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ICTSD Project on Tropical Products



Value Chains and Tropical Products in a Changing Global Trade Regime



By **Charles Mather**

University of the Witwatersrand, South Africa



International Centre for Trade
and Sustainable Development

Issue Paper No. 13

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LIST OF ACRONYMS

ABF	Associated British Foods
ACP	African, Caribbean and Pacific
ADM	Archer Daniels Midland Company
AGOA	Africa Growth and Opportunity Act
ATPA	Andean Trade Preferences Act
BACP	Biodiversity and Agricultural Commodities Programme
CBI	Centre for the Promotion of Imports from Developing Countries
CDDC	commodity dependent developing country
CMO	Common Market Organisation
CPO	crude palm oil
CSR	corporate social responsibility
DFC	Dubai Flower Centre
EBA	“Everything But Arms”
EC	European Commission
EPA	Economic Partnership Agreements
ETI	Ethical Trading Initiative
EU	European Union
FELDA	Federal Land Development Authority (Malaysia)
FFBs	fresh fruit bunches
GAP	Good Agricultural Practices (as in EurepGAP, GlobalGAP)
GATT	General Agreement on Tariffs and Trade
GSP	Generalised System of Preferences (EU)
GVC	global value chain
HEBI	Horticultural Ethical Business Initiative (Kenya)
ICC	International Code of Conduct
ILO	International Labour Organization
IMF	International Monetary Fund
ISO	International Standards Organization
LDC	least developed country
MPS	Milieu Programma Siersteelt (environmental standard)
NAFTA	North American Free Trade Agreement
NERA	NERA Economic Consulting
NGO	non-governmental organisation
OPM	Oxford Policy Management
RBDPO	Refined Bleached Deodorised Palm Oil
RSPO	Roundtable for Sustainable Palm Oil
SFA	Special Framework for Assistance
SME	small and medium-sized enterprises
SPS	Special Preferential Sugar
SSA	Special System of Assistance
TRIPS	Trade Related Aspects of Intellectual Property Rights
UPOV	Union for the Protection of New Plant Varieties
WTO	World Trade Organization

FOREWORD

The importance of agricultural commodities for developing countries, including tropical products, is undeniable. Their significance has been recognised in an array of studies, fora and organisations. As indicated in the Global Initiative on Commodities Report (UNCTAD *et al*, 2007), as many as 38 developing countries are estimated to be dependent on a single commodity for more than 50 percent of their export income, with an additional 48 countries depending on only two. These countries depend on commodities as a source of livelihood, employment, foreign exchange and public revenue; the commodity sector is their principal stimulus for economic growth.

There are no studies estimating the importance of tropical and other commodities using economic, social and foreign trade indicators. Nonetheless, the participation of such products in exports from developing countries is significant: the twenty main tropical products account for 36 percent of developing countries' incoming foreign currency from agricultural exports. This proportion reaches 46 percent for low income developing countries (Perry, 2008). Many of these products are grown primarily by small farmers in developing countries - as in the case of coffee, cocoa, tobacco and cotton. Others (i.e. sugar, rubber and rice) are vital in the generation of rural employment. Therefore, besides their considerable contribution to foreign currency generation, they also play an important role from a social point of view.

The built-in agenda of the World Trade Organization's (WTO) Agreement on Agriculture reflects the longstanding priority attached to tropical and diversification products, that "having agreed that in implementing their commitments on market access, developed country Members would take fully into account the particular needs and conditions of developing country Members by providing for a greater improvement of opportunities and terms of access for agricultural products of particular interest to these Members, including the fullest liberalisation of trade in tropical agricultural products [...]." The 2004 Framework Agreement reached during the Doha Round notes that the full implementation of the liberalisation of trade in tropical agricultural products is "overdue and will be addressed effectively in the market access negotiations." However, the way in which the commitment is to be implemented and even the identification of such products remain far from clear.

In the last decade, the commodity issues have re-emerged as central to development initiatives and poverty alleviation strategies. The objective of this Issue Paper by Charles Mather is to contribute to this debate by providing an analysis of the value chains of four tropical commodities (bananas, sugar, cut flowers and palm oil) in a rapidly changing global trade environment. The author seeks to provide insights on the different ways the significant changes occurring in the structure and governance of commodity chains ultimately affect producers' income and production sustainability. He also suggests recommendations to improve these two variables.

The value chain approach has become an increasingly important framework for examining changes in the global trade of commodities and their implications for primary producers. Rather than describing the broad patterns of global exchange and assessing their consequences for producers and consumers exclusively through market mechanisms and equilibrium price changes, the global value chain (GVC) framework encompasses the production, processing, distribution and marketing of specific globally-traded commodities, and identifies the main stakeholders involved at each stage. It also highlights governance patterns (how these different stages are coordinated) and specifies the role of lead firms in determining market access, defining products and value across the chain (Schmitz, 2005).

The commodity studies in this paper focus on four themes: changes in the geography of production, changes in chain governance, new developments in trade agreements and their impacts on primary producers in different developing countries, and initiatives towards sustainable production, ethical trade and worker welfare. With regard to changes in production, the paper provides insights into new developments in the production of bananas, sugar, palm oil and cut flowers, which have been driven by changes in trade agreements and new investment patterns. In several of the commodities concerned, an important development has been the rise of new low cost producers who will play a role in shaping the global market for these commodities.

This paper was produced under an ICTSD dialogue and research project which seeks to address the opportunities and challenges of the full liberalisation of trade in tropical and diversification products, and explores possible areas of convergence between different groupings and interests in WTO negotiations. The project seeks to generate solutions-oriented analyses and possible policy responses from a sustainable development perspective.

A handwritten signature in black ink, appearing to read "R. Meléndez-Ortiz".

Ricardo Meléndez-Ortiz
Chief Executive, ICTSD

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EXECUTIVE SUMMARY

This report addresses the issue of commodity trade and its impact on developing country producers. In the last decade the “commodity issue” has re-emerged as a key problem for developing country producers and has become a significant topic of debate within governments and multilateral institutions. A solution to the commodity crisis is now seen as central to development initiatives and poverty alleviation strategies.

The aim of the report is to provide input into these debates through a value chain analysis of four tropical commodities (bananas, sugar, cut flowers and palm oil). The value chain framework is used to reveal changes in the structure and geography of production for the four commodities and changes in their governance. The restructuring of production and the reconfiguration of the commodity chains is occurring in a context of significant new developments in trade regulations. A parallel development is the emergence of a range of new market initiatives associated with niche markets including fair trade and organically produced food and fibre products.

The chapter on the banana chain examines the impact of the changing EU banana regime on ACP (African, Caribbean and Pacific) banana exporters. The reform of the trade regime over the last 15 years has led to increased competition in the EU market and lower prices, which have had a devastating impact on higher cost ACP banana exporters. In contrast, banana exporters from the ACP region with lower costs, have increased their exports to the EU market. A parallel development in the banana value chain has been the growing power of supermarkets associated with the concentration of retail sales in most EU countries. The banana chain may now be described as “buyer-driven” with important implications for the large trans-national banana exporters and also for producers interested in exploring market niches for bananas.

A key theme addressed in this chapter is the EU’s support programme for banana producers. Support for banana producers affected by trade preference erosion started in the mid-1990s, shortly after the introduction of a single market for bananas in the EU. This assistance was initially focused on improving the competitiveness of all producers, but since then the emphasis has shifted towards helping uncompetitive banana producers to diversify out of banana production. While the support has improved the competitiveness of some banana exporters, the chapter argues that its support for diversification efforts is tentative and inconclusive. The programme also failed to support farmers in exploiting niche markets, despite its mandate to do so. In the short time that is left under its assistance programme, the EU should direct its support towards assisting banana exporters in their efforts to supply fair trade banana markets.

The chapter on the sugar chain focuses on the impact of the reform of the EU’s Common Market Organisation (CMO) on African, Caribbean and Pacific countries (ACP) sugar exporters. For ACP sugar exporting countries, the key issue is the future price of sugar in relation to production costs. Where production costs are high, sugar exporters are likely to find it difficult to compete in a context of much lower EU prices for sugar. Lower cost sugar producers will need to increase export volumes to make up for the lower sugar prices on the EU market.

The EU’s action plan for sugar is aimed at supporting ACP sugar exporters. For “uncompetitive” sugar producers the action plan will support efforts towards diversification, which must be linked to broader development programmes. Competitive sugar exporters will be supported in improving the efficiency of their sugar industries. The chapter argues that the EU’s action plan can draw two

important lessons from the experience of support in the banana sector. First, efforts to support diversification in the banana sector have been disappointing and it is important that this problem is not repeated in the EU's action plan for ACP sugar exporters regarded as "uncompetitive". Second, banana sector support for exporters regarded as "uncompetitive" prevented the EU from assisting producers to develop new market opportunities where its support could have played an important role. The same mistake could be avoided if the action plan for sugar is open to the many opportunities available to sugar producers.

Unlike the banana and sugar sectors, the cut flower trade is not affected by tariffs and trade regimes. Low or zero tariffs in most importing countries, together with improvements in transport logistics, have led to a shift in production to developing world countries. Several ACP countries have become significant players in the cut flower export trade. The cut flower value chain is undergoing rapid transformation in the face of increased production, changing consumer demands, new codes of conduct and the role of supermarket retailers in the sale of flowers. Although the process is uneven, the cut flower chain is becoming increasingly buyer-driven.

While the complexity of cut flower production has tended to exclude smallholders in the developing world, this is a labour intensive industry. Women workers make up a high proportion of the labour force in the cut flower export sector. The poor working conditions for those employed in the cut flower industry has been the focus of many media and NGO campaigns. These highly publicised campaigns have revealed problems associated with wages, working hours, freedom of association and health and safety. The cut flower chapter assesses multi-stakeholder efforts to improve working conditions.

Malaysia and Indonesia control the production and export of palm oil products. Palm oil is now the most widely traded vegetable oil product. The growing demand for palm oil is due to its versatility and its high yields relative to other seed oil commodities. Increases in the volume of palm oil production in the last decade have consistently exceeded industry forecasts.

The palm oil value chain is producer-driven, but the role of consumers and NGOs in the chain represents a significant development. In the last decade non-governmental organisations (NGOs) have actively campaigned against palm oil producers by highlighting the impact of their activities on fragile ecosystems and indigenous communities. The problem for NGO activists is that palm oil is a hidden ingredient in a very wide range of foods, cosmetics and detergents. This makes it difficult for NGOs and other stakeholders to encourage consumers to exercise the choice of purchasing a sustainably produced palm oil product.

In the last decade many companies involved in the palm oil sector have introduced codes of conduct to ensure that they source from - or invest in - sustainable palm oil production. More recently, the industry has established a multi-stakeholder group for sustainable palm oil. The group is active in establishing criteria for sustainable palm oil and in supporting smallholder producers. Since consumer choice is fundamental to the process of mobilising pressure on the industry, a key challenge for this multi-stakeholder group involves establishing a credible mechanism for tracing sustainably produced palm through the value chain.

The concluding chapter brings together some of the key themes that have emerged from the four commodity study. These include: new patterns of investment linked to trade reform, the role of multi-stakeholder groups, support for producers affected by trade preference erosion, and chain governance.

1. INTRODUCTION

In the last decade the “commodity issue” has re-emerged as a key problem for developing country producers and has become a significant topic of debate within governments and multilateral institutions. A solution to the commodity crisis is now seen as central to development initiatives and poverty alleviation strategies. The purpose of this report is to contribute to these debates by providing an analysis of the value chains for four tropical commodities (bananas, sugar, cut flowers and palm oil) in a rapidly changing global trade environment. We seek particularly to provide insights on the different ways the significant changes occurring in commodity chains’ structure and governance ultimately affect producers income and production sustainability. We also offer recommendations for improving producer income and sustainability.

The value chain approach has become an increasingly important framework for examining changes in the global trade of commodities and their implications for primary producers. Rather than describing the broad patterns of global exchange and assessing their consequences for producers and consumers exclusively through market mechanism and equilibrium price changes, the global value chain (GVC) framework encompasses the production, processing, distribution and marketing of specific globally-traded commodities, and the main stakeholders involved at each stage. It also highlights governance patterns whereby all these different stages are coordinated and the role of lead firms in determining market access, product definition and value across the chain is specified (Schmitz, 2005). The early literature on value chains identified two distinct ways in which value chains are governed (Gereffi 1994, Gereffi 1999). In buyer-driven chains the lead firms are usually retailers, traders or large processors and they play an important role in determining the functional division of labour in the value chain. Producer-driven chains, on the other hand, are those where barriers to entry to production roles are high and where

economies of scale are important. The more recent literature on value chains has elaborated on the concept of chain governance. Through case studies, researchers have documented changes in governance associated with the shift from producer-driven to buyer-driven chains, and derived the economic consequences for the stakeholders involved at the various stages. The way in which chains are driven and the role of lead agents in the chain are particularly important for developing country producers as they determine their relative gains or losses (when compared to the other actors in the chain) during the globalization process.

Further, from a sustainable development perspective, the GVC debates on chain governance and upgrading are of particular significance. The idea of upgrading has particular relevance for policy makers and especially those interested in “spreading the gains from globalisation” (Kaplinsky, 2000). Upgrading refers to the process of firms or entire sectors taking on more complex and profitable production functions within a value chain. It is also associated with firms adding more value to products with a view to capturing more value in the chain. For developing country firms and farmers, upgrading provides a way of securing a more sustainable position in a context where the terms of trade are highly unstable and consequently, raw commodity export specialization can be highly risky.

Lastly, researchers have identified other ways in which value chain analysis may be important for policy-makers and development agents. The GVC framework allows NGOs, unions and other stakeholders to identify leverage points with a view to improving working conditions, offering new opportunities for small enterprises and for pressing for improvements in the environmental impact of production and trade. As is discussed in the case studies on cut flowers, palm oil, bananas and sugar, NGOs and other stakeholders have been very successful in mobilising consumer pressure to influence the social and

environmental conditions under which globally traded commodities are produced.

The report focuses on four tropical commodities: bananas, sugar, cut flowers and palm oil. The selection of the four commodities was based on several criteria. First, sugar and bananas represent commodities that are highly regulated through global and multilateral trading agreements while cut flowers and palm oil represent commodities that are much less regulated through multilateral or bilateral trading arrangements. Second, the commodities selected are subject to different forms of chain governance. The cut flower and banana chains are becoming increasingly buyer-driven by supermarket retailers; in contrast the sugar and palm oil chains are not buyer-driven. In these last two commodity chains, large processors or trading companies rather than retailers are responsible for determining the governance pattern. Third, two of the products are processed (sugar and palm oil) and two are sold with only limited processing (cut flowers and bananas). These differences play an important role in shaping issues of quality, traceability and chain governance. While the four commodities reveal different patterns of change and restructuring, it is significant that there are also commonalities which reflect broader processes of change in the trade of tropical commodities.

The commodity studies in this report focus on four themes: changes in the geography of production, changes in chain governance, new developments in trade agreements and their impacts on primary producers in different developing countries, and initiatives towards sustainable production, ethical trade and worker welfare. With regard to changes in production, the report provides insights into new developments in the production of bananas, sugar, palm oil and cut flowers, which have been driven by changes in trade agreements and new investment patterns. In several of the commodities concerned an important development has been the rise of new low cost producers, who will play a role in shaping the global market for these commodities.

With regard to changes in chain governance the commodity studies reveal different patterns of chain reconfiguration. In the banana and cut flower chains supermarket retailers are now playing a central role in chain governance with important implications for exporters and primary producers. In the sugar and palm oil chains the role of buyers is limited and these chains are driven by large processors and producers. The large sugar and palm oil companies are actively involved in new international investments associated with changes in the trade regime (in the case of sugar) and new opportunities for low cost production (in the case of palm oil).

The banana and sugar chapters are concerned with the impact of trade reform and specifically the impact of trade preference erosion on ACP banana and sugar exporters. The process of trade reform in bananas has already had a significant impact on higher cost banana exporters. This chapter assesses the potential of fair trade as a way of overcoming the loss of trade preferences. In the case of sugar, the reform process is more recent, but is also likely to impact higher cost ACP sugar producers. However, the options for sugar producers are greater due to the different ways in which the commodity can be transformed into a tradable good. The report also assesses EU support for ACP banana and sugar producers. EU support for banana exporters has been in existence for more than a decade and its impact on competitive and uncompetitive exporters is currently under scrutiny. The report argues that the lessons of the banana experience can be used to inform more recent efforts to assist ACP sugar exporters affected by trade preference erosion.

With regard to the emergence of sustainability initiatives and worker welfare initiatives, the report details the emergence of multi-stakeholder groups, which are most evident in the cut flower and palm oil commodities. In the case of the cut flower sector the effort of multi-stakeholder groups is geared primarily to issues of worker welfare while initiatives in the palm oil chain are associated with the environmental sustainability of palm oil

production. In both cases NGOs have been able to mobilise consumer pressure to demand more sustainable production practices.

The four commodity case studies and the four themes provide important insights into changes in the trading environment for tropical commodities and their implications for producers and exporters. Although there are significant differences between the four case studies there are also important commonalities, which point to broader processes driving the restructuring of the trade in tropical products.

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2. ACP BANANA EXPORTS AND TRADE PREFERENCE EROSION

2.1. Introduction

The reform of the EU banana regime over the last 15 years has played an important role in shaping the global trade in bananas. EU trade preferences for African, Caribbean and Pacific (ACP) countries have led to several ACP countries, especially in Africa, becoming significant exporters to the EU market. At the same time, however, changes to the regime over the last decade have led to greater competition in the EU market and lower prices, which has had a devastating impact on higher cost producers, particularly in the Caribbean. Support to ACP exporters affected by trade preference erosion has been in place since the mid-1990s, but the success of these initiatives has been uneven.

A parallel development has been the growing concentration of fruit retailing in the United Kingdom and other European countries. Supermarkets have challenged the power of trans-national banana exporters that have traditionally controlled the banana trade. The governance of the value chain seems to have shifted from one controlled by producers to one where buyers play a dominant role. The shift to supermarket-driven banana chains has led to a greater emphasis on quality and niche markets including fair trade. Indeed, all

of the major UK retailers now sell fair trade bananas. The growth of the fair trade market is very important to high cost Caribbean banana exporters affected by trade preference erosion. For most analysts this represents the only option for their continued participation in the banana export market.

This chapter argues that the EU's programme for ACP banana exporters has missed the opportunity of supporting fair trade banana exporters in the Caribbean. EU support in the Caribbean was, instead, directed towards diversification efforts, the results of which are tentative or inconclusive. The recommendations emphasise the challenges of the fair trade market for smallholder farmers and the support they require to become competitive in this value chain.

The second section of the chapter examines the production and trade in bananas. Section three examines the banana value chain and explores recent changes in chain governance. Sections four and five focus on the EU's banana regime and its impact on ACP banana exporters. In section six the EU's support framework for ACP banana exporters is described and evaluated.

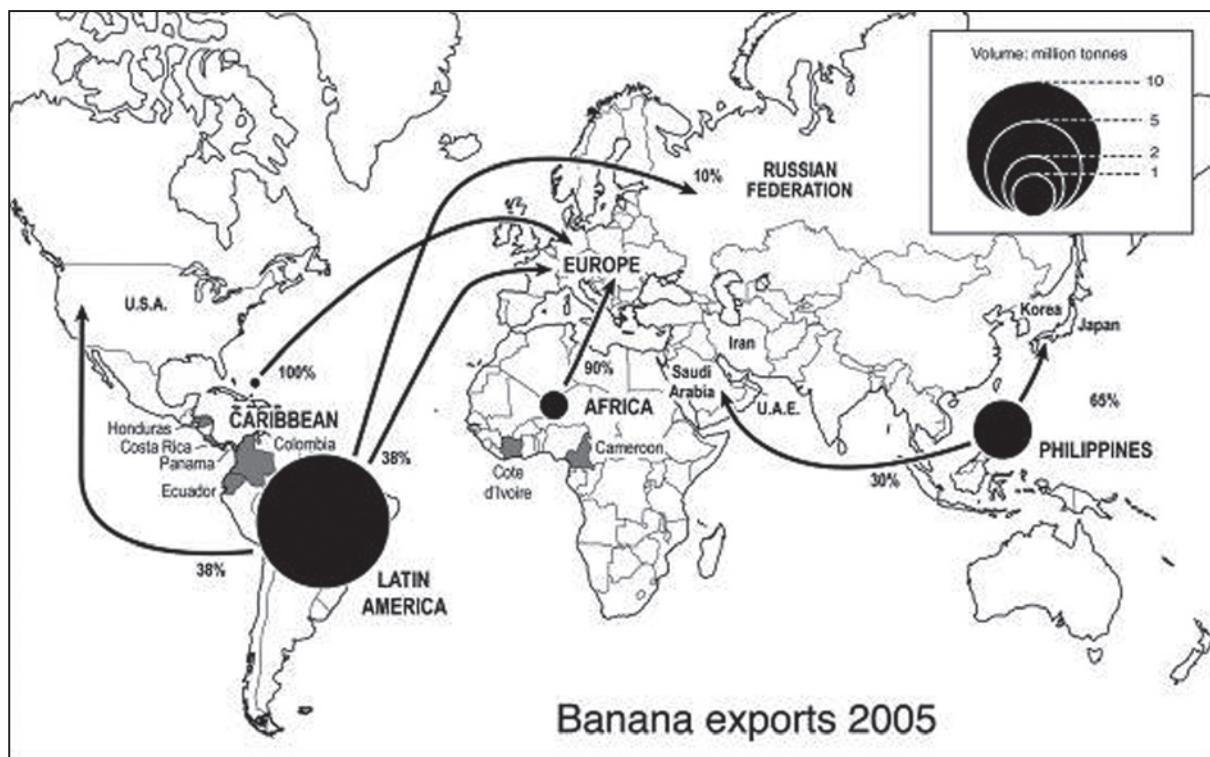
2.2. Global Trade, Production and Prices

The global trade in bananas may be divided into three systems (Arias *et al*, 2003). Latin American exports are equally divided between North America and Europe with the remainder going to Russia, Asia and New Zealand. Caribbean and African banana exports are sold almost exclusively in Europe. The Philippines is the largest exporter of bananas in the Asian region. This country's banana production represents over 75 percent of Asian country exports. The Philippines supply markets are Japan and several countries in the Middle East (Figure 2.1). Although there has been some diversification in terms of import markets, banana exporters

remain focused on North American, European and several Asian country markets.

Most banana producers are, or have been, highly dependent on bananas for export earnings. In Latin America there is some diversity in terms of export dependence. In 2000, Ecuador's banana exports represented over 60 percent of agricultural exports and over 16% of all merchandise exports. The other large Latin American banana exporters (Costa Rica, Colombia, Guatemala and Honduras) are somewhat less dependent on banana exports. In these countries, bananas represent between

Figure 2.1: Banana Exports 2005



16 and 30 percent of agricultural exports and between 3 and 23 percent of all exports (UNCTAD, 2003). Although they are less dependent on exports, banana production is usually restricted to specific regions and these rely heavily on the banana economy for both direct and indirect employment. Caribbean countries, in contrast, are far more dependent on banana production for export revenue and employment (Anderson *et al*, 2003).

The 2000 figures for African banana exporters - Côte d'Ivoire and Cameroon - reveal lower levels of export dependence on bananas. Banana exports for Cameroon in this year were 3 percent of all merchandise exports while the same figure for Côte d'Ivoire was less than 2 percent, a figure that remained unchanged to the present (Arias *et al*, 2003). The growth of banana exports in Cameroon since 2000 has resulted in this figure increasing to 5 percent of total merchandise exports.¹

The extent to which banana exporters are "commodity dependent" on bananas for export earnings has changed dramatically in the last 15 years. In the mid-1990s, Latin America's

most important banana exporting countries - Ecuador, Costa Rica, Colombia and Guatemala - were classified as "commodity dependent developing countries" (CDDCs).² By 2003 all four of these countries had moved out of the category of CDDC through the diversification of their export markets.³ Predictably, given the dominant position of these four countries in the banana export market, the share of bananas produced by CDDC countries declined from 67.4 percent in the mid-1990s to only 7.4 percent in the mid-2000s (Gibbon, 2006).

Several other banana exporting countries also moved out of the category of commodity dependent countries, but not necessarily because they successfully diversified their economies. St Lucia and Grenada, two of the Caribbean's Windward Islands, are cases in point. Banana exports in these two countries have declined dramatically in the period since the early 1990s. According to the most recent statistics, Grenada has effectively withdrawn from the export market altogether. In St Lucia, banana exports were well over 100,000 tonnes per year until the mid-1990s; the most recent figures indicate that St Lucia exported only

34,243 tonnes in 2005 (Windward Islands, 2007). Both countries have not diversified their economies away from bananas but have instead replaced one form of dependence with another. In St Lucia, for example, the economy has focused on tourism, which is now the island's most important economic sector and generator of foreign exchange (Gillson *et al*, 2005). Several other ACP banana exporters remained in the category of CDDC. Africa's most important banana producers - Cameroon and Côte d'Ivoire - continued to be classified as commodity dependent countries, largely because of their dependence on several agricultural commodities (cotton, cocoa).

The significance of these changes is that the largest and most competitive banana exporting countries are no longer "commodity dependent". In contrast, many of the least competitive banana producers remain in a situation of commodity dependence in an increasingly competitive global market. These commodity dependent banana exporters are characterised by smaller farm size, weak infrastructure and an inefficient financial system (Gibbon, 2006), and they compete with banana exporters producing large volumes of cheaper fruit.

Key changes in production and exports:

Decline in Caribbean island exports. Export volumes from the Caribbean have declined rapidly in the last 15 years. In the mid-1990s the Caribbean's share of global exports was 4 percent, but this has since declined to less than 2 percent. The decline in exports has, however, been uneven within the Caribbean. In the four Windward Islands (St Lucia, Grenada, St Vincent and the Grenadines and Dominica) exports have declined sharply over the last decade. The 2005 exports figures are less than a third of what they were in the early 1990s. The Dominican Republic was granted ACP status in 1990 and it has since then increased its banana exports significantly. In the mid-2000s it contributed almost 50 percent of all Caribbean banana exports. Belize, Jamaica and Suriname have also increased exports in the last 15 despite short-term environmental and economic challenges.

Increased exports from Latin America. This region dominates the global production of bananas for export. In 2005, Latin American exports represented almost 80 percent of total global exports of bananas.⁴ The most important exporting countries are Ecuador, Costa Rica, Colombia, Guatemala and Honduras with almost 90 percent of the region's exports. These five countries contribute almost three quarters of global banana exports. In the last two decades exports from Latin America have increased rapidly, although they have most recently lost some share to Asian countries.

Increased exports from Africa. Within Africa there are two important producing countries: Côte d'Ivoire and Cameroon. Although there are other exporting countries in the continent (e.g. Ghana), these two countries represent over 85 percent of Africa's banana exports. Banana exports by these countries increased from around 180,000 tonnes in the early 1990s to over 450,000 tonnes in 2005.⁵

The rise of new exporters. The largest percentage increases in banana exports over the last decade have come from Brazil and Vietnam. Brazil now exports over 220,000 tonnes of bananas while Vietnam exported more than 100,000 tonnes in 2002. Although Vietnam's exports of bananas have more recently declined, apparently due to quality problems, the country plans to increase plantings to 25,000 hectares by 2010. The significance of these countries for the banana export market is that they are "commodity developers" (Gibbon, 2006). The term refers to countries that have become extremely effective in competing in global markets for food and fibre commodities thanks to economies of scale in both primary production and in infrastructure and through their ability to identify new markets. The scale of production has allowed countries like Brazil and Vietnam to become competitive in volume and price terms, but often at the expense of other commodity exporters who are adversely affected by lower prices. India also has the potential to become a new exporter: in 2007 it began trial exports of bananas to the Middle East.⁶ Given that India is the largest producer of bananas in the world, it has the potential

of playing a very significant role in the global export market. The prospect of Brazil, Vietnam and India becoming significant players in the banana export market should be of concern to other exporters, particularly those with higher cost structures.

Increased competition, lower value. In real terms, the rapid growth of exports has had a negative impact on global export values for bananas. The increase in export volumes in the period from the mid-1990s is associated with

the changes in the EU banana trade regime and the expectation that a more liberal trading environment would lead to significant increases in consumption. Since these expectations were not met, export production has exceeded consumption leading to price pressure and increased competition in most markets (UNCTAD, 2003). The EU's new trade arrangement introduced in 2006 has led to further increases in imports, which has increased competition and put further pressure on banana prices.

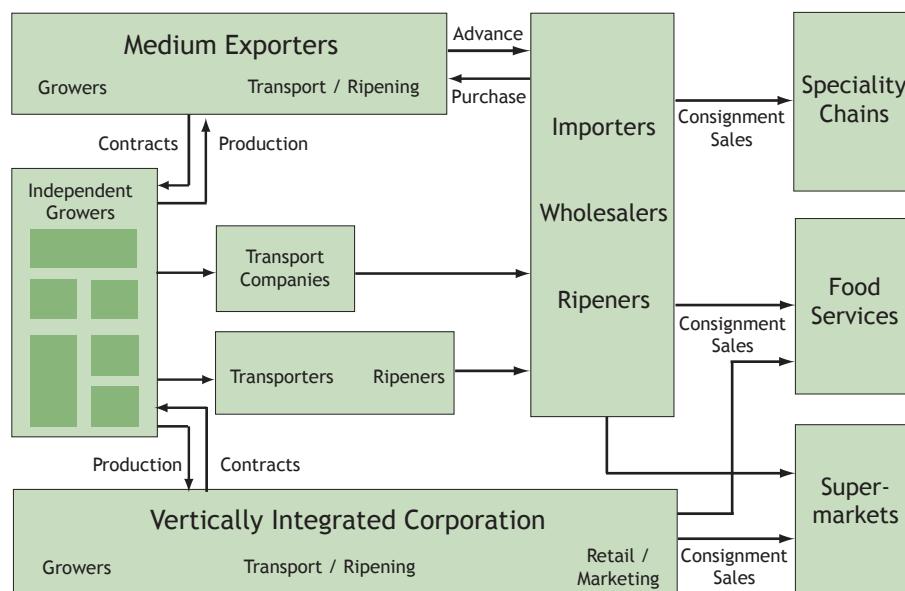
2.3. The Global Value Chain for Bananas

The global value chain for bananas is represented in Figure 2.2. At the level of production, bananas tend to be produced either on very small land holdings or on very large plantations. It is estimated that 80 percent of global exports originate from large-scale plantations and the rest from smaller farms (Arias *et al*, 2003). There is considerable diversity of production systems both within and between banana exporting countries. For instance, while small-scale farming is dominant in the Windward Islands (Anderson *et al*, 2003), large-scale plantation production dominates in Costa Rica (Brenes and Madrigal, 2003). In Ecuador, banana production for export occurs on a range of scales including small and medium-sized farms as well as very

large plantations. There is also diversity in terms of farm ownership. While production in Ecuador tends to be in local hands, in Costa Rica trans-national banana exporters own or control a significant proportion of banana plantations (UNCTAD, 2003).

There is considerably less diversity in the chain after the farm gate. The process of transporting, ripening and distributing bananas is highly concentrated with five very large corporations controlling as much as 80 percent of banana exports. The remaining 20 percent of exports is nonetheless very fragmented: a large number of smaller exporting companies are involved in sourcing and marketing bananas, often using the

Figure 2.2: Banana Export Chain



infrastructure of the larger banana corporations (van de Kasteele and van der Stichele, 2005).

The five large trans-national banana exporters - Dole, Del Monte, Chiquita, Fyffes and Noboa - are vertically integrated to varying degrees into production, transportation, ripening and distribution. Of the five large transnationals, only Fyffes is not directly involved in producing bananas on company-owned farms (Fyffes, 2006). The other large companies own plantations in Latin America, Africa and Asia. The large banana exporters own, or have owned, the infrastructure for shipping and transport. The situation regarding shipping has, however, changed over time. For example, Chiquita purchased a fleet of ships in the late 1990s in order to prepare itself for an expected increased consumption in Europe in the wake of the reform of the EU banana regime. By the mid-2000s, however, Chiquita was forced to sell off much of the fleet due to the financial crisis facing the company. Although Fyffes did own several refrigerated ships, these were sold in 2001. Noboa owns refrigerated ships through its subsidiary Transmabo.

Once the bananas are offloaded at ports in Europe, the United States and Asia they are transported to ripening facilities so that the fruit can be prepared for distribution. All of the trans-national banana exporters own their own ripening and distribution facilities in the markets they supply (UNCTAD, 2003). In Europe, investment by these companies in ripening and distribution infrastructure increased in the period after 1993 with the shift to a single European market for bananas. Under the post 1993 banana regime, trans-national companies were able to secure access to the EU market by investing in ripening and distribution facilities in Europe (Taylor, 2003).

The concentrated structure of production shipping, ripening and distribution in the banana export chain has allowed the five large banana companies to exercise market power over other agents in the chain. According to a recent UNCTAD (2003, 9) report, "a few major trans-national banana-marketing corporations dominate international banana marketing and

trade and are able to exercise their market power at several or all stages of the banana marketing chain".

While the banana trans-nationals have historically exercised market power in the banana chain, the growing power of supermarket retailers in both Europe and the United States is providing an important challenge. The source of retailer power is the increasing concentration of retailing in both the US and the European Union (Dolan and Humphrey, 2004). In Europe food sales are most concentrated in Austria, the Netherlands, Sweden, the United Kingdom and France. Although the level of retail concentration is lower in the Mediterranean countries of Spain, Italy and Greece, the last decade has seen growing levels of retail concentration. Data on the sale of bananas in different retail environments is not available. However, the figures on sales of fresh fruit and vegetables provide an indication of the level of concentration in banana sales (van de Kasteele and van der Stichele, 2005). The figures on fresh fruit and vegetables suggest that concentration is higher than it is for general food product sales. In the Netherlands and the United Kingdom, more than 70 percent of all fresh fruit and vegetables are sold through supermarket chains.

Supermarket chains have been able to use their dominant position in fresh fruit and vegetable sales to make new demands on suppliers, which has in turn led to significant changes in the structure of fruit and vegetable value chains. Supermarket chains, and especially the "discounters", have also played a more active role in setting prices, which appears to have been controlled by banana exporters in the past.⁷ Finally, supermarket chains have used the "structural oversupply" of bananas to press for more value added services from their suppliers.

The "reversal" of the banana chain from one that has been producer-driven, to one that is increasingly buyer-driven has led to important changes in the banana value chain. Lower prices for bananas and intense competition have led to the large transnationals moving out of less

profitable parts of the banana value chain and into activities that generate higher profits. An example is the shift from owning plantations to sourcing bananas from independent producers: "Multinationals now tend to establish long term supply contracts with independent banana growers, specifying shapes, quantities, standards of quality and packaging" (UNCTAD, 2003, 11). By divesting out of primary production, the large exporters can avoid the environmental problems associated with primary production as well as the risks of industrial action. Chiquita's sale of its Colombian division in 2004 to Banacol, a local exporter, is an example of this process. The trans-national now has an eight-year agreement to purchase a specified volume of bananas from Banacol (Chiquita 2006). Overall, Chiquita has decreased the amount of bananas originating from company-owned farms from 64 percent in the mid-1980s to less than 50 percent in the early 2000s (UNCTAD, 2003). The sale of its Colombian division in 2004 is likely to have reduced this figure.

Although there has been some shift out of direct production by banana trans-nationals, these companies continue to own and invest land in banana producing countries. The divestments that have occurred are often linked to political problems or higher cost structures and this is often followed by re-investment in another country where production costs are lower. In its 2006 annual report, Del Monte declared its intentions to expand production in South America, the Philippines and Africa (Del Monte, 2006), while Dole has announced its plans to increase its land holdings in Ecuador and Cameroon (Dole, 2005). The investments by Dole and Del Monte in Cameroon and Côte d'Ivoire are directly linked to the changes in the EU banana regime, which created incentives for exporters to source bananas from ACP countries, particularly where costs were lower. According to an estimate made in the early 2000s, as much as 50 percent of the bananas marketed by Dole and Del Monte are from company-owned plantations (Arias *et al*, 2003).

In the last decade, the largest three exporters have decreased their dependence on bananas for export revenue and have diversified into

other fruit and vegetables. They have also moved into prepared fresh fruit. Banana sales represent around 33 percent of the total sales for Dole and Del Monte (Dole, 2005; Del Monte 2006). Chiquita has traditionally been more dependent on bananas than the other trans-nationals, but this changed dramatically in the last few years. In 2004, bananas represented 55.7 percent of sales, but only 43 percent of sales in 2006 (Chiquita 2006).

The large banana exporters have all diversified into the "prepared food" market in order to increase the value of their fruit exports. In 2004 Chiquita acquired Fresh Express, a company that supplies ready made salads to supermarkets and other retail outlets (Chiquita, 2006). Fresh Del Monte acquired Del Monte Foods, which produces processed fruit and vegetables, juices, snacks and desserts (Del Monte, 2006). Besides these initiatives all of the trans-nationals have attempted to improve the efficiency of their supply management and logistics systems (Taylor, 2003).

The new strategies of the banana trans-nationals are shaped by the competition to become "preferred suppliers" of the large supermarket chains. In the last decade, supermarkets have decreased the size of their supply base for individual categories of fruit like bananas, citrus and apples (Wilson, 1996; Dolan and Humphrey, 2004). The competition between exporters to become a preferred supplier has allowed supermarkets to pass down many functions to exporters including distribution, quality control, marketing and logistics. Fyffes' recent decision to separate its produce and distribution/marketing division by creating a new division called "Total Produce" reflects the demands placed on the company by supermarkets as well as Fyffes' efforts to become a preferred supplier.

Banana producer organisations have responded to the market challenges of the last decade by becoming vertically integrated into the value chain. The Jamaican Producers Group was established in the 1940s and was originally a banana cooperative. In the last decade the company has extended its role by shipping

bananas from Jamaica and Costa Rica through its own fleet of boats. The bananas are ripened and distributed through a UK-based importing company. By extending its presence in the value chain, the company hopes to capture more value (Banana Link 2006).

The new tariff-only trade regime that was introduced on 1 January 2006 has intensified competition in the European Union banana market and has created additional financial problems for the major banana exporters. According to preliminary figures, imports to the EU increased by 12 percent in 2006. The increased competition in the EU combined with a higher tariff rate of €176 per tonne of bananas led to financial losses for the large trans-national banana corporations. Fyffes reported a loss of €49 million for 2006, which they attribute to the increase in import duties (Fyffes, 2006). Chiquita reported having lost a total of USD 185 million for 2006; they attribute USD 110 million in losses to lower banana prices and the remaining loss to higher tariffs in the EU (Chiquita, 2006). The impact of the €176 tariff on banana producers has prompted EU negotiators to offer a tariff cut to Latin American producers with a view to persuading them to withdraw trade suits against the EU.⁸

Key changes in the value chain:

"Reversal" of the chain. The most significant development in the banana value chain is the impact of powerful buyers on the large trans-

national banana exporters. In the period before the increasing consolidation of supermarkets in Europe, banana exporters played a "prominent role in setting the rules of the game" (UNCTAD, 2003, 12). Since the mid-1990s, however, supermarkets have exercised their growing market power over banana exporters by demanding higher quality and process standards and by passing functions "up the chain".

Strategies of trans-nationals. The large trans-national banana exporters are adapting to changes in the governance of the chain by providing a wider range of fruit and more value added products in order to increase profits and to improve their chances of becoming a preferred supplier of a supermarket chain. Increased competition, especially in the EU market, is also leading to diversification out of bananas and divestment out of riskier aspects of production, especially in banana growing. The sale of banana landholdings in Latin America by trans-nationals is, however, uneven and these large exporters continue to play an important role in banana production.

Direct sourcing. Several supermarkets are bypassing the large trans-nationals and are now sourcing bananas directly from producer organisations in Latin America and the Caribbean. In the Caribbean, direct sourcing is frequently associated with efforts to increase the volume of fair trade bananas on the supermarket shelves.

2.4. EU Banana Trade Regime

The changing EU banana regime has played a crucial role in shaping the structure of banana exports. For banana exporting countries the overall impact has been to increase competition between ACP and non-ACP countries as well as within the ACP group itself. The impact of changes in the EU banana trade regime have been particularly difficult for higher cost banana producers who have found it increasingly difficult to compete with lower cost producers in a more competitive market.

Before 1993, individual European countries determined their own banana import regulations.

These regulations ranged from zero duty in Germany to a 20 percent tariff rate in Belgium, Denmark, Ireland and the Netherlands. The United Kingdom, Spain, Portugal and France provided access to their own producers or former colonies in Africa, the Pacific and the Caribbean. In 1993, these diverse import regimes were harmonised to bring them in line with the single European market (Arias *et al*, 2003). The new regime introduced in 1993 provided a compromise between countries still wanting to provide preferential access to former colonies and the demands of Latin American exporters of bananas, whose production costs were low.

The new regime provided a duty-free quota of 875,000 tonnes of bananas for ACP countries. The quota for non-traditional ACP countries and Latin American exporters ("dollar" producers) was initially set at two million tonnes with a duty of €75 per tonne.⁹

A second component of the 1993 regime was a license system, which encouraged EU based importers to source from more expensive ACP producing countries. In practice, the license system has led to trans-national banana producers investing in ripening and distribution enterprises in the European Union and in production in lower cost ACP countries, most notably Cameroon and Côte d'Ivoire (Taylor, 2003).

During the mid and late 1990s, the single European market regime was subject to numerous challenges through the dispute settlement mechanism of the General Agreement on Tariffs and Trade (GATT) and subsequently through the World Trade Organization (WTO). From the 1st of January 2006, the quota-license-tariff regime was replaced by a tariff only system. The tariff adopted in late 2005 was €176/tonne for non-ACP countries; ACP countries have benefited from duty-free access to the European Union, although the total quota is now 750,000 tonnes (Agritrade, 2007). Whether ACP countries will continue to benefit from the tariff only system, has been brought into question with Ecuador's challenge against this regime through the WTO's dispute settlement mechanism. In late 2007 the WTO's dispute panel released an interim ruling,

in favour of Ecuador and against the EC's tariff regime for bananas. There are two potential courses of action for the EC. First, the EC may attempt to build a case insisting that the tariff system is compatible with signed or interim EPAs with banana producing countries. Alternatively, the EC may be forced by the ruling to reduce the tariff on bananas for non-ACP imports to the EU.

The single European market has led to much lower banana prices in the EU, which has impacted negatively on exporters with higher cost structures. There is evidence to suggest that prices for bananas within the European Union are now converging as a result of the single market (Gillson *et al*, 2005). The unfolding of the new regime has also created competition within the ACP group of countries. In 1999 the allocation of quotas to individual ACP countries was replaced in favour of a "first come first served" general quota for all ACP countries. The impact of this change has allowed lower cost ACP producers to increase their share of the quota at the expense of higher cost exporters, especially in the Windward Island banana exporters.

The introduction of a tariff-only system in 2006 has had a significant impact on the EU banana market. In the first 11 months of 2006, ACP exports of bananas to the EU increased by 20 percent. Banana exports from Latin America also increased by 10 percent. The impact of the larger volume of bananas on the EU market was a 20 percent decline in prices (Agritrade, 2007).

2.5. Impact on Banana Exporting Countries

The statistics on the costs of banana production are not widely available and most surveys rely on older data on wage rates and other proxies for production costs (Chambron, 1999; Vanzetti *et al*, 2005). Providing accurate figures on production costs is complicated by the wide range of factors that contribute to higher or lower production costs including yields, wage rates, economies of scale, transport costs and the impact of climatic events. The most recent survey, conducted by NERA Economic Consulting and Oxford Policy Management (OPM), has

export unit values as a way of analysing different production costs (NERA/OPM 2004). In this report a similar approach is followed with the most recent available data.

The most recent data on export unit values suggests that there have been some important changes in production costs in the last three years. The NERA/OPM report found that while Caribbean producers had the highest costs, export values were similar for Latin American and African producers (NERA/OPM). The most

Table 2.1: Banana Export Unit Values (USD per tonne)

	1990	1995	2000	2001	2002	2003	2004	2005
Belize	413	480	382	386	409	367	414	551
Dominica	523	485	440	437	452	478	514	517
Dominican Republic	463	468	378	391	434	451	497	518
Grenada	416	490	450	443	454	505	555	260
Jamaica	550	540	506	471	479	435	388	402
Saint Vincent and the Grenadines	535	493	445	432	433	461	499	529
Cameroon	439	452	392	346	287	374	412	416
Côte d'Ivoire	500	468	297	315	325	412	539	566
Colombia	285	336	288	291	287	310	315	329
Costa Rica	325	342	276	286	286	311	315	322
Ecuador	261	299	259	273	270	291	290	308

Source: Comtrade

recent statistics confirm that Latin American producers have retained their competitive advantage and that Caribbean production costs are much higher. Export unit values for African producers have, however, increased significantly in the last three years (Table 2.1). Indeed, the values for Côte d'Ivoire now exceed those of the least competitive Caribbean producers. It remains to be seen whether this is a short term issue that will be resolved soon or whether it represents a more serious structural problem in banana production.

The figures on export unit values also suggest some important changes within the Caribbean. Jamaica's production costs appear to have decreased dramatically between 2003 and 2005. Given that export volumes from Jamaica have declined during the same period (see below), it is difficult to determine whether these represent a real change in production costs. In contrast, production costs in Belize have increased dramatically; based on these data, Belize is now the highest cost producer in the Caribbean.

The structure of production plays a crucial role in accounting for the differences in banana production costs. In the Caribbean's Windward Islands, production is dominated by a large number of smallholders who farm in landscapes that limit the possibilities of mechanisation or irrigation (NERA/OPM,

2004). In contrast, the structure of production in the lowest cost banana exporting countries is far less fragmented with most export production coming from large plantations where mechanisation, irrigation and rapid transport are possible. Where production is more differentiated, as is the case in Ecuador, small and medium-sized farmers are efficiently integrated into modern and mechanised export chains. In Côte d'Ivoire and Cameroon, production also occurs on a large scale, which has allowed exporters to compete in European markets. Indeed, according to one source, production costs in Cameroon are lower than they are in Ecuador (Banana Link, 2006).

Climatic factors play an important role in shaping production costs in the long and short term. In the Caribbean, banana producers tend to be more reliant on irrigation, which has a significant impact on production costs. Perhaps more importantly, they are more vulnerable to severe climatic events associated with hurricanes (NERA/OPM, 2004). The impact of Hurricane Dean in August 2007 underlines the vulnerability of the Caribbean to severe weather events. The impact of hurricanes like Dean requires replanting, which in turn leads to higher costs. The delay in resuming production can be as long as eight months, which imposes financial hardships on owners, farm workers and other people linked to the banana sector. Although it is difficult to quantify the precise

Table 2.2: Banana Exports 1990–2005 ('000 tonnes)

	1990	1995	2000	2001	2002	2003	2004	2005
Belize	24,167	44,531	66,539	53,162	41,363	99,866	82,977	77,298
St Lucia	133,777	103,668	70,280	34,044	48,029	34,420	43,199	30,958
Dominica	53,156	34,521	31,505	20,626	19,738	11,802	13,637	13,526
Dominican Republic	24,208	77,056	71,179	100,285	109,415	125,395	117,206	159,383
Grenada	11,119	4,741	792	601	566	451	412	3
Jamaica	66,803	88,700	45,573	47,200	46,077	51,448	29,203	12,017
Saint Vincent and the Grenadines	83,805	51,962	45,839	33,660	36,742	24,847	27,114	19,531
Côte d'Ivoire	107,522	182,288	234,408	241,619	252,134	232,229	237,297	198,686
Cameroon	74,535	149,192	159,030	188,476	213,710	278,874	244,659	246,850

Source: Comtrade

impact of climatic events on cost structures, it is clear that they play a role. Climatic conditions in Latin America, in contrast, are far more favourable: not only are Latin American countries more protected from hurricanes but the climate allows farmers to produce bananas throughout the year.

There have been several surveys of wage costs, which all confirm that wages are higher in the Caribbean than they are in Latin America or Africa. The NERA/OPM (2004) report cites an International Monetary Fund (IMF) study that found wage rates to be five times higher in the Windward Islands than in Ecuador, which is recognised to have the lowest wage rates of all countries.

Exports from the Caribbean, and especially the Windward Islands, have declined dramatically as a result of the changing trade regime for bananas and the higher cost structure for banana production. Grenada has effectively stopped exporting while exports from St Lucia, Dominica, St Vincent and Jamaica have declined dramatically from the early 1990s. In the case of Jamaica, export volumes in 2004 and 2005 were affected by Hurricane Ivan. The Caribbean countries of Belize and the Dominican Republic are exceptions and both countries have increased the volume of banana exports. Within the ACP group of banana exporters, African producers have also increased export volumes to Europe. The main exporters in Africa are Côte d'Ivoire and Cameroon.

Banana exports from the Windward Islands have decreased dramatically from the early 1990s. In the last three or four years, however, export volumes from the Windward Islands appear to be stabilising, albeit at low levels (Table 2.2). The stabilisation of banana exports in the Windward Islands may be due to the shift by many producers to fair trade and other niche market opportunities.

Information on the impact of the contraction of the banana sector in the Caribbean and especially the Windward Islands is not generally available. The data that exists suggests that the number of registered farm workers has declined from over 24,000 in the early 1990s to around 7,300 in the early 2000s. It is estimated that 67,000 people - 18 percent of the total working population in the Caribbean - lost their jobs between 1993 and 2001 due to the decline in banana trade. This figure does not include sectors that support banana exports; the total number of jobs lost in the economy as a result of declining banana exports may be far higher (NERA/OPM, 2004). A concern is the extent to which former banana farmers may be "diversifying" into marijuana.¹⁰

Research on the impact of trade preference erosion on ACP banana exporters with high cost structures consistently suggest two strategies: diversify out of banana production or explore the possibility of niche markets (UNCTAD 2003; FAO, 2003; PASS, 2004; Gillson *et al.*, 2005; NERA/OPM 2005). In niche markets such as fair

trade, the price premium paid to producers could make up for the loss of preference and lower prices for bananas on the EU market.

The shift to fair trade banana production in the Caribbean in the last seven years has been remarkable. Fair trade exports from the Caribbean started in late 1990s through the efforts of the Windward Islands National Farmers Association (Fair Trade, 2004; Moberg, 2005). The most recent reports suggest that as much as 50 percent of banana exports from St Vincent bear the fair trade label. In St Lucia, 75 percent of banana exports benefit from the price premium offered through the fair trade label (Vidal, 2007). Sainsbury's, the large UK-based supermarket chain, has recently declared its intention to source fair trade bananas from St Lucia. Farmers on the island will be granted three-year contracts in order to ensure the sustainability of banana production. The success of St Vincent and St Lucia has prompted other Caribbean Islands to follow suit with Jamaica now declaring its intention to shift all of its banana exports to fair trade.¹¹ According to the Fair Trade Foundation, this market opportunity has led to the revival of banana exports in Dominica with a number of farmers returning to banana production (Fair Trade, 2004). Media reports indicate that fair trade has had a beneficial impact on producers and banana-dependent communities (Vidal, 2007).

Detailed field-based research suggests that the benefits of fair trade go beyond production related benefits. In Moberg's (2005, 12) survey of fair trade banana producers in the Eastern Caribbean, he found that the farmer organisations established for fair trade production had important social benefits: "For most farmers, participation in a Fair Trade group is the first opportunity to be part of a democratically-run community organization not affiliated with party politics". Moberg (2005) found that these organisations were also playing a role in broader local development planning initiated and undertaken by local communities.

Field based surveys on fair trade also warn of the difficulties of supplying this potentially important niche market. Production standards

and certification requirements are high and are potentially important obstacles to the participation of smallholder farmers in fair trade markets. In her survey of 275 small scale banana exporters in the Dominican Republic, Shreck (2002, 2005) found that the rejection of fruit for fair trade markets, often for cosmetic reasons, was common. She argues that it creates a significant obstacle to the "redistributive potential" of fair trade markets (Shreck, 2005, 24). The challenges associated with this niche market are such that only 50 of the 275 growers in her survey could meet its exacting standards. La Cruz's article (2006) on smallholders and fair trade confirms that this niche market "does not protect inefficiencies".

Fair trade exporters must also find ways of meeting the demand of supermarkets for consistency of supply. Severe climatic events in the Caribbean periodically destroy plantations and disrupt exports. The most recent hurricane to hit the Caribbean destroyed the entire crop in Dominica and 65 percent of the St Lucia's banana plantations (Oxfam, 2007). While supermarkets like Sainsbury's have declared their commitment to selling only fair trade bananas, they cannot afford not to have an important commodity like bananas on their shelves, even in the face of a natural disaster.

A third challenge for Fair Trade producers involves competition from other ethical labels. Murray and Reynolds (2000) argue that the proliferation of certification systems claiming environment and social standards in banana production poses a serious threat to fair trade bananas. Many of the new social and environmental standards have been developed by large trans-national exporters or large producer organisations interested in capturing lucrative niche markets. Yet their standards are often weaker and may not provide the benefits that are guaranteed through fair trade. They also have the potential of confusing consumers interested in making ethically based consumption choices.

2.6. EU Policy Response in the Banana Sector: Assessment and Options for Future Support

The EU's support programme for banana exporters started in 1994 with the Special System of Assistance (SSA), which allocated €95 million to ACP banana producing countries. The aim of this programme was to improve the competitiveness of banana producers, with the assumption that producers could overcome production constraints to become competitive in international markets. The level of assistance was determined by the "competitiveness gap" of individual countries (Goodison, 2007).

A detailed evaluation of the SSA programme in 2000 found that its impact was most effective where it was focused on the productivity of banana production, which then had a direct impact on competitiveness (Hubbard *et al*, 2000). On the other hand, its impact was least effective in terms of reforming and improving the efficiency of marketing structures. The report also noted problems in terms of the efficiency of disbursement of funds (Hubbard *et al*, 2000). The outcome of the assessment was five recommendations for future assistance: remove the competitiveness gap formula for distributing funds; focus on improving the effectiveness of industry organisations and structures; continue the focus on field productivity, including assistance on certification (e.g. organic, fair trade) for banana producers; prioritise social and environmental conditions given the increasing interest by consumers in the conditions under which fruit is produced; and provide assistance for those displaced from the banana export sector.

In 1999, the Special Framework for Assistance (SFA) replaced the previous support system. The SFA focused its efforts on 12 ACP banana-exporting countries: Belize, Cameroon, Cape Verde, Dominica, Grenada, Côte d'Ivoire, Jamaica, Madagascar, St Lucia, Saint Vincent and the Grenadines, Somalia and Suriname. An important change in the new programme was the recognition that not all banana exporting countries could become internationally competitive after the reform of the EU's banana regime. While competitive banana producers would continue to be supported in becoming

more efficient, exporters that could not compete in the new market environment would be offered assistance in diversifying out of banana production. Diversification efforts would focus on providing social and economic support to banana farmers and farm workers affected by trade preference erosion.

The European Commission releases biennial reports on the work of the SFA programme. Its most recent assessment of the SFA was released in December 2006 (European Commission, 2006). According to this report, the SFA appears to have had some success in assisting banana producers in becoming more competitive. In countries where banana production was increasing or stable, as was the case for Côte d'Ivoire and Cameroon, the SFA has strengthened productivity and reduced costs (European Commission, 2006, 12). The SFA was also successful in accreditation efforts for producers in Belize, Jamaica and Cameroon. In all three countries, the SFA supported producers in meeting EurepGAP (now GlobalGap) and ISO14001 standards. Besides improving productivity on banana farms, SFA support was also used to improve working conditions in banana plantations.

Support for diversification and other social initiatives associated with the contraction of banana production are, according to the biennial report, more difficult to assess given the longer time frame of these projects (European Commission, 2006). In terms of the social impact the report makes the somewhat tentative statement that the "diversification activities under the SFA seem to have had a social impact, as the social projects and infrastructures they financed aimed to improve the living conditions of the population affected by the decline of the banana sector" (European Commission, 2006, 14).

The SFA programme has come under considerable scrutiny and criticism in the last year. With regard to its programmes for assisting competitive banana producers, the evidence is vague and there is little detail on the scale and extent of the impact. It may be that it is more

difficult to assess the impact of SFA support for producers that are already competitive in export markets. A more recent unpublished review of the SFA has been described as "half-hearted" and provides no recommendations on how the programme could be improved. In terms of the diversification initiatives, it is worrying that the report is so hesitant on the impact of the SFA's diversification programmes which it claims can only be assessed in the long term.

SFA support also seemed to have missed opportunities where it could have made a substantial impact. Since the Windward Islands were considered to be uncompetitive in world markets, support for banana producers and farm workers shifted to diversification efforts. In 1999 and 2000, all four of the Windward Islands received support for technical assistance in banana production. From 2001 to 2006, only St Lucia received funding for improving productivity and only for the year 2005 (European Commission, 2006). The period after 2001 coincides with the growth of fair trade production from the Windward Islands, but the SFA played no role in this strategy despite the fact that one of its mandates is to support farmers attempting to break into niche markets. Indeed, the biennial report notes that "the Windward banana sector remains present on specific EC markets" and that a "key element of this relative success of the Windward Islands strategy for their banana sector has been its orientation towards the fair trade market" (European Commission, 2006, 13). A recommendation from this biennial

report is that the "SFA draw lessons from other relatively successful experiences, such as the Windward conversion to the fair trade market, as an opportunity for smaller scale enterprises to survive in global market competition" (European Commission, 2006, 14).

The lack of support provided by the SFA to Windward Island banana producers involved in supplying fair trade markets is unfortunate. It may be that the structure of the programme is partly to blame. Funding through the SFA is driven by producing countries which are required to present proposals for support. In the 2006 biennial report the reasons for not supporting banana producers in the Windward Islands is that "so far no project has been put forward to directly support that aspect of their strategy" (European Commission, 2006, 13). Yet it also needs to be acknowledged that the Windward Islands were considered uncompetitive banana producers, which led to all support being shifted to diversification efforts.

The SFA could have played an important role in assisting producers in their efforts to supply fair trade markets. Fair trade producers tend to be more successful when they are organisationally strong. This may be why the recommendations that emerged from the assessment of the SSA support programme focused on the need to support the efforts of farmers attempting to supply niche markets and industry structures and organisations (Hubbard *et al*, 2000).

2.7. Recommendations

Support is needed for producers in their efforts to supply fair trade markets. There is scope for assisting banana producers in their efforts to participate successfully in fair trade markets and other luxury markets (e.g. organics). The role of the SFA is significant here. The SFA should assist in the process of certification and in strengthening industry structures. This would mean working in conjunction with industry representatives, growers and even the UK-based supermarkets that have shown their commitment to fair trade banana production. While this approach goes against the concern that supporting fair trade

producers might somehow "crowd out" private sector initiatives,¹² it recognises the challenges facing banana producers in a fair trade market.

Deepen and thicken marketing campaigns for banana producers affected by preference erosion. There is consensus that although the market for fair trade bananas is growing rapidly, competition within the sector is also increasing. The growing range of certified products supplied by both smallholder-organised farmers and larger enterprises also raises the potential for confusion amongst consumers. The supply of

fair trade bananas, for example, comes from both high cost producers in the Caribbean and low cost producers in Latin America and Africa. Marketing efforts should focus on drawing connections between producers and consumers in Europe, and especially the United Kingdom. A description of fair trade producers in Dominica that appeared in The Observer provides an example of what is possible: "And Dominica is precisely the sort of place that ethically minded British consumers would like to think their bananas came from. They are grown on small family farms, where workers are reasonably remunerated, protected by well-observed labour laws".¹³ Support should be provided to industry players to highlight the distinctiveness of their fairly traded product.

More effective and targeted efforts towards those who have experienced social dislocation as a result of the contraction of the banana

export sector. The diversification support for farmers and farm workers affected by the contraction of the banana sector appears to have little or no impact. While it is important to acknowledge the problems in establishing sustainable diversification efforts, especially in small island economies, the European Commission needs to urgently address the apparent lack of success in this area. A more comprehensive assessment of the diversification efforts is a first step in this direction. A second step is to develop effective diversification plans for banana exporting countries affected by trade preference erosion.

Urgent assistance to banana farmers affected by Hurricane Dean. Hurricane Dean has destroyed banana production in several Caribbean banana exporting countries. The SFA should urgently support efforts to rehabilitate banana farms affected by the hurricane.

2.8. Conclusion

The changing trade regime for bananas over the last 15 years has exposed differences in production efficiency within the ACP group of countries. High cost producers, particularly in the Caribbean, have not been able to maintain production in the face of lower costs and more intense competition in the EU market. Lower cost ACP exporters in the Caribbean and in Africa have been able to increase their share of the ACP quota despite higher competition in the EU banana market.

Banana exports are concentrated with five large trans-national banana exporters controlling most of the trade. Despite this, the value chain is becoming increasingly buyer-driven with supermarket retailers now dictating terms. The trans-nationals are now repositioning themselves as preferred suppliers to supermarkets. The shift to a buyer-driven chain has opened the way for new initiatives including fair trade and other niche markets.

EU support for banana producers has been in place for more than a decade. The initial efforts focused on supporting all banana producers in their efforts to become more competitive. After 2001 banana exporters considered to

be uncompetitive were provided support for diversification away from banana production. The track record of support for banana producers is very uneven. While there appears to have been some success in improving the efficiency of competitive banana producers, the results of the diversification efforts are tentative at best. The programme also failed to support banana producers supplying fair trade markets. The lessons of the support system to ACP banana producers should inform current efforts to assist ACP sugar exporters.

In smaller banana-producing countries attempts to improve competitiveness have focused on fair trade and other speciality markets, which are being supported through supermarket retailers and fair trade organisations. The role of EU support mechanisms in these developments has been very limited. While the market for fair trade bananas has grown quickly in the last decade, value chain analysis has revealed the increasing competition within this market niche. Moreover, the barriers to entry in speciality markets can be high, which may restrict participation by smallholders. NGOs and EU-funded agencies can play an important role in supporting smallholder banana exporters in this market.

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3. EU SUGAR REFORM, ACP SUGAR EXPORTERS AND THE EU'S ACTION PLAN

3.1. Introduction

The institutional price of sugar on the EU market has dominated the policy debate on the reform of the EU's sugar regime and its impact on African, Caribbean and Pacific (ACP) sugar exporters. Over the next four years the reference price of sugar in the EU market is set to decrease progressively from its current level of €523 to €335 per tonne, a total decline of 36 percent. Most analysts predict further decreases in the price of sugar after 2013 linked to the unfolding of the reform process (Agritrade, 2008). Indeed, there are expectations that the world price of sugar and the EU price will be roughly the same in 2015. The lower price of sugar in the short and medium term will affect all ACP sugar exporting countries, especially given the very large difference between the current EU and world price of sugar. Most estimates suggest that the decline between now and the 2009/10 season could lead to a loss of €470 million for ACP sugar exporters (Milner *et al*, 2004; Chaplin and Matthews, 2005).

The lower reference price for sugar in the EU has led to a large number of studies that have modelled future market equilibrium prices and their impact on individual ACP countries exporting sugar to the EU. These analyses typically categorise ACP countries as either "competitive" or "not competitive" based on an analysis of production costs relative to the world's most efficient producers (e.g. Brazil) and future EU sugar prices (LMC/OPM, 2003). ACP countries that are found to be "not competitive", according to most reports, should be supported in diversifying their economies out of sugar while those that are likely to be competitive in a reformed trading environment should be supported in their efforts to become more efficient in a more competitive global market.

The European Community's support programme for ACP sugar exporting countries was released in 2005 (European Commission, 2005). The EC's "action plan" follows a similar approach: countries that are found to be competitive sugar

producers based on an "objective assessment" of their industries will be supported in their efforts to become more competitive. On the other hand, ACP sugar exporters with high cost structures will be supported in diversifying out of sugar production through broadly supported development initiatives.

One of the possible consequences of the reform process is the concentration of sugar production among a smaller number of ACP countries with more competitive cost structures. ACP sugar exporters with higher cost structures are likely to struggle in the new environment unless they receive considerable assistance from their respective governments. Several countries may be forced to abandon sugar production altogether and will need to find alternative economic activities, which the EU will support. More efficient ACP sugar exporters will also be affected by lower prices, but they can compensate for this loss by increasing production volumes. Overall the impact may lead to a smaller number of relatively larger and more competitive ACP sugar exporting countries.

The complexity of the EU's sugar regime and its relationship to world markets means that there is considerable uncertainty on the future price of sugar in EU and world markets, which is so central to most analyses of the impact of trade reform on ACP sugar exporting countries. The price of sugar in the medium and long term depends on the magnitude of reform in the EU, which is by no means certain, and the response of global exporters and investors to possible increases in world sugar prices. Part of the problem in forecasting future prices, as Milner *et al* (2004, 804) have argued, is that the EU's sugar regime is undergoing partial reform: "for partial reforms there is greater ambiguity depending on how the reforms affect the world price and the EU intervention price, on the relative importance of exports to the EU and non-EU markets for each of the countries and on the relative elasticities of export supply to

the (higher price) EU market and (lower price) non-EU market". The use of sugar by-products for the bio-fuels sector and for electricity cogeneration is additional variables that complicate forecasts of sugar prices.

This chapter provides an analysis of the reform process on ACP sugar producers and an assessment of the EU's support programme. The global production and trade of sugar is

described and the most recent figures on production and export are assessed. The global value chain for sugar is examined and recent changes in the chain are explored. The chapter then examines the reform of the EU's sugar regime, its impact on ACP sugar exporters and the EU's support programme. The recommendations focus on the EU's action plan and ways that it might be strengthened to support ACP sugar exporters.

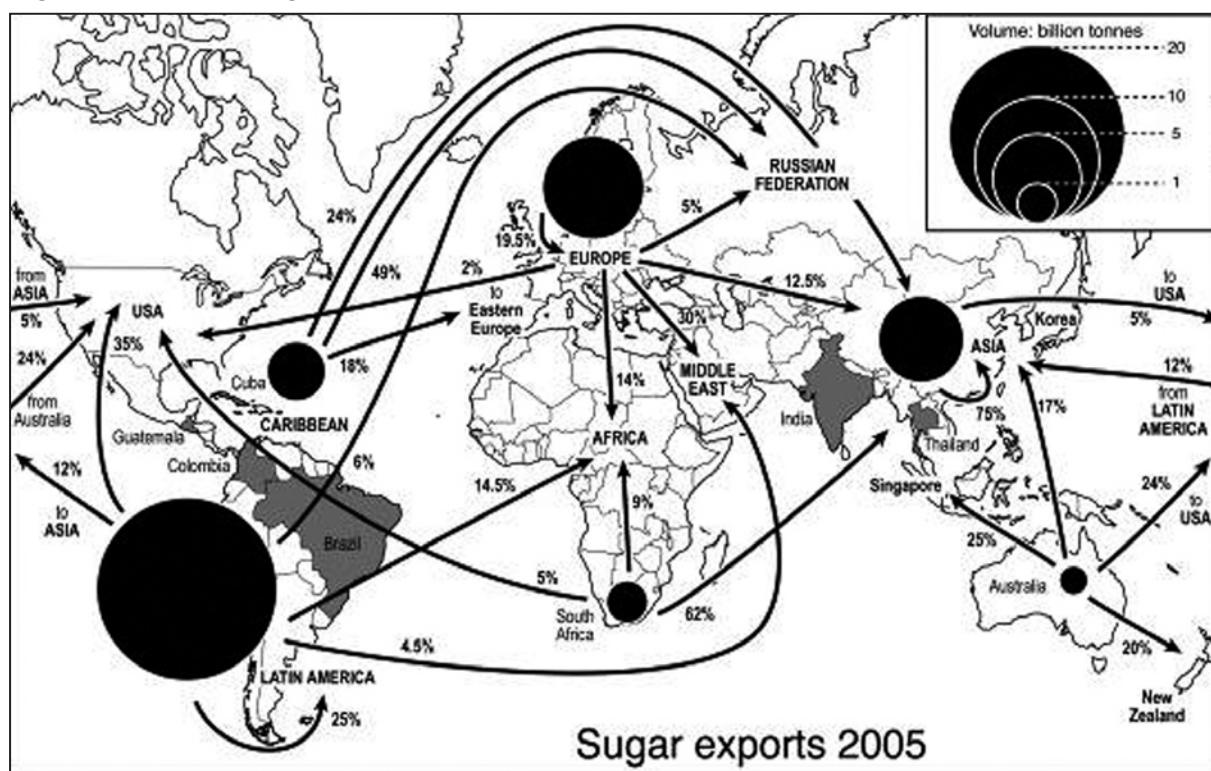
3.2 Global Production, Trade and Prices

The largest producers of sugar are India, the European Union and Brazil. These three countries produced around 14 percent of world production between 1999 and 2001 (Mitchell, 2004). About a third of world sugar production is traded. The largest exporters in volume terms are Brazil, the EU, Australia, Thailand, Cuba, South Africa and Colombia. Exports from these seven countries represented almost 80 percent of all sugar exports (USDA, 2007). The Russian Federation is the largest importer of sugar: it consumes around 14 percent of total sugar exports. The pattern of global imports after Russia is highly dispersed primarily because many countries produce some sugar from either

sugar cane or sugar beet (Figure 3.1).¹⁴ The most significant change in the global trade of sugar is the European Union's shift from an importer of sugar in the 1960s to the second most important exporter of sugar.

The most recent figures for production and exports show that world sugar production for the 2007/8 marketing year will be 163 million tonnes. The increases in global production and trade are due primarily to Brazil, India, China and Thailand. Exports are predicted to exceed 50 million tonnes for the first time (USDA, 2007). The largest exporters are Brazil (21.8 million tonnes), Thailand (4.5 million tonnes), Australia

Figure 3.1: World Sugar Exports in 2005



Source: Comtrade

(4.1 million tonnes) and India (2.5 million tonnes). These figures show two important changes from the situation that prevailed in the early 2000s: first, Brazil is strengthening its position as the largest exporter with almost 43 percent of the global trade of sugar, up from an average of 24 percent in the period between 1999 and 2001. A second new development has been the rise of India as an important exporter of sugar (USDA, 2007). A number of African, Caribbean and Pacific countries are involved in the export of sugar. Although the volumes traded by this group of countries are not significant in global terms, these exports are very important for export earnings and employment.

Estimates are that 80 percent of world sugar production and 60 percent of trade is supported through subsidies and price controls. World sugar prices have been shaped by these domestic support systems. Apart from two spikes in sugar prices in the mid-1970s and the early 1980s, sugar prices have shown a long-term decline. Sugar prices spiked again in 2006/7, but have since followed the more typical pattern of long-term decline. In real terms, sugar prices have declined by around half since 1950 (Mitchell, 2005).

Key changes in sugar production and trade:

Changes in EU production and trade. From the longer-term perspective, the most important

change in the global trade of sugar has been the rise of the EU as a producer and later an exporter of sugar. Increases in the production and export of sugar have strongly influenced world markets, but have provided important preferences for ACP sugar exporters.

Brazil's sugar production. The production of sugar in Brazil continues to exceed industry forecasts. The most recent figures suggest this country is now responsible for 43 percent of exports, which is a dramatic increase since the early 2000s. The role of Brazil in world sugar markets as the EU reform process unfolds is uncertain given the growth of the bio-fuels sector (OECD-FAO, 2007). If the bio-fuels sector absorbs large volumes of Brazilian sugar cane, it may lead to relatively higher sugar prices on global markets in the longer term. If, however, Brazilian production continues to grow and there is a lower than expected demand from the bio-fuels sector, Brazil's exports will have a very profound impact on world markets given its status as the world's most competitive sugar cane producer.

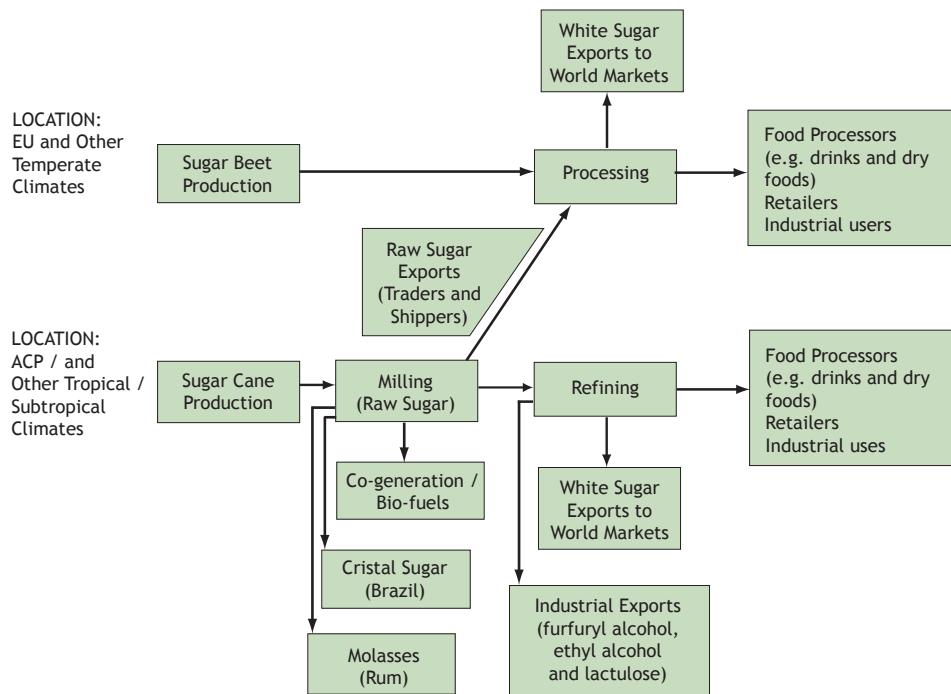
Rise of India. India is very rapidly becoming an important player in the global market for sugar. India's production has increased from 1.4 million tonnes in 2006 to an estimated 2.5 million tonnes in 2007. New investments in refining facilities are ongoing and these will increase India's ability to export refined sugar.¹⁵

3.3. The Global Value Chain for Sugar

The global value chain for sugar is complicated by the fact that refined sugar is derived from two products, sugar cane and sugar beet. Sugar cane is produced in tropical and subtropical climates and sugar beet is produced in temperate climates. The process of deriving refined sugar from these two commodities is also different. While sugar beets can be processed into sugar directly, sugar cane must be milled into raw sugar before it can be refined into sugar products that are fit for human consumption (Figure 3.2).

With regard to competitiveness between the different production systems, sugar beet

producers tend to have a much higher cost structure than sugar cane producers. There are, nonetheless, considerable differences in terms of production costs within the sugar beet and sugar cane sectors. In the European Union, high levels of support for sugar beet producers have encouraged production in marginal areas with high costs (Gillison *et al*, 2005). In the sugar cane sector Brazil is widely recognised to have the lowest production costs, thanks in large part to the scale of sugar cane plantations, and the low cost of land and labour. Indeed, Brazil's production costs are usually used as a benchmark to assess other countries' cost

Figure 3.2: Sugar Production Chain

Source: Compiled from Garside et al, 2005

structure. Within the ACP group of countries there are significant differences in production costs. While several ACP countries are among the most competitive in the world, a large group of ACP countries have very high cost structures (LMC/OPM, 2003). Although it is not always the case, many of the less competitive producers are characterised by state owned processing facilities and smallholder sugar cane growers (e.g. Fiji and Jamaica).

In ACP countries sugar cane is produced on large-scale plantations and on smallholder farms. The supply of sugar is usually regulated through contractual agreements between processing companies and growers. In Southern Africa sugar mills rely on both large scale and small-scale producers, although the former tend to supply significantly larger volumes of cane (Sandrey and Vink, 2007). The number of smallholder sugar cane producers in Southern Africa is, nonetheless, very large and sugar plays an important role in the livelihoods of many rural people in South Africa, Malawi, Zambia and Mozambique. Smallholder farmers in this region are usually supported by the mills who provide credit and extension support. In some countries, the sugar cane mills also

provide a range of social services including schools and health clinics. In Fiji and in most of the Caribbean, sugar cane is produced largely by the smallholder sector on farms that are between one and four hectares in size.

Unlike other globally traded commodities (e.g. bananas) the key players in the sugar sector - processors and refiners - are not organised on a global scale. In both developed and developing regions, processors and refiners usually have a national presence with sugar exports controlled by a single desk company or organisation (Garside et al, 2005; Bureau et al, 2007). In most countries, processing and refining is highly concentrated. In the last decade the level of concentration in the European Union appears to be increasing: according to an Oxfam report, the number of processors and refining companies decreased by a third between 1989 and 1999. In eight of the 14 EU-member countries, one company controlled the sugar beet quota (Oxfam, 2002). In the developing world, the concentration of processing is equally high and sugar processing and refining is either owned by the state or by one or two large privately owned companies. In the last decade the pressure to liberalise markets has led to the sale of some former state owned sugar processors.

Regional and international investments by large transnational companies involved in several stages of the sugar value chain represent a more significant development in the sugar sector. Many of these investments are a response to the liberalisation of the EU's sugar regime and the growing importance of the bio-fuels sector. At the global scale transnational companies like Cargill, Tate & Lyle and ED&F Man have invested in sugar refining and biofuels manufacturing in Africa, Latin America and Asia. At a regional scale, South Africa's largest sugar companies, Illovo and Tongaat-Hulets, have made very large investments in Mozambique, Tanzania and Malawi (Garside *et al*, 2005). These three countries fall into the category of least developed countries and have access to the EU's "Everything But Arms" (EBA) trade arrangement. South Africa's third largest sugar processor (Tsb Sugar) also has regional aspirations, but was unsuccessful in its efforts to purchase the state owned Ugandan sugar processing company. Associated British Food's (ABF) acquisition of a controlling share of Illovo in 2007 suggests that European food manufacturers are also responding to the EU's changing trade regime for sugar. By purchasing Illovo, ABF now has access to an important source of EBA sugar. Another European processor that has invested in Africa is the French based sugar processor Tereos. The company has purchased a 50 percent stake in the Mozambican Marromeu sugar factory. There is an equally dynamic change occurring in the bio-fuels market where companies like ABF and Cargill are making investments in ethanol plants in large sugar producing countries like Brazil.

The value chain for sugar is clearly in a state of considerable flux, but largely in response to changes in the EU's sugar regime. While powerful buyers are restructuring the production chain

for other commodities, in the sugar sector trade reform and the potential of the bio-fuels industry is playing a more important role in shaping new patterns of investment and chain restructuring.

Key developments in the value chain:

Smallholders. A significant aspect of the sugar chain is the contribution of smallholders to global sugar cane production. In most ACP countries a proportion of the sugar milled by processors is produced on a small scale. Smallholders tend to produce under contract and the mills often support them through credit and extension services or in some cases through schools and health clinics.

Concentration in processing. There is evidence that the sugar processing and refining node of the chain is becoming more concentrated. This may be a process that has been occurring over some time and it remains to be seen whether the process of trade reform will intensify the concentration in processing.

International investments. Sugar processing and refining companies have tended to restrict their operations to within national borders. Although refiners in the EU have always been involved in sourcing raw sugar cane internationally and exporting it to other countries as refined sugar, their processing operations have tended to be nationally based. The same is true of developing country processors. The reform of the EU trade regime and the rise of the bio-fuel sector is leading to new investments within regions (e.g. Southern Africa) and internationally. These new investments point to a possible realignment of power in the chain away from nationally-based processors towards large transnational companies involved in several stages of the chain and in a range of different sugar-based products.

3.4. European Union's Common Market Organisation for Sugar

The European Union's Common Market Organisation (CMO) for sugar regulates the production, export and import of sugar products through a range of subsidies, quotas and price supports. For sugar producers within the European Union - who produce sugar from beet - the regime has led to significant increases

in production and, since the 1980s, in exports (Bureau *et al*, 2007). The EU is now the world's second largest exporter of sugar. At the same time, because of the preferences provided to other sugar producers, who produce sugar from cane, the EU is also the world's second largest importer of sugar. This somewhat anomalous

situation (Chaplin and Matthews, 2005) has had important implications for the world's sugar market. Prices for sugar in the EU are three times higher than world prices, which is an important issue for those countries that have had access to this market through preferential trade agreements. Countries that are not beneficiaries of the EC's CMO have also been affected in that the large volume of subsidised sugar exports from the EU has depressed world market prices for sugar (Gibb, 2004; Garside *et al*, 2005). The reform of the CMO is likely to have complex and unpredictable results given uncertainties in the pace of reform in the long term, its impact on world sugar prices and the response of other low cost (current and potential) exporters to new market opportunities.¹⁶ Another important variable is the impact of the bio-fuels sector on sugar consumption and production. These uncertainties are difficult to model using general equilibrium models, which are often used to predict the future price of sugar.

Critics of the EU sugar regime contend that reform was necessary to remove distortions in the world sugar market, the worst being that prices for sugar in the EU were three times higher than world prices. The European Commission itself has argued that the reform was essential because the price the EU and its consumers paid for sugar was three times the world price and that the price cuts would bring down prices to more competitive levels and benefit European consumers. The ACP countries, on the other hand, as beneficiaries of preferential prices in the EU sugar market through the Sugar Protocol, argued that the world price does not represent true value and should not be the benchmark against which to measure efficiency in sugar production, since the world price derives from a market of last resort for the disposal of the surplus production of large sugar producers, often resulting in an artificially low world price (Insanally, 2005). By the time EU sugar reform was implemented in July 2006 the EU sugar price was no longer three times the world price.

The EU has three trade preference systems for developing country sugar exporters. The first is the Sugar Protocol, which provides ACP countries a specific duty-free quota of exports to the

EU. The volume that individual countries are permitted to export to the EU under the protocol was determined on the basis of historical supply patterns between individual countries and sugar refineries in the United Kingdom. The result is that three countries (Mauritius, Fiji and Guyana) have over 62 percent of the total sugar protocol quota. A further 15 ACP countries and India are allocated smaller, yet nonetheless significant portions of the 1.3 million tonne quota of sugar (Table 3.1).

There are two important points regarding the price of sugar for ACP exporters. The first is that the protocol was drawn up in the early 1970s, which was a period of high sugar prices. The negotiated sugar price for ACP exporters has continued to reflect this high price despite the rapid decline in world sugar prices due to larger volumes of exports by both Brazil and the European Union (Goodison, 2007). A second aspect of the protocol related to prices is the limited potential for competition between ACP countries. The sugar protocol quotas prevent EU-based refiners from establishing agreements with individual countries: "refiners are limited in their ability to manipulate prices through agreements with individual countries since trade with one country cannot be substituted with that from another without compromising the total volume imported into the EU" (Chaplin and Matthews, 2005, 3).

The Special Preferential Sugar (SPS) system is a second preferential trade agreement that allows ACP sugar exporters access to the lucrative European Union sugar market. The purpose of the SPS was to meet the requirements of French, Finnish, Portuguese and UK sugar refineries for additional volumes of raw sugar, which were not being met through the sugar protocol. The quotas under the SPS are allocated to individual countries and refineries within these countries (Table 3.1). The total quota for ACP countries has varied between 200,000 and 350,000 tonnes since SPS was established in the mid-1990s. Exporters under the SPS are not subject to any duties for raw sugar cane. The price paid to exporters is slightly lower than the guaranteed price for preferential sugar exports to the European Union.

Table 3.1: Tariff Rate Quotas for the EU Market, 2003 (tonnes)

Country	Sugar Protocol	SPS	EBA
Côte d'Ivoire	11,072	11,470	
Madagascar	11,696	4,710	4,140
Malawi	22,636	12,097	5,269
Mauritius	533,751	53,180	
Republic of Congo	11,072	4,076	
Swaziland	128,098	39,551	
Tanzania	11,072	4,676	4,217
Zambia	0	11,672	4,209
Zimbabwe	32,855	28,955	
Barbados	54,689	5,449	
Belize	43,859	4,370	
Guyana	173,279	17,265	
Jamaica	129,023	12,855	
St Kitts & Nevis ¹⁷	16,947	1,689	
Trinidad & Tobago	47,557	4,738	
Fiji	179,733	17,908	

Source: LMC/OPM 2003

The most recent trade preference system in the European Union is the "Everything But Arms" (EBA) protocol. This new initiative was introduced in 2001 and will eventually allow 49 least developed countries (LDCs) duty-free and quota-free access to the EU market. Full market access is provided in a graduated fashion: custom duties for sugar exports will decrease from 20 to 80 percent between 2006 and 2008. Quotas for LDC sugar exporters started at 71 thousand tonnes in 2001/2 and the quota has been increasing by 15 percent a year. In July 2009, all custom duties and quota restrictions for LDC sugar exports to the European Union will be removed (UNCTAD, 2005).

In the last five years there have been several attempts to forecast the response of LDC countries to the EBA trade preference system. The more conservative estimates tend to suggest that the response will be limited to between 300,000 and 500,000 tonnes above the current quota (van Berkum *et al*, 2005; Conforti and Rapsomanikis, 2006). These analysts stress the significant obstacles many LDC countries will face including a poor transport

infrastructure, limited capital for investments in new production and processing facilities, and limited resource endowments. Chaplin and Matthews (2005) argue that since most LDC countries are net importers of sugar, the supply response is likely to be limited. They do, nonetheless, consider the possibility that LDC producers will divert local production to the more lucrative export market and import sugar at the much lower world price. The European Union's own estimates are far more optimistic: the EU has predicted that total exports under the EBA system could reach 3 million tonnes by 2011. One of the difficulties of estimating the response by LDC countries is the absence of more detailed national and regional analyses of the real potential for sugar production and export (Conforti and Rapsomanikis, 2006). Several Southern African countries - including Malawi, Tanzania and Mozambique - are well placed to take advantage of the EBA scheme (Sandrey and Vink, 2007). Indeed, Mozambique has become an exporter of sugar since the establishment of the EBA thanks to considerable investment by South African-based sugar processing industries (Malzbender, 2003). Ethiopia and Sudan are

also LCD sugar producers and both have the potential of benefiting in the long term from the EBA initiative.

The European Commission has included a safeguard mechanism in the event that LDC

country exports increase in a way that "destabilises" the EU sugar market. Imports from LDC countries will be subject to "review" if they increase by more than 25 percent in a single year.

3.5. Reforming the EU's Common Market for Sugar

The process of reforming the EU's sugar sector has its roots in the early 1990s and the broader debates on the reform of the Common Agricultural Policy (Goodison, 2007). Yet it was only in 2005 that agreement was reached on the process of reforming the Common Market Organisation for sugar. By this time the EU had lost its case and its appeal against a complaint filed at the World Trade Organization (WTO) by five sugar-exporting countries. The complaint concerned the EU's practice of subsidising sugar exports, including a large volume of sugar that it re-exported. The need to reform the CMO was also hastened by the EBA preference system, which allowed unrestricted access to EU markets by least developed countries. Although the impact of exports from LDC countries is likely to be limited in the short term, investments by processors in Southern Africa and elsewhere suggested that the EBA process could have a significant impact on the EU sugar market.

The reform of the EU sugar sector does not represent a full-scale liberalisation of the CMO. Price controls will remain in place (until 2009/10) and quotas, imports and exports will continue to be regulated, although under WTO guidelines. The reform process will instead change the level of prices, total production volumes and the volume of subsidized exports. With regard

to prices, these will decrease by 36 percent over a four-year period (Table 3.2). Subsidized exports from the EU to the rest of the world will be limited to 1,273,500 tonnes of sugar following WTO rulings (Agritrade, 2008). In order to manage EU production and exports down to lower levels, funds will be allocated for the restructuring or closure of "less competitive" sugar processing factories. Support will also be provided to beet farmers interested in withdrawing from production or in diversifying into other food and fibre commodities. A total of €8 billion has been set aside to support processors and farmers interested in diversifying out of sugar or discontinuing production.

One of the challenges of the reform process in the EU is that it depends on industry players - farmers and sugar processors - agreeing to use the funds to restructure or withdraw from production. The experience since 2005 has been disappointing in that only a small proportion of the funds for restructuring have been used (equivalent to 1.5 million tonnes of sugar), with the result that the EU has had to deal with a sugar surplus of around 4.5 million tonnes. In the 2007/8 season the applications for withdrawal/diversification fell to only 0.65 million tonnes, which has resulted in a very large surplus of sugar in the EU.¹⁸

There have been several important developments in the reform of the EU's sugar regime during 2007. First, there has been a change to the Special Preferential Sugar (SPS) arrangement. Previously SPS quota figures were affected by the size of the quotas granted under the EBA scheme. In other words, a significant rise in the EBA quota would result in a smaller quota for countries supplying the EU with sugar through the SPS. The EU has now decided to set specific SPS quotas that are independent of the EBA (Table 3.3). This new development has allayed the concern

Table 3.2: Changes in Price for ACP Raw Sugar

	Price per tonne	% change (cumulative)
Current	€523.7	
2006/7	€496.8	-5.1%
2007/8	€496.8	-5.1%
2008/9	€434.1	-17.1%
2009/10	€335.0	-36%

Source: Mitchell (2005)

Table 3.3: ACP Special Preferential Sugar Arrangement (SPS) Access (tonnes)

African	Caribbean	Pacific
Congo	4,985.2	Barbados 2,841.2
Côte d'Ivoire	10,000.0	Belize 4,985.2
Kenya	11,023.4	Guyana 19,931.7
Madagascar	2,550.0	Jamaica 15,926.8
Malawi	10,000.0	St Kitts & Nevis 1,831.3
Mauritius	41,980.1	Trinidad & Tobago 5,592.2
Swaziland	30,000.0	
Tanzania	2,485.9	
Zambia	12,731.5	
Zimbabwe	25,000.0	

Source: *Agritrade* (2008)

that increases in EU sugar imports through the "Everything But Arms" (EBA) scheme would reduce the quota for exports through the SPS mechanism. This new "complementary quota" which will be in place until 2009 will mean that low cost ACP non-LDC sugar producers will not be affected by increases in EBA imports to the EU (European Research Office, 2007).

A second development in the reform process is related to the relationship between the ACP sugar protocol and the Economic Partnership Agreements (EPA) process. In late 2007 the EC announced the end of the sugar protocol, a decision that has angered the ACP group of countries. The EC's rationale for denouncing the sugar protocol is based on its unwillingness to provide different levels of access to countries within EPAs, which would occur if the protocol were maintained. In addition, the EC has declared its unwillingness to guarantee prices for ACP exporters but not for its own sugar

producers. The sugar protocol will, however, remain in place until 1 October 2009.

The impact of the decision to remove the sugar protocol combined with the new EPA agreements is likely to further widen the gap between competitive and less competitive sugar producers. In the Caribbean EPA, for example, any unused quota allocated to an individual sugar exporter can be transferred to other sugar producers within the CARIFORUM EPA. This is a significant development given the decision by Trinidad & Tobago and St Kitts & Nevis to withdraw from the sugar export market. These unused quotas are likely to be allocated to countries like Belize, Guyana and the Dominican Republic, which are more competitive sugar producers (*Agritrade*, 2008). The decision to renounce the sugar protocol and the signing of EPAs is therefore unlikely to change the overall impact of EU sugar reform on ACP sugar exporters.

3.6. Impact of the Reform on ACP Countries

The reform of the CMO sugar regime has led to considerable discussion and debate on the value of trade preferences to ACP Sugar Protocol countries, and the potential impact of a reformed system on the economies of these countries. Most recently, it has led to proposals within the European Commission on the measures that should be put in place to mitigate the potentially disruptive impact of trade reform on the economies and societies of ACP countries

that have relied on preferential access to the EU sugar market.

Assessing likely impact of trade reform is a complex process and depends on the effectiveness of the reform of the sugar regime in the EU, changes in EU and world sugar prices, and the response of low cost exporting countries to new market opportunities in the wake of a more liberal sugar market. Despite this uncertainty, it

is nonetheless possible to identify ACP countries that are likely to be more vulnerable to lower sugar prices in the EU market.

Garside *et al* (2005) identify two broad criteria for assessing a sugar exporting country's vulnerability to changes in the EU sugar market. First, sugar exporters that have a "lower quota dependency" are likely to be more effective in weathering lower prices. These are countries that are not wholly dependent on preferential access to EU or US markets. In addition, these countries have options for diversification (e.g. ethanol, bio-fuels, organic and fair trade sugar) and have the potential to supply regional markets. The second criterion is industry "competitiveness". This criterion refers to production costs, but it also makes reference to whether there is scope for expanded production and the level of corporate ownership. Countries that are competitive and with a "lower quota dependency" are clearly in a very good position to not only adapt to the new regime, but also to take advantage of new opportunities that are likely to arise in a reformed sugar regime.

Garside *et al*'s (2005) approach suggests that in Africa, Malawi and Zambia are well placed to benefit from the new trading environment. Malawi exports to both the EU and the US and also supplies markets in the Southern African region. It is also diversified into speciality sugars: it supplies Billington's in the United Kingdom with high quality fair trade sugar. Finally, production costs in Malawi are among the lowest in the world, which will shield the local industry from lower prices in the EU market. While Zambia is in an equally strong position in a reformed sugar market, Mauritius is likely to face serious challenges in an environment of lower EU sugar prices. Not only does it have a very large sugar protocol quota, but most of its sugar exports are destined to preferential markets (EU and US). Finally, production costs relative to other low cost ACP exporters are very high. The Mauritius government has recognised these problems and has embarked on an extensive restructuring programme to address the impact of preference erosion. Swaziland's future in sugar production seems uncertain. Within the Southern African region the country has a slightly higher cost

structure and it is relatively more dependent on preferential markets. Goodison's (2007) analysis of sugar production in Swaziland suggests that the impact of preference erosion over the longer term is likely to have serious repercussions on the industry.

In the Caribbean, Garside *et al* (2005) find that only Guyana and Belize are likely to continue sugar production for export in a reformed EU sugar market. Production costs in these two Caribbean countries are low and both have diversified into other sugar markets.¹⁹ This assessment is consistent with most other analyses of the situation for sugar exporters in the Caribbean, which find that production costs in Jamaica, Trinidad and Tobago, and St Kitts are too high to allow them to compete in a post-reform sugar market (Mitchell, 2005). The situation in many Caribbean countries is exacerbated by the debt carried by many of the parastatal sugar companies. As Mitchell (2005, 13) argues, debt affects "competitiveness by increasing interest costs, constraining equipment maintenance and replacement, and limiting application of production inputs such as fertilizer".

Fiji is the only Pacific Island country considered by Garside *et al* (2005) in their analysis of the impact of preference erosion. Fiji's sugar sector is characterised by high costs of production and a milling infrastructure that requires urgent upgrading in order to produce sugar cane more efficiently. Other reasons for the high costs of production in Fiji include payment systems for growers that do not reward quality, limited use of fertilisers by smallholder farmers, high freight and insurance costs, and higher labour costs (Prasad and Akram-Lodhi, 1998).

The most widely cited analysis of the impact of preference erosion on ACP sugar suppliers is the LMC International/Oxford Policy Management report (2003). The report focuses on the profitability of sugar exports based on expected production costs and market access. Their analysis on the impact of preference erosion is summarised by grouping countries into three categories. In the first group of countries, production remains profitable after preference erosion based on the analysis of current costs or on

Table 3.4: Competitiveness of ACP Sugar Exporters

Group 1: Competitive based on current costs or through restructuring	Group 2: Competitive through restructuring beyond their existing plans	Group 3: Not competitive
Congo Br.	Fiji	Barbados
Malawi	Guyana	Belize ²⁰
Swaziland	Mauritius	Côte d'Ivoire
Tanzania		Jamaica
Zambia		Madagascar
Zimbabwe		St Kitts
		Trinidad and Tobago

Source: LMC/OPM 2003

future costs following restructuring. The second group of countries will not be competitive in a reformed EU market and will need to restructure "beyond their existing plans" (LMC/OPM 2003). The third group of countries are, according to the analysis, unlikely to be viable with lower EU prices for sugar (Table 3.4).

A recent assessment of the impact of preference erosion on sugar exporters is based on a

straightforward analysis of production and transport costs relative to the pre-reform price, the EU price in 2010 and a possible EU price in 2015 that is likely to be very close to the prevailing world price (Agritrade, 2008).²¹ While this analysis seems to lack the sophistication of other modelling approaches, it nonetheless highlights how a very low EU/world price will affect ACP producers. Only five countries - all

Table 3.5: Projected EU Sugar Prices and ACP Sugar Production Costs

Country	Production cost (€/tonne)	Transport costs (€/tonne)	Total cost (€/tonne)	Pre-reform EU price (€/tonne)	EU price 2010 (€/tonne)	Possible 2015 price (€/tonne)
Mozambique	141	68	209	523.7	335	261.85
Malawi	141	92	233	523.7	335	261.85
Zimbabwe	158	84	242	523.7	335	261.85
Swaziland	176	76	252	523.7	335	261.85
Zambia	141	116	257	523.7	335	261.85
Guyana	211	76	287	523.7	335	261.85
Mauritius	229	64	293	523.7	335	261.85
Belize	211	92	303	523.7	335	261.85
Fiji	229	80	309	523.7	335	261.85
Jamaica	264	56	320	523.7	335	261.85
Tanzania	211	120	331	523.7	335	261.85
Congo	229	104	333	523.7	335	261.85
Côte d'Ivoire	264	112	376	523.7	335	261.85
Kenya	264	120	384	523.7	335	261.85
Madagascar	317	80	397	523.7	335	261.85
Barbados	352	60	412	523.7	335	261.85
St Kitts & Nevis	440	80	520	523.7	335	261.85
Trinidad & Tobago	440	80	520	523.7	335	261.85

Source: Agritrade (2008)

African - would be able to continue production at a world price of €261.85 per tonne (Table 3.5). A further seven ACP countries will be competitive up to 2010, while six other countries are not competitive at the current sugar protocol price (Agritrade, 2008).

It is important to note that investment flows, innovation and subsequent productivity gains are not considered by the LMC report and other forecasts on sugar prices and production costs. These new investment patterns should lead to productivity gains, which will influence competitiveness, although how these will be distributed across countries is very uncertain.

The social and economic impact of sugar trade reform on less competitive ACP countries is potentially very serious indeed. In Fiji, it is estimated that there are approximately 21,000 sugar cane farmers and 14,000 sugar cane cutters who are employed on a seasonal basis (Chand 2004; Oxfam 2005a). In addition, there are 3,000 workers in the country's four sugar cane processing factories. When these figures are added to the number of people working in enterprises that support the sugar cane sector, the total number of people involved in the sugar cane sector is estimated to be between 200,000 and 250,000 workers (Asian Development

Bank 2002). The importance of sugar to Fiji's economy is of great concern to those involved in the sector (Reserve Bank of Fiji, 2005). In the Caribbean, sugar generates an estimated 125,000 jobs and USD 300 million in foreign exchange (McDonald, 2005).

For more competitive ACP producers like Mozambique and Zambia the reform process has the potential to create substantial employment opportunities and new livelihoods for smallholder farmers. Oxfam (2004) has estimated that investment in the sugar sector in these two countries could lead to 30,000 jobs being created. Since sugar companies are frequently involved in providing workers with access to health care and education facilities, investment in sugar has the potential for long-term development outcomes for these countries.

The key impact of EU reform is the uneven distributional effects it will have across ACP countries. Most projections suggest that the beneficiaries of the reform process are those countries with lower cost structures. New investments by transnational sugar companies in the most competitive sugar producing nations may further entrench the division between ACP sugar producing countries.

3.7. EU support for Preference Erosion in Sugar

The EU has committed itself to a "programme of action" to assist ACP sugar exporters negatively affected by preference erosion. It recognises the likely impact of trade reform on ACP countries and has declared its willingness to "support ACP countries in their path to poverty reduction and sustainable development" (European Commission, 2005, 1). As was seen in the case of support to ACP banana exporters, the assistance has a trade as well as a development-assistance component. The type of assistance "package" provided to individual ACP countries - and the balance between trade and development assistance - will depend on "an objective assessment of the constraints and potential of the sugar sector, as well as of other alternative economic sectors both within and outside of agriculture" (European Commission 2005, 6, bold

in the original).²² To this end, support initiatives should "strengthen" and "complement" existing national development strategies and be pro-poor in their focus (European Commission 2005). Eighteen ACP countries are identified for support (Table 3.6).

The trade component of the EC's "programme of action" for Sugar Protocol countries does not outline specific support initiatives for ACP sugar-exporting countries.²³ Instead, the document underlines the EC's commitment to ensuring that trade reform at the multilateral and bilateral levels leads to economic growth and poverty reduction.

The support for development assistance provides more concrete measures for supporting ACP sugar

Table 3.6: EC Support for ACP Countries Affected by Trade Preference Erosion

Country	Budget (millions of €)
Côte d'Ivoire	13.467
Kenya	6.230
Madagascar	8.428
Malawi	9.911
Mauritius	127.541
Mozambique	6.0
Republic of Congo	6.245
Swaziland	69.895
Tanzania	6.0
Zambia	6.0
Zimbabwe	22.137
Barbados	34.667
Belize	45.147
Guyana	84.170
Jamaica	77.547
St Kitts & Nevis	74.286
Trinidad & Tobago	41.643
Fiji	60.024

Source: *Agritrade* (2008)

exporters. Three axes of support are identified: support to enhance the competitiveness of the sugar sector; assistance in promoting diversification in sugar areas; and support for addressing broader adaptation needs (European Commission 2005, 9). As noted earlier, the criteria for supporting the sugar sector will depend on the country's "competitiveness gap" and the extent to which the gap is a consequence of structural problems that are unlikely to be overcome through development assistance. If a case can be made for sustainable sugar, the support will take the form of assistance in terms of production, chain coordination, diversifying into value added products, and by encouraging processing companies and farms to adhere to corporate social responsibility (CSR) standards. CSR standards "could be used by ACP industries as a commercial asset, in particular in ... relations with certain European buyers" (European Commission 2005, 10).

The EC acknowledges that the other two axes of the programme of action - diversification and broader adaptation - are potentially more challenging, particularly for smaller

economies that are heavily dependent on sugar for employment and export revenues. Diversification should focus on identifying market opportunities in sectors that offer lower risk and price stability. Broader adaptation support must focus on the social and economic impacts of sugar sector downsizing or closure on workers and farmers.

The EC's action plan is clearest in terms of the proposed measures to improve industry competitiveness, but vague in its proposals for diversification and adaptation (also see Oxfam 2005a). Those sectors that are found to be both competitive and sustainable will be supported through a range of very specific measures to improve the efficiency of all aspects of sugar production and processing. Yet the adaptation and diversification measures provide very little by way of concrete suggestions other than that they should be pro-poor in their emphasis and that they should address the likely social and economic disruption associated with industry downsizing or closure. Comparing this approach to the support provided by the EC to ACP banana exporters over the last decade is instructive.

The emphasis of the sugar action plan on an "objective assessment" of competitiveness was also used to structure support for ACP banana exporters affected by trade preference erosion. In the banana sector it resulted in a situation where support was provided to ACP banana exporters who were already competitive. Supporting competitive ACP banana exporters has made it very difficult to assess the real impact of the EC's support system. At the same time, this approach led to the EU's support mechanism ignoring initiatives where it could have made a significant difference to banana producers who were undergoing a process of restructuring in order to become more competitive in niche banana markets (e.g. fair trade, also see Chapter 2). The lesson here is that an approach that is based on an ostensibly objective assessment of a very dynamic market environment is likely to overlook opportunities where the programme of action can make a significant difference to ACP sugar exporters. The need for greater flexibility in the approach to support is perhaps greatest where the sector

plays a dominant role in terms of employment and livelihoods. Within the sugar sector there are options for diversification into other sugar products and by-products including bio-fuels, electricity co-generation and alcoholic drinks like rum (e.g. Oxfam 2005b).

A second lesson that may be drawn from the banana experience relates to programmes for diversification. Independent assessments of the support to ACP banana exporters found that these efforts either had a limited impact or that it is too early to tell whether the mechanisms had any impact on farmers and farm workers involved in the banana sector (Chapter 2).

3.8. Recommendations

Provide assistance and support for competitive sugar-producing countries to spread the gains of trade reform to both smallholders and farm workers. A positive aspect of the EC's action plan is its commitment to small and medium-sized enterprises (SMEs) and smallholder farmers. Proposals for support need to acknowledge the problems associated with smallholder sugar farming. Many of the countries that rely heavily on smallholders have higher cost structures than those that source cane from plantations. For Malzbender (2003, p. 13), the EU's reform programme on sugar prices will have a direct impact on the smallholders sector: "This could mean that small-scale sugar farming schemes could simply be financially unsustainable and alternative solutions for poverty alleviation would need to be sought". The South African experience provides a somewhat more positive outlook on the future role of smallholder sugar farmers in a more liberalised sugar market. Over the last 30 years the sugar industry has supported smallholder sugar farmers in several parts of the country. The lessons from this experience include: the importance of grower participation in the design and structure of financial support systems; the need to ensure that extension and technical services are efficient to support productivity gains among smallholders; the need to ensure representation by small sugar producers in industry structures; the need for millers to be "supportive" rather than "interventionist" in their dealings with small growers; and the need

The support to ACP sugar producing countries is different in that it emphasises broad development initiatives for regions affected by sugar trade reform. For instance, support must be linked to national and regional development strategies and other international development assistance programmes. Although this new approach is welcome and appropriate, national development initiatives to diversify away from primary commodities have a very poor track record (Mitchell, 2005). The experience of diversification highlights the difficulties involved in transforming regional economies that have been dependent on one commodity for many years.

to find ways to ensure that sugar production in regional economies leads to new opportunities for small and medium-sized enterprises (e.g. McIntosh and Vaughan, 1996). In the South African context processors sourced from smallholders because they needed an additional supply of sugar that could not be provided by large scale producers. Subsequently this has become a way for processors to demonstrate their commitment to corporate social responsibility. In other producing countries, especially in Southern Africa, this has become an incentive for processors to source from smallholders, many of whom are organised in cooperatives.

Provide a more concrete set of proposals and guidelines for diversification and adaptation. This is particularly significant for countries that are heavily dependent on sugar for employment and livelihoods. In countries like Fiji and several Caribbean countries, the sugar sector plays an extremely important role in terms of employment and foreign exchange earnings. The options for diversification in the EU's action plan are not concrete enough or large enough given the potential impact of sugar reform on the livelihoods of those involved in the sector. An important policy solution would be to develop concrete guidelines for diversification and adaptation that are in line with the principles for sustainable development.

Increase the value and efficiency of support mechanisms. Critics of the EC's action plan for

ACP sugar exporters have pointed out the limited value of the support to countries affected by trade preference erosion. Comparisons have also been drawn to the much larger support provided to EU sugar farmers relative to ACP sugar exporters. There have also been calls to make the funding more efficient, particularly in the light of the problems faced by EU agencies supporting ACP banana exporters (see ACP, 2007). These are legitimate concerns and the EC should revisit the value of support for ACP sugar exporters, especially given its potential impact on countries with high levels of dependency on sugar. The scale of the potential crisis facing ACP sugar exporters is not being matched by

the value or the efficiency of EC support. The EC should be lobbied to increase the value and efficiency of its support.

Assist competitive producers in finding ways to increase volumes and efficiency. Sugar exporters with more competitive cost structures can minimise the impact of trade preference erosion, but they will need to increase production volumes and levels of efficiency. The EU's action plan must support efficiency efforts in management and technical aspects of production that are in line with the principles of sustainable development.

3.9. Conclusion

The reform of the EU's sugar regime will affect all developing country exporters of sugar. In the short term, it is possible to calculate the scale of the impact and the countries that are likely to be worst affected by the reform process. In the longer term, the growing dominance of Brazil in the world's export market, the rise of India as a sugar exporter, the speed of the EU reform process and the role of the bio-fuels sector and industrial investors all make it very difficult to map the future gainers and losers across and within countries. In particular, the uncertainty of sugar prices for ACP sugar is exacerbating the challenges they face in dealing with trade preference erosion.

It is unfortunate that ACP countries with higher cost structures (e.g. Fiji and most of the Caribbean countries) are also those where smallholder farmers play a significant role. The EU's action plan has emphasised the importance of supporting small enterprises, including smallholders, in diversifying into other areas of agricultural production. The scale of the support provided by the EU may not, however, be enough

to make up for the impact of trade preference erosion. More competitive sugar exporters have the potential to use this opportunity to create opportunities for smallholders and farm workers and thereby make a tangible impact on poverty in least developed countries.

Despite this seemingly bleak outlook there are opportunities for ACP producers. One strategy involves supplying EU markets with specialty sugar products and sugar that can claim social attributes (e.g. fair trade and organic). Although the demand for these sugar products in the EU needs to be carefully assessed, there are examples of sugar producers that have been able to successfully supply these market niches (e.g. Barbados' "plantation reserve" sugar).²⁴ A second option would involve supplying regional markets, which is something that the EPA process has stressed. Careful planning will be required to ensure that a regional focus does not disrupt regional sugar markets (Agritrade, 2008). Finally, the sugar commodity offers many opportunities for diversification into other products besides milled or refined sugar.

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4. VALUE CHAINS AND CODES OF CONDUCT IN THE CUT FLOWER VALUE CHAIN

4.1. Introduction

The share of developing country cut flower exports to the European Union, the United States and Asia has increased significantly in the last twenty years. These increases have been facilitated by innovations in logistics which now allow the rapid transport of fragile flowers from producing countries to consuming countries. Developing country producers have also benefited from low tariffs in the main cut flower markets of the European Union, the United States and Japan.

The cut flower value chain is undergoing rapid transformation in the face of increased production, changing consumer demands, new codes of conduct and the role of supermarket retailers in the sale of flowers. Although the auction system continues to be the route for most cut flower producers, direct sales to retailers and especially supermarket chains is an important recent development in the value chain with implications for exporters. A second development with implications for the cut flower value chain has been the growing concern over the environmental and social impacts of cut flower production in the developing world, which has given rise to a large range of new labelling and certification systems.

The cut flower sector has not provided very many opportunities for smallholder farmers in

the developing world. Small-scale producers have faced barriers in terms of the high cost of investment in production and post-harvest treatment and their lack of access to efficient cool chains. Yet the sector has provided many new opportunities for workers, and particularly women workers in most cut flower producing countries. The poor working conditions for those employed in the cut flower industry has been the focus of many media and NGO campaigns. These highly publicised campaigns have revealed problems associated with wages, working hours, freedom of association and health and safety. Supermarket retailers, producers and importers have responded to these problems by introducing codes of conduct which allow exporters to certify that their flowers have been produced according to acceptable social and environmental criteria.

This chapter begins by examining the global trade and consumption of cut flowers. In the third section the value chain for cut flowers is analysed and recent changes in the chain are discussed. Section four and five focus on tariff and non-tariff barriers in the cut flower sector and section six examines codes of conduct for labour. The chapter also provides recommendations for improving working conditions, which are of relevance to industry players and multistakeholder groups.

4.2. Global Production, Trade and Consumption

The global trade of cut flowers may be divided into three regional complexes (Figure 4.1; Table 4.1, 4.2). The first regional complex is the United States and Canada, which is supplied largely by Latin American producers (Ecuador, Colombia and Costa Rica). These lower cost flower producers displaced US producers of cut flowers in the 1990s, although not without some resistance from US producers (Ziegler 2007). US imports now represent over 60 percent of total consumption (Tips/AusAid 2005).

The European Union is the second regional complex and is also the world's largest consumer of cut flowers. European countries consume almost 70 percent of global production. There are important differences within the European Union. Germany, the Netherlands and France are traditionally the largest consumers of cut flowers, but consumption in these three countries is stagnant or declining. The United Kingdom market has grown rapidly in the last decade and is now the largest European consumer of cut

Table 4.1: Cut Flower Imports 2004

Importers	Value US Dollars	Growth in value 2000–2004	Growth in value 2003–2004	Share in world imports
World	5544720	9	13	100
European Union	3751550	10	10	68
NAFTA	978600	4	15	18
Asia	293889	5	22	5
Central and Eastern Europe	141384	19	49	3

Source: *Tips/AusAID 2005*

flowers. Consumption of cut flowers is growing quickly in Spain, Italy and Poland. The main suppliers for the EU are European countries (the Netherlands, Italy, Belgium and Spain) and African countries (Kenya, South Africa, Zambia, Tanzania, Zimbabwe and Uganda). African exports of cut flowers now represent 18 percent of total imports to the European Union.

**Table 4.2: Cut Flower Exports 2006
(including ACP countries)**

Country	Exports (US Dollars)
Netherlands	3,332,530,684
Colombia	967,037,234
Ecuador	435,834,047
Kenya	231,889,576
Italy	81,072,375
Belgium	75,129,476
Israel	69,685,000
Thailand	67,598,139
Spain	62,776,097
Malaysia	40,269,707
Costa Rica	39,442,128
India	31,610,122
Ethiopia	25,136,699
South Africa	24,410,391
China	20,519,607
Singapore	20,853,207
Zimbabwe	16,869,858
Zambia	11,536,347
Tanzania	9,259,266
Uganda	2,050,029

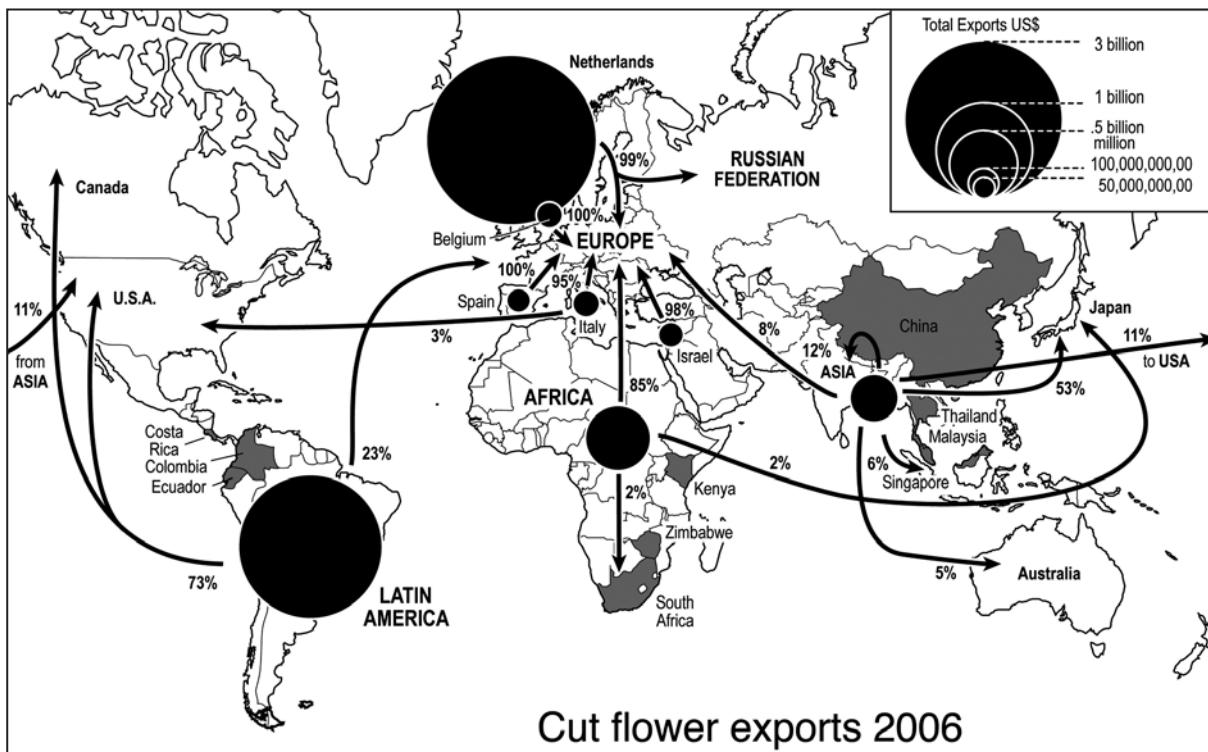
Source: *Comtrade* (note figures for Zimbabwe are for 2004).

Asia represents the third regional complex with Japan dominating imports of cut flowers with almost 75 percent of the total. Previously local producers supplied most of Japan's consumption of cut flowers but this has changed in the 1990s with cheaper imports playing a more important role. The source of Japanese imports has also changed in the last decade. Almost half of all Japanese imports came from the Netherlands and Thailand. These two countries are now responsible for only 20 percent of imports. Although Thailand continues to play an important role in Japan, Malaysia, Korea, Taiwan and China have displaced the two traditional suppliers of cut flowers to Japanese consumers.

The regional pattern described here is in flux (Figure 4.1). Latin American producers are becoming important suppliers to the EU market, while African suppliers are now supplying the US market through the Africa Growth and Opportunity Act (AGOA).²⁵

Key changes in production and exports:

Rise of developing country cut flower exporters. In the three most important markets - the EU, the US and Japan - the pattern of imports has changed in favour of developing country importers. In Latin America, Ecuador, Colombia and Costa Rica now supply over 80 percent of the United States cut flower imports. Total European Union cut flower imports from developing countries now represent over 21 percent of the market in value terms (CBI, 2007). Kenya has increased its share of the EU market by 12 percent per annum between 2002 and 2006 (CBI, 2007). Other important African producers are Zambia, Zimbabwe (but see below), South Africa, Uganda, and Tanzania. The increase in

Figure 4.1: Cut Flower Exports and Imports

Source: Comtrade

developing country imports has been facilitated by low tariffs and by improvements in the transportation infrastructure for cut flowers. Most developing country exporters to the EU are ACP countries and are thus exempt from duties. The "Everything But Arms" initiative will ensure that least developed countries will continue to have duty-free access to EU markets. In the United States, efforts by domestic producers to limit cut flower imports through duties and anti-dumping measures were initially successful, but during the 1990s political considerations led to several trade pacts which led in turn to the elimination of tariffs on Latin American cut flower exporters.²⁶ Cut flower exports to Japan do not face import duties or tariffs.

Collapse of Caribbean production during the 1990s. In the 1980s and early 1990s, the Caribbean had a vibrant cut flower sector focused on tropical flowers (anthurium) and other cut flower varieties. The main Caribbean exporting countries were Jamaica and Trinidad. Despite the region's proximity to the United States market, the industry declined rapidly during the 1990s due to various plant diseases and the high cost of importing plant material.

The collapse of the Caribbean's cut flower sector underlines the complexity of the cut flower export trade.

Decline in Zimbabwean cut flower production. Zimbabwe's cut flower production increased rapidly during the 1990s (Davies 2000). By 2003, Zimbabwe was exporting almost USD 70 million worth of cut flowers, mainly to the European Union. Zimbabwe seemed well placed to mirror Kenya's rise as a major African exporter of cut flowers. The political crisis in Zimbabwe has, however, led to a collapse in cut flower exports. The country's exports of cut flowers declined to USD 54 million in 2004 and to less than USD 17 million in 2005 (Tips/AusAID, 2005 and Comtrade). Although the land reform process and the seizure of farms have played a role, exporters have faced problems associated with a difficult macro-economic situation that has created problems in terms of securing fuel, fertilisers and other equipment that requires access to foreign exchange. Two of the four auctions in the Netherlands are now refusing to accept flowers from Zimbabwe; for other importers, Zimbabwe has become an unreliable source of cut flowers (CBI, 2007).

New producers. Although cut flower exports are concentrated among a few countries, the last five years have seen the emergence of several new cut flower exporters. India and China have both increased their volume of cut flower exports. In 2004, China and India were 25th and 27th on the list of world exporting countries and both have plans to increase production and exports. In Africa, Ethiopia and Tanzania have increased their exports and show the potential to become important exporters. Ethiopia's progress has been astonishing: it is now predicted that it will soon rival Kenya as the continent's largest cut flower exporter.²⁷

Continued high growth rates for flower consumption. One of the outstanding features of the cut flower sector is its rapid growth, especially in the period since the early 1960s. From the 1960s to the mid-1980s the annual growth rate in sales turnover exceeded 10 percent (Malter *et al*,

1999). By the mid-1990s, cut flower consumption appeared to reach its limit and during most of the decade the value of sales hovered around USD 4.1 billion per annum. From the early 2000s the upward trend in consumption resumed: from 1999 to 2003 the growth rate in sales increased by 9 percent per year. Estimates are for a continued upward trajectory in consumption (Tips/AusAID, 2005).

New trading hubs. The Netherlands has historically played a key role in the production and trade of cut flowers, and in many ways continues in this role. As is discussed in more detail below, the Netherlands is increasingly focusing on playing the role of cut flower distributor rather than producer. It is likely to face increasing competition in this role: the Dubai Flower Centre was established in 2005 and is positioning itself as a new "state-of-the-art" hub for the trade in cut flowers.

4.3. The Global Value Chain for Cut Flowers

The barriers to entry in cut flower production and export are high. Producing and exporting high quality flowers requires investment in greenhouses, sophisticated irrigation equipment and access to an efficient cool chain. Although cut flower production in developing countries can and does occur outdoors, the demands for flowers with a long "vase life", uniform buds and stems, and blemish-free leaves, has encouraged exporters to invest in covered growing facilities (Malter *et al*, 1999). The technical demands of cut flower production are equally high and require skills, experience and expensive inputs.

The high barriers to entry in the cut flower sector have shaped the structure of production and exports. In most developing countries, cut flower exports are concentrated in the hands of a small number of large companies. In Kenya there are as many as 500 producer exporters, but only 60 companies are responsible for almost all cut flower exports. The largest 25 companies are responsible for over 60 percent of exports (Dolan *et al*, 2002). In countries like Uganda, Tanzania and Zimbabwe, production is also concentrated in the hands of between 10

and 20 operations (Asea and Kaija, 2000; Davies, 2000; Hatibu *et al*, 2000). An exception in Africa is South Africa, although the industry's focus on internal markets may explain the relative lack of concentration.

The high barriers to entry have tended to exclude smallholders from the cut flower export sector. Although there are 500 smallholder cut flower farmers in Kenya who may use the packing facilities of the larger corporations, their contribution to the country's cut flower exports is very limited (Thoen *et al*, 2000). The Kenyan Flower Growers Association has run a training programme for smallholders but there is little evidence that the programme has led to significant increases in cut flower production from small scale producers. One of the reasons why smallholders face problems in Kenya may be that they are restricted to supply chains that are riskier and more costly: "smaller growers have to deal with more agents in the supply chain, weaker marketing links and the risk that their product may not even gain access to space on flights at all" (Hughes, 2000, 184; also see Wijnands, 2005). In other African countries, including Uganda and Tanzania, there are

no smallholder cut flower farmers (Sonko *et al*, 2005). The most important producers in Latin America - Ecuador and Colombia - are also concentrated with few opportunities for smallholder farmers (Korovkin, 2003).²⁸

While cut flower production may exclude smallholders, the nature of production is labour intensive and the cut flower sector has created many new employment opportunities. In Kenya the industry employs between 40,000 and 50,000 people, while as many as 110,000 workers are employed in Colombia's flower sector (Kovorkin and Sanmiguel-Valderrama, 2007). Cut flower farms employ a large proportion of women and they tend to be concentrated in the most labour intensive areas of production (Dolan *et al*, 2002). In addition to those directly employed in the sector many more jobs have been created in service sectors that supply the cut flower farms, including logistics and input supply firms.

There is a significant difference in the cost structure of cut flower production in Europe compared to most other developing countries. While the highest cost for European producers is labour, among developing countries the highest costs are for freight and marketing (CBI, 2007). At present, European and developing country producers do not always compete head-to-head given that the latter export most of their flowers during the European winter when production costs become very high. When they do compete, European producers tend to be more competitive given their proximity to markets and the higher diversity of their production range.

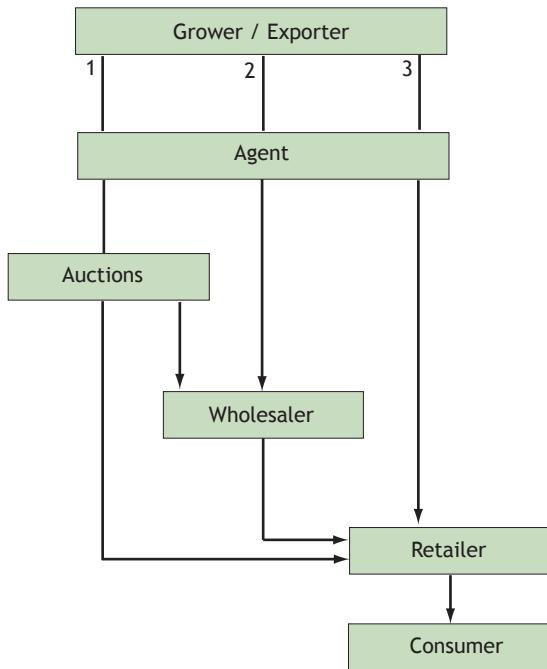
Given the significance of freight costs for developing country producers, the distance to markets and the efficiency of the logistics system is an important factor in determining competitiveness. For instance, Ethiopia's advantage as a cut flower exporter over Kenya is that it is two hours closer by plane to European markets. Given the fragility of the commodity and the relationship between quality and time to market, two hours is an important competitive advantage. Both Uganda and Zambia have faced problems in the cut flower export market due to their relatively

less efficient logistics infrastructure (Asea and Kaija, 2000). The importance of proximity to markets also explains why Latin American cut flower exports focus on the United States market while African producers supply most of their flowers to Europe.

Given its relative success in exporting deciduous and subtropical fruit, South Africa is surprisingly the least competitive African exporter of cut flowers. A recent study on the South African cut flower sector found that it was "lagging behind its African counterparts" due to the "primitive set-up of greenhouses, the low levels of investment in the industry and the inappropriate varieties that are being produced" (Matthee *et al* 2006, 514). One of the key problems facing the sector in terms of becoming a more effective exporter is the relatively large local market for flowers, which results in local producers exporting sporadically (e.g. when the currency weakens or when local demand falters). Exporters are, as a result, not accredited by international certification systems and tend not to shape production methods or the product to international markets.

Cut flower producers and exporters rely heavily on an efficient and effective cool chain infrastructure. The time between harvesting and delivery to a retail outlet should not be longer than four days; anything longer than this compromises the quality and vase life of the product. The importance of logistics is such that Kenyan exporters have their own logistics system to transport flowers from the farms to the airport and onto the planes.

There are four routes to international markets for cut flower producers and exporters (Figure 4.2). These are: directly to auctions; through an agent who then sells on to an auction; via an import wholesaler; and directly to a supermarket or retail store (Tips/AusAid, 2005). In the European Union, the majority of cut flower sales are handled through two auctions based in the Netherlands. The advantage of the auctions for producers and exporters is that they do not make demands on suppliers in terms of variety. Auction sales are also efficient, payment systems are quick, and there tend to be

Figure 4.2: Cut Flower Chain

Source: CBI, 2007

fewer quality disputes. Exporters using auctions must have licenses that specify varieties and quantities of cut flowers to be supplied, and they must guarantee that a certain percentage of their business goes through the auction. A disadvantage of the auction system is that small and medium scale cut flower producers compete with very large producers. The majority of developing country imports to the European Union go through the Netherlands, which confirms the importance of auctions to cut flower exporters from the developing world (CBI 2007). In the United States most sales are through wholesalers although there are auctions in several major cities including Miami, New York and Los Angeles, but these are not nearly as important as they are in Europe. Japan's supply system, in contrast, depends on a complex and decentralised auction system (Tips/AusAid, 2005).

A second route to Europe involves the use of agents, who handle the logistics involved in receiving the flowers at the airport and arrange for the flowers to be transported to the auction. Agents will also perform other functions for flower producers to prepare them for sale at the auction. For developing country producers and exporters of cut flowers who

do not have a presence in Europe, agents are especially important in bringing the flowers to market. In the last five years, the role of agents has become more important and they have acquired a range of new "competencies" including "purchasing and consolidating flowers in supplier countries; becoming financially integrated into flower farms; and providing a wide range of marketing information on consumption trends, environmental programmes, and quality-related aspects of distribution" (CBI, 2005, 85). Agents are also involved in providing value-added services to supermarkets and other retail outlets.

A third route to European markets is by selling cut flowers directly to European based wholesalers. These buyers play an important role and will "assist producers on all manner of know-how, from quality, presentation and assortment to transportation and handling matters" Tips/AusAid (2005, 40). Wholesalers may sell the flowers they have purchased from producers/exporters to the auction or they may export the product to retailers in other European countries. Contracts with wholesalers are rare and they tend to source the product they need depending on market demands. Quality claims and payment problems tend to be more common with wholesalers.

The last route involves selling directly to supermarket chains and garden centres. Supplying supermarkets is more complicated for producer/exporters as it requires greater involvement in logistics. As is discussed in more detail below, direct sale to supermarkets is a growing trend given the increasing volumes of flowers now sold through large retail chains.

The route that flower exporters use varies within the most important cut flower exporting countries. In Kenya there are several companies that export exclusively to supermarkets in the United Kingdom (Thoen *et al*, 2000). Other exporters tend to use a range of routes including supermarkets, auctions and direct sales to wholesalers. Companies supplying supermarkets are normally larger as they have the capacity to meet the demands for volume and product specificity. In Uganda and Tanzania, cut flower

exporters tend to rely on auctions rather than direct sales to supermarkets.

The structure of cut flower retailing shows considerable diversity within Europe. In Germany, which is one of the largest importers of cut flowers, most sales (54 percent) are through florists. These retailers tend to be independently owned and have the reputation of providing a better service to customers and a higher quality and range of flowers. They are also involved in providing customers with flowers for special occasions (e.g. weddings

and funerals). The share of cut flowers sales in Germany through growers and supermarkets is only around 15 percent, although it has been growing in the last five years (Table 4.3). The Netherlands and France tend to have similar retail structures and a similar shift towards supermarket sales. In the United Kingdom, in contrast, around 65 percent of cut flower sales is through the large supermarket chains while only 24 percent is sold through florists. Supermarkets have come to dominate the sale of cut flowers in a remarkably short period of time (Table 4.4).

Table 4.3: Cut Flower Sales in Germany (%)

Germany	1999	2000	2001	2002	2003
Florists	64	63	60	57	54
Growers	13	13	14	16	16
Supermarkets	10	10	11	12	14
Street and market	8	8	8	8	8
Garden centres	2	3	4	4	4
Others	3	3	4	3	4

Source: CBI 2005

Table 4.4: Cut Flower Sales in the United Kingdom (%)

United Kingdom	1999	2000	2001	2002	2003
Supermarkets	45	51	58	64	65
Florists	36	30	27	25	24
Street and market	7	6	6	5	5
Groceries	3	3	3		
Garden centres/growers	3	3	3	2	2
Others	5	7	6	4	4

Source: CBI 2005

Key changes in the cut flower value chain:

Product differentiation and price. The last ten years have seen increasing product differentiation. The demand is high for classic flower varieties that have become increasingly commoditised and oversupplied. But the fastest growth markets are for exotics and novelty flowers, including indigenous varieties. In many ways the market for flowers parallels the market for high value fruit and vegetables in that there is greater competition and price pressure on traditional varieties, while there is

a growing demand for new, exotic or indigenous varieties and for value added products. The implication for cut flower producers is that the market for traditional varieties is becoming more competitive and they face pressure to diversify their production range. The price of cut flowers is determined by a wide range of factors including the variety, the quality, uniformity of stem length and bud size, colour and overall appearance. Prices are also shaped by the reputation of the supplier in terms of regularity of consignments and their consistency over time. There are marked seasonal differences

as well and intra-day price fluctuations (CBI, 2005). Despite the complex way in which prices are determined in the cut flower sector, there is evidence that prices have declined in the last decade, especially for products where there is a perceived oversupply (e.g. roses). The prices for more new varieties, on the other hand, may be increasing, which reflects the demand for flowers that are beyond the ordinary.

Concentration of wholesaling. The wholesale trade in Europe is becoming more concentrated. The consolidation of the wholesale trade is partly due to the emphasis on shorter chains between producers and retailers and the growing dominance of supermarket chains in cut flower sales. As the most recent EU market report by the Centre for the Promotion of Imports from Developing Countries (2005, 86) notes, the "fastest growing companies are the ones working with supermarkets". Their role in linking cut flower producers with supermarkets has also led to wholesalers taking on greater functions including the monitoring of quality and coordinating supply logistics. The changing role of wholesalers reflects a significant change in the value chain for cut flowers that are partly driven by the growing importance of supermarkets in the industry.

Role of supermarkets. Although cut flower sales in Europe and North America continue to be sold mainly through florists and other independent retail outlets, the role of supermarkets is growing rapidly. In the United Kingdom, as noted earlier, supermarket multiples now dominate the sale of flowers. In other European markets the volume of flowers sold through supermarkets is considerably less, but it is increasing rapidly at the expense of independent florists. Supermarkets usually source flowers through dedicated importers rather than through the auction system. As is more broadly the case with fresh fruit and vegetables (Dolan and Humphrey, 2004), supermarket sourcing practices have reshaped the supply chain and have created new demands on primary producers. While a recent CBI (2007) report suggests that supermarkets have gone some way to improving the quality of flowers they offer, the highest quality flowers in the European market are still sold through the auctions.

Vertical integration. Increased competition in the cut flower trade has encouraged producer country firms to establish a presence in consumer markets. In Miami, for example, many of the importers have been established by very large cut flower firms based in Colombia and Ecuador (Tips/AusAid, 2005; Korovkin, 2005). Flamingo Flowers is an example of a company that started as an exporter in Kenya (Homegrown) and then expanded its business to the United Kingdom in order to manage and market its flowers. The company currently markets cut flowers in the UK sourced from its own farms in Kenya and South Africa. Importers in consuming countries have also become involved in primary production and in some cases have made investments in cut flower farms or export companies. Dole Flowers is not only vertically integrated into the production and sales of cut flowers, it also leases airplanes to transport flowers from its farms in Colombia and Ecuador to its warehouses in the United States. The vertical integration of cut flower production, transport and sales is a significant development in the cut flower value chain.

New market demands associated with environmental and social requirements. The labour intensive nature of flower production and its impact on the environment through chemical inputs has attracted the attention of non-governmental organisations and consumer groups. Consumers are particularly concerned that flowers that are purchased for gifts are produced in a sustainable way: "who wants to be seen giving an item that is suspected of being unhealthy or not environmentally friendly?" (ILO, 2000, 1). The range of environmental and social certification systems is very wide indeed. Many of the environmental and social standards are set by private agents including GlobalGAP (formerly EurepGAP) and the MPS (Milieu Programma Siersteelt) environmental standard. Individual supermarket chains are also involved in setting their own production and environmental standards. Non-governmental organisations have been very active in attempting to improve conditions for farm workers on flower farms, especially in Colombia and Ecuador. In the United Kingdom, NGOs have exposed the "human costs" of cut flowers supplied to large supermarket chains in an effort to make

companies accountable for the conditions under which flowers are produced (Morser and McRae, 2007).

The growing role of supermarkets in cut flower sales seems to suggest that the value chain is becoming buyer-driven. Supermarkets are restructuring the flower chain much in the way they did for fruit and vegetable exports from developing countries. There is greater emphasis on quality and variety, there are more demands on meeting various codes of practice including traceability, and functions previously performed by supermarkets are being passed down to suppliers and primary producers. The shift from "market-driven" to "buyer-driven" in Europe is, however, uneven as is its impact on developing country suppliers. While cut flower sales in the United Kingdom are dominated by supermarkets, in other European countries the situation is changing more slowly and it is likely that florists and garden centres will continue to sell more flowers than supermarkets for some time. The same is true of the Dutch auction system: although direct supplies to supermarkets represent a challenge to the auction system, it seems unlikely that direct supply to supermarkets will replace auctions. For cut flower suppliers, especially those based in Africa, the implications of these changes are important. The lesson from the fresh fruit and vegetable sector is that those suppliers who are large enough and well resourced enough to meet the demands of supermarkets

will supply this channel, but smaller and less resourced cut flower exporters will continue to use the less demanding auction system. The disadvantage for smaller exporters is that the auction system is becoming more competitive with greater pressure on prices. Larger cut flower exporters supplying supermarkets, as we have seen, may not be significantly better off given the demands, buying practices and the functions that are passed down the chain.

Tallontire *et al* (2005) suggest that the difference between the supermarket and the Dutch auction supply chains shapes production practices and by implication the conditions for farm workers. They argue that the "absence of dedicated customers dictating the terms of the trading relationship gives flower producers greater latitude to establish employment strategies that match production conditions (e.g. the annualisation of production), while simultaneously maintaining their competitiveness". In other words, the Dutch auction system allows cut flower suppliers the leeway to provide relatively better conditions for workers on cut flower farms. In contrast, the demands made by supermarkets means that cut flower exporters are more likely to rely on casual or temporary labour. Tallontire *et al*'s (2005) argument underlines the insights that may be gained from a value chain analysis in that it provides a way of linking buying practices to employment conditions.

4.4. Tariffs

In stark contrast to the tariff regimes in both sugar and bananas, the trade in cut flowers is not heavily influenced by tariffs. Most developing country exports to Europe fall under the "Everything But Arms" initiative for least developed countries. In the United States, cut flower exporters from Latin America have faced tariffs in the past but now enjoy duty-free access to this market through the Andean Trade Preferences Act. Although most Latin American cut flower exports are sold in the United States, they also have access to the EU market through the GSP+ protocol. Similarly, African exports are mostly sold in Europe, but they have preferential access to the US through the African Growth and Opportunity

Act (AGOA). South Africa is an exception within the ACP group as it has a bi-lateral agreement with the EU, which imposes a 4 percent tariff on its flower exports. The Dubai Flower Centre (DFC) is a duty-free zone and therefore there are no tariffs for flower exporters. Exports to other countries in the Middle East will, however, carry a 5 percent tariff.

The absence of tariffs for cut flower exports is one of the reasons why the industry has developed so successfully in developing world countries like Kenya, Colombia and Ecuador. Yet current trade negotiations associated with the EPA process pose a very real threat to flower exporting countries that are not classified

as LDCs. If EPA process is not successfully negotiated by the end of 2007, Kenya will face the prospect of having to export its flowers under the EU GSP arrangement, which has a tariff of 5 percent on imports. Given the very tight profit margins in cut flower exports, this tariff could be very costly to the industry. It would also allow cut flower competitors like Ecuador, which has duty-free access to the EU through the GSP+ agreement, to begin to take market share from Kenya. One of the possible outcomes is the shift of cut flower production from Kenya to LDC countries like Zambia, Tanzania and Ethiopia, which have preferential and duty free access to the EU through the EBA.

This scenario is similar to what has occurred in

the region's sugar sector, with sugar processors making very large investments in LDCs.

While cut flower exporters are not (yet) affected by tariffs, they are faced with a daunting range of non-tariff barriers which can provide a serious obstacle to trade, particularly if they lead to shipment delays for this highly perishable commodity. In addition to formal requirements associated with phytosanitary regulations, producers are increasingly encouraged to meet a set of social and environmental codes. Since the range of regulations and standards is wide, this issue is discussed in more detail in the following section.

4.5. Non-tariff Barriers and Codes of Conduct

Cut flower exporters face a bewildering range of grades and standards related to plant health control, breeders' rights, quality standards, and environmental and social issues. A hallmark of the new standards regime is the involvement of both public entities and private agencies in standard setting.

Phytosanitary regulations protect importing countries from pests and plant diseases that can be transmitted via plant exports. Exports of cut flowers to European countries are regulated through Directive 2000/29/EC, which identifies a range of pests and plant diseases that are to be controlled. Exporters to the EU require a phytosanitary certificate, which certifies that the plant material conforms to the EU's Directive. The intensity of inspection is increasing, particularly for exporting countries where there is a perceived problem in terms of weak inspection procedures for plant diseases and pests (Tips/AusAID, 2005). In addition, of the total interceptions for horticultural products, over 60 percent were for cut flowers (PricewaterhouseCoopers, 2006). The availability of an effective plant protection service is especially important in the cut flower trade as delays due to extended inspections can affect the quality of the product (Wijnands, 2005). In Kenya there is no local agent accredited to issue phytosanitary certificates: the country's Plant Inspectorate Service is only permitted to accredit fruit and vegetables. Kenyan cut

flower exports must be inspected both prior to leaving Nairobi airport and on entry to Europe, which is costly both in terms of time and money (PricewaterhouseCoopers, 2007).

The development of new plant varieties is very important in a market that is increasingly becoming oversupplied. In order to compensate the research and development costs that are required to develop new plant varieties, there are various regulations that protect intellectual property rights. The International Union for the Protection of New Plant Varieties (UPOV) protects plant breeders for a period of 25 years, who then usually recoup the development costs through a licensing system. The agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) is encouraging Members of the WTO to introduce frameworks to protect the intellectual property rights of breeders.

In addition to these formal regulations, cut flower exporters are subject to a wide range of production codes that can be usefully divided into four categories: company codes, northern trade association codes, southern producer codes, and independent codes. Company codes are those implemented by individual supermarkets and retailers. The origin of these codes, especially in the case of UK supermarkets, is the pressure they have faced in terms of defending themselves from claims for food safety violations as well as

environmental and ethical considerations. Most large supermarket chains introduced their own "ethical", "responsible" and "sound" sourcing codes in the 1990s.

GlobalGAP (formerly EurepGAP) is an example of a northern trade association code. The code was established in the late 1990s as a standard for fruit, vegetable and flower suppliers of the largest supermarket chains in Europe. From 2003 all suppliers to supermarkets that are members of the EurepGAP consortium had to have met the good agricultural practice regulations of the code. While the emphasis of the code is on environmental and food safety issues, the code does include worker welfare and safety concerns. The Milieu Programma Sierteelt (MPS) is one of the earliest codes for cut flower exporters and it remains the most important code for flowers sold through the Dutch auction system. The code emphasises the importance of environmentally sustainable production by focusing on pesticide use, recycling practices, and energy and water use. Although the code has focused on environmental issues, as is the case with many other codes it now includes guidelines for labour and social conditions.

Producer countries have also established their own set of codes, partly in an effort to reduce the number of compliance certificates required by exporters, but also as a way of providing a brand image. African exporters like Kenya and Zambia have their own codes. In Kenya, the Kenyan Flower Council established its own code in early 1990s. The code has two standards: the silver standard meets ILO conventions, Kenyan labour laws, and the country's environmental regulations. Meeting the KFC's gold standard demands adherence to a stricter set of environmental regulations. The major Latin American countries have also established their own codes for cut flower exporters. In

Colombia, the cut flower producers' association (Asocolflores) has introduced the Flor Verde code (literally "green flower"), which requires that growers and exporters meet a range of environmental and social goals including professional training, welfare, human resource management and control of emissions (Winjgard, 2005). Ecuador's cut flower exporter association has introduced a similar code for its members (Korovkin and Sanmiguel-Valderrama, 2007).

While the quality standards implemented by private and public agencies are focused on production methods and good agricultural practices, independent codes are usually implemented by non-governmental organisations (NGOs) and they emphasise the social conditions under which cut flowers are produced. The International Code of Conduct (ICC) for cut flowers was established by the International Union of Food Workers and a range of European-based NGOs in the late 1990s. The ICC code emphasises fair treatment of workers including the right to freedom of association as well as adequate wages, good living conditions, and normal working hours. In addition, the code prohibits child and forced labour. The ICC code is implemented and monitored through a range of stakeholders including workers, unions and growers associations. In Switzerland, the ICC has been embraced by the Migros supermarket chain, which was involved in verifying that producers in various cut flower exporting countries were meeting the code. In the case of Zimbabwe, the company agreed to pay an additional 5 cents per stem, a cost that was not passed on to consumers. The company hoped to make up the difference through larger sales volumes of ICC accredited cut flowers (ILRF, 2003). In 2001 the ICC code was recognised by the Max Havelaar Foundation, which then allowed certified exporters to use benefit from a fair trade label.

4.6. Codes and Cut Flower Farm Workers

The majority of the codes of conduct for cut flower operations were introduced in the early 1990s. By the late 1990s and early 2000s, a number of research papers were published focusing on the effectiveness of the codes in

improving the working conditions of men and women involved in the cut flower sector. The research was prompted by ongoing reports of poor working conditions in the cut flower export sector and by the perceived need to assess the

effectiveness of the codes in addressing the social and environmental problems associated with cut flower exports. Improving the auditing process and the way the codes are governed were two important outcomes of this process.

For several reasons, Kenya has provided an important "laboratory" for assessing the impact of codes. First, Kenya has been proactive in establishing its own producer code through the Kenya Flower Council. In other words, the country has a long history of developing and implementing codes for cut flower exporters. Second, Kenya's flower sector has over the years shifted its focus from the Dutch auction system to the direct supply of supermarkets in the United Kingdom. This shift has exposed Kenyan growers to a far greater range of codes; it has also led to greater scrutiny of the working conditions on cut flower farms. Finally, the Kenyan sector was one of the pilot programmes for the Ethical Trade Initiative, which was a multi-stakeholder programme to improve working conditions in the country's cut flower sector. The discussion here draws primarily on the Kenyan experience, but where possible the experience of other African and Latin American countries is also used.

Although much of the research on the impact of codes of conduct has stressed the limited impact that they have had on working conditions in the sector, there are several positive developments. The companies interviewed by Dolan *et al* (2002) in Kenya in 2002 reported that the codes had led to them becoming aware of a range of issues including: their legal and social obligation to workers, a better understanding of both local and international legal requirements and an awareness of sensitive employment issues, especially those associated with women workers. In addition to this, employers understood the necessity of meeting these codes of conduct in order to compete in European markets. An unexpected positive development was that several cut flower producers "equated worker welfare directly with productivity of the company" (Dolan *et al*, 2002, 26; also see Collison, 2001). Finally, there were benefits in terms of improving managerial practices, which in turn

assisted flower enterprises in becoming more efficient and economically sustainable.

Despite these positive developments, a key concern is the ongoing reporting of code violations in the cut flower export sector of developing countries like Kenya, Ecuador and Colombia (Dolan and Opendo, 2005). The literature on codes of conduct in the flower sector suggests that there are four reasons why the various codes have not had their desired effect. First, the codes are often highly technical and focused on the environmental aspects of production rather than the social conditions under which flowers are produced. For Hale and Opendo (2005), this is because the codes themselves were, initially at least, a response to the concerns by consumers for their own health and safety. When the codes do include broader social issues such as worker welfare, they are implemented selectively so that the emphasis remains on the technical and environmental aspects of production. There are codes that have a stronger focus on worker welfare, but these tend to focus on permanently employed workers. Workers employed on a temporary or casual basis are often ignored by the codes, despite the fact that they are the most vulnerable groups in the cut flower labour force. The research on the Kenyan cut flower sector has also played a crucial role in revealing the gender bias of the codes. While some codes cover gender discrimination and inequality, "very few codes extend beyond working conditions to work-related issues such as the provision of housing, childcare, reproductive rights, parental leave, and transport" (Tallontire *et al* 2005, 564). Given that a high proportion of the workforce on cut flowers is female, the gender bias of codes goes some way to explaining why they have not played a more positive role in improving working conditions on cut flower farms.

A second problem with the codes is that with regard to working conditions, they frequently rely on national labour legislation. In countries like Kenya the legislation for workers is weak, which renders the codes ineffective in improving working conditions on flower farms. In most of the surveys of Kenyan cut flower farms, the results show that progressive exporters meet

or exceed the codes of conduct as they are based on national labour legislation. Where the labour legislation is progressive, as it is in the case of countries like South Africa, there are problems in terms of enforcement. In countries like Colombia the labour legislation is not only weak, it has created the space for cut flower employers to hire more workers on a temporary or casual basis (Kovorkin, 2007). The reliance of codes on local labour laws is not always an effective way of improving conditions on cut flower farms.

A third problem is related to the auditing process itself. Writing on the basis of their research in Kenya, Dolan and Oundo (2005, 88) raise "questions about the capacity of conventional auditing procedures to detect workplace violations and breaches of codes of conduct". Auditing procedures frequently employ a "checklist" approach, which may involve interviews with workers, but rarely allows for any in-depth exploration of working conditions (cf. Du Toit, 2002). The checklist approach is also not effective in revealing sensitive problems such as sexual harassment, gender discrimination and unfair labour practices (Dolan *et al*, 2002). As Dolan *et al* (2002, 53) argue "many of these issues are often deeply embedded in social norms, practices, and institutions, and are therefore not easily picked up by 'parachuting' monitors who make snapshot assessments" (also see Hughes 2001b).

A fourth problem is related to the different codes for cut flower exporters. In countries like Kenya, local producer codes were introduced in order to simplify the situation for both producers and importers/consumers. To this end, the Kenya Flower Council codes were designed so that they were in line with GlobalGAP and other important northern trade association codes. From the perspective of Kenyan cut flower exporters the alignment between different codes could also hopefully make it possible for producers to avoid having to meet multiple codes. In Colombia and Ecuador the relationship between southern and northern codes is not as positive. In both of these countries the producer codes emphasise industry productivity and profitability rather than worker welfare. More importantly, these codes are presented

as the only code for cut flower exports and are used by the industry to deflect efforts to introduce more progressive codes of conduct. While the producer codes in Kenya seem to work hand-in-hand with northern producer codes, in Colombia and Ecuador - where there is considerable hostility to codes of conduct - producer organisations have introduced their own codes as a way of shielding themselves from more progressive systems aimed at improving working conditions.

A final problem is the relationship between codes of conduct and the buying practices of northern supermarkets. As Hughes (2001a) has pointed out, the codes "almost always ignore the terms of trade between producers and buyers". Research on working conditions suggests that the terms of trade - and especially lead firm buying practices - accounts for many of the problems faced by workers including long working hours, health and safety problems, the shift to a casual workforce, and the intensification of work. In contrast, when the terms of trade are characterised by lower levels of "buyer-drivenness", as is the case with the Dutch auctions, cut flower exporters have the leeway to provide more progressive and acceptable working conditions. It is somewhat ironic that supermarket supply chains, which have strict requirements on code compliance, are characterised by buying practices that place pressure on employers to intensify working conditions and employ more casual and temporary workers.

The various problems with existing codes of conduct have led to important initiatives to improve the operation of the codes and the auditing procedures. Two prominent solutions are participatory social auditing and multi-stakeholder approaches. Participatory social auditing has been proposed as a way of overcoming the problems inherent with overly technical approaches to auditing. This approach to auditing goes beyond the "checklist" method and involves a range of information gathering techniques that may not be revealed in a snapshot audit. Proponents of participatory social auditing recommend the use of semi-structured interviews, focus group discussions, participant observation and group exercises as

a way of ensuring that the voices of marginal groups are heard. Other advantages of the method are that it is flexible, it can be adapted to different contexts, and it has the potential for awareness building that may lead to long term changes in the conditions of workers on cut flower farms.

For participatory social auditing to be an effective method for change it requires the participation of all stakeholders involved in the value chain including consumers, retailers, producers, farm workers, unions and civil society groups. A multi-stakeholder approach

code implementation, combined with participatory social auditing, is viewed as another way of addressing some of the problems associated with codes of conduct in the cut flower sector. The best example of a multi-stakeholder organisation is Kenya's Horticultural Ethical Business Initiative (HEBI), which has the support of government, civil society and cut flower producers. Despite problems in terms of managing the different interests in the stakeholder group, HEBI is committed to addressing the ongoing employment problems in Kenya's cut flower industry (Dolan *et al*, 2002).

4.7. Recommendations

Bring worker welfare issues into the mainstream of all codes of conduct. One of the problems with the codes that have been implemented, with perhaps the exception of the Ethical Trading Initiative (ETI), is that they are strong on environmental regulations but relatively weak in terms of the provisions for working conditions. An example is the Ethiopian Code of Practice on Sustainable Flower Cultivation. The code of practice was developed by the country's horticultural producers association and is a response to the demand by Ethiopia's rapidly growing cut flower sector for guidelines on corporate social responsibility. While the code does make some reference to labour and the social conditions of workers, the emphasis is on competitiveness, market trends, quality and logistics. NGOs and other interested stakeholders should pressure all agents in the flower chain to ensure that producer codes of practice include social and worker welfare issues.

Continue to refine multi-stakeholder approaches to codes of conduct. Codes of practice were introduced in the early 1990s and have undergone a period of considerable change and development. There seems to be consensus on the benefits of multi-stakeholder approaches. In terms of participatory social auditing, it is unclear to what extent these have replaced the "snapshot" auditing process of the past. Nonetheless, the multi-stakeholder approach provides a forum for beginning to explore new methods of auditing. Further developments in

the content and auditing of codes of conduct may assist in building on what has already been achieved through multi-stakeholder approaches.

Pressure through trade agreements. The cut flower sector emerged in the developing world thanks partly to the trade preferences offered to Latin American and African producers. In Latin America, cut flower exporters benefited from the Andean Trade Preferences Act (ATPA) while exporters from Africa were able to export duty free to the European Union through the Cotonou agreement. Both trade preference systems contain provisions for worker rights. The ATPA system requires exporting countries to "take steps to afford internationally organized worker rights" (cited in US-LEAP, 2007). Similarly, under the Cotonou agreement members commit themselves to internationally recognised core labour standards. There is a further provision for the exchange of information on labour legislation and education and awareness raising programmes. In the United States, NGOs, politicians and unions have submitted petitions to the US trade representative to review the ATPA status of Colombia and Ecuador based on their findings of worker abuse and rights violations. Their efforts have not led to trade bans, but have instead resulted in Ecuador's status being placed "under review" since 2003. Although the impact of placing Ecuador under review remains to be explored, this is potentially one (somewhat blunt) lever to improve working conditions on cut flower farms.

4.8. Conclusion

The growth of cut flower exporters from developing countries has been a significant development in the global trade of horticultural products. The rise of developing country exporters has been facilitated by low tariffs, improved communications and logistics, and lower labour costs. ACP countries, but most notably Kenya, are important players in the global cut flower trade.

The role of supermarkets in flower sales represents the most significant change in the cut flower value chain. The role of supermarkets in the flower chain varies within Europe and between Europe and other importing regions. Supermarket sourcing strategies are, nonetheless, playing a far more important role in most cut flower markets. Value chain analysis has provided insights into the relationship between the organisation of chains and their impact on working conditions

and wages. Research suggests that supermarket chains, which are characterised by high levels of "buyer-driveness", may be associated with more difficult conditions for farm workers. The organisation of non-supermarket cut flower chains (e.g. auctions), on the other hand, seems to provide employers with the space to offer better working conditions. More research is needed to confirm the strength of the relationship between chain organisation and working conditions.

Codes of conduct have proliferated in the cut flower industry. Company codes of conduct are common and several producing countries have introduced multi-stakeholder forums to improve working conditions and the environmental impact of cut flower production. The Kenyan experience provides important lessons for other multi-stakeholder initiatives.

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5. SUSTAINABILITY, VALUE CHAINS AND MULTI-STAKEHOLDER APPROACHES IN THE PALM OIL SECTOR

5.1. Introduction

Indonesia and Malaysia dominate the production and trade in palm oil products. Increases in production from these two countries have led to palm oil becoming the world's most important edible oil product. The commodity has a wide range of uses in food manufacturing, feed production, cosmetics and the chemical sector. The growth in demand for palm oil is due to its lower price relative to other vegetable oils, its versatility as an ingredient and its status as a healthier product. Increases in the volume of palm oil production in the last decade have consistently exceeded industry forecasts.

A key issue in palm oil industry is the global concern for the environmental and social impact of palm oil plantations and processing facilities in South East Asia. In the last decade, non-governmental organisations have actively campaigned against palm oil producers by highlighting the impact of their activities on fragile ecosystems and indigenous communities (Wakker, 1998; Glastra *et al*, 2002; Milieodefensie, 2007). NGOs have encouraged retailers and financial institutions to press for more sustainable palm oil production (Friends of the Earth, 2004a). They have also targeted consumers in the north by linking their consumption of palm oil products to the destruction of tropical rainforests and the habitats of endangered species like the orangutan, the Sumatran tiger and the Asian elephant (Friends of the Earth, 2005). The problem for NGOs is that, unlike other finished export commodities, palm oil is an ingredient in food products, cosmetics, soaps and detergents. The use of palm oil as an ingredient has made it more difficult for NGOs and other stakeholders to encourage consumers to exercise their choice by purchasing a sustainably produced palm oil product.

Despite this challenge, NGOs have succeeded in encouraging numerous private sector organisations to establish codes of conduct for sourcing palm oil. In the case of financial institutions, codes

have been developed to ensure that investments are made in plantations and processing facilities that meet the goals of sustainability (van Gelder and Wakker, 2006). Most recently the industry has established a multi-stakeholder group that is actively involved in creating mechanisms for a sustainable palm oil industry. As is the case with other multi-stakeholder groups, the organisation faces the problem of having to negotiate the different interests of NGOs, retailers, consumers, plantation owners, processors, refiners, smallholders and indigenous communities. This multi-stakeholder group faces an additional problem that is specific to the palm oil value chain. The structure of the chain makes it very difficult to trace palm oil from a plantation to a biscuit, a bar of soap or lipstick (Glastra *et al*, 2002, p. 31). Since consumer choice is fundamental to the process of mobilising pressure on the industry, a key challenge for this multi-stakeholder group involves establishing a credible mechanism for tracing sustainably produced palm through the value chain.

The first section of this chapter examines the production and export of palm oil. While there are developments in the palm oil sector outside of South East Asia it seems unlikely that the dominant position of Malaysia and Indonesia in production and exports will change in the near future. Papua New Guinea is the third most important exporter, but this ACP country only contributes slightly more than one percent of total world exports. The second section describes the value chain, the different uses of palm oil, and recent changes in the structure of the chain. This section stresses the complex structure of the chain, which makes it difficult to trace palm oil from a plantation to the consumer. The third section examines the codes of conduct within individual companies involved in the palm oil industry and the more recently established multi-stakeholder organisation that is pressing for a sustainable palm oil industry. This section argues that the complexity of the

value chain, and the commodity itself, raises significant challenges for multi-stakeholder groups in their efforts to promote sustainable

palm oil production. The recommendations focus on measures that might be taken to strengthen this multi-stakeholder group.

5.2. Global Production, Trade and Consumption

Malaysia and Indonesia produce over 85 percent of the world's palm oil. During the 1990s and the early 2000s Malaysia maintained the position of the world's largest producer and exporter. Indonesia's production has, however, grown more quickly during this period and by 2006 Indonesia had eclipsed Malaysia as the world's largest producer of palm oil (USDA, 2007). Other palm oil producing countries include Thailand, Brazil and Colombia, but their volumes are far less than for the largest two producers. Among ACP countries the largest producers are Nigeria, Papua New Guinea and Côte d'Ivoire (Table 5.1).

Increases in the volume of palm oil produced by Malaysia and Indonesia are a result of the massive expansion of production from the early 1990s. In Indonesia, the area of land under palm oil rose from 1.1 million hectares in 1990 to 3 million hectares in 2000 and 4.5 in 2008. During this period the average annual expansion of production was 190,000 hectares (Teoh, 2002). Indonesia's financial crisis in the late 1990s slowed the expansion of production significantly, but the rapid expansion has now resumed: according to one estimate 240,000 hectares were planted in 2002 alone (Wakker, 2005). Indonesia's Ministry

of Agriculture has set a total target of 9 million hectares of palm oil plantations (IIED, 2004). In Malaysia the area under palm oil plantations also increased dramatically during the decade of the 1990s: from 1.7 million hectares in 1990 to 4.1 million hectares in 2006 (IIED, 2004). Given the relatively higher costs of production in Malaysia, the expansion of plantations has slowed (Teoh, 2002). Malaysian companies are now involved in Indonesia where production costs are significantly lower; Malaysian companies are also exploring options for palm oil production in Africa and Latin America.

Amongst ACP countries production has grown significantly, but off a smaller base when compared to the dominant two producers. In Nigeria, total production was around 580,000 tonnes in 1990 and rose to 800,000 tonnes in 2005 while in Côte d'Ivoire production has remained relatively stable over the same period. Papua New Guinea's growth has also been notable: production has more than doubled between 1990 and 2005 (Table 5.1). While these figures are impressive, they have not challenged the dominant position of Indonesia and Malaysia in palm oil production.

Table 5.1: Palm Oil Production ('000 tonnes)

	1990	1995	2000	2005	2005 share
Malaysia	6,088	8,123	10,842	14,962	44%
Indonesia	2,413	4,220	7,050	14,070	42%
Nigeria	580	660	740	800	2%
Thailand	232	354	525	685	2%
Colombia	226	388	524	661	2%
Papua New Guinea	145	223	336	310	1%
Côte d'Ivoire	270	285	278	260	1%
Brazil	66	75	108	160	0%
Others	1,000	5,994	5,191	1,826	5%
World Total	11,020	20,322	25,594	33,733	100%

Source: Basiron (2007)

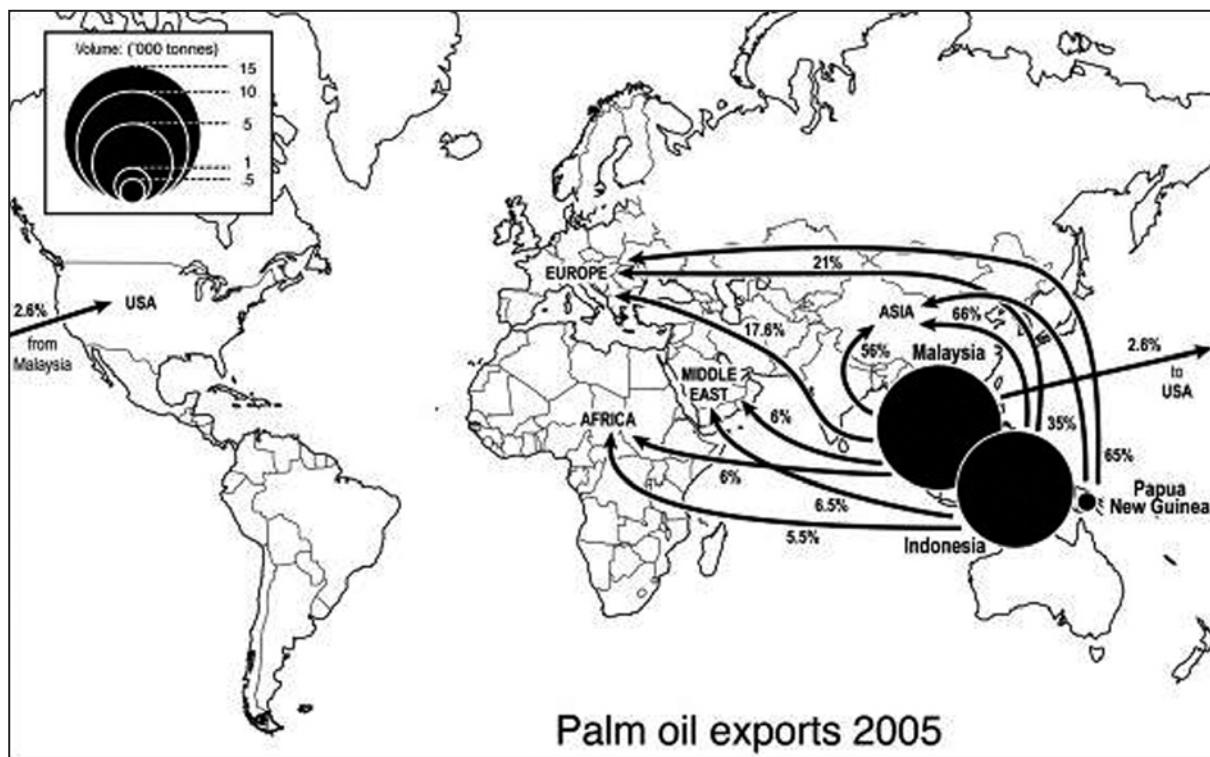
Table 5.2: Palm Oil Exports ('000 tonnes)

Exports	2003	2004	2005	2006
Malaysia	11,602	12,634	12,780	12,900
Indonesia	7,856	9,621	11,135	11,600
Papua New Guinea	347	362	360	360
Jordan	355	333	265	280
Colombia	188	222	213	225
Other	1,326	1,426	1,459	1,390

Source: USDA 2007

Exports of palm oil show a similar pattern (Table 5.2). The two largest producers - Malaysia and Indonesia - dominate the trade in palm oil with over 90 percent of global exports (Figure 5.1). While Malaysia has traditionally dominated the export trade it has seen its share of global exports decline from around 53 percent in 2003 to 48 percent in 2006. In contrast, Indonesia's share of global exports has increased from 36 to over 43 percent over the same period. The growth in world exports in the last five years is therefore largely due to increases in Indonesian production. Seventy percent of the total palm oil produced is exported onto the world market (IIED, 2004). There are several

other exporters including Papua New Guinea, Jordan and Colombia. Papua New Guinea is by far the most important ACP exporting country with 360,000 tonnes of exports; the next largest ACP exporter of palm oil is Ivory Coast, which exported 104,000 tonnes in 2007. As an ACP country, Papua New Guinea has preferential access to the EU market and there seems to be some interest from investors keen to take advantage of the country's preferential access to the EU (van Gelder 2002). Several other countries - including India, Brazil, Nigeria, Uganda and Suriname - have expressed the desire to either rehabilitate existing plantations or start palm oil production, usually in response

Figure 5.1: Palm Oil Exports

Source: Comtrade

to the opportunity for bio-fuels. Despite these new developments, the dominance of Indonesia and Malaysia in the palm oil sector is unlikely to be challenged in the near future.

The most important palm oil importing countries are China, the European Union, India, Pakistan and Bangladesh (Table 5.3). Imports to the United States and Egypt have increased rapidly in the last five years. Beyond these countries, trade is highly dispersed. Global consumption figures have increased rapidly, largely as a result of higher demand in developing countries and the replacement of animal fats in processed food and feeds with vegetable oils (IIED, 2004). The growth in palm oil production is occurring at a far faster rate than the broader edible oils complex. While palm oil production has increased at an average rate of 9.5 percent per year between the late 1990s and the mid-2000s, the average growth rate for edible oils was only 4 percent (Agritrade 2007). Since productivity gains have been limited, most of the increase in production has occurred through increases in production area and substitution with more labour consuming and hence relatively less profitable crops such as rubber.

Palm oil imports to the United States are expected to increase more quickly as a result of new food labelling legislation passed in 2006. The new law requires that food manufacturers list the amount of trans fat in food products.

However, the most common oil used by food manufacturers is partially hydrogenated soybean oil, which has high levels of trans fat. Palm oil has no trans fat and is regarded as viable alternative to soybean oil under the new labelling regime (Brown and Jacobsen, 2005). The major producing countries - Indonesia and Malaysia - are aggressively promoting the health benefits of palm oil relative to other oil seed products.²⁹

Prices for palm oil products are volatile given that the commodity is traded relatively freely on global markets. The substitutability of the different vegetable oils, and the new focus on bio-fuels, has added further volatility to the price of palm oil on world markets. The price of crude palm oil has ranged from USD 240 a tonne in 2001 to USD 780 in 2007. The most recent prices for palm oil have shown a rapid increase in response to its potential role in the production of bio-diesel.

Key points for global trade, production and consumption:

Dominance of Indonesia and Malaysia. The production of palm oil is dominated by Malaysia and Indonesia. Despite developments in tropical Africa and Latin America as well as in other countries in South East Asia, it seems very unlikely that their dominant position will be challenged any time soon. The rise of these two countries is relatively recent. In the 1960s several African countries played a very important role in the

Table 5.3: Palm Oil Imports ('000 tonnes)

Imports	2003	2004	2005	2006
China	3,710	4,363	4,975	4,900
EU-27	3371	4027	4124	4300
India	3,486	3,725	2,899	3,800
Pakistan	1,297	1,550	1,796	1,785
Bangladesh	528	757	847	900
Egypt	459	616	754	780
United States	281	345	600	630
Russian Federation	402	594	546	535
Turkey	336	439	462	510
Japan	450	492	494	500
Other	7,097	7,236	8,236	7,610

Source: USDA 2007

palm oil trade, but since then production and exports have declined dramatically. Most palm oil produced in Africa is for domestic consumption.

Competitive advantage of palm oil. Palm oil is one of several oil crops: the other main oil crops being soybean, rapeseed and sunflower. Palm oil production has a competitive advantage over these oil seeds in terms of production costs and yields. Indeed, palm oil requires ten times less land to produce the same volume of oil as soybeans (Teoh, 2002). The other advantage for palm oil producers is that they are not vulnerable to consumer concerns around genetically modified organisms, which is a potential problem for soybeans. In 2006, production of palm oil surpassed soybean oil production for the first time (USDA, 2007).

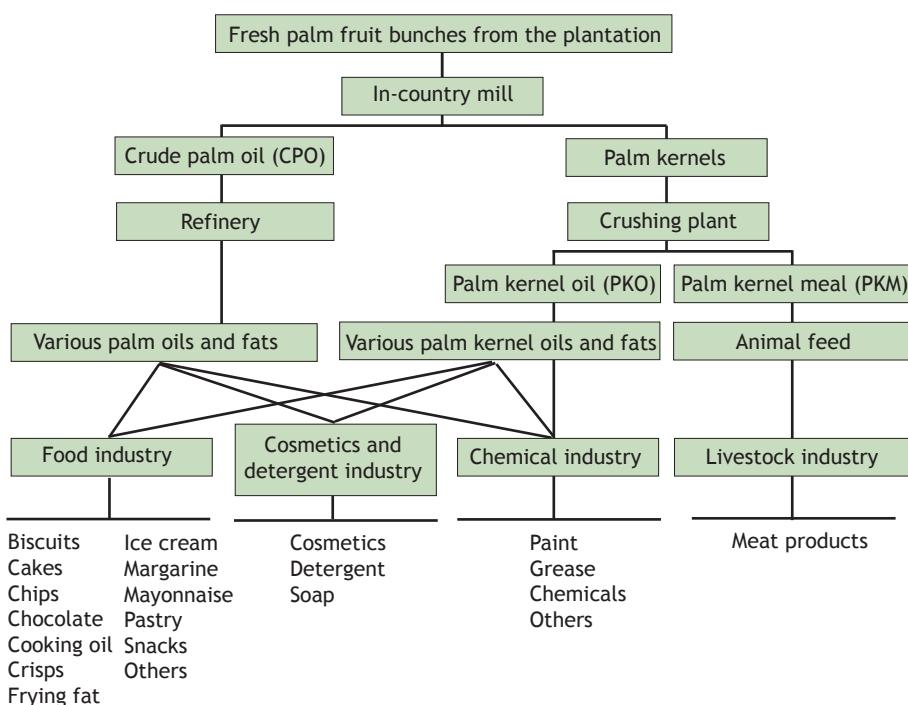
Palm oil demand. The competitive advantage of palm oil is predicted to lead to higher levels of world production. The demand is likely to be driven by its advantage over other oils in terms of its lack of trans fats, which is predicted to increase demand for palm oil in the United States and other developed markets.³⁰ In the developing world, the rapid transition from grain to fat in diet patterns, the demand for processed food products particularly in growing urban areas is predicted to play a role in driving world production higher. Finally, the potential for palm oil as the raw material for bio-diesel is also encouraging new investments in palm oil plantations. The increase in global palm oil production is likely to be an issue for a range of NGOs concerned about its environmental and social impact in tropical countries all the more so the crop is a perennial crop with long lasting potential effects.

5.3. The Global Value Chain for Palm Oil

The palm oil value chain is complex due to the range of conditions under which it is produced, the different stages of processing and refining, and the bulk transportation of different palm oil products (Figure 5.2).

Palm oil is produced by smallholder farmers and on very large industrial plantations of between 10,000 and 25,000 hectares. In Malaysia and Indonesia, the plantations have been established on state owned land and companies

Figure 5.2: Palm Oil Chain



Source: Friends of the Earth 2004a

are granted concessions to use the land for palm oil production.³¹ In Papua New Guinea, plantations have been established on land owned through a customary rights framework. Establishing palm oil production on this land requires consent from local communities. The amount of land under smallholder production in Malaysia and Indonesia varies considerably. While smallholders control up to one third of the land under oil palm in Indonesia, small-scale production in Malaysia accounts for only 11 percent of the area devoted to this commodity (Teoh, 2002). The total contribution of smallholders to palm oil production globally is estimated to be 20 percent; the remainder is produced on large-scale estates in South East Asia, South America and Africa (IIED, 2004).

Palm oil plantations and processing factories are usually located in close proximity as the fresh fruit bunches (FFBs) must be milled within 24 hours of being harvested. The milling companies are usually involved in the primary production of palm oil, and farming typically occurs on a large scale. Processing factories process palm oil produced by other large plantations and by groups of smallholders. It is estimated that at least 4,000 hectares of palm oil production is required to support a crude palm oil mill (Wakker, 2005).

Smallholder farmers who supply palm oil to the mills may do so independently or they may receive support from the milling companies in the form of credit guarantees, planting material, fertilisers and pesticides. As is the case in other contract farming relationships, these loans are paid back by deductions from crop price. In some countries, state support is provided for smallholder associations, as is the case of the Federal Land Development Authority (FELDA) in Malaysia (Fold, 2000b). FELDA was established in the mid-1950s with the aim of addressing the problem of rural poverty in Malaysia. The organisation is currently responsible for over 1 million hectares of palm oil and assists its smallholder members with access to finance and other support mechanisms. According to the Vermeulen and Goad (2006, 31), FELDA has "grown into a well-organized force in the Malaysia Palm Oil Industry, and in conjunction

with other supporting bodies is well positioned to influence the plantation sector to improve the adoption of best practice". Indonesia also provides support for smallholder palm oil producers through low interest loans and minimum prices. In Papua New Guinea the majority of smallholders are integrated into nucleus estates, which offer small scale farmers financial and extension support.

Palm oil seeds are milled to produce crude palm oil, palm kernel oil and palm kernel meal. Palm oil yields are very high: one hectare of palm oil produces between 2 and 7 tonnes of crude palm oil and a smaller volume of palm kernel oil, which is extracted from the kernels (Wakker, 2005). The crude palm oil must undergo a further stage of processing before it can be consumed. This second stage involves refining the crude palm oil, a process that extracts fatty acids, colour and other impurities. The refining process transforms the crude palm oil into Refined Bleached Deodorised Palm Oil (RBDPO), which is now ready to be used in food products. The final stage in processing involves fractionation of the refined palm oil to produce liquid palm olein and a solid product called palm stearin. The liquid fraction is used in baking and frying while the solid fraction of refined palm oil is often used in the manufacture of margarine (Teoh, 2002).

The kernels of the palm oil seed are crushed to produce palm kernel oil and palm kernel meal. Palm kernel oil is used in various non-food consumer items including soaps, detergents and lubricants. The main use of palm kernel meal is in protein rich animal feeds.

The refining of crude oil can take place in the country where the palm oil is produced or it can be shipped in tankers to another destination. In some cases, individual companies are responsible for primary production, crude oil milling and refining. In other cases refiners are independent companies based in Malaysia, Indonesia or in other countries where there is a large demand for refined palm oil (e.g. the Netherlands, China, India). Malaysia has greater capacity for refining crude palm oil (CPO), while Indonesia tends to export most of its production as CPO (IIED, 2004). The difference between the

two countries is largely as a consequence of the Malaysian government's emphasis on producing finished palm oil products (Fold, 2000a). While crude palm oil exports carry a 10 percent export tariff, there is no tariff on refined palm oil products. State encouragement of downstream processing through incentives and taxation systems in Malaysia has led to the establishment of 46 refining facilities with the capacity to process 16 million tonnes of crude palm oil a year (Vermeulen and Goad, 2006).³² The financial crisis affecting Indonesia may have placed a brake on efforts to establish the infrastructure for refining and further processing.

The mills that extract crude palm oil from the fresh fruit bunches often source the fruit from several plantations and from many smallholders (IIED, 2004). When the crude palm oil is transported from mill to refinery, it may be combined with oil produced by other mills. The complexity of the production chain makes it difficult to trace palm oil products back to source, which has become an issue for environmental NGOs pressing for sustainable palm oil production.

The number of plantations, processing facilities and refineries in Indonesia and Malaysia is very large indeed. Yet the ownership pattern is relatively concentrated with several business groups controlling most production and palm oil processing and refining (Wakker, 2005). An important development in the last decade has been investments by Malaysian palm oil companies in refining facilities in the European Union, India and China. These investments are allowing Malaysian based companies to manage the entire value chain, from production through to final processing.

Investments by palm oil companies are not restricted to refining and further processing. Malaysian and Indonesian companies are investing in other parts of the world in order to boost their primary production. It was recently reported that the Indonesian government was exploring opportunities for investing in palm oil production in Tanzania, a country that has similar ecological conditions to Indonesia (Africa News Network, 8 May 2007). Malaysian companies are

involved in primary production in the Democratic Republic of the Congo, Venezuela and Suriname. Large importing countries like China are also exploring opportunities in Africa to source palm oil directly and thereby reduce their dependence on Malaysia and Indonesia. Joint ventures between European or North American palm oil consumers and primary producers in tropical Africa, Latin America and South East Asia have been a feature of the industry for some time. Cargill's first investments in primary production were in Indonesia in the mid-1990s and the company has since then expanded into Papua New Guinea and Borneo. In total, it controls 56,000 hectares of land dedicated to palm oil production in South East Asia. The growth of the bio-fuels sector is spurring investments in primary production in Africa and in Latin America (Friends of the Earth, 2006).

The evidence seems to suggest that the production, processing and refining of palm oil are becoming more concentrated and that large players are becoming involved in various stages of the chain and in different producing and consuming markets. When it comes to the bulk trade of palm oil, the chain is far more fragmented; it is possible to identify four types of traders (van Gelder, 2004). First, there are European trading subsidiaries of Malaysian and Indonesian companies. Second is a group of trading companies associated with large palm oil refiners such as Cargill and Archer Daniels Midland (ADM). These companies will source from their own plantations and from other producers. Third, the major European food, chemical and cosmetics manufacturers (e.g. Unilever) have their own trading companies. These companies source directly from plantations or on spot markets in Europe. Finally there is a large group of small independent traders and brokers who sell to European refineries that have not developed a trading function (van Gelder, 2004).

Most palm oil processing companies have a lower profile than the end users of palm oil products. In the food sector the most important consumers of palm oil are brand name manufacturers of processed items such as ice cream, biscuits, snacks and cereals. These companies are well-known to consumers as their products are

heavily advertised and include prominent brand names such as Cadbury Schweppes, Kellogs, Danone, Kraft and McCains (Teoh, 2002). Palm oil is also used in non-food products including detergents, soaps, shampoo and cosmetics. As is the case with food products, these users are branded companies like the Body Shop, Unilever and Marks & Spencer.

Key points on the palm oil value chain:

Palm oil and traceability. The structure of the palm oil value chain makes it very difficult to achieve traceability from plantation to final consumer. Production is in the hands of a large number of plantations and hundreds of thousands of smallholder farmers. Processing mills often source from their own plantations and from both independent and company supported smallholders. Crude palm oil exports are transported in bulk containers due to the high costs involved and the need to maintain the quality of the product. These containers usually source from many different palm oil mills. Refineries also source from a range of suppliers, which makes traceability extremely difficult. Even large integrated companies like Unilever source from their own plantations, from other producers and from spot markets in Europe. The challenge of traceability, which seems central to the development of a sustainable palm oil industry, is considerable.

Vertical integration. Palm oil producers, refiners and other enterprises involved in the palm oil sector are investing both upstream and downstream in the palm oil value chain. There are three types of investments: first, companies are investing in primary production as a way of securing access to new sources of palm oil. Investments by Malaysian companies in South East Asia (especially Indonesia), Latin America and Africa are in response to the relatively higher costs of production and labour shortages in Malaysia.³³ The Malaysian government has shown its support of such endeavours by decreasing duties for imported crude palm oil and by continuing to limit duties on refined palm oil exports. Second, palm oil manufacturers in countries like Malaysia are investing in refining facilities in their key markets, notably the European Union, India and China. Third, North

American and European based refiners and bio-fuel producers have invested in primary production in Indonesia and other parts of the tropical world where palm oil production is possible. An important question is whether these investments are leading to a less complex chain structure, which might facilitate traceability for some companies that are vertically integrated through the production chain.

Branded companies. A notable feature of palm oil is that although producers, millers, refiners and traders are largely anonymous to consumers, the companies that sell food and cosmetic products are highly visible branded companies. Branded companies are more vulnerable to NGO campaigns that reveal unethical sourcing practices. In the case of both German and UK companies, the problem is that many companies seem to have little knowledge of the source of the palm oil used in the manufacturing of food, cosmetics and detergents (van Gelder, 2004; Wakker, 2005). Large palm oil producers and processors based in South East Asia are increasingly becoming the target of NGO reports. The situation is, however, changing with large integrated palm producers also now becoming the target of NGOs. Most recently, the world's largest trader of palm oil (Wilmar) was accused of illegally logging and burning forests and violating the rights of indigenous communities (Milieudefensie, 2007). Wilmar (2007) responded immediately to the report by denying all the allegations and outlining its commitment to corporate social responsibility in palm oil production.

Chain governance. The palm oil value chain is producer driven. The dominance of Malaysia and Indonesia in the production of palm oil has allowed these suppliers to exercise some control over global markets (Wakker, 2005). With many of these companies becoming vertically integrated they have the potential of further shaping the market for palm oil products. Yet as is the case in many other agri-food chains, the growing role of end-users is beginning to be felt in the palm oil chain. Concerns over the environmental effects of palm oil production, and over the welfare of smallholders and indigenous land owners, has prompted a range of new initiatives with the goal

of encouraging sustainable palm oil production (Down to Earth 2007). The development of codes of conduct by the private sector and through

multi-stakeholder initiatives is explored in more detail in the next section.

5.4. Towards Sustainable Palm Oil Production: Company Codes and Multi-stakeholder Groups

The environmental, ecological and social impact of oil palm production and expansion in South East Asia has been a concern for NGOs, the private sector and other stakeholders for over a decade (Miliedefensie, 2007). One of the first reports on the environmental and social impact of palm oil production was produced by the World Wide Fund for Nature in 1998 (Wakker, 1998). The report highlighted the relationship between the consumption of oil palm products in Germany and deforestation and environmental degradation in Indonesia. Its title - "lipstick traces in the forest" - drew attention to the way in which German consumers were implicitly involved in the environmental and social crisis brought on by oil production and expansion in Indonesia. The report called on German companies to reveal their sources of palm and to develop responsible sourcing strategies as a way of encouraging sustainable land use in palm production. For consumers the message was clear: they could not "evade their responsibility for protecting the Indonesian forest" (Wakker, 1998, 2).

The German WWF report revealed the multiple impacts of palm oil production including the destruction of the rainforests, which was reducing the habitat of endangered species including the orang-utan, the Sumatran tiger and the Asian elephant. Clearing land for oil palm plantations through burning leads to multiple environmental problems including the release of greenhouse gasses and the spread of fires to other forests not designated for palm oil production (Wakker, 1998).

Since the late 1990s, many of the companies involved in the palm oil sector have released codes of conduct for palm oil sourcing. Unilever is a major producer and importer of palm oil products and has had a code for sustainable palm oil since 1998. The code includes measures to ensure the sustainability of its own plantations

and its suppliers while it "works to improve quality and sustainability" (Unilever, 2003).

Other companies that have introduced codes of practice for the sourcing of palm oil include Nestlé, Migros, and the Boots cosmetics chain. The Body Shop's response was dramatic: the company declared that it was shifting its source of palm oil from South East Asia to an environmentally responsible producer in Colombia. In its press release, the Body Shop declared that it made this "pioneering move as a response to the continued and rapid destruction of the world's ancient rainforests caused by irresponsible palm oil production" (The Body Shop, 2006).

Financial institutions supporting palm oil production have also released codes of practice for investments in palm oil plantations, processors and refineries (van Gelder and Wakker, 2006). For example, the Dutch based Rabobank is an important financier of palm oil developments in South East Asia. The company has a detailed corporate social responsibility policy and is in the process of developing specific strategies for palm oil including a supply chain policy for its customers (Srivastava, 2005).

Codes of conduct are not restricted to the private sector. The World Bank's International Finance Corporation has initiated a new programme for improving the sustainability of palm oil production and several other commodities. The new initiative is called the Biodiversity and Agricultural Commodities Programme (BACP) and it has a budget of USD 50 million, which it will disburse over ten years. The funds will be used to provide technical assistance for better management practices, to increase the demand for sustainably produced products and to support the work of multi-stakeholder programmes involved in promoting sustainable commodity production (IFC, 2007).

The need for a multi-stakeholder group for sustainable palm oil production was recognised in the early 2000s. While private sector codes could be effective for individual companies, there was a need to develop a more participatory strategy that involved representation from industry, NGOs, states, smallholders and indigenous communities. In 2002, several large private companies involved in palm oil production and a number of NGOs came together to discuss the potential of forming a multi-stakeholder group to promote sustainable palm oil production. The participants in this first meeting held in 2002 included EU and South East Asian-based palm oil producers and refiners (Aarhus United, Gold Hope, Malaysian Palm Oil Association), European retailers (Sainsbury's and Migros) and NGOs (World Wide Fund for Nature). The outcome of this meeting was the Roundtable for Sustainable Palm Oil (RSPO). The membership of the RSPO now includes 55 palm oil producers, European retailers and NGOs. The goal of the RSPO (2004, 1) is to create an "acceptable credible definition of sustainable palm oil production and use and the implementation of better management practices that comply with this definition".

Over the last five years the RSPO has focused on three initiatives: the development of agreed criteria for sustainable palm oil production; a smallholder task force; and measures for traceability in the palm oil value chain. In October 2005, the RSPO released its principles and criteria for sustainable palm oil production (RSPO, 2005). There are eight key principles and criteria: commitment to transparency; compliance with applicable laws and regulations; commitment to long term economic and financial viability; the use of best practice by growers and millers; environmental responsibility; responsible consideration of employees and communities affected by oil palm production; responsible development of new plantings; and commitment to continuous improvement (RSPO, 2005). These principles are being pilot tested in plantations and mills in palm oil producing countries.

The second key initiative of the RSPO is a smallholder task group. Given the significance of smallholders in palm oil production, the RSPO

decided to establish a task force to address the specific needs and problems facing small-scale palm oil producers. Smallholder palm oil producers were also likely to face problems in implementing the sustainability principles and criteria and the role of the task force was to play a role in finding ways to assist smallholders in meeting the goal of sustainable palm oil production. As Colchester (2006, 1) noted, the principles and criteria were developed "mainly with large-scale holdings in mind" and there was thus an urgent need to address the specific problems facing smallholder farmers. The task force is led by an Indonesian NGO (Sawit Watch) and the United Kingdom-based Forest Peoples Programme. In the last two years, the smallholder task force has translated the principles and criteria into indigenous languages and has conducted research on the complexities involved in implementing sustainable production amongst small-scale farmers. The task force has also organised several meetings where smallholders have been able to raise general problems facing this sector including land rights, access to credit, and the effect of pesticides on women workers.

The RSPO's third initiative has focused on the palm supply chain (ProForest, 2005; RSPO, 2007). In order to translate the benefits of sustainable production to producers and millers, the RSPO has recognised the importance of distinguishing between "sustainable" and "unsustainable" palm oil. The problem in the case of palm oil is that it is usually the "hidden ingredient" in a wide range of consumer goods. Although labelling of food ingredients is now mandatory in most developed markets, when palm oil is present in biscuits, ice cream and other consumer goods the label usually states vegetable oil, stearin or olein rather than palm oil. In other words, current labelling practices make it difficult for consumers to identify the existence or otherwise of palm oil.

There is a second problem in tracing palm oil back to particular sustainable or unsustainable production sites. Unlike coffee, tea and fruit products, which can be traced back to individual production sites, the complexity of the palm oil value chain makes it very difficult to trace

back to a plantation or even a country. Palm oil mills in producer countries usually process fresh fruit bunches from their own plantations, but also from other plantations and from a large number of independent and company assisted smallholders. Crude and refined palm oil is transported in bulk and, given the high cost of transport, from a number of suppliers to ensure that the containers are full. The challenge of traceability persists even for larger companies that are involved in several stages of the chain. The larger companies source from their own plantations and mills, but they also source palm oil products from independently owned mills. The companies will know little about whether the palm oil from these mills and plantations is produced sustainably (ProForest/ISIS, 2003).

The RSPO has recognised the need to establish credible mechanisms for traceability (WWF, 2005a). Indeed, the success of the RSPO initiative depended on consumers being able to distinguish between palm oil produced under the RSPO principles and criteria from non-accredited palm oil. At the 2004 Roundtable meeting in Jakarta, the RSPO stated that traceability was "absolutely critical to the success of the criteria since they are much more likely to be widely implemented in plantations if there is a clear market demand" (RSPO 2006, 3). Palm oil producers have echoed this sentiment. The head of New Britain Palm Oil based in Papua New Guinea has argued that the principles were more likely to succeed if there was a financial incentive for producers, which in turn depends on an effective mechanism for traceability (WWF, 2005b).

In the last three years, the RSPO has explored various measures for traceability in the palm oil value chain. In 2006, the RSPO released its final report on the issue and suggests three mechanisms: segregation, mass balance and "book and claim". The segregation option is the most straightforward, but the most difficult to implement given the complexity of palm oil production and transportation. It involves separating RSPO accredited plantations, mills and refineries from non-RSPO produced palm oil at every stage in the chain, including bulk transportation. The second option, mass balance,

involves calculating the relative proportions of RSPO and non-RSPO palm oil. This balance is maintained through the production chain so that consumers know the relative proportion of accredited palm oil in the product. The mass balance is not a traditional traceability mechanism in that palm oil is only identified as RSPO or non-RSPO oil. The mass balance approach does not provide any information on the site of production or processing. The "book and claim" approach also fails to trace palm oil along the value chain. Instead, this method involves the use of a tradable certificate for producers accredited by the RSPO, which is sold separately from the oil itself.

The RSPO held several meetings with stakeholders on the various traceability options in 2006. While the segregation option is clearly the most credible of the three options, it was estimated that it would increase production costs by as much as 20 percent (RSPO, 2006). This option also depended on having larger volumes of palm oil and would be easier to implement where a company is involved in all stages of production. The mass balance approach was regarded as less credible given that palm oil from RSPO accredited plantations and mills would be mixed together with palm oil produced in a way that does not meet the organisation's principles and criteria. In addition, calculating the relative proportions of palm oil along the chain is a complex process and is likely to further undermine the credibility of this approach. Yet the production cost implications of mass balance were lower (5 percent higher) and are thus likely to be more attractive to producers. The "book and claim" approach was supported by many industry stakeholders, but there was a concern that the method requires a commitment to transparency for it to be credible.

At the most recent RSPO meeting it was agreed that, although in principle a full traceability mechanism was the most desirable, in practice the mass balance approach would be employed as a "stepping stone" towards a more credible traceability mechanism. In the mass balance approach, importers and consumers will know the relative proportion of RSPO and non-RSPO accredited palm oil (RSPO, 2007).

5.5. Multi-stakeholder Groups, Value Chains and Sustainable Production

Jenkins (2001) has provided a detailed review and assessment of codes of conduct. While company codes of conduct have been around for a long time, the contemporary form originates from the early 1990s and is associated with the rise of global value chains and the growing awareness of the impacts of suppliers on the environment and labour in the developing world. Companies implementing codes of conduct are often branded companies and are concerned that negative publicity will damage their reputation among consumers. Improvements in communication, especially the Internet, have ensured that violations of the environment or labour can be quickly transmitted to NGOs and other stakeholders, which have played an important role in publicising the negative activities of companies and their suppliers.

The debate on codes of conduct has focused on their scope and content, how they are monitored and their impact on developing country suppliers (Vallejo and Hauselman, 2005; Hamilton and Hassel, 2006). With regard to scope and content, researchers and NGOs have highlighted the limited scope of the codes and the weak content, particular with regard to social and environmental considerations. In some cases the "company codes are little more than general statements of business ethics with no indication of the way in which they are to be implemented" (Jenkins 2001, 26). In terms of monitoring, critics have argued that there is limited monitoring of the codes; where monitoring does happen, it is not carried out by independent agents.

Despite these problems, the codes of conduct represent a positive development in global trade. First, the development of codes for complex supply chains suggests that companies now recognise their responsibility in the activities of supplier companies. Second, the ability of NGOs to mobilise activity around prominent brand names shows that northern consumers are now aware of the potential impact of their consumption choices. Third, there is evidence that codes have led to improvements in the environment and in conditions for those involved in global supply chains including smallholder farmers and farm workers (see chapter on cut flowers).

For Jenkins, the most effective codes are those that are complementary to government regulations and which also allow workers and other groups to organise collectively. These tend to be multi-stakeholder codes rather than individual company codes. He also argues that codes of conduct "should be seen as an area of political contestation, not as a solution to the problems created by the globalization of economic activity" (Jenkins 2001, iv-v).

The Roundtable on Sustainable Palm oil has the potential to transform the image of the palm oil sector. It has representation from a wide range of industry participants including retailers, producers, processors and financial institutions. In terms of the code content, the RSPO has developed an extensive set of principles and criteria for sustainable palm oil production, which are now being tested in palm oil producing countries. In addition, the organisation has recently introduced a specific initiative to assist smallholders in meeting the principles and criteria. Finally, it has recognised the need to establish credible mechanisms for supply chain traceability.

The challenge facing this multi-stakeholder organisation is one of establishing a credible set of standards for sustainable palm oil production while at the same time gaining the support of the industry. Already the RSPO is finding it difficult to balance the interests of NGOs, retailers and palm oil producers. For instance, although it has the support of some major NGOs - including the World Wide Fund - there are several prominent NGOs that have refused to join the RSPO. One of these is the Friends of the Earth (FOE, 2004b, 2), who have declared the RSPO's statements regarding the social and environmental impact of palm oil production "seriously understates the extent of the problem". Against the Grain has been equally vociferous in its condemnation of the RSPO's approach to palm oil production (Against the Grain, 2006). The RSPO's refusal to consider limiting palm oil production raises questions, for this organisation, on the RSPO's real commitment to sustainable production. The key difference between these NGOs and those that are signatories of the RPSO is their scepticism on

whether an industry-led organisation can regulate palm oil production (also see Wakker, 2005).

The tensions between the different constituencies represented within this multi-stakeholder organisation have also appeared in the work of the smallholder task force. The task force is led by two NGOs - the Indonesian SawitWatch and the UK-based ProForest. These NGOs are signatories of the RSPO, but they also continue to produce reports that are highly critical of the activities of palm oil producers especially in Indonesia. During the most recent meeting of the smallholder task force in January 2007, plantation companies expressed their concern that the two NGOs were members of the task force, but were nonetheless producing reports that were critical of the activities of palm oil companies.

The last issue in terms of the RSPO's work relates to its ability to transform the palm oil industry. In the original discussion paper that led to the formation of this multi-stakeholder group, the organisation set itself the goal of transferring "best practice from the best plantations to the poorer performing ones" (ProForest 2005, 1). This depends of course on the organisation's effectiveness in gaining the confidence of industry players. It also depends,

crucially, on market forces playing their role in terms of encouraging companies to shift to sustainable production methods.

In terms of market forces, it is important to note that the largest proportion of palm oil exports from South East Asia go to China and India. Only 15 percent is exported to European Union. The difficulty facing the RSPO is that the Chinese and Indian markets are relatively less receptive to the ideas of sustainable production. It is possible that value chains destined for the European Union will have a stronger sustainability component, while those supplying other markets will not be under as much pressure to meet sustainability requirements. This problem has the potential of occurring at other scales: Colchester and Jiwan (2006) have raised the concern that unless smallholders are supported in their efforts to meet the RSPO's principles and criteria, they could be excluded from RSPO markets. In this way, the RSPO "will serve as an engine of social exclusion, encouraging standards to be raised on estates but not on smallholdings" (Colchester and Jiwan, 2006). The key challenge facing the RSPO is in convincing the industry as a whole to embrace sustainable palm oil production.

5.6. Recommendations

Supporting traceability initiatives. This chapter has argued that ensuring traceability is central to the RSPO's efforts in establishing a sustainable palm oil industry. Although the RSPO has undertaken some research on traceability, further support could be provided to the organisation through research support on traceability initiatives in other bulk commodities. The new EU regulations on traceability for genetically modified organisms, for example, is generating much discussion and debate on traceability. A possible policy response would be to ensure that labelling guidelines in the EU are made clearer and more explicit for palm oil used in food and other commodities.

Support for smallholder farmers. There is considerable field-based research on smallholder palm oil producers (e.g. Koczberski, 2007). This research has provided detailed analyses of how smallholders can be assisted in improving

their livelihoods and in producing more sustainably. Strategies can be developed from these case studies, which can then be deployed more broadly.

Pressure on palm oil importers. The RSPO initiative focuses on improving the sustainability of palm oil production within the industry. A possible policy response would be to explore ways of ensuring that European importers are pressured to import sustainably produced palm oil. This would ensure that importers are sourcing from plantations that practice sustainable production and are supportive of smallholder farmers.

The RSPO multi-stakeholder forum. As a multi-stakeholder forum, the RSPO is mandated to improve the sustainability of palm production. In other sectors where multi-stakeholder initiatives have emerged (e.g. the cut flower sector),

weak auditing methods have undermined the credibility and sustainability of the forum and its efforts to establish sustainable production methods. Support in the form of training and capacity building should be offered to the RSPO as a way of building the credibility of the sustainable palm oil initiative. The RSPO could also be assisted in terms of managing

fragmentation and conflict, which is a common problem in multi-stakeholder groups. There are international agents (e.g. the International Labour Organization) and other private or public institutions that have considerable experience in assisting organisations in their efforts to build consensus among stakeholders with divergent interests (Humphrey, 2007).

5.7. Conclusion

Palm oil has become the most important edible oil in the world. Production is likely to be stimulated by growing demand for processed food and other commodities and also by the growth of the biodiesel sector. Despite the positive outlook for the palm oil sector, there is growing concern over the environmental and social impacts of palm oil plantations, especially in South East Asia, but also in other tropical areas where production might be re-established. NGOs have been extremely successful in highlighting the negative impact of palm oil production, which is of great concern to individual enterprises and producer associations. Individual companies have responded with their own codes of conduct and there is now a multi-stakeholder group for sustainable palm oil. The challenge for this new multi-stakeholder group, which importantly has a mandate that includes support for smallholders, is to develop credible systems of sustainable production that are accepted by NGOs, retailers and consumers. A

key problem is the way the commodity is used in production:

Palm oil does not reach the market as an end product, but as an "invisible component" of numerous food and chemical products. This puts palm oil in a different position as compared with other tropical products such as timber, coffee and tea. With these latter commodities it is much easier to make consumers aware of ecological and social production aspects.

An additional problem is the structure of the value chain, which makes it extremely difficult to trace palm oil from the plantation to the final consumer. While the multi-stakeholder group is currently working to find a solution to the problem of traceability, its efforts are likely to lead to partial solutions in the short term. In the longer term, it may be that the RSPO is only successful in accrediting a portion of palm oil producers who supply particular markets.

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6. CONCLUSION

The commodities discussed in this report range from bulk produced products that are used as an ingredient in food to individually wrapped cut flowers. The value chains in each of the commodities show considerable variation in structure and governance. In this concluding chapter, four key themes emerging from the commodity studies are drawn together.

New investment patterns. The changing trade regime for the four commodities is leading to new patterns of investment. In the cut flower sector there is evidence that investors are moving from Kenya, Uganda, Zimbabwe and Tanzania to Ethiopia, which is an LDC country and therefore has access to the EU market through the "Everything But Arms" trade initiative. The Ethiopian government is also offering very substantial incentives to potential investors in the cut flower industry. In the sugar sector there are both regional and international investments taking place in order to benefit from the changing trade preference landscape (e.g. in Southern Africa). These investments should be monitored to ensure that they are sustainable and have an impact on poverty alleviation. They should not be associated with a "race to the bottom" where investors are shifting production from one location with higher costs or stricter regulations (e.g. environmental, social) to another location where labour is cheaper and environmental and other regulations are not important.

Support for mitigating trade preference erosion. A key theme in the sugar and banana chapters is the issue of support for countries affected by trade preference erosion. The support for banana producers has a long history and much can be learned from the experience - both positive and negative - of 13 years of support from the EU to ACP banana exporters. Two issues stand out. First, the support for diversification efforts seems not to have had a substantial impact on less competitive banana producers. This is maybe because of the problems inherent in attempting to diversify economies that have been dependent on a single

export commodity. The problem is greater when one is dealing with small island economies. Second, the support for banana exporters in the period after 2000 depended on an assessment of whether the industry was "competitive" or "uncompetitive" based on production costs in relation to EU market prices. This is a very blunt approach because it fails to acknowledge the complex relationship and dynamics between a country's export industry and world market prices. In the case of bananas it also led to the support structures ignoring the potential of niche markets. The banana experience provides important lessons for current efforts to support ACP sugar exporters. First, it is important to acknowledge the challenge of developing effective diversification programmes. These need to go beyond piecemeal projects, which seem to characterise how banana producers were supported. There is a need for effective, realistic and well-funded diversification programmes that can provide a viable economic alternative to sugar production. Second, the support for sugar producers needs to consider the wide range of possible options for diversification within sugar production.

Value chain governance. The banana and cut flower chains have become buyer-driven, with supermarkets or other buying agents playing a more important role in chain governance. The growing role of buyers has coincided with a greater emphasis on the environmental and social conditions under which bananas, palm oil and cut flowers are produced. Producers supplying supermarkets are under greater pressure to meet quality and food safety standards as well as a wide range of social and environmental certification systems. These pressures shape who can participate in the chains and the conditions for farmers and farm workers in the chain. It is significant that two of the commodity studies highlight supply chains that are less demanding of suppliers. In the cut flower chain, research suggests that exporters who supply the auctions have more leeway in hiring practices and improving working conditions. The opposite problem happens in

the palm oil value chain: the group involved in promoting sustainable palm oil are concerned that their efforts will be limited because the main buyers of palm oil are India and China. These are markets that do not have NGOs urging consumers to consume sustainable palm oil. The difference within global value chains and its relationship to social and environmental codes is an important area of research.

Multi-stakeholder groups and codes of conduct. In two of the commodities - cut flowers and

palm oil - multi-stakeholder groups play an important role in the value chain. Although there is no formal multi-stakeholder group in the banana chain, there are many codes of practices for companies and producers. The role of codes and multi-stakeholder groups is becoming more important in global trade as value chains become increasingly buyer-driven. A key issue is to improve their credibility and their capacity to manage the widely divergent interests of actors in the value chain.

ENDNOTES

- 1 Own calculations using Comtrade data.
- 2 As Gibbon notes, the concept of commodity dependent developing country is used frequently in the literature on the commodity crisis, but is rarely defined. He defines a commodity dependent developing country as one that has "50 percent or more of all merchandise exports are made up of non-oil commodities" (Gibbon, 2006, 10).
- 3 Costa Rica's diversification is perhaps most impressive. In 1970 exports of bananas, coffee, sugar and beef made up 61 percent of export earnings. By 2000 these four commodities represented only 12 percent of export earnings (Nathan, 2003).
- 4 Own calculations from Comtrade.
- 5 Own calculations from Comtrade.
- 6 Reported on 14 August 2007 (www.freshplaza.com/news_detail.asp?id=5690 accessed 30 August 2007).
- 7 In 2003 Asda (owned by Walmart) was able to slash the price of bananas by up to 25 percent in an effort to draw customers away from its competitors (BananaLink, 2003).
- 8 Food Industry News, 30/07/2007 EU offers banana tariff cut to soothe Latin America (www.flexnews.com/pages/10101/Banana/European_Union/ accessed 29 August 2007).
- 9 The quota was initially set at €100 per tonne, but it was reduced to €75 per tonne in 1995 (NERA/ODI, 2004).
- 10 According to Moberg (2005) the increase in marijuana production in the Caribbean is largely due to the efforts of former banana farmers.
- 11 Vidal (2007) reports that "Money is going into run-down schools, the banana sheds are being repaired and the farmers can scarcely believe the turn round in their fortunes".
- 12 An example of this is the recommendations provided by PASS (2004). They argue that fair trade and other niche marketing initiatives "should be privately financed to avoid skewing investment decisions away from commercial considerations" (PASS 2004, 2). This recommendation ignores the extent to which support for banana producers was most successful when it was done in conjunction with private sector initiatives (see Goodison 2007).
- 13 "Banana wars" The Observer, 13 March 2005.
- 14 Mitchell (2004) estimates that 160 countries produce sugar from sugar cane or beets.
- 15 See: "EID Parry teams up with Cargill for sugar joint venture", The Hindu, 25 April 2006.
- 16 In a recent FAO study cited in Mitchell (2005), the price of sugar on world markets is expected to increase by between 30 and 40 percent under full trade liberalisation, but would decrease as Brazil and other sugar exporters responded to the higher sugar prices. Indeed, it is not inconceivable that exporters like Brazil might respond pro-actively to expected price rises, which would effectively dampen potential increases in world sugar prices.
- 17 St Kitts & Nevis ceased sugar production in 2005.
- 18 Bureau *et al* (2007) have analysed the pattern of processor restructuring in the EU. While they note that a large number of processors closed, or are scheduled to close, many of the quotas were transferred to other operations rather than being withdrawn. This goes some way to explaining why production volumes continue to be far lower than planned under the reform programme.
- 19 Guyana is promoting the production of high quality Demerara sugar for the Caribbean and other specialty sugar markets, and both Guyana and Belize are increasing their capacity to use sugar for electricity co-generation. Guyana is also considering the establishment of a refinery to meet Caribbean demand for white sugar and prospects for expanding sugar cane cultivation for the production of ethanol.
- 20 Belize has strenuously contested this conclusion, arguing that the authors of the study did not consult fully with the Belize Sugar Industry.
- 21 This analysis is based on a report by Stephen Thornhill and summarised by Agritrade (2007).
- 22 A key question in the document is whether "the sugar industry, possibly after restructuring, could be sustainable in the future market environment". This underlines the EC's determination not to support sugar sectors that are unlikely to be competitive following the ongoing reform of the CMO for sugar.
- 23 Oxfam (2005a, 4) has pointed out that the trade dimension aspects are "potential and may not be realised".
- 24 The demand for fairly traded products has increased dramatically in the last decade. According to the Fair Trade Foundation, the consumption of Fairtrade products in 2006 was 42 percent higher than the year before (Fairtrade, 2007). For products like coffee and cocoa, the increases have been even more dramatic. The extent to which these increases can be sustained is subject to much speculation. With regard to organic food, the demand in the EU and the US continues to outstrip supply.
- 25 Kenya started exporting to the US in 2001 (USITC, 2003).
- 26 The decision to eliminate tariffs on cut flowers in the US was a measure aimed at encouraging Latin American countries to shift out of the production of narcotics and into other commodities like cut flowers (Ziegler, 2007).
- 27 The growth of cut flower production in Ethiopia is in part due to very generous incentives and tax rebates offered to both local and international investors. Some of the investments in new farms have come from Kenya and Uganda as well as from farmers in Zimbabwe who have had their land seized under the fast track land reform programme (www.volkskrantblog.nl/bericht/153287, accessed 20 September 2007).
- 28 Blumenthal and Gow (2006) report that companies in Ecuador have established successful contract farming relations with small scale flower producers.
- 29 The claim that palm oil is a healthy alternative is controversial. For a detailed review of the evidence see Brown and Jacobsen (2005). It is ironic that during the late 1980s the American Soybean Association launched a campaign against palm oil imports claiming that they increased the risk of heart disease (Fold 2000b).
- 30 Some company investing in the US to take advantage of the expected demand for palm oil products.

- 31 In Malaysia companies own the land after it has been converted.
- 32 The taxation system, which encouraged local processing as opposed to raw material exports was established in the mid-1970s (Fold, 2000a).
- 33 In Uganda and Tanzania palm oil production is in the hands of the locally owned company Bidco. This enterprise produces edible oil and other palm oil based products for consumption in East Africa. Expansion of palm oil production is happening in partnership with major players in the palm oil sector including Wilmar and ADM (Steege, 2007).

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