costly disputes. If companies consider host communities as a nuisance, communities will see companies as hostile intruders. Antagonistic attitudes will undermine climate change mitigation, local livelihoods and operational efficiency, unless this is reversed and companies and communities are willing to engage in FAIR partnerships.

BACKGROUND AND RATIONALE

The palm oil sector is growing rapidly and the demand for the multipurpose oil is expected to double before 2050. Consequently large investments in expanding oil palm plantations are on the way. While this potentially leads to direct employment and income opportunities for local communities – if done fairly – it also leads to a pressure on land and other natural resources which could negatively impact the livelihoods and food security of local communities and furthermore contributes to climate change.

Along with the expansion of large-scale oil palm plantations, the number of smallholders engaged in the sector has been growing continuously. Smallholders hold more than 40% of the land planted with oil palm and are now responsible for a significant share of fruit supply in mainstream oil palm supply chains, and this share is growing. Smallholders do not live in isolation but are part of local communities. The models applied to produce oil palm and to engage with smallholders determine to a great extent whether these local communities will benefit or lose from investments in palm oil. This is particularly true for women. The introduction of oil palm cultivation to communities may deteriorate already unequal gender relationships and deprive women from existing land and food resources, while placing an additional burden on them to find alternative sources of food for their families.¹

There are various opportunities to ensure that oil palm cultivation contributes to climate change mitigation, land-efficiency and improved livelihoods. For example, evidence shows ample opportunities to increase the productivity on smallholder farms and consequently improve their livelihoods.² Moreover this will contribute to land-use efficiency which in turn could contribute to reducing agricultural emissions from land-use change as higher amounts of oil can be produced on the same land. Despite the potential, local win-win partnerships of companies and communities are virtually non-existent. Most oil palm plantations, from large-scale to smallholders, are underinvested and inefficient. Conflicts between companies, smallholders and local communities are numerous, while the consequences for women are structurally neglected. In fact, some companies try to reduce their dependency on communities, for example by reducing sourcing from smallholders. In countries where smallholders produce a significant part of oil palm, such development is a significant threat to local livelihoods. Also, it is an equally significant missed opportunity in creating more value from a social, environmental and economic perspective.

Managing the company–community relationship with the mere objective of avoiding risk can turn out complex and can easily turn into a deception for both companies and communities. Building mutually beneficial company–community partnerships to create a truly sustainable production model may seem almost impossible. Still, this is exactly what is required in mainstream palm oil supply chains in order to realise the full sustainability potential, including climate considerations, land-efficiency and pro-poor objectives. Such a reconsideration of the company–community partnerships is particularly relevant in the development of new plantings or in the replanting phase. At those moments, the rules of engagement with long-term implications are defined and this determines, to a great extent, the boundaries of future sustainability performance.

This report makes the case to invest in such mutually beneficial company–community partnerships and presents design principles for these partnerships. It underpins a call to action to the palm oil industry and its stakeholders to take company–community partnerships seriously and start investing in them urgently.

This paper starts with a short introduction of the palm oil sector. Chapter 2 continues with a more in-depth analysis of the potential benefits and drawbacks of oil palm cultivation. Chapter 3 presents different existing production models and discusses their sustainability trade-offs. Chapter 4 briefly presents how current sustainability initiatives address these trade-offs. Chapter 5 presents the principles for FAIR partnerships. Four principles will describe how a company–community partnership should be set-up to come to a truly sustainable sector. Chapter 6 explains what roles other stakeholders have in enabling FAIR partnerships, because such partnerships do not emerge in isolation but also depend on incentives from others to trigger and sustain them. The paper concludes in Chapter 7 with some final considerations.

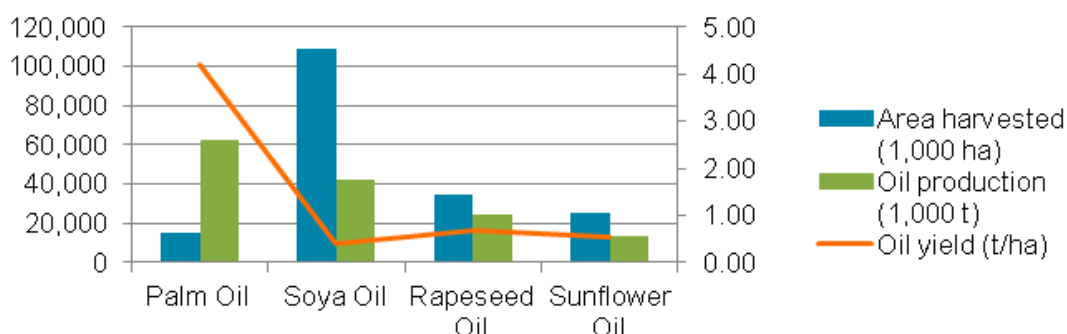
1 PALM OIL: A HIGHLY PRODUCTIVE VEGETABLE OIL

Oil palm cultivation has some specific characteristics. The crop provides year-round and predictable yields over an economic life span of 25 years. Growing conditions are best in the tropical belt, with regular high rainfalls and solar radiation. High investments are necessary upfront to establish the plantations and bridge the three or four years after field planting until the palm starts bearing fruit. The Fresh Fruit Bunches (FFB) harvested from oil palms are the feedstock to mills for the production of crude palm oil (CPO) as well as palm kernel oil (PKO). Processing of the FFB should take place within a maximum of 48 hours after harvesting to prevent that the quality deteriorates and free fatty acids build up. These delays make farmers dependent on neighbouring palm oil mills that extract the oil from the FFB. The capacity of commercial mills usually ranges from 15 to 60 tons of FFB per hour. The palm kernels are left after CPO extraction and processed to PKO in designated processing facilities. CPO and PKO are further refined for a large number of food and industrial uses. Palm oil can also be produced in medium-scale artisanal mills. In that case it is hardly refined and mostly used for local consumption.

1.1 A VERSATILE AND EFFICIENT VEGETABLE OIL

Palm oil is a commodity serving multiple purposes. An estimated 74–80% of global palm oil production is consumed as food.³ The oil and derivatives are also used in the oleo-chemical industry (to produce soaps, cosmetics, plastics and many more), the medical and bio-energy industry. The waste products from palm oil processing are used as animal feed, organic fertiliser and as a source of energy. Due to its cheap price and availability, it is often the preferred vegetable (cooking) oil used by poor households in emerging economies such as India, Indonesia and China. In some African countries, palm oil is also an important part of the local diet. An estimated 10% of CPO is currently used in the biofuels market.⁴

Figure 1: Yield comparison of the 5 major vegetable oils⁵



As Figure 1 illustrates, palm oil production is by far the most land-efficient way to produce vegetable oil. Oil yields (CPO and PKO combined) are 6 to 10 times higher compared to other major vegetable oil sources. Furthermore, the carbon stock in oil palm plantations that stand for 25 years or more is significantly higher than the carbon stock of other vegetable oil crops which

are replanted annually. Those facts make oil palm a strategically important crop to meet the global demand for vegetable oils which is expected to double in 2050 compared to 2009.⁶ While this increase in demand will certainly result in a further expansion of agricultural land; according to experts, palm oil has the highest potential to meet this growing demand in an efficient and climate-friendly way with pro-poor impacts (acknowledging that the climate-friendly potential will largely depend on previous land-use).⁷

1.2 PALM OIL PRODUCTION, TRADE AND CONSUMPTION

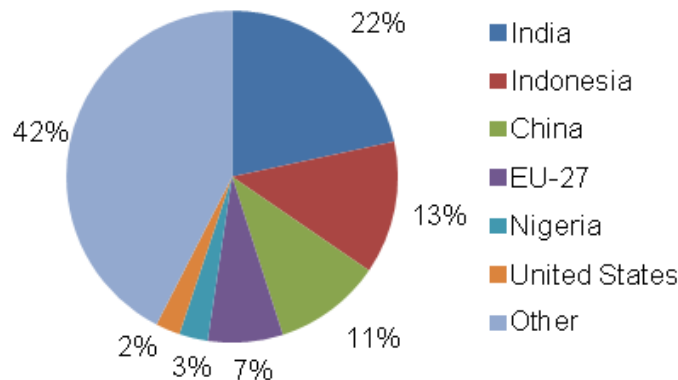
Palm oil's versatility and high productivity resulted in an explosive growth over the last decades. The area under global production has been expanding rapidly and quadrupled over the last 30 years.⁸ Over the last 4 years (2010–2013) the total mature area has increased with an average annual growth of 4.7% (see Table 1). In 2012 global palm oil production amounted to more than 50 million tons, more than any other vegetable oil. Production is largely dominated by the two main producing countries, Indonesia and Malaysia, which together produce 84% of the global output. Dozens of other countries produce much smaller volumes, of which Thailand, Nigeria, Colombia, Ecuador and Papua New Guinea are the most important ones. Due to rising production costs and reduced availability of land in Malaysia, current investments are shifting to other countries.⁹ Growth has been especially fast in Indonesia, Colombia, Costa Rica (all between 6% and 8% of annual growth) and numerous other tropical countries in Africa and Latin America.

Table 1: CPO main producers and exporters¹⁰

Country	Production (1,000 t)	Global share	Mature area (1,000 ha)	Annual growth ¹¹	Export (1,000 t)	Global share
Indonesia	28,500	51%	6,900	6.7%	20,600	47%
Malaysia	19,400	34%	4,450	2.6%	18,700	43%
Thailand	1,720	3%	680	5.1%	350	1%
Colombia	1,040	2%	310	7.8%	185	0 %
Nigeria	960	2%	470	3.1%	20	0%
Ecuador	565	1%	220	4.5%	250	1%
Papua New Guinea	545	1%	146	2.7%	555	1%
Others	3,583	6%	1,671	4.7%	3,010	7%
Total	56,313		14,847	4.9%	43,670	

The main consumers of palm oil are India, Indonesia and China, followed by the aggregate consumption of the 27 EU countries (see Figure 2). Production in Latin America is mostly consumed in other Latin American countries or exported to the EU.

Figure 2: Share in global palm oil consumption by main consuming countries



Source: Index Mundi (2013)

Oil palm is produced by agro-industrial conglomerates with plantations of a hundred thousand hectares or more, as well as by small and medium enterprises, and by a few million smallholders. The smallholders only have a few hectares and sell their fruits to large mills. Despite the presence of a few million smallholders, production in the sector is fairly concentrated. One reason for this is that in most countries smallholders depend on large-scale palm oil mills to process the highly-perishable fresh fruit bunches. Consequently, close relationships between smallholders and mills are common. Thus, mills have a high degree of power over smallholders. In Malaysia, the palm oil sector is dominated by a dozen large conglomerates who are often vertically integrated and operate plantations, mills and trade, down to processing plants in consumer markets like Europe, China or India. These companies also have important shares in the production in other countries such as Indonesia (an estimated 30% of harvested area) and Africa.¹²

Global palm oil trade is controlled by a handful of large commodity trading companies. Wilmar alone controls 45% of global palm oil trade while other major players in global palm oil trade are Sime Darby, IOI and Golden Agri Resources (also known as Sinar Mas). Although they are also oil palm producers and have own mills and plantations, they source the majority of their traded CPO from third-party mills. On the consumer goods manufacturing and retail end of the supply chain, the sector is less concentrated. The world's biggest buyer is Unilever with approximately 3% of global consumption.¹³ The relatively high degree of horizontal and vertical integration in the palm oil supply chain poses opportunities for mainstream adoption of sustainable production models as relatively few actors can have leverage over a large share of global production.

1.3 OIL PALM DEVELOPMENT OPPORTUNITIES FOR COMMUNITIES

Considering the prospect of a steadily rising demand, the oil palm industry holds a large potential for reducing poverty by providing jobs and other livelihood opportunities to rural populations in developing countries in the tropics. Under the right conditions and by using good agricultural practices, the economic performance of oil palm cultivation often outperforms alternative cash crops.¹⁴ Where communities engage in oil palm cultivation, they usually do so on small plots of land as smallholders. A number of factors make oil palm a suitable crop for

smallholders. The oil palm is relatively pest-resistant, tolerates low-quality soils, yields all year around, tolerates neglect in times of low prices and, compared to alternatives like rubber, labour requirements are low.¹⁵ On the other hand, self-germinated oil palms have a very low productivity and, therefore, yields largely depend on quality seedlings. But even managed extensively, semi-wild oil palm groves are common in Africa. The potential of the oil palm to contribute to poverty reduction seems high as long as it is developed in a sustainable way, with the consent of host communities. Benefits, however, are often unequal for men and women. This is due to intra-household power relationships, the role of women in communities as well as the role of women in oil palm production. This varies between countries and even within countries (see below an example of the division of labour between men and women in oil palm cultivation in Ghana).

Table 2: Gender roles in oil palm cultivation: an example from Ghana¹⁶

Men's roles
<ul style="list-style-type: none"> • Activities such as land preparation, carrying planting materials to field sites and transplanting, manual weeding, spraying of herbicides, pruning and harvesting are mostly done by men. • Decisions regarding planting, harvesting, hiring of labour and processing are mostly made by men. • The lands are owned mostly by men.
Roles of both men and women
<ul style="list-style-type: none"> • Nursery management; • Fertiliser application.
Women's roles
<ul style="list-style-type: none"> • Key activities such as rodent control, aggregating and carrying of harvested fruits and collection of loose fruits are mostly done by women. • Women are in charge of marketing and receiving money from sales. • Artisanal palm oil processing is dominated by women, working either in groups or as individuals.

For a number of reasons, smallholders often have lower yields than plantation companies. In Indonesia, official accounts report them to be 35% below average private companies and 45% below government companies. But the yields amongst smallholders vary strongly. Some can enjoy the same or higher yields as large-scale commercial operations,¹⁷ especially when these companies work in close partnership with the smallholders. In anecdotal evidence, however, smallholders' yields are said to be between 1 and 3 tons CPO per hectare while large oil palm growers easily reach 6 tons and more. There is a large potential to substantially increase the yields of existing smallholders around the world,¹⁸ in an environmentally-responsible way, and to subsequently improve livelihoods. This potential is certainly timely for those smallholders approaching the moment when their oil palms need to be replaced by new palms. Replacing old palms with the right varieties and under good agricultural practices offers opportunities to structurally increase productivity,¹⁹ and improve land-use efficiency with its positive impacts on poverty reduction and climate change. Moreover, decisions on replanting provide openings to also apply good practices in land acquisition, community engagement and inclusive business approaches. Combinations with alternative livelihood options may also be considered. Implementing good practices – such as the right to free prior and informed consent (FPIC) – can improve the overall benefits of new plantation development in expansion regions for entire communities, beyond oil palm smallholders only.

Capturing these opportunities requires a thorough rethinking about how companies would best engage with communities (and vice versa). The continuation of current practices does not seem to be a sustainable option, as the following chapter will explain.

2 SUSTAINABILITY TRADE-OFFS IN OIL PALM PRODUCTION

The rapid expansion of the palm oil industry has raised serious concerns about its sustainability performance. Numerous reports highlight the adverse impacts that oil palm development can have on the environment (notably deforestation and climate change) and local communities (notably land grabs, food security and working conditions). This chapter briefly presents the main positive and negative trade-offs associated with palm oil development and how they affect the emission of greenhouse gases (climate-friendly), efficient use of resources (land-efficient) and poverty reduction (pro-poor), during plantation establishment and management.

2.1 CLIMATE-FRIENDLY: REDUCING GREENHOUSE GAS EMISSIONS

Palm oil expansion has come at the expense of substantial tracts of tropical forests. Furthermore, peatland with high carbon stocks is often drained for palm oil development leading to especially high greenhouse gas (GHG) emissions. 15% of all human-induced greenhouse gas emissions are caused by deforestation, forest degradation and peatland emissions. While environmental impacts of large plantations are well-documented, less is known about the impacts from smallholders, let alone the indirect land-use changes from both large and small growers. But the economic development in rural areas through oil palm certainly contributes to an increasing demand for land. In some cases this leads to an uncontrolled expansion of smaller, often unregistered farms on forest land and even in protected areas like national parks. Nonetheless, expansion by smallholders appears to be more likely to occur through conversion of other agricultural land uses to oil palm.²⁰

While the contribution of palm oil to deforestation and greenhouse gas emissions is undisputed, from a global perspective one has to recognise that many other crops have contributed to the same. Moreover, compared to other oil crops, palm oil outperforms any alternative with regards to oil yields. Rather than switching to alternative vegetable oils, sustainable palm oil should be considered as an important alternative. Good management practices on new and existing smallholder farms are not only important for the economic performance but can also support land-use efficiency and reduce GHG emissions. On the other hand, the high profitability of professionally-grown oil palm is the major driver for its expansion with more and more companies, but also smallholders and governments, wanting to reap the economic benefits.²¹

Different palm oil development models may result in different dynamics in land-use change patterns. Models that maximise oil yields lead to the highest land-use efficiency and strengthen the argument for oil palm to meet the demand for vegetable oil in a land-efficient way. Development by smallholders, especially independently from company schemes, leads to more diverse mosaic landscapes with a higher ecological value when compared to large-scale mono-crop plantations.²²

Climate considerations are particularly relevant in the early phases of plantation development or replanting. It is at this stage when the decision is made to cut down a forest, to convert peatland or to burn a palm, which needs to be replaced. Such activities have long-lasting impacts on the climate and can only be avoided at the early stages of designing oil palm development models.

2.2 LAND-EFFICIENT: USING COMMUNITY RESOURCES WISELY

The predominant palm oil development model has been mimicking a "slash and burn" approach on the large scale by expanding new plantings into forest land and leaving older plantations abandoned. Expanding the agricultural frontier seems to be often preferred above replanting. A large-scale production model enables economies of scale in oil palm production, high productivity and high quality standards to be obtained. Large-scale plantations generally have higher yields than smallholder plantations. But to achieve high productivity from smallholders requires additional investments in the organisation of technical extension, input supply, harvesting cycles and transport. Consequently, large-scale plantations appear to be more land-efficient than smallholder plantations. This is likely to be true when only considering the production of palm oil as a relevant service of that land. In most situations, however, the same land also provides communities with important additional livelihood, cultural and ecological services. The concept of land efficiency should take these different services into account to create a sustainable palm oil sector. Unfortunately, many cases exist in which this has not happened and large-scale monocultures have been developed without the consent of the host communities.

Land efficiency refers to the optimisation of land use in terms of long-term oil palm productivity and profitability, natural resource use efficiency and alternative land uses. It should not be confused with yield or profit maximisation, which can jeopardise long-term productivity, for example by resource depletion. It does also take into account the economic, social, cultural or ecological values of alternative land uses.

Many of the investments in palm oil, in both new plantings as well as in replanting, have benefited domestic elites and foreign investors, while the development opportunities to host communities have often been missed or even reversed. Local governments serving macroeconomic goals have often misrepresented the interests of local communities. Especially in agricultural frontier areas, the introduction of oil palm cultivation was transformational, affecting mostly indigenous communities with previously little exposure to modern lifestyles and the market economy. FPIC was inconsistently applied. Faced by large-scale oil palm development, local communities were forced to change their traditional livelihoods and abandon extensive forms of land use, like hunting, use of forest products, rattan and jungle rubber. Women have been particularly vulnerable and were confronted with changes in their roles in the household and communities. They were often deprived of their traditional livelihoods and given a limited role in oil palm development (although this may differ per region as the Ghanaian example in the previous section has shown).²³ Thus, despite new sources of income, local food security has been negatively affected.

The initial phase of palm oil development or replanting has proven to be crucial in defining whether host communities will benefit or lose in the subsequent 25 years or more. Communities are often not aware of the short and long-term effects of selling or leasing their land to plantation companies and the loss of autonomy related to a shift from traditional subsistence

practices to cash crops. Some development models also imply an influx of migrants as workers or through resettlement schemes, which can magnify the pressure on local cultures and traditions and have long-lasting impacts.

Most commercial land deals for palm oil entail transfer of land ownership on the large scale. Although these presume a willing buyer and a willing seller, they often involve non-inclusive contract negotiations between powerful groups that rarely include the people, especially women, who are affected by these decisions. For example, men often decide about cash crops but women lose the land they require for subsistence farming. Even when replanting offers communities a second chance for a next planting cycle, they often lack the capacity to freely negotiate equitable contracts, or lack prior information about the proposal or about alternative models of engagement which offer different levels of benefits. Unfortunately, often when the community selects its leaders to talk or negotiate with a company, women are not included nor consulted. In this way, women are excluded from having a voice, to secure their rights to their (customary) lands and to improve their economic positions. Once the land deal with a company has been concluded, host communities have little possibilities to return to their previous way of life.²⁴ In many cases, withholding consent to development is not presented as an option, undermining effective FPIC.

The lack of transparency, corruption and unequal negotiation power generally results in unfair land deals, not only for new plantings but even at the stage of replanting. For example, the areas allocated to smallholders as part of outgrower schemes often contradict with previous land-use patterns. Companies receive land in good conditions and locations, while the community members receive less favourable plots (e.g. steep, wet, far from mills, far from the village, or with poorly accessible roads). Community members are indignant about the fact that they have to shoulder large debt burdens as a result of the land arrangements. Their debts amount to the same as the debt of beneficiaries of resettlement schemes, generally migrants who did not have any previous customary rights on the land. The usually quickly-rising land prices in the years after a land deal is done, leaves host communities with the feeling of being cheated by the company.²⁵

Company–community relationships can be aggravated when institutions for effective land governance are lacking, and when there is ambiguity and informality over existing land rights. In many cases in agricultural frontiers, oil palm development has been a trigger for formalising land tenure rights, replacing existing customary arrangements, but without FPIC. This can result in severe conflicts over land between communities, companies and migrants as well as within communities.²⁶ For Indonesia alone, around 4,000 conflicts over land related to oil palm development have been documented.²⁷ Numerous other conflicts have been registered in the newly-emerging palm oil production countries, for example in Liberia. Procedures to raise grievances or hold companies to account are commonly absent or not functioning. Consequently, many communities express their dissatisfaction through demonstrations, road blocks, as well as through occupation or seizure of contested land or company property, triggering aggressive company responses. Some conflicts escalate into violence between community members and security personnel of companies or government authorities. This can leave community members criminalised or even claim lives, especially in countries with a poor human rights record. At the same time, companies are frustrated with the challenges to develop the concessions they received from national or local government when they find themselves dealing with long-lasting and costly conflicts.

Such lose–lose situations can be avoided with changing the intent and practices of the establishment or re-establishment of plantations. It requires much more attention to FPIC and principles such as voice, transparency and accountability. It also requires the respect of rights and the willingness to invest sufficient time in trust-building and negotiation to come to fair

agreements that will benefit both the company and the host community at large over a long period. Instead of large-scale monocultures, this would also result in mosaic landscapes. Moreover, expansion and land-use change would be balanced with more optimal use of existing subsistence farming land.

2.3 PRO-POOR: CREATING LOCAL DEVELOPMENT OPPORTUNITIES

As part of respectful negotiations about land, oil palm plantations and palm oil mills can offer host communities employment opportunities and the option to become oil palm smallholders. These opportunities can have an important pro-poor impact. Where working conditions are good, this can improve living standards and lead to economic development. However, numerous reports have documented unacceptable or poor labour conditions in palm oil plantations violating internationally recognised labour and human rights.²⁸ Some of the main labour issues include long working hours, underpayment, discrimination, forced labour and child labour, dangerous working conditions (e.g. pesticide poisoning of women), lack of the provision of basic services like safe drinking water, health, education and social insurance. Women, casual, and migrant workers are particularly vulnerable to abuse. For example, women and children may assist their husband or father on estates to help him in reaching daily targets, but they are not paid for this.²⁹ Reports on violation of labour rights focus on large plantations but labour issues may also exist on smallholder plantations, where oversight and regulation is even more challenging.³⁰

The activity of producing oil palm can be very profitable for community members and contribute significantly to higher living standards. This, however, requires that certain conditions are in place to enable smallholders to produce efficiently and have good market access. In practice, these conditions are often not in place. Smallholders tend not to meet their potential in terms of profitability and productivity, due to various causes. First of all, oil palm is a new crop to most farmers and to many it may even be the first cash crop in which they engage. Agronomic knowledge is necessary to successfully grow oil palm. Smallholders lack the basic technical capacity to implement the required agronomic practices and even governments often have limited ability to help develop these skills. While governments, at least on paper, privatised the provision of extension services to the plantation companies, in reality smallholders have often been deprived from access to technical assistance, farm inputs such as planting material and fertilisers, and finance. Where access to these services exists, it is often of poor quality.³¹ Women may face additional constraints to access these services. Smallholders can also lack entrepreneurial skills or an entrepreneurial attitude, which may result in them reallocating resources for consumption purposes (e.g. fertiliser stocks are sold for cash income) while they were designated for farm management. And, consequently, the performance of smallholder farms can suffer.³² Whereas in theory smallholder oil palm plantations can be managed with the same or higher efficiency than large plantations,³³ in practice this is rarely the case.

Arguably, governments and the private sector fall short in providing the necessary services to smallholders which would allow them to become efficient. Smallholders do represent a difficult market for these services. But as long as smallholders remain in survival mode, this will not change. Although governments continue to have a role too, closer company and smallholder relationships provide opportunities to break through this vicious circle. Companies have the ability to organise the transfer of knowledge, inputs and finance to smallholders, either by themselves or via partnerships. If this is systematically done at an early stage of plantation development or replanting, the chances increase that, at a certain moment, smallholders

themselves can invest in their farms and become an interesting market for other service providers.

The profitability of oil palm cultivation does not only depend on the efficiency of the production process, but also on the market access. Various palm oil development models include exclusive sales contracts between a company and smallholders or very close relationships between smallholders and local traders (or middlemen). Whereas exclusivity can increase the incentive of a company or trader to invest in smallholders, it can also be abused. The dependency on one mill or trader combined with asymmetrical power relationships and limited negotiation power can lead to conflicts as well as structural mistrust. Smallholders are often little informed about market prices, service charges (e.g. for transport), quality requirements and price formulation.

In addition, many smallholders are indebted to the company (e.g. for the costs of plantation development or inputs) and debts are generally reimbursed via levies on FFB sales. In many cases though, the calculation of those costs is not transparent and is unfair. The risk burden seems to be more on the smallholders than on the company. Many smallholders feel overburdened by the debt resulting from oil palm development and often they do not understand the terms of their contracts.³⁴

If contracts and price-setting lack transparency and are considered to be unfair, smallholders can easily feel deceived by the company. This can also lead smallholders to try to find ways to take advantage of breached agreements by selling to other mills or local traders or by applying practices that impair FFB quality to increase weight or cut cost (adding water or sand, reducing harvesting cycles). Such practices further undermine the relationship between a company and smallholders and reduce the incentives of companies to invest in smallholders. Also these lose-lose situations can be avoided if they are addressed at an early stage of oil palm development. The establishment of plantations and replanting demand long-term investments and the financial modalities should be considered alongside the market access modalities.

In order to become genuinely pro-poor, company–community relationships should be based upon the intent to invest in the improvement of the farming business, including those of smallholders and in employees. The trust-building required for that process calls for transparency, accountability and fair negotiations.

3 ARCHETYPES OF PALM OIL DEVELOPMENT MODELS AND THE ROLE OF HOST COMMUNITIES

The previous chapter discussed various sustainability trade-offs. While the underlying reasons for those impacts are manifold, many of these trade-offs are determined at the early stage of oil palm development. They often depend on how the company–community relationships are shaped. How this relationship is organised and managed can play a crucial role in the sustainability performance of oil palm development.³⁵ This chapter attempts to develop a better understanding in current palm oil development models, how they shape company–community relationships and, consequently, what opportunities and risks they provide for climate-friendly, land-efficient and pro-poor oil palm production.

The five most common palm oil development models applied are:

1. Company estates
2. Joint venture arrangements
3. Nucleus estate schemes (NES)
4. Contract farming
5. Independent smallholders

The palm oil development models imply a specific relationship between a company and the community in which it operates. This chapter attempts to make some generalisations for each model. This requires a note of caution as in reality, the way in which each model is implemented can differ significantly, even within single countries.³⁶ Palm oil development under similar modalities can have very different outcomes, depending on the policy and market environment in which companies and communities operate.³⁷ In some local contexts, e.g. in (post-)conflict areas, power imbalances will be too large to even consider any of these development models, especially if policies and regulation are absent, lax or biased. Nevertheless, some 40% of the land planted with palm oil is farmed by smallholders, making it pertinent to consider these models.

The cases presented in the boxes do not attempt to provide comprehensive and balanced pictures of pros and cons of each archetype model, but aim to highlight some selected characteristics in one particular application of these models and within the local constraints.

Table 3 gives an overview of the modalities of the five archetype palm oil development models. The modalities include land tenure arrangements, responsibilities in plantation development and management, risk and revenue sharing, market access and the delivery of various smallholder relevant services.

Different palm oil development models could be faced with varying risks and opportunities for climate change mitigation, land-efficiency and pro-poor impacts. An overview is given in Table

4. All these risks are especially high, when the oil palm development model includes large-scale non-inclusive land transfer and land conversion as is generally the case for large estates, profit-sharing arrangements and NES projects.³⁸ In the more centralised models like estates and joint ventures, the company holds responsibility for development and management of the plantations. This has a high potential for land efficiency, partly due to the company's access to farm inputs (high-quality seedlings) and agronomic knowledge. Whether these impacts are met strongly depends on the company's efforts. These models, however, take land away from community members, leaving them in the role of workers or as passive shareholders without rights, rather than as active investors in their own livelihoods. The NES model provides these opportunities, but it all depends on the intent and quality of the model's implementation. In general, the large-scale development models have both opportunities as well as considerable risks.

Independent smallholders or certain contract farming agreements allow for more responsibility and freedom in decision making to the smallholders but are at higher risk to underperform economically, especially if local service and product markets are ill-functioning. The necessary high up-front investments in oil palm plantations require smallholders to already have significant resources available or to have access to finance and support from business or government.

The next sections will discuss the modalities, risks and opportunities of each of the different development models in more detail.

Table 3: Different development models and their relevance for key modalities in the company–community relationship

	Company estates	Profit sharing	NES	Contract farming	Independent smallholders
Access to land:	For company	For company	For company and SH	For smallholders	For smallholders
Land-use autonomy of SH:	n.a.	Possible after partnership expires	After debt is repaid or contracts expire	After debt is repaid or contracts expire	Full
Plantation development by:	Company	Company	Company	Usually by smallholder	Smallholder
Plantation management by:	Company	Company	Smallholder or cooperative	Smallholder	Smallholder
Commercial risks with:	Company	Company and smallholders	Company and smallholders	Primarily smallholders	Smallholders
Income for communities from:	Employment, land sales or lease	Employment, lease, royalties	FFB sales and/or employment	FFB sales	FFB sales
SH markets access:	n.a.	n.a.	Exclusive contracts, usually long-term duration	Exclusive or volume based contracts	Usually open market; depends on mills and trader network
Farmer organisation through:	none	none	Usually company	Possibly company, trader, NGO, government	Possibly government, own initiative, NGO
Access to inputs for SH through:	n.a.	n.a.	Usually company or cooperative	Possibly provided by company	Open market or cooperative
Access to training for SH through:	n.a.	n.a.	Usually company	Possibly company	Public extension or service providers
Access to finance for SH through:	n.a.	n.a.	Participating bank and/or company	Possibly company and/or open market	Open market, often informal

Table 4: Sustainability risks and opportunities of the main palm oil development models

		Independent estate	Joint venture	NES	Contract farming	Independent smallholder
Climate-friendly	Risks	<ul style="list-style-type: none"> Large-scale conversion of high carbon stock areas Forest fires 	<ul style="list-style-type: none"> Large-scale conversion of high carbon stock areas Forest fires 	<ul style="list-style-type: none"> Large-scale conversion of high carbon stock areas Forest fires 	<ul style="list-style-type: none"> Uncontrolled small-scale expansion on high carbon stock areas Use of fire in land clearing 	<ul style="list-style-type: none"> Uncontrolled small-scale expansion on high carbon stock areas Use of fire in land clearing
	Opportunities	<ul style="list-style-type: none"> Rational land-use planning Reduced need for additional conversion (compared to other vegetable oil) 	<ul style="list-style-type: none"> Rational land-use planning Reduced need for additional conversion (compared to other vegetable oil) 	<ul style="list-style-type: none"> Rational land-use planning Reduced need for additional conversion (compared to other vegetable oil) 	<ul style="list-style-type: none"> Diverse landscapes. Some control on supply to eliminate additional land conversion 	<ul style="list-style-type: none"> Diverse landscapes Communities value ecological services of forests
Land-efficiency	Risks	<ul style="list-style-type: none"> Land conflicts Reduced food security Loss of cultural identity and traditional livelihoods Marginalisation of women 	<ul style="list-style-type: none"> Land conflicts Reduced food security Loss of cultural identity and traditional livelihoods Marginalisation of women 	<ul style="list-style-type: none"> Land conflicts Reduced food security Loss of cultural identity and traditional livelihoods Marginalisation of women 	<ul style="list-style-type: none"> Reduced food security Marginalisation of women 	<ul style="list-style-type: none"> Marginalisation of women
	Opportunities	<ul style="list-style-type: none"> High efficiency in oil production Economies of scale 	<ul style="list-style-type: none"> High efficiency in oil production Economies of scale 	<ul style="list-style-type: none"> High efficiency in oil production Economies of scale 	<ul style="list-style-type: none"> Freedom to choose on land-use Resilience due to diversified cropping systems 	<ul style="list-style-type: none"> Freedom to choose on land-use Resilience due to diversified cropping systems
Pro-poor	Risks	<ul style="list-style-type: none"> Bad labour practices Exploitation of smallholders 	<ul style="list-style-type: none"> Bad labour practices Lack of transparency and unfair revenue sharing model 	<ul style="list-style-type: none"> Bad labour practices Exploitation of smallholders 	<ul style="list-style-type: none"> Exploitation of smallholders Limited capacity to develop and manage plantations 	<ul style="list-style-type: none"> Limited capacity to develop and manage plantations Unreliable market access
	Opportunities	<ul style="list-style-type: none"> Employment Community investments 	<ul style="list-style-type: none"> Employment Regular incomes for communities Community investments 	<ul style="list-style-type: none"> Employment Smallholder development support (including knowledge, inputs and finance provision) 	<ul style="list-style-type: none"> Smallholder development support (including knowledge, inputs and finance provision) 	<ul style="list-style-type: none"> Autonomy and flexibility Added value through investment in processing Efficient market through competition

3.1 INTEGRATED COMPANY ESTATES

Oil palm is often started via large-scale plantation models, especially in frontier regions. This model combines large-scale plantations and a palm oil mill. To reach economies of scale in processing, mills usually have a capacity of 45–60 tons per hour. To utilise this capacity, an oil palm plantation of 5,000 to 10,000 hectares is necessary, but much larger plantations exist. The land for these plantations can be obtained through concessions on government land or by sale or lease agreements from local communities or individual owners. The company shoulders the investments in developing the plantation, the processing facility and possibly the necessary infrastructure like roads. Plantation management is fully in the hands of the company and all commercial risks are taken by the company and its financiers. How companies acquire the user rights on land is a crucial condition for whether host communities can benefit or lose from such investments. Unfortunately, many of the land rights' related issues presented in Chapter 2 are linked to the establishment of such large-scale plantations, notably including the lack of FPIC, land conflicts and disruptive effects on local livelihoods, food security, culture and the position of women.

Large integrated company estates, independent from external supply, usually provide an efficient management of the land with strong incentives to increase oil yields. Access to finance is usually good and helps to shoulder the necessary large upfront investments necessary for oil palm development, especially in agricultural frontiers. The large-scale nature of the project allows companies to invest in highly-qualified management and technical staff needed for long-term economic success. It also allows companies to access high-quality farm inputs at competitive prices, which is important to avoid some of the agro-economic shortcomings smallholders are often facing.

Whereas large-scale plantations can be efficient in terms of productivity, the direct benefits to the host community usually depend on the number of community members who will receive employment in the company and the prevention of negative impacts on livelihoods and food security. This development model does not foresee any palm oil cultivation by communities. The host community is involved in the operations by providing labour during the plantation development as well as for the management. Considering the heavy work of most of the employment opportunities in company estates, women are disadvantaged in assessing employment opportunities. Especially in agricultural frontiers and for initial plantation development, labour is often brought in from other regions.

Integrated company estates have been set-up without too much dialogue and collaboration with local communities. Especially if concessions are provided by the government, companies can work pretty independently. In such situations, the benefits for local communities are limited while they often bear the direct and indirect negative consequences linked to these plantations. In the worst case scenario, companies can just come, reap the highest returns in the shortest possible term without considering long-term performance of the land such as soil fertility and ecosystem services. In order to become sustainable, this model requires much more consideration of the local needs prior to the development phase. Opportunities to create more mutual benefits need to be explored between companies and host communities, and consent should be given before development takes place.

3.2 JOINT VENTURES

The joint venture arrangement is, to a large extent, similar to the independent integrated estate discussed in the previous section, however usually with stronger community engagement. The risks and opportunities are similar. A company is responsible for developing and managing the plantation and a processing mill and can do so in an efficient way. Employment opportunities are provided to local communities. The difference to an integrated estate is that communities have a higher stake in the company and potentially benefit from a certain way of profit-sharing. This could be a royalty on the estate's total revenues or profits, or for a dedicated part of the estate. In some cases, host communities obtain shares in the company's equity or partial cash payments in return for the land provided. Joint venture models can also be based upon land-lease contracts, in which community-based land rights are leased to the company for a limited amount of time. Some joint ventures may also allocate a certain area to the community but manage these areas via a company-managed cooperative. In this case, the individual community members receive a share of the cooperative's income, based on the size of the land allocated to them (this can also be considered as a model of the nucleus estate and smallholder scheme presented in the next section).

When payments are linked to the profits of the company, commercial risk is shared between the company and the host community. Shared ownership could also imply more influence on how the company operates and as such provide more potential for mutually-beneficial partnerships. The success of this model varies a lot and depends on the arrangements between the company and community members, including participation and transparency in decision making. If the joint venture model is chosen in order to create clear benefits to local communities, this allows a company to maintain full control over production while creating local buy-in. By contrast, if it is chosen as a model which allows a company to gain access to land while having the least possible interference with communities (such as currently is the case in various countries that apply this model), this model can turn into a disaster. Where the expectations of host communities diverge from the outcomes of the oil palm development this can lead to strong conflicts as seen for example in the case described for the Konsep Baru in Malaysia (see box). Considering the long-term impact of the arrangements, the modalities of the arrangement could also get outdated, e.g. due to inflation, which negatively impacts communities and further feeds their discontent. Like with any large-scale development model, it requires important efforts in awareness raising, transparency, consultation, negotiation and actual influence on decision-making in order to make it a mutual success. This also implies that women need to be involved in such processes. All community members need to understand the risks and opportunities attached to increase its dependence on one single crop and how this affects their resilience, future livelihoods and culture.³⁹

Box 1: Disappointment with a Konsep Baru project in Malaysia

The Malaysian Konsep Baru is a policy instrument to open up customary land for oil palm development through the Land Custody and Development Authority (LCDA). LCDA persuades customary landholders or state authorities to provide their land under a consolidated land title for oil palm development over 60 years, in a joint venture agreement with a private sector company. The payment for the land-use at a pegged price per hectare is done in cash (10%), accounts in a government trust (30%) and equity shares in the company (60%). This results in a 30% share in the companies' equity being given to the community. LCDA holds 10% of shares. Based on their shares, community members can expect dividend payments from the company.⁴⁰

One evaluation of a palm oil development project under this model, however, shows that community members have been deeply disappointed with the economic returns from participating in oil palm development. In practice, wages in the company were reportedly not high enough to provide an attractive income for local communities and therefore migrant labourers dominate. The land that community members gave up in hope for attractive incomes from palm oil had previously provided them with incomes from rubber and pepper or rice production. Host communities received a meagre cash payment for their share of the customary land and no further regular incomes after the deal was struck. Furthermore, the community expected dividend payments in the fourth year of plantation establishment. After these payments failed to materialise, discontent arose among community members. It took another 7 years without dividend payments till conflict broke out and community members in protest blocked the access to company plantations. Community members have now brought the case to court.⁴¹

3.3 NUCLEUS ESTATE AND SMALLHOLDER SCHEMES (NES)

The NES consists of a nucleus estate, a plantation with integrated processing mill, managed by a private or state-owned company. To supplement FFB supply from the nucleus estate, a smallholder scheme is developed in close proximity. The company usually gains access to community or government land on a lease basis and in return develops the plantings for smallholders who are members of the communities or beneficiaries of a resettlement scheme. Individual land titles can also be swapped into a NES project. A number of variations in the design and management of NES projects exist in the major palm oil producing countries.⁴² The share of nucleus estate in relation to smallholders varies in different NES projects and can range from 80:20 to 20:80. Smallholder plots usually range up to 7 hectares, but in Indonesia they are most commonly 2 hectares. The arrangement is regulated by contracts between the company and the smallholders, often grouped in cooperatives, with the involvement of public or private banks and supervision by the local government.⁴³

The cost of the development of the smallholder scheme is usually transferred to a loan provided to smallholders through a participating bank. Plantation management is transferred to the smallholder when the palms begin to yield. Smallholders often access inputs like fertilisers and tools through the company or a cooperative which would usually also hold responsibility for transportation of the FFB to the mill. Smallholders are bound through a contract to sell their FFB to the nucleus which usually deducts the debt and cost of other services like transportation from the FFB sales of farmers. Once the loans are repaid, farmers can receive individual land titles

which are held as collateral by the bank or the company during loan repayment. In NES projects, a company usually provides training to scheme smallholders and establishes a farmer's organisation, which is supposed to manage the relationship between the mill and the company.⁴⁴

Box 2: Successful cooperatives in a NES/PIR project in Indonesia

The Indonesian government awarded the smallholder cooperatives of a major palm oil producer in Indonesia for their successful management. Smallholders manage 2 ha of palm oil. In this scheme management, responsibility is handed over from the company to the smallholders in the fourth year after planting. An assessment of the success of the cooperatives acknowledged the importance of capacity building. Technical assistance is provided on a range of issues, by the cooperatives as well as company. Further success factors are reported to be:

- mutual benefits for the company and the smallholders;
- provision of services by the cooperative that meet the demands of cooperative members;
- independence of the cooperative management from the company through leadership elected by the farmers;
- accountability of the cooperative management by a separation of functional responsibilities and independent external audits;
- functioning mechanisms for communication and grievances;
- integrity and leadership of cooperative executive management.⁴⁵

With plantation development in the hands of the company, the potential land efficiency of NES projects is high because it can access high-quality planting material and ensure the right care for the palms during the immature phase, which is crucial for the FFB yields in the years to come.⁴⁶ The close relationships required in NES schemes would in theory also allow for a knowledge transfer from professional companies to communities and the development of strong, community-based farmers' organisations providing agricultural services for professional, entrepreneurial farmers. Through the company or farmers' organisations, the access to high-quality inputs at affordable prices can be secured and the high investments for palm oil development and replanting can be financed and the implementation of good practices can be enforced.

In reality however, the performance of NES schemes in oil palm development around the world is daunting. They are generally perceived as gender-biased by focusing on participation of male community members.⁴⁷ Where little interdependence between host communities and companies exists and the local authorities do not enforce good practices, the motivation of companies to make the necessary investments in the capacity building and empowerment of smallholders can be limited. Lack of companies' consideration for smallholders' interests can turn their relationship with the host communities sour with all the negative side effects outlined in Chapter 2. In such a case, benefits and risks are not aligned and the importance of efficient land use, which requires efforts by both parties, is often neglected. Smallholders can implement practices that undermine FFB quality, slow down debt repayment and favour area expansion over intensification of existing farms. And companies can respond with further disinvestments in communities.⁴⁸ This could have disastrous consequences, including the risk for smallholders to lose their land rights, as many companies hold smallholders' land titles as collateral for the loan-based development costs. So, if smallholders perform poorly due to lack of inputs and market access, they may not be able to reimburse their loans and retrieve their land certificates.

Generally, NES models have little safeguards for smallholders in case a company fails to deliver what it is expected to do.

Box 3: Revision of the Plantation Regulation in Indonesia

In late 2013, the Ministry of Agriculture of Indonesia issued a regulation (Permentan) on the licensing guidelines for plantations which constitutes a revision of the previous regulations.⁴⁹ To hold a plantation license beyond 250 hectares or a license for integrated estates, companies have to develop 20% of the total plantation size for smallholders in the community. This land is supposed to be found outside of the company's concession area, which is the major change with regards to the previous regulation that required this to be within the concession area. The land development has to be implemented through a credit scheme, via a profit-sharing model or another funding model. The eligible community is required to hold legal titles on the land to be developed.

The outlines of NES models are often stipulated by national regulation and to a great extent determine the true sustainability potential of these models. They have often been designed to promote rural development and provide additional benefits to local communities and migrants. However, enforcement of these models is an issue in some countries resulting in all kinds of variations which are less beneficial to local communities. The stipulated models have some inherent weaknesses. For example, in the Indonesian plantation models, the ratio between nucleus estates and smallholder schemes has shifted from 20:80 in its original design to 80:20 in more recent schemes.⁵⁰ This has reduced the dependency of mills on smallholders considerably and consequently reduced the incentive to invest in smallholders. The changes lead to conditions where mills do not need the supply of the scheme smallholders to operate their mills at full capacity during certain periods of the year and consequently smallholders are deprived of reliable market access. One could also doubt whether the prescribed 2 ha of oil palm is large enough to provide a smallholder with a sustainable livelihood. It may allow an average farmer just to remain in survival mode. By contrast, if the plantation would have been a few hectares larger, it could have provided the smallholder with a decent income and sufficient revenues to invest in its plantation.

Local regulation will support or constrain the establishment of so-called independent mills, which operate without owning a plantation. Those mills are often an important market for independent smallholders who take advantage of increased competition for FFB between mills operating below their capacities. Although one should consider the risks of establishing independent mills, their presence can reduce power asymmetries between companies and communities.

3.4 CONTRACT FARMING

Whereas the above-mentioned NES model can be considered as a form of contract farming, this section outlines contract farming models which do not involve land transfer between the company and the community. It implies that farmers enter a contract on selling their produce with a company that is operating a palm oil mill, and possibly also a plantation. Contracts can be exclusive or for a certain share of production, and the duration of contracts varies. But the contracts generally allow both parties to reconsider their relationship on a regular basis, including the sharing of risks and benefits, in theory. Other terms of contracts can be very diverse and possibly regulated by government. They usually include marketing terms, price

agreements, the provision of seedlings, input supply, technical assistance to develop the land as well as credit to purchase those seedlings and shoulder initial investment costs or bridge the time until the palms become productive. Contracts can be between individual smallholders as well as their organisations but the arrangement would usually not include organisational development provided by the company. Contract farming can be a measure for companies to secure additional FFB supply where they do not have sufficient access to land. It can also be promoted or required by the government as is the case in Colombia and India, respectively.⁵¹

Contract farming establishes a formal relationship between companies and communities with the potential community benefits being access to knowledge, technology and finance through the company. Smallholders are provided with a secure market, in many cases at a price based on a negotiated agreement. Contract farming also increases the control of the company over its supply base and the possibility for it to enforce certain practices like no deforestation or burning of land. As contract farmers develop their own land, this generally results in a more diverse agro-ecological landscape than the top-down planned NES schemes. While this holds potential benefits to host communities, success depends on fair negotiations in the relationship between company and community.

Box 4: Illuminating aspects of change in a contract farming project in Costa Rica

A study based upon 25 producers, a relatively small number, concluded that palm oil development in the Brunca region of Costa Rica remained relatively limited until an infrastructure project and the increasing price of palm oil led to an increased expansion. A major palm oil producer in Costa Rica provided farmers, who had limited resources of their own to invest in oil palm, with access to the necessary resources. Based on exclusive sales contracts for 12–14 years, the company provided farmers with seedlings as well as low interest rate loans to cover operational expenses for the first 3 years after cultivation. The land of the farmers was used as a first or second degree mortgage. After the third year, when palm starts yielding, 30% of the sales revenues from farmers' FFB were deducted for loan repayment. After the contracts expired, farmers were able to sell their FFB to alternative markets, often fetching higher prices for FFB.

Expansion took place on agricultural land of small to medium-sized farms in the area, due to the attractive economic returns from oil palm cultivation when compared to alternative crops. This suggests that no deforestation took place. Reportedly, oil palm cultivation in the area led to a doubling of incomes and improved access to health and education. The oil palm usually replaced food crops as well as pastures that provided lower economic returns. Cash incomes from FFB sales increased food security in the region. The study notes, however, that significant gaps remain in understanding the socioeconomic and environmental impacts of plantation expansion. Other uncertainties include the impact on future food security and the potential to permanently alter lifestyles and community dynamics.⁵²

Smallholders' bargaining power over the terms and conditions of contracts, however, is limited in the absence of alternative market outlets and without a strong farmer's organisation. Limited experience in oil palm cultivation and unawareness about potential positive and negative trade-offs risks that smallholders agree to contracts which they later experience as unfair or not beneficial. This is especially worrying where those contracts are fixed for a long time and include loans for smallholders. When smallholders feel disadvantaged and are disappointed with the outcomes of palm oil development, the company–community relationship will suffer and conflicts will emerge. In such a constellation, as in many other commodities, smallholders tend

to look for side-selling to avoid debt repayment and price agreements. Moreover, required good management practices to ensure FFB quality are not applied and inputs that were provided by the company or government are sold instead (input diversion).⁵³

While contract farming models have the potential to provide host communities with higher flexibility and more autonomy on their activities, they may as well entail the same power imbalances and disadvantages as bad examples among the NES schemes. The actual benefits depend on the specific design of the relationships, the degree of trust and mutual respect to fulfil commitments as well as the willingness and capacity to solve emerging issues in a constructive way.

Box 5: Contractual provisions only partly met in Strategic Alliance projects in Colombia

The Colombian government provides financial incentives for palm oil producing companies to establish contract farming agreements with smallholders, usually via small farmer organisations. This allows companies to improve their access to FFB to optimise the usage of mill capacity. As part of the contract, companies provide a secure market for FFB, an agreed mechanism for price calculation and, in most cases (83%), seedlings, and also loans to purchase those seedlings. Technical assistance is also provided by the company or third parties, sometimes for free. Smallholders commit to work on the plantations following the recommendations of the company on agricultural practices and deliver their full FFB harvest in accordance with quality requirements to the company.

An evaluation of the national programme revealed that despite positive effects on incomes and the higher economic returns of oil palm to communities when compared to other crops, 57% of the evaluated farmers' productivity was lower than expected, undermining land efficiency. To a large extent (55% of cases), the technical assistance, considered as crucial for success of communities engaging in oil palm, has been provided by an external party, hence outside the contractual agreement. Administrative cost, delay in loan repayments and the diversion of FFB to other mills have been major obstacles experienced in strategic alliances.⁵⁴ While some parties praise the economic benefits that oil palm development brought to communities under strategic alliances in the extremely challenging context of internal armed conflicts in Colombia, others highlight that it contributed to the dispossession and displacement of indigenous and afro-Colombian communities.⁵⁵

3.5 INDEPENDENT SMALLHOLDER DEVELOPMENT

Independent smallholder development often co-exists with other oil palm development models. Enticed by the economic benefits of the company or farmers in a company scheme, community members perceive an opportunity in developing oil palm on the land they own, or by investing in land, to set-up small to medium-sized plantations independently. Farmers develop and manage the plantations by themselves or with support from extension service providers (governments or NGOs). The income is generated through FFB sales to mills, cooperatives or trader networks in the vicinity of the plantation. Certain economic stability is required to shoulder the necessary investments and a general agronomic knowledge is necessary to be successful, features that company staff or professional farmers have for example.⁵⁶

While independent smallholder development is usually unplanned, it can also be promoted by the government through subsidies or loans for plantation development and management and through targeted extension services. For example, the government can promote the conversion of lands from one crop to another, as in the case of rubber to oil palm in Thailand. The government can also be involved in organisational development, e.g. through setting up cooperatives. A prerequisite for smallholder oil palm development is that processing facilities in the vicinity of the community exist. Depending on infrastructure, FFB are transported to rather far away processing facilities, a service usually provided by local traders and transporters.⁵⁷ Compared to large-scale plantation developments, independent smallholder development usually results in a diverse agro-ecological landscape consisting of small-scale plantations scattered between other land uses.

The risk for companies to initially invest in the processing mill is high when they do not control own plantations or have reliable independent suppliers. As processing and FFB production are disintegrated to a large extent in such models, companies depend on the host communities to implement the practices that ensure the efficient use of land. The informal relationship, often managed by middle men, makes traceability of FFB and the enforcement of production practices extremely difficult for the company. Especially where competition for FFB is high, companies are limited in their ability to implement quality standards. This can lead to the deterioration of quality which drives down the oil yields. Low oil yields lead to low FFB prices, which limit the ability and willingness of smallholders to make the necessary investments in their farms.

The potential of efficient farm management by independent smallholders is however high as long as they have access to knowledge, inputs, finance, markets and the right incentives to implement quality standards. Companies can reduce transaction costs when they can source from well-organised independent smallholders.⁵⁸ Farmers' organisations are also the prerequisite in the process to achieving sustainability certification which is increasingly required by international markets. Independent smallholders have an intrinsic interest in the health and sustainable management of their land and environment. When they are aware of sustainability impacts and how to address them, the potential for sustainable land use is high. The decision on how to use the land and what to grow allows independent smallholders to diversify crops. This can create economic opportunities for women, increase local availability of food, increase resilience to shocks (e.g. pests, weather, prices) and lead to diverse mosaic landscapes with a higher ecological value than vast mono-crop oil palm plantations.⁵⁹

A successful independent smallholder model can potentially be combined with investments in an own palm oil mill. This can have important pro-poor impacts as smallholders capture more value and it can provide additional incentives to smallholders to increase productivity and quality in their oil palm cultivation. There are only a few examples of smallholder-based mills, but the example of the Federation Mill in Thailand provides a promising alternative to the top-down agro-industry dominant development model.

Box 6: A Federation of Cooperatives invests in own palm oil mill in Thailand

A total of 26 cooperatives, totalling 15,000 oil palm farmers came together to form a federation of cooperatives in Thailand. The federation invested in a palm oil mill with a processing capacity of currently 60 tons per hour. The farmers are shareholders in the palm oil mill of the federation and through their shares they receive dividends from the profit of the mill. This provides incentives to deliver high-quality FFB which positively affects the oil extraction rate in the mill and hence its profits. Through implementing a quality management programme in cooperation with the farmer cooperative, the federation mill has a higher oil extraction rate than its competitors. In turn, it can pay higher prices to its suppliers and gain an edge in the often fierce competition for FFB in the region. The federation mill is also investing in biogas facilities, wherein harmful methane gases coming from the mill's wastewater are transformed into electricity. This does not only significantly reduce GHG emissions, the sales from electricity into the Thai electricity grid adds further value to the farmers' oil palm products.

By coming together in a large group, the farmers are able to invest in downstream processing, reap the added value and promote good practices along the value chain. The lower-level organisation in individual cooperatives contributes to participatory decision making and the enforcement of quality standards in cooperative-owned loading facilities before FFB reaches the mill gate.⁶⁰

4 EXISTING INITIATIVES TO PROMOTE SUSTAINABLE PALM OIL DEVELOPMENT MODELS

Over the last ten years, a number of initiatives have emerged to address the sustainability challenges in the palm oil industry. This chapter briefly discusses a few of them from the perspective of how they deal with the sustainability trade-offs in company–community relationships, especially the role of oil palm smallholders.

The Roundtable on Sustainable Palm Oil and other standards

The Roundtable on Sustainable Palm Oil (RSPO) is a multi-stakeholder initiative to transform markets and make sustainable palm oil the norm. The RSPO developed a voluntary standard for sustainable palm oil production and manages a certification scheme. Since its foundation in 2004, the RSPO has become the largest multi-stakeholder initiative in the palm oil sector. The RSPO Principles and Criteria positively address company–community relationships in various ways. They include requirements to companies to respect legal, customary and users' rights over land, the use of free prior and informed consent (FPIC), the development of user rights' maps by participatory mapping to obtain clarity on customary rights, and the consultation as well as information of all affected groups within local communities covering impact assessments and proposals for benefit sharing (Criteria 2.2 and 2.3). The standard also requires the assessment of any High Conservation Values⁶¹ (HCV) that could be affected by mill or plantation management, and to safeguard community rights in set-aside HCV areas, in accordance with community agreements (Criterion 5.2). The guidance under Criterion 7.6.6 specifically calls for the consent of communities to be given before the issuance of a concession or land title on the initial planning phase for the development of new plantings. Where communities lost rights or access to land, companies have to be ensured that they benefit from the development of new plantings (7.6.4).

RSPO Principle 6 specifically covers the impacts of oil palm companies on communities and requires the company to assess all potential impacts, as well as to promote positive and mitigate negative impacts (6.1 and also 7.1). Assessments as well as management and monitoring plans are to be developed with the participation of the affected parties. This includes the impacts of smallholder schemes. Further requirements under Principle 6 that are relevant for the company–community relationship are:

- A complaints and grievance system open to all affected parties like communities, workers or smallholders (6.3)
- Compensation payments for loss of land rights in accordance with a documented system (6.4 and also 7.6)
- Paying living wages to workers and ban of forced or trafficked labour (6.5 and 6.12)

- Freedom of association and collective bargaining (6.6)
- No discrimination of communities or minorities (6.8)
- Contribution to local sustainable development, including efforts to increase smallholder productivity (6.11)
- Respect for human rights (6.13)

Criterion 6.10 explicitly touches on the relationship to smallholders. It requires fair, transparent and legal contracts, timely payment and documented pricing procedures which have to be explained to smallholders. The RSPO makes specific reference to the importance of gender issues and taking into account the situation of women throughout Principle 6.⁶²

In support of the implementation of the RSPO Principles and Criteria there is specific guidance for independent smallholders, as well as scribed smallholders and a standard that allows smallholders to get certified as a group.⁶³ Moreover, RSPO has established a Smallholder Support Fund and a dedicated Working Group.

In addition to the RSPO, other certification schemes have emerged in the palm oil sector. A frequently used standard is the International Sustainability & Carbon Certification (ISCC) for biofuels. Also, the Rainforest Alliance recently entered the palm oil sector. Both standards have fewer requirements on company–community relationships compared to RSPO. They both refer to national and international labour rights and regulations. In both standards, the impacts for surrounding areas, communities, users and land owners has to be taken into account and sufficiently compensated for. They also require the legitimacy of land-use rights (but no reference to FPIC) and ISCC has a minor requirement on protecting local food security. The Rainforest Alliance requires certified farms to consider the interests of local populations, prioritise local hiring and training, contribute to community infrastructure as well as to the protection of natural resources of communities. Both standards do not refer to the relationships between companies and smallholders.⁶⁴

Sustainable Trade Initiative: palm oil programme

The palm oil programme of the Sustainable Trade Initiative (IDH) works towards increasing the output of palm oil while at the same time avoiding deforestation. They work with companies to invest in smallholder improvements and increase the productivity of around 250,000 farmers in regional supply sheds in North Sumatra, Central Kalimantan and Riau provinces in Indonesia. Supply sheds are considered as clusters of oil mills which jointly work towards the implementation of sustainable practices and certification to supply certified palm oil to a refinery. The programme furthermore aims to engage with the financial sector to fund the improvement and replanting efforts through innovative business models.

The theory of change of the programme is to improve the livelihood of smallholders (pro-poor) by increased profitability of their farms through higher productivity and quality (climate friendly and efficient land-use). Financing the replanting is key to increase oil palm yields because unproductive palms or low yielding varieties can be replaced with palms that reach the full yield potential of the oil palm. To ensure that the land-use efficiency is maximised, it is foreseen that smallholders are trained in good agricultural practices. To access the services of the programme, smallholders are asked to commit to not expanding oil palm plantations into forests (climate-friendly). Mills in the programme are stimulated to enter contracts with independent smallholders.⁶⁵ There is no specific mention of the gender aspect of palm oil in the IDH programme, however, the programme includes trainings and sustainable palm oil production which, depending on the reference to define sustainability, could also include gender aspects.

Smallholder Acceleration and REDD+ Programme

The Smallholder Acceleration and REDD+ Programme (SHARP) is a multi-stakeholder partnership to support smallholders in sustainable production practices. In cooperation with the private sector, SHARP works towards sustainable livelihoods of smallholders by increasing yields, access to markets, empowering smallholders and creating environmental benefits. This very much aligns with the objective of oil palm development models that are climate-friendly, land-efficient and pro-poor. SHARP's three main programmes are:

- Successful models for smallholder development
- Responsible supply chains
- Practical approaches for minimising deforestation

Stakeholder consultations to identify smallholder challenges have been held in West Africa, and baseline studies for the main palm oil producing regions have been published.⁶⁶ Focal points will be established in the three regions and guidelines for companies to work with smallholders are currently under development. It is not clear yet how gender is integrated in SHARP's guidelines and how smallholders will be supported to organise.

The above described initiatives do relate in different detail to company–community relationships. The RSPO has the most comprehensive list of criteria to which companies need to comply in their community relationships. This gives an impression of what such relationships should look like. The other initiatives do acknowledge the relationships between companies and communities but the level of detail or guidance that such relationships should comply with is not (yet) available. Current initiatives focus on how a company should engage with communities and as such advocate a top-down approach. However, mutual beneficial relationships between companies and host communities require genuine partnerships with responsibilities for both companies and communities. They also require clear rules of engagement and a clear intent to not only mitigate potential risks but also to realise the full sustainability opportunities. To provide a clearer idea on how genuine company–community partnerships can be set-up, the following chapter presents a set of design principles that can guide the development and implementation of such partnerships.

5 FAIR COMPANY– COMMUNITY PARTNERSHIPS

The previous chapters have shown different risks and opportunities in palm oil production's climate-friendliness, land-use efficiency and on pro-poor impacts. The different existing palm oil development models and relationships between companies and smallholders have been described. The world's challenge is to meet future demand for vegetable oil by investing in better social and environmental practices and ensuring efficient and sustainable replanting of existing plantations. Any necessary expansion of the plantation area should be climate-friendly, avoid land grabs and be based upon models which continuously provide benefits to communities at large, including both women and men. Palm oil production should not jeopardise, but rather promote rural communities to thrive by improving the availability of quality basic services, promoting diversified livelihood opportunities, and respecting human, cultural and religious rights. Whenever smallholders are involved, the applied model should result in fair, transparent and efficient supply relationships and enable smallholders to become sustainable and continuously invest in the improvement of their farms. Compared to current practice, this requires a rethinking of how companies and communities engage with each other.

This chapter presents a set of design principles for developing company–community partnerships. They are briefly referred to as the principles for FAIR partnerships. They should not be considered as a new standard, nor a toolkit or manual. The principles for FAIR partnerships do not suggest additional criteria for the certification that existing sustainability initiatives – like RSPO – are pursuing, but rather guide development at an earlier stage, when a company and community start to build first relations. The design principles should provoke rethinking of company–community partnerships. The principles for FAIR partnerships provide guidance on the necessary intent and practices in order to create the conditions for palm oil production to become truly sustainable. FAIR partnerships are considered to be a condition for climate-friendly, land-efficient and pro-poor palm oil production. FAIR partnerships are particularly relevant when the rules of engagement between a company and communities are set for a long period; prior to new plantings and replanting. They could also provide inspiration to revitalise existing company–community relationships involving productive plantations. This chapter provides more detail on what FAIR company–community partnerships should look like, by focusing on the roles and responsibilities of companies and communities. The next chapter will outline what other actors should do in order to create the right enabling environment for FAIR partnerships.

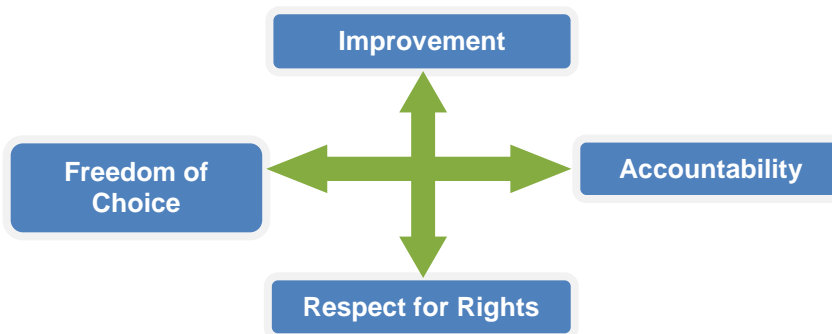
5.1 PRINCIPLES FOR FAIR PARTNERSHIPS

The principles for FAIR partnerships address the relationship between companies and communities and should guide the various investments in a sustainable palm oil sector. It proposes a redesign of current palm oil development models. Companies and communities both have a stake in making the partnership successful and have different roles and responsibilities to fulfil within the partnership.

The principles for FAIR partnerships are formulated as follows:

- **F**reedom of Choice
- **A**ccountability
- **I**mprovement
- **R**espect for Rights

Figure 3: The FAIR company–community partnership principles



Out of the four principles, the Improvement design principle should be the driving force in FAIR partnerships. It concerns the creation of shared value between a company and host communities and the capacity to continuously create additional value. Value is found in terms of healthy business relationships (based upon preferred choice) and climate-friendly, land-efficient and pro-poor impacts. This cannot be done without respecting the rights of all stakeholders involved, including women and minorities. Respect for Rights is, therefore, the basic design principle. In order to respect rights and realise Improvement, the rules of engagement in the partnership should create a balance between Freedom of Choice and Accountability. These two inter-acting design principles stress the importance of the voluntary nature of FAIR partnerships, but also the need for a certain rigor in implementation in order to make it a trustworthy partnership. Freedom of Choice and Accountability include concepts such as voice, transparency and mutual responsibility. Table 5 outlines the basics of the four design principles.

5.2 FAIR PARTNERSHIPS IN PRACTICE

The principles for FAIR partnerships apply to any palm oil development model. The degree to which they can be implemented can differ per existing development model as described in Chapter 3. It also depends on the institutional context in which the models are implemented. This section will not promote one development model over the other, but presents a set of practices that will redesign existing models and inspire the development of new ones.

Table 5: The FAIR company–community partnership principles in more detail

Freedom of Choice	1. Companies and communities promote free, prior and informed consent, including women, minorities and workers in decision-making (e.g. on land acquisition, partnership agreements, contracts, financial arrangements).
	2. Community members, including women and minorities, have a voice in determining how land is used and owned.
	3. Companies and communities pursue long-term partnerships based upon symmetrical power relationships and a healthy interdependency (including the promotion of community and smallholder organisations).
Accountability	4. Companies and communities ensure internal alignment on the intent of the partnership and respect the commitments they have made.
	5. Companies and smallholders enter into fair and transparent agreements and respect defined conditions on pricing, quality norms, delivery, payments and loan reimbursement.
	6. Mechanisms to submit grievances and solve disputes are accessible and functioning, also for women and minorities.
Improvement	7. Companies and communities pursue shared value creation, enabling smallholders - both men and women – to earn a decent living and to invest in the improvement and continuity of their farms.
	8. Companies and communities collaborate to close yield gaps by increased resource use efficiency (water, nutrients, chemicals and energy).
	9. Companies and communities improve resilience to shocks linked to prices, pests and climate.
	10. Companies and communities apply climate-friendly practices and protect biodiversity.
	11. Companies and communities invest in community infrastructure (e.g. health, education, water and roads).
Respect for Rights	12. Companies and communities respect land and other resource use rights, including those of women and indigenous peoples and do not negatively affect local food security.
	13. Companies and communities respect labour rights, human rights and indigenous peoples' rights.
	14. Companies and communities promote equal opportunities and rewards between men and women.

5.2.1 FREEDOM OF CHOICE

FAIR partnerships require a participatory process from the earliest design phase of an investment. Participation should result in a freedom of choice by all stakeholders involved. Freedom of choice goes beyond being informed. This design principle concerns the knowledge and capacity of companies and communities to make decisions based upon free, prior and informed consent (FPIC).

First of all, this requires a mutual understanding between the company and the community. Both company and community should understand each other's concerns and aspirations. The company needs to fully understand the local context, including the social and cultural aspects within communities, customary and legal land rights, current livelihood strategies, ecosystem services and natural resource use. Communities should be aware of the risks and opportunities attached to the introduction of oil palm production in their area. In this initial phase of setting up company–community partnerships, important activities are stakeholder identification and analysis, participatory social and environmental assessments, awareness raising and starting the process of stakeholder dialogue. This includes identifying and addressing real and potential conflicts over land and tenure rights, community interests (including women and minorities), traditional land-use and livelihoods, poverty, exclusion and climate change.⁶⁷ Community-mapping is a powerful tool that could support this process, especially when conducted with the help of independent external parties.

Secondly, in order to exert freedom of choice, host communities should have the capacity to negotiate on an equal basis with a company. This capacity is often absent. In such cases, the appointment of a community liaison officer or an independent organisation like a NGO could be a solution. Women and minority groups should also have freedom of choice and consequently need to be considered as full participants in the awareness raising and negotiation phases. Awareness, knowledge and the negotiation capacity implies that communities can say no to a company's proposal and are able to come up with alternatives and reach compromises. Thus, palm oil development models should allow for a certain degree of flexibility in order to accommodate varying community interests. The "one size fits all" model that certain companies or governments promote does not allow for this.

Freedom of choice also applies to smallholder arrangements. Palm oil development models should avoid asymmetrical power relationships in which one actor becomes too dependent on the other and, as such, vulnerable to exploitation. Whereas the provision of services such as inputs or finance from a company to smallholders can be an important condition for success, the smallholder's dependency on the company for these services should not be abused in, for example, the price setting of FFB. As an alternative to the company providing these services, a company could support the development of local service providers in order to enable a clean separation of service provision and trade relationships. A potential strategy to promote more balanced power relationships and efficient negotiations is the development of farmers' organisations. An important condition is that these organisations are considered legitimate by their members and can operate independently from the company.

Box 7: Freedom of choice in Nucleus Estate Smallholder scheme

The various problems occurring in NES projects show the relevance of the principles for FAIR partnerships in general. Especially applying the principle of Free Choice seems to be important in NES projects where communities enter agreements over their land, with irreversible consequences. These consequences and alternatives need to be brought across to communities ideally with the help of independent mediators. As NES projects are often implemented in agricultural frontier areas with little livelihoods alternatives and limited access to markets, they usually lead to a strong dependency of communities on one company and strong power imbalances. This calls for Accountability of companies with regards to contracts and loan agreements, especially about the basis for price calculation and income deductions for service provision.

The NES model also involves the set-up of farmer cooperatives. While they can play an important role in service delivery and defending member interests to the company in theory, in reality smallholders often consider them to act on behalf of the company.⁶⁸

The share of land for the nucleus estate in relation to the smallholder scheme is a crucial determinant of the relationship. Where the nucleus does not depend on the smallholders for a significant share of its mill feedstock, they will most likely not receive the attention and investment required.

5.2.2 ACCOUNTABILITY

If freedom of choice is considered one side of a medal, accountability should be the other. Decision-making based upon free, prior and informed consent should be followed by consistent implementation, although some flexibility to respond to changed circumstances is necessary. Consistent implementation first requires internal alignment within companies and communities and respecting the commitments made. For example, different departments within a company should operate in a coherent way to realise the objectives of the partnership.⁶⁹ Similarly, communities should avoid that certain members or groups act against the partnership. This requires transparency and participation in the preparation and implementation of the partnership and a regular joint evaluation to consider possible improvements. Sharing risks and benefits can improve mutual accountability. This favours a joint-venture based model.

For smallholder arrangements, this implies assurance that each smallholder, including women, fully understands land transfer, purchasing, loans or other service contracts with companies. Full transparency is required on pricing, quality norms, delivery, payment and reimbursement conditions. Smallholders are informed on the nature of deductions on FFB payments and how they are calculated. Furthermore, companies respect commitments made in terms of FFB off-take, pricing and service delivery. If intermediaries such as local FFB traders or service deliverers are involved in the company smallholders relationships, their practices should be aligned. Smallholders also have their responsibilities. They should be transparent on their financial situation to enable the assessment of their bankability. Any loan or inputs obtained for oil palm cultivation should not be diverted to consumptive purposes or other crops. Furthermore, they should honour contractual terms with companies and abstain from side-selling to local traders or cheating on quality. In order to make such contractual arrangements between companies and smallholders work, the contracts need to have a reasonable duration and to be renegotiated on a regular basis. Contracts may also include provisions for renegotiation in the case of natural or manmade disasters.⁷⁰

Accountability also requires effective mechanisms to submit grievances and to solve disputes. Independent complaint handling and dispute resolution mechanisms should avoid conflict of interest and can positively influence trust-building. These mechanisms should be accessible to all stakeholders, including women and minorities. Where necessary, stakeholders should be able to call for support to make use of these mechanisms.

Box 8: Relevance of accountability for joint venture arrangements

Accountability is key when joint ventures are used for oil palm development. Joint venture agreements between communities and companies should be developed jointly with involvement of representatives of the community's own choosing. The terms of the agreement need to be clear and understood by all parties involved. This is particularly important for the duration of the agreement and the tenure status of the community land, as well as the joint venture governance.

Especially where profit or revenue-sharing models are used, transparency is needed on the calculation of payments and performance of the company on the indicators that determine payments. Public availability of production and financial information and ensuring that these are understood by communities creates trust. Independent audits can be a tool to further promote accountability and transparency.

Independent mediators like government representatives or NGOs could be involved in the governance structure of joint venture agreements to balance the power between communities and companies. Joint ventures on community land should not cover all the land available for community members to ensure that they can pursue other land-based livelihood activities, which reduces their dependency on the income from the company and reduces the risks for loss of food security.

Box 9: Relevance of accountability for contract farming

Companies should offer adequate terms of contracts which do not take advantage of farmers in need for finance, inputs or a reliable market. Smallholders on the other hand have to adhere to agreements and restrain from postponing loan repayment or diversion of farm investment towards consumption purposes. Contract farming arrangements should leave some flexibility on the scope of services and ideally are designed in accordance with the individual needs of farmers instead of a "one size fits all" contract.

5.2.3 IMPROVEMENT

FAIR company–community partnerships should be ambitious in the sustainability impacts they pursue. This requires a joint vision between the company and host community on these ambitions and the roadmap towards them. Existing sustainability standards provide excellent input for the ambitions. Ambitions can be formulated for:

- Estate: productivity, wages, working hours, health & safety, secondary labour conditions, training;
- FFB supply relationships: volumes, prices, quality, transport efficiency;

- Smallholder farms: income, productivity, quality, worker's safety, resource efficiency, training, resilience;
- Community: basic infrastructure, employment, local sourcing, food security, access to natural resources;
- Environment: climate, biodiversity protection, landscape restoration.

Box 10: Examples of climate-friendly practices

- Jointly identify High Conservation Value (HCV) and High Carbon Stock (HCS) areas (like forests, peat lands) and make agreements that they cannot be destroyed for oil palm or other purposes;
- Companies clearly communicate that FFB produced on identified HCV or HCS areas will not be accepted;
- Farmers holding property rights over HCV or HCS areas should be rewarded for maintaining the values and supported in identifying alternative livelihoods or in accessing land that can be used for oil palm cultivation;
- No burning of land for oil palm development. The risks and negative impacts of burning have to be explained to communities. Alternative practices need to be developed and promoted to the smallholders;
- Promoting the use of organic fertilisers, especially the use of empty fruit bunches (EFB) can reduce the need for chemical fertiliser and at the same time improves soil quality properties;
- Reduce FFB transport costs by introducing coordinated harvesting cycles;
- Create incentives for ecosystem service restoration;
- Promote renewable energy at oil palm mill and community level.

The challenge is to promote community ownership, empowerment and self-reliance in these improvement ambitions. FAIR partnerships should result in a situation where communities can invest themselves in the long-term viability of their community and farms. The role of the company is to support and reward these investments. Support can include the provision of inputs, finance, the transfer of knowledge and the brokering of partnerships. It is important that the support and rewards do not exclude women and minority groups. For example, extension services should target both men and women and, if necessary, create the conditions for women to participate. FAIR partnerships can also set-up activities to promote the position of women (see box as example). Investing in improvement does imply taking risks. FAIR partnerships should ensure that potential risks (and benefits) are clearly identified and fairly shared between companies and communities. For example, enabling access to crop insurance programmes should be evaluated as a means of risk management.⁷¹ Shared commercial risk and insurance against failure are frequently cited as the cement of successful relationships.⁷²

Box 11: The Ophir Project – a participatory NES scheme in Indonesia

This project located in West Pasaman District in the Indonesian province of West Sumatera consists of five primary cooperatives. They were established in the area in the 1980s as part of a NES project of a state-owned company (PTPN 6) with support from German Development Cooperation. The company received 20%⁷³ of the land to establish the nucleus and 80% of the land was developed for smallholders organised in the 5 cooperatives. Most of the beneficiaries were migrants from Java where population pressure is high and land availability is limited.

What differentiated the Ophir project from other PIR projects in Indonesia was the participatory element which gave more responsibility to smallholders and included them in organisational management. Smallholders are organised in self-help groups (kolompok) of around 25 farmers, together managing 500 ha of oil palm. The model applies the principle of subsidiary, where all issues are dealt with at the lowest level of responsibility possible. The group selects an overall representative who is held responsible for performance and represents the group in the primary cooperative. The members' income is based on a share of the overall revenues from the 500 ha. This leads to a strong interdependence of individual smallholders and a social pressure that encourages all members to implement best practices. Standards on good agricultural practices are strictly implemented and controlled.

Almost 30 years after its initiation, the project is now recognised as one of the few successful smallholder projects in Indonesia. The cooperatives under the Ophir project managed to become strong, independent organisations. They provide technical assistance and monitor the implementation of good agricultural practices. After the contracts with PTPN 6 expired, it became free to sell its FFB to oil mills in the area. The yields of smallholder plantations are now high, especially for smallholder standards, often exceeding the yields in the (former) nucleus. The quality of smallholders' FFB is high, leading to negotiation power for high FFB prices from the processing mill.⁷⁴

5.2.4 RESPECT FOR RIGHTS

FAIR partnerships respect human, labour, land and indigenous peoples' rights. They also respect customary rights and legal land tenure rights. Linked to the Freedom of Choice design principle, any land ownership or land-use transfer to a company should be based upon free, prior and informed consent. Awareness of gender relationships is important and situations should be avoided in which customary land that is held evenly by women and men, is replaced by male-owned smallholdings. A participatory social and environmental risk assessment will help in the identification of potential violations of the above-mentioned rights and in the initial identification for potential mitigation actions.

Companies and communities engaging in oil palm development should take into account the impact of land-use change on local food security. In particular, the situation of those community members not integrating oil palm in their livelihood strategies should be considered. It is ensured that they continue to pursue those livelihood activities or develop viable alternatives before oil palm development takes place. To avoid a decrease in the local availability of food, agricultural land in host communities should be maintained for other uses than oil palm. This requires awareness of the importance to grow alternative food crops to avoid negative impacts in the case of price hikes or limited access to markets for food. FAIR partnerships should

respect national and international labour and human rights, whether on estates or on smallholdings. Where infringements are identified, efforts shall be made to develop, implement and monitor solutions. Awareness raising, integrating solutions in local practices and setting up safeguards are prerequisites to realise a long-lasting impact.

Box 12: Ensure women benefit from oil palm development: a case study from the Mama Lus Frut scheme (Papua New Guinea)⁷⁵

The Mama Lus Frut scheme was introduced in a pilot region in Papua New Guinea and quickly scaled up to cover over 5,000 smallholder blocks. The programme provides women in smallholder households with nets to collect the loose fruits dislodged from oil palm bunches during harvesting.

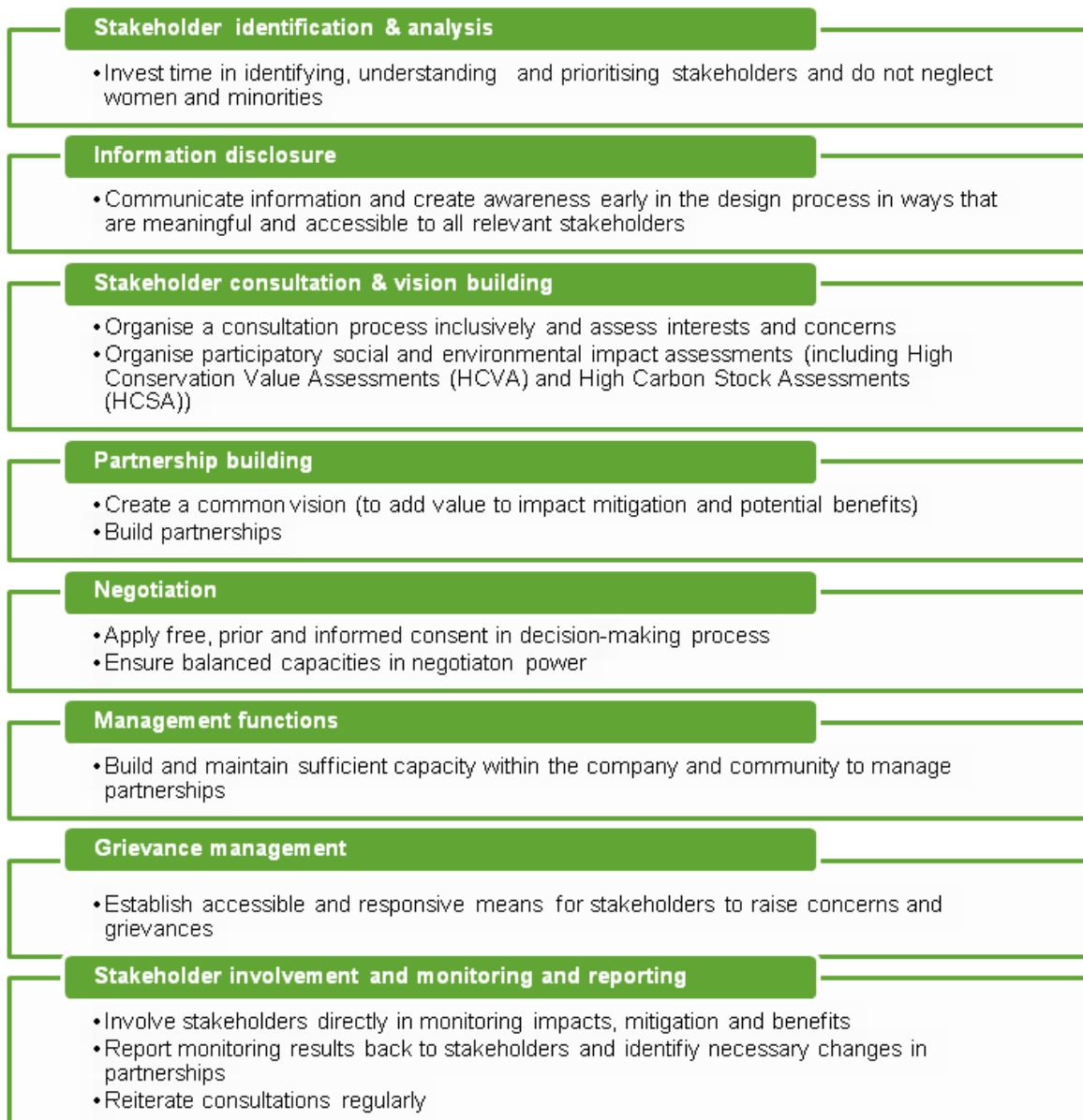
Under the scheme, women are paid separately from their husbands for the loose fruit thereby guaranteeing payment for their labour in loose fruit collection. With the company paying women directly for their labour, women's incentive to harvest loose fruit increased significantly, to the extent that nearly all loose fruit is now collected. On smallholder plots without the mama card, women earned around 16% of household income; with the card, they earned 29%. Anecdotally, other results on social dynamics have included a decrease in the rate of smallholder domestic disputes, an increase in financial independence allowing some women to establish small businesses, and increased willingness by shop owners to extend credit to women.

One key success factor in the Mama Lus Frut scheme was the collaboration between communities, researchers, NGOs, plantation companies and extension services. Each of these entities played a critical role in ensuring that the programme was culturally relevant and successful.

5.3 TOWARDS OPERATIONAL FAIR PRINCIPLES

The design principles and the selection of the related practices have presented what FAIR company–community partnerships could look like. This chapter has shown a selection of rather generic activities. For each principle, alternative practices could be identified and the detailed design of each practice may largely depend on the local context. Rather than only focusing on particular issues, it is important to develop an integral process in which FAIR partnerships can be tailored and come to live in the specific local context. Good practices in stakeholder engagement are one important element in such a process. Figure 4 presents a framework for good stakeholder engagement.

Figure 4: Good stakeholder engagement⁷⁶



6 CREATING AN ENABLING ENVIRONMENT FOR FAIR PARTNERSHIPS

There are various reasons why companies and communities should engage in FAIR partnerships. The implementation provides companies with a more sustainable business model based upon shared value creation between a company and a community. Trust-based, long-term relationships will reduce risks for conflict-related costs like interruptions of processing and harvesting, maintaining security personal, property damage, and theft. The risk of legal procedures and associated costs can be reduced. The provision of a reliable market for FFB and labour can further enhance the license to operate in host communities and improve operational efficiencies. There is increasing evidence that developing the right partnerships results in better economic performance. A recent survey among different agricultural companies and involved communities on the performance and impacts of agribusiness investments (in various commodities) showed that those companies that were financially and operationally successful tended also to be those that had the most positive impact on their host economies and surrounding communities (as a result of more sophisticated approaches to social and environmental responsibility).⁷⁷ Similarly, those investments which were well-integrated with the host country and surrounding community were most likely to be financially successful. Investors who acquired land but did not conduct thorough consultations with communities and impact assessments, or left it to host governments to conduct them on their behalf, often found themselves subsequently dealing with costly and time-consuming land disputes.

Like the companies, communities also benefit from FAIR partnerships. They benefit from the better-protected community rights, the ability to make conscious choices on what to do with their land, employment opportunities and the possibility to invest in a potentially profitable crop. FAIR partnerships enable oil palm smallholders to increase farm revenues, to invest in the improvement and continuity of their farms and to bring in more money to the household. The value generated by oil palm cultivation and additional social investments can make rural communities better places to live in and prevent the rural exodus.

Whereas the principles for FAIR partnerships can have clear advantages for both companies and communities, their success also depends on the context in which they are applied. Both company and community can refrain from deforestation, but without additional protection of that forest, others still may cut it down. Both companies and communities can have the intent to negotiate fairly, but if the communities lack the basic capacities, the negotiations are likely to become a farce. It is difficult to consider the company–community relationships in isolation. In order to make them successful and increase the chances that the desired impacts are met, an enabling environment is necessary. A number of actors play an important role to shape this enabling environment. This chapter outlines the potential roles these actors can play and the drivers for their involvement.

6.1 DOWNSTREAM BUYERS

Trading companies and brands have a responsibility to ensure that their oil palm supply is sustainable. Their buying practices and CSR strategies have an influence on how producers act. Oil palm production is characterised by high environmental, social and economic risks. Sector-wide efforts to address these risks exist through sourcing certified sustainable palm oil. However, making a sector sustainable requires more than just buying certified products. The gaps between current practice and desired practice are simply too large and closing it requires proactive policies and additional investments. Downstream buyers that are genuinely interested in making their supply chains more sustainable should go beyond certification. Companies are increasingly expected to know the origins of their supply and engage with their suppliers to tackle the sustainability challenges linked to palm oil production. This requires clear and consistent supplier codes and purchasing practices as well as more direct collaboration between peers, with grower companies, governments of producing countries and smallholders to solve some of the most complex issues. The principles for FAIR partnerships offer a framework to address one of the most complex and crucial issues in the palm oil sector: the relationships between palm oil companies and communities. By promoting FAIR partnerships in their supply base, downstream buyers can share the common language offered by the design principles and jointly work with suppliers to ensure that palm oil is not associated with the infringement of community rights, land grabbing and climate change. This reduces the need for ad-hoc issue management of individual companies.⁷⁸ FAIR partnerships create the conditions in which companies have a higher chance to realise sector-wide or supply chain-specific sustainability ambitions. Where necessary, downstream buyers should provide support to their suppliers in implementing the FAIR partnerships. Collaboration along the supply chain can further contribute to increased supply chain efficiency, a reduction of supply-side cost and the availability of supply in the longer term. Brands can increase their value by referring to their support for establishing FAIR partnerships in corporate communications.

6.2 GOVERNMENTS

The concept of preventing deforestation and land grabs by making more efficient use of existing land is not undisputed, because additional investments in expansion are arguably attracted. Therefore, effective regulation on land tenure and the protection of forests is urgently required. Governments should acknowledge and put processes in place to implement the UN Voluntary Guidelines on the responsible governance of tenure of land, fisheries and forests in the context of national food security. National and local governments play a crucial role in promoting responsible palm oil development models by creating an enabling environment through national policies, regulation and enforcement.⁷⁹ They have an important responsibility in assuring that investments in oil palm production do create optimal benefits for host communities and companies, protect the rights of the disadvantaged and do not contribute to climate change.

The above-mentioned World Bank survey showed that the outcomes of large-scale investments in land were strongly influenced by policies and practices of host country governments.⁸⁰ Key policies appeared to be land tenure policies. This included the provision of a clear, transparent regulatory framework for land acquisition (purchase or lease), consultations, resettlement, and compensation, as well as formalised local community tenure rights under a proper land registry system. The monitoring and enforcement of environmental and water regulations as well as the reduction of red tape by governments also play into the success of investments in land. This requires government officials who negotiate company–community arrangements to act

responsibly, following regulations and acting with best intentions for the communities they represent instead of pursuing personal goals. The survey also revealed that community members often need independent advice and expect that this is provided by their representatives in government. Local governments also play important roles in ensuring that when communities consent to oil palm development, they are fully informed about the terms and conditions as well as the expected impacts on their livelihoods.⁸¹

Governments could also take a more proactive role towards companies by performing rigorous pre-screenings with regards to their experience, financial capacity and technical capabilities to implement sustainable palm oil production. Obtaining commitments for social development programmes, employment, and other benefits as well as the monitoring of these commitments is another approach governments can use. They should also monitor the responsibilities of companies to conduct consultations and social and environmental impact assessments.⁸²

Land-use planning and monitoring (e.g. to exclude high conservation value or high carbon stock areas from oil palm development), and the protection of forests and community land are other tasks the public sector should ensure in order to promote successful company–community partnerships. Community participation through community-mapping and public hearings is helpful as a preparation for land-use planning on the local level.⁸³ Similarly, FAIR partnerships benefit from sound and enforced labour regulation and a well-functioning judicial system. The public sector should also conduct research and provide infrastructure extensions, inputs and finance. Furthermore, governments should play a key role in avoiding market failure, e.g. by enforcing quality standards for FFB, fertiliser or pesticides and access to information. In addition to public services, the government could promote the development of a professional service delivery sector. A healthy service delivery sector, including a degree of competition, can reduce dependencies of smallholders on palm oil companies compared to the situation where smallholders rely on these companies for service delivery. This may enable companies and smallholders to focus on improving the efficiency of their selling-buying relationship. Promoting a certain level of competition in FFB markets could also improve the position of independent smallholders.

In various countries, the government sets the rules on how investments in palm oil should be implemented. For example, the Indonesian Plantation Act determines how a NES model should be set-up,⁸⁴ including detailed rules for the maximum size of a plantation, the total plantation size for smallholders, the financial models to develop the land, land ownership, sourcing agreements with third-party suppliers and profit-sharing modalities. Linked to this, the government-led financial funds to finance these models determine loan conditions, including reimbursement modalities. These policies largely determine the boundaries in which FAIR Partnerships can be set-up. Governments should become aware of this and review their policies accordingly. Such review should consider:

- rules for land transfer or lease arrangements and land acquisition practices (e.g. FPIC with a clear notion on how this influences the gender relationships);
- revision of the required share of smallholders versus company plantations to create a healthy interdependency between the company and smallholders;
- larger plot sizes per oil palm smallholder (in order to improve the conditions to obtain a decent income per smallholder);
- additional rules on transparency in price-setting (especially with regards to loan reimbursement);
- clear conditions in terms of technical support and input provision to smallholders;
- clear rules on complaint and dispute handling and resolution.

Governments could also encourage phasing of investments, rather than mega-land deals, e.g. provision of an initial allocation of land, with further allocations contingent upon successful development.⁸⁵ In addition, regions and districts spared from oil palm development should be supported in developing viable alternatives for economic development to avoid that competition between local governments for investments leads to a race to the bottom regarding the requirements posed to the investors.⁸⁶

The public sector can benefit from creating a clear, transparent and coherent enabling policy environment for FAIR Partnerships. Potential benefits would include higher living standards, reduced costs of illegality and conflicts and possibly increased tax income (depending on tax regime). An enabling local government can also result in increased trust and support by the electorate towards the political leaders.

6.3 FINANCIAL SECTOR

Finance is a crucial element in the establishment of new plantations and replanting efforts. Consequently, the financial sector has a certain degree of influence on whether and how these investments are implemented. Firstly, their responsibility is to make investments available for smallholders, who currently have no or very limited access to finance, notably for the long-term planting and replanting investments. Without good access to finance, both companies and communities will not be able to invest in FAIR Partnerships. To solve the finance gap, dedicated credit lines are necessary and the financial sector should accept a more flexible range of collateral and repayment terms to account for smallholder needs.⁸⁷

Secondly, the financial sector has the responsibility to have full information about the sustainability risks attached to their investments and lending. Social and environmental risks often imply financial risks (e.g. in case of long-lasting land conflicts). To mitigate these risks, the financial institutes should develop clear policies that pose requirements to the social and environmental conditions of investment and lending opportunities, and RSPO requirements at a minimum. They should provide incentives to the producing companies for implementing sustainable practices. In support of this, they should implement rigorous due diligence processes. The principles for FAIR partnerships provide a framework to develop such policies and processes. A direct dialogue between the financial sector and oil palm producers will raise company's awareness of the importance of FAIR partnerships and stimulate companies to integrate these principles at the initial phase of developing an investment proposal.

6.4 CIVIL SOCIETY ORGANISATIONS

Civil society organisations (CSOs) have various roles to play to promote FAIR Partnerships. One role is to raise awareness among consumers, industry and governments about the sustainability issues and possible solutions in company–community partnerships. This can imply a watchdog function of naming and shaming bad performers, as well as initiating constructive dialogues between companies and communities to promote FAIR partnerships.

Civil society organisations can provide support services in implementing FAIR partnerships. A recent World Bank survey showed that CSOs were particularly instrumental in ensuring that relevant stakeholders had their voices heard in community consultations, impact assessments and grievance mechanisms.⁸⁸ They also assisted local communities to become well-organised, to understand their rights and how to exercise them.

A Civil society organisation can play an important role in providing guidance on issues like community participation, community-mapping and FPIC procedures as well as ensuring that women are included in and benefit from FAIR partnerships. They can also monitor conflicts between companies and communities. While companies do not always appreciate this, NGOs are well-positioned to publicise conflicts between investors, governments and stakeholders and, as such, contribute to greater transparency on the conduct of agricultural investment.⁸⁹ Consequently, civil society organisations need to have self-reflection and continuously review their role and the potential effects on the success of FAIR partnerships.

6.5 SUSTAINABILITY INITIATIVES

As explained in the previous chapter, the principles for FAIR partnerships are not a new standard. They should not compete with existing sustainability standards. By contrast, they create the conditions for successful implementation of these sustainability standards and a consequent long-term, positive, climate-friendly, land-efficient and pro-poor impact. Sustainability initiatives can promote FAIR partnerships among their constituencies by raising awareness and developing additional guidance or training on how FAIR partnerships can be implemented at an early stage of investments. In recognition of the complex challenge to build truly sustainable company and community relationships, the promotion of FAIR partnerships should be considered as an important complementary effort in realising the missions of sustainability initiatives in the palm oil sector.

7 CONCLUSIONS

The palm oil sector is growing rapidly and the increase in demand for the multipurpose oil is expected to continue in the future. As a result, large investments in expanding oil palm plantations are on the way. There are various opportunities to ensure that oil palm cultivation contributes to improved livelihoods, land efficiency and climate change mitigation. However, current practices show opposite outcomes with negative impacts on all three issues. The design and implementation of current palm oil development models are an important cause for these disappointing outcomes. Notably, the relationships between companies and communities are poorly developed. In too many cases, companies seem to consider communities as a nuisance, whose potential risks to the company's profitability need to be managed at minimum costs. Consequently, communities often consider companies to be hostile intruders in their environment upon which they can have no influence. These attitudes result in antagonistic behaviour, operational inefficiencies and irreversible impacts on local livelihoods – notably those of women – land efficiency, and climate change.

This report argued that this situation can be reversed if stakeholders are willing to rethink how companies and communities engage with each other. In order to capture the full sustainability potential in palm oil production, companies and communities need to engage with each other on a fair partnership basis. The likelihood that such partnerships will result in positive outcomes depends on the design of the palm oil development model and the way that companies and communities interact from the early start of an investment. A redesign of company–community relationships is particularly relevant in the development of new plantings or in the replanting phase. It is at these moments that the rules of engagement with long-term implications are defined.

This report has presented the principles for FAIR partnerships as a framework for building company–community partnerships. FAIR partnerships are based upon the principles of freedom of choice, accountability, improvement and respect for rights. They provide guidance on the required intent and practices that companies and communities need to have when they engage in partnerships. FAIR partnerships can be considered as an important vehicle to achieve a climate-friendly, land-efficient and pro-poor palm oil sector. The principles for FAIR partnerships do not prescribe a specific “one size fits all” palm oil development model, by acknowledging that different models already exist in different contexts. The design principles, however, are considered to be applicable to all palm oil development models. Implementation will require a redesign of these models; from top-down, risk-based management and short-term profit-orientation to partnership-based, opportunity-driven, and long-term and impact-oriented. This also requires a fundamental shift in stakeholder engagement. More emphasis should be given to inclusiveness, participation, empowerment, and the application of FPIC, which should result in a more equal division of responsibilities, risks and benefits between companies and communities. Particular attention to the position of women and minorities is an important element in this.

While the primary responsibility of building FAIR partnerships lies with companies and communities, their success will also depend on the extent to which other actors create the right enabling environment. Governments have important responsibilities in developing and enforcing the appropriate laws and regulations for a sustainable palm oil sector to become a reality. Governments need to revise current policies and regulations on land acquisition, plantation establishment and management. This largely determines the boundaries in which FAIR

partnerships can be set-up. Governments should also review their policies and regulations to protect high-carbon lands and provide supportive measures such as the provision of (access to) extensions, inputs and finance.

There is an urgent call to action to the industry and other stakeholders to take this issue seriously and to start to invest in FAIR partnerships. This requires strong commitment from downstream industry in terms of coherent communication on expected supplier performance, performance monitoring and co-investments.

The financial sector has a role to play in making the necessary finance available for companies and communities to implement FAIR partnerships, and can promote its implementation via its lending and investment policies.

Civil society organisations have different roles to play. They can publicise conflicts between investors, governments and stakeholders and, as such, contribute to greater transparency on the conduct of agricultural investment. They can support communities to acquire the necessary awareness and capacities to participate in FAIR partnerships and provide guidance to both companies and communities on specific practices.

Finally, existing sustainability initiatives can use the principles for FAIR partnerships as a complementary framework to promote sustainability impacts and to increase, for example, the feasibility of certification in various contexts. Developing truly sustainable company–community partnerships is a complex challenge. Sustainability initiatives should analyse how the implementation of existing standards can contribute to meeting this challenge, by developing additional guidance and training on how such partnerships can be operationalized.

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- ⁶¹ HCV 5 and 6 cover the basic needs and sites of critical cultural significance to local people.
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- ⁶³ The relevant guidance documents are currently (March 2014) under review.
- ⁶⁴ SAN (2010) & ISCC (2011).
- ⁶⁵ IDH (2013).
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- ⁷⁰ FAO (2012).
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⁷² CIAT (2012).

⁷³ The share of the company eventually increased to 40% due to additional land development at a later stage.

⁷⁴ Jelsma et al. (2009).

⁷⁵ World Bank (2011).

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⁸⁶ Fairhurst et al. (2010).

⁸⁷ See IFC (2013) for more considerations in smallholder finance.

⁸⁸ World Bank (2014).

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