

# Who reaps the fruit?

**Critical Issues in the Fresh Fruit  
and Vegetable Chain**

**June 2006**

**Myriam Vander Stichele  
Sanne van der Wal  
Joris Oldenziel**





This SOMO report critically analyses the influence of trade and distribution on production and production conditions in the Fresh Fruit and Vegetable (FFV) sector. The report identifies the key challenges and opportunities of the sector from the perspective of poverty eradication and sustainable development.

The report provides an overview of the key production, trade and consumption characteristics and trends in the FFV sector. It outlines the main market structures and corporate entities in the FFV chain, lists the most relevant initiatives for corporate social responsibility in the sector and covers the most important international and EU legislation and regulation relevant for the sector.

More specifically, the report provides insights into the market structures and trade channels on the world FFV market. The FFV chain is increasingly dominated and controlled, from production to distribution, by a few large multinational corporations. Such market structures influence the prices producers receive and the conditions under which they can produce.

The study aims to provide arguments for civil society organisations to feed the debate on trade & investment, corporate accountability and globalisation. The final chapter provides a comprehensive framework of recommendations that tackle different bottlenecks in the FFV chain through a range of diversified instruments.

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**(update)**

## Colophon

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**Critical Issues in the Fresh Fruit & Vegetable Chain**  
**(Update)**

**By:**

Myriam Vander Stichele, Sanne van der Wal  
& Joris Oldenziel

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## Introduction

This study of the Fresh Fruit and Vegetables (FFV) sector investigates the influence of trade and distribution on production and production conditions of FFV products. SOMO focuses on the corporate structures and corporate relations throughout the sector and in the production, supply and value chains.

The study aims to identify 'critical issues' in the sector from the perspective of poverty eradication and sustainable development. The study concludes with arguments for civil society organisations to feed the debate on trade & investment and corporate accountability.

SOMO conducted the study from 2004 to mid 2006. Southern partners in Indonesia and Senegal collaborated with the case studies. The study is part of a four-year research project (2003-2006) in which SOMO conducts two sector studies per year. This research project is co-funded by the Dutch Ministry of Foreign Affairs. The FFV sector study was co-funded by Oxfam Novib and the Consumentenbond (Dutch consumer organization).

## Background of the project

During international negotiations on trade in agriculture, it is often argued that more market mechanisms and increased export of agricultural products by developing countries will benefit the producers in these countries. Such arguments often lack insights into the market structure of trading in agricultural products on the world market and in distribution countries.

There are huge concentrations in trade in agricultural commodities (including bananas) and in retail of non-bulk fresh fruits and vegetables. Another trend is the control over the market from production to distribution by a few companies (vertical integration). Such market structures influence the prices producers receive and the conditions under which they can produce. This, in turn, influences the fight against poverty and the chances for a shift towards sustainable agriculture.

The research project aims to:

- Increase knowledge among Northern and Southern civil society organisations about the effects of corporations' activities in developing countries and the position of developing countries in the world trading system.
- Build the capacity of Northern and Southern civil society organisations to improve their ability to influence the behavior and activities of corporations and the international regulatory framework in which they operate.



- Increase cooperation between Northern and Southern civil society organisations in order to promote the exchange of information and views regarding corporate activities in developing countries.
- Lobby (inter)national decision makers with the goal of increasing the influence of Southern civil society organisations in the debate concerning Corporate Social Responsibility, the world trading system and investment regulations.

## The report

The report aims to give insights into the major issues and problems in the FFV sector from the perspective of poverty eradication and sustainable development.

Below, a brief description of the subjects covered by each chapter. Each chapter ends with conclusions and a summary that gives a quick insight into the critical issues.

- **Chapter 1: Overview of the FFV sector**  
This chapter provides an overview of the key production, trade and consumption characteristics and trends in the sector. The chapter also identifies some of the most important issues in trade, working conditions and the environmental impact of the sector. The overview focuses on figures and issues relevant for the Global South.
- **Chapter 2: Corporate structures of the FFV chain**  
This chapter outlines the main corporate structures and corporate entities in the FFV chain, from production in developing countries to sales in supermarkets in the North. This chapter shows how food retailing, while at the final stage of the fresh fruit and vegetable chain, has an impact that is felt throughout the chain, all the way down to the production level. This chapter particularly focuses on the EU and producers in the South.
- **Chapter 3: The case of Senegal's export-oriented mango supply chain**  
In order to highlight some of the most outstanding questions and problems in the FFV sector, a case study was conducted in Senegal and summarized in this report. The case study focuses on the chances and problems in mango production for export, particularly to Dutch supermarkets.
- **Chapter 4: Case study: the effects of local supermarket policies in Indonesia in the banana and carrot supply chain**  
A case study from Indonesia focuses on the influence of (western) supermarkets operating in Indonesia on FFV production in the country. The case study especially looked at carrot and banana production, from the perspective of poverty eradication and sustainable development.

- ❑ **Chapter 5: Corporate Social Responsibility in the FFV Sector**  
In the FFV sector, there is a large number of initiatives that can be seen as part of Corporate Social Responsibility (CSR). This chapter lists the most relevant initiatives in the sector and outlines the key conclusions and outstanding issues from these initiatives. A central question in this context is whether these CSR initiatives have made an impact and have contributed to poverty eradication.
- ❑ **Chapter 6: Trade and regulation in the FFV chain**  
This chapter covers the most important international and EU legislation and regulation relevant for the FFV sector. It includes a detailed description and discussion of trade barriers (both tariff and non-tariff) and preferences for FFV, trade rules governing liberalisation of supermarkets (GATS) and (non)regulation of concentration in the sector (competition policy).
- ❑ **Chapter 7: Recommendations**  
This chapter concludes the study with a number of recommendations aimed at sustainable development and poverty eradication. They focus on equitable purchasing and trading conditions as well as better social and environmental conditions throughout the whole FFV chain.

## Process and methods

The results of this report are based on information from literature, databases, expert consultations, interviews with stakeholders (including workers) and their input at workshops in:

- ❑ Amsterdam (28 April 2005), organised by SOMO in cooperation with the Dutch CSR Platform
- ❑ Dakar, Senegal (12 July 2005) organised by ASPRODEB.

In addition to these activities, (field) research was conducted by independent consultant Macoumba Mbodj under supervision of SOMO and ASPRODEB in Senegal and the Institute for Global Justice (IGJ) in Indonesia.

Thanks go to Macoumba Mbodj and IGJ for the research, to ASPRODEB for the supervision of the Senegal research and the organisation of the workshop.

## Information about SOMO

The report is published by the Centre for Research on Multinational Corporations (SOMO), an independent non-profit research institute that advises non-governmental organisations and trade unions in the Netherlands and worldwide. SOMO researches multinational corporations and their international context. By exposing unfair practices and systems, SOMO seeks to contribute to the struggle against exploitation, poverty and

disparity, and to provide means for achieving sustainable economic and social development and a globalisation based on justice. The objectives of SOMO are:

- ❑ Changing through knowledge building: SOMO's research is directed at inducing change. The research and analysis and alternatives SOMO puts forth contribute to the policy advocacy of NGOs and the policy development of international organisations, government and business.
- ❑ Strengthen civil society: SOMO brings fragmented available knowledge together and stimulates and coordinates cooperation between organisations. In addition, SOMO trains local organisations in the South.
- ❑ Policy influence: SOMO organises workshops, public meetings and lobby activities in order to influence government policies. SOMO wants the voice and development needs of the South to be brought to the front of Northern policy making that regulates corporations.

The research and activities of SOMO focus on: corporations, sectors and supply chains in an international context, Corporate Social Responsibility and international trade and investment.

## Follow up

This report is the result of two years of research and activities, but it certainly is not the end of the process. SOMO sees this report as an invitation to participate in further activities aimed at structural change. SOMO will follow-up this study with research about the processed food sector. Also, SOMO welcomes comments including about new issues, (NGO) perspectives and recommendations. Please send us your (research) experience in this sector or contribute to the list of recommendations. Comments can be sent to [info@somo.nl](mailto:info@somo.nl). New information will be published on [www.somo.nl](http://www.somo.nl).

Myriam Vander Stichele, Sanne van der Wal & Joris Oldenzien

*Amsterdam, June 2006*

# Chapter 1

## Overview of the fresh fruit and vegetables sector

### Introduction

This report highlights critical issues affecting the “Fresh Fruit and Vegetables” (FFV) sector. This chapter provides an overview of the key production, trade and consumption characteristics and trends, and focuses on data for the Global South, grouping developing countries and the least developed countries together to highlight trends.

### Comparative figures: World production and export for FFV

Figures only apply to fresh fruit and vegetables and do not include potatoes and nuts (see footnote 2 for a detailed list of FFV included in this chapter)

**table 1: World production of FFV in million tons in 2003**

|                          | World   | Developing countries | Least developed countries |
|--------------------------|---------|----------------------|---------------------------|
| Fresh fruit & vegetables | 1,348.5 | 1,046.2              | 56.5                      |
| Fresh fruit              | 487.9   | 365.0                | 32.3                      |
| Fresh vegetables         | 860.6   | 681.2                | 24.2                      |

Source: FAOstat 2004

**table 2: World exports of FFV in 2003 in thousand tons and million US dollars (including intra EU trade)**

|                          | Volume   |                      |                           | Value    |                      |                           |
|--------------------------|----------|----------------------|---------------------------|----------|----------------------|---------------------------|
|                          | World    | Developing countries | Least developed countries | World    | Developing countries | Least developed countries |
| Fresh fruit & vegetables | 73,330.1 | 37,532.4             | 264.0                     | 45,116.9 | 14,897.1             | 106.7                     |
| Fresh fruit              | 46,180.6 | 25,699.5             | 105.2                     | 26,431.3 | 9,429.3              | 41.3                      |
| Fresh vegetables         | 27,149.5 | 11,832.9             | 158.8                     | 18,685.6 | 5,467.7              | 65.4                      |

Source: FAOstat 2004

## 1.1 Production and trade in fresh fruit and vegetables

### 1.1.1 *Worldwide production and trade in fresh fruit and vegetables*

In 2003, annual global production of fresh fruit and vegetables<sup>1</sup> totalled 1.35 billion tons (see table 1), an increase of 43 percent over the last decade (1994 to 2003). Vegetables accounted for 64 percent of total production.

Although global trade accounted for only a little over 5 percent of total FFV production in 2003<sup>2</sup>, this trade totalled 73 million tons (see table 2), valued at 45 billion US dollars, an increase of 37 percent in volume and of 51 percent in value over the last decade. Trade in fresh fruit accounted for 63 percent of global trade in volume and 59 percent in value. The primary internationally traded FFV by value (in descending order) were: bananas, tomatoes, apples, grapes, oranges and peppers and chillies.

#### → **Trend**

Production and international trade in FFV has grown by 43 and 37 percent respectively in volume over the last decade. Trade in volume has grown more than for any other agricultural commodity<sup>3</sup>.

## 1.2 Fresh fruit

In 2003, world fruit production reached 488 million tons and total fresh fruit exports amounted to 26 billion US dollars, an increase of 44 percent in value since 1994. With 4.9 billion US dollars in export value and 15.9 million tons traded internationally (FAOstat) bananas<sup>4</sup> are the world's most popular fruit. They are both a staple fruit and also an internationally traded strategic commodity as the producer countries in the South depend heavily on them for export income<sup>5</sup>. But the importance of bananas in total world fresh fruit exports has declined. In 1994, banana trade accounted for 23 percent of the total world fruit trade by value but by 2003 this share had fallen to 19 percent. Nevertheless, trade in bananas grew by 19 percent during the same period (see table 3).

Other important fresh fruit exports for developing countries are those of "non-traditional" tropical fruits such as pineapples, mangoes, and papayas. These are often important foods in their countries of origin but in recent years an increasing proportion have been exported to countries where consumption was previously very limited. The 123 percent growth in exports (see table 3) reflects this trend. Nevertheless their combined share by value in world fruit trade is still modest, rising from 6 percent in 1994 to 10 percent in 2003.

When looking at the combined share of fresh temperate fruit exports the picture is different. Exports in temperate fruits like apples, pears and grapes and those of "other fruits" like peaches and nectarines, berries and kiwi-fruit grew by about 50 percent. As this growth was close to the average for the combined growth of all fresh fruit exports, their



share in total fresh fruit trade only increased slightly. With only a 35 percent increase growth in fresh citrus exports was a little below average.

**table 3: World export of different groups of fresh fruit by value (in billion US dollars), by share of total fresh fruit exports, and by export growth (1994-2003)**

|                        | 2003  |       | 1994  |       | Growth |
|------------------------|-------|-------|-------|-------|--------|
|                        | Value | Share | Value | Share |        |
| Bananas & plantains    | 4.9   | 18.7% | 4.1   | 22.6% | 19.0%  |
| Tropical fruits*       | 2.6   | 9.7%  | 1.2   | 6.3%  | 122.7% |
| Citrus                 | 6.0   | 22.7% | 4.4   | 24.2% | 34.9%  |
| Apples, pears & grapes | 7.7   | 29.2% | 5.2   | 28.3% | 48.7%  |
| Other fruits           | 5.2   | 19.8% | 3.4   | 18.7% | 52.6%  |
| Total                  | 26.4  |       | 18.3  |       | 44.0%  |

\*excluding bananas

### → Trend

Exports of “non-traditional” tropical fruits like mangoes, papayas and pineapples have more than doubled in value over the last decade. Whereas export growth for temperate fruits and traditional (sub)tropical fruits like citrus and bananas has been much more modest.

## 1.3 Fresh vegetables

World fresh vegetable production totalled 861 million tons in 2003 and exports totalled almost 19 billion US dollars, an increase of 62 percent since 1994. Tomatoes dominate international vegetable trade (see table 4) with 22 percent of the total trade by value in 2003. Looking at export values, chillies and peppers, lettuce and cucumbers and gherkins are important fresh vegetable categories. Their share of exports, combined with those of tomatoes and the category “vegetables fresh nes” (nes means not elsewhere specified), which includes inter alia radish, bamboo shoots and celery, captured 58 percent of the total value of world fresh vegetable exports. The category “other vegetables”, with a 42 percent share of export value, (see table 4) includes a range of fresh vegetables like onions, melons, cabbages and mushrooms.

Exports of chillies and peppers more than doubled in value over the last decade, making their growth in trade well above average. The 91 percent growth in value of “vegetables fresh nes” category was also above average. Although not mentioned specifically in table 4, the export growth for spinach (166%) and green corn (127%) have been dramatic. Even more remarkable has been the growth in exports for string beans,<sup>6</sup> with export growth of 3577 percent from 1994 to 2003!

## → Trend

With a 62 percent increase in value from 1994 to 2003, total fresh vegetable exports are growing faster than those of fruit.

**table 4: World export of the most important (categories of) fresh vegetables by value (in billion US dollars), by share of total fresh vegetable exports and by export growth (1994 –2003).**

|                           | 2003  |       | 1994  |       | Growth |
|---------------------------|-------|-------|-------|-------|--------|
|                           | Value | Share | Value | Share |        |
| Tomatoes                  | 4.2   | 22.7% | 2.6   | 22.5% | 63.8%  |
| Chillies & Peppers, Green | 2.4   | 12.6% | 1.1   | 9.6%  | 113.4% |
| Vegetables Fresh nes*     | 1.6   | 8.3%  | 0.8   | 7.1%  | 90.9%  |
| Lettuce                   | 1.4   | 7.5%  | 0.9   | 7.4%  | 65.0%  |
| Cucumbers and Gherkins    | 1.2   | 6.6%  | 0.8   | 7.1%  | 51.6%  |
| Other vegetables          | 7.9   | 42.2% | 5.4   | 46.4% | 47.3%  |
| Total                     | 18.7  |       | 11.5  |       | 62.0%  |

\*not elsewhere specified

## 1.4 Prices

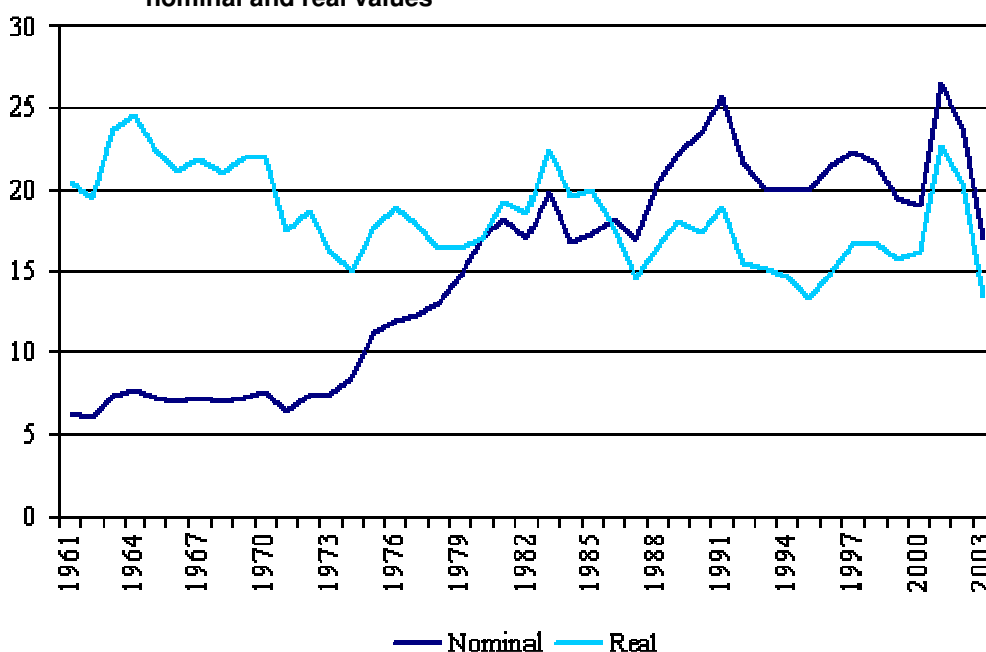
Real agricultural commodity prices<sup>7</sup> have declined by about 2 percent per year over the past four decades amounting to an almost 50 percent decline. However, the fall in real prices has been less severe for horticultural commodities<sup>8</sup>. Real banana prices, for example, have declined by about 25 percent in the same period (see figure 1).

As can be seen in figure 1 real unit prices for most selected fruits have declined little from 1992 to 2001. Decline in real prices for apples, grapes, and especially mangoes, was more pronounced than for those of papayas and pears. Real prices for pineapples, avocados and grapes have improved slightly (see figure 2) and those for bananas (see figure 1) improved (to later decrease sharply). Real unit prices for most selected vegetables like onions, cabbages and green peas also have declined little (see figure 3) during these ten years. Real prices for aubergines have remained stable. Real unit prices for green beans improved slightly, while those for green corn, and tomatoes increased more pronouncedly.

Although real prices for most selected FFV have declined little over the last decade, the real prices for some FFV like bananas, avocado, papaya and green beans fluctuated considerably over time. This volatility is a problem for countries that depend greatly on income from exports of single or a few FFV. For instance important banana exporting countries Costa Rica, Panama and especially Ecuador all depend greatly from these exports. Banana exports constituted from more than 20 percent (Costa Rica, Panama) up to almost 30 percent (Ecuador) of their total export earnings<sup>9</sup>. When prices go down,

which in generally reflects a global oversupply, income is greatly reduced. Naturally the same is even more true when prices drop (more) structurally like those for mangos and bananas (with respect to bananas over a period of 40 years). This can be a serious problem as developing countries, and again especially least developed countries, often depend on greatly export income from agricultural products to be able to import food to make up for shortfalls in domestic production or to repay their debts. Needless to say that in developing countries many people depend on work in export oriented agriculture like FFV production<sup>10</sup>.

**figure 1: Evolution of banana prices in US dollar cent per lb (+/- 0,45 kg) in nominal and real values**

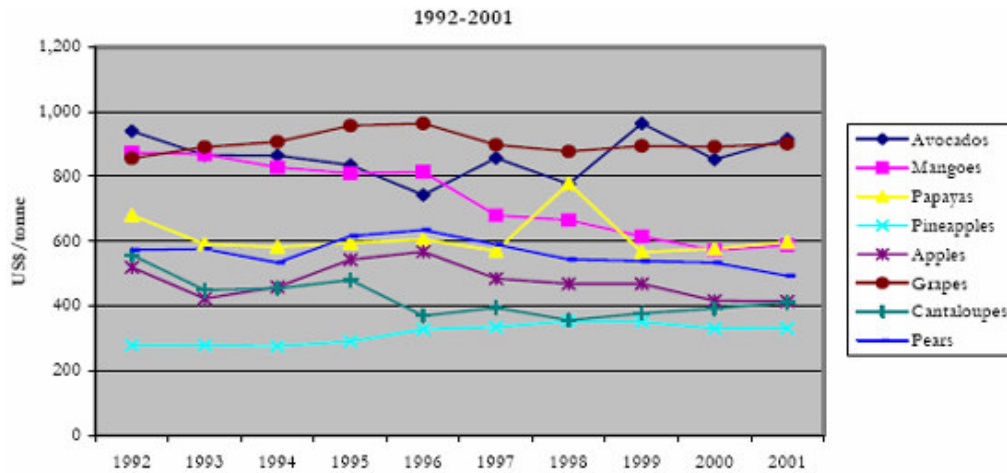


Source: UNCTAD Commodity Price Bulletin<sup>11</sup>

→ **Trend**

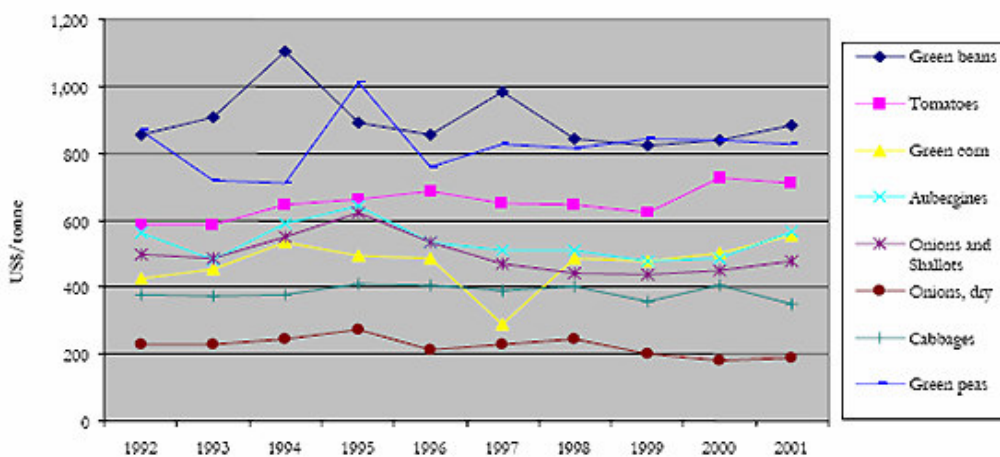
Real prices for horticultural commodities have shown a decline over the last decade but much less so than for agricultural commodities in general. Real prices for most selected FFV, and especially vegetables, have declined little. However prices for some FFV (bananas, avocados, papayas, green beans) have shown considerable fluctuation over time and in some cases have dropped (more) structurally (mangoes). This creates a problem for developing countries that depend on a few varieties of FFV for export income.

**figure 2: Real unit prices in US dollar per ton of selected fruits**



Source: Hallam et al.

**figure 3: Real unit prices in US dollar per ton of selected vegetables**

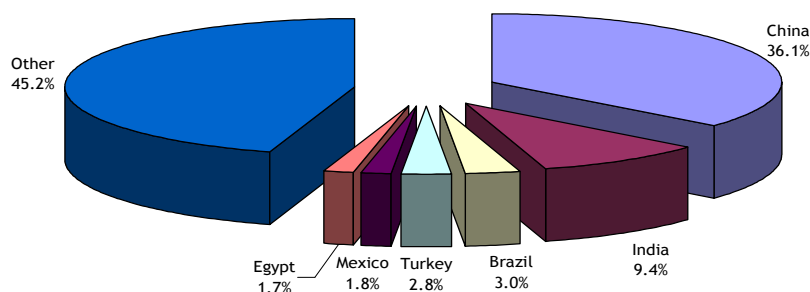


Source Hallam et al.

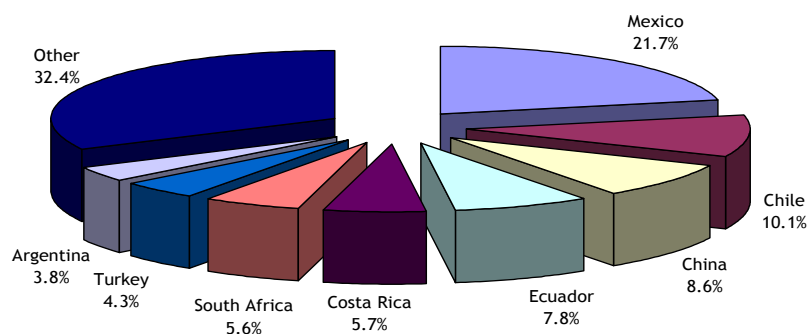
## 1.5 Role of developing countries in global fresh fruit and vegetable production and trade

Developing countries dominate world FFV production: they produce three quarters of the world supply although only 4 percent is produced in the least developed countries. China is the world's largest fruit and vegetable producer with 36 percent of world production (see boxed text and figure 4). India is the second largest producer but only has a 9.4 percent share of world production. Other important developing countries producing FFV are Brazil (fruits), Mexico (fruits), Turkey (vegetables) and Egypt (vegetables). Together these countries produce almost 55 percent of all FFV produced world-wide.

**figure 4: Leading countries in production of FFV, percentages shown represent the share of the selected countries of world production in 2003**



**figure 5: Leading developing countries in FFV exports, percentages shown represent the share of the selected countries of total developing country exports by value in 2003**



A considerable share of world fruit and vegetable production is the result of FFV grown and consumed locally in developing countries. Developing countries are however playing an increasingly important role in world fruit and vegetable trade. Looking at value, the percentage of developing countries exports in total world exports rose to 33 percent in 2003 (see table 2 for details on value and volume) up from 30.5 percent in 1994. And overall, both developing countries and least developed countries showed export growth of 64 percent. While fresh fruit exports from least developed countries have actually declined by 7 percent in this period, fresh vegetable exports in 2003 were more than three times those of 1994. Despite the considerable growth in FFV exports from least developed countries, their share of total FFV exports is still marginal: only 0.24 percent in 2003, up from 0.22 in 1994.

A closer look at the exports of FFV from developing countries by country (groups) reveals considerable concentration (see figure 5). Roughly two-thirds of all developing world exports are from just eight countries. Although this concentration has declined since 1994 when the combined share of FFV exports from these “big 8” was 4 percent higher. Mexico



is by far the most important developing country FFV exporter with almost 22 percent of export share, totalling 3.2 billion US dollars in 2003. Even more significant is Mexico's share in fresh vegetable exports which account for 45 percent of total exports from developing countries. It is clear that especially the fresh vegetable trade from developing countries is concentrated : Mexico and China, the second biggest fresh vegetable exporter (see also boxed text), highlight this concentration as together they capture 61 percent of the total value. With 1.5 billion US dollars in export trade, Chile is second to Mexico in FFV exports. Chile exports mainly fruit and is the most important fresh fruit exporter of the developing world. This country alone accounts for almost 16 percent of all developing world fresh fruit exports. Other important developing country FFV exporters are, in descending order of importance, Ecuador (1.2 billion US dollars, mostly fruit), Costa Rica (0.9), South Africa (0.8), Turkey (0.6) and Argentina (0.5). For comparison: least developed countries FFV exports totalled 0.1 billion US dollars or roughly 0.7 percent of all developing world FFV exports.

### → **Critical issue**

While developing countries capture a third of world FFV exports in value, and this share is growing, just a handful of developing countries, mainly from Latin-America, account for two thirds of all developing country exports. Developing country fresh vegetable exports are dominated by just two countries: Mexico and China. Least developed countries have a marginal share with only 0.7 percent of all developing world exports.

As developing world FFV exports are dominated by a handful of countries, it is no surprise to find concentration when zooming in on exports of different kinds of FFV. For example, only four countries hold a 46 percent share in world banana exports in value. The most important exporting countries are Ecuador (20 percent of world exports in value), Costa Rica (11 percent), Colombia (8 percent) and the Philippines (7 percent). Chile and Mexico control half of world trade in avocados. Mexico, Malaysia and Brazil hold 60 percent of papaya trade. And Mexico, India and Brazil account for half of the world's mango trade. Morocco is almost the sole world string bean<sup>12</sup> supplier. Cyprus, Malaysia and Jordan control the total trade in okra. There are no least developed countries amongst leading exporters of FFV. However some lower income developing countries like Kenya (beans for shelling, see box below) and Côte d'Ivoire (pineapple) are important FFV exporters.

In general those countries that are successful in exporting FFV have more developed infrastructures and mostly rely on large-scale commercial farming for production. Some large-scale producers in these countries like Dole operate as vertically integrated chains and control the whole of the supply chain from production up to distribution (see also chapter 2).

### **Off-season produce**

Although the role that developing countries play in the supply of fresh vegetables is far less pronounced than in the supply of fresh fruit, some developing countries have been successful in exporting non-traditional crops like green beans, asparagus and onions to

meet supermarkets' off-season demands. Kenya, Zimbabwe, Zambia and other African countries have developed export oriented horticulture. Kenya is often cited as a success story for FFV production and export amongst developing countries (see box below).

**Kenya: an export success story?**

Kenya is often cited as an example of a developing country that is a successful exporter of horticultural products. Agricultural products accounted for between 54 - 57 percent of the country's total exports over the period 1992 and 2000 in value<sup>13</sup>. With more than 330 million US dollars generated in 2002, after tea, horticultural exports are the biggest source of foreign exchange<sup>14</sup>. The industry employs 70,000 people<sup>15</sup>.

In 2003, Kenya was the world's leading exporter of fresh green beans for shelling (mostly french and runner beans, snow peas and sugar snaps) in value (FAOSTAT, 2004). Kenya is also an important exporter of more exotic tropical fruits like passion fruit. In 2003 Kenya exported 46,000 tons of vegetables and 20,000 tons of fruit up from 26,323 and 11,232 tons respectively in 1992<sup>16</sup>. This remarkable growth is attributed to a dynamic private sector that benefited from structural and macro-economic reforms<sup>17</sup>. Smallholder participation in FFV export chains has however decreased rapidly over the years: smallholder production for horticultural exports dropped from approximately 75 percent in 1992 to about 18 percent by 1998<sup>18</sup>. One large company, Homegrown, is dominating the export (see chapter 2).

The EU is by far the most important destination for Kenyan fresh horticultural produce, accounting for 85 percent in 2000. In 2003, Kenya was, after Morocco, the biggest fresh vegetable supplier to the EU, accounting for 16 percent of developing country imports. Kenya also exports to Saudi Arabia and South Africa.<sup>19</sup> Although exports have fared well, smallholders have difficulties to sell their produce to European retailers<sup>20</sup> and are increasingly excluded from the export chain.

Large parts of productive land where people were growing food for local consumption has been turned into land for growing food for export. In the 1970s, Kenya was largely self-sufficient in food, now it is a net food importing country that has compromised its food security.<sup>21</sup>

→ **Critical issue**

Some countries like Kenya have food security problems related to increasing export production. In Mindanao (Philippines), 50% of the land has turned into the hands of foreign multinationals producing fruits, such as bananas by Dole, and other commodities for export. This has left the local population without land and food for local consumption resulting in hunger and migration.<sup>22</sup>

Most fruit and vegetables in developing countries are produced in fields rather than in greenhouses, a common production method in developed countries. Hence producers in the developing world tend to have very low input costs in terms of energy. They can also rely on an abundant and cheap supply of labour. Other important factors that explain growth of FFV exports from developing countries are technical improvements in storing

and conditioning, improved (use of) inputs (irrigation, seeds, fertiliser, pesticides), increased scale of production, improved agricultural equipment, cultivation and harvesting techniques, better and cheaper logistics (refrigerated bulk sea freight services) and, last but not least, increased demand from developed countries<sup>23</sup>.

#### **China, giant producer and growing exporter**

China produces over a third of all fruit and vegetables in the world, making it the largest global producer of FFV. Half of the world's vegetables and 16 percent of all fruits are grown in China. Although China only currently exports 1 percent of its vegetable production, exports are growing by 10 percent annually<sup>24</sup>. And although total FFV exports grew by 30 percent from 2002 to 2003 only 2 percent of China's 2003 fruit production was exported<sup>25</sup>.

China mainly exports temperate fruits like apples, tangerines and pears and its most important export market is Russia. Other primary markets are mainly located in South-East Asia<sup>26</sup>. China ranks second in world apple and pear exports in value amongst developing countries.

Important markets for Chinese vegetables are Japan, Hong Kong, Russia, South Korea and Singapore<sup>27</sup> and China is the world's leading exporter of garlic by value. The use of plastic tunnels has been a key factor for the country's growth in vegetable production<sup>28</sup>.

## **1.6 EU consumption and fresh fruit and vegetable imports**

### **1.6.1 Consumption**

In the EU countries, fresh fruit consumption totalled 25 million tons in 2003 and vegetable consumption totalled 30 million tons<sup>29,30</sup>. There has been a trend towards healthier diets in the West that increased consumption of FFV between 1980 and 1995<sup>31</sup>. However, EU fruit and vegetable consumption has been stable in recent years and levels of consumption are often far below the recommended levels of intake.<sup>32</sup> There are wide variations between countries. For instance, consumption of FFV is relatively high in Italy and Germany and low in Scandinavian countries like Denmark, Finland and Norway<sup>33</sup>.

There are also differences within countries for the volume of FFV consumed over time. In some EU member countries, like Germany and the Netherlands, consumption has shown a slight decline<sup>34</sup> in recent years. Only in 2005 did the Netherlands show a slight increase.<sup>35</sup> Whereas in Spain it is steadily growing. In the UK, where FFV consumption is typically low, fresh fruit consumption increased by 23 percent between 1990 and 2000. However consumption of potatoes and fresh green vegetables in this same period decreased by 29 and 13 percent respectively. Tomatoes and mushrooms, on the other hand, showed an increase of 5 percent which has kept consumption relatively stable<sup>36</sup>. Due to a growing demand for convenience foods (eg. pre-packed and cut FFV) and growing concerns over health, analysts expect a growth in consumption of prepared vegetables and salads and fresh fruit over the coming years in the UK<sup>37</sup>.

## **1.6.2 Imports**

Bananas are the leading imported fresh fruit, with 4.9 million tons imported in 2002, accounting for a quarter of the EU's total fruit imports. Tomatoes are the leading imported fresh vegetable with a 22 percent share of total vegetable imports.

In 2002, fresh fruit originating in developing countries and imported into the EU totalled 4.95 billion US dollars and 6.88 million tons: an increase of 18 percent in value and of 7 percent in volume since 2000<sup>38</sup>. This also represented 35 percent of all fruit imports into the EU in 2002. Developing countries are major EU suppliers of papayas, tamarinds & lychees, pineapples, bananas, dates, guavas & mangoes and passion fruit. The leading suppliers of fresh fruit from developing countries to EU markets are in descending order of importance: South Africa, Costa Rica, Ecuador, Chile and Colombia<sup>39</sup>.

EU imports of fresh vegetables amounted to 696 tons and 793 million US dollars in 2002. An increase of 33 percent in volume and 40 percent in value since 2000<sup>40</sup>. 10 percent of all EU vegetable imports in 2002 were produced in developing countries. Morocco is the leading fresh vegetable exporter to the EU from amongst the developing countries and other important suppliers in decreasing order of importance are: Kenya, Turkey, Egypt and Thailand<sup>41</sup>.

### **→ Trend**

Whereas FFV consumption in the EU has remained relatively stable in recent years, there has been a growth in FFV imports from developing countries, making them increasingly important suppliers to EU markets.

## **1.7 Labour rights, environmental impact and trade related issues**

This section provides a short overview of some important critical issues in the FFV supply chain. Most research on these issues, which include working conditions and environmental impacts of FFV production, is done in the banana sector. Critical research on most other FFV is very limited. For instance, apart from SOMO research, there is virtually no research in this field on the mango sector.

### **1.7.1 Labour rights**

#### **Child labour**

Child labour in agriculture is widespread. According to estimates of the International Labour Organization (ILO) at least 250 million children between the ages of 5 and 14 work worldwide. Half of them work full-time. Most of them work in agriculture. The ILO minimum age convention (C138) bans all forms of commercial labour by children under 14 years old. According to the same convention, however, children are allowed to work in family or

small-scale agricultural holdings for local consumption, as long as the work is not dangerous for the children nor prejudices their education.

Child labour is mostly found in more marginal, family- owned horticultural plantations. Nevertheless children also work, often alongside their parents, on large-scale, capital intensive plantations. In general, children perform time-consuming and relatively unskilled activities on farms for little or sometimes no pay at all. Often their work serves to release time for adult members to increase household earnings. However child labour can be hazardous and can constitute a barrier to school attendance or performance even in the context of the family<sup>42</sup>.

Children work in fruit and vegetable production in developing countries that are important FFV exporters like<sup>43</sup>: Mexico, Chile, Brazil, Ecuador, Guatemala, Peru, Colombia and Costa Rica in Latin-America; China, Thailand and the Philippines in Asia; and Cote d'Ivoire, Kenya, Zimbabwe, South Africa, Senegal and Burkina Faso in Africa. On at least Ecuador's banana plantations<sup>44</sup> this child labour takes on the worst form (hazardous work, long working days). Child labour does not only occur in developing countries, for example, young children also work in FFV production in the US<sup>45</sup>.

### **Bonded labour**

In the definition of slavery, the use of forced labour in agriculture is confined to a small number of countries with extreme civil unrest. However, newer forms of forced or bonded labour are more widespread. This is mostly in the form of debt bondage where workers have to repay debts through labour in the fields. For example, migrant workers may be promised good jobs on condition they pay labour recruiters for securing them work and arranging transport to the workplace. When they arrive, conditions and pay may be disappointing, but nevertheless they owe the middle man and/or their employers. Often debts will grow and they cannot get off the treadmill, in other words, they are bonded. Sometimes additional measures are taken to prevent workers from leaving these conditions, like retention of working papers or even violence<sup>46</sup>. Examples of developing countries that export FFV, and where forced and bonded labour in the agricultural sector occurs, are Brazil, India, Pakistan, Ghana, Cote d'Ivoire and Senegal<sup>47</sup>.

### **Freedom of association**

In many countries that export FFV, like the Philippines, Thailand, Kenya and Indonesia, the right to freely organise is acknowledged by law. In practise however workers find it difficult to join free trade unions and to carry out union activities like collective bargaining or exercising their right to strike. Costa Rican legislation, for instance, acknowledges freedom of association but in practice agricultural workers do not have the freedom to associate and/or to form a trade union. Brazilian legislation also acknowledges the right to freedom of association, but particularly in rural areas, workers who actually make use of this freedom encounter serious resistance from employers. They are blacklisted, have difficulty finding employment, and are subjected to threats. Also activities to improve working conditions, like going to court and seeking police protection might be time-consuming and costly and most workers do not have either the money or time to do this.



Hence only the most courageous and active challenge the status quo. Countries like China do not acknowledge the right of freedom of association at all<sup>48</sup>.

### **Gender issues and discrimination**

Many seasonal workers in developing countries' (export oriented) horticulture are women. They are more likely to be dependent on this type of unskilled and low pay labour because in general they have less education, land and money than men. Women continue to have primary responsibility for housework (the care of children and the elderly) so that increasing participation in paid employment often simply means women work extra long hours, making them even more disempowered and likely to suffer health problems. In addition, because of their family responsibilities, women have less chance of securing permanent jobs (which bring social security benefits) and they tend to move in and out of the labour force several times over the course of their lives, leaving them with fewer opportunities for continuous training and lifelong learning.

Women's participation in horticulture varies from country to country. For example in Ghana women form the minority of the workforce, while in Zimbabwe they form the majority, especially amongst casual workers<sup>49</sup>. In the South African fruit industry, 69 percent of workers are women. But in Mexico a 1999 study into the mango supply chain found a proportional division of 63 percent men and 37 percent women. The women usually work in packing while the men harvest the crops. In the field study commissioned by SOMO in Senegal it was found that the majority of the seasonal and daily workers employed by producer-exporters of mangoes are women because the bulk of the work, selecting, packing and post-harvest treatment of mangoes, is exclusively female work (see chapter 3).

Discrimination against women is not uncommon in agriculture. For example, women in Burkina Faso do not have the right to own land or earn money directly from growing. Discrimination against women is also known to occur in the agricultural sector in South Africa and on banana plantations in Latin-America. Interestingly, although it is known that women can suffer discrimination within the agricultural sector in Senegal, the case study conducted for this report revealed no discrimination on the plantations included in the research. Other kinds of discrimination exist as well. For instance, in Ghana there are significant differences between the treatment of workers from local communities and migrant workers<sup>50</sup>.

### **Living wages**

In many FFV producing countries, like the Philippines, Thailand, Senegal and Indonesia, minimum wages are set by law. However, according to the US State Department, these wages do not constitute a living wage and violation of minimum wage standards is common in these countries. In the case study in Senegal it was found that wages in the mango sector were considered by (field) workers as too low to be able to support their families and they were obliged to supplement their wages with other professional activities. Their problems were made worse by the fact that there often is a shortage of work during the mango season.

In important FFV exporting countries like Kenya and Cote d'Ivoire minimum wages do not apply to agricultural workers. Banana plantation workers in Latin America can earn as little as 1 percent of the final price of a banana. In Nicaragua, for instance, banana plantation workers earn as little as one dollar a day, and in Ecuador, between 3 and 5 US dollars a day<sup>51</sup>. In Kenya, workers in pack houses for FFV exports typically earn 60 percent more than similar workers in other sectors. But workers are under pressure to meet deadlines from orders from supermarkets in the developed world and this frequently leads to long working hours and misuse of overtime<sup>52</sup>.

### **Health and safety**

Most agricultural work in developing countries is physically demanding: long periods of standing, stooping, bending and repetitive movements in awkward body positions. The nature of this work can therefore directly affect the health of workers. Additionally, (field) workers are exposed to the physical hazards of weather, terrain, fires, dust and machinery and the toxicological hazards of pesticides, fertilizers and fuels. Also, because work can be very tiring, it increases the risk of accidents. The ILO estimates that every year at least 170,000 agricultural workers are killed worldwide as a result of workplace accidents of which about 40,000 are from exposure to pesticides<sup>53</sup>.

Although increasingly stringent food quality demands from Northern buying parties and requirements of Good Agricultural Practices (GAP) for developing world FFV exporters have resulted in restrictions on the use of the most hazardous pesticides, problems still exist. For example, workers may be untrained in handling and in the application of pesticides which can result in accidents or health problems. And because of high temperatures and/or ignorance of the health hazards, workers are not always willing to wear uncomfortable protective clothing that is available for them when spraying pesticides. Other problems can arise because of poorly maintained equipment, inadequate storage practices and the reuse of old chemical containers for food and water.

### **Other labour rights**

As work in the FFV sector for plantation and handling workers is typically seasonal, they tend to experience less attractive working conditions than permanent workers. Typically, seasonal workers do not receive pensions or payments during illness or pregnancy and do not enjoy job security in the form of a contract.

Working days in agriculture can be extremely long during planting and harvesting and there is little chance of rest. The fact that many workers are at least partly paid on a piece-rate basis means there is a strong financial incentive to work as long as possible to maximize income. Also, because workers might be working far away from home, many field workers have no proper meal in the course of the day which increases their fatigue and undermines their productivity. At the other extreme during off-peak times working days are short or there might be no work at all<sup>54</sup>.

### **1.7.2 Environmental impact**

The environmental impact of banana production in Latin America has been extensively researched. Industrial banana production causes deforestation and other loss of biodiversity, soil degradation, erosion and contamination, water pollution and (plastic) waste<sup>55</sup>. The sector is infamous for its abundant use of pesticides. According to a publication in 1998, the Costa Rican banana industry was using up to 44 kilograms per hectare per year, or about 16 times the estimated level of 2.7 kilograms per hectare utilised in intensive agriculture in the industrialised countries, in pesticide control<sup>56</sup>.

There is very limited research on the environmental impact of production for other FFV. Although there are reports that pesticide use in the Costa Rican pineapple plantations is almost as high as that used for bananas<sup>57</sup>. However there is a wide variance in the environmental impact for different types of FFV production. Mango production is, for instance, in many aspects much more sustainable: growers typically use much lower doses of pesticides and fertilizer (see Senegal case study in chapter 3) than, for example, banana or citrus production.

FFV production in both the North and South requires huge amounts of water. Export oriented mango production in Senegal also uses considerable amounts of ground water, and to a much lesser degree tap water, for irrigation. This raises concerns about the risk of groundwater shortages leading to higher salinity in the water used for irrigation and adverse effects on soil and crop quality. However, production of vegetables for export in Senegal requires much more water and vast amounts of tap water are used for irrigation. This is an important reason for the serious drinking water shortages in the city of Dakar.

In South-Africa, the Kruger Park (a nature reserve) suffers from a lack of water partly as a consequence of export oriented orange production which consumes a large part of the river water. Since rivers have dried up (in combination with drought in recent years) the wildlife in the park needs to be supplied by artificial water sources. On the other hand, in the same study<sup>58</sup>, it was found that water pollution and eutrophication, caused by runoff from pesticides and fertilizers applied in South African orange orchards, appeared to be low.

The environmental impacts of transportation (emissions of trucks, airplanes and boats) and cooling (emissions of CO<sub>2</sub> and chemicals) of FFV are also significant in the production of FFV in developing countries.

## 1.8 Summary and conclusions

In 2003, annual global production of fresh fruit and vegetables (FFV) totalled 1.35 billion tons (FAOstat) and international trade in FFV amounted to 73 million tons and 45 billion US dollars. Both production and international trade in FFV has grown by 43 and 37 percent respectively in volume over the last decade. Trade in volume has grown more than for any other agricultural commodity. The primary internationally traded FFV by value are, in descending order of importance, bananas, tomatoes, apples, grapes, oranges and peppers and chillies. Exports of “non-traditional” tropical fruits like mangoes, papayas and pineapples have more than doubled in value over the last decade. This growth was much stronger than that of temperate fruits and traditional (sub)tropical fruits like citrus and bananas. But with a 62 percent increase in value from 1994 to 2003 total fresh vegetable exports in general are growing faster than those of fruit.

Real prices for horticultural commodities have declined over the last decade but much less so than for those of agricultural commodities in general. Real prices for most selected FFV, and especially for vegetables, have actually declined little. Prices for some FFV (bananas, avocados, papayas, green beans) have however fluctuated considerably over time and in some cases have dropped (more) structurally (mangoes). This causes a problem for developing countries that are heavily dependent on a few FFV for export income.

While developing countries capture a third of world FFV exports in value, and this share is growing, just a handful of developing countries, mainly from Latin-America, account for two thirds of all developing country exports. In particular, fresh vegetable exports are dominated by just two countries: Mexico and China. Least developed countries have a marginal share with only 0.7 percent of all developing world FFV exports. In general developing countries that are successful in exporting FFV have more developed infrastructures and mostly rely on large-scale commercial farming for production.

Although FFV consumption in the EU has remained relatively stable in recent years, the importance of FFV imports from developing countries is growing, making them increasingly important suppliers to EU markets.

There is limited research on the rights of workers, environmental impacts and trade relations in the FFV sector in developing countries. However the findings in this report suggest that much is still to be done to improve working conditions: child labour is widespread, bonded labour is not uncommon, the right of freedom of association is often restricted, wages are too low and there are problems concerning the health and safety of (seasonal) workers. Also, it is clear that FFV production sometimes can be associated with loss of biodiversity, pollution via chemicals (pesticides, fertilizers) and elevated water consumption.

- 1 Amount refers to total production of fresh fruit, whether finally used for direct consumption for food or feed, or processed into different products: dry fruit, juice, jam, alcohol, etc. And amount relates to all vegetable crops grown mainly for human consumption. Crops such as cabbages, pumpkins and carrots, when explicitly cultivated for animal feed, are therefore excluded. Potatoes, roots and nuts are excluded. Selected FV: Cabbages; Artichokes; Asparagus; Lettuce; Spinach; Tomatoes; Cauliflower; Pumpkins, Squash, Gourds; Cucumbers & Gherkins; Eggplants; Chillies & Peppers, Green; Onions & Shallots, Green; Onions, Dry; Garlic; Leeks and Oth.Alliac.Veg; Beans, Green; Peas, Green; Broad Beans, Green; String Beans; Carrots; Okra; Green Corn (Maize); Mushrooms; Vegetables Fresh nes; Olives; Watermelons; Cantaloupes & oth Melons. Selected FF: Bananas; Plantains; Oranges; Tang.Mand.Clement.Satsma; Lemons & Limes; Grapefruit & Pomelos; Citrus Fruit nes; Apples; Pears; Quinces; Apricots; Sour Cherries; Cherries; Peaches & Nectarines; Plums; Stone Fruit nes, Fresh; Strawberries; Raspberries; Gooseberries; Currants; Blueberries; Cranberries; Berries nes; Grapes; Figs; Mangoes; Avocados; Pineapples; Dates; Persimmons; Kiwi Fruit; Papayas; Fruit Tropical Fresh nes and Fruit Fresh nes.
- 2 This study deals with fresh FFV. Dried, preserved or otherwise transformed or processed fruit and vegetables are therefore excluded from all calculations. As production data is not specific about future use of crops this percentage is somewhat low. For example most of the olives exported are preserved and hence not included in the trade figures however production data for olives is included.
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potatoes not included



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<http://www.agriculture.purdue.edu/agtransition/pubs/FF-10.html>> (February 2005)  
 32 Baas et al., p. 56  
 33 CBI, 2004, p. 17  
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 35 Verse groente weer populair, Metro, 10 March 2006.  
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 Fruit and Vegetables(Key Note, April 2004), p. 20  
 37 Key Note, p. 1  
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 39 CBI, 2004, p. 63  
 40 CBI, 2004, p. 64  
 41 CBI, 2004, p. 65  
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## Chapter 2

# Corporate structures of the FFV chain

Not much information is easily available about the corporations behind production, trade and retailing of fresh fruit and vegetables (FFV) and how they structure the market. Most statistics refer to countries, as described in chapter one, rather than the corporations that are behind those statistics.

This chapter outlines the main corporate entities and market structures in the fresh fruit and vegetable chain, from production in developing countries to supermarket sales in the North, concentrating on the EU and producers in the South. How retailing affects the entire FFV chain is a major focus. It leaves out the beginning of the chain: the companies that deliver the seeds for fruit and vegetables plants, the seed biotechnology and the agrichemicals used in production. These three types of businesses are increasingly in the hands of the same companies and are already very concentrated.<sup>1</sup>

### 2.1 Export production: trend towards large-scale companies

The export production of fresh fruit and vegetables is highly fragmented and diversified, from small farmers and farmer cooperatives to large-scale farmers using modern crop management systems and plantations owned by multinationals. The involvement of large scale production businesses varies for different fruit and vegetables. In some developing countries, a few large farming companies export are responsible for a significant market share of (packaged) FFV exports, as is the case with Safina in Senegal (fruit and vegetables) (see chapter 3) and Homegrown in Kenya (vegetables). Large-scale production of FFV for export raises the question as to whether small farmers are being squeezed out of the market and might have nothing to gain from further trade liberalisation.

#### 2.1.1 *Fruit combines and fruit brands*

Fruit combines that group together different producers and look after common interests, have grown up on the American Continent. They run their own plantations and, if necessary, buy additional products from private producers. Many also own their own fleets of ships. The role of fruit combines in the FFV chain is expected to increase in the future.<sup>2</sup>

Most fruit and vegetables do not have brands that are recognized by consumers. Some FFV products have branded labels and are exported throughout the world. Branded fruit and vegetables come from large international producers and marketing businesses such as<sup>3</sup>:

- ❑ Capespan (South Africa, with branded fruits such as Cape apples, Outspan citrus fruit, Goldland citrus fruit, Bella Nova exotic fruit)
- ❑ Carmel (Israel, a range of FFV, also herbs, wine)
- ❑ Coplaca (Canary Islands, bananas and other FFV)
- ❑ Enza (New Zealand, especially apples and pears)
- ❑ Turbana (Colombia, bananas)
- ❑ Sunkist (US, citrus fruit)
- ❑ Sun World International (US, 75 varieties of FFV)
- ❑ Zespri (New Zealand, kiwi)

Many of the companies have the characteristics of fruit combines and are the result of producer cooperatives and, or, marketing support organisations. They group different producers to strengthen their capacity to access transport and to increase global export possibilities. For instance, Sunkist is a not-for-profit marketing cooperative entirely owned by and operated for the 6,500 California and Arizona citrus growers who make up its membership. On the other side of the spectrum, Capespan is not only selling produce from South African growers but is also “leasing production areas” throughout the world so that the many products that are allowed to carry its brand labels have a year-round availability. Capespan’s activities cover many links in the FFV chain, from support for producers to a close relationship with retailers such as supermarkets. This is the result of different collaborative agreements, disappearing or privatised marketing boards, and mergers with producer groups or trade agencies. Out-growing, producing under contract for exporting companies or fruit combines is common practice.

Many of the above mentioned brands make promotional material that is used to promote sales directly to consumers. They are thus supporting retailers in promoting their products. Some brands also process their products, such as Sunkist citrus drinks.

→ **Critical issue**

Fruit producers that have been very successful in exporting and supplying large retailers have done so by becoming big farms or by forming cooperatives which bring other organisations or companies with packing, exporting, marketing and distribution capacities under one roof. This model could be useful for developing countries where retailer supply requirements are squeezing small farmers out of the market.

Setting up such a corporate model for fruit exports takes time and needs a lot of financial and human resources to establish the complex communication and logistics networks. For many small and poor producers in developing countries, this cannot be done without external support.

The question is whether such businesses with collaborative structures can continue or whether they will move to operate as large fruit producing multinationals as they need to respond to retailers’ demand for large volumes of good quality, year-round and low price products.

**table 5: Different parties and activities involved in the production of FFV**

| <b>Parties involved in production</b>        | <b>Scope of work in production chain</b>   |
|--|--|
| Producer                                     | fresh fruit production<br>pre-harvest treatment<br>first processing level<br>quality control<br>packaging for trade  |
| Fruit combines                               | fresh fruit production, in some cases buying from other producers<br>quality control<br>packaging goods for export<br>sale of export goods in their own name (including to contract importers) |
| Private and co-operative export organisation | goods treatment (washing, sorting, etc.)<br>packaging goods for export, often in customer's packaging (with price tags)<br>sales and marketing in their own name or on behalf of their members |

Source: CBI, EU Market Survey 2004 Fresh Fruit and Vegetables, September 2004

### **2.1.2 Bulk products and large-scale production: the example of bananas**

Production of fruit is much more in hands of large organisations and multinational companies than the production of vegetables, which are less exported and sourced more close to consumption.

Traditionally there have been a few bulk fruit products whose production has been large-scale. Eighty percent of world banana exports are grown on plantations of between 100 and 4,000 ha<sup>4</sup>. Bulk fruit production is mostly owned or controlled by multinationals, such as pineapples (Del Monte Fresh Produce, Dole) and bananas (Dole, Del Monte fresh Produce and Chiquita). These multinationals source their produce on a global scale and take care of all processes involved in exporting produce: production, pre-harvest treatment, quality control, washing and packaging of the goods. This handful of multinationals are now using a diversification strategy throughout the FFV chain to add a whole range of FFV products (see 2.2.3 and 2.2.4).

The five leading banana companies<sup>5</sup> controlling an estimated 78% of world exports (2003) are Dole, Chiquita, Del Monte Fresh Produce, Fyffes and Noboa. The same multinationals have dominated the banana sub-sector for decades and their market share has grown consistently, from 47% of world market share by the top three multinationals in 1966<sup>6</sup> to around 60% in 2003.

The banana companies are highly integrated and control the entire chain from production to distribution. Not all have the same production strategies. While Dole, Chiquita and Del Monte Fresh Produce and Noboa own or lease part of the plantations from where they

source their bananas, Fyffes totally divested its land property in the 1990s. Bananas that are not grown on company controlled land are supplied to the banana multinationals through contracts with independent producers. This allows the banana companies to control supply and production with minimal risk of having to pay for bad harvests or low productivity.

Ownership of plantations allows banana multinationals to have much better control of the required quality and supply. The three leading banana companies have been divesting their old plantations and reinvesting in new areas, like Del Monte Fresh Produce in Brazil. Others favour West Africa because of the EU import regime (see chapter 6, box: The many aspects of the preferential banana import regime) and low production costs.

**table 6: Overview top 5 banana companies in 2003**

|  | <b>Dole<br/>(US)</b>                                       | <b>Chiquita<br/>(US)</b>  | <b>Fresh Del Monte'<br/>(US)</b>                                   | <b>Fyffes<br/>(Ireland)</b>                            | <b>Noboa<br/>(Ecuador)</b> |
|--|--|---|--|--|----------------------------|
| World rank (imports)                       | 1<br>(Est. 23%)  | 2<br>(Est. 22%)   | 3<br>(15%)   | 5<br>(Est. 7%)   | 4<br>(Est. 11%)            |
| Net sales 2003 (in million US \$)          | \$ 4,773   | \$ 2,614  | \$ 2,486   | € 1,924  | \$ 500                     |
| Net income (m US\$)                        | \$ 84  | \$ 99   | \$ 57  | € 63   | n.a.                       |
| Banana sales 2003 in % of total sales      | 28%  | 60%   | 39%  | n.a.   | n.a.                       |
| % banana supply from company owned sources | Est. 25%   | 40%   | 28%  | 0%   | 20%                        |
| Employees<br>Full time<br>Seasonal         | 36,000<br>23,000   | 24,000  | 26,000<br>2,000  | 2,700  | n.a.                       |
| Main source countries                      | Latin America (Ecuador 30%)<br>Philippines,<br>West Africa | Latin America (Costa R /Guatemala)<br>Philippines,<br>Ivory Coast | Latin America, (Guatemala/Costa Rica),<br>Philippines,<br>Cameroon | Latin America,<br>West Africa,<br>Caribbean<br>the EU, | Ecuador                    |
| Main markets                               | USA, EU,<br>Japan  | USA, EU,<br>Japan   | USA, EU, Japan   | EU   | USA, EU,<br>Japan          |

Source: A. van de Kastele based on company sources (annual reports, SEC filings), FAO, Banana Link reports, América Economía for information on Noboa.

The banana multinationals control 100% of exports from Guatemala, Honduras, Panama and Belize, and 80% from Costa Rica.<sup>8</sup>

It is worth noting that banana exports increased while real world prices decreased by 25% between 1960 and 2003 (see chapter 1). This is due to the oversupply on the world market and increasingly the pressure on prices from retailers.

→ **Critical issue**

Many serious problems have been reported in the production chain of the four leading multinationals (see chapter 1). The pressure from retailers for lower prices, combined with an oversupply in the market, is making the situation worse. There are reports of pay cuts and the increased use of short term contract labour.

Although fair trade and organic bananas are available as alternatives, their market share and consumption is limited. For example, organic banana consumption is 1% of world consumption; the largest market for fair trade bananas is Switzerland: 50%.<sup>9</sup>

### **2.1.3 Non-bulk fruit and vegetables**

Export production of quite many FFV categories are not dominated by multinationals. For example, small or independent farms and plantations produce mangoes. This fruit is imported via specialised trade wholesalers who often have direct relations with producers as well as retailers (see chapter 3). There is however a growing trend in developing countries for large-scale production of non-bulk fruit and vegetables.

### **2.1.4 Trends in demand that stimulate large-scale production**

Consumers in (Western) supermarkets are attracted by high quality fruit presented in attractive packaging. The demand from buyers for quality and attractive packaging is particularly high in Japan and the US.<sup>10</sup> Examples are individual wrappers for Fuji apples or packaging designed to appeal to children.

This consumer demand requires a sophisticated mind-set from producers which puts the consumer first, rather than production priorities.<sup>11</sup> Producers need to pick and store in ways that keep the FFV intact and slow down the ripening process until it reaches the consumer (known as the 'cold chain'). Consumer demand for high quality and improved standards on chemical residues as well as on social and environmental compliance and product traceability has put pressure on producers to use sophisticated technology. However, as producers meet the additional costs of compliance and certification requirements (see also chapter 5), they are faced with falling prices and fewer outlets with markets increasingly dominated by large-scale retailers. This has led to a growth in large-scale production to reduce production costs and increase efficiency. The trend is set to continue in the current competitive market where, for example, even banana companies are struggling to get contracts from large supermarket chains. Mergers and acquisitions at the producer level are likely to intensify in the coming years<sup>12</sup> as vertical integration of FFV companies increases in order to shorten supply chains.

## → Critical issues

It is expensive and challenging for new entrants to penetrate the current FFV export market which favours large-scale production. This makes it particularly difficult for small farmers. Although this does not rule out their participation, it does require a very well organized pool of marketing or out grower schemes for them to be successful.<sup>13</sup> Many small producers need support to get successfully organized and to avoid that they become price takers who are forced to sell at prices below production costs.<sup>14</sup>

The question is how far this trend towards large-scale production will affect production of FFV that is currently in the hands of small farmers and companies. It is generally assumed that small-scale production is more labour intensive than large scale production<sup>15</sup> Therefore, increasing exports from developing countries may not automatically result in more jobs and poverty reduction. Some argue that economies of scale and rationalisation of farm production is good for the economy whereas others argue that poverty eradication and economic development starts from providing small farmers with enough income and purchasing power to spill over into the rest of the economy. Research indicates that both types of farming can reduce poverty.<sup>16</sup> In chapter 3 the case study from Senegal shows that where extensive production does not replace smallholder production but just fills an export niche, it creates jobs in rural areas where jobs can be scarce. However, if extensive export production replaces smallholder production, as is the case in Kenya, this could potentially lead to a loss of jobs in the sector. Also, smallholder participation in FFV exports leads to more food security and keeps social fabrics (e.g. wider geographical spread) more intact. More research on the effects of smallholder exclusion and inclusion in FFV export chains on poverty reduction is needed.<sup>17</sup>

Another concern relates to the trend of retailers and distributors to source from cheaper overseas suppliers. This is almost certain to continue as developing countries expand production and European producers are unable to compete.<sup>18</sup> The result is farm job losses in the North as Southern producers expand their export markets. The relentless pressure to keep prices low, however, cuts the profits of Southern producers (see below: buyer power).

Recent EU raids at the offices of multinational fruit companies over cartel claims involving alleged price-fixing in the European banana and pineapple market<sup>19</sup> raises the question whether even multinationals see a price cartel as the only way to deal with the continuing downward pressure on price from retailers.

## 2.2 Wholesale, export and import

Although the FFV chain is kept relatively short because it is perishable, a number of different actors are involved in the trade in FFV products:

- exporters



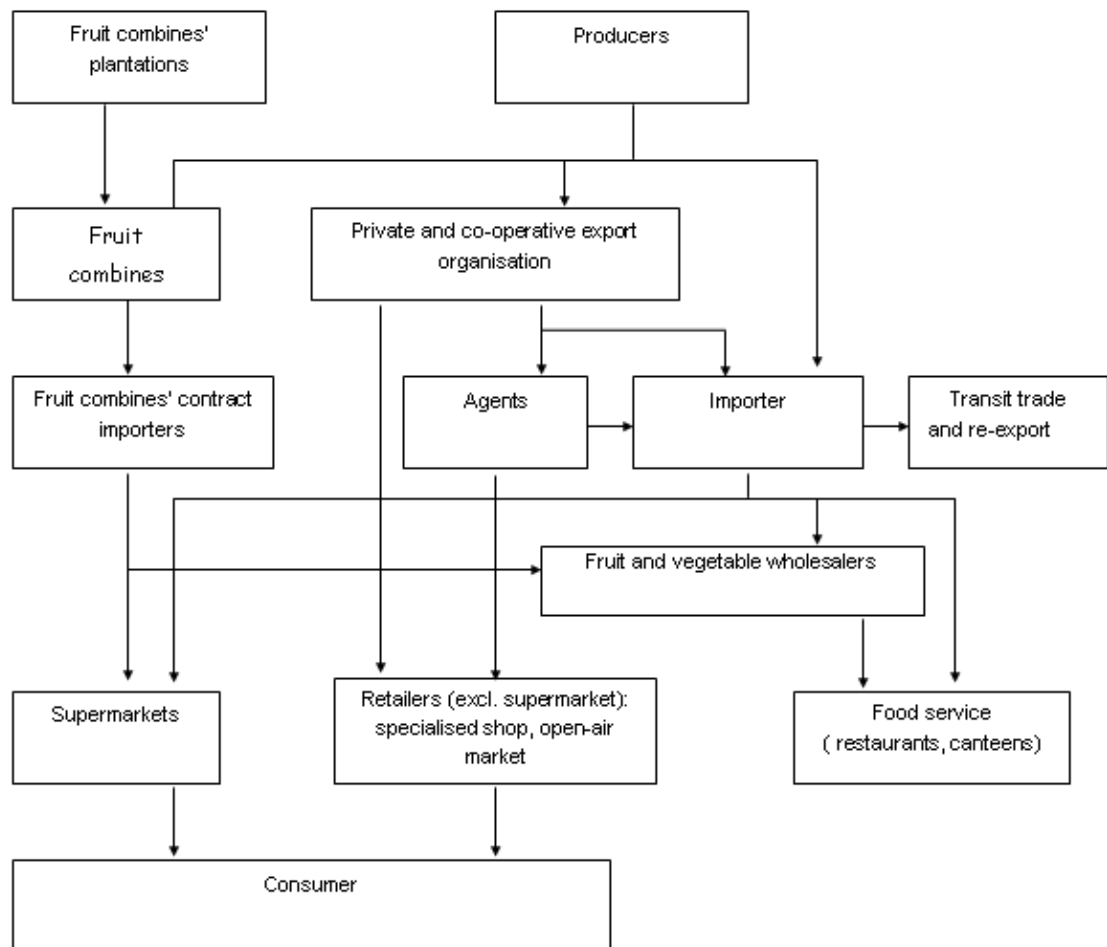
- fruit combines
- transport companies
- importers and (shipping or forwarding) agents that service importers by handling the import activities and papers
- commission agencies
- auctions
- wholesale traders, and wholesale dealers that service specialised FFV shops
- distributors
- sorting companies
- packaging companies
- buying groups

The different functions of exporter, importer, wholesale trader and distributor are becoming increasingly blurred as mergers and acquisitions bring them under individual company control.<sup>20</sup> For example, wholesale trade can be completely excluded when there is a direct link from producer to retailer. As this is increasingly the case, the role of independent auctions and wholesale dealers is diminishing.<sup>21</sup> The different actors in the FFV chain from export to import and distribution are described in figure 6.

International traders and wholesale traders identify FFV products in global markets and channel them into the distribution chain. Wholesale has traditionally been an important interface between producers and retail trade. Now, some large-scale producers and fruit combines also export their own produce. For example, Chiquita, Dole and Del Monte export their own bananas and pineapples. In addition, they source from other producers. Small-scale producers who are supplying these companies benefit from a guarantee to export and other support. However, the continuous drive to squeeze costs has intensified mergers and acquisitions and only the most efficient suppliers to these multinationals are likely to survive. Also, importers, distributors and retailers prefer to deal with large-scale producers and exporters, and tend to favour vertically integrated export operations that are able to provide fully-assured produce.

Small-scale producers without contracts rely on middlemen or exporters to sell their produce. Middleman can work for exporters and source produce from the countryside. In times of harvest and overproduction, they are able to buy at low prices or delay payments to producers when producers have no storing facilities and need to get rid of their perishable produce. This leaves producers unable to invest in better systems to avoid selling when prices are low.<sup>22</sup> Sometimes small-producers export their produce jointly with other small-scale producers in a cooperative.

**figure 6: Distribution network of FFV trade in the European Union**



Source: CBI, Trade structure for FFV in the EU, 2004, chapter 7.

→ **Critical issue**

Current export structures, outside those of large companies, cannot provide small producers with enough bargaining power, storing facilities and price management techniques to enable them to receive fair prices. Coordinated support from public or cooperative structures do not exist in many developing countries and donors have advised against marketing boards.

**2.2.1 Transport: freight services**

FFV requires careful transportation, a capacity which is not always available in developing countries. Ripening is slowed down during transport through a “cold chain” of refrigerated logistics. Transport can be by road, rail, air and sea.

As the handling of the cool chain and sea freight have improved and become more economic, developing countries have more export capacity to exploit the off-season markets in countries with temperate climates. For example, switching from air to sea freight services for produce such as mangoes and green beans has made them cheaper. As a consequence producers in temperate zones are losing their markets to those from the cheaper South.

Transport prices vary between continents in function of distances from exporting to importing country. For example, shipping prices from Latin America to Europe are lower than from Asian countries such as Malaysia or Indonesia.<sup>23</sup>

### → **Critical issue**

As supermarkets continue to demand low prices, freight charges play an important role in determining which FFV products are imported into developed countries.

### **Sea freight<sup>24</sup>**

Bulk FFV products such as bananas, citrus, grapes, apples and other stone fruits are transported in high volumes by refrigerated ships ("reefers"), or using ships with refrigerated containers. Chiquita, Dole and Fresh Del Monte own a fleet of reefers and also have long term contracts with reefer companies that ship from the same ports. Although Fyffes invested in a fleet in the 1990s, it decided to dispose of its freight shipping business in 2001.<sup>25</sup> Ownership allows for investment in specialised techniques for shipping bananas and other FFV produce that improves quality and facilitates the ripening process. Ownership needs a high capital investment that can only be profitable if the company has a high volume of produce all year round. Some banana multinationals have also invested in port facilities.

The majority of fresh fruit travels on regular routes hired through fixed, seasonal contracts, or in reefer vessels on scheduled liner terms. Export groups that operate worldwide increase the trend towards more regular sea transport services.

When no space is available with regular shipping services, a broker is hired to find shipping space on the spot market. During the season when large quantities of fresh fruit needs transporting, e.g. from South America and New Zealand to Europe in January - May, there can be a lack of shipping capacity and the freight prices on the spot market shoot up. There was a consistent trend towards higher spot prices for reefer shipping services which began in 2003 and which slowed down at the end of 2005.<sup>26</sup>

The reefer fleet has an estimated total of 1200 vessels. The world's leading reefer operators are:

- ❑ Seatrade (about 130 ships),
- ❑ Lavinia (about 80 ships),
- ❑ ReeferShip together with LauritzenCool (about 50 ships),
- ❑ Star Reefers (about 40 ships)

The specialized reefer industry is changing and can be volatile. New individual operators entered the world market after deregulation of the fruit sectors in Israel, South Africa and New Zealand. In recent years reefer companies appear to have been consolidating through mergers, acquisitions and different forms of collaboration. Also, traditional reefer services are being replaced by refrigerated container services.

There has been a global decline in reefer freight capacity over the last decade - a possible result of falling prices for freight before the rapid increase in spot prices since 2003. This could cause logistical problems in the future as the existing reefer fleet is ageing (average age of a ship is 19 years) and the demand for refrigerated shipping looks likely to increase. New ships are being built but they are unlikely to be in use before 2007. Possibilities for producers in developing countries to benefit from new FFV markets, such as in Russia and China or the reformed EU market from 2006 (see below), could depend on accessing shipping services at affordable prices.

→ **Critical issue**

When spot prices for reefer services shoot up, independent producers and traders are left with very little profit, especially if retail prices are low. Some producers have difficulties finding any possibility to ship their produce during seasonal peaks. The lack of access to cheap transport to developed countries has been a barrier for small independent or alternative (fair trade, organic) producers of FFV in the South to find their own export channels and chains.

The increase in FFV shipping does not factor environmental damage into the costs. Large ships burn some of the dirtiest fuel on the planet and emit gases that contribute to global warming, acid rain, lung disease and heart problems. However, in terms of fuel to cargo ratio, transport over sea is 100 times less polluting than air transport.

→ **Critical issue**

Environmental officials ignored pollution from marine vessels for decades while they regulated road transport. The problems look likely to intensify as shipping, for instance, to and from the US is expected to double by 2020 and environmental officials estimate that marine vessels will nearly double their percentage of US smog-forming pollution over the next 25 years. Increasing sea transport with dirty fuel will make it more difficult to reach the emission limits of the Kyoto Protocol.

### **Air freight**

Exporters of FFV produce that is highly perishable or exotic and produced in low volumes use air freight services. Consumers are willing to pay more for high quality or for something that is unusual.

There are two options for exporting FFV by air:

- cargo space on passengers flights

□ cargo flights in (chartered) cargo planes

FFV exporters who use cargo space on scheduled passenger flights are limited to whatever is available on each flight. They also face competition from other FFV exporters or from other products, like fish, especially in high season. Some exporters, as in Senegal, have developed a programme of chartered flights, but to make this economically viable they need to fill every flight.

Large airline companies have different strategies to handle freight. Lufthansa operates and owns cargo planes, and has hubs such as Miami or Nairobi where merchandise needs to be grouped. British Airways, in contrast, has no cargo planes and transports most cargo on passenger flights. When necessary the company hires cargo planes or cargo space. Air France has scheduled cargo flights. But company policy to maximise profits dictates itineraries. African airlines are developing freight services after the deregulation of landing rights.

→ **Critical issue**

Exporters in developing countries often have to fight to obtain freight space on (cargo and passenger) flights.<sup>27</sup> As a result, they have no guaranteed export possibilities for perishable goods.

The environmental costs of air transport are not incorporated into the price of these products. Air Transport is 100 more polluting than transport by boat, more than 10 times more polluting than transport by train and 5 to 1.2 times more than transport by road. More air transport will affect the reduction targets for CO<sub>2</sub> emissions as agreed under the Kyoto Protocol.

### **2.2.2 Importers and agents**

Importers take care of the import formalities and process imported goods for further distribution or for re-export to other countries. They also perform additional tasks such as ripening bananas, portioning and packaging fresh fruit for self-service, or re-palleting goods when necessary. In most cases, importers have long-standing contacts with their suppliers which is an advantage for small farmers. Importers advise their suppliers on issues such as quality, size and packaging. In some cases, importers also make use of agents.<sup>29</sup> Importers do not buy from wholesalers or wholesale markets in developing countries. Wholesale trading in developing countries is mostly for local markets when FFV is too ripe for export.

Specialised agents function as intermediaries for establishing contact between small producers, exporters and importers. They do not trade products on their own account. Agents maintain contacts with foreign suppliers, gather the produce necessary to fill containers for transport, and procure produce for their customers, who are generally wholesalers. Most agents work on the basis of a commission on the sale price.

Fruit combines (see above) have their own contracted importers and the significance of this structure is expected to increase in the future, because fruit combines have professional marketing directed at consumers which can be used by supermarkets and other retailers.<sup>30</sup>

Direct trading between producers or exporters and large retail chains is eroding the function of the specialised importers. Although in general, importers continue to play an individual and specific role in the chain, because they have a strong relationship with their suppliers and because they play an indispensable role as collectors of a broad package of products.<sup>31</sup>

### → **Critical issues**

The lack of wholesale trading for export in developing countries is making it difficult for small-scale producers to engage with the export network of importers and agents. In addition, export and import channels are narrowing because of the increasingly direct relationships with supermarkets.

Experts<sup>32</sup> consider importers as the most important distribution channel for exporters of fresh fruit and vegetables in developing countries because of their knowledge of international markets and relationships with suppliers and buyers. Importers know how to service supermarkets and play a role as quality controller, logistics service provider, and co-ordinator of the stream of goods to their final destinations. There is a question whether small-scale producers will continue to get access to these critical importer services as companies continue to integrate and concentrate their chains.

### **2.2.3 Trends in wholesale and distribution of imported FFV, especially in Europe<sup>33</sup>**

Developed countries have mature markets, which means that there is not much prospect for spectacular growth of FFV sales. However, the share of developing countries exports to the EU is still growing. In addition, exporters of exotic FFV are finding new markets in new member countries of the European Union where the integrated FFV companies do not yet have a stronghold.

In Europe, large wholesale traders or distributors are often closely linked to retailers which increasingly operate on larger scales, with centrally controlled systems of purchasing, and want to have the minimum number of suppliers. Retailers such as supermarkets are imposing costly requirements for good quality produce, food safety and all year round supplies, but at low prices. This means that distributors have to do their own sourcing to guarantee a wide range of products throughout the year. Distributors engage in direct links with producers and producer organisations and, as a result of this, traditional auctions and wholesale trade of imported FFV are losing their importance. This puts pressure on producers to increase production or to produce from different regions. For example, a number of Spanish growers are producing in more than one region of Spain, as well as in

the Canary Islands and in Morocco, to extend seasons. Consistency of supply over extended seasons has become a source of strategic competitive advantage for many producers and distributors.<sup>34</sup> A distributor such as Fyffes provides a range of services, including financing and marketing services for their producers (for example, Turbana in Europe). These distributors “communicate” their clients’ demands on quality, volume and food safety to producers, importers and exporters.

Distribution companies have engaged in mergers, acquisitions and alliances to meet supermarkets’ demands for large, cheap and diversified volumes of FFV. These consolidation activities are increasingly cross-border and cross-continental. For instance, the second largest Dutch FFV trader, Bakker Barendrecht (which is the main provider of FFV to largest Dutch supermarket, Albert Heijn), has been taken over by a Belgian distributor, De Weide Blik, which supplies the Belgian branches of the French supermarket chain Carrefour and has also strong positions on the South African and Uruguayan market. Both De Weide Blik and Bakker Barendrecht supply to wholesaler Makro in their respective countries.<sup>35</sup> Interestingly, when mergers or acquisitions take place between large distributors, the supermarkets they supply get involved in the discussions before the merger or acquisition takes place.<sup>36</sup>

Traditionally, trade in FFV has been in the hands of small family companies. Now some of the large FFV multinationals are getting involved as part of a strategy to diversify and increase scale. For instance, US multinational Dole is taking over a Dutch importer (Velleman & Tas) and taking over Swedish trader Saba.<sup>37</sup> Chiquita bought the German fruit and vegetable trader Atlanta that has a turnover of Euro 1 billion. This means that importers are increasingly in the hands of foreign companies.

In Europe, FFV wholesale traders and distributors can expect to operate in an environment of growing consolidation.<sup>38</sup> Analysts expect that major take-overs in the coming years will result in only 10 to 15 food distributors operating in Europe. These expectations might however underestimate the recently growing role of discounters who still buy on the spot market and look for the cheapest products available.

## → **Critical issues**

The growth of global FFV companies who manage and sometimes own the entire chain means that FFV is increasingly channelled through parallel large handling companies. This has major implications for both producers and exporters in developing countries. This reduces the marketing possibilities for small-scale and new producers of FFV in the South, even if trade barriers are reduced in the developed countries. Also, producers require huge financial and human resources to get organised and enter the concentrated FFV chain.

The strategy of discounters that want to source from the cheapest traders provide an opportunity to keep independent wholesale channels open but do not provide good prospects for good prices to the producers.



### **Strategies to increase margins through value-added**

The profit margins of wholesalers and distributors have been decreasing because of the competition for contracts with large-scale retailers and pressure for low prices. As a consequence, distributors now provide more value-added services to increase profits. This includes meeting supermarket demand for year round supplies, conceiving marketing concepts and promotional activities, cutting, washing, mixing, packaging, ripening of fruit, offering prepared salads, etc. Stock control is also an important service, along with logistics. The European distributor Fyffes<sup>39</sup> has diversified successfully (see box below). Distributors such as Geest have begun specialising in cutting and packaging salads and distributing many pre-cut salad mixes after selling its banana trade business. They are responding to a growing demand for 'convenience food', such as packaged cut vegetables or ready to eat salads.

Banana companies in general have sought to strengthen relationships with leading retailers through value-added services such as banana ripening and distribution, category management, branding initiatives and establishment of long-term supply agreements. Also, they are looking for higher margins by moving away from commodity fruits and vegetables towards more value-added products, as ready-to-eat salads, bagged vegetables, fruit bowls and processed produce.<sup>40</sup>

#### **2.2.4 Leading distribution companies and structure of the European FFV wholesale market**

The market structure of wholesale and distribution is different in many countries and for each FFV sector. For instance, in the markets of the EU, the Baltic and the Mediterranean distribution of bananas is much more fragmented than in the US where Chiquita, Dole and Fresh Del Monte control most of the banana chain.<sup>41</sup>

##### **Major distributors in the EU with largest market shares in the EU**

|                                       |
|---------------------------------------|
| Fyffes (United Kingdom/Ireland)       |
| Atlanta Group (Germany/US)            |
| Dole Fresh Fruit Europe Ltd. Co. (US) |
| Pomona (France)                       |
| Geest (United Kingdom)                |
| The Greenery (The Netherlands)        |
| Del Monte Fresh Produce (US)          |

Source: EU Market survey 2004, Fresh fruit and vegetables, Compiled for CBI by ProFound and R. Abbenhuijs, September 2004, p. 75.

The Atlanta Group claims<sup>42</sup> to be the largest distributor in Germany, and also in Europe. It operates mainly in Germany, but also in Austria, Italy, the Netherlands and Spain, and is expanding into all Eastern European countries with a full assortment of FFV. Its core business is bananas, citrus fruit and seasonal Southern European produce. In 2003, Atlanta was acquired by Chiquita.<sup>43</sup>

Fyffes also claims to be the largest fresh produce distributor in Europe and to be amongst the top five distributors globally.

**Fyffes**<sup>44</sup> is one of the few FFV companies operating at an EU wide level. With headquarters in Ireland, Fyffes operates from approximately 75 separate locations in more than 10 countries, mainly in Europe. In 1999, it was the largest fresh produce importer in Europe with a market share of 6-7%. The Fyffes group sources from a large number of countries and transports the produce in Europe where it is packaged for distribution. Most sales come from fruit.

Fyffes is a leading EU importer of bananas, together with Atlanta Group and Chiquita, and sells bananas with the Fyffes brand label. Fyffes operates very differently from other US fresh produce companies. It manages the entire chain from production to distribution without owning the links in the chain. It markets and distributes FFV for large production companies with branded FFV such as Turbana, Coplaca, Cape and Outspan and its distribution network is geared towards large retailers.

In order to guarantee its market place, Fyffes provides services such as regular retail promotions in conjunction with growers and suppliers, to increase sales for its clients (mostly large retailers). Fyffes increases its presence in European countries through acquisitions and shared ownership of local FFV companies.

The fact that two banana multinationals, Dole Fresh Fruit Europe and Del Monte Fresh Fruit Produce, belong to the list of largest European distributors does not only mean that bananas are one of the most traded fruits. These multinationals have invested heavily in other fresh produce and activities. They had the capital to buy themselves into the chain and they have the infrastructure and knowledge to meet the many requirements of large retailers (see 2.2.3.).

The largest distributors at European level still have a relatively small share of the EU market. For instance, The Greenery (see box below) has a market share in FFV distribution of only 4%. This could mean that a lot of mergers and acquisitions are required before full consolidation takes place. An analyst for Rabobank likens this to “a fight among titans”.<sup>45</sup> Although differing regulations in the various European countries, for example on pesticide residues, might delay mergers and some niche markets could remain.<sup>46</sup>

There are some important differences between individual European countries. In the Netherlands, 80% of the fruit trade before retailing is controlled by 20% of the wholesalers or distributors.<sup>47</sup> In the UK, Mack is one of the largest suppliers of fresh fruit and vegetables from over 40 countries to major supermarkets and independent retailers in the UK.<sup>48</sup>

**The Greenery**<sup>49</sup> is the largest FFV wholesale trader<sup>50</sup> in the Dutch market. It has a major import and distribution role. The Greenery supplies the second largest Dutch supermarket Laurus as well as other supermarkets and discounters, and this is reflected in the structure of its business.<sup>51</sup> It distributes produce of 2,500 Dutch producers or producer-owned companies who are the shareholders of the company. The Greenery also sources from many other countries so that it provides its customers with a complete range of both domestically grown and imported vegetables, fruit and mushrooms throughout the year.

The Greenery started operating in 1995 as a result of a merger between nine Dutch fruit, vegetable and mushroom auctions. The flow of products is co-ordinated from a central point instead of from various auctions. A number of prominent import-export companies have merged with The Greenery since 1998. Their major markets are Germany, the UK, Scandinavia, France, USA and Japan.

The Greenery backs up its extensive range of products with a first-rate computerised logistical organisation and extensive marketing mechanism that supports its customers.

## **2.3 Retailing: from wet markets to hypermarkets**

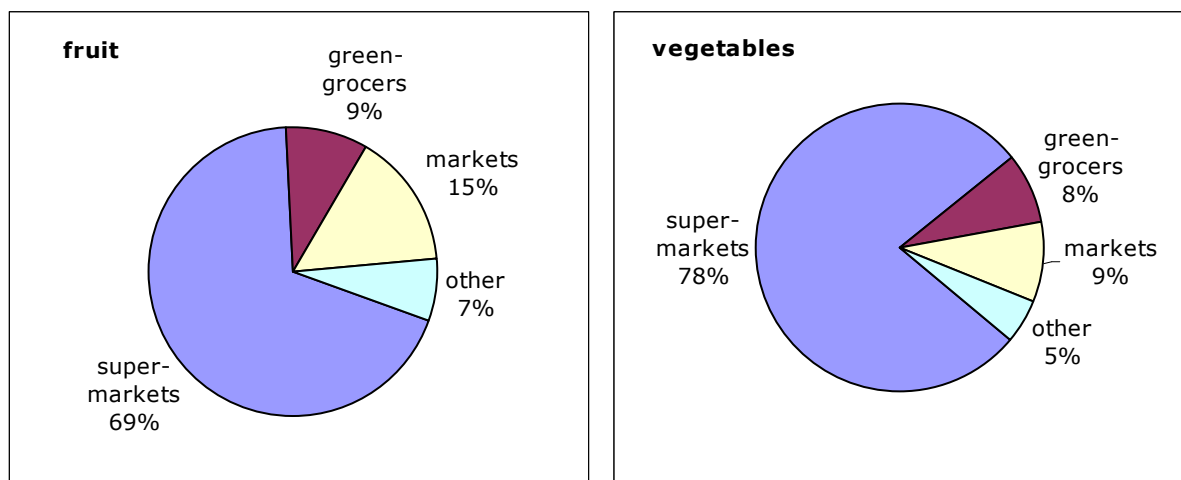
Major retail channels of fresh fruits and vegetables for consumers are:

- ❑ large retailers, including hypermarkets, supermarkets and discounters
- ❑ specialised fruit and vegetable shops
- ❑ open-air markets or wet markets
- ❑ producers and farmers who sell directly to consumers
- ❑ Food services (restaurants, canteens, etc.)

### ***2.3.1 Increasing sales of FFV by large supermarkets and discounters***

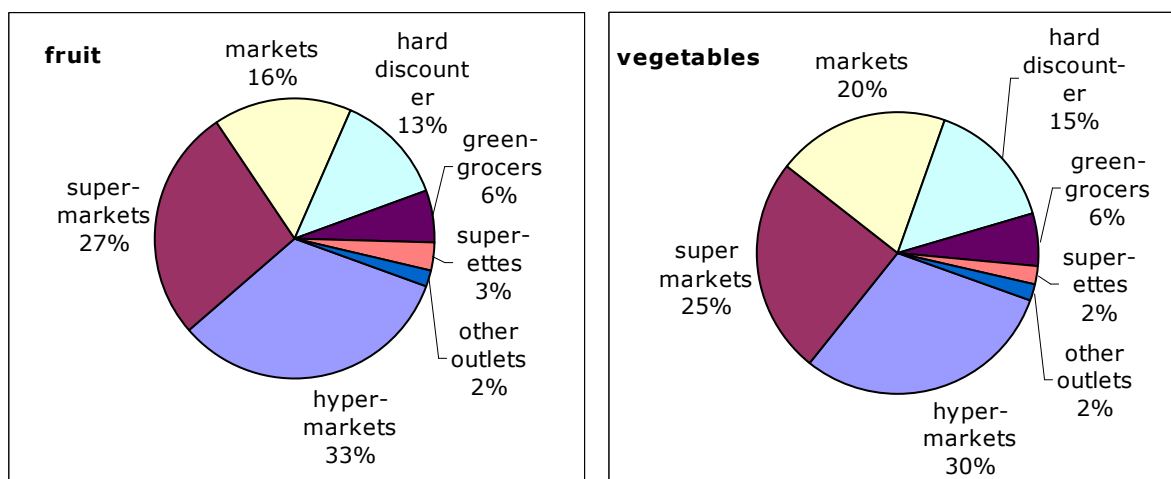
Supermarkets are major outlets for FFV in Europe, although market shares vary in each country.<sup>52</sup> The Northern European markets, including the Netherlands, have the highest proportion of FFV sales through supermarkets. Figures for the Netherlands for 2005 are showing that the trend is continuing.<sup>53</sup> In Italy and Spain, traditional markets and greengrocers continue to sell a significant share of fresh produce.

**figure 7: The Netherlands, retail distribution of fresh fruit and vegetables in 2002, % of volume**



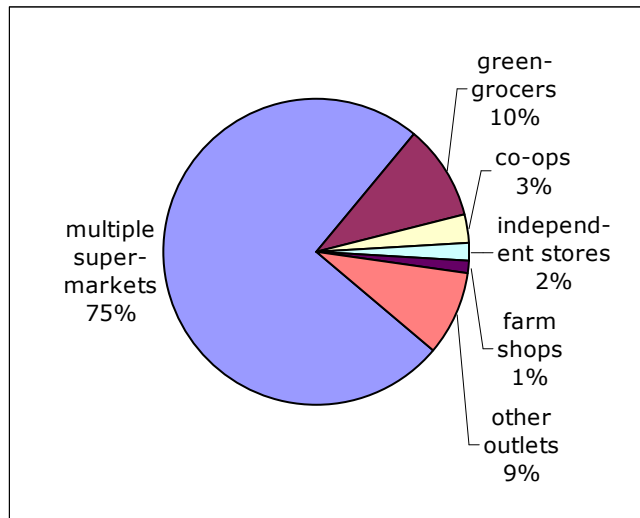
Source: Productschap Tuinbouw 2003, quoted in CBI, EU market survey – Fresh fruit and vegetables, April 2005, p.86.

**figure 8: France, retail distribution of fresh fruit and vegetables in 2003, % of volume**



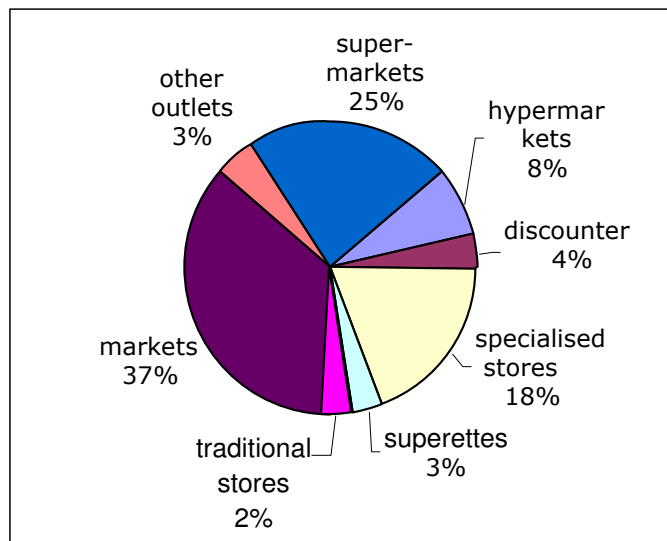
Source: Ctifl/Secodip,2004, quoted in CBI, EU market survey – Fresh fruit and vegetables, April 2005, p.83.

**figure 9: The UK: retail distribution of fresh fruit and vegetables in the UK, % of total retail sales**



Source: www.austrade.gov.au, quoted in quoted in CBI, EU market survey – Fresh fruit and vegetables, April 2005, p.84.

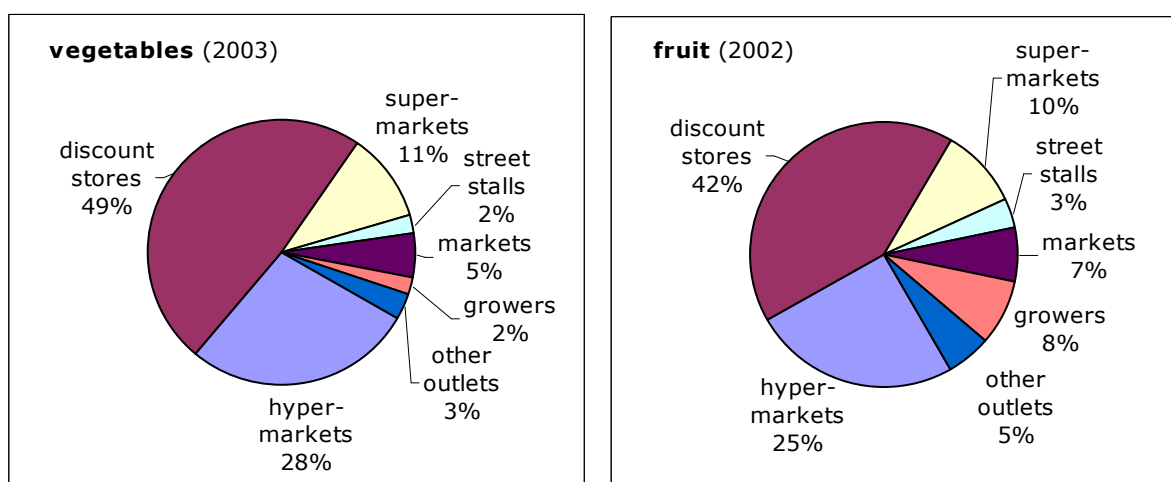
**figure 10: Italy, retail distribution of fresh fruit and vegetables in 2001, % of total sales**



Source: CSO Centro Servizi Ortofrutticoli, 2005, quoted in quoted in CBI, EU market survey – Fresh fruit and vegetables, April 2005, p.83.

The situation in Germany needs special attention. The discount stores have the largest market share of FFV sales, larger than supermarkets and hypermarkets together. Over recent years, discount stores have been increasing their market share in other European countries, for example in France.

**figure 11: Germany: retail distribution of fresh fruit and vegetables in 2002-2003, market share**



Source: CBI, EU market survey – Fresh fruit and vegetables, April 2005, p.82.

### Marketing strategies of the major retailers

Major retailers use two distinct strategies for selling FFV. First there are 'service supermarkets' that offer a complete range of fruit and vegetables all year round. These service supermarkets are increasingly supplied by one or more FFV distributors (see below). Secondly, there are 'discounters' who sell fruit and vegetables at the lowest price-quality ratio of the week or who attract consumers with all year round low prices for FFV. These discounters are supplied by wholesale traders or distributors who are structured to meet their needs, and by spot markets.<sup>54</sup> There is little information about the FFV sourcing by hypermarkets, who might fall under both categories.

#### 1. Supermarkets

- ❑ Supermarkets use fresh fruit and vegetable displays to demonstrate store quality and appeal to new clients.
- ❑ Supermarkets cater for their customers' lack of time by offering prepared fruit and vegetables and ready meals. Small shops are unable to deliver this service and offer fewer products to their customers.<sup>55</sup>
- ❑ Supermarkets and large retail chains have the capital to invest in health and safety requirements and in new marketing strategies.
- ❑ FFV producers need to comply with various supermarket and EU legal requirements. These include the introduction of EUREPGAP certification from 2002 (see chapter 5)<sup>56</sup> and others relating to packaging, tracking and tracing origin. It is reported that the cost of these additional requirements are often not covered by the prices offered by the retailers to the producers.
- ❑ Supermarkets are able to relocate to more convenient places for customers, which further erodes small shopping centres.

- Price wars by supermarkets increase the price differences between large supermarkets and small shops, making it very difficult for the latter to survive.<sup>57</sup> Although fresh fruit and vegetables are not always affected, the price war started by Asda/Wal-Mart in the UK included bananas, resulting in a large price reduction for consumers. In the Netherlands, Albert Heijn started a price war in October 2003, which was followed by the other supermarkets but bananas and other FFV were only included in a later stage.
- Fresh produce provides the highest margins for supermarkets (30% - 40%).<sup>58</sup> In the UK, the price war led Asda/Wal-Mart to slash its FFV margin from 32% to 22%. Other major retailers have tried to slash the supplier prices, rather than reduce their margins or maintain consumer prices.<sup>59</sup>

## 2. Discounters

- Discounters offer the lowest possible prices but sell a more limited range of products.
- Discounters look for the cheapest price available, for instance on the FFV spot markets and wholesale markets. This determines the range of fruit and vegetables they sell.
- Discounters are satisfied with 10% overall net margins.

### → Trends and critical issues

Supermarket sales of FFV are expected to continue to rise.<sup>60</sup> Similar increases are expected in other outlets, for example in petrol stations.<sup>61</sup>

The growth in FFV sales through discounters appears to be the most significant trend that continued in 2005. The growing appeal of the discount concept within the European retail sector has influenced pricing policy amongst the traditional supermarket chains. Permanent price wars in some countries, which often include FFV, are the consequence of this competition. This is pressing down prices up to the producer.

The low prices from discounters and price wars between supermarkets have been felt amongst others by South African producers.<sup>62</sup> Europe had long been a preferred market which they supplied all year round with reasonable returns. Now, they face decreased returns and profits margins. At the same time, production costs have gone up due to an unfavourable exchange rate, ever-stricter food safety standards, and the pressure to invest in more varieties. "As a consequence, South Africa's grape sector is in crisis, mango shipments are down and the avocado market is looking very tight."<sup>63</sup> The new markets in the new EU countries offer some hope but prices in these markets are lower than those previously available.

According to Banana Link, the price wars have led to a race to the bottom in banana prices and ever more extreme exploitative labour practices at the plantations.<sup>64</sup>

Concentration and vertical integration means that prices are determined less and less in “the market” and farmers have fewer references to judge what is a fair price from the supermarkets. As a result, they are more vulnerable to price manipulation.<sup>65</sup>

### **2.3.2 Consolidation in food retailing**

Since FFV is increasingly sold through large retailers such as supermarkets and discounters, an overview in the level of concentration, or “consolidation”, of large retailer chains provides an insight of the market structure of FFV sales to customers. It was not always possible to find figures for only the FFV, or food, sales by retailers. Since grocery retailers mostly sell fresh fruit and vegetables, figures of their market shares are used below to give a better indication of the current trends.

#### **Food retail in Europe**

Between 1993 and 2002, the top five food retailers showed an average increase in market share of 21.7% in the **15 EU member states**. In 2002, their market share reached 69.2%<sup>66</sup> ranging from 37% (Italy) to 94.7% (Sweden).

**In France**, the main food retailers during the first half of 2004<sup>67</sup> were Carrefour (13.3%), Inter-marche (11.2%), Auchan (10.2%), Leclerc/Système U, and Casino Cora. Discount stores gained market share (up to 12.7%) and show a trend that suggests an on-going annual increase of 1%. By 2005, discounters had become a major challenge for market leader Carrefour. The top retailers are also opening discount chains in France.<sup>68</sup>

**In Germany**<sup>69</sup>, food retailing is dominated by Edeka/AVA, REWE, Aldi, Metro and Swartz Group (Lidl). The top five had 64.5% of the food retail market in 2003. The market share in food sales by the German discount food retailers had increased from 15% in 1992 to at least 41% in 2003, while the FFV market share of supermarkets (excluding hypermarkets) dropped from 38% to 22% over the same period. The German discount food retailers are expected to increase their domestic market share to 45% by 2008.

**In the UK**, the main food retailers in 2004 were Tesco (28%), Asda/Wal-Mart (16.9%), Sainsbury (15.3%), and Safeway-Morrisson (13.6%).<sup>70</sup> These top four held 73.8% of UK food sales which is among the highest market share in Europe. The level of concentration is rapidly increasing. Early 2006, Tesco already held more than 30% of the market.<sup>71</sup> Large supermarkets such as Tesco and Sainsburys are buying up local convenience stores. Small convenience stores that are part of large retail chains offer more choice at cheaper prices than small shop owners who cannot compete. 7.4% of all independent grocery stores closed in 2004 (2,157 stores). A 500% increase from 2003.<sup>72</sup>

**In the Netherlands**, the top five supermarkets selling fresh fruit and vegetables in the third quarter of 2003 were Albert Heijn (Ahold) (18%), Laurus (11.1%) which is partly owned by Casino (Fr), SuperUnie (9.7%), Schuitema (9.7%) and Aldi (5.5%). But there has been an important shift within the Dutch supermarket sector. First, the proportion of



sales by discounters increased from 9.6% of all fresh fruit and vegetables sold in the last quarter of 2001, to 14.7% during the third quarter of 2003<sup>73</sup>. Secondly, the number of sales points in the Netherlands for fruit and vegetables declined by 50% between the end 2000 and the end 2004 and only 1664 sales points remain.<sup>74</sup> This is a very rapid decline due to the price wars and closure of small shops. Thirdly, the two year price war has forced Laurus in May 2006 to sell an important part of its business to various Dutch retailers, including number one Ahold.<sup>75</sup>

In **Eastern Europe**, the top five supermarkets have 23.1% of the food retail market. They are all foreign-owned supermarkets. In **Central Europe**, privatisation of the state-owned retail system since the 1990's has been followed by a rapid concentration of privately-owned retailers who are largely foreign owned (see also table 13: figures for Central and Eastern Europe together). In less developed European countries such as Romania, foreign retailers are waiting to move in.<sup>76</sup>

### **Clear concentration trend in grocery retail sector**

The grocery retail sector as defined in the tables below includes hypermarkets, superstores, supermarkets, discount stores, convenience stores and drugstores, cash & carry, delivered wholesale and open markets, excluding independent specialist outlets such as butchers and bakers. Although grocery products do not only include FFV and other food products but also non-food, their sales are indicative of the market structure of FFV sales. On average, food sales account for 70% of the grocery market.<sup>77</sup>

The grocery retail sector is becoming a “truly globalised and concentrated industry, with a handful of players readying themselves to take on the stature of genuine international titans in this field”.<sup>78</sup>

At the global level, the top 30 retailers have expanded their operations from 15 countries in 1993 to 85 countries in 2003. A similar trend can be seen taking place much more rapidly in developing countries.<sup>79</sup> Problems resulting from overexpansion by some retailers do not seem to discourage the worldwide trend for concentration. Although in some countries regulations (competition policy) are preventing very high levels of concentration in their national markets.

Table 7 identifies the major players and their market share in the world retail markets for groceries. It is important to note that number one, Wal-Mart, has almost as much market share as the 3 retailers who follow (Carrefour, Ahold and Metro Group).

The **level of concentration** varies widely between continents and countries. In 2003, the top 30 retailers of Asia and Oceania had just 19% of the market share of modern grocery distribution, while the top 30 Latin American retailers had 29%. Europe had the highest concentration with the top 30 retailers having 69%.

**table 7: Ranking of the world top 15 grocery retailers, 2004**

|    | <b>Group</b> | <b>Country of Origin</b> | <b>Market share (%)</b> |
|----|--------------|--------------------------|-------------------------|
| 1  | Wal-Mart     | USA                      | 6.1                     |
| 2  | Carrefour    | France                   | 2.3                     |
| 3  | Ahold        | Netherlands              | 1.8                     |
| 4  | Metro Group  | Germany                  | 1.6                     |
| 5  | Tesco        | UK                       | 1.3                     |
| 6  | Ito-Yokado   | Japan                    | 1.2                     |
| 7  | Kroger       | USA                      | 1.2                     |
| 8  | Rewe         | Germany                  | 1.1                     |
| 9  | Costco       | USA                      | 1.1                     |
| 10 | Aeon         | Japan                    | 1.0                     |
| 11 | Target       | USA                      | 1.0                     |
| 12 | Casino       | France                   | 1.0                     |
| 13 | Aldi         | Germany                  | 1.0                     |
| 14 | Auchan       | France                   | 1.0                     |
| 15 | ITM          | France                   | 1.0                     |
|    | <b>TOTAL</b> |                          | <b>23.7%</b>            |

Source : M+M Planet Retail

For individual European countries, figures on the number and market share of grocery retailers vary widely because of different definitions for grocery retailing. The tables below show that in some countries, the top 5 grocery retailers have a very large market share and thus a high level of concentration.

**table 8: EU members in Western Europe (15): share of modern grocery distribution<sup>80</sup> of the top 5 retailers in each country (%) in 2004**

| <b>Country</b> | <b>Market share</b> |
|----------------|---------------------|
| Finland        | 88.2%               |
| Sweden         | 86.2%               |
| Ireland        | 83.2%               |
| Denmark        | 82.4%               |
| Luxembourg     | 82.3%               |
| Austria        | 78.7%               |
| Belgium        | 78.6%               |
| Portugal       | 71.3%               |
| France         | 70.4%               |
| Germany        | 68.4%               |
| Spain          | 67.9%               |
| Netherlands    | 67.7%               |
| United Kingdom | 56.3%               |
| Greece         | 53.7%               |
| Italy          | 41.3%               |

Source: M + M Planet Retail, Global Retail Concentration 2004, April 2005.

**table 9: EU members in Central and Eastern Europe (8): share of modern grocery distribution of the top 5 retailers in each country (%) in 2004**

| Country        | Market share |
|----------------|--------------|
| Lithuania      | 81.4%        |
| Slovenia       | 76.2%        |
| Hungary        | 64.7%        |
| Estonia        | 64.4%        |
| Latvia         | 49.3%        |
| Czech Republic | 42.8%        |
| Slovakia       | 29.9%        |
| Poland         | 23.3%        |

Source: M + M Planet Retail, Global Retail Concentration 2004, April 2005.

**table 10: Non-EU members in Western Europe: share of modern grocery distribution of the top 5 retailers in each country (%) in 2004**

| Country     | Market share |
|-------------|--------------|
| Switzerland | 87.9%        |
| Norway      | 86.3%        |

Source: M + M Planet Retail, Global Retail Concentration 2004, April 2005.

**table 11: Western Europe: top ten European grocery retailers in 2005**

| Ranking                  | Company              | Grocery retail banner sales <sup>81</sup><br>market share (%) |
|--------------------------|----------------------|---|
| 1                        | Carrefour (Fr)       | 6.8%  |
| 2                        | Metro Group (Germ)   | 4.9%  |
| 3                        | Tesco (UK)           | 4.7%  |
| 4                        | Rewe (Germ.)         | 3.9%  |
| 5                        | Edeka (Germ)         | 3.7%  |
| 6                        | Schwarz group (Germ) | 3.4%  |
| 7                        | Auchan (Fr)          | 3.3%  |
| 8                        | Aldi (Germ)          | 3.0%  |
| 9                        | Leclerc              | 2.9%  |
| 10                       | Casino (Fr)          | 2.7%  |
| <b>TOTAL</b>             |                      | <b>39.3%</b>  |
| <b>CR 4<sup>82</sup></b> |                      | <b>20.3%</b>  |

Source: Planet Retail - [www.planetretail.net](http://www.planetretail.net)

Some European retailers<sup>83</sup> have been involved in a **consolidation process at a European-wide level**, resulting in larger market shares in Europe. The five biggest names in European grocery retailing are Carrefour (F), Metro (D), Tesco (UK), Rewe (D) and Intermarché. In 1989 only a few companies – Metro, Aldi and Carrefour operated outside the home market and the top ten European retailers held a market share in Western Europe of less than 20%. Whereas in 2004, the total market share of the top ten grocery

retailers in Western Europe was nearly 40% (M+M Planet Retail). An indicator of the level of concentration is the market share by the top 4 (CR 4) which stands at almost 20%.

**Discounters** have been increasing their market share in Europe since the 1990s. Their overall market share rose from 7% in 1992 to 10% in 2004.<sup>84</sup>

In individual European countries, discounters had different market shares, as shown below<sup>85</sup>:

**table 12: Grocery sales by discounters in European countries, 2005**

|                               |                        |
|-------------------------------|------------------------|
| 31.9% market share in Germany | 8.9% in Czech Republic |
| 23.3 % in Austria             | 8.3% in France         |
| 14.6% in Hungary              | 8.2 % in Netherlands   |
| 12.3% in Belgium              | 6% in Ireland          |
| 10.1% in Spain                | 3.7% in UK             |

Source: Planet Retail - www.planetretail.net

German discounters are clearly ahead in terms of market share although those in Spain, France, Ireland and the Netherlands show an upward trend.

In Central and Eastern Europe, the same retailers dominate the market as in Western Europe but the level of concentration of the top 4 retailers in the region is not yet as high.

**table 13: Central & Eastern Europe top 10 grocery retailers, 2005**

| Rank | Retailer             | Grocery retail banner sales <sup>86</sup> |
|------|----------------------|---|
|      |                      | Market share (%)                          |
| 1    | Metro Group (Germ)   | 5.6%                                      |
| 2    | Tesco (UK)           | 2.3%                                      |
| 3    | Carrefour (Fr)       | 2.1%                                      |
| 4    | Rewe (Germ)          | 1.8%                                      |
| 5    | Schwarz Group (Germ) | 1.7%                                      |
| 6    | COOP EURO            | 1.5%                                      |
| 7    | Ahold (NL)           | 1.4%                                      |
| 8    | Auchan (Fr)          | 1.3%                                      |
| 9    | Tengelmann           | 1.2%                                      |
| 10   | Mercator             | 0.9%                                      |
|      | TOTAL                | 19.8%                                     |
|      | CR 4                 | 11.8%                                     |

Source: Planet Retail - www.planetretail.net

In comparison, **the US** concentration level is growing and has become the same as in Western Europe. The top four grocery retailers have 19.5% of the retail market.

**table 14: Top 10 grocery retailers North America, 2005**

| Rank | Retail            | Grocery retail banner sales |
|------|-------------------|-----------------------------|
|      |                   | <b>Market share (%)</b>     |
| 1    | Wal-Mart (USA)    | 15.4%                       |
| 2    | Kroger (USA)      | 3.6%                        |
| 3    | Sears             | 3.5%                        |
| 4    | Target            | 3.1%                        |
| 5    | Costco            | 2.9%                        |
| 6    | Walgreens         | 2.5%                        |
| 7    | Ahold (NL)        | 2.4%                        |
| 8    | Albertson's (USA) | 2.4%                        |
| 9    | Safeway (USA)     | 2.3%                        |
| 10   | CVS               | 2.2%                        |
|      | <b>TOTAL</b>      | <b>40.3%</b>                |
|      | <b>CR4</b>        | <b>25.6%</b>                |

Source: Planet Retail - [www.planetretail.net](http://www.planetretail.net)

While the US retail market is dominated by Wal-Mart, smaller-format discount stores and limited assortment grocery discounters have shown a dramatic increase, which Planet Retail predicts to continue.<sup>87</sup>

### Supermarket strategies for market leadership

- ❑ Large supermarkets aim to be a major player in their mature home market and achieve market leadership in other countries. For instance, by the beginning 2002, Carrefour was market leader in food retailing, in terms of market volume, in France, Spain, Belgium and Greece and had over 20% of market share in Italy and Portugal.<sup>88</sup>
- ❑ Apart from price wars, the top supermarkets engage in acquisitions, mergers, expansion or organic growth abroad, and for opportunities in new markets. Acquisitions allow the quickest expansion. "Consolidate or quit" has been the basic strategy of many large supermarkets. New markets in developed and developing countries may offer less stringent regulations than at home.<sup>89</sup>
- ❑ Instead of merging, another strategy involves vertical coordination through alliances, networks and contractual relationships to buy products at the lowest price level. For example, some supermarkets have direct contractual or preferred supplier relationships with fruit and vegetable producers.
- ❑ Supermarkets have also increased their surface area. In the Netherlands, the average size of supermarkets increased by 24% from the winter of 2000 to the same time in 2004.<sup>90</sup> However, in many Western European countries, there are legal restrictions on new store developments and new large hypermarkets.
- ❑ Diversification is the key. Supermarkets attract new customers by increasing the number of their products, selling new categories of merchandise (e.g. furniture) and services, developing new commercial structures, and operating in new geographic locations.<sup>91</sup>

→ **Critical issues**

As supermarkets draw the attention of consumers to the lowest food prices and to shopping convenience, awareness among consumers about the the long term and global consequences down the chain is very low.

**2.3.3 Relationships between retailers and their suppliers**

The consequences of concentration and integration throughout the supply chain have been described above. Now we turn to the relationships between retailers and their FFV suppliers and look at what the consequences are on price, especially in developing countries.

Supermarket chains do not use one particular model for sourcing FFV but all use systems of 'category management'; exotic fruits is one such a category. For example in the UK, each supermarket has a different sourcing strategy. As previously discussed, sourcing mechanisms range from the use of spot markets or traditional wholesale supply chains to preferred suppliers and direct relations with large farmers. The model of preferred and long term relationships is becoming increasingly important. This is causing problems for small farmers to find outlets but also provides opportunities for some farmers in the South to have access to Northern markets when they are part of the preferred relationships.

**Buyer groups**

In many EU countries buyer groups or buying desks are prominent. They buy the majority of products sold by retailers. The buyer group purchases collectively on behalf of members who remain independent retailers. During the research for this report, it was not clear whether they buy fresh fruit and vegetables for retailers.

Buyer groups can insist on receiving low prices because of their scale. Buyer groups tend to have two structures. They either represent many small retailers, or two or more large retailers. A number of significant cross-border buying groups and alliances have emerged in recent years. Buying price information is shared and there is collaboration over the sourcing of private label products.<sup>92</sup> Further mergers and acquisitions amongst buyer groups continue.<sup>93</sup> It should be noted that the existence of buyer groups means that the concentration level of the food retail industry is even higher (see figure 12).<sup>94</sup>

→ **Critical issue**

The fact that buyer groups are able to squeeze the price of processed food from their suppliers might have an indirect effect on FFV producers.

**Exclusive suppliers and long term supply agreements**

Large-scale retailers increasingly operate through exclusive supplier or preferred supplier relationships and long-term contracts. Such relationship can cover the whole range of FFV or only one category (e.g. exotic fruits, citrus fruits, mushrooms). In addition they are

increasingly “seeking (if not demanding) regional and global agreements with their suppliers” especially for manufactured and processed products. Such global supply agreements are “extremely contentious” because suppliers prefer to deal with customers on a more local basis.<sup>95</sup>

In some countries like the Netherlands, the two largest food retailers have had an exclusive relationship with one large distributor who is responsible for delivery of all FFV produce. The advantage for retailers is that they have better control over the quality and volumes. Their distributor ensures low stocks and provides logistical support. These guaranteed sales mean that the distributor can invest in quality management, which extends to their producers.

In the UK, fresh fruit and vegetable production and packing has a trend towards narrow specialisation. This is in response to supermarket requirements for category management and traceability. It is a way of staying profitable and reliable to consumers. Examples of specialist grower-packers include United Vegetables (Brassicas), Lanmead Farms (lettuce), and Rustler Produce (onions).<sup>96</sup>

Some European retailers work with long-term contracts. This is particularly the case for exclusive or specialised suppliers. For instance, banana multinationals have long-term contracts with retailers.<sup>97</sup> Approximately 80% of Dole’s retail volume in North America is under contract. These exclusive supplier contracts mean that there is fierce competition between suppliers to obtain contracts as they offer major sales outlets.

Most contracts are for one year which allows the retailer to renegotiate price and quality requirements or opt for a new (cheaper or better) supplier. Asda/Wal-Mart has recently signed a three year contract, at rock bottom prices, which might indicate a change in supply policy by large retail chains. Banana multinationals are currently large enough not to be dependent on one contract. This puts them in a stronger bargaining position than suppliers dependent on one food retailer.<sup>98</sup>

### **Direct links with producers**

Supermarket chains avoid the wholesale market or distributors and increasingly seek to ensure their supplies through direct contact with producers and producer associations, especially for bulk tropical fruit and vegetables.<sup>99</sup> As explained above, some producer associations in developing countries are part of an integrated export or wholesale business. Interestingly, Carrefour, the second largest retailer in the world, signed a contract in 2004 with APEX, the Brazilian export promotion agency, to export fresh fruit, including bananas. Within a year the fruit was to be supplied to Carrefour stores in 16 of the 26 countries where it operates.<sup>100</sup> In this way, the supermarket is becoming a wholesaler itself and even an exporter via its global sourcing system. This provides secured export opportunities for Brazilian FFV producers.

Some food retailers have direct relationships with farming businesses in developing countries. One example is Homegrown in Kenya, which produces green beans. According to the managing director, “rarely does Homegrown grow anything unless a supermarket

has programmed it".<sup>101</sup> The relationship is so direct that UK supermarkets will email at midday the volumes of produce they want put on the plane that night, depending on the previous days' sales. The orders can go up and down dramatically. At Christmas it can be a three or four ton increase in one day for sliced or topped and tailed beans. The suppliers know that they just have to get the job done or they lose the business with hardly any other outlet left. A flexible workforce working longer hours or workers without long term contracts are essential to supply the additional orders.<sup>102</sup>

Research by OXFAM International<sup>103</sup> also indicates that supermarkets' sourcing practices put farming businesses under pressure and that owners pass this pressure on to their workers who are often women. This includes a deterioration in working conditions, very low pay, not paying for protective clothing, and casual employment without the labour rights associated with longer term employment.

Many farm suppliers have no written contracts with supermarkets and thus have nothing to specify quantities or guarantee good prices from the supermarkets.

In the case study in Senegal, it was found that FFV sector exporting parties mostly send products in consignment. This means that the exporter/producer pays for all the costs (shipping, insurance, commission etc) to get the product to the market destination and does not know how much he will get for his merchandise on arrival. The price received can be below production costs, which means that the producer/ exporter will lose money. As a consequence of this practice, several exporters of FFV go bankrupt every year in Senegal. Consignment sales are typical of the FFV sector.

### → **Critical issue**

The system of no written contracts and consignments places the financial risks solely with the producers/exporters. The buying parties, such as supermarkets, do not run any financial risk.

The advantage for supermarkets of such direct relationships with farmers is that they can eliminate nearly all financial risks from their end of the chain. They have no stocks, no price risks and no commitments to buy. Other advantages are:

- more control over, and traceability of, FFV production
- reduced risks of bad or over-ripened produce, through the right storage and a direct cold chain
- more possibilities to impose standards and production requirements, including short-term market trends, and ensure that they are being implemented
- more possibilities for sufficient supplies in large quantities at the right time
- direct negotiations with the producers and by-passing intermediaries, which provides more possibilities to cut prices.

The advantages for FFV farmers, depending on the relationship and (contractual) agreements, are:

- direct links to high value export markets with transport provided



- ❑ attractive prices in comparison with domestic outlets
- ❑ possible financial or technical assistance
- ❑ access to export markets and possibilities to export new products

With these direct relationships, it is no wonder that some supermarkets have started to take over the specialised wholesale trade for fruit and vegetables and have established their own distribution centres in order to collect the products and supply their own stores.<sup>104</sup> Some supermarkets even own the land where the produce is farmed.

### → **Critical issues**

Many of the European supermarket requirements are difficult for small farmers to meet. The very high costs of technology, management techniques and auditing can only be met by large farms through their economies of scale.

In the case of large farms, when prices are good and outlets are guaranteed, payments and working conditions can be better than those available for farmers producing for the local market. There are however many examples where this is not the case. The case study in chapter 3 looked at whether export production on large farms supports or undermines poverty eradication, or has impact on local markets.

#### **2.3.4 Buyer power and low prices for suppliers**

The fact that food retailers have such a large market share has given them 'buyer power', also referred to as 'buying power'. The fresh fruit and vegetable sector is the most vulnerable to buyer power because perishable food products have few alternative outlets and need to be sold within a short period of time.<sup>105</sup> Buyer power is exercised in different ways in different countries.

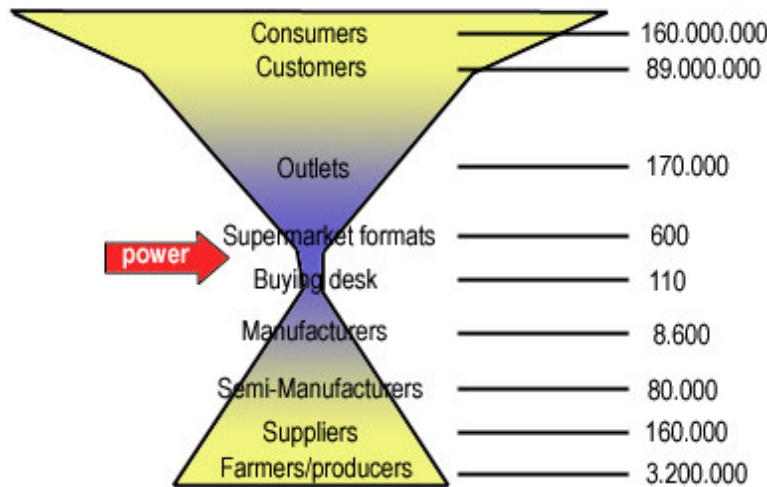
##### **What is "buyer power" and "oligopsony"? <sup>106</sup>**

Supermarkets are often accused of having buyer power that squeezes their suppliers. Buyer power exists when, for like transactions, a supermarket can obtain from a supplier more favourable terms than other buyers. These more favourable terms do not just refer to price. The UK Competition Commission investigation in 2000 revealed that there was a strong link between a retailer's market share and its ability to exercise buyer power. The biggest UK supermarket, Tesco, consistently paid suppliers 4% below the average price paid by retailers.

"When a power buyer squeezes its supplier, it merely reallocates profit margin from supplier to retailer. There should be no assumption that the retailer's saving will be shared with consumers."

Buyer power often results from a situation of oligopsony, i.e. the concentration of buyer power in the hands of a few.

**figure 12: Supply chain bottleneck in Europe that leads to buyer power**



Note: covers retail food and represents about 85% of the total sales of West European countries  
 Source: J. Grievink Cap Gemini, OECD, 2003.

One typical example of supermarket buyer power is the UK supermarket Asda/Wal Mart who used its buying power to negotiate price cuts with banana suppliers in 2002. This brought the retail price for bananas down from £ 1.08 to £ 0.94 per kg. Other supermarkets followed suit and demanded similar price cuts from their suppliers. By 2004, bananas were retailing at £0.74p per kg. in UK supermarkets.<sup>107</sup>

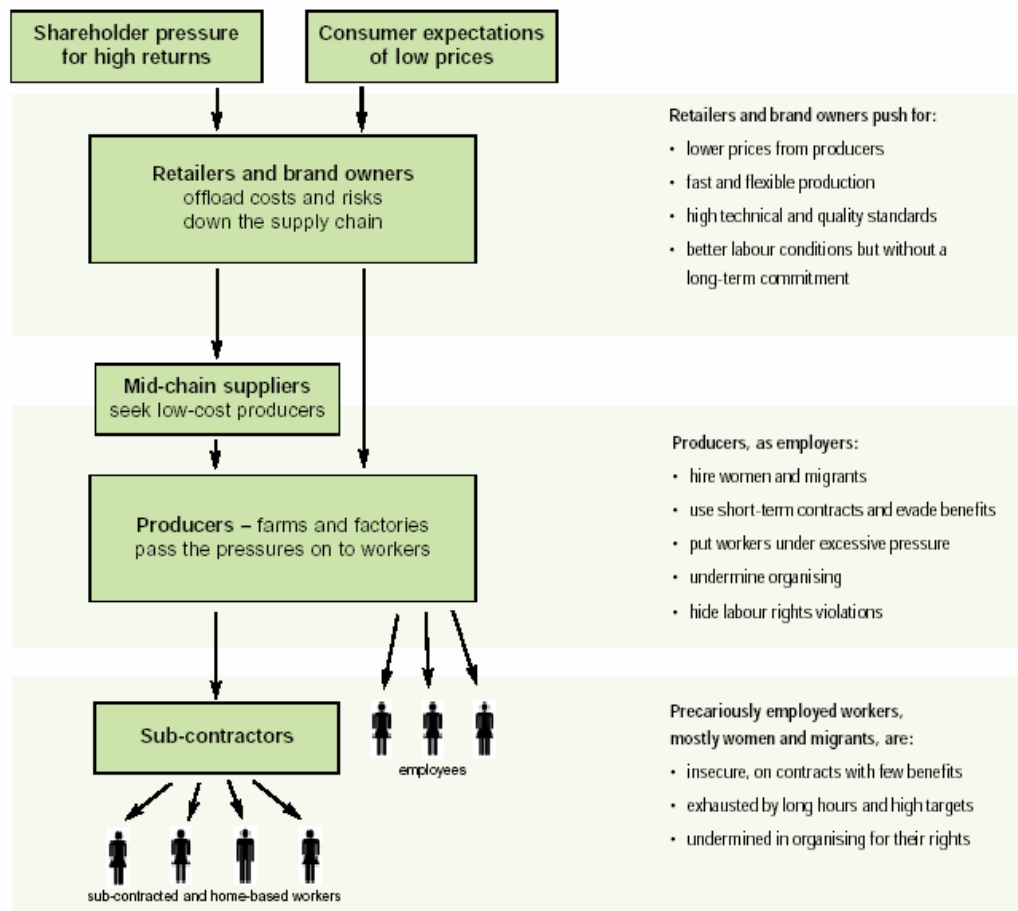
The UK Competition Commission investigated the supermarket sector in 2000 and revealed that there was a strong link between a large retailer's market share and its ability to exercise buyer power. Smaller supermarkets, in contrast, paid above the average price.

Research by the European Economic and Social Committee reveals that aggressive price promotions have frequently led to basic products being sold below cost in some EU member states.<sup>108</sup>

### **Diminishing income for European farmers<sup>109</sup>**

The low farm gate price, compared to the retail price, and the subsequent decline in profits for farmers has been attributed to the buyer power of supermarkets and the lack of power balance between supply and demand in food markets. Farm output prices for all agricultural products in the 15 EU countries fell by 27% between 1990 and 2002. Since international trade in fresh fruit and vegetables only accounts for just over 5% of global production, the impact of the buyer power of supermarkets can have more impact on producers and farmers at the domestic level.

figure 13: Supply chain pressures create precarious employment



Source: Raworth

A survey of UK farmers found that the power imbalance between buyers and suppliers was one of the two major issues of concern to farmers who wanted the government to make trade relationships between retailers, processors and producers more equitable.<sup>110</sup> Low prices pose investment problems for producers who are also under pressure to respect environmental and social factors.<sup>111</sup>

Research into buyer power in the US and Europe has been inconclusive and more research has been requested. Research in the Netherlands by LEI (2003) and the competition authorities (2004) concluded that buyer power and price wars were not the main culprits of the low farm prices.<sup>112</sup> However, investigations into concrete supermarket practices and prices seem to reveal more than studies which look at the impact at the macro-economic level. UK official investigations revealed 52 malpractices resulting from buyer power, but suppliers were afraid to denounce supermarket malpractices themselves.

Other factors also influence the difference between farm and retail price. These include:

- ❑ supply and demand shocks e.g. oversupply on the world market such as is currently the case for bananas
- ❑ growing demand for quality and marketing services for FFV which increases costs
- ❑ increasing demand for imported FFV products
- ❑ a competitive industry characterized by diversity
- ❑ the decline of co-operative sellers, intermediaries and buyers
- ❑ changing consumer tastes influence buying and food consumption habits
- ❑ changes in the end use of the agricultural product (food processing versus direct retail sales)
- ❑ new competitors (e.g. organic products)
- ❑ foreign market developments
- ❑ policy changes such as the Common Agricultural Policy, trade agreements etc.
- ❑ exchange rate fluctuations

### **Are declining farm prices being passed on to the consumer?**

Although farm prices have been declining, the difference between retail and farm prices ('spread') is high. Studies show that this is also the case in developing countries. Just to give one example, in February 2002, sample research in Manila (Philippines) revealed the difference between wholesale prices -e.g. for carrots, onions, tomatoes and eggplants- and retail prices can be 2 to 3 times the farm price.<sup>113</sup> Chapter 3 and 4 below also provide examples.

There are conflicting research results about whether lower farm prices have been passed on to consumers in Europe.<sup>114</sup> According to the London Economics institute the reduction in farm prices in Europe were only passed on to the consumer in the UK. There are examples in the UK and the Netherlands where retail price cuts are partly passed on to producers. Supermarkets try to maintain their margins of 30-40% on FFV, even during price wars. When lower prices are not passed on to consumers, this means either higher profits for the supermarkets<sup>115</sup> or compensation to the supermarkets for losses in other sectors.

#### **→ Critical issue**

Large retailers are offering a growing number of fair trade products sourced from chains that provide third world growers with a fairer price and fairer relationships. However some experts suggest that "supermarkets are taking advantage of this label to increase profits because they know that consumers are willing to pay a bit more because it is fair trade".<sup>116</sup>

### **Supermarket malpractices towards producers**

Supermarket buyer power has led to some underhand tactics<sup>117</sup> by suppliers and producers. The ones documented in the UK and France include:

- ❑ payments to be on the list of suppliers (“listing”), and threats of (de)listing from the suppliers list when the supplier’s price is not low enough
- ❑ payment by producers for advertisements, price promotions and openings for new supermarkets
- ❑ payment by producers (!) of a percentage of their annual supermarket sales (‘rebates’)
- ❑ minus margins whereby the supplier of a supermarket is not allowed to supply at the a higher price than the supermarket’s competitors.

Supermarkets also use the following abusive tactics when they have a direct relationship with FFV producers, which have very negative impacts<sup>118</sup>:

- ❑ delaying payment for products already delivered and sold
- ❑ changing, i.e. lowering, prices at the last minute, when farmers have few alternative outlets
- ❑ changing non contractual agreements to buy certain produce, or demanding different quantities with little notice
- ❑ changing stringent quality standards with little support or time to change the production system
- ❑ introducing a ‘just –in time’ business practice so that supermarkets have less storage costs, but farmers carry the risk
- ❑ removing farmers from suppliers lists without good reason
- ❑ charging high interest on credit
- ❑ using contracts that cannot be enforced by the suppliers

→ **Critical issue**

These abusive practices squeeze big and small farmers in developed and developing countries. This results in social and environmental exploitation and disruption of FFV production in many countries.

Low prices for fresh FFV might mean there is not enough income or capital in developing countries to enable them to move into processing FFV.

Not only do retailers exploit their FFV suppliers, employment practice is also a problem in food retailing. Low wages, job cuts, long and irregular working hours, young age employees, non-contract workers are some of the strategies used by various supermarkets to reduce labour costs.

The world’s leading supermarket Wal-Mart, with 1.5 million workers, is well known for its anti-union, low wage and poor employment practices. In Canada, where the company employs 65,000 people,<sup>119</sup> the company tried to stop a legal move by the union to obtain internal documents, including one referred to as “Wal-Mart - A Manager’s Toolbox to Remaining Union Free.” By February 2005, Canadian trade unions could not reach an agreement with Wal-Mart over major issues such as work schedules, employee status, and seniority clauses, and asked for governmental help to overcome the stalemate. In April 2005, Wal-Mart decided to close the Canadian store.<sup>120</sup>

Not all supermarkets operate in the same way. Tesco employees in the UK for example earn better wages than workers in small supermarkets.

→ **Critical issue**

By exploiting its domestic and overseas suppliers, supermarkets are transferring wealth from the farming communities to consumers in the cities and to the owners of supermarkets, some of whom belong to the richest people of their country. Wealth is not always shared with employees of supermarkets.

**2.3.5 The impact of supermarkets operating in developing countries**

The role of supermarkets in food distribution has seen rapid growth in developing countries in recent years. Growth starts in countries and areas with rich consumers, typically in the large cities, and then spreads to poorer countries, regions and consumers. Fresh fruit and vegetables can be the last segment to be incorporated in supermarket ranges but it can also be a segment that attracts customers who want quality and convenience not on offer in wet markets.

Despite differences in the pace and level of growth, the overall picture is clearly one of increasing supermarket control over food retailing in developing countries.<sup>121</sup> The level of domestic and foreign supermarket penetration is not the same in all developing countries. It is most advanced in the Latin American region.<sup>122</sup>

By 2001, supermarkets in the 12 largest Latin American countries accounted for an average of 60% (population weighted) of national food retailing, a huge increase since 1990. There remain important differences between countries. In Argentina, Brazil, Chile, Colombia, Costa Rica and Mexico the market share was 45-75% whereas in El Salvador, Guatemala, Honduras and Nicaragua it was 20-40%.

**table 15: The share of supermarkets in national food retail sectors of selected LAC countries (non-population weighted)**

|             |                                  |
|-------------|----------------------------------|
| Brazil      | from 20 % to 70 % over the 1990s |
| Argentina   | from 20 % to 60 % over the 1990s |
| Mexico      | 45 % in 2000                     |
| Chile       | 62 % in 2000                     |
| Costa Rica  | 50 % in 2000                     |
| El Salvador | 50 % in 2000                     |
| Guatemala   | 25 % in 2001                     |
| Nicaragua   | 20 % in 2000                     |
| Peru        | 15 % in 2001                     |

Source: FAO, Trade reforms and food security - Conceptualizing the linkages, Rome, 2003, p. 131, <[http://www.fao.org/documents/show\\_cdr.asp?url\\_file=/DOCREP/005/Y4671E/y4671e0f.htm](http://www.fao.org/documents/show_cdr.asp?url_file=/DOCREP/005/Y4671E/y4671e0f.htm)>

In Asia, food retailing by supermarkets and hypermarkets is growing in Malaysia, Thailand, Indonesia and the Philippines. Supermarket retailing is in its early stages in

Bangladesh, Cambodia, India, Lao PDR, Vietnam, Myanmar and Pakistan. In China supermarkets and hypermarkets have been expanding rapidly throughout the country, from 2,500 stores in 1995 to over 50,000 in 2002, i.e. from 0.18% to 11.2% of total Chinese retail sales (food and non-food) over the same period.

Supermarket food retail took off most recently in Africa. South Africa is the front-runner, with supermarkets holding a 55% share of overall food retail. In all other African countries, the traditional outlets remain the most important food retailers although supermarkets are starting to operate in some markets, especially in the large cities, but their impact is limited. For example in Kenya, the two large domestic supermarkets only controlled an estimated 10-20% of the FFV market until one collapsed mid 2006.<sup>123</sup>

### Levels of concentration

While in several developed countries four or five supermarkets have the major market share of food and grocery retailing, this is not the case in most developing countries.

In the Latin America region, where retail sales have been most restructured by supermarkets, the top ten grocery retailers had 16.3 % of the market share in 2004. This compares with 39.6% held by the top ten grocery retailers in Europe. In some Latin American countries, the top 5 supermarket chains covered 65% of the sales through supermarkets.<sup>124</sup> These levels of concentration in Latin America were reached through mergers and acquisitions and setting up of new stores.

The high concentration figures of grocery retail in Africa is explained by South Africa that has the highest grocery retail concentration figures of the whole African region. The growth of large supermarkets in Southern Africa together with more involvement of large processors, has resulted in increased vertical integration and concentration.

**table 16: Top 10 grocery retailers in Latin America, 2005**

| Rank         | Retailer                              | Grocery retail banner sales Market Share (%) |
|--------------|---------------------------------------|--|
| 1            | Wal-Mart (US)                         | 6.8 %  |
| 2            | Casino (Fr)                           | 3.2 %  |
| 3            | Carrefour (Fr)                        | 2.7 %  |
| 4            | Censosud                              | 1.7 %  |
| 5            | Soriana (Mex)                         | 1.5 %  |
| 6            | Falabella                             | 1.2 %  |
| 7            | Gigante (Mex)                         | 1.1 %  |
| 8            | D&S (Distribución y Servicio) (Chile) | 1.1 %  |
| 9            | Comercial Mexicana                    | 1.0 %  |
| 10           | OXXO                                  | 0.9 %  |
| <b>TOTAL</b> |                                       | <b>21.2 %</b>                                |
| <b>CR4</b>   |                                       | <b>14.4 %</b>                                |

Source: Planet Retail - [www.planetretail.net](http://www.planetretail.net),

Note: CR4 is the level of concentration by the 4 top retailers

**table 17: Top 10 grocery retailers in Asia, 2005**

| Rank         | Retailer         | Grocery retail banner sales<br>Market share (%) |
|--------------|------------------|---|
| 1            | AEON (Jap)       | 3.2 %   |
| 2            | Seven & I        | 2.9 %   |
| 3            | Uny (Jap)        | 1.3 %   |
| 4            | Daiei (Jap)      | 1.0 %   |
| 5            | FamilyMart (Jap) | 0.9 %   |
| 6            | Lawson (Jap)     | 0.9 %   |
| 7            | Wal-Mart (US)    | 0.8 %   |
| 8            | Lotte            | 0.7 %   |
| 9            | Carrefour (Fr)   | 0.6 %   |
| 10           | Tesco (UK)       | 0.6 %   |
| <b>TOTAL</b> |                  | <b>12.9 %</b>                                   |
| <b>CR4</b>   |                  | <b>8.4 %</b>                                    |

Source: Planet Retail - [www.planetretail.net](http://www.planetretail.net)

**table 18: Top 10 grocery retailers in Africa, 2005**

| Rank         | Retailer                   | Grocery retail banner sales<br>Market share (%) |
|--------------|----------------------------|---|
| 1            | Shoprite (South Africa)    | 5.9 %   |
| 2            | Pick 'n Pay (South Africa) | 5.7 %   |
| 3            | Massmart (South Africa)    | 4.9 %   |
| 4            | Metcash (South Africa)     | 3.9 %   |
| 5            | SPAR (South Africa)        | 2.5 %   |
| 6            | Woolworths (South Africa)  | 2.3 %   |
| 7            | Casino (Fr)                | 1.9 %   |
| 8            | Carrefour (Fr)             | 1.0 %   |
| 9            | Auchan (Fr)                | 0.8 %   |
| 10           | Metro Group (Germ)         | 0.3 %   |
| <b>TOTAL</b> |                            | <b>29.2 %</b>                                   |
| <b>CR4</b>   |                            | <b>20.4 %</b>                                   |

Source: Planet Retail - [www.planetretail.net](http://www.planetretail.net)

### Foreign supermarkets penetrate developing countries

Foreign supermarkets have been entering developing countries since the 1990s through mergers and acquisitions and by setting up new stores. Latin America, Asia and Central & Eastern Europe are the regions where Western supermarkets invest most.

It is striking that only a few foreign supermarket chains are able to get an important market share in one or more continents. These chains include: Carrefour, Casino, Metro, Tesco and last but not least Wal-Mart. Ahold had acquired many supermarkets in Asia and Latin America but has sold them after it was badly affected by a fraud scandal and large debts.



In Latin America, roughly 60-80% of the top five supermarket chains that operate in the region are multinationals<sup>125</sup>, such as Wal-Mart. In Asia, modern retailers are mostly foreign-owned in Thailand and the Philippines. Foreign supermarkets are also entering Vietnam and China. Some countries still have no foreign supermarket presence, such as Pakistan.<sup>126</sup>

South African retailers have been rapidly expanding into other African countries. Shoprite was operating in more than 14 African countries in 2005 (and had plans to expand further). South African Metro Cash & Carry and Woolworth have recently entered Kenya.<sup>127</sup> Foreign supermarkets have been finding it difficult to enter the market in Kenya because two domestic supermarket chains, Nakumatt and Uchumi, each had about 35% of the supermarket business.<sup>128</sup> Uchumi expanded in to Uganda where it was competing with Shoprite of South Africa. However, Uchumi collapses beginning June 2006, leaving 1200 workers without jobs, but the government intended to bail out the company.<sup>129</sup> European supermarkets such Carrefour, Casino and Metro are also expanding into Africa.

There are other supermarket chains that operate only regionally. Dairy Farm has supermarkets in different Asian countries. In Latin America, Cencosud (ranked eleventh in grocery retail in 2004<sup>130</sup>) operates in Chile and Argentina. Falabella<sup>131</sup>, a Chilean non-food department store that wants to expand in to grocery retailing and to increase its operations in other countries, was already operating in Argentina, Chile, Colombia, and Peru in 2005.

Interestingly, supermarkets with headquarters in developing countries tend to be part of holdings offering a range of activities (financial services, real estate, etc.) while Western supermarkets only have operations that belong to their core business.

When domestic supermarkets have a large market share, it becomes more difficult for Western supermarkets to enter the market. Within certain countries, such as Chile, there is strong competition and rapid consolidation at national level, which makes it difficult for foreign supermarkets to enter or remain in the country.<sup>132</sup> Interestingly, the country closest to the US, Mexico, has a retail model dominated by domestic supermarkets and Carrefour had to leave the country.

## → **Critical issues**

The technical and financial capacity of Northern supermarkets to enter Southern markets means that they can easily buy up local supermarkets.

Many local or domestic supermarkets have less capacity to compete, expand or develop in ways that adapt to the societies in which they operate. Domestic companies with local connections might get fewer chances to develop. In order to compete, local supermarkets imitate some of the tough conditions set by their Northern counterparts. It is not clear whether large supermarkets based in developing countries, which often belong to conglomerates, provide more benefits to their workers and suppliers than their Northern competitors.

### **Changes in the sourcing of FFV and its impact on small farmers**

Some supermarkets in developing countries find it cheaper and easier to source food from imports rather than from local producers. It takes time for some supermarkets in developing countries to switch to local sourcing of FFV.<sup>133</sup>

When supermarkets in developing countries do source from domestic farmers, small producers are not in a strong bargaining position (see chapter 4: case study of the Philippines). Small farmers' supply capacity has already undermined in some countries by cheap imports from trade liberalisation. Often either domestic or foreign-owned supermarkets change their procurement practices which negatively impact on small farmers. Different changes are applied depending on the level of development and scale of the supermarket chain, which can be summarized<sup>134</sup> as follows:

- ❑ a shift from the use of spot markets to the use of preferred suppliers
- ❑ a shift from general wholesalers to specialised or dedicated wholesalers
- ❑ a shift from local or store by store (decentralised) procurement to nation-wide or regional centralised procurement
- ❑ a shift to private standards on food quality and food safety

These shifts are not taking place everywhere yet. In developing countries some supermarket chains are still sourcing from traditional wholesale supply chains, or have a mixed new and old procurement system. However, research shows that supermarket chains in Central America are moving away from traditional supply systems as soon as possible to source FFV more cheaply. There is a clear trend for small independent or traditional food supermarkets to imitate the sourcing strategies of the more modern food retailers in order to remain competitive.<sup>135</sup>

Centralised systems of procurement result in more competition amongst suppliers. Small farmers have problems meeting all the requirements to become a preferred supplier. Even in countries where the retail sector is in its early stages, requirements for large volumes and all year round supplies (which requires costly irrigation) can already be a barrier to small farmers. The system of supermarkets paying suppliers 30 to 60 days after delivery is also a serious problem.

Farmers who can meet the new requirements of the supermarkets in their countries can benefit from a more secure relationship and possibly from technical, credit and transport support assistance. When large farmers are unable to meet all their volume requirements they sometimes draw small farmers into the system.

### **Indirect impacts**

The growth in food retailing by supermarkets also has indirect effects. The parallel wholesale FFV market can be affected by produce that is rejected by supermarkets, leaving it with poor quality produce or oversupply. Traditional wholesalers and food sellers try to compete with the FFV sold in supermarkets and have become more demanding towards their suppliers. This improves the overall quality of FFV for consumers but also

results in small farmers losing their traditional outlets if they are not able to meet the new requirements.

In some Eastern European and developing countries independent restaurants and retailers source fresh produce from 'cash and carry' outlets that traditionally sell to shopkeepers and foreign retailers such as Wal-Mart and Metro have started to operate these stores in some countries. In Southern Africa, Metro Cash and Carry controls 63% of the South African wholesale market, and operates or services over 950 stores in nine other African countries.<sup>136</sup>

### → **Critical issues**

The level of access that farmers have to restructured FFV supply systems in developing countries depends on their financial and human resource capacity and on the kind of product they produce (some require more technology and larger scale production than others). In practice, the more food retailing by supermarkets advances, the more small farmers will have difficulty in finding outlets for their produce.<sup>137</sup> This is especially true for poor and women farmers who have less flexibility to meet new demands and adapt to new competition for their fresh produce. The restructuring of FFV supply systems could lead to a polarisation of existing inequalities or lead to new ones.<sup>138</sup> When poor producers lose their income and purchasing power in rural areas, can this be balanced by cheaper prices for urban and unemployed consumers?

When supermarkets in developing countries engage in direct or preferred relationships with FFV producers, small farmers who were traditionally selling to wholesale traders are losing their outlets.

It is difficult for farmers who directly supply supermarkets to know what the prices are when there are no wholesale markets to serve as a reference point. The more wholesale markets lose their function in developing countries, the less they will be used by (small) supermarkets to supply their FFV products. The public sector mostly lacks policies and the necessary financial and human resources to provide support for wholesale markets and traditional retailers.<sup>139</sup> Private sector assistance so far has been mainly targeted at supporting its own suppliers not at maintaining small farmers in or outside the supermarket supply chain.

Small farmers not only face problems from restructuring markets by supermarkets, many of them also have to deal with more cheap imports of agricultural products, expensive imports of agricultural inputs, privatisation of credit and marketing systems, etc. More research is needed to assess the role of restructuring supply chains in developing countries and the other the main challenges faced by small farmers.

## 2.4 The importance of technological change

Technology plays an important role in the different links of the FFV chain. Below are just a few examples.

Fruit companies have created new varieties with the use of technology. These new varieties are protected by intellectual property rights. For instance, Del Monte's "Gold" superior pineapple variety has been protected by a patent for many years. But once the patent protection period of a new variety expires, it is then widely planted by other companies.<sup>140</sup>

Technological innovations have significantly improved the post-harvest handling and transportation of FFV, increasing the geographic scope of trade. Technological changes can help make transport less environmentally polluting. For example, it is estimated that transporting oranges to the Netherlands in specialised ships would eliminate 322,000 international lorry transits and avoid empty lorries making cross-border trips from Spain.<sup>141</sup>

Producers, exporters or the government in some developing countries have set up internet sites that allow potential buyers from all over the world to identify products and producers. One example is the Fresh Produce Exporters Association of Kenya (FPEAK), a private association in the horticultural industry that aims at enhancing the country's competitiveness in the horticultural export market.<sup>142</sup> The internet can provide a useful export promotion tool for those who can afford it but this research report did not identify what the impact has been.

Internet and computerisation have also made the creation of internet auctions possible. For instance, Fyffes (Europe's largest FFV distributor) created the internet market place to guarantee its market share in the growing business in 1999. However, business to business e-commerce in FFV had a shakeout in Europe in 2001. Fyffes had to wind down its fresh produce e-marketplace Worldoffruit.com due to financial constraints.<sup>143</sup>

Technology has allowed better management and control over buying, storing, just-in-time-supply (even from abroad), and selling of FFV, which is important given its short shelf-life. Computer programmes in logistics, management of the supply chain, and direct invoicing are part of these technological changes. ICT has been used to increase markets for the supply of large distributors and retailers.<sup>144</sup>

Some experts estimate that perhaps the most profound impact on trade and competition will be created by changes in information technology because it allows supply chains to minimize the cost of information flow and its management.<sup>145</sup>

### → Critical issues

Producers, traders and supermarkets from the South which lack financial and human resources to access, develop and use the latest technologies that support FFV trade and retailing are disadvantaged in their access to buyers at national or international level.

New technologies have contributed to the decline of traditional wholesale distribution channels and the increase in vertical and horizontal strategic alliances in the FFV sector as described in this chapter.

## 2.5 Summary and conclusions

In Western, mainly European, markets fresh fruit and vegetables are increasingly being sold to consumers through different kind of supermarkets, from service supermarkets to discounters and hypermarkets. Overall, supermarket retailing reveals a trend towards concentration whereby only a few supermarket chains dominate the supermarket sales. To a lesser extent, this trend is also visible in some developing countries, mostly in Latin America. World wide, a few Western supermarkets dominate the modern retail markets on many continents. The report shows that such an increasing scale and concentration of FFV sales has consequences in all the links in the FFV chain, with severe effects for small producers and plantation workers in the South being severely affected.

The FFV chain is impacted by the demands of supermarket chains for:

- ❑ low prices
- ❑ high quality and safety standards
- ❑ high volumes, and
- ❑ all year round supply.

The growing success of discounters is further pushing FFV prices down in some European countries and the US.

Also, many supermarket chains want to have the least possible amount of suppliers. Some supermarkets have only one supplier for all the FFV products they sell, while others have one per FFV sub-category (e.g. for mushrooms). Some large supermarket chains have a direct relationship with FFV producers in developing countries. Discounters make more use of the spot market to find low priced FFV produce.

A major problem in the FFV sector is that concentrating supermarkets, the growth of discounters and oversupply in some FFV products have enabled supermarkets abusing their dominant position in retailing to extract low prices from FFV producers (“buyer power”) while keeping high margins themselves. Domestic and export producers of the main FFV products have been particularly vulnerable to these practices because, with less shops to sell to, their perishable produce loses its important outlet if they refuse the low prices or other abusive trading conditions set by supermarkets. Producers of exotic FFV products might escape these pressures to a certain extent.

In response to the high demands but low prices by large supermarket chains and their buyer power practices, the rest of the FFV chain is adapting and concentrating. This is manifested by the following phenomena:

- ❑ the growing scale of producers to cut costs and obtain economies of scale
- ❑ the increasing vertical integration through mergers & acquisitions and strategic alliances from production to trade and distribution of FFV
- ❑ diminishing trading through wholesale markets to supply Western markets
- ❑ the supply to Western supermarkets without contracts or guarantees about fair prices and timely payments
- ❑ large multinationals that were dominating some FFV bulk sectors, such as bananas, are penetrating many parts of other FFV chains; their financial capacity

and FFV bulk expertise can lead to unequal competition and squeezing out small producers and businesses

- the pressure to cut costs in order to supply at low prices is being pushed through the whole FFV chain with those at the end of the chain suffering most, especially plantation workers and small farmers.

This trend is set to continue in the current competitive market where, for example, even banana companies are struggling to get contracts from retailers.

The result of these trends is that small and poor farmers in developing countries are increasingly less able to supply to Western markets, even if there are no trade barriers. They cannot meet the demands from the concentrating retailers nor can many reach the necessary growth in size or build integrated networks from production to distribution.

In developing countries where Western supermarkets rapidly enter the market, FFV sales to consumers are also changing. Small farmers are facing the challenges of supermarket demands for high quality and high volumes, the decreasing importance of wholesale and wet markets, or even competition from FFV imports by the supermarkets.

Some small farmers have been able to maintain a beneficial relationship with the supply chains of supermarkets, based on specific products or niche markets.

Two more key bottlenecks for FFV exports from developing countries have been identified by the report and would need more attention:

- The lack of transport capacity by Southern FFV producers and the increasing concentration of sea transport for FFV is hampering small holders' access to markets. Transport costs can shoot up, leaving no profits to the producers or traders. There may even just be no transport facilities to exploit new markets. Also, the higher dependence on overseas FFV products by supermarkets leads to more CO<sub>2</sub> and other polluting emissions.
- Technological innovation, computerised logistics, and high tech supply chain & information management play a very important role in supermarkets demands and suppliers ability to respond. These high tech requirements are difficult to meet by smaller producers and traders, especially in developing countries.

The trends and bottlenecks shown in several chains of the FFV sector indicate that the sector can only be supporting poverty eradication and sustainable development in developing countries under specific conditions. The current trend is heavily biased against small producers and plantation or farm workers. However, the high degree of supermarket concentration provides a possibility that the effects of influencing a few big supermarket chains for more socially and environmentally conditions can have a large scale effect.

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## Chapter 3

# Sustainable development and poverty eradication: the case of Senegal's export-oriented mango supply chain

### Introduction

At the end of January 2005, SOMO commissioned ASPRODEB, the French acronym for the Senegalese Association For Bottom-Up Development, to conduct research into the Senegalese export-oriented mango supply chain from the perspective of poverty eradication and sustainable development. The research was led by Macoumba Mbodj, an independent consultant in Senegal, under the supervision of ASPORDEB and SOMO, and was conducted from January to September 2005. The research was based on a literature study and interviews with different actors in the supply chain (exporters, producers, workers) and on different types of plantations (large and small-scale producers, cooperatives). In July ASPRODEB organised a workshop for stakeholders in the FFV export chain where the draft was presented. The input of these stakeholders is integrated in the research.

There were several reasons why the Senegalese mango supply chain was thought appropriate for a case study:

- ❑ There is scant information on the environmental and social impacts of the mango supply chain in general.
- ❑ World trade in mangoes has grown strongly over the last decades from almost 22,000 tons in 1974 to almost 919,000 tons in 2003 (FAOstat, 2004); mangoes now are popular fruits among developed country consumers.
- ❑ Studies focusing on trade and sustainability in Africa tend to concentrate on countries where people speak English (former British colonies) whereas less research has been carried out in French speaking countries (former French colonies).
- ❑ Senegal is one of the least developed countries, but has recently become an important supplier of mangoes to the EU.
- ❑ Small-scale producers are crucial to food production in Africa and are important suppliers of FFV for export.

## 3.1 Objectives

The broad research objectives of the Senegal case study were as follows:

- ❑ Identifying and analysing the constraints on, and opportunities for Senegalese mango exports.
- ❑ Identifying and analysing the effects of Senegalese mango exports on working conditions, the environment and the local economy.
- ❑ Exploring solutions for the constraints that were found.

More specifically, the study looks into aspects such as:

- ❑ The causes of exclusion of smallholders from mango export chains
- ❑ Trade relations between supermarkets and exporters (prices, contracts, etc.)
- ❑ Pressure from supermarkets to lower prices
- ❑ Trends towards concentration in production and exporting
- ❑ The effect of mango exports on mango production for local consumption

A summary of the research conducted in Senegal is given below. More details can be found in the comprehensive report about the research conducted in Senegal, which has been published separately. However this summary refers to several findings from the case study which were not included in the comprehensive report about the case study. Moreover, some information was added to this summary by the authors of this report that cannot be found in the comprehensive report in order to clarify some aspects of the findings and to put them in context.

## 3.2 Summary

Senegal is located in the western-most part of the bulge of Africa. In 2004, the population was estimated at 10.5 million, half of which is urban<sup>1</sup>. The country is predominantly agricultural. 60 percent of the labour force is engaged in agricultural work and 20 percent is engaged in fishing<sup>2</sup>. The country's Gross National Income (GNI) was 7 billion US dollars in 2004. In the same year, GNI per capita was 670 US dollars<sup>3</sup>. In 2001, 54 percent of the population was estimated to live below the national poverty line<sup>4</sup>.

### 3.2.1 Exports

Senegalese mango exports started at the end of the nineties. The country's tropical climate is well suited to mango production. The Niayes Zone, in the west of the country close to the capital of Dakar, is by far the most important region for mango production for export. Mangoes have been grown for local and self consumption by many small-scale (family) farms for many generations. There are many different varieties of mangoes grown in Senegal. The traditional varieties in Senegal are not fit for export because, among other reasons, they contain too much fibre, something which is not appreciated by consumers in importing countries in the North. In 1979, however, exportable varieties, mainly Keitt and Kent, were introduced in Senegal.

Senegal's recent exports of mangoes were facilitated by the support of the PPEA (project for promotion of agricultural exports) programme initiated by the government and the World Bank. In 2004, local production was estimated to be around 150,000 tonnes, about 30 percent of which were exportable varieties. In the same year, exports amounted to 3297 tonnes, up from 280 tonnes in 1998. This makes mangoes Senegal's third most important horticultural export product in volume after green beans (haricots verts) and cherry tomatoes.

Senegalese mangoes are mainly exported, mostly by boat, to the EU (France, the Netherlands, Belgium); other important markets are Morocco and the South African Republic. Senegal is among the ten most important suppliers of mangoes to the EU. Most of the FFV that are exported from Senegal are sold through wholesale markets, such as Rungis in France. "Direct" exports to supermarkets, via specialised importers, are becoming increasingly important, however. Senegal's largest exporter producer of FFV, Safina, for example, has seen its share in Senegalese mango exports grow from 14 percent in 1999 to 45 percent in 2004. Most of Safina's production is destined for the two largest Dutch retail chains Albert Heijn and Laurus.

### **3.2.2 Markets and characteristics of production**

Three different types of mango plantations can be distinguished in Senegal:

- ❑ Small-scale plantations (2 to 5 hectares) that produce traditional varieties for the local market.
- ❑ Plantations that produce traditional varieties and improved varieties for local markets and exports. These plantations can be both large (more than 20 hectares) and small-scale. The owners of these plantations usually do not export directly but sell their produce to exporters who collect their mangoes.
- ❑ Large-scale plantations that produce exclusively for export and export mangoes themselves.

On the supply side of the mango value chain there are many small-scale producers that produce for export and the local market. Additionally there are a few large-scale plantations. Sometimes, as in the case of Safina, large-scale producers take care of the whole export process from production and packaging to export. These large-scale producers/exporters often export mangoes from other producers. And mostly these companies produce and export other FFV as well. There are about fifteen exporters active in the Senegalese mango chain who collect mangoes from smallholders for export.

There is a distinct market for traditional and improved varieties. Traditional varieties are sold on the local market only. Improved varieties are sold on both the local market and on foreign markets. Mangoes for the local market (both improved and traditional varieties) are mostly sold at (roadside) marketplaces that buy their mangoes on wholesale markets which, in turn, are served mostly by traders who collect mangoes from plantations. Mangoes for export are collected by exporters from different plantations and/or are exported directly by the producers.

### **3.2.3 Prices and trade**

Traditional varieties are cheaper than improved varieties, whether exported or not. Prices for traditional local varieties range from 0.18 to 0.27 US dollars per kilo on wholesale markets. Whereas improved varieties sell for 0.37 to 0.46. Prices for export quality mangoes paid by exporters to farmers when collecting are on average 0.41 US dollars per kilo. Farm gate prices for exporters with their own production are around 0.35 per kilo. Contracts between exporters and producers are rare. A date is fixed by the exporter and the price is agreed upon.

There are several reasons why margins for producers can be low. For example, producers are not always well informed about prices on local and export markets, and might therefore be underpaid. Additionally, like most FFV, mangoes are perishable and need to be transported swiftly to markets and/or need to be stored chilled in special conditioning houses. As most mango farmers do not have access to either of these, this negatively affects their bargaining power. Furthermore, revenues can be low because not all yielded mangoes are of export quality. They can be too small or bruised, for example.

On plantations on which production is not exclusively geared for export (no tube irrigation, less or no fertiliser or pesticides), net yields typically range from 2 to 3 tonnes per hectare. Whereas in large-scale export-oriented production net yields range from 7 to 10 tonnes per hectare. On smallholder plantations, only about 30 percent of harvested improved varieties are of export quality. The less appreciated fruits are sold as second or third-rate fruit on local markets. This means that on average the price they receive for their total production is effectively 23 US dollar cents per kilo rather than 41.

Contracts between exporters and importers are also rare. Mangoes are exported under consignment: exporters send their goods to importers in the countries of destination and pay for all expenses, the importer then sells the goods and pays the exporter. The sum that the exporter receives is equal to the price the importer receives minus his expenses and 8 percent commission. Additionally, if a pre-financing has been granted to the exporter, the loan plus interest (sometimes at excessive rates) is deducted as well. This means that sometimes the price exporters/producers receive can be below production costs (but usually above, of course). In this consignment system, therefore, the financial risk of trading is borne solely by the exporter.

The literature reports practices by supermarkets, such as pressure on producers to reduce prices, and changing the quality norms after agreement has been reached. Such practices were not reported by the exporters interviewed in this study. On the other hand, buying parties buying less than agreed amounts, and not paying for fruit that has been damaged, were reported.

### **3.2.4 Economic impact**

While revenues from mango exports are still modest compared to other Senegalese exports, they are an important source of income for Senegal. In 2004, Senegalese mango exports represented about 5.7 million US dollars. Salaries distributed in the mango export



chain equalled roughly half a million US dollars. Employment in the mango supply chains is mostly seasonal. Very few people are employed outside the harvest season.

Handling of mangoes at packaging plants is the most labour-intensive process in the mango supply chain. In harvest season, mainly women are hired for handling activities that include selecting and packing of mangoes for export. Far fewer workers are employed for harvesting mangoes on the plantations, which is done mostly by men.

The mango harvest season in Senegal is from June to October. The harvest season for other exported FFV is from November to April. The fact that these harvest seasons are complementary is important to many workers. If this would not be the case many would be out of work at the end of the harvest season.

Also, the complementarity of harvest seasons is one of the main reasons why mango production is an important source of revenues for producers, both large and small. Many mango plantation owners grow other crops as well. This means that they have an income from mango production when there is no income from growing vegetables. For many smallholders, this income helps them to be able to pay for their children's education and to make necessary investments in their business.

It should be noted that these revenues are not solely from the export of mangoes but also from selling mangoes to local markets. Indeed, during the course of the interviews it became clear that many smallholders prefer to sell their produce on local markets. The reason being that prices on local markets are sometimes higher and more predictable, and quality and production demands are less stringent on local markets than on export markets. Prices are not always higher on local markets, however: during the peak season, local markets can become saturated because of an oversupply, which results in low prices. This is sometimes due to an oversupply of improved varieties on the local market that were produced for export, but which are sold on the local market because export markets are saturated (for instance when mangoes from other countries are cheaper).

### **3.2.5 Workers' rights**

A collective labour agreement (CLA) applies to all workers in the agricultural sector in Senegal. This CLA establishes mandatory minimum wages and the right to freedom of association, among other things. During the course of interviews with workers from large-scale plantations it became clear that very few workers exert their right to organise and bargain collectively. Although they are aware of the importance of unions to improve working conditions, very few join or form unions. According to the workers interviewed, this is because of the seasonal nature of the work and the vulnerability of their position (few jobs for many willing workers). Nevertheless, in cases in which workers were represented by a (union) delegate, it was found that they could exert their rights.

The results of the interviews with workers at Safina show that most workers are aware of their rights concerning working hours, overtime, contracts and salary. All workers have a contract, although only workers who have a permanent contract are entitled to benefits

such as pensions and medical insurance. As already mentioned, most workers are seasonal workers.

On the plantations visited by the researchers it was found that the hourly rate paid was in line with the statutory minimum for workers in the sector. Supplements for working overtime are also paid. The lowest agricultural minimum wage for an eight-hour day is about 2.90 US dollars. The researchers found that for many workers in the packing houses, a day's salary would range from 1.10 to 2.18 US dollar(s) a day, depending on the number of hours worked. Hence these salaries reflect the fact that, in this sector, a day's work usually comprises (much) less than 8 hours a day. Moreover, workers cannot count on working every day during the harvest season.

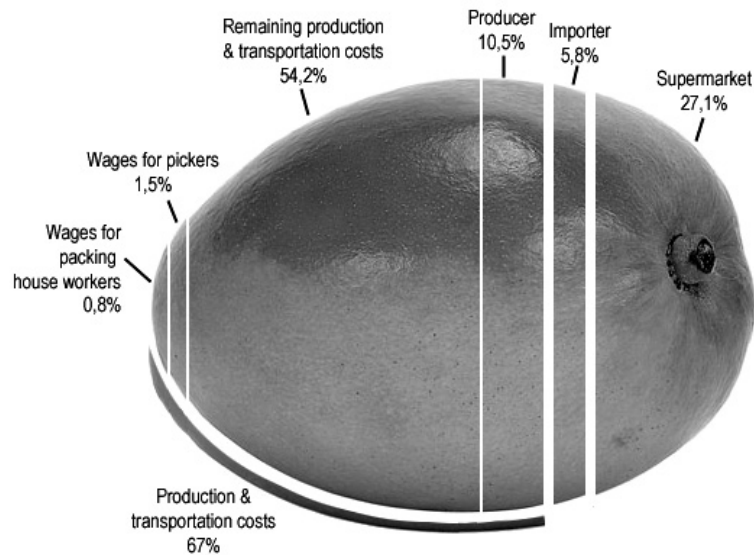
Agricultural minimum wages are marginally above the general minimum wages in Senegal. According to the US State Department, this general minimum wage does not constitute a living wage. Indeed, many of the workers who were interviewed claimed that their salaries are too low to sustain a family. Many workers therefore seek to supplement their income with other activities (retailing, farming etc). For example, in one case a woman stated that she supplements her income and that of her husband from working on a plantation by hairdressing. Workers who are involved in harvesting and irrigation or loading or unloading trucks mostly earned more than those in the packing houses. They were paid around 3.10 US dollar a day.

Health and safety measures on plantations were generally adequate at the premises visited. However it was found that not all plantations provided workers with protective clothing when applying fertiliser and pesticides, nor did they always pay for a twice-yearly medical check-up. The researchers found that workers were not discriminated against, although some women who were interviewed did complain that internal promotion was slow. Child labour was absent on the plantations visited, but children do sometimes work on family plantations in Senegal.

### **3.2.6 Distribution of value in the supply chain**

Figure 14 shows an estimation of margins in percentages for different links in the mango supply chain from Senegal to a Dutch supermarket<sup>5</sup>. It should be noted that only the producer's *profit* margin is estimated. In this example, the producer exports his mangoes himself, and therefore all the costs involved in production, wages, irrigation, storage, taxes, insurance and conditioning are covered by the producer. After deduction of these costs, the profit margin for the producer is 10.5 percent. The figure shows that the gross wages of mango pickers and women working in the packing houses combined represent only 2.3 percent of the net value of a mango sold in a Dutch supermarket. Supermarkets capture 27.1 percent of the net retail price (without deduction of costs made by the retailer) and the importer 5.8 percent. It is therefore clear that a minor redistribution of margins in the value chain and/or a minor increase in the price of mangoes on the supermarket shelves in the EU could improve wages for workers substantially.

**figure 14: Estimation margins of various actors in the mango value chain and costs of production for a mango sold in a Dutch supermarket in percentages of the net shelf price**



### 3.2.7 Environmental impact

In countries like Senegal, which are hot and have a long dry season, water can be scarce. The city of Dakar, for example, has a major drinking water problem. Demand is far greater than supply. The elevated use of drinking water for irrigation of horticultural production in the vicinity of the city is an important cause of this shortage. Water consumption for irrigation of export-oriented mango plantations is much less than that for most vegetables and other fruits that are produced in Senegal. Indeed, irrigation is only common (and a necessity) for the production of mangoes for export. Plantations for local consumption often rely on rain alone, which can be scarce.

In the Niayes region, the quality and availability of the groundwater is increasingly becoming a problem. Export-oriented mango plantations in this region rely mostly on groundwater for irrigation. Due among other things to its intensive use in horticultural production, groundwater levels in the region are decreasing, while salinity is increasing. Varieties for export, such as Kent, seem less resistant to drought than local varieties such as Divine. Research on the possibility of growing, exporting and marketing these more drought-resistant varieties is recommended.

The (increasing) production of mangoes does not seem to be negatively affecting biodiversity in Senegal. Additional research should be carried out into this aspect of production, however. Within the framework of the time available for this research, it was not possible to investigate this issue thoroughly. The use of fertiliser and especially

pesticides is also relatively low compared to its use in the production of other fruits and vegetables. Additionally, mango trees play an important role in preventing soil erosion due to wind. Due to a lack of time, it was not possible to assess whether the environmental impact of large-scale plantations for export was relatively higher or smaller than that of small-scale plantations.

### **3.2.8 Exclusion of small-scale farmers**

As referred to earlier, in Senegal there are many smallholders involved in mango production for export. Their future as producers for export looks grim, however. Without serious measures to organise smallholders, investments in infrastructure, and training in Good Agricultural Practice (GAP), for example, it is expected that increasing numbers of smallholders will be excluded from lucrative export chains.

There are several factors that might cause exclusion. For example, supermarkets in the Netherlands buy only EurepGAP certified FFV (see also chapters 1 and 5). This kind of scheme for ensuring food safety and quality virtually excludes smallholder participation in the supply chains: the investments that have to be made in order to be able to get certified are beyond the reach of most smallholders. Accordingly, many producers who were interviewed expressed their concerns about this development. Moreover, supermarkets are increasingly dominating FFV retailing in importing countries. In many European countries, supermarkets typically source FFV directly from the farmer or through wholesale traders and specialized importers. The influence of wholesale markets and independent wholesale traders in these countries has diminished accordingly (see also chapter 2). Wholesale markets in Europe are still important destination for Senegalese mangoes. But because these markets are eroding, it could mean that smallholders are increasingly excluded from export chains if this trend continues.

Also the success of large scale production could be a threat to smallholders. As mentioned in the export section of this chapter the importance of large scale production in Senegalese mango exports has grown considerably. This trend is geared by among others quality and quantity demands of buyers. To meet these demands exporters increasingly take production in their own hands and/or have out-growers produce according to their specifications. In 2005 this development alarmed smallholders because they fear exclusion of the supply chain of these same exporters. In 2006 there are indications that the number of smallholders in mango export chains is indeed diminishing. Increased large scale production is an important factor in this trend.

Another factor that can cause exclusion of small-scale farmers from export chains is the increasingly stringent legislation on pesticide residues and pests on FFV and the increasing demand for traceability in importing countries. This means, among other things, that (smallholder) producers need to incur extra costs, for which they are rarely compensated. Traceability legislation applies to EU operators (see also chapter 6) only, as retailers/importers might see traceability as an important tool for maintaining consumers' trust (food safety), however, as well as protecting themselves from legal liability, it would

seem that retailers/importers require full traceability from exporters<sup>6</sup>, which is the case with Dutch retailers (EurepGAP). The downstream costs are for the exporters and producers. This practice would virtually exclude smallholders, because its application would appear to be very difficult/costly under the current system of collection of mangoes by exporters from different smallholder farms. Illiteracy is a further major obstacle for the administration involved in traceability schemes.

Because of EU maximum residue level (MRL) legislation, smallholders sometimes cannot export to the EU at all, because they lack the experience or training to comply with the norms. For example, the MRLs for some pesticides that may (still) be used by many producers in developing countries are set at zero. This is the case with pesticides, application of which is considered by the authorities to be relatively too damaging for the environment and/or (consumer) health. Current practice for MRL settings, however, is that the agro-chemical industry provides the research information on which to base the MRL settings. When such information about certain pesticides is lacking, the MRLs for this substance are set to zero by default. Agro-chemical companies focus on providing experimental data for the substances that they sell most (pesticides for most common FFV) and not on minor culture pesticides and/or pesticides on which patents have expired. These substances need not be less safe than patented pesticides.

Fortunately there are a few initiatives in place to support the agricultural sector in Senegal, to enable compliance with these new contingencies. For instance, the EU finances programmes in ACP countries to build capacity, train farmers in GAP and inform them about MRLs and prices. Also, two collective storages facilities will be opened in the near future: one refrigerated storage in the Niayes region and one at Dakar airport. These facilities will be used to enable smallholder(s) cooperatives to store their produce before shipping. Finally, with the support of the Dutch ministry of foreign affairs, research was conducted in Senegal to investigate the possibility of inclusion of small-scale green producers within the EurepGAP certification scheme.

### 3.3 Conclusions

Mango exports are of growing importance to Senegal's economy. For both growers and rural workers, mango exports each year generate revenues during the season in which no or few other FFV are exported. However, agricultural minimum wages are too low to support a family in Senegal. Also, health and safety measures on plantations are not always adequate. Buying parties, especially supermarkets as major stakeholders, do not ensure that working conditions on plantations improve. They could for example demand that living wages are paid. Stakeholders in Senegal stress the importance of organising workers and small-scale producers, however, to improve working conditions. When organised, a collective demand to the government for better labour legislation and better government verification of compliance with labour laws would have more success in improving working conditions. Only on condition that this approach were made would the Senegalese stakeholders endorse an approach that would urge supermarkets to take their corporate responsibility. For example, the value chain analysis presented suggests that workers would not claim the impossible when demanding higher wages, as this would just require minor redistribution of margins.

Smallholders in Senegal represent a large potential for increasing exports. However, recent developments in mango export chains, such as stringent MRLs and traceability requirements of importers/retailers, food safety initiatives from supermarkets in importing countries such as EurepGAP and changing market structures (diminishing importance of wholesale markets as an outlet) have made it more difficult for smallholders to either enter or stay within export chains. Governments, NGOs and private parties such as supermarkets could, however, support smallholders by providing training (GAP, MRL) and information (export market information, prices), for example, financing infrastructure geared to meet smallholder needs (refrigerated transport and storage facilities) and providing cheap credit.

Producers need to shift away from pesticides whose application is forbidden in the EU. However, maximum residue levels (MRLs) are not being set for substances that are of little or no commercial interest to the agro-chemical industry, but which are used in developing countries. Governments and industry could finance research into new MRLs and ensure that they are not more damaging than their patented counterparts.

Export in consignment is an unfair system from the perspective of producers because the selling party is carrying all of the financial risk of exports instead of both the buying and selling parties sharing the financial risk. This undermines government and development strategies to raise living standards and eradicate poverty.

The costs involved in gaining the certification needed to export to some European supermarkets is very high. These costs could be lowered by building capacity (training of local auditors) to enable local certification and auditing of food safety certification schemes.

The primary focus of the present study was on social and economic aspects of the mango chain, and much less on its environmental impact. It is therefore impossible to make definite conclusions and recommendations regarding this aspect of sustainability of the chain. It can tentatively be concluded, however, that compared to other horticultural exports, the production of mangoes seems more sustainable. Less agricultural inputs (fertiliser and pesticides) are used and needed than in other horticultural production. Water consumption for production is also relatively low. It also seems that so far increased production has not resulted in a loss of biodiversity. More research on this aspect is needed, however.

Water is scarce in Senegal and problems with the quality of groundwater for irrigation resulting from overexploitation are reported in the most important production region in the country. The costs of irrigation already represent a major part of the costs of exploitation of a mango plantation. Both from an economic and an environmental angle, therefore, more research into the production, export and marketing of more drought-resistant mango varieties is recommended.

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- <sup>1</sup> World Bank, Senegal at a glance, 25 August 2005, <[http://www.worldbank.org/data/countrydata/aag/sen\\_aag.pdf](http://www.worldbank.org/data/countrydata/aag/sen_aag.pdf)> (12 October 2005)
  - <sup>2</sup> US Department of state, Senegal Country Reports on Human Rights Practices, 25 February 2004, <<http://www.state.gov/drl/rls/hrrpt/2003/27748.htm>> (12 October 2005)
  - <sup>3</sup> World Bank, Senegal at a glance, 25 August 2005, <[http://www.worldbank.org/data/countrydata/aag/sen\\_aag.pdf](http://www.worldbank.org/data/countrydata/aag/sen_aag.pdf)> (12 October 2005)
  - <sup>4</sup> CIA website, World Fact Book, "Field Listing - Population below poverty line", 20 September 2005, <<http://www.cia.gov/cia/publications/factbook/fields/2046.html>> (12 October 2005)
  - <sup>5</sup> Calculations based on information of the PPEA (fiche de prix de revient mangue 4 kg bateau see appendices of the Mango report Senegal) and the Consumentenbond (Dutch consumer organisation): (No author), "Voelen om te proeven", Consumentengids (Consumentenbond), April 2005, p. 68. In the calculations a mango weighs 450 grams and costs 90 euro cent including 6 percent VAT.
  - <sup>6</sup> M. Doherty, "Traceability – a step too far", Commonwealth Trade Hot Topics, 42 (no date), Economic Affairs Division of the Commonwealth Secretariat (<http://www.crosq.org/tradehottopics42.pdf>)

## Chapter 4

# Case study: the effects of local supermarket policies in Indonesia in the banana and carrot supply chain

### 4.1 About the case study

There is currently a lack of literature and information regarding the impact of supermarkets operating in developing countries. SOMO therefore approached the Institute for Global Justice (IGJ) to conduct research in the context of a broader study of the FFV sector in 2005. IGJ investigated the effects of foreign multinational supermarkets selling in Indonesia on the banana and carrot supply chains, from the perspective of poverty eradication and sustainable development. The research, led by Oleh Agus Sopian and Lutfiyah Hanim of IGJ, is based on a literature study, a survey of producers and consumers, and a number of interviews with other stakeholders, including producers, consumers, supermarket managers and officials.

The establishment of foreign supermarkets in Indonesia is not as well advanced as in some Latin American countries. The study aimed to assess changes and impacts in the early stages, with particular attention to farmers. The objectives of the case study were therefore as follows:

The broad research objectives of the Indonesia case study were:

- ❑ Identifying and analysing the impact of supermarket policy on production, distribution, packaging, market prices and quality standards of carrots and bananas in Indonesia
- ❑ Identifying and analysing the environmental and social impact of the production of carrots and bananas for supermarkets compared to traditional outlets.
- ❑ Exploring solutions for the critical issues that were found.

More specifically, to study:

- ❑ Growth of supermarkets/retailers in Indonesia
- ❑ Trends in food distribution by (Western) supermarkets in Indonesia
- ❑ The importance of supermarkets in FFV sales
- ❑ The effect of supermarket policies (quality, safety, CSR demands) on producers of FFV
- ❑ Demands placed on FFV suppliers of supermarkets in their relationship with suppliers (e.g. honouring of contracts)



- The challenges faced by the poor and small farmers as a result of the growth of supermarkets in Indonesia

The full details of the research conducted in Indonesia can be found in the comprehensive report that will be published by IGJ separately. This chapter gives a summary of the case study with some additional and explanatory information to clarify some aspects of the findings and to put them in context.

## 4.2 The supermarket sector in Indonesia

Indonesia is the world's largest archipelagic state and is located mostly just below the equator in South East Asia. With a population of 245 million, Indonesia also has the world's largest Muslim population. In terms of employment, the agricultural sector is the most important sector: 45 percent of the working population is active in the agricultural sector and 14.7 percent of Indonesia's GDP is generated in this sector. In terms of GDP contribution the agricultural sector is far less important than the services (41.7%) sector, but more important than the industrial sector (11.8%)<sup>1</sup>. The country's Gross National Income (GNI) was 248 billion US dollars in 2004. In the same year, GNI per capita was 1,140 US dollars<sup>2</sup>. In 2004, 16.7 percent of the population was estimated to live below the national poverty line<sup>3</sup>.

### 4.2.1 Supermarket sector

The supermarket sector has grown rapidly and there are now over 800 supermarkets in Indonesia.<sup>4</sup> While the number of traditional retailers (wet markets, small shops) in Indonesia has been diminishing by 8 percent annually the number of supermarkets and hypermarkets has increased by 26 and 15 percent respectively<sup>5</sup>. In 2006 supermarkets will account for 30 percent of all retail sales in Indonesia according to AC Nielsen. 70 percent is effectuated via traditional outlets.

The Indonesian government has traditionally been keen on preventing foreign retailers to enter the national market. From 1969 to 1998 the Indonesian retail sector was off limits for foreign investment. However a loophole in regulation allowed foreign companies to enter the Indonesian market through franchise and technical arrangements<sup>6</sup>. In the early nineties Walmart (US) and Makro (NL) were the pioneers by forming joint ventures with local partners Lippo Group and Goro respectively. Other pioneers were the Japanese retailers Seibu and Yoahan, which entered by operating a franchise formula. Later during the nineties, many other international retailers would enter the Indonesian market, such as Ahold (NL), Delhaize (B), Carrefour (FR) and Dairy Farm. The reform and liberalisation of Indonesia's foreign investment regulation, in particular, spurred on by the IMF during the severe economic crisis in Indonesia and South East Asia in 1997-1998, accelerated the entry of foreign retailers.

Indonesia is seen as an attractive market for foreign retailers: with its large and youthful population, the market has huge potential, is benefiting from strong economic growth and

is relatively fragmented. These opportunities are important incentives for foreign retailers to enter Indonesia's retail market. In 2003 the leading supermarket chains in Indonesia were, in descending order of importance, Carrefour, Salim Group (Indomaret, Superindo, Indogrosir), Alfa Group, Hero/Giant, Makro and Matahari<sup>7</sup>. Among these leading retailers there are three - Dairy Farm's Hero/Giant (Malaysia/Indonesia), Carrefour (France/Indonesia) and Makro (Netherlands/Indonesia) - joint ventures between large international retail chains and Indonesian partners. However leading domestic operations such as Alfa Group, Matahari, Salim Group and Ramayana are also important players. Estimates suggest that foreign investment is very dominant (66%) in the hypermarket (Carrefour, Makro, Giant, Indogrosir) sector only. Foreign investment in regular supermarkets (Matahari, Superindo, Ramayana but also Hero) and minimarkets (Indomaret, Alfamart) is estimated at around 10 percent<sup>8</sup>.

#### **Carrefour: short company profile**

Carrefour is the Europe's largest retailer and second only to Wal-Mart in the world. Global net sales amounted to 94 billion US dollars in 2005. Carrefour has 10,000 outlets spread in 29 countries. Sales in France, Carrefour's home market, contributed almost half of its total sales. The rest came from the European region (38%), Asia (8%) and America (7%).<sup>9</sup> In Asia, Carrefour opened its first stores in Taiwan in 1989, then Malaysia in 1994, China in 1995, Singapore in 1997 and Indonesia in 1998. Carrefour now has 424<sup>10</sup> outlets in Asia (including South Korea and Japan), far more than its main non-Asian competitor, Wal-Mart, which has around 15 outlets in the region.<sup>11</sup>

The first Indonesian branch opened in Jakarta, and in 2005 Carrefour had 20 outlets spread throughout the country<sup>12</sup>, including Medan, Palembang, Bandung and Surabaya. In 2005 Carrefour was the largest hypermarket operator in Indonesia (47% of market share) and second largest retailer. Unlike other hypermarket outlets on the outskirts of cities, pioneered by Makro in 1992, Carrefour started with outlets in the inner city. This is a remarkable strategy since most of its outlets, in Europe for instance, are suburban outlets. Obviously their strategy has raised debate, as Carrefour is seen as a threat to vendors and small retailers in the inner city. Carrefour's net sales in Indonesia amounted to 593 million US dollars in 2005<sup>13</sup>.

#### **4.2.2 Supermarkets versus traditional markets**

The rapid expansion of supermarkets in Indonesia has resulted in a reorganisation and losses for traders in traditional markets in Indonesia. Regional zoning laws exist and can be used to protect traditional retailers, such as small shops and wet markets, by regulating where supermarkets can be established in the city and suburbs. However, mostly as the result of allocation zone overlapping and poor law enforcement, these regulations are often not effective in preventing conflicts of interest between various actors. For instance in different cities, groups of local entrepreneurs have protested in various ways against the emergence or planning of supermarkets close to their shops. As the result of the lack of regulation and the possibility of escalating conflicts between parties, smaller retailers and traditional market entrepreneurs are calling for effective national zoning regulation, and

the supermarkets for agreement on zoning by all actors. In 2005, new legislation was in the pipeline, which will give more authority to provincial and local governments to regulate the supermarket allocation.

### **Hero: short company profile**

Hero is one of Indonesia's domestic supermarket pioneers. They opened up a mini market in 1971 targeting ex-pats in Jakarta, among others. Hero was also the first Indonesian supermarket to go public in 1989. Nine years later they forged a strategic alliance with Dairy Farm, a member of the Jardine Matheson Group, an English conglomeration established in Guangzhou, China, in 1832.

Dairy Farm is the leading Asian retailer, which operates in eight countries in addition to Indonesia: Hong Kong, Mainland China, India, Malaysia, Indonesia, South Korea and Taiwan. The number of outlets operating under Dairy Farm reached 2,493 units in 2003 with 53,000 employees. In the same year retail sales amounted to 5.2 billion US dollars.

Dairy Farm's cooperation with Hero continued and strengthened in 2002 when they opened up the first Giant stores, thereby introducing the hypermarket concept to Indonesian consumers. Giant, a member of the Dairy Farm group, is one of the leading retailers in Southeast Asia. In 2004 there were 10 Giant outlets, other outlets were 99 Hero supermarkets, 81 Guardian pharmacies and 43 Star mart outlets . Annual net income in 2004 was 3.7 million US dollars<sup>14</sup>. Due to financial difficulties, Hero has closed down several outlets since 2003.

The city of Jakarta is the only city in Indonesia that has explicit regulations for the retail sector including:

- ❑ Zoning: regulation of the proper distance between local markets and supermarkets, with the minimum distance between traditional and supermarkets increasing in proportion to the surface area of the supermarket shop floor.
- ❑ Opening hours: supermarkets are only allowed to operate between 10 am to 10 pm.
- ❑ Selling price: items at supermarkets should not be lower than those in surrounding shops and traditional markets
- ❑ Obligation to provide a certain amount of store space to smaller businesses
- ❑ Regulations on the items on sale in supermarkets: for instance mini-markets should stress selling packaged products instead of fresh unpackaged products

The Jakarta regulations have attracted criticism from the supermarket sector because according to them the zoning is impossible to implement, there is no regulation covering the distance between supermarkets, and renting space to small-scale businesses, such as street vendors, is costing them money. There is also criticism from another corner: researchers of IGJ have observed that the Jakarta supermarket regulations are poorly implemented, for instance there is no clarity on the sanctions for non-compliance and responsibility for implementation and monitoring is also unclear. In fact they observed that some supermarkets in Jakarta fail to comply with the regulations: opening hours were

longer than allowed, items are sold at a price much lower than that of traditional competitors and fruits are sold prominently in mini-markets.

Another factor that has contributed to the increase in supermarket activity at the cost of traditional outlets in Indonesia is the policy of decentralisation of governance which was implemented in the 1990s. This policy effectively obliges local governments to be financially highly self-reliant. Local authorities can and should generate income through local taxes and non-tax revenue such as Building Establishment Licences, Land and Building Tax and store, advertisement and car parking taxes. In this situation, malls, hypermarkets and supermarkets are seen as welcome contributors to local income, and large retailers are therefore being invited to open malls, wholesale stores and hypermarkets, resulting in rapid expansion of these stores in populated areas all over Indonesia.

### **Indomaret case**

On the grounds of unfair competition, the Indonesian Business Competition Authority (KPPU) ordered the Indonesian chain of mini-markets (small supermarkets) Indomaret to stop expanding its activities in areas where traditional retailers operate. In 2000, at the time of the KPPU investigation, Indomaret was planning to expand its 290 stores by an additional 2000. According to KPPU, each Indomaret threatens the existence of 10 small-scale local stores. One of the reasons Indomaret is feared by local small-scale entrepreneurs is their low prices. These are the result, among other things, of economies of scale and cheap sourcing of products from a large distributor of food products that owns almost half of the shares of this retail chain. KPPU also advises the government to take action to empower traditional retailers.

Source: Decision of Komisi Pengawas Persaingan Usaha (KPPU) Republik Indonesia, no 03/KPPU-L-I/2000

In addition to external factors, there are internal factors which enable supermarket expansion in Indonesia. For instance, supermarkets provide comfort (air-conditioning, parking spaces), convenience (large assortment of products, one stop shopping) and low prices. In addition, some supermarkets have more unconventional strategies to gain market share and profits. They oblige suppliers to pay compensation if another retailer sells the same product for less (minus margins), accept only suppliers of a certain size (not small but certainly not too large) and only suppliers that are not part of a large business group or affiliated to such a group (see also boxed text). Many supermarkets also have listing fees, which means that suppliers have to pay for their products to be on the shelves. This is normal practice for supermarkets in some other countries as well. In Indonesia, Carrefour charges the highest listing fees in the country (see box).

### Carrefour case

In August 2005, the French retailer Carrefour was fined 170 thousand dollars by the KPPU for not sourcing goods from a listed supplier who then went bankrupt, which was considered to be an unfair competition practice. In addition, Carrefour was ordered to stop minus margin practices.

In the KPPU investigation it was found that suppliers are required to sign a written agreement with Carrefour, known as the National Contract. The agreement includes trading terms negotiable to the supplier (see chapter 2): listing fee, fixed rebate, minus margin, terms of payment, regular discount, common assortment cost, opening cost/new store, fees for bi-weekly Carrefour advertisements and penalties. According to suppliers, the trading terms are imposing a heavy financial burden, especially the listing fee and minus margin.

Carrefour has more market power than its competitors, which results in more bargaining power to negotiate favourable trading terms with their suppliers. According to the KPPU Carrefour has abused its bargaining power, for instance Carrefour's listing fee is significantly higher than those of its competitors and it is applied before suppliers can sell in its supermarkets. Carrefour is also found to sometimes hold back due payments, to alter or cancel orders unilaterally and to put pressure on suppliers not to sell to its competitors.

Nearly 90% of Carrefour's goods sold are local products, but only 20% of them are made by small and medium sized enterprises (SMEs). Many products are sourced from Unilever, Nestle and Procter and Gamble producing in Indonesia.

Source: [www.kppu.or.id](http://www.kppu.or.id), Visited on December 5, 2005; Planet Retail Daily News, 25 August 2005.

### → Critical issue

The trade organisation of traditional markets in Indonesia fears for the existence of numerous members in the coming years, due to the rapid expansion of supermarkets in Indonesia.

## 4.3 FFV production in Indonesia: the banana and carrot supply chain

### 4.3.1 Production of FFV in Indonesia

In Indonesia, bananas made up the bulk of total fruit production in 2005 (33%), followed by mangoes (11%), oranges (10%), pineapples and papayas (both 5%). In the vegetable sector, the total production volume in 2005 of cabbages (17%) was highest, followed by chillies and peppers (12%) green beans, onions (both 11%), and tomatoes (8%)<sup>15</sup>.

Although large-scale commercial cultivation is becoming increasingly important, fruit and vegetables in Indonesia are still largely produced by small-scale farmers. To date, Indonesian exporters have not organised themselves in a recognisable manner. Export

channels are maintained and developed at individual business levels, while domestic sourcing is characterised by all forms of market arrangements, e.g. out-grower schemes, use of agents, infant product market organisation. Some of the large retail chains have their own distribution centres and organise conditioned transportation of the fruits and vegetables<sup>16</sup>.

#### **4.3.2 Characteristics of the carrot and banana supply chain**

The case study about banana and carrot supply chains to supermarkets and traditional markets focused on the supply chains for the city of Bandung on West-Java. One of the most important production regions for carrots, bananas and other FFV for Bandung markets is the Garut district which is located about 60 kilometres south of Bandung.

The production of carrots and bananas in this area is typically small scale (less than one hectare per farm) and is labour intensive, with simple farming tools. Most farmers are not landowners and the income from farming is generally not enough to sustain their livelihoods. Most farmers have additional (agricultural) jobs and/or resort to borrowing money to make ends meet. A few farmers grow other crops as well to generate additional income. The production areas visited by the researchers were mostly small isolated villages that are sometimes difficult to reach even with a four wheel drive vehicle. The vast majority of the villagers are involved in agriculture.

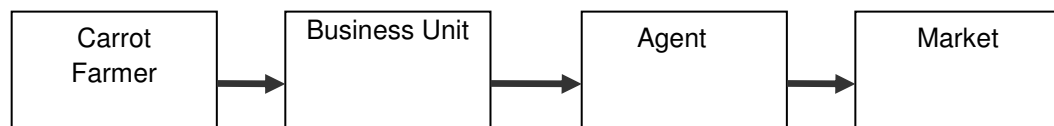
The research found that in the Bandung region, the impact of the growth of modern retailers in Indonesia is not yet being felt at the producer level. The graphic description of the banana and carrot supply chain below shows a number of players in between producers and supermarkets, such as agents and wholesale markets. As a result, farmers who were interviewed did not know where their products would finally be sold, or at what price. Additionally, interviews at Bandung's largest wholesale market revealed that supermarkets source their FFV from the same wholesale markets and merchants that smaller retailers buy from. It should be noted that there are suppliers that sell most of the horticultural products they collect from smallholders to supermarkets as well. These were however not interviewed by the researchers. These specialized agents have close relationships with other suppliers and small farmers in order have to have products supplied in certain quantities and possibly other specifications. It is estimated that 40 percent of the horticultural produce supermarkets and hypermarkets sell is supplied by these specialized agents. 10 percent is supplied by large agricultural firms that deal with supermarkets directly<sup>17</sup>.

As shown in the next section, Indonesians still prefer to buy their FFV in traditional outlets and the FFV sales volumes of supermarkets are therefore still relatively small. Illustrative of this fact is that larger agents do not consider supermarkets to be serious clients, because the volumes purchased by them are low, although they sometimes might pay them twice as much. It should be noted that in theory supermarkets could hand down their specific quality, quantity or production demands to agents/wholesale traders, who in turn would hand them down the distribution chain. This case study revealed no such demands

being made, however, as referred to above large scale suppliers and smallholders that supply specialized supermarket agents produce at least to certain demands.

The banana supply chain is a little more complex than the carrot supply chain (see figure below). In the banana supply chain local agents, or croupiers as they are called in Indonesia, do not supply (wholesale) markets directly but supply city agents. City agents are larger traders/agents that have their businesses in the larger cities in areas such as Bandung. Another difference between the two supply chains is that the carrot farmers interviewed have a collective unit that functions as a collector and collecting point of carrots produced locally for the market. This unit pays local farmers in the form of a cheque/receipt that can be cashed after 1 to 3 days when the unit has sold the collected carrots to the agent. From the interviews with the FFV merchants in Bandung it became clear that the carrots they sell are mostly of West Javanese origin. Bananas are also sourced from Java but, in contrast to carrots, they sometimes source bananas from Sumatra as well.

**figure 15: Carrot Supply Chain**



**figure 16: Banana Supply Chain**



**→ Critical issue**

The lack of information about prices, markets, in addition to their isolation, lack of transportation and financial means, hampers the bargaining position of farmers to get better prices for their produce. This also prevents them from taking action to face future changes in sourcing by supermarkets.

While prices for carrots and other FFV differ depending on supply and demand, prices for “domestic” carrots in Carrefour in Bandung were found to be about four times more expensive than the highest recorded farm gate price. As interviews with Carrefour managers revealed that margins on FFV are typically low to attract consumers (see also 4.3.3) it is likely that most value added is captured by the intermediate links in the supply chain, taking into account that agents take care of cleaning, sorting, transport and packaging.

### **4.3.3 FFV retailing in Indonesia**

According to a survey by AC Nielsen, the role of traditional outlet stores is still very strong in Indonesia. AC surveyed the buying preferences of consumers (see table 19) and found that for fresh products such as fruits, vegetables, meat and fish, traditional outlets (traditional shops, wet markets, vending chart) are still the first choice. Their advantages over supermarkets include their number, location, and payment by credit.

IGJ performed a (small) survey of consumer buying preferences as well. Of the 80 consumers interviewed outside supermarkets and traditional markets, half preferred buying fruit and 86 percent preferred buying vegetables in traditional markets. With respect to FFV, the trends are in line with the AC Nielsen research. One remarkable difference, however, is the popularity of supermarkets for buying fruits in the IGJ survey which is higher than in the AC Nielsen study. Possible explanations for these differences could be the sample size and of course the locations of the survey (in the city for IGJ).

Another remarkable difference between the two surveys is that IGJ found that traditional markets are *only* preferred for fruits and vegetables. When buying other products such as fish, meat and non-food grocery products, supermarkets are the first choice. Whereas in the AC Nielsen research, consumers clearly prefer buying meat and fish from traditional markets, even more so than buying FFV. Nevertheless from both surveys it seems clear that supermarkets are competing with traditional markets especially in the area of fruit retailing, and less so in the case vegetables.

As for prices, most respondents perceived supermarket and traditional market prices for FFV as “normal”. Only a few respondents stated that prices at traditional markets are very low. However, 26 percent perceived supermarket prices to be high or very high. The income of respondents did not correlate with a preference for either outlet.

The small IGJ survey suggests that the role of supermarkets in Indonesia could grow if supermarkets can provide FFV at competitive prices. Supermarkets such as Carrefour are well aware of this opportunity: Management of Carrefour in Bandung told the researchers that the margin on FFV is set at 3 percent. This is very low compared to the margins on FFV set by Dutch supermarkets, that are at least ten times as high. Low FFV margins can be compensated for by higher margins on other products. With such business strategies, it seems unlikely that producers of FFV in Indonesia can expect an increase in income from the increasing market shares of modern retailers.

Accentuating food quality and food safety is another strategy supermarkets use to compete with traditional retailers. Unlike traditional markets that offer produce in various qualities (ranging from low to high) and corresponding prices, supermarkets tend to offer only products of good quality. If the image that “supermarket produce equals quality” pertains, quality conscious consumers could increasingly turn to supermarkets instead of traditional markets.

In addition there have been a number of food safety incidents in Indonesia. Consumers could perceive supermarkets as more trustworthy than traditional markets in guaranteeing



food safety. Hence both quality and food safety concerns could attract more consumers to supermarkets. Notwithstanding the fact that, as has been demonstrated in this research, traditional markets and supermarkets largely source from the same suppliers when it comes to FFV. Finally, as already mentioned, other important factors in supermarkets becoming increasingly popular with Indonesian consumers are comfort and convenience.

**table 19: Shopping Preferences of consumers (%)**

|                        | Fruit | Vegetables | Meat | Fish |
|------------------------|-------|------------|------|------|
| Hypermarket            | 4     | 1          | 4    | 1    |
| Supermarket            | 20    | 2          | 8    | 4    |
| Minimarket             | 4     | -          | -    | -    |
| Traditional shop       | 7     | 15         | 8    | 10   |
| Wet/traditional market | 46    | 47         | 67   | 63   |
| Vending cart           | 15    | 36         | 14   | 23   |
| Others                 | 5i    |            |      |      |

Source: AC Nielsen, APPSI, 2005<sup>18</sup>

## 4.4 Conclusions

Modern retailing in Indonesia is expanding considerably. Domestic supermarkets pioneered in the sector in the seventies. Foreign retailers, which now are among the leading supermarkets in Indonesia, were forbidden to enter the market from 1969 onwards but entered through a loophole in the regulation in the beginning of the nineties.

Afterwards, especially towards the end of the century, when protectionist policies were abandoned in order to secure IMF loans during the Asian financial crisis, more foreign retailers entered the market mostly in joint ventures with Indonesian partners.

This case study focussed on the impact at the bottom of supply chains for production and trade in bananas and carrots. Although the outcomes could be different for other FFV, the results suggest that production and trade in FFV have so far hardly been affected by the expansion of modern retailing in Indonesia. Two main reasons for this are that producers are not informed of changes in consumer outlets because of the many intermediate links in the supply chain that separate them from the retailers. And the overall share of FFV products sold at supermarkets is currently too low to impact overall prices and quality demands.

Traditional retailers such as wet markets, small shops and vending charts still enjoy considerable popularity among consumers, especially for buying FFV. Accordingly, supermarkets do not significantly shape trade and production of FFV. It was found that supermarkets from the city of Bandung source FFV from the same FFV distributors and agents at wholesale markets that traditional outlets use for their sourcing. In the area studied, there was no evidence of any additional standards, food safety, quality and/or CSR demands imposed on producers by supermarkets which could change production for better or worse. However a study by Padjadjaran University (Bandung Indonesia) indicates that supermarkets also deal with large scale farms directly and with specialized agents. These suppliers are producing/sourcing according to specific supermarkets requirements such as volume and quality. It is therefore likely that supermarkets to some extent shape production at these more dedicated suppliers.

The possibility was anticipated that supermarkets could erode the importance of local production of FFV by importing FFV from abroad, as is the case in many European countries. However bananas and carrots sold by the agents interviewed that also supply supermarkets were produced in Indonesia only. Therefore tentatively it can be concluded that with respect to these FFV in the Bandung region the impact of imports are low or are hardly felt yet. Figures of carrot imports and exports are unavailable (FAOstat, 2006). However figures on production, import and export of bananas corroborate this tentative conclusion. Imports fluctuate considerably over time but the volume has been very low over the last ten years compared to local production and there is no clear trend of growing imports. Also a study from Padjadjaran University indicates that only 10 percent of horticultural products sold by modern retailers is imported<sup>19</sup>. Nevertheless in general there are serious concerns with respect to imports of supermarkets: in April 2006 the trade ministry issued regulation to ensure that local products make up at least 30 percent of all traded goods at large retailers<sup>20</sup>.

→ **Critical issues**

A number of critical issues have been observed vis-à-vis supermarket expansion in Indonesia in this study. One of the most important issues is that supermarkets are allowed to open outlets in the vicinity of traditional small-scale retailers. This fierce competition leads to social unrest, sometimes to bankruptcy of small retailers, and potentially affects the livelihoods of thousands of people.

National zoning legislation regulating supermarket penetration is in the pipeline in Indonesia. However, so far the absence of such regulations at the national level facilitates supermarket expansion in urban zones. Whereas some cities, for example Bandung and Jakarta, have local zoning laws that could curb expansion, these are not always implemented effectively. Meanwhile decentralisation policies encourage local authorities to accommodate supermarkets in their cities. Moreover whereas large supermarket outlets such as hypermarkets normally are allowed to operate on the outskirts of cities, some supermarkets, such as Carrefour and Hero, have opened large outlets close to city centres or even in city centres in Indonesia.

Another critical issue relates to the abusive demands made by large retailers of their suppliers, in order to generate more income and increase market share in Indonesia. Such demands include listing fees, minus margins, fixed rebate, and contributions to store openings and advertisements. Suppliers can find these terms of trade burdensome and too costly, which hinders inclusion of small suppliers. The way supermarkets implement listing fees is not always legal, as Carrefour has been found guilty by the national competition authorities of making a supplier go bankrupt. However it should be noted that the fines imposed on Carrefour are negligible compared to the capital and profits of Carrefour in Indonesia.

In addition to these critical issues, there are also regular intrinsic factors that enable the growth of supermarkets in Indonesia's retail sector. For instance, large retail chains have the advantage of economies of scale, have access to (foreign) capital and offer consumers comfort, convenience and low prices. Together all these factors will no doubt alter the retail landscape in Indonesia.

Competition by supermarkets is already being felt by traditional retailers. If supermarkets in Indonesia were to adopt the same strategies as they have applied in developed country markets, this development might also have implications for many actors in the FFV supply chain. For instance, supermarkets could increasingly source more directly from producers, and this would doubtlessly lead to a preference for large-scale producers. Large-scale producers are generally better equipped to meet supermarket demands, such as in-time delivery of large quantities and product and production quality demands. Small-scale FFV producers and small agents and traders will find it increasingly difficult to stay within supply chains. Due to the intermediaries, who apparently to some extent have remained the same, and who do not inform them about the trade and prices, they are currently not aware of the changes in retailing brought about by supermarket expansion. Small

producers are therefore poorly prepared at present to anticipate and face these inevitable changes.

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  - <sup>2</sup> World Bank , Indonesia at a glance, 19 September 2005, <  
[http://devdata.worldbank.org/AAG/idn\\_aag.pdf](http://devdata.worldbank.org/AAG/idn_aag.pdf) > (27 April 2006)
  - <sup>3</sup> CIA website
  - <sup>4</sup> M+M PlanetRetail Grocery retailing in Indonesia, 2004
  - <sup>5</sup> AC Nielsen Indonesia website, "The Economy and Health Are Major Concerns Among World Consumers", <http://www.acnielsen.co.id/news.asp?newsID=104www> (visited 29 February 2005).
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  - <sup>10</sup> Ibid.
  - <sup>11</sup> Florence Chong, The Australian, "West on Shopping Quest for Asia Malls", February 5 2004.
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  - <sup>14</sup> Hero Indonesia website, <[www.hero.co.id](http://www.hero.co.id)>, (visited May 23, 2006).
  - <sup>15</sup> FAOstat 2006, calculations SOMO, figures for 2005
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  - <sup>17</sup> Natawidjaja
  - <sup>18</sup> Bisnis Indonesia Online, [www.bisnis.com](http://www.bisnis.com). Pasar Tradisional Bisa menjadi Tempat Belanja (Favorit Traditional Market Could Become a Favorite Shopping Place) edition of 8 Dec, 2005, downloaded on 8 Dec 2005)
  - <sup>19</sup> Natawidjaja
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# Chapter 5

## Corporate Social Responsibility in the FFV Sector

### Introduction

The concept of Corporate Social Responsibility (CSR) has gained increasing attention since the 1990's. There are many definitions of what constitutes CSR, ranging from corporate philanthropy, charity, partnerships, codes of conduct and certification systems. This report focuses on those initiatives in the Fresh Fruit and Vegetables (FFV) Sector that aim to improve the social, environmental and economic conditions in the supply and value chains of FFV products. The focus is on the relevance for developing countries. As a large part of FFV producers in developing countries are small farmers, the question how CSR initiatives affect and apply to them is of particular importance.

For the purpose of this report, a definition of CSR is used that was developed by a coalition of Dutch civil society organisations (Dutch CSR Platform) - in its CSR Frame of Reference<sup>1</sup>

CSR is defined as:

*“a process in which corporations take responsibility for the social, ecological and economic consequences of their actions – throughout their product and service delivery chains –making themselves accountable, and engaging in a dialogue with all those involved.”<sup>2</sup>*

Some initiatives in FFV such as fair trade have existed for quite some time, while others have been developed as a result of civil society campaigns (for example in the banana sector). More recently, a number of initiatives have been developed as a consequence of increasing food quality concerns. While it may be argued that food quality standards are not part of CSR, some do include limited social and environmental aspects. Moreover, most Dutch supermarkets cite their compliance to, for example, EurepGAP (see below) as their commitment to CSR.

This chapter lists a number of relevant initiatives in fairtrade, organic and mainstream markets and outlines the key conclusions and outstanding issues from these initiatives. A central question in this context is whether these CSR initiatives have made an impact and have contributed to poverty eradication.

## 5.1 Critical elements of codes of conduct

In the last decade of the twentieth century, companies, trade unions and non-governmental organisations (NGOs) started to develop codes of conduct because the existent governmental legislation did not lead to many practical results. This is often the result of a lack of resources (such as labour inspectorates) or an unwillingness to implement legislation by developing country governments. Issues addressed in these codes usually include human rights (based on UN Conventions), workers rights (based on ILO Conventions) and / or environmental issues.

As a result of growing pressure by companies' stakeholders (unions, NGOs and consumers), some multinational companies have decided to develop specific codes of conduct, in which they define their business principles referring to the environment, human rights, worker rights and /or corporate governance (integrity and corruption). These codes are voluntary and the level of effectiveness is often questioned, as they lack some essential elements.

Leading codes of conduct create a framework for a whole sector or branch. It is important to emphasize that a good code does not only determine standards, but also contains mechanisms and principles for its execution that can be independently verified.

Prominent codes share a range of characteristics:

### 1. Labour norms have to be in accordance with the ILO conventions

All state-of-the-art codes have adopted the following eight basic norms:

- ❑ No forced labour (ILO conventions 29 and 105)
- ❑ No discrimination, for example gender discrimination (ILO conventions 100 and 111)
- ❑ No child labour (ILO conventions 138 and 182)
- ❑ Freedom of association and collective bargaining (ILO conventions 87, 98 and 135)
- ❑ A living wage that covers basic needs (ILO conventions 26 and 131)
- ❑ No excessive overtime (ILO convention 1)
- ❑ Healthy and safe working conditions (ILO convention 115)
- ❑ Legal labour contracts (ILO Tripartite Declaration of Principles Concerning Enterprises and Social Policy)

National legislation is always preferred if it establishes higher standards.

### 2. Environmental aspects

Codes of conduct have to specify how their environmental requirements and recommendations can contribute to sustainable development. Clear links should be established between a healthy and clean environment and the welfare of all stakeholders involved. The Aarhus Convention (1998) was the first to link human rights with environmental rights. This Convention includes important clauses on stakeholder

participation, transparency and access to justice. A number of general principles have been stated in the EC treaty and the Rio Declaration, designed to prevent adverse effects on safety and the environment:

- ❑ The principle of preventive action (Art. 174 (130 R, section 2) EC Treaty)
- ❑ The precautionary principle (Rio Declaration, Art.15 and Art. 174 (130 R, section 2) EC Treaty)
- ❑ Tackling environmental damage at the source (Art. 174 (130 R, section 2) EC Treaty)
- ❑ 'The polluter pays' principle (Rio Declaration, Art. 16, Art. 174 (130 R, section 2) EC Treaty)

### **3. Implementation and monitoring**

A code of conduct should not only exist in theory, it also has to be implemented through management systems and monitoring schemes. Companies have to develop an internal system to make sure that suppliers follow the code and to ensure that they are able to assess the progress of this process.

### **4. Multi-stakeholder involvement**

The backing of civil society is essential to the credibility of a code of conduct. A state-of-the-art code of conduct is based on the interaction between the stakeholders: companies, labour unions and NGOs. This is relevant to the actual development of the code and to its elaboration at a local level, i.e. when a local community has to decide on which concrete improvements should be given priority. Workers organisations and NGOs should not only be involved in the drafting of the standard, to ensure their concerns are included, but they should also be part of the governance structure of the initiative. Finally, it is increasingly acknowledged that unions and NGOs should play a role in the social and environmental auditing processes, to ensure that audits reveal all issues, including more sensitive issues such as discrimination and freedom of association.

### **5. External verification**

An organisation independent of the company or the certification scheme and trusted by all stakeholders has to verify whether a company actually follows its code of conduct. This is to make sure that stakeholders get an objective guarantee of the company's actions regarding the implementation of its code of conduct. Codes of conduct can only be effective if they include solid monitoring rules and independent verification.

### **6. Responsible commercial conditions & purchasing practices**

A company has to give it's suppliers the opportunity to implement the code of conduct without obliging them to make excessive financial sacrifices. This can be done by offering suppliers long-term contracts and fair prices. Prices paid should allow both supplier and buyer to benefit from the relationship and should enable those further along the chain to also benefit from a price which adequately covers their living costs of production.<sup>3</sup>

### **7. Addressing small farmers**

An issue that is particularly relevant in agriculture is the position of small farmers. If CSR initiatives aim to improve social and environmental conditions throughout the whole supply

chain, small farmers need special attention as they are often the weakest link in the chain. Imposing standards on small farmers without responsible purchasing practices could do more harm than good from the perspective of poverty eradication and sustainable development, when small farmer cannot meet the standards and are excluded from the export production chains.

## **5.2 Overview of CSR initiatives**

### **5.2.1 Fair trade**

The primary aim of fair trade is to improve the livelihood of marginalised producers in developing countries by developing more direct, equitable and long term trading relationships. Central to the fair trade concept is the notion of empowerment: smallholders and workers are required to organise and cooperate to strengthen their position in the trade chain. An important aspect of the fair trade system is the premise that fair trading practices are the key to improving the situation of producers. Therefore, buyers must pay a price that covers the costs of socially and ecologically sustainable production; pay a premium specifically for the social and economic development of the workers or small farmers; pre-finance the trade if necessary and aim for long term contracts.

The Fairtrade Labelling Organisations International (FLO) is the international umbrella organisation for national Fairtrade initiatives. FLO sets the Fair Trade Standard and has certified over 800,000 producers in more than 40 countries. These certified producers may carry the 'Fairtrade' label.

Within the major demand centres in Europe, the United States and Japan the fair trade market for the main FLO-certified products is most developed within Europe, and is still relatively unimportant in Japan and the United States. In the United States market only coffee sells in any volume.<sup>4</sup>

FLO uses two sets of standards, one for small farmers, organised in co-operatives or other organisations with a democratic structure, and one for workers of plantations or factories.

The key difference between the Fair Trade standards for small farmers and those for hired labour is that they target different groups. In the smallholder standards price and premium are instrumental to better business performance and returns for the organisation and its members. Decisions on the fair trade benefits are made collectively in the organisation. Labour standards only apply when the organisation employs a considerable number of workers. In the hired labour standards that target workers, the price serves to help their employer to comply with the labour and environmental standards. The premium generated is for social development of the workers. Through the establishment of a Joint Body, workers and management decide jointly about the use of the premium.



**The generic standard contains the following sections:**

- ❑ Social development
- ❑ Economic development
- ❑ Environmental development
- ❑ Standards on labour conditions

FLO International follows several internationally recognised standards and conventions, especially those of the International Labour Organisation (ILO). The standard is then followed by requirements that serve as parameters for verification. These requirements are divided into:

- ❑ *Minimum requirements*, which all producer organisations must meet from the moment they join Fairtrade, or within a specified period;
- ❑ *Progress requirements*, on which producer organisations must show permanent improvement.

FLO also requires that producers abide by national legislation-, in case this sets higher standards on particular issues than FLO. Both the standard for the small farmers and the standard for 'hired labour' refer to the ILO Conventions regarding discrimination, forced labour and child labour, freedom of association and the right to collective bargaining, safe and healthy working conditions and wages. The standards do not include a "living wage" clause (which can be seen in other social codes of conduct). The producer has to pay wages that at least match the legal minimum or regional average, and a gradual increase of payment above national/regional averages is a progress requirement.

FLO is working with both organised smallholders and larger farms in the FFV sector. Preference is given to smallholders, but FLO works with larger scale farmers as well, to "satisfy market demands in terms of quality's and quantity's consistency".<sup>5</sup>

Alongside the generic standards there are additional product-specific standards, the Fairtrade Standards for Fresh Fruit (except bananas) and Fresh Vegetables & Fairtrade Standards for Fresh Fruit for Hired Labour. These do not include additional requirements for social, economic, and environmental standards, but they specify minimum prices and premiums for the Fairtrade products. FFV products that FLO certifies are exotic fruit (banana and pineapple), sub-tropical fruit (avocado, mango), citrus fruit (lemon, lime, orange, soft citrus), and deciduous fruit (apple, grape, pear, plum).

### **5.2.2 Social standards**

#### **The Ethical Trading Initiative (ETI)**

The Ethical Trading Initiative (ETI) is an alliance of companies, NGOs and trade union organisations, aimed at the identification and promotion of 'best practices' in the area of implementation of corporate codes of practice which cover supply chain labour conditions.

The goal of the ETI is to ensure that labour conditions of employees producing goods for the UK market comply with international labour standards. The ETI mainly focuses on the

implementation of labour standards in the supply chains of the participatory companies. Participatory companies commit themselves to the ETI's Base Code and the implementation of that code by their suppliers. This code is similar to the model code of the International Confederation of Free Trade Unions (ICFTU) and shows a strong resemblance to the SA 8000 standard. The ETI has pilot projects in various sectors, including agriculture, food and the clothing industry.

The nine elements of the ETI Base code are in accordance with the relevant ILO Conventions:

- employment is freely chosen
- freedom of association and the right to collective bargaining are respected
- working conditions are safe and hygienic
- child labour shall not be used
- living wages are paid
- working hours are not excessive (48+12)
- no discrimination is practised
- regular employment is provided
- no harsh or inhumane treatment is allowed

A project that is particularly relevant for CSR in the fresh fruit and vegetables sector is ETI's "Smallholder project", in which a large number of UK retailers participate (Asda, Flamingo Holdings, Marks & Spencer, Premier Foods, Ringtons, Sainsbury's, Somerfield, Ethical Tea Partnership, The Body Shop International, The Co-operative Group (CWS) Ltd, Union Coffee Roasters). This project was set up to provide guidance to members on how to tackle the challenges faced by small agricultural producers in their supply chains, and to define corporate responsibility with regard to labour standards in the smallholder context.

This project can be regarded as an acknowledgement by ETI and the participating members that it is important to maintain smallholders in the chain instead of excluding them due to the current lack of compliance to internationally agreed labour standards (in particular the ETI Base Code). At the same time, there are a number of challenges for retailers that aim to implement labour standards throughout their supply chain, if it involves smallholders, such as the sheer number and traceability of the producers, the costs of monitoring large numbers of locations, and the fact that working conditions at smallholding are less formal than on plantations.

In September 2005, the ETI smallholder guidelines were published. As the ETI is a voluntary initiative, the guidelines should not be seen as an obligation for retailers to maintain small farmers within their supply chain. However, ETI recognizes the important role of smallholders in production and urges other players to do the same.<sup>6</sup> On the other hand, ETI does not favour buying from smallholders rather than plantations as a way of avoiding obligations to employees.

The project identified that a lack of transparency and information is a major problem for small farmers, as they often lack information about price setting, volume and quota

requirements, markets and the retailer calendar in terms of product demands. Therefore, one of the key recommendations include better information sharing with the small farmers within the supply chain. Retailers should make a commitment towards small farmers and inform everyone including buyers and sourcing teams of this commitment. The next step is a mapping exercise to find out where smallholders are present in their supply chains, so that they can be supported to implement the guidelines. As smallholders are particularly vulnerable and dependent on continued purchases from retailers, it is recommended that retailers offer better guarantees for purchases over longer periods, and consider their pricing and ordering procedures. Finally, retailers are recommended to build suppliers' and smallholders' capacity.

### **SA 8000**

SA 8000 is a worldwide multi-sector standard for monitoring and certifying labour standards. SA 8000 stands for 'Social Accountability 8000' and is also used in the agricultural sector, although most SA 8000 certification can be found in the manufacturing industries. The standard was developed by Social Accountability International (SAI). It is intended primarily for producers and suppliers.

The SA 8000 is based on the Universal Declaration of Human Rights (UDHR) and fundamental labour conditions and augmented with a number of important ILO conventions regarding safety and health, working hours and a living wage. The SA 8000 system is arranged according to the ISO 9000 system that companies use for quality control. SAI trains and accredits audit agencies, who can then be hired by producers and suppliers to obtain SA 8000 certification. Producers and suppliers are responsible for compliance with the standard. They also pay for the audits and any required improvements. This is seen as a fundamental problem with the system as the SA 8000 system does not require the company at the 'top' of the chain to enable their suppliers to make the additional changes, so the burden is placed on the suppliers and sub-contractors. The audit costs are borne by the suppliers, as well as the costs for improvements to be made for certification. There is no mechanism within the system that guarantees contracts or prices that take into account sustainable production costs.

The SA 8000 standard is based on the Universal Declaration of Human Rights and the (fundamental) labour conditions of the ILO and includes:

- ❑ No child labour
- ❑ No forced labour
- ❑ Health and safety
- ❑ Freedom of Association and Right to Collective Bargaining
- ❑ No discrimination
- ❑ Discipline
- ❑ Working hours
- ❑ A living wage
- ❑ Management systems

The normative framework of the SA 8000 is increasingly viewed as a basic standard in CSR initiatives when it comes to social standards, and very similar standards can be seen in other initiatives and model codes of conduct. It contains the fundamental ILO labour standards, augmented by stipulations regarding working hours, living wages, health and safety working conditions and job security.

The current scope of SA 8000 in FFV is limited. 25 out of the 655 certified facilities as of March 31, 2005 were in the agricultural sector, and only 10 of these related to the production (and processing) of fruit and vegetables, the majority relating to bananas and pineapples.

### **IUF Charter on migrant workers in agriculture**

Apart from the general ILO Conventions, there are standards and codes that were developed to specifically address issues in the agricultural sector, such as migrant workers in agriculture. The International Union of Food, Agricultural, Hotel, Restaurant, Catering, Tobacco and Allied Workers' Associations (IUF) has developed a charter to deal specifically with this issue.

It's focus is "Labour is not a commodity: poverty anywhere constitutes a danger to prosperity everywhere. No worker is an illegal worker"

The charter contains the following norms:

- Equal pay
- Freedom of association
- No child labour
- No forced labour
- Freedom of movement (employers cannot withhold passports or other documents)
- Freedom from physical or psychological violence and harassment
- No discrimination
- Safe and healthy working conditions
- No forced deductions from wages
- Adequate accommodation and sanitation
- Access to education for workers' children
- Access to medical services, social security and justice
- Access to accurate information

These norms provide important points of reference for CSR initiatives specifically addressing the issue of migrant labour.

### **→ Critical issues**

#### **Social auditing**

The SA 8000 system and other social auditing schemes working with commercial audit firms (such as SGS and PwC) have been criticised by a number of civil

society organisations in the North and South. NGOs and trade unions have pointed to the commercial relationship between the audit firms and the organisations demanding such audits which may not be trustworthy enough to guarantee an independent assessment of the situation. The fact that audit companies are often paid directly by plantation owners being audited, raises questions of independence.

Besides that, the outcome of the audits by commercial audit firms may not reflect reality as commercial auditors are not always trusted by the workers. For example, workers often see commercial auditors as being aligned with management. Therefore, workers may be afraid to speak openly about sensitive issues such as discrimination, harassment and forced overtime. Various studies have shown that these commercial audits may be able to detect visible violations of codes of conduct (such as health and safety issues), but they are less capable of finding violations that are less visible, such as working hours, wages, discrimination, and so on.

In sum, civil society organisations have questioned the competence of commercial auditors to perform social audits, which require different competences than financial audits. The methodology used when conducting the audits can sometimes be questioned. For example, there is discussion whether announced visits by auditors will reveal as much of the reality as unannounced visits. Also, whether, where, how and which workers are being interviewed is of importance. For instance, if the management selects the workers for interviews by the auditors, they may not feel free to speak openly.

#### **Low levels of organising in agricultural sector**

In the agricultural sector there are generally very low levels of organisation. At the same time, the right to organise and bargain collectively is a fundamental labour standard that is included in most CSR initiatives. This presents a challenge for social certification bodies. CSR initiatives should therefore actively encourage and support the development of workers' organisations where they currently do not exist.

### **5.2.3 Environmental standards**

#### **Organic**

Organic production is a holistic management of the agro-ecosystem, emphasising biological processes and minimising the use of non-renewable resources. The key element of organic farming and growing is creating nutrient rich, healthy soil that contains abundant organic matter, which helps to prevent erosion, retain water and control the release of nutrients to plants.

The International Federation of Organic Agriculture Movements (IFOAM) has established private voluntary basic standards for organic production, while the FAO/WHO Codex

Alimentarius Committee has adopted guidelines for the production, processing, marketing and labelling of organic foods.

IFOAM, founded in 1972, is an umbrella organisation of approximately 750 member organisations and institutions from more than 100 countries. IFOAM's goal is the worldwide adoption of ecologically, socially and economically sound systems that are based on the principles of Organic Agriculture.

In 1992 the General Assembly of IFOAM decided to include social aspects in its Basic Standards for organic agriculture. In 1996 a chapter concerning social justice was added.

The IFOAM Basic Standards are structured as "standards for standards." They provide a framework for certification bodies and standard-setting organisations worldwide to develop their own more detailed certification standards which take into account specific local conditions. Many developed countries, including the EU, have defined their own organic standards. In the EU these standards and the inspection thereof are laid down in regulation. Producers and exporters of organic fruit and vegetables seeking to sell their produce to developed countries, have to meet the rules established by the importing country concerned and to gain organic certification from a body recognised by the importing country.

The Basic Standards of IFOAM encompass the following articles:

1. The Principle Aims of Organic Production and Processing
2. Genetic Engineering
3. Crop Production and Animal Husbandry in General
4. Crop Production
5. Animal Husbandry
6. Aquaculture Production
7. Food Processing and Handling
8. Processing of Textiles
9. Forest Management
10. Labelling
11. Social Justice

Organic farmers use a variety of methods to maintain and build soil fertility. By utilizing compost and recycling plant and animal waste materials, organic farmers create high-quality organic matter that is rich in beneficial micro-organisms. Organic farmers also use cover crops to rejuvenate the soil and prevent erosion. Complex crop rotation, the planting of a diverse variety of crops on a field over time, is another integral method that organic farmers use to create a sustainable and efficient farming system.

Growing crops organically presents particular challenges for developing country producers. Managing crops without the use of synthetic pesticides and fertilisers, while maintaining crop quality and soil fertility, requires considerable skill. At the same time, for smallholder growers that have traditionally used little or no artificial inputs, the transition to certified organic production could require little change in current practices. Smallholder

farming systems are generally more environmentally friendly compared to large commercial plantations, due to smaller plot size and lower use of inputs. But awareness and knowledge of environmental issues is often low.

The market for organic produce has grown strongly over the past years. The United States and Europe had markets of roughly equal size, of around 11 billion USD of retail sales, in 2003.<sup>7</sup>

### → **Challenges posed by consumer demands**

One of the barriers to the export of fresh organic produce (as well as fairtrade) is at consumer level. Many consumers of organic produce are also concerned about “food miles”. In many European countries, consumers tend to opt for locally-grown conventional produce in preference to imported organic produce. In Switzerland, the rules of Bio-Suisse, the leading national organic label, expressly forbids air freighted organic food.<sup>8</sup>

Especially when it comes to fresh vegetables, organic and fair trade imports from developing countries may not be regarded as an option from the sustainability perspective. Therefore, the exotic fruit market in developed countries might offer most opportunities for organic and fair trade imports from developing countries.

### **Sustainable Agriculture Network/Rainforest Alliance**

The Sustainable Agriculture Network (SAN) is a coalition of conservationist NGOs in the Americas. The Rainforest Alliance is an international conservation organisation and the main force behind the initiative. Their mission is to protect ecosystems and the people and wildlife that live within them by implementing better business practices for biodiversity conservation and sustainability. Companies, cooperatives, and landowners that participate in the programmes of the Rainforest Alliance must meet standards for protecting the environment, wildlife, workers, and local communities. The Network mainly covers the North American market and South and Central American production countries. However, in August 2005, the Rainforest Alliance opens its first European branch office in Amsterdam.

Since 1991, the Network has developed guidelines for the responsible management of export agriculture, certifying bananas, coffee, cocoa, citrus, and flowers and foliage according to environmental and social standards. Farms that meet the Sustainable Agriculture Network standards are “certified” and may use the Rainforest Alliance-certified label in marketing their products.

The social and environmental criteria for “Rainforest Alliance Agricultural Certification” are:<sup>9</sup>

- ❑ **Ecosystem conservation** -- Farmers promote the conservation and recuperation of ecosystems on and near the farm.
- ❑ **Wildlife conservation** -- Concrete and constant measures are taken to protect biodiversity, especially threatened and endangered species and their habitats.

- ❑ **Fair treatment and good conditions for workers** -- Agriculture should improve the well-being and standards of living for farmers, workers and their families.
- ❑ **Community relations** -- Farms must be “good neighbours” to nearby communities, and positive forces for economic and social development.
- ❑ **Integrated crop management** -- Farmers must employ Integrated Pest Management and strictly control the use of any agrochemicals to protect the health and safety of workers, communities and the environment.
- ❑ **Complete, integrated management of wastes** -- Farmers must have a waste management plan to reduce, reuse and recycle whenever possible and properly manage all wastes.
- ❑ **Conservation of water resources** -- All pollution and contamination must be controlled, and waterways must be protected with vegetative barriers.
- ❑ **Soil conservation** -- Erosion must be controlled, and soil health and fertility should be maintained and enriched where possible.
- ❑ **Planning and monitoring** -- Agricultural activities should be planned, monitored and evaluated, considering economic, social and environmental aspects and demonstrate compliance with the law and the certification standards. Planning and monitoring are essential to efficacious farm management, profitable production, crop quality and continual improvement.

#### **5.2.4 Food Safety Standards**

##### **EurepGAP**

EurepGAP, which was started in 1997, is an initiative established by retailers who belong to the Euro-Retailer Produce Working Group (EUREP). Their mission is to develop standards and procedures for a food safety system in the agricultural sector. The EurepGAP Protocol for Fresh Fruit and Vegetables is their normative frame of reference for the FFV sector.

The EurepGAP standard may not be regarded as CSR, because of its focus on food safety and quality. But there are some elements in the standard that are relevant from a CSR perspective. Moreover, supermarkets may refer to the EurepGAP standard when they are asked about labour standards in their supply chains.

In December 2004, SOMO and the Dutch consumer organisation (Consumentenbond) conducted a survey among Dutch supermarket chains that sell mangoes. All the supermarkets surveyed referred to EurepGAP when questioned about which labour standards they demand from their suppliers. The study also revealed that at the end of 2004, not all FFV products sold by the supermarkets came from EurepGAP certified production sites. This was made compulsory as of January 2005.



The EurepGAP protocol covers the following:<sup>10</sup>

- ❑ Traceability
- ❑ Record Keeping
- ❑ Varieties and Rootstocks
- ❑ Site History and Site Management
- ❑ Soil and Substrate Management
- ❑ Fertiliser Usage
- ❑ Irrigation
- ❑ Crop Protection
- ❑ Harvesting
- ❑ Post-Harvest Treatments
- ❑ Waste and Pollution Management, Recycling and Reuse
- ❑ Worker Health, Safety and Welfare
- ❑ Environmental Issues

The EurepGAP standard has been developed for large-scale European companies. For many small farmers, especially in developing countries, it is difficult to meet the administrative requirements set by EurepGAP or to pay for the certification. This standard therefore potentially poses a problem for small farmers in the fruit and vegetable supply chain.

Apart from the problem of excluding small farmers, from a CSR viewpoint a number of other critical points can be made against the standard:

### **Provisions on labour standards**

The EurepGAP protocol states that growers' labour conditions, such as wages, job security and freedom of association, must comply with local and national regulations (point 12f #1). No precise definitions are offered for the terms used, nor are there any references to ILO conventions. There is no prohibition of forced labour or of discrimination. Neither is there any mention of the right to a living wage. Inspectors have to meet training requirements regarding food safety but not with regard to monitoring labour conditions.

The procedure described in EurepGAP's Control Points and Compliance Criteria only checks if someone in a management position is taking responsibility for complying with local regulations on labour. This requirement is a 'Minor Must', which means that in principle it may be ignored as, according to the General Regulations, a maximum of three 'Minor Musts' may be ignored. As the aforementioned stipulations concerning labour conditions are grouped together in a 'Minor Must', this means that in principle any number of violations by the grower of the related local regulations will result at most in the violation of one 'Minor Must'. Moreover, local legislation regarding labour conditions is often lacking, as is its compliance and control.

There are several other 'Minor Musts' concerning working conditions, e.g. clean sanitation and habitable accommodation for workers. A 'Major Must' is protective clothing in

accordance with the instructions on the label of pesticides if these are used. A 'Major Must' means that it must be complied with, and cannot be declared to be 'not applicable.'

## **Environment**

### *Pesticides*

"Chemicals that are banned in the European Union must not be used on crops destined for sale in the European Union." In addition to this 'Major Must', there are two 'Minor Musts' relevant to sustainability that stipulate pesticide use must be kept to a minimum and that non-chemical methods are to be preferred over chemical agents.

There are, in short, regulations for producers to minimise use of pesticides before and after harvest. However these are not very clearly defined. What constitutes 'minimum', for example, and when, as an inspector, do you decide an inadmissible amount has been used. The environmental minimum requirements for Fair Trade are also not always very specific, but there is a definite push for organic production (i.e. no pesticides or fertilisers). While within EurepGAP there seems to be a basic assumption that pesticides are necessary. Organic mango growers have shown that this is not the case.

### *Fertiliser*

Fertiliser application must meet the needs of the crops as well as maintaining soil fertility ('Minor Must'). Any application of nitrogen in excess of national or international limits must be avoided ('Minor Must').

As nitrogen is an important component of fertilisers, these are not very specific stipulations for the minimisation or elimination of fertiliser application.

### *Field cultivation, soil erosion and groundwater management*

For all new agricultural sites, a risk assessment must be undertaken, taking into account the prior use of the land and all potential impacts of the production on adjacent crops and other areas ('Major Must'). If the risk assessment indicates an unmanageable/inadmissible risk that is critical to health or the environment, the site may not be used for agriculture.

Although this requirement is intended to prevent food safety risks, and is primarily focused on the quality of the site itself, the risk assessment also covers the expected effect of the new site on the adjacent area. The reason for this is to assess the consequences of groundwater use for irrigation on other users and flora and fauna, as well as the possible negative impacts of erosion on and around the site. This does, however, only apply to new sites. Sites where producers are already growing FFV do not have to meet these requirements. What's more, when exactly is something regarded as an 'inadmissible risk' or 'unmanageable'? This seems open to multiple interpretations.

There are also omissions concerning other requirements which may have adverse effects. For example, no requirements are set to prevent valuable nature areas from being used as new agricultural sites.

### *Biodiversity*

There is one explicit stipulation regarding biodiversity in the EurepGAP guidelines: “A key aim must be the enhancement of environmental biodiversity on the farm”. The grower must have a regional or individual documented wildlife and conservation policy plan to cover this requirement (‘Minor Must’).

### **Global Food Safety Initiative (GFSI)**

The Global Food Safety Initiative is a collaborative project involving a number of world-wide retail companies aimed at improving food safety. The companies have joined forces with the world’s largest producers to establish and implement food safety standards, develop an early warning system and provide more consumer information.

Conditions of the Global Food Safety Initiative (GFSI) are:

- ❑ To determine criteria for the key elements of the standards:
  - Quality management systems
  - Good Practices:
    - Agriculture (GAP)
    - Manufacturing (GMP)
    - Distribution (GDP)
    - HACCP
- ❑ To build an international early warning system
- ❑ To encourage co-operation between the world-wide food sector and national and pan-national governments and authorities
- ❑ To communicate the GFSI to all concerned parties and promote consumer education

The GFSI Guidance Document elaborates the key elements. This document is a compilation of the Codex Alimentarius, legal requirements, ISO standards and the relevant Good Practice Codes, placed within the contemporary context of consumer concerns regarding health and safety. This document also contains the requirements which a supplier’s certification has to meet to be accepted by GFSI. Food safety schemes that meet all these criteria are eligible for acceptance as a standard by the GFSI.

GFSI is coordinated by CIES – The Food Business Forum in Paris, in collaboration with the Food Marketing Institute (FMI) in Washington.

There is no direct cooperation between EurepGAP and GFSI even though EurepGAP is a European initiative and GFSI a worldwide initiative of supermarket chains. (Many European and Dutch supermarket chains are members of both organisations). Unlike GFSI, EurepGAP only focuses on food safety in the production phase. Good agricultural practice standards have, of course, already been developed within EurepGAP. EurepGAP can therefore be viewed as an initiative by European supermarkets to help develop the GAP standards of the GFSI.

→ **Challenges and opportunities from food safety and traceability requirements**

As shown in this chapter, the EurepGAP standard is weak in terms of labour standards. The scheme is primarily aimed at food safety issues, but there is a danger that the standard is used by supermarkets as a CSR initiative. As one of the reasons to create EurepGAP has been “to respond to consumer concerns on food safety, animal welfare, environmental protection and worker welfare”<sup>11</sup>, EurepGAP is often mentioned by retailers when they are asked about their CSR policies.<sup>12</sup> Civil society organisations are calling for the incorporation of ILO Conventions in EurepGAP, involvement of stakeholders in the scheme and improved verification and external scrutiny.

The obligation for European retailers to improve traceability under the European Food Law provides both challenges and opportunities from the perspective of CSR. A potential danger is that small farmers may be even further excluded from supply chains, as retailers decide that it will be too difficult to trace their products down to specific small farms, and will increasingly choose to source from fewer, larger plantations. However, the increased attention to traceability could also be seen as an incentive for companies at the top of the supply chain to increase their influence and insight into these chains, and at the same time use their leverage to positively influence social, environmental and economic conditions.

### **5.2.5 Integrating social and environmental standards**

Most of the above mentioned CSR codes and standards focus on one specific area, such as labour issues or environmental issues. Some of them include provisions in both areas but often the focus remains on the specific area of concern.

There are a number of attempts to converge different social and environmental standards and certification initiatives. The fact that combined demand for fair trade and organic produce is still small as a percentage of total demand, and consumers who buy fair trade may also be inclined to buy organic, suggests that a composite category “organic and fair trade” may be increasingly demanded by supermarkets. This may set a trend for imported produce and may be one means for developing countries to penetrate more effectively the organic market for temperate produce in developed countries, which currently tends to favour locally-grown produce over imported equivalents.

→ **Critical issue**

#### **Convergence of standards**

The concept of CSR is often defined as a holistic approach which includes addressing “people, planet and profit”. This implies an integrated approach to social, environmental and human rights issues. However, questions remain as to whether social and environmental standards should be integrated into one system. Proponents argue that the two cannot be solved in isolation, particularly in the agricultural sector where for example the use of agrochemicals affect

agricultural workers. Improved collaboration between different initiatives in social and environmental certification may lessen the burden of multiple certifications for farmers.

On the other hand, opponents of integrating social and environmental standards argue that there is still a lot of work to be done in terms of developing credible verification mechanisms for social and environmental standards alone, and therefore the issues should not be made more complicated by trying to integrate the two. Also, a different type of expertise is needed to check on social standards than on environmental standards, so the monitoring and verification systems should be different.

### ***ISEAL Alliance***

The International Social and Environmental Accreditation and Labelling (ISEAL) Alliance is an association of eight international standard-setting, certification and accreditation organisations that focus on social and environmental issues. The Alliance aims to improve the systems of their members and to increase the compatibility between them. ISEAL acts as a broker in the harmonisation of the members' systems through various projects and formal and informal exchanges.

### ***SASA project***

Four members of the ISEAL Alliance, FLO, IFOAM, SAI and SAN are collaborating in the SASA project (Social Accountability in Sustainable Agriculture). The SASA objectives are to improve social auditing processes in agriculture and to foster closer cooperation and shared learning between the participating initiatives. Alongside these general objectives, the SASA project has also formulated four sub-objectives:

- ❑ Developing guidelines for social auditing and determining standards in sustainable agriculture
- ❑ Examining the impact on, and responsibilities of, supply chain actors with regard to certification of social justice issues in agriculture
- ❑ Addressing the particular needs of smallholder producers in the development of social guidelines for sustainable agriculture
- ❑ Exploring the possibilities for mutual promotion of complementary systems

Within this initiative a number of pilot audits have been completed, including a mango audit with mango products from Burkina Faso.

## **5.3 Critical issues in CSR**

The above mentioned initiatives in the field of Corporate Social Responsibility (CSR) raise a number of key questions and issues that need further discussion. If CSR initiatives are to contribute effectively to better social and environmental conditions in FFV chains, then

these outstanding issues need to be addressed. Some key over-arching issues are outlined here.

### **1. Potential constraints for developing countries and small farmers**

One of the key concerns with CSR initiatives is that they may actually present more constraints for developing countries, and especially smallholders, and thereby lead to the exact opposite of the aims of the initiatives in terms of sustainability and poverty eradication. Studies have shown that often the cost of demonstrating compliance to high standards is the main problem, sometimes even more than compliance to the standards themselves. The costs for obtaining individual certification of EurepGAP is no option for individual small-scale farmers in, for example, the Sub-Sahara region, as the costs for inspection and certification are too high. The existing requirements for group certification (for example as a "Farmer Group" for EurepGAP) are too complicated and expensive for many farmers in developing countries.

Certifying small farmers is a complicated and costly process, without support it will be too expensive for smallscale producers to get certified. The CSR initiatives relevant for the FFV sector each face this challenge and are developing different tools to deal with this but the results of these efforts remain to be seen.

### **2. Integrating economic aspects into CSR initiatives**

The current CSR initiatives in the FFV sector focus mainly on environmental, human and labour rights. Much less attention has been paid to economic aspects. From the perspective of poverty eradication, there should be more focus on economic sustainability of the trade in FFV. For example, the question remains whether there is net job creation in developing countries due to export-oriented production, and whether the wages paid are sustainable. Other aspects, such as the local prices (of water, electricity) should also be considered, as the buying power of a large number of the population might decrease.

### **3. Credibility of the initiatives and their verification systems**

Each of the different CSR initiatives and standards has to deal with the issue of credibility from different stakeholders, employees, consumers, and civil society organisations. Initiatives that are set up by one stakeholder group, such as EurepGAP (business) may lack credibility from other stakeholders, such as NGOs and trade unions. A key issue is often the lack of involvement of different stakeholders in the governance of CSR initiatives. When, for example, initiatives are dominated by retailers, and suppliers are not part of the governance structure, CSR standards are often seen as an imposition on the suppliers and producers by the multinational retailers.

The credibility of the certification system relies on the credibility of the monitoring and verification system as well. By establishing effective internal monitoring systems, companies or certification systems can ensure that the standards are adhered to. But in order to gain credibility, transparency and external verification need to be much further developed. Commercial auditors that have been involved in auditing, have been criticised by NGOs for lacking the background and competence to undertake effective worker

interviews. Another concern in current auditing processes is the overall lack of involvement in monitoring by workers and workers' organisations.

#### **4. Pricing and ordering policies**

A problem with many CSR initiatives is that they often do not take into account the pricing and sourcing policies of the companies at the top of the supply chain. Some standards have been widely criticised for imposing more requirements on producers without remunerating them for the extra costs involved. The recent price war between supermarkets in the Netherlands shows that supermarkets have not integrated their CSR intentions into their overall pricing and sourcing policies. The question remains whether it is possible to increase prices or improve sourcing malpractices through corporate social responsibility (CSR) initiatives.

#### **5. Impact on poverty alleviation**

CSR initiatives came about as a means of getting companies to take responsibility for labour conditions in their supply chains and as a way of reassuring consumers. But the question remains whether the initiatives make a difference in terms of poverty alleviation by improving social conditions and introducing more sustainable production methods. The exact scope and scale of the initiatives is often unclear. The fair trade initiatives have only covered a small percentage of the total markets, and only a few 'frontrunners' are active in the initiatives aimed at the mainstream markets.

CSR initiatives need to be scaled up much further and involve more retailers as well as medium-sized companies in order for them to contribute significantly to poverty alleviation. The fragmentation of the efforts and lack of coordination and cooperation among the initiatives is another concern hampering the integration of CSR issues in regular business behaviour.

## 5.4 Summary

In the fresh fruit and vegetable sector many different initiatives can be seen that aim to improve the social, environmental and economic standards under which FFV products are produced and traded internationally. However, the scope and impact of most of the initiatives has been limited up to date. Fairtrade and organic initiatives have been unable to gain large markets shares. Initiatives focusing on social standards for mainstream trade channels are still in an experimental phase (ETI) or have not been able to cover large market shares (SA 8000).

Except for fairtrade, economic aspects are often not taken into account in current CSR initiatives. This is a serious caveat given the growing buying power and market dominance of those on the top of the supply chain, such as supermarkets. Producers and suppliers in developing countries point to the need to receive fair prices that take into account sustainable production costs. Supermarkets have a responsibility to enable their suppliers to meet the social, environmental and safety standards they impose on them.

Current CSR initiatives pose threats to small farmers, as they will potentially be excluded from export-oriented production chains. Specific guidelines should be formulated for small farmers that take into account their specific situation. Such guidelines could include simplified record keeping requirements, longer lead times for compliance and flexible interpretation of labour standards for specific labour characteristics found on smallholder farms.<sup>13</sup>

Nevertheless, codes of conduct and other CSR initiatives are a potential means of ensuring environmental and social conditions within the FFV chain. However, their efficiency depends on their content, on the extent of their enforcement and on the credibility among various groups of stakeholders. Multi-stakeholder participation provides a mechanism for external scrutiny and enforcement where (labour) law inspectorates and national mechanisms are weak. When such an approach is taken, CSR can become more meaningful from the perspective of poverty eradication and sustainable development. However, this will only apply to those producers, suppliers, buyers and retailers that are willing to seriously engage with civil society. It is unlikely that the whole FFV market will be covered through such initiatives. Therefore, additional measures need to be put in place to ensure large-scale improvements in the social and environmental conditions under which FFV production takes place, and to hold food retailers and supermarkets to account.

An implementation system is a necessary, integral and inseparable part of a CSR initiative. Elements of an implementation system at the level of the company or of its suppliers, contractors and sub-contractors shall include a commitment to the CSR standards communication thereof, a management system, internal monitoring, worker education and training, independent verification, a complaints mechanism and reporting.

One way to implement CSR standards is through a system of monitoring and verification. Monitoring means keeping a close watch over the implementation of and compliance with such standards, and the results of such monitoring needs to be verified. Because the



essence of verification is credibility, it must be performed by organisations or individuals that are independent, financially and otherwise, of the company or organization whose claims are being verified.

The large, commercial, globally operating audit firms that presently perform the majority of audits cannot, in their present way of working, deliver the kind of quality that is needed. Labor-related NGOs and trade unions have to be involved at the local production level if good quality monitoring and credible verification is to take place. The precise role which these groups should play in monitoring and verification systems are still something that needs considerable attention, as the varied contexts found throughout the global FFV chain means that what works or is appropriate in some situations might not be feasible in others. Therefore, a multi-stakeholder initiative in FFV should support local level approaches and locally based auditing systems to improving social and environmental conditions. The local level stakeholders need to set out what good conditions look like for their context and how to work towards improving conditions. This way improvements will be made in the areas of greatest concern to locally based stakeholders, these people will believe and participate in the process, and so sustained improvement can be achieved.

Such a multi-stakeholder initiative should address the negative impacts that purchasing practices can have on code compliance by developing more stable relationships with suppliers and producers. By fully reflecting the costs of observing social and environmental standards in the prices that they offer their suppliers and producers, and ensure that the workers and small farmers concerned actually benefit.

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- <sup>1</sup> CSR Frame of Reference, developed by the Dutch CSR Platform of civil society organizations, The Netherlands, 2002 < <http://www.mvo-platform.nl/mvotekst/CSR%20frame%20of%20reference.pdf>>
  - <sup>2</sup> CSR Frame of Reference, developed by the Dutch CSR Platform of civil society organizations, The Netherlands, 2002
  - <sup>3</sup> February 2006 "Buying Matters. Consultation: sourcing fairly from developing countries, Responsible Purchasing Initiative" Traidcraft Exchange
  - <sup>4</sup> FAO 2004, The market for non-traditional agricultural products
  - <sup>5</sup> FLO website, Fresh Fruit <<http://www.fairtrade.net/sites/products/freshfruit/why.html>>
  - <sup>6</sup> ETI smallholder guidelines: recommendations for working with smallholders, 2005
  - <sup>7</sup> FAO 2004, The market for non-traditional agricultural products
  - <sup>8</sup> ibid
  - <sup>9</sup> Rainforest Alliance website, < <http://www.rainforest-alliance.org/programs/agriculture/certified-crops/nine-principles.html>>
  - <sup>10</sup> EurepGAP Pr 2001
  - <sup>11</sup> EurepGAP, The Global Partnership for Safe and Sustainable Agriculture
  - <sup>12</sup> CSR in the mango-chain. Research by SOMO commissioned by the Dutch Consumers Union.
  - <sup>13</sup> NRET Theme Papers on Codes of Practice in the Fresh Produce Sector, "Managing Codes in the Smallholder sector"

## Chapter 6

# Trade and regulation in the fresh fruit and vegetable chain

This chapter looks at how governments have regulated, or not, trade aspects of the Fresh Fruit and Vegetable (FFV) sector from the perspective of small farmers, poverty eradication and sustainable development. These aspects include standard setting, lack of access to foreign markets and protection from cheap FFV imports from abroad, retailer expansion and buyer power. This chapter focuses on regional and international regulation of these aspects, such as trade agreements, and gives some general information about national regulation. The previous chapter dealt with the voluntary initiatives and governmental regulation of social and environmental problems. It is not within the scope of this work to cover regulation of technological innovation or information management.

### 6.1 International standard setting

The fresh fruit and vegetable sector is subject to all kinds of regulations and standards that deal with:

- the potential health hazards for plants, animals and humans from FFV sold to consumers e.g. from pesticide residues –known as the sanitary and phytosanitary measures -, and
- the ways that fruits and vegetables are produced , traded, packaged and marketed – known as the technical standards.

As many national governments have introduced their own standards, international harmonisation has become necessary to enable trade and avoid abusive trade restrictions.

#### 6.1.1 *Codex Alimentarius*

The Codex Alimentarius Commission was established in 1963 under the auspices of the Food and Agricultural Organisation (FAO) and the World Health Organisation (WHO). Codex Alimentarius, or 'Codex', as it is referred to, has at least 170 members.<sup>1</sup>

Codex's main purpose is to protect public health against contaminated food and facilitate trade in food by setting international food standards. It also helps raise governments' awareness of food safety issues and prevents the use of unscientific arguments while considering differences in culture and legal systems amongst the member countries.

Codex officially covers all foods, whether processed, semi-processed or raw, but most attention has been given to foods that are sold directly to the consumer. Codex provides commodity quality standards and classification for specific foods and for each of the most traded fruit and vegetables, In addition, Codex issues general standards or recommendations for all foods, including:

- ❑ food safety, including pesticide residues
- ❑ food hygiene
- ❑ processing and storage of food
- ❑ food labelling
- ❑ packaging
- ❑ food import and export inspection by governments, and certification systems
- ❑ assessment of the safety of foods derived from modern biotechnology.

### **Decision making**

The Codex Alimentarius Commission is the major decision-making body where governmental representatives can vote. Preparatory work and discussions on standards and recommendations are carried out by 16 different Committees. Each Committee is chaired and administered by a country that is responsible for convening meetings, normally every two years. For example, Mexico hosts committees that that cover commodities such as 'fresh fruit and vegetables' and the US hosts 'processed fruit and vegetables'. The Netherlands hosts the committees on 'pesticide residues' and 'food additives and contaminants'.<sup>2</sup> Five 'coordinating committees' meet each at their regional level, e.g. Latin America & the Caribbean, to ensure that Codex meetings take account of regional interests and developing countries' concerns. In various countries, there are national Codex consultative committees.

A proposal to develop a new food standard has a procedure of five to eight official steps and provides members with time to comment on several drafts - a process that takes several years. In order to implement the Codex standards, the Committees strive to reach international agreement on the foods standards. Once accepted, all countries are encouraged to use Codex standards for food quality and safety and integrate them into their legislation. Governments can then start their own procedures to implement the standard.<sup>3</sup> Each Codex committee specifies whether a new code is applicable world wide or in a particular region.

Member country delegations to Codex meetings can consist of governmental officials, industry and consumer representatives, and academic experts. In practice, many countries do not have the resources to send representatives from each group. In the case of developing countries, representation by governmental officials might even not be present. Europe and North America combined represent 60% of Codex participants, despite the fact that these regions account for just 14.6% of the world's population.<sup>4</sup>

## → **Critical issues**

Codex decision-making has long been criticised by NGOs and consumer organisations for being undemocratic and untransparent with too much influence from business representatives lobbying for their interests. As a result, standards are not always protective enough against life-threatening substances in food.<sup>5</sup>

Developing countries are under-represented and allow resourceful business representatives to take their place. Consumer organisations' views are too little heard. Democratic participation of developing countries, in both number and effectiveness, in international standard-setting bodies needs to be addressed through the necessary (financial) means.

The slow pace of the standard setting process at Codex means that many new issues need to be first addressed at national and EU level.

## **Improving the application of food standards by developing countries**

As a result of the advanced technical requirements, many developing countries and their producers lack the human and financial resources to implement the Codex standards. Although Codex does provide support for technical assistance, training, awareness raising and skills development,<sup>6</sup> developing countries increasingly face standards that prevent them from trading their agricultural produce.

## → **Critical issue**

Developing countries do not receive enough technical, financial and human resource assistance from national governments, foreign governmental donors, Codex, retailers or consumers to meet the necessary food standards to enable them to trade internationally.

Codex Alimentarius lacks the resources to broadly publish and distribute its global standards; in April 2005, the update on the Codex website dated from 2002. This makes it more difficult for governments and producers in developing countries to implement the latest standards.

## **Large impact of trade agreements**

In the case of a trade dispute between two WTO members relating to certain standards, the WTO will use Codex standards as a framework for reference. If imports are barred from a country that applies more strict or different standards to Codex, that country will need to provide legitimate scientific proof to justify their standards. If not, the WTO can rule that these standards are non-tariff trade barriers which are unnecessary for the protection of consumer, animal or plant health. The WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS) and the Agreement on Technical Barriers to Trade (TBT) recognise Codex standards as criteria based on scientific evidence and recognise them as appropriate benchmarks against which countries' trade restrictions can be measured.

→ **Critical issues**

Because Codex standards have become important points of reference for the WTO since 1995, Codex decision-making has become more politicised and the focus of NGO and corporate lobby. Also, Codex has now become more concerned with facilitating international trade in food rather than fair trade practices and ensuring high levels of consumer protection.<sup>7</sup> The use of Codex standards in the WTO, has made them the lowest common denominator and countries find it difficult to set necessary higher standards.

The under-representation of developing countries in Codex raises the question whether the WTO founds its decisions on balanced and equitable 'scientific' evidence.

**6.1.2 The WTO agreements on trade and standards : the “SPS” agreement and “TBT” agreement**

**Sanitary measures**

The WTO has a separate agreement that deals with standards and measures to protect human, animal and plant life or health: the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS agreement). The aim of this agreement is to avoid sanitary standards being used to prevent imports or trade, making them non-tariff trade barriers. The agreement disciplines the way governments introduce and use such standards. It promotes harmonisation of standards by using the standards of international bodies (which are not always governmental) as a reference.

There is still a lack of mutual recognition of inspections and standards among countries. Several major importing countries are asking for 'sameness' in the process (harmonisation), rather than 'equivalence' through mutual recognition of other countries' sanitary procedures. Moreover, so far, only a handful of equivalence agreements have been agreed upon, all amongst developed countries. In terms of financial and technical assistance, FAO reports that there are few cases of concrete assistance to developing countries from outside, as had been promised amongst others in the SPS agreement (Art. 9).<sup>8</sup>

The WTO recognises governments' rights to set sanitary standards but they need to be based on scientific evidence and not discriminate against foreign products. Codex standards have had an important economic impact not originally anticipated. For instance, because of lack of scientific evidence, the EU was prohibited by the WTO to ban imports of meat with growth hormones from the US and Canada. The EU still prohibits these imports but is paying annual compensation amounting to millions of dollars in extra tariff payments to the US.

→ **Critical issue**

While there is a need to prevent the use of non-scientific arguments for banning imports from other countries and to introduce international standards based on available scientific standards, full scientific evidence is not always available. Imposing the use of Codex standards prohibits the use of the precautionary principle, e.g. regarding the use of pesticides on FFV. The prevalence of scientific arguments makes it difficult to include ethical and environmental protection justifications such as the potential risks of new biotech food. There are no internationally agreed criteria to prevent the risks of trade to the environment, public health, workers' rights and animal welfare.

The disciplines of the SPS agreement also cover non-governmental bodies, i.e. WTO member governments have to take measures to ensure that non-governmental bodies comply with the relevant provisions of the agreement (Art. 13). As a result of this, different Latin American WTO members complained in June 2005<sup>9</sup> that the EurepGAP sanitary standards imposed by the Euro-Retail Produce Working Group (see chapter above) had higher criteria than EU governments' requirements and should be reduced. The EU however considered that these were not EU governmental standards and that it cannot intervene in private sector standards.

→ **Critical issue**

The acceptance by the WTO of private or CSR standards that are higher than national or international governmental standards is a grey area that needs further clarification. The challenge is whether this discussion will be solved in a way that standards improve prices for producers and are acceptable for both developed and developing countries.

During the current Doha round of negotiations in the WTO, a number of developing countries have raised concerns relating to the implementation of the SPS agreement and made specific proposals to redress these problems. They demand improved special and differential treatment, a principle included in the SPS agreement. These proposals and concerns need to be addressed in the Doha round negotiation body - the Special Session of the WTO General Council<sup>10</sup> - but evidence shows that implementation problems receive little attention from the WTO developed country members.

### **Technical barriers to trade**

The WTO Agreement on Technical Barriers to Trade (TBT Agreement) prescribes how central and local governments, and non-governmental bodies, have to prepare, adopt and apply technical standards and regulations. Such technical standards and regulations relate to technical requirements for food safety and quality such as packaging, labelling, terminology, etc. The agreement refers to the Code of Good Practice for the Preparation, Adoption and Application of Standards. The focus of the agreement is again to prevent these regulations unduly restricting trade while acknowledging legitimate objectives such as regulating to protect human, plant and animal life or health, and the environment.

### **Many challenges from the WTO standard agreements**

The non-discrimination principles enshrined in the SPS and TBT agreements have resulted in many discussions about voluntary standards or codes. It remains unclear whether compulsory or voluntary standards that relate to the production method, e.g. labour standards, are WTO compatible because these standards do not result in products that are physically different from products made without respect of labour rights. Also the labelling of products related to production methods that leave no traces in the product remains a grey area, especially when governments are involved in the labelling.<sup>11</sup> Therefore, it cannot be excluded that in case of a WTO dispute settlement, some ethical labelling would be condemned by a WTO panel ruling. When ethical labels have visibly trade restrictive and discriminatory effects, they might be difficult to justify under WTO rules.

The interpretation of whether a country unduly applies standards and prevents trade has led to many WTO dispute panels giving 'rulings' or judgements. The problem with WTO panel judgments is that environmental and social objectives or regulations that tackle real environmental or social problems can be undermined by the priority given in the SPS and TBT agreement texts to prevent trade distortions.

An additional challenge for developing countries is when the developed countries are allowed to adopt higher private standards than those currently recognised by international standard-setting bodies. Rising consumer concerns in affluent countries over food safety and quality compound the difficulty of the developing countries in meeting ever higher standards<sup>12</sup> while the means to implement them are often lacking. The FAO<sup>13</sup> considers it to be counter-productive for the developing countries to press for exemption from, or a weakening of, WTO rules relating to sanitary measures or technical standards, or to press for lower international standards. This would merely have an adverse effect on consumer confidence in importing countries. A positive approach appears necessary, but many developing countries require assistance to meet these standards. Developing countries will thus be more willing to strengthen the SPS and TBT Agreements based on effective mechanisms being put into place to assist them in upgrading their SPS standards. The SPS and TBT agreements contain promises of financial and technical assistance for the developing countries; translating these promises into concrete action would be one to solve the implementation problems.

The FAO proposes a mechanism (e.g. an international ombudsman/arbitrator) to minimize "trade harassment", i.e. unduly stopping agricultural imports from the South at the borders of the North for health and safety or technical reasons.

## **6.2 European regulation on health, safety and traceability**

Because of the free trade area within the EU, many food standards have been developed at EU level.<sup>14</sup> Those relating to fruit and vegetables are as follows:

## **General food law**

In the General Food Law (EC Regulation 178/2002) general regulations and principles for food are laid down. Apart from food safety and traceability regulations, this law introduces precautionary principles as the basis for food legislation and the principle that operators are responsible for food safety.

## **Food Safety**

Article 14 of the EU General Food Law states that food is not allowed to be placed on the market if it is unsafe. Food is considered unsafe if it is injurious to health or unfit for human consumption. Food is considered to be safe when it complies with EU food safety legislation. EU countries can have more strict and additional food safety legislation than the harmonised EU legislation. EC Regulation 466/2001 is important for FFV as this sets maximum levels for contaminants like dioxins, nitrates, mycotoxins and heavy metals.

## **Pesticides**

Two European directives (76/895 and 90/642) lay down the maximum amount of pesticides permissible in food, including in fruit and vegetables. These so called maximum residue levels (MRLs) are based on Good Agricultural Practice (GAP) and are specific for combinations of crops and pesticides. When MRL's are established, the toxicology of substances and their effect on human health are also taken into account.<sup>15</sup> Countries may set their own MRLs for pesticide crop combinations for which no (harmonised) EU MRLs exist.

## **Traceability**

Recent food scandals in the EU with BSE and dioxin contaminated foods have shown the importance of traceability. In order to deal with food safety problems the authorities need to be able to track down the source of the problem in the food chain. The new General Food Law includes traceability requirements for food. As of January 2005 all EU food and feed businesses have an obligation to know from whom they bought their food (ingredients) and to whom they supply it. They should be able to prove this with documentation. In addition, they have to label their products.

## **Quality and marketing**

EU Regulation 2200/96 determines market standards for FFV. This regulation aims to ensure that poor quality produce is kept off European markets. In addition, these standards allow producers to match consumer requirements while facilitating intra-community trade. Where there are no specific EU standards for FFV the UN standards apply, as is the case for mangoes (see case study in Chapter 3).<sup>16</sup>

## **Food irradiation**

Food is treated with ionising radiation to delay the ripening of fruit, to inhibit the sprouting of vegetables, to kill bacteria that can cause food spoilage or food poisoning, and to kill insects which infest foods.<sup>17</sup> Harmonised EU legislation allows for dried aromatic herbs,



spices and vegetable seasonings to be irradiated. Several EU countries, the UK, France, Italy, Belgium and the Netherlands<sup>18</sup> permit the irradiation of additional foods. France, Italy and Belgium permit irradiation of some FFV. The UK permits irradiation of all FFV. The Netherlands does not allow FFV to be treated with irradiation.

### **Phytosanitary regulations**

Directive 2000/29 prohibits or restricts the introduction into the EU of organisms that are harmful to crop production, based on a list of harmful organisms. The directive also lays down provisions for restrictions on the introduction of certain plants and plant products<sup>19</sup>.

### **Organic production**

Regulation 2092/91 lays down rules for organic production, organic products (including labelling) and inspection systems. For instance, no fertiliser or chemical pesticides may be used in the production of organic crops. The regulation also applies to non-EU organic products marketed in the EU.

#### **→ Critical issues**

The European standards are very high and difficult to meet by poor FFV producers from the developing countries. The traceability regulations are new burdensome standards. Some standards are heavily focused on European norms or unduly oriented towards standardisation of products (size, color, etc.). This prohibits non standard FFV, such as green tomatoes, to be imported in the EU. Consultation procedures with developing countries before introducing new EU food standards are far from sufficient. There are no legal mechanisms that ensure that implementation of the standards are also compensated by fair prices that cover at least the costs of implementation.

## **6.3 Trade agreements on agriculture: WTO and regional trade agreements**

Trade in fresh fruit and vegetables is somewhat more than 5% of total FFV production, but has exhibited a general increase over the past 30 years (see chapter 1). Trade liberalisation has served to accelerate growth in FFV trade, rather than substantially changing previous trade patterns except for China. This chapter will explain that trade liberalisation in the FFV sector has nevertheless been slow, because imports of FFV have been “sensitive” for developed countries who were reluctant to open up their markets through tariff reduction.

Growth in FFV trade has not only been the result of trade agreements in the World Trade Organisation (WTO) or at regional level, as was for instance the case among Canada, the USA and Mexico after signing the North American Free Trade Agreement (NAFTA).<sup>20</sup> Governments unilaterally opening markets, cheaper transport costs, new technologies and the increased presence of multinationals have also influenced trade.<sup>21</sup> In the future,

market access conditions and further refinement in food safety regulations will continue to affect trade flows. However, trade policy may become less important in structuring trade as borders blur with the increased globalisation of supply chains.<sup>22</sup> As explained in chapter 2, the concentrating retail sector's desire for a continual supply of a large array of FFV products has stimulated global strategic alliances, the shrinking and concentration of the FFV wholesale and trade sector, and the increase of long-term contracts between retailer and growers or shippers.

Before 1995, there was no international agreement nor other international rules on agricultural and FFV trade, only bilateral or regional trade agreements. Many countries used a variety of measures to promote their domestic agriculture, especially in the developed countries. This often resulted in prohibiting agricultural imports, providing subsidies for exporting domestic agricultural products or even subsidizing domestic agricultural production.

In 1995, the WTO came into force and included a new WTO Agreement on Agriculture (AoA) which aimed to liberalise agricultural trade. This was the result of the Uruguay Round negotiations (1986-1994) which were particularly long and difficult because industrialised WTO members were very keen to keep protectionist measures for their farming sector. The resulting WTO rules have been twisted in their favour.

The AoA aimed at liberalising agricultural trade in three ways, by:

- ❑ increasing **market access** e.g. by cutting tariffs;
- ❑ reducing **export subsidies** that result in unfair competition with non-subsidised agricultural exports or domestic agricultural products;
- ❑ reducing subsidies to domestic farmers ("**domestic support**"), which result in distorting trade and unfair competition against producers that do not receive domestic subsidies.

In addition, the AoA took to a limited extent special & differential treatment for developing countries into consideration, as well as "non-trade" concerns such as food security and the environment.

Non-tariff barriers are being dealt with in WTO agreements on sanitary and phytosanitary measures (SPS agreement) and technical barriers to trade (TBT agreement) (see above), and in WTO agreements on import licensing procedures, pre-shipment inspection, and rules of origin.

Some additional basic WTO rules that aim at liberalisation are also applicable in trade in agriculture which include the principles<sup>23</sup> of:

- ❑ **non-discrimination** whereby imports or exports may not be treated differently because of their country of origin or destination country (**Most-favoured-nation treatment (MFN)**);
- ❑ equal treatment of imports and national products regarding internal taxation and regulation (**national treatment**);
- ❑ non-discrimination in administration or quantitative restrictions of imports or exports, and elimination of quantitative –i.e. volume based- restrictions (**quota's**).

## → Critical issues

The aim of the WTO is to liberalise trade, not to ensure a global sustainable and equitable agricultural system. Liberalisation is claimed to benefit developing countries through better access to Northern markets. But the WTO also gradually increases openness by developing countries to international trade and this comes at a cost. Free trade may gradually redistribute world production according to countries' natural or competitive strength ("comparative advantage") and some countries will increase imports that are cheaper than domestic production. This will inevitably lead to changes in production structure and weaker economies might be faced with declining agricultural production and prices, and more unemployment if no alternative employment can be found. Liberalisation has already increased FFV competition, which makes it difficult for small and least developing countries to enter the global FFV market as trade figures show.<sup>24</sup> The increased concentration of the food system excludes small-scale farming and processing while agrifood corporations are capturing significant market power and consequently the benefits from more free trade in agriculture.<sup>25</sup>

In general, government intervention tends to be less in the FFV sector than in other agricultural sectors. The main trade intervention of governments in the FFV sector is through market access regulation as described below (6.3.1) but subsidies are also being provided (see 6.3.2).

### 6.3.1 Issues relating to reducing tariff barriers

"Many developed countries' governments provide support to horticultural production, including measures that limit competition from imports or that encourage exports. Tariffs levied on fresh fruits currently average 58%, somewhat less than the average 68% tariff on fresh vegetables. For some countries and products, fruit or vegetable tariffs exceed 100% and constitute significant barriers to trade."<sup>26</sup> Some developed countries' tariffs are characterised by relatively high tariff rates on temperate-zone food products and lower tariff rates (0% to 20%) on fresh tropical products.<sup>27</sup> This means that developed countries have **tariff peaks**, i.e. much higher tariffs than average agricultural tariffs. Such **tariff peaks** are most common in three product groups: fruit and vegetables, major staple foods (e.g. cereals), and processed food products. It is not uncommon for these high tariff peaks for FFV to exceed 100% in rich countries.<sup>28</sup> In contrast, an UNCTAD/WTO study found that agricultural tariffs above 100% were rare in developing countries.<sup>29</sup> Developing countries however did raise tariffs, introduced tariff quotas and occasionally banned imports of selected fruit and vegetables.<sup>30</sup>

## → Critical issue

In the current WTO tariff regime, many countries still apply **tariff escalation** in the FFV sector which means that tariffs increase the more a product is processed. It is a way of protecting their domestic industries.<sup>31</sup> Tariff escalation is becoming more and more a trade barrier since trade is rapidly shifting to processed products. It is also a major obstacle for developing countries interested in

escaping from the cycle of producing and exporting primary products and earning less and less given the deteriorating terms of trade for primary commodities. Tariff escalation prohibits diversification, which is very important for developing countries' economies, particularly as most of the value added is created at the latter stages of production.

In order to improve market access, the developed WTO members agreed in the AoA to reduce their tariffs over 5 years by an average of 36%, with a minimum tariff reduction per product of 15%. However, because applied tariffs during the base years (1986-'88) were very high, developed country (OECD) governments reduced high tariffs on sensitive products by a smaller percentage, while reducing low tariffs by a larger percentage. As a result, tariff reductions were generally lower for temperate-zone products.<sup>32</sup> The FAO found that few developing countries took advantage of this possibility of reducing low tariffs by high amounts, in contrast to developed countries.<sup>33</sup>

Developing countries were required to reduce their tariffs over nine years by 24% overall, with a minimum tariff reduction per product of 10%. Least developing countries were not obliged to reduce their tariffs but had to either convert all their non-tariff measures into tariffs or fix, i.e. "bind", all their tariffs at a certain level in a WTO list of tariffs (schedule).

Another method to improve market access was through the conversion of all non-tariff measures (e.g. quotas, seasonal limitations) into tariffs ("**tariffication**"). This "tariffication" measure of the AoA has proved to be a difficult and also politically manipulated exercise. Not all countries have chosen the tariffication measure because countries could also choose to apply a general ceiling for tariffs across all their imports - but not both. Developing countries in particular have chosen the simpler solution of applying a general ceiling.<sup>34</sup> The result of tariffication has been that the tariffs of many developed countries became much higher than before the AoA was implemented, including for some FFV products. The EU, US, Japan, and Canada in particular have set some very high tariffs, reaching 350% or more.<sup>35</sup>

Because it was foreseen that tariffication could lead to higher tariffs which would prevent imports, even of products that were regularly entering a country's market, the AoA introduced **tariff rate quotas**<sup>36</sup> to oblige a minimum level of imports up to 5% of domestic demand. Importers had to pay a lower tariff rate (between zero and the high tariff following the tariffication) when importing within a **quota** i.e. a set amount of imports.

### → **Critical issues**<sup>37</sup>

This tariff rate quota system means that developing countries were compelled to import a minimum amount of many products, regardless of the situation of their farmers and food security issues. Although this has stopped Northern markets from being completely closed for imports from the South, such as for FFV, it has also compelled developing countries to import products regardless of the problems of unfair competition (due to subsidisation in the North) and foreign currency constraints.

The implementation of the tariff quota system was left up to importing countries. There have been many manipulations in the calculations and the filling of the quotas by developed countries, while developing countries have set low rates for their in-quota tariffs. This has disadvantaged developing countries and has provided them with little improvement in additional access for FFV and other agricultural products under the quota schemes.

### **Little possibility for developing countries to protect domestic production**

If a country faces a surge in imports or a decline in import prices, the AoA has **Special Safeguard provisions (SSG)**<sup>38</sup> that allow an importing country to temporarily raise tariffs above levels fixed under the WTO. However, the WTO agricultural SSG measures were reserved for countries undertaking tariffication. As most developing countries did not use tariffication, they do not have access to such measures. The potential use of SSGs is more likely in the sector of fruit and vegetables as well as meat, cereals, oilseeds and oil products and dairy products.

#### **→ Critical issues**

The current SSG<sup>39</sup> system discriminates against WTO Members that do not have the right to use the special safeguard measures, mostly vulnerable developing countries. Only 21 or 22 developing countries have access to the SSG provision. In contrast 38 rich countries or more have used the instrument for a large number of products.

Other WTO safeguards (set out in the Agreement on Safeguards) are difficult to apply by developing countries because they make proving injury difficult, and costly, and involve delays. As a consequence, developing countries find it almost impossible to defend their FFV farmers against cheap FFV imports. Hence, a simple-to-use SSG mechanism in the AoA for all developing countries is highly desirable, an issue which was raised in the negotiations for a new AoA (see below).

### **Complex tariffs for FFV**

Contrary to the promise of a simple "tariff-only" regime in the WTO, the tariff structure of several major developed countries remains very complex since the implementation of the AoA in 1995. The EU, the USA and Japan each operate a complex system of seasonal duties, quotas and entry prices to regulate fruit and vegetable imports. As the main aim is to protect domestic producers in the North, more complex systems apply to temperate crops. Different kinds of tariffs can be applicable to the same product, such as:

- ❑ **seasonal tariffs** or tariffs that only apply during a certain season
- ❑ **in-quota tariffs** that impose a certain (lower) tariff level for a limited amount of imports (quota)
- ❑ **above-quota tariffs** that impose (higher) tariffs for imports that come after the quota has been filled.

These are **non-ad valorem tariffs** because the tariff rates are not based on the value of the import as is normally the case ('ad-valorem tariffs') but are fixed for instance per volume of the product imported. Non-ad valorem tariffs have been increasingly used and applied to a significant proportion of imported agricultural products in OECD countries (42% in the EU and the US, around 90% in Switzerland)<sup>40</sup>. Experts have concluded that this will do little to diminish the previous fluctuation in tariffs (e.g. per season, per quota).<sup>41</sup>

→ **Critical issue**

Non-ad valorem tariffs create uncertainties and disadvantages for developing country exporters. They are less transparent and complicate the comparison of trade restrictiveness across countries. In this way many under-resourced producers and traders from developing countries are prevented from exporting to the Northern country with most opportunities.

**The EU** uses a huge variety of domestic and border policies in the FFV sector in order to protect European farmers and temperate crops against the competition from cheap production abroad. Before 1995, measures included high tariffs and non-tariff barriers such as limits on imported quantities (quotas), seasonal limits on imports, subsidies for producers, a "reference price" that formed the basis for defining the import tariffs, etc. Since 1995, the EU replaced the reference price with a system that includes an entry price. The entry price system is a peculiar feature of the EU and is only used in the FFV sector as an instrument of external protection.<sup>42</sup> The entry price<sup>43</sup> is set by the European Commission, is calculated daily, changes during the year, and operates only for a limited period of the year for many FFV products. The EU imposes minimum entry prices for products such as citrus, apples, grapes, pears and tomatoes.<sup>44</sup> It adds to the complexity for developing countries of exporting to the EU. However, countries exporting FFV outside the European seasons seem to benefit most in terms of increased market access. Also, some tropical fruits enter duty-free, as is the case with mangoes.<sup>45</sup>

→ **Critical issues**

The entry price system can be beneficial to exporters who export the right amount at the right time. Some exporters and importers are likely to benefit at the expense of those exporters/importers that do not have the capacity to use sophisticated systems and operations, as was the case with tomato exporters from Morocco.<sup>46</sup> This system can thus stimulate concentration of FFV trade through well established traders.

The many and complex tariff systems have been an important factor preventing many developing country producers from exporting to Northern markets. This has promoted the dependence of Southern producers on large wholesalers and retail chains to enter those markets.

A totally liberalised FFV trading system might mean that there are hardly any (small) FFV producers left in smaller industrialised countries. So far, trade negotiations have not aimed at worldwide sustainable FFV production with

balanced trade which is in the interest of those who most need income and food security.

### **Tariff reductions and trade preferences for developing countries**

The export of fresh FFV has recently received attention as a new sector or a niche market for countries that wish to diversify exports.<sup>47</sup> Uganda, for instance, considers the development of a modern and efficient export sector of (pre-packed) FFV as a poverty eradication measure.<sup>48</sup> Given the many tariffs left under the WTO rules, better access for FFV from developing countries has been included in different free trade and cooperation agreements between developed and developing countries, and other preferential schemes. But FFV import liberalisation has always been a very “sensitive” issue as was visible in the negotiations for an agreement between the EU and South Africa, and the EU and Mercosur.

The import regime of the EU has to manage the conflicting interests of protecting the European FFV producers while preserving or improving trade flows from countries with which it has preferential agreements. With some countries, such as Turkey, or the African, Caribbean and Pacific (ACP) countries, the EU provides comprehensive trade preferences. The EU's “entry price” system plays an important role to apply the trade preferences given to particular developing countries.<sup>49</sup>

Different developing countries now have, to various degrees, preferential access to developed countries for their FFV products. Most preferences have the form of lower tariffs than tariffs fixed (“bound”) by each country under the WTO. In principle, imports from all WTO members should be given the same treatment (MFN/Most Favoured Nation principle). However, the WTO rules allow for better access to countries with which a full free trade agreement is signed or which fall under the system of general preferences (GSP) to developing countries.

### **General System of Preferences (GSP)**

The GSP was designed by UNCTAD to stimulate exports from developing countries. The GSP allows import preferences to be given to developing countries who do not have to give more trade access in return to countries giving GSP. An overview in 2003 revealed that there were 15 GSP schemes offered by 29 preference-giving countries.<sup>50</sup> The FFV sector is included as one of the many sectors covered by the GSP.

#### **→ Critical issue**

Although tariff preferences granted to developing countries through the GSP tend to be relatively generous, on average ‘sensitive’ products such as FFV are often excluded from these schemes or face some type of quantitative limitation. Preferences tend to be concentrated in products which already enjoy low tariffs (between 0 and 10 %) rather than reducing tariff peaks; the EU is an exception to this.<sup>51</sup>

## **Erosion of trade preferences**

The trade preferences received by certain developing countries are being diminished (“eroded”) by the continuous liberalisation of agricultural trade through WTO and regional or bilateral trade agreements. The WTO rule on regional or bilateral trade agreements<sup>52</sup> requires all trading partners to substantially liberalise trade. This also includes reciprocity, i.e. developing countries also have to substantially open up their market for (agricultural) products from developed countries in the free trade agreement.

The substantial preferential schemes given by the EU to the ACP countries under the Lomé Convention and Cotonou Agreement, and by the USA under the Caribbean Basin Initiative (CBI) are in breach of WTO rules and required a WTO waiver. Under the current Cotonou agreement, the EU and the ACP agreed to negotiate a new trade regime that is compatible with the WTO. The EU has pushed for EPAs (Economic Partnership Agreements), i.e. 6 regional free trade agreements (4 regions in Africa, 1 each in the Caribbean and the Pacific). Trade liberalisation will first be applied amongst the ACP countries and, in the long term, the EPAs should mean free trade between the EU and the ACP. It remains to be seen how much protection for ACP producers against EU agricultural imports will remain, a controversial issue given that the EU does not discuss the reduction of its (export) subsidies on agricultural products that enter the ACP markets.

### **→ Critical issue**

There are fears by NGOs and the ACP countries that, in the long term, subsidised agricultural products from the EU will be dumped on the ACP markets, e.g. tomatoes, and distort markets at the expense of ACP farmers. It is not clear how the EPAs will maintain better access for ACP fruit and vegetables to the EU compared to FFV imports from other developing countries.

As some have argued that preferences should not be based on ex-colonial links, as is the case with the ACP, the EU has introduced an import regime that gives the same duty and quota free preferences to all least developed countries’ imported products, except for bananas, sugar, rice and weapons (“Everything but arms initiative” or EBA). Similar schemes of duty and quota-free market access for least developed countries have been adopted by other developed countries, including New Zealand, Norway and Switzerland but the EU wants all rich countries to adopt such schemes. The US Africa Growth and Opportunity Act (AGOA) offers similar access for African countries<sup>53</sup> with conditions attached.



### The many aspects of the preferential EU banana import regime<sup>54</sup>

In 1993, the EU had to harmonise the different banana imports systems of the 12 EU member states and introduced an import quota regime that protected the ACP banana suppliers on the EU market against the cheaper Latin American bananas. The regime was successfully challenged by dollar banana producing countries and the US at the GATT/WTO in 1994, 1996 and 1999. The WTO condemned the EU for non-application of some basic WTO rules of non-discrimination, as well as some articles from the WTO Agreement on Import Licensing Procedures and the WTO Agreement on Trade in Services (GATS).

In 2001, the EU made agreements with its challengers and obtained a waiver from the WTO members to be able to discriminate in favour of ACP countries' bananas in order to keep their market share in the EU, based on the following terms:

(1) A new tariff quota regime would be introduced from 2002 onwards with different quotas and tariffs for ACP and non-ACP banana producing countries. The quotas were allocated on the basis of past trade through import licenses distributed, but were informally traded among the big importers.

(2) A new banana import system without quotas and only using tariffs would be introduced in January 2006. Therefore, the EU notified the WTO in January 2005 that it intended to apply a new tariff of Euro 230 per tonne in the new tariff-only banana import system that would apply from January 2006 onwards except for ACP bananas. As the Latin American banana producing countries complained that the new tariff was much too high, the proposal was taken to the WTO arbitration system at the WTO. On 1 August 2005, the WTO arbitrator ruled that the EU's proposed tariff was too high. After a new EU proposal was rejected by another WTO arbitration ruling on 27 October 2005, the EU once more revised its tariff. The result was that a flat-rate tariff of Euro 176 per tonne of bananas was introduced in January 2006. At the same time, ACP suppliers received an annual duty-free import quota of 775,000 tonnes (the same volume as under the old regime), managed through different import licencies systems. The EU plans to monitor the impact and adjust the tariff if too much ACP market share is lost.

The Caribbean ACP countries have been arguing all along for very high tariffs and were in favour of continuing the old tariff quota system, while African ACP countries, whose production increased over the last years, wanted high tariffs in a tariff only regime. The loss of the preferential trade regime for the Caribbean banana producers has continuously reduced exports to EU markets since 1992. The new 2006 regime is predicted to continue further loss of exports. Increased EU imports of bananas from Latin America and cheap African producing countries, together with supermarket price wars, have reduced banana prices below the cost of production by many Caribbean producers. In the Caribbean Windward Islands, an average of around 45% of rural employment was based on producing bananas on equitable distributed land in 2000 but such employment continuously being lost. Other industries, such as tourism, cannot easily replace the income of small producers. At the same time, world wide overproduction and low prices lead to a race to the bottom for wages and working conditions in Latin American and West African plantations producing for leading banana multinationals.<sup>55</sup> Higher prices seem necessary.

## → **Critical issues**

Many analysts, and developing countries, such as the ACP, have argued that trade preferences are providing important opportunities for poor countries to increase their exports to industrialised countries, earn foreign exchange and increase rural employment. But they claim that there has been no dramatic impact because of the remaining protectionist or complex measures like the rules of origin. Others argue that trade preferences have not really worked and that full world competition should provide incentives to improve exports. None of these arguments sufficiently include the technical supply problems which are especially high in the FFV sector with its need for a cold chain and for accommodating retailers' demands.

Given that WTO tariffs are still high for many FFV agricultural products, substantial scope for maintaining and expanding trade preferences in agriculture remains.

The developing countries whose preferential trade access is being eroded will have to adapt to increased competition to be able to continue to export, which will require new financial and human resources. Maintaining or deepening trade preferences for these countries could help them cope with the new challenges and focus on strengthening supply capacities for both domestic and export markets.

### **6.3.2 Subsidies**

In the WTO's Agreement on Agriculture, three kind of domestic subsidies have been identified related to trade:

- ❑ **Export subsidies** that clearly distort trade and have to be reduced ("amber box"); the AoA prohibits subsidies that exceed the reduction commitments.
- ❑ **Domestic support subsidies** that can be continued if they require farmers to limit their production ("blue box"), even if they are trade distorting.
- ❑ Subsidies that do not distort trade, do not involve price support and are funded by the government, e.g. for environmental or health reasons, are allowed ("green box") according to criteria set in the AoA.<sup>56</sup>

In general, there tends to be less subsidies in the FFV sector than in other agricultural sectors

#### **Export subsidies<sup>57</sup>**

The WTO agreement on agriculture required developed countries to reduce the value of their export subsidies (applied between 1986 and 1990) by 36% over a period of 6 years once the AoA came into operation. At the same time they had to reduce (by at least 21%) the volume of their subsidised export products.

Developing countries had to cut the value of their export subsidies by 24% and the volume of their subsidised exports by 14% during a period of ten years. Least developed countries had no obligations to reduce export subsidies.

In practice, during the 5 first years of implementation of the AoA, there was a relative increase in the EU in export subsidies on peaches, apples and oranges. While EU subsidies on lemons, table grapes and tomatoes decreased<sup>58</sup>, after they had significantly grown with the entry of the Mediterranean countries in 1993.<sup>59</sup> Although there were important export subsidy reductions under the AoA in the EU's FFV sector, note that the years in which the reductions had to be calculated were pre 1993, i.e. when they were quite lower than in 1995!

The EU introduced three ways in which EU exporters can be granted export subsidies, including a "a first come first served system" and an auctioning procedure. It appears that this system allows some subsidies for EU exporters seeking to enter new markets.

### **Domestic subsidies to support farmers**

According to the FAO, industrialised countries do not generally subsidise horticultural producers directly, and there are no price support mechanisms. There is indirect support through processing subsidies (e.g. for citrus in the EU), provision of phytosanitary services and support to generic advertisement and export promotion programmes (in the USA and the EU).<sup>60</sup> There are mixed reports of the level of domestic support for the FFV sector which is explained by the fact that most data is incomplete.<sup>61</sup>

#### **→ Critical issue**

Many developing countries do not have enough finances to subsidise domestic FFV production for local consumption, food security or export.

## **6.4 New negotiations<sup>62</sup> in the WTO on agriculture, including FFV**

As agreed in the Uruguay Round, WTO member countries began new negotiations on agriculture in 2000 to try to reach agreement over further reductions in trade barriers. A full trade negotiation round of the WTO was launched in Doha (Qatar, November 2001), which added further issues to the ongoing negotiations on agriculture and services (GATS). The rationale behind such a negotiation round was that it provided opportunities for bargaining between different sectors.

The EU has been under heavy attack to make its agricultural import regime, including for FFV, less protectionist. Since May 2004, the EU has expanded to include 10 Central and Eastern European countries for whom FFV production is important. In addition, these 10 countries are keen to export to the original 15 EU members states - thus putting further pressure on the latter's FFV production. It should also be noted that through the Doha Round, the EU hopes that concessions on agriculture will be compensated by more market access in the services (GATS) and industrial goods (NAMA) sectors.

Since the Ministerial Conference in Cancun in 2003, a group of developing countries (G-20), under the leadership of Brazil and India, have become more vocal. It began to look possible that their pressure might prevent the EU and the US pushing through their own consensus, as was the case in the Uruguay Round. Since July 2004, the EU and the US have tried to isolate those they fear most, India and Brazil, from other developing countries by asking them to join their closed informal talks, together with Australia (called the "Five Interested Parties" - FIPs). However, at the Hong Kong Ministerial Conference in December 2005 all developing countries were clearly linking up together and insisted on the EU and US offering more real market access and a real decrease in market distorting subsidies. Northern countries, however, resist strongly although the negotiations have a development agenda, because they are perceived as potentially totally destroying the current agricultural production system in the North.

Some issues in the agricultural negotiations were clarified in an interim agreement made in July 2004, called the July Framework. Since, progress has been slow and difficult. The WTO Ministerial Conference made little progress at the end of December 2005 and agreed that the figures and formulae for tariff and subsidy cuts ("modalities") would be decided at the end of April 2006. As the new deadline was missed again, new attempts were made to agree on modalities by end of June or July 2006. However, positions were still far apart by mid June 2006 as all wanted to defend their export and import protection interests.

The following issues<sup>63</sup> are of importance to production and trade in FFV products and relate to the three 'pillars' of the negotiations:

### ***(1) market access***

**Cutting tariffs:** Proposals discussed to reach an agreement by mid 2006 focused on tariff cuts whereby countries would not be able to choose tariff cuts per product but countries would agree on a tariff reduction formula. This formula would apply to all tariffs depending on the level of tariffs ("tiered formula"). The overall aim is to get the biggest cuts in the highest tariffs, with developing countries cutting tariffs (somewhat) less but still cutting higher tariffs more. Least developed countries would be exempt from tariff cuts. Some countries want to prohibit very high tariffs under the WTO and agree on what constitutes the highest permitted tariff ("capping"), while others strongly reject this.

In addition, member states have agreed to reduce **tariff escalation** but the issue was still little discussed by June 2006. A proposal was made that tariffs on processed products could be reduced more than by the potential tiered formula if there was still tariff escalation left after tariffs were cut according to the formula.

The negotiation mandate includes achieving the "fullest" liberalisation in **tropical products**. This would also apply to tropical FFV products but negotiators found it difficult to define the list of products covered. By mid June 2006 there was still little agreement how better access would be given to tropical products.

**Simplifying tariffs:** WTO members have proposed different ways to get rid of the complex tariff quotas<sup>64</sup> (see above) and also non-ad valorem tariffs (tariffs that are not based on the value of the import but for instance fixed per volume of the product imported).

Fierce negotiations on non-ad valorem tariffs have held up the negotiations for months during the beginning of 2005. But in May 2005, a preliminary agreement was reached on the formula by which countries would convert non ad-valorem tariffs to tariffs based on the value of the imported product.

### → **Critical issue**

The abolition of non-ad valorem tariffs, as applied by many developed countries<sup>65</sup>, is an important way of creating more access for FFV from developing countries. The negotiations, however, excluded many developing countries and the outcome was weighted in favour of the EU members. Moreover, this new FFV export market potential might be undermined by the introduction of 'sensitive products' (see below) by developed countries.

**Special products:** It was agreed in Hong Kong that developing countries self-designate a list of products based criteria of food security and livelihood security, and rural development. These products would be less, or not, subject to the tiered tariff cutting formula. Developed countries, however, are very reluctant to negotiate special products despite the fact that they have already secured their own category of 'sensitive products'.

**Sensitive products:** The Hong Kong Ministerial Conference agreed that (developed) countries would have the possibility to protect some products that are important for their agricultural system. These products are likely to include temperate fruit and vegetables and cover more than 1% but less than 15% of a country's agricultural products. Proposals in June 2006 discussed how tariffs of these products would be reduced less than what would be agreed by the tiered formula, and how tariff quota's of these products would be expanded.

**Special safeguard mechanism (SSM):** Ministers agreed in Hong Kong that developing countries would be allowed to use a mechanism to protect all or some agricultural products from import surges or a loss in price which destroy a country's agricultural sector and farmers' livelihoods. Developed countries, however, have little interest in such a mechanism and want strict criteria for how and when developing countries could protect their agricultural markets.

**Duty-free and quota-free access for products from least developed countries** to all richer (developed and developing) countries' markets is one of the main objectives to fulfil the development aspect of the negotiations.<sup>66</sup> The EU and a few countries are already giving such market access (see above: EBA) but the US has been opposing access of more than 97%, which would result in many products from least developed countries to be excluded.

**Preference erosion:** the WTO negotiations decided only at a very late stage to find ways to address the fact that countries will end up with fewer trade preferences that might make them less competitive to enter developed countries markets. By mid June 2006, very diverse proposals were on the table with no agreement.

**Special treatment of recently acceded members** such as China which has recently undergone major reforms and tariff cuts to become a member of the WTO: such countries would not have to implement immediately the full tariff cuts, especially the most vulnerable countries.

### ***(2) Domestic support (see 6.3.2)***

The negotiations aim at cutting subsidies for domestic support to farmers. They want to ensure that the different WTO categories that prohibit or permit subsidies are better defined to prevent subsidy use that directly or indirectly leads to unfair competition. However, while developed countries successfully push to keep many of their subsidies, developing countries want the WTO definitions to allow them to use subsidies to support their domestic farmers. The EU is particularly pushing to keep subsidies for “non-trade” concerns, such as care for the environment.

### ***(3) Export subsidies***

The WTO members need agreement on how and when to reduce and, in the long term, eliminate all forms of export subsidies, including export credit or insurance programmes related to export credit. The EU has been under high pressure to name a date for ending all its export subsidies and agreed at the Hong Kong Ministerial Conference in December 2005 to stop export subsidies by 2013, not 2010 as some had hoped. Heated negotiations at the Hong Kong Ministerial Conference put pressure on the US but did not solve the problem of abuses of US food aid for conquering new export markets.

### **Lack of consideration of developing countries' concerns**

Agreement on particular issues that are important for the FFV sector in developing countries -such as special products, special safeguard mechanisms or preference erosion- have been delayed. While the Hong Kong Ministerial agreed to further negotiate these issues, they have been left until late in the talks and hindered by positions of developed countries that do not support developing countries' positions. Developed countries are finding all kinds of tricks and complex proposals to delay and manipulate the outcome in their interest and avoid free trade wiping out their farmers.

In addition, many developing countries are excluded from the informal talks, even at Ministerial level, where solutions are being proposed and discussed. They are only consulted at a later stage when the major players have already found common ground on solutions, as was the case for the non-ad valorem tariffs, an important issue for FFV producers. This leaves many developing countries with little bargaining power to defend their interests.

Experts expect that the degree of agricultural trade reform resulting from the current WTO Round is not likely to require as great a level of adjustment from horticultural producers as in some other farm production sectors. According to one such expert "horticultural exports of Central and South America, and the Middle East and North Africa can be expected to increase, as can be the net imports of the EU, USA, the rest of Europe and Japan. China is emerging as an increasingly important horticultural exporter and this role could be boosted should trade be liberalised, especially with increased exports to Japan, Korea and the rest of Asia".<sup>67</sup>

### → **Critical issues**

Even if developing countries succeed in getting better access for FFV products, not all developing countries producers have enough knowledge and supply capacity to use the export opportunities and actually export to new markets. The quality and production standards and the trade and retailing networks are further hurdles to market entry, as explained above.

Freer trade in FFV can provide benefits for some farmers in developing countries. In the long term, however, the question remains about how far more world wide competition in FFV will lead to lower prices and less income, as is already the case for bananas and many other commodities.

The push by developed countries to compel developing countries to lower their high tariffs could hurt developing countries and prevent them from protecting their vulnerable sectors, such as FFV. Good outcomes in the negotiations on special products and the special safeguard mechanism are needed to protect farmers in the South from unfair competition. Pushing for market opening goes against the demands made by many small farmers from North and South such as those organised in Via Campesina who advocate food sovereignty, i.e. allowing countries to promote sustainable food production at national level, including through protection (with managed imports in the North) and democratic decisions.

## **6.5 Trade in services: GATS rules for supermarkets and their impact on the production of fresh fruit and vegetables**

Chapter 2 of this report has described the impact of the expansion of supermarkets. Liberalisation of supermarkets means that governments have provided market access for foreign supermarkets to operate in their countries. This can be done through unilateral liberalisation by a country, but can also be regulated through international agreements such as the General Agreement on Trade in Services (GATS) under the WTO.

### **6.5.1 GATS rules and the production of fresh fruit and vegetables**

Although government regulations on agricultural production are disciplined by the WTO Agreement on Agriculture, the General Agreement on Trade in Services (GATS) can have an impact on production and trade of fresh fruit and vegetables. As explained in the chapters above, supermarkets and other large retailers have a large influence on who can produce where and what, and at what price. International trader, multinational distributors and foreign supermarkets equally influence production and prices. Supermarkets, distributors, importers and exporters are "distribution services" covered by the GATS. Thus government regulation of international trading companies, such as Chiquita, and foreign retail companies, such as Carrefour, are subject to GATS rules and GATS liberalisation agreements. For instance, the EU's regulations on banana imports that gave imports from some developing countries preferential treatment, was condemned by the WTO amongst others for not respecting some GATS rules.<sup>68</sup> Chiquita had been successfully lobbying the US administration to challenge the EU through a WTO dispute settlement procedure.

In addition, GATS rules and commitments can include "services incidental to agriculture"<sup>69</sup> and cover privatised services that support agricultural production such as extension services, agricultural credit facilities, environmental (advisory) services such as the protection and clean up of soil and water, and advisory services for the protection of biodiversity and landscape<sup>70</sup>. Because GATS Art. 1.3. subjects not only national laws but also sub-national (regional, local) authorities' measures to GATS disciplines, the WTO services agreement can affect local agricultural policies. Most controversially, Art. 1.3 also stipulates that a public service is not subject to GATS disciplines only when consumers do not pay for the service or when there are no other private competitors for such services. This means there is a legal grey area for many public agricultural extension services and other subsidised services (e.g. subsidised financial credit) provided by governmental agencies for a fee.

Transport -an important factor in the chain of trade of fresh fruit and vegetables- is also covered by GATS regulations. Maritime transport was not included in the Uruguay Round negotiations, because of US resistance, and subsequent talks also failed. The GATS agreement has a special Annex on Airport Transport Services to exclude air traffic rights from GATS disciplines. Insurance of maritime and other transport is covered by the many disciplines on financial services under GATS.<sup>71</sup>

Other services sectors negotiated under the GATS can also impact FFV and other agricultural production. Liberalisation of sectors such as financial services<sup>72</sup>, water services and other infrastructure services can lead to less access to such essential services by poor or small farmers.<sup>73</sup>

### **6.5.2 Liberalisation of trading and retail companies under the GATS**

Given the increasing importance of the retail sector in production, trade and distribution of fresh fruit and vegetables, this report's coverage will focus on distribution services. The GATS agreement is the multilateral agreement with the most members which regulates



and liberalises trade in, and investment by, services, including distribution and retailing of fresh food and vegetables. Liberalisation of distribution services is also dealt with in many regional and bilateral trade and investment agreements but will not be analysed in this report; however many points of analysis might be the same. Note that countries can unilaterally liberalise (distribution) services without being subject to requirements of GATS rules .

The GATS agreement was negotiated in the Uruguay Round (1986-1994) and has to be applied by all the WTO members since it came into force in 1995. GATS is covered by the WTO's decision-making and dispute settlement structures. Since 2000, negotiations have taken place for sharpening some GATS rules and to improve market access for many service sectors.

Because services provided by foreign companies often imply that the companies have to be established in the country where they deliver their services, GATS rules (see Annex 1 to this report) also cover investments by foreign services providers (mode 3).

### → **Critical issues**

GATS provides a general regime that protects foreign investors against 'unfair' government regulations and gives them more rights than can be assumed by "trade in services" . In contrast, the GATS agreement does not provide international instruments to protect consumers or poorer citizens against the negative impact of, or bad quality services delivered by, foreign (distribution) services suppliers.

While GATS rules oblige governments to be transparent in their decision-making, they do not compel governments to make (foreign) service suppliers more transparent regarding their ownership, performance and social or environmental impact.

The GATS sets conditions to keep markets open (Art. XXI) but has little provision to close markets if social development is at stake, foreign services suppliers have a very negative impact, or if their behaviour is resisted by the population. This results in an imbalance between rights and obligations in favour of foreign service companies. The negotiations on an "emergency safeguard clause" did not succeed under the Uruguay Round and continue to be resisted by Northern countries in the current GATS negotiations due to pressure by companies against such a clause.

#### **6.5.3 GATS rules on "trade barriers" in distribution services**

Although the GATS preamble gives governments a right to regulate, GATS rules define to what extent governments can regulate, take administrative decisions or support local or national companies in the distribution sector. When countries liberalise under GATS, i.e. when they make "commitments", they become subject to more disciplines than when they unilaterally liberalise.

Once a country has made commitments in the retail or wholesale sector, **GATS Art. XVI on market access** forbids for instance regulations that limit the number of service suppliers or service operations, e.g. in the form of numerical quotas. This means that governments cannot stop foreign supermarkets from rapidly expanding, by measures that restrict supermarkets to a certain market share or to a certain number of outlets. Other governmental restrictions that GATS prohibits are: requirements regarding citizenship or residency of retail services' owners, limitations on the purchase or rental of real estate and land for building supermarkets or hypermarkets; and restrictions on the percentage of company shares that foreigners can own. Countries can be exempted from some rules of Art. XVI if these are written in their commitment schedules as exemptions, a technical issue governments need to be aware of during GATS negotiations.

Making commitments also implies that governments need to treat foreign retail and wholesale services in the same way as national ones ("**national treatment**", **Art. XVII**), except if notified otherwise in the schedules. This means that it becomes difficult for governments to use measures that support underdeveloped national retailers or wholesalers, e.g. through certain tax and subsidy measures.

Many of the measures covered by **Art. VI on domestic regulation** apply in the distribution sector. Art. VI of GATS covers measures and procedures which governments have in place requiring authorisation of establishment, licensing, particular qualifications or technical standards. These governmental measures have to be applied in a way that they do not undermine the market access provided through GATS commitments, i.e. "not be more burdensome than necessary". Moreover, governments have to guarantee information about how they handle applications by (foreign) service providers, and have to review administrative decisions when requested by a (foreign) service provider. Art. VI therefore puts pressure on these governmental measures to be the least trade restrictive as possible.

→ **Critical issue**

Governmental measures that might be socially necessary could be seen as trade restrictive and be challenged under the WTO dispute settlement system; if condemned by the WTO, the measures have to be changed or become subject to sanctions. For instance, zoning laws that limit the areas in which retailers can be established, are allowed under GATS rules but under pressure to be eliminated during the negotiations because they are seen as barriers to trade.

The GATS negotiators have the mandate (Art. VI.4) to clarify which measures are permitted or rejected: see 6.5.6

When making market access commitments, many governments have **excluded the distribution of certain products**, such as alcohol or explosives. Some countries have excluded agricultural raw materials and live animals, food, beverages and tobacco from the GATS rules and market liberalisation in distribution services. If countries exempt fresh fruit and vegetables from their commitment to liberalise under GATS, they keep more

freedom to take measures that promote the sourcing of local FFV produce by (foreign) supermarkets.

The “**economic needs tests**” is one of the domestic regulations that are forbidden under article XVI. Some countries base their decisions on whether or not to allow a retailer to open a shop in a new place on such tests. These tests often look at the impact on employment and other social or economic consequences. However, these procedures are considered by retailers are barriers to trade.

Article IX of the GATS agreement recognises that **anti-competitive behaviour** of service investors, including too much concentration, may restrict trade in services. The Article encourages WTO members to exchange non-confidential, publicly available information when requested by another WTO member who suffers from anti-competitive behaviour.

### → **Critical issue**

The GATS does not have any good instruments to deal with buyer power internationally nor to deal with increasing concentration of grocery retailing in a few hands at world level.

#### **6.5.4 Existing market openings in distribution services under the current GATS agreement**

The EC and European business have been complaining that very few countries made market access commitments in distribution services during the Uruguay Round of negotiations.<sup>74</sup>

By the end of 2004<sup>75</sup>, fifty-five (55) of the 148 WTO members had made market access commitments in retail services. If the EU-15 is counted as one, then 41 had made commitments. In wholesale services, the number of commitments is somewhat higher.

What is striking is that the new WTO members who joined the WTO after 1995 have mostly made comprehensive commitments in retail services, including Taiwan and China (with exemptions). This could indicate that there is strong pressure for liberalisation of distribution services during accession negotiations to the WTO. Lithuania, one of these new WTO members is now feeling the negative consequences of such far reaching liberalisation, according to an expert.

The commitments made in the retail services do not mean that all modes of supply have been liberalised. Movement of persons (mode 4) has mostly been excluded. Regarding investment in retail services (mode 3), different countries have made exemptions e.g. regarding foreign ownership of retailers and regulations on the location and size of retailers (zoning laws). The distribution sector within the EU is largely open to foreigners, and the EU already made GATS commitments in all sub-sectors. There are some restrictions such as an economic needs test (see below) for department stores in some EU countries. The argument behind the openness of the EU distribution sector is that it

“allows EC citizens to have a wider choice of better quality products at much more affordable prices”<sup>76</sup>.

### **6.5.5 Continuous GATS negotiations without impact assessment**

Art. XIX stipulates that negotiation guidelines should be based on impact assessments of trade in services, in general and per sector. Developed countries have ignored this GATS provision and pushed for the start of new negotiations in 2000 without impact assessments. The EC commissioned a sustainable impact assessment (SIA) of distribution services after the start of the new GATS negotiations. The SIA was only finalised in mid 2005 and is unlikely to be taken into account by the EC negotiators and the EU member states.<sup>77</sup> Early on, Thailand made an interesting impact assessment of its swift unilateral liberalisation in the distribution sector, clearly explaining benefits and negative impacts. Thailand calls for regulation and liberalisation adapted to the economic needs of the country.

#### **Thailand's impact assessment of retail services liberalisation**

Thailand has liberalised the retail services and wholesale sector as part of its investment liberalisation policy. Only commission agents' services have been liberalised under GATS. The "trade" sector –or retail and wholesale- attracted a major part of new foreign investment, especially after the financial crisis of 1997 when Thai corporations in financial difficulties were on sale. Between 1970 and 2001, 20% of FDI in Thailand went to the trade sector. In 2001, the trade sector accounted for 16% of GDP and 15% of total workforce.

In accordance with GATS Art. XIX, Thailand made the following impact assessment of its retail sector liberalisation.

Between 1997 and 2001, the traditional retailers, the so called "mom-and-pop" shops have lost market share from 74% to 60% (- 14% in 4 years). At the same time, "modern retailers" have gained market share from 26% to 40%. The modern retailers are mostly foreign retailer groups such as Carrefour and Tesco, and foreign wholesalers such as Makro (SHV Holdings, NL). The sectors where foreign retailers are major players are hypermarkets, supermarkets and Cash&Carry wholesale. Together, these three groups have 55% share of the modern retail markets in Thailand and are mostly in European hands. Sales of hypermarkets and Cash&Carry have been growing at the rate of 15% every year in the period 1999-2001.

The benefits of liberalisation of the retail and wholesale sector have been:

- cheaper products
- choice of more varieties
- guaranteed product availability
- employment
- increasing know how
- some domestic producers can export through the foreign retailers

The negative impacts of liberalisation of the retail and wholesale have been:

- ❑ a continuing sharp reduction in the traditional retail shops while retail sales in total were shrinking , leading to an "acute political outcry"
- ❑ decreasing role of traditional wholesalers and middlemen, eroding their income and bargaining power
- ❑ the retail sector is developing into an oligopolistic structure, which leads to fears of price fixing and monopolistic control of all distribution channels
- ❑ air pollution and traffic congestion around areas where large retailers are based

As a result, the government felt it imperative to introduce new appropriate regulations in order to prevent further negative impacts on the small, traditional retailers. Such measures were for instance requiring very large supermarkets to locate at least 15 km from city centres (' zoning') and restricting buyer power or demands for heavy price cuts. At the same time, various measures are taken to increase competitiveness of the domestic small retailers (training, community distribution networks). Thailand's experience of liberalisation in a fast and uncontrolled manner has convinced the government that an appropriate and sound regulatory framework is to be set up beforehand; liberalisation should take place at a pace commensurate to the economic (and perhaps, social) readiness of a country. Thailand did not intend to make offers in the current GATS negotiations.

In March 2005, the government was to revise its zoning policy for superstores - looking to cut the required distance from city centres to 5 km, down from 15 km according to current law. This change of law is understood to result from lobbying by French chains such as Carrefour and Casino (owns Big C) who claimed to be put at a disadvantage against other retailers, such as UK's Tesco Lotus, that had built outlets in municipal areas prior to zoning law changes in 2003. The GATS rule of equal treatment (MFN) of foreign service providers prevents in this way the introduction of new laws.

Sources: Communication from Thailand, Assessment of Trade in Services, 22 July 2002, WTO document TN/S/W/4, p. 9-14; [www.planetretail.net](http://www.planetretail.net) (14 April 2005); B. Vorley, Regoverning markets phase 1 review, 10 November 2004, p. 15.

### → **Critical issues**

While the need for regulations is recognised in theory, in practice regulations prior to liberalisation are often not established. GATS negotiation procedures do not have instruments that guarantee that GATS market openings in (distribution) services only occur when appropriate measures are in place. Also, GATS procedures do not prevent liberalisation commitments being made when the socio-economic impact would be too severe.

Many impact assessments do not take into account the impact of liberalisation of the grocery retail sector on agricultural producers, nor the impact of the restrictions GATS rules pose on governmental regulation to remedy the negative impacts.

### **6.5.6 Liberalisation issues in the current negotiations**

The major issue in the current GATS negotiations is how far WTO member countries will, or will not, take decisions to permanently give more market access to particular foreign services. A country receives "requests" from other WTO members, i.e. lists of services (sub-)sectors for which other countries demand market openings for their companies. A country then replies with an "offer", a list of services it is prepared to liberalise according to the GATS agreement. Subsequently, secret bilateral negotiations follow in which countries bargain between each others offers and requests. Although this process is supposed to be a give and take exercise, power games and arm-twisting happen. At the end of the bilateral negotiations among the many WTO members, each country agrees to provide new market access, or not, according to a schedule of services attached to the GATS agreement and which is valid for all WTO members (Most Favoured Nation principle).

In 2002, the EU submitted requests to 109 WTO member countries. To 60 of them, including Thailand, the EU asked for new market access in distribution services.<sup>78</sup> The EU, pushed by its services export industry, wants to get major market access out of the GATS negotiations and insists on more market access in return for making concessions in the area of agricultural negotiations. On the other hand, some countries do not want to make offers or concessions in the GATS negotiations until more concessions are made by the EU and other rich countries in the agricultural negotiations.

In 2003 the EU made an offer, which was significant according to the EC, to further open up the distribution sector in different EU member states.<sup>79</sup> It offered to eliminate discrimination against foreign distribution services.<sup>80</sup> The most controversial issue for the EU is whether to allow staff and managers of distribution companies to travel to the EU to provide services (mode 4) for a limited period of time (up to one year), which relates to many immigration issues.

In July 2004, it had been agreed that WTO members would submit revised -better- offers by end May 2005. By the end of June 2005, 8 of the 10 developed countries' offers and 13 of 58 developing countries' offers covered distribution services. These 21 offers were considered of poor quality and not adequately responding to requests made. Exclusion of products from committed distribution services, and limits to full foreign ownership, were mentioned as important restrictions to market access. Nevertheless, some (developed) WTO members stressed the importance of distribution services for developing countries during the June 2005 GATS negotiations sessions<sup>81</sup>, in order to press for greater access.

In June 2005, the EC tried to find a way to push the GATS negotiations forward. It announced that the negotiations were in crisis and introduced the idea of 'benchmarks', i.e. a particular number of commitments in key sectors.would have to be made by developed and economically more advanced developing countries. But this proposal for additional negotiation procedures was not accepted by other WTO member states. However the EC managed to introduce a plurilateral approach which was accepted at the WTO Ministerial Conference in December 2005. Opposition by developing countries ensured that plurilateral negotiations would not be compulsory and not replace bilateral negotiations.

At the end of February 2006, the EU submitted a plurilateral request on distribution services together with a group of 7 countries to a group of countries from whom market opening is demanded.<sup>82</sup> The request aimed at a high level of liberalisation regarding sub-sectors and ways of trading, with as little limitations as possible, especially limiting the number of excluded sensitive products and the economic needs test.

### → **Critical issue**

The EC proposals for benchmarking, plurilateral and sectoral negotiations attempted to undermine the 'flexibility' in the GATS agreement, i.e. the possibility for each WTO member to decide whether or not to make liberalisation commitments, how much, and for which sub-sector. Using plurilateral negotiations might put pressure on developing countries to open up the distribution sector without being prepared to deal with the negative effects. However, by responding collectively developing countries might be stronger in resisting liberalisation they do not desire. It is difficult to predict how far the GATS negotiations' guidelines, which state that the interests of developing countries need to be taken into account, will be respected during the power games and bargaining of the secret negotiations.

Other GATS negotiations which are important to distribution services and which relate to the negotiations on improved GATS rules include the following issues:

- The GATS negotiators have the mandate (Art. VI.4) to clarify what "**domestic regulations**" governments are allowed to take, or not, regarding technical standards, qualification requirements and licensing in relation to services suppliers. Defining the criteria whether governmental standards, qualification requirements and licensing would not "constitute unnecessary barriers to trade" has resulted in opposing views whether or not these measures should be subject to a "**necessity test**" to prove that they are not more burdensome to trade than necessary as outlined in Art. VI.4. Also proposals have been made to establish criteria about the "relevance", the "reasonableness", and even the conformity with international standards, of government requirements. Such proofs of the necessity could result in governments or parliaments being restricted in regulating in what they see necessary for social, developmental and environmental purposes or in administrating the sector in the most appropriate way for the country.<sup>83</sup>
- The "**economic needs tests**" have been hotly debated. At the Hong Kong Ministerial Conference it was agreed that WTO should increase improve their offers which would have to remove or substantially reduce economic needs tests (Ministerial Declaration, Annex C). How much developing countries will adhere to this principle was not clear by mid June 2005.

→ **Critical issue**

At the beginning of the new GATS negotiations, the EU proposed that the economic needs test for distribution services should be clearly defined and non-discriminatory.<sup>84</sup> This would limit the use of the economic needs test rather than expanding it to include the impact on agricultural producers and excludes the promotion of domestic small retailers. The internal EU services directive agreed in May 2006 is eliminating the economic needs tests in the EU, which makes it much easier for the EU to push for it in the WTO negotiations.

The **exclusion of some products** that can be traded by foreign distribution services is under pressure during the current negotiations.

→ **Critical issue**

The EU has proposed that the exclusion of products should be limited to extremely sensitive or specific products.<sup>85</sup> Such a proposal seems unlikely to allow governments to regulate distribution of fresh fruit and vegetables by (foreign) retailers, for instance by imposing that fresh fruit and vegetables are sourced from the country itself.

More disciplines are being discussed on **transparency** (Art. III, see above) regarding all laws and other measures governments have on services even if they made no GATS commitments. Such additional disciplines are likely to put a heavier administrative burden on developing countries. Also, business is pushing hard to have GATS transparency disciplines that allow the “interested persons” in a country (thus also foreign business lobbies) to comment on new measures and laws before their publication to prevent measures that undermine profit-making. Governments would have to “address in writing substantive concerns received”.<sup>86</sup>

### **6.5.7 The lobby of the European retailers**

During the GATS negotiations, the EC has been lobbied by different European corporate lobby organisations representing the wholesale, retail and franchising sector.

- EuroCommerce represents national and European branch associations and federations in retail, wholesale and international trade. It also has individual members such as the largest retailers Carrefour, Metro, Ahold, Delhaize, Asda/Wal-Mart, Tesco.
- The Foreign Trade association (FTA) represents large retail associations and companies which are particularly related to clothing imports (but does also include Carrefour).
- UGAL is the European umbrella organisation for groups of independent –mostly small and medium-sized retailers- in the food and non-food sectors.
- IFDE also represents the independent small and medium-sized food and non-food wholesalers and retailers.
- The European Retail Round Table (ERRT) is a lobby group that allows the CEOs of the largest retail companies, including food retailers such as Asda/Wal-Mart,



Carrefour, Delhaize, Metro, Ahold, Sainsbury and Tesco, to regularly meet the temporary President of the EU as well as EC officials at the highest level.

- Many retailers are also directly or indirectly represented at the European Services Forum (ESF) that has close contacts with the EC on the GATS negotiations, and UNICE, the European employers' federation.

EuroCommerce, EFTA, ESF, UNICE and the ERRT are all strong proponents of free trade.

The FTA<sup>87</sup> considers that “[t]he protection for investment provided by the GATS now is too weak”. It wants<sup>88</sup> all WTO member countries to make market access commitments in distribution services.

Key demands of EuroCommerce<sup>89</sup> and EFTA<sup>90</sup> include:

- international free movement of temporary personnel between WTO member states, by getting rid of lengthy and difficult immigration procedures;
- simplification, clarification or removal of measures that are considered as trade barriers such as lengthy authorisation procedures to build and open up a store, restrictions on acquiring real estate or building in certain areas (land-use planning or zoning laws);
- more transparency and legal certainty of national and local regulations relating to distribution services;
- removal of restrictions on distribution of certain products, including alcoholic beverages;
- removal of the economic needs test for large department stores.

The ESF<sup>91</sup> lobbies strongly for liberalisation of trade and investment for all service markets and includes the European Retail Round Table (ERRT) amongst its members. However, the ESF is publicly cautious and argues that “liberalisation needs to be accompanied by a good regulatory infrastructure that encourages transparency, competition and fairness. Liberalisation should be a managed process, which takes into account the social and cultural background of the liberalising country, and respects the development stage of the economies by granting special and differential treatment and agreed periods of transition”.

The ESF lobby documents, in contrast, demand that government regulations should be very strict and disciplined, and should be appropriate and proportionate.<sup>92</sup> Moreover, ESF wants GATS rules to include an obligation that governments consult business operators, including foreign ones, during the period that laws and other measures (on standards, quality requirements and licensing) are being developed.

### → **Critical issues**

The ESF demand to ensure that foreign business operators are consulted during law making would give business an instrument based on international laws (GATS) to be able to lobby. This is a practice that foreign retailers are already

engaged in, as is clear from the Thailand case of changes in legislation (see box above). This ESF demand is similar to that of US business for more transparency.

If negotiators do incorporate (some of) the rules that business demands, this would make the GATS agreement more unbalanced and in favour of the service operators such as retailers, with no internationally binding rights for consumers, suppliers and citizens to have more transparency over pricing, buying practices, lobby practices, ownership and oligopoly structures, etc. In addition, these latter groups would have no right to be protected by government regulations against abuses and malpractices of foreign retailers, nor to have instruments (e.g. such as a Emergency safeguard clause - against which business has been lobbying) to protect local and communal economies and agriculture against negative consequences, even if they are purely due to the large size of foreign retailers.

The ESF has been pressing hard in 2005 for WTO member countries to make more and new market access available that would benefit them. It has made lobby coalitions with services lobbies of other countries<sup>93</sup>, produced a variety of press releases and position papers, had several meetings with EC negotiators, including chief negotiator Commissioner for Trade Peter Mandelson<sup>94</sup>, and organised a visit with business representatives to the WTO during the June 2005 GATS negotiation sessions, which included a meeting with the WTO Director General and many key negotiators of WTO members.<sup>95</sup> The EC position during the June 2005 negotiation session reflected the ESF statement that the GATS talks were in crisis.

The ESF and other lobby groups have clearly stated in several documents to which countries they want new market openings. This includes China, India, Japan, the US, Mexico, Brazil and Australia in the case of EuroCommerce.

### **Other lobby groups on (distribution) services worldwide**

Many countries, mostly the rich and large ones, have a services business network and lobbying coordination. In the US, there is the strong US Coalition of Services Industries. All associations meet each other at the international level; for example at the World Services Congress, the Global Services Network (GSN) and Services Business Network of the Americas (RedServ).<sup>96</sup>

## **6.6 Competition policy**

Competition policy aims to protect consumers against malpractices of corporations dominating the market. It aims to make a free market work, achieving economic efficiency, and ensures that there are enough competitors in the market to keep prices low and provide enough choice for consumers. In other words, it tackles abuses of 'seller power'. Competition law is also called anti-trust law.

### 6.6.1 Dealing with concentration

In order to avoid a few, or even one single company, dominating and abusing the market of a particular sector, competition policy and competition laws deal with:

- ❑ **Monopolies:** when only one company exists to provide a certain product or service. Such a company can abuse its dominant position to enforce high prices on consumers, restrict distribution or provide bad quality.
- ❑ **Oligopolies:** when only a few companies operate in a certain sector or market and have a dominant position (usually controlling one quarter or more of a market). They can take similar advantages as monopolies such as setting the exorbitant consumer prices which competitors cannot challenge.
- ❑ **Cartels:** when a number of companies secretly agree not to compete but make arrangements among themselves to:
  - fix prices for the same products they sell,
  - restrict sales of certain products to keep prices high,
  - not compete in certain parts of the market by dividing up markets or allocating customers and suppliers to each of the cartel members by fixing tenders.

Cartels do everything to prohibit new competitors from entering the market and to avoid the effects of free market competition.

- ❑ **Mergers, acquisitions and joint ventures:** companies and joint ventures can reach dominant positions, or excessive concentration of market power, in a certain sector through mergers and acquisitions or other forms of company ownership control. Ultimately this can lead to monopolistic abuses.
- ❑ **Strategic alliances, collaboration agreements, etc.:** different forms of collaborative agreements amongst companies providing the same products or services can have similar effects as the practices mentioned above.

### 6.6.2 Dealing with other malpractices

Competition policy and competition laws also deal with malpractices by, often dominant, companies that exploit retailers and consumers. As the law forbids these 'restrictive business practices (RBPs)', they are often made secretly and are not visible to consumers. These RBP practices include :

- ❑ **Predatory pricing:** a company sells at a loss in order to drive competitors out of business (similar to dumping).
- ❑ **Tied selling:** a company compels the customer (e.g. a grocery shop or the final consumer) to purchase more goods or services than he needs in order to have access to the goods or services, otherwise the company will refuse to sell.
- ❑ **Resale price maintenance:** whereby the distributor or retailer is obliged to sell at the price decided by the producer, manufacturer or supplier.
- ❑ **Market sharing:** a few companies agree amongst themselves who will sell in a certain market without competition from the other companies
- ❑ **Transfer pricing:** a company makes fraudulent invoices with higher or lower than real prices between a parent company and its subsidiary (or between subsidiaries) in order to avoid the highest taxes related to the invoices or profit

repatriation, and to lower the costs of the subsidiary in order to eliminate competitors.

Some competition policy and laws also legislate the conditions under which authorities can support companies through **state aid**. Such legislation aims to avoid damage to other companies or public interests.

One of the restrictive business practices that are possibly used by internationally operating FFV traders and supermarkets is transfer pricing. Predatory pricing or below cost selling is practiced by supermarkets that are competing against each other, which can lead to them selling FFV products at a loss.

Some competition authorities are also dealing with other malpractices in the FFV chain all the way up to retailing, some of these are explained below:

- ❑ **buyer power** abuses, also referred to as unfair trading practices
- ❑ **misleading advertising** with false information<sup>97</sup>
- ❑ **first mover advantage**
- ❑ **local pricing** or **price flexing**, where consumers in low competition areas subsidise others in more competitive areas
- ❑ **lack of choice** for consumers because of a limited number of retailer chains.

Excessive expansion of supermarkets and wholesalers is also regulated by planning and zoning laws that limit floor space and prohibit large retailers from opening close to town centres.

### **6.6.3 Not dealing with buyer power**

As explained in chapter 2 (see 2.3.4), a major problem in the FFV chain is the power imbalance and use of 'buyer power' by the ever-larger food retailers towards FFV and other food producers. It is estimated that around 110 buying desks of large retailers are responsible for about 85% of total retail food sales in Western Europe (see figure 12 in chapter 2).<sup>98</sup> Since supermarkets and other large food retail chains have become the dominant outlets for many FFV producers, they are able to **push prices down** in the whole FFV chain and even apply abusive practices, leading to mergers and acquisitions within and between parts of the FFV chain, poor labour standards on FFV farms or plantations, and bankruptcy or exclusion of small farmers.

Up to now, competition policy and laws have barely tackled the problem of buyer power used by the retailers. Although there have been various studies at national and regional level in Europe, competition authorities have been reluctant to intervene and downsize the largest retailers. One of the reasons is that competition policy is geared towards protection of consumers and not towards protection of (small) producers. In their strategy to capture an even larger market share, large supermarkets are using buyer power and sometimes applying exploitative practices towards suppliers in order to offer attractive low prices for consumers. Competition authorities therefore see little reason to intervene, as for example was argued by the competition authorities in the Netherlands. Also, governments are happy that cheap supermarkets prices keep inflation down.

As competition policy aims at economic efficiency, authorities are reluctant to stop supermarkets or FFV wholesale traders from expanding and becoming very large-scale operations. However, low prices obscure the fact that food retail concentration leads to free market inefficiencies such as oligopolistic control over consumer markets and logistical chains, barriers to entry for competitors and small suppliers, unequal access to financial resources for marketing or research. Experts estimate that retail companies need a much smaller market share to exert buyer power than is needed to exert seller power.

There is too little attention paid to the fact that supermarkets are setting low prices and high product quality conditions in the rest of the FFV chain while keeping their own margins very high in comparison with the small (or no) profit margins of the suppliers.<sup>99</sup> Low prices are often the result of **abusive practices**. An investigation by the UK's Competition Commission in 2000 found that supermarkets carried out 52 buyer power malpractices and restrictive business practices. These included:

- ❑ imposing conditions on suppliers' trade with other retailers,
- ❑ requiring high discounts or listing fees,
- ❑ making late payments,
- ❑ changes in contracts without due notice, and
- ❑ unreasonably transferring different kind of risks to the supplier.<sup>100</sup>

Some responses to buyer power have been taken in some countries. The UK authorities responded by a voluntary Supermarket Code of Practice, which was under investigation in 2004 because it did not achieve the required changes in behaviour. A major problem has been that suppliers did not make accusations against exploitative retailers out of fear of losing their outlet, a fear that has been noticed in other countries as well. In May 2006, the Competition Committee was mandated to start a new investigation, amongst others because there was "evidence to suggest that the big supermarkets' buyer power has increased" and that they have a pricing behaviour that includes below-cost selling and price flexing.<sup>101</sup> However, this mandate was given from the perspective of potential distortion of competition, not to tackle buyer power as such.

French supermarkets have also been guilty of malpractices.<sup>102</sup> The Loi Galand pricing legislation was adapted in July 2005: listing fees were limited to 20% of the shelf price, the size of authorised supplier discounts was reduced and a ban on below cost selling was retained.<sup>103</sup>

French supermarkets operating in developing countries have also been applying buyer power malpractices. In Indonesia, Carrefour was found applying listing fees on suppliers before they could sell in its supermarkets, and to put pressure on suppliers not to sell to its competitors or not to sell the same goods at cheaper prices to its competitors. In 2005, the Business Competition Supervisory Commission of Indonesia only fined Carrefour for not taking on the goods of a listed supplier which then went bankrupt (see also chapter 4).<sup>104</sup> In South Korea, Carrefour was fined in 2001 for unreasonably reducing the price for products of 112 suppliers by \$ 1 million. The Korea Fair Trade Commission which tightly regulates big retailers' malpractices also fined Walmart-Korea for its behaviour towards its

suppliers: unfair return of products, refusal to accept products, coercion to buy Walmart-Korea goods, unfair reduction of prices after the products were purchased and unfair imposition of advertisements fees on its suppliers. Carrefour and Walmart-Korea also had to publicly announce their violations in two big newspaper advertisements.<sup>105</sup> In Thailand, competition regulations strive to control buyer power by supermarkets and protect rural producers against demands of heavy price reductions.<sup>106</sup>

In the US, the 'motherland of anti-trust', has also started looking at buyer power. According to experts, this might have repercussions on regulating buyer power in other countries.<sup>107</sup>

## → **Critical issues**

When Northern supermarkets cut prices below cost and use other buyer power malpractices towards FFV suppliers from developing countries, there are no trans-border mechanisms that can effectively deal with the problem. So far national competition authorities of the supermarket home country have not intervened when there are no negative effects on the national market.

In response to buyer power, producers and suppliers could make agreements amongst themselves over prices or organise collective behaviour towards retailers, as for instance the milk producers in the UK have done. However, this might be considered as a cartel and price fixing, which is the worst crime under competition law. The US competition law is more lenient to farmers to defend their interests in this way.

What needs to be incorporated in competition law, or other laws on behaviour among business partners, are concepts of **distributive justice** that deal with how benefits and burdens are shared, and **procedural justice** in negotiations which deals with the formal procedures, e.g. contracts, explanation of decision-making and interpersonal treatment.<sup>108</sup>

In order to effectively deal with buyer power and fair treatment of all suppliers, a group of UK NGOs has been requesting more formal UK regulation:<sup>109</sup>

- ❑ **Legally binding and clearly worded rules** to ensure the fair treatment of all suppliers, in the UK and abroad, supplying directly or through intermediaries;
- ❑ **An independent retail supervisor and regulator** who pro-actively monitors the breach of interests of farmers and small suppliers, protects complainants, ensures that the binding rules are followed (mediation and legal action), makes its findings public and recommends necessary changes to the rules;
- ❑ **Support for local shops** from local authorities and the government;
- ❑ **Measures that hold supermarkets accountable** for internationally recognised workers' rights throughout their supply chain.

This means that not only competition authorities need to deal with large FFV producers, traders and retailers. Also other legislative practices and voluntary initiatives need to be

developed to deal with the supplier, social and labour, and environmental aspects of buyer power problems. Such initiatives should go beyond the focus on market efficiency and consumer interests in current competition policy. They should also take account of the lobbying of companies against such measures.

#### **6.6.4 Regulations at different levels and their deficiencies**

##### **Competition law at national level**

Around the world, there are now roughly 100 jurisdictions with competition laws. Half of them have been operating for less than ten years.<sup>110</sup> Although industrialised countries have operated free market policies for a long time, they have been much slower in passing legislation on competition policy, a basic principle of free market theory. Most industrialised countries now have extensive, but diverse, competition laws. However, enforcement mechanisms in several countries still show some flaws, e.g. lack of human resources. Regulations or enforcement are constantly adapted because they face many challenges and changes in the marketplace.

Existing competition law has hardly stopped increasing concentration in FFV wholesale trade at national level. However, competition laws have played a role in stopping supermarkets from expanding within their home country, resulting in supermarkets expanding in other countries.

As just described above, different national competition authorities are reluctant to act upon buyer supermarkets' power malpractices towards suppliers. Others have legislation that has led to fines being imposed. Compulsory publication of the abuses might be an effective tool but this research has only found evidence of this in South Korea. Dealing with buyer power by retailers at home and abroad requires substantive capacity, legislation and cooperation mechanisms with foreign competition authorities, which is lacking, as is explained below.

An important challenge for competition policy authorities who have to authorise mergers is the ability to define the 'relevant market', i.e. defining in what segment of the market, or in which geographical area, a merged company can become dominant. In the UK, for instance, competition authorities did not consider small convenience stores to be the same market segment as that of supermarkets, although they are all grocery retailers. As a consequence, dominant supermarkets were allowed to make acquisitions of convenience stores or small supermarkets, which further increased the UK supermarket concentration in grocery retailing. Leading supermarket Tesco has in this way conquered more than 30% of the UK food market, thus, technically speaking, breaking competition law.<sup>111</sup> A market share of 25 % has traditionally been set as the limit by the UK competition authorities.<sup>112</sup> In some countries, regulators will only take an interest if a company has 40 % or even 50% of the market.<sup>113</sup>

A challenge for competition authorities in small or developing countries is to assess what level of concentration can be allowed at the national level for companies who want to expand abroad. By not allowing national companies, such as FFV exporting producers or

supermarkets, to grow above 25% of national market share, these companies cannot reach the necessary economies of scale to expand to other countries and compete against rivals that are based in large markets such as the UK or the US.

One particular problem with supermarkets in many countries is **selling products below production cost and at predatory pricing**, where prices are aggressively cut -often basic products that draw customers- to force competitors to sell at a loss. Some, but not all, countries in Europe have legislation that prohibits below-cost selling. However, finding the right legislation and implementation mechanism that addresses the problem adequately is problematic. In Ireland, business complained that existing legislation leads to other abuses.<sup>114</sup> In Germany, authorities acknowledged that once a new law prohibiting permanent below-cost selling would be introduced, it would be difficult to apply.<sup>115</sup> Calls to prohibit below cost selling in the supermarket price war in the Netherlands had not been received favourably by the competition authorities.<sup>116</sup>

Not all developing countries have competition policy or laws, although experts recognise that competition policy can be useful for development if adapted to the level of development and the needs of the country. Some developing countries introduce a broader perspective in their competition policies than just protecting consumer prices and choice. They look at social objectives and the importance of protecting small producers. South African competition law includes the fundamental principle of balancing “the need for economic efficiency with socio-economic equity and development” and ensuring that SMEs have an opportunity to participate so that disadvantaged groups can gain ownership.

UNCTAD provides technical assistance to developing countries, financed by voluntary, and thus unpredictable, financial contributions of UNCTAD members. UNCTAD's support and assistance consists of advisory services to develop national competition policy legislation, institutional and capacity building, technical papers, a 'model law on competition' and international meetings.

The OECD also provides capacity building through voluntary financial and human resources from OECD members for seminars, needs assessment workshops, high-level policy briefings, and reviews of a country's competition law and institutions.<sup>117</sup>

### → **Critical issue**

There is evidence<sup>118</sup> that national and foreign retailers are lobbying against the different regulations that prohibit abusive practices of buyer power. Without transparency, publicity and regulation about such lobbying, retailer interests could outweigh supplier and consumer interests in regulation and supervision by the authorities.

### **Competition policy at regional level**

Since regional free markets are being created, some instruments of regional competition policy have been instituted.



The strongest set of regional competition laws and authorities exists at the EU level. A European Competition Network has been set up to facilitate close cooperation between national and EU competition authorities. The European Commission (EC) competition authorities already had to deal with mergers of European supermarkets. It prohibited the merger of two leading Finish food retailers, and required some actions to be taken to ensure that competition was not harmed during two other supermarket mergers notifications (Rewe/Meinl, Carrefour/Promodès).<sup>119</sup>

In 1999, the EC indicated that it was concerned about the increased concentration in the supermarket sector and its impact on suppliers.<sup>120</sup> It ordered a report "Buyer power and its impact on competition in the food retail distribution sector of the EU" which recommended new EU policies to deal with buyer power.<sup>121</sup> However, the pressures to achieve efficiency and economies of scale by companies in a global market have prevented much progress on the issue. Also Commissioner Nelie Croes has shown little interest in the issue but rather focuses on consumer interests.<sup>122</sup>

→ **Critical issue**

Research commissioned by the UK Food group concluded that current EU competition policy laws and mechanisms were not useful in protecting farmers and small suppliers from buyer power and increasing concentration of supermarkets at the EU and national level. Laws on mergers and using the mechanisms to make submissions when mergers are being notified to European and national competition authorities could have more effect. A lot of discussions and advocacy to raise awareness with national and European competition authorities and policy makers in parliaments and governments is seen as necessary to make competition policy evolve. Since the effects of buyer power are diverse, other authorities could be addressed, e.g. employment.

In different regional free trade agreements, especially among developed countries, some provisions for cooperation on competition issues to facilitate enforcement and minimize conflicts amongst governments have been included. Regional competition rules and mechanisms are being proposed to developing countries in order to tackle their lack of national capacity on competition policy issues.

→ **Critical issue**

Developing countries do not have substantial cooperation mechanisms in regional free trade agreements. Their lack of capacity and experience of competition policy at national level results in mistrust from more developed countries' authorities.<sup>123</sup>

### **Lack of competition regulation at international level**

Competition policy issues were introduced at the international level when the UN was created after World War II and more intensively discussed in the 1960s-70s, especially from the perspective of protecting developing countries against the abuses of

multinationals. But due to pressure from business, no enforceable international rules were established. Only non-binding mechanisms now exist:

(1) "The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices, which was adopted in 1980 and subtitled since 2000 as the "UN Set of Principles and Rules on Competition". This agreement defines many anti-competitive practices by companies against which countries should take action. Every five years since 1980, UNCTAD hosts a UN Conference to Review All Aspects of the Set.

(2) The OECD Guidelines on Investment by Multinationals also include an article which discourages multinationals from some forms of the above mentioned restrictive business practices.

Recent attempts to negotiate binding global competition policy rules in the WTO failed in 2004 after proposals were opposed by developing countries, and the US showed little interest in promoting such rules. The EU had been pushing for a competition policy agreement in the WTO but its main concern was that all developing countries legislate for basic rules of national competition policy. The reasoning was that this would avoid foreign companies being prevented from entering developing country markets due to national (public) monopolies and cartel practices. Also, the EU wanted some WTO principles to apply to competition policy, such as equal treatment between national and foreign companies (national treatment). The EU made however only limited proposals for more cooperation between WTO members that suffered anti-competitive practices by a foreign company. Cooperation would exist of giving information from the home country to the host country, but if the requested country was willing to do so.

Article (Art. VIII) of the WTO GATS agreement aims to limit the negative effects of monopolies, but does not deal with buyer power.<sup>124</sup> Article IX recognises that anti-competitive behaviour of services investors may restrict trade in services, and encourages WTO members to exchange non-confidential publicly available information when so requested. But these rules are insufficient to deal with market concentration and resulting abuses. The GATS' Reference Paper on Telecommunications is an example of how to prevent abuses by dominant businesses in a certain sector.<sup>125</sup>

### → **Critical issues**

Because the WTO has created a global free market without global rules on competition policy, basic instruments are missing that tackle anti-competitive behaviour and concentration at a world wide level.

The recent WTO attempt to tackle global competition rules shows that industrialised countries take little account of the specific circumstances of developing countries, and are unwilling to tackle the problem of concentration and malpractices at a global level.

The main obstacles to more binding global competition rules are:

□ **The diversity** of national legislation and of the objectives of competition policy.

- ❑ **Authorities at national level** who compete with each other to deal with competition issues at national and international level.
- ❑ **Lack of experience and capacity** in developing countries to deal with competition regulation, and mistrust of developed countries to cooperate with inexperienced authorities.
- ❑ **Extraterritorial issues:** implementation of competition law either relating to, or affecting, the actions of a company abroad; the need for authorities in one country to find evidence of malpractices in other countries; fear that 'confidential papers' by companies will become public or will be seen by rival companies (commercial secrets), lack of political will.
- ❑ **Lobbying by multinational corporations** against strict competition laws that restrict their expansion and profit making operations.

### → **Critical issue**

Since the UN Centre for Transnational Corporations was closed down as a result of pressure from the US in the 1990s, there is an urgent need for monitoring concentration and behaviour of multinationals at the global level, e.g. agricultural traders and food retailers. The tasks of the former UN Centre to collect information, research policy advice and develop standards of corporate behaviour have been only partly addressed by UNCTAD, the OECD and the UN's Global Compact.

### **Cooperation on competition law enforcement through bilateral agreements**

Since the 1990s, the EU, the US, Canada and other industrialised countries have made bilateral agreements between themselves. These agreements allow a varying degree of regular exchange of information and notification of cases being handled by one country which involve the company or other interests of another country.

The most advanced cooperation agreements are in the form of "comity" agreements. One party to the agreement can request the other country to take appropriate action against malpractices that affect the requesting country. Each party takes the interest of the other into account when implementing competition laws. These agreements have helped to build trust among competition authorities from different countries and helped to coordinate competition enforcement. They are considered the building blocks for more multilateral cooperation on competition policy issues.

### **International cooperation on competition policy and law enforcement**

Competition policy authorities are aware that more cooperation is needed at multilateral level for reasons which include:

- ❑ **increasing levels of globalisation of companies and global free markets** which has led to a surge of mergers and operations by companies which need to be looked at by competition policy authorities in many different countries. This is considered costly and time consuming for the companies and the many

authorities involved. Competition authorities wish to avoid conflicts resulting from different implementation of competition laws.

- ❑ **the discovery of many global cartels** where rival companies in various countries secretly agree to fix prices or allocate markets among themselves at worldwide level.
- ❑ **the need for increased cooperation** with developing countries who are increasingly adopting competition laws.

There have been some important forums where competition authorities have cooperated in order to exchange experience and provide guidance on competition law implementation. This raises possibilities for harmonisation of competition laws and increases best practices for coordinated actions regarding anti-competitive behaviour of companies in different countries.

The **OECD Competition Law and Policy Committee** has for decades been the leading forum amongst developed countries for "regular, focused, off-the-record policy dialogue among the world's leading competition officials".<sup>126</sup> Its meetings and reports have led to convergence in analysis, change in national competition laws and greater practical cooperation between competition authorities. A number of non-binding recommendations<sup>127</sup> have been adopted such as the 1995 "Recommendation of the Council concerning cooperation between member countries on anticompetitive practices affecting international trade". This included the result of many years of work on more effective cooperation among competition authorities who handle procedures on international mergers. A focus of the OECD work has been strengthening enforcement against cartels, considered to be the gravest violation of competition law. The 1998 "Recommendation of the Council concerning effective action against hard core cartels" aimed at developing more effective tools to prevent, detect, and punish cartels.

The OECD members have started a dialogue with non-OECD developing countries which was institutionalised in 2001 through the **OECD Global Forum on Competition**. The annual meetings of this forum bring together high-level officials from 55 or more economies to share experiences on "front burner" competition issues.<sup>128</sup>

In 2001, the **International Competition Network** was created among developed and developing countries to encourage discussions amongst government officials, private law firms and non-governmental organisations. The aim is to promote effective enforcement of competition law through more common understanding and convergence of analysis. There are currently about 68 governmental members, including from Africa (5) and South America (7).

### → **Critical issue**

Several developing countries are not included in any of the international forums that discuss competition policy issues in order to enhance capacity to deal with anti-competitive behaviour or mergers, and foster cooperation with other competition authorities.

## **6.7 Summary, critical issues and conclusions**

### **Codex standards do not meet developing country needs**

The main international standards related to production, safety, trade, packaging, labelling and marketing of FFV are set by the Codex Alimentarius Commission (Codex). Decision making at Codex is criticised for being undemocratic, lacking transparency and allowing business interests too much influence. Developing countries have too little resources to defend their interests in Codex meetings and to implement Codex standards that enable them to trade internationally. Non-compliance with international standards is a major hurdle preventing many FFV producers from exporting. Traders, retailers and consumers do not provide enough financial or other support to allow new FFV producers to apply these standards.

### **WTO agreements impact on international standards**

Codex standards could first not be enforced through international sanctions, but were implemented nationally by Codex members. Since 1995, however, WTO agreements on Sanitary and Phytosanitary Measures (SPS agreement) and on Technical Barriers to Trade (TBT agreement) have made Codex standards important points of reference. This has had a major impact because the use of standards higher than Codex can be considered to be barriers to trade if not justified by scientific evidence. This has overly politicised Codex decision making and shifted the focus from fair trade practices and high levels of consumer protection to simply facilitating international food trade.

### **WTO challenges social and environmental measures**

The SPS and TBT agreements' focus on scientific evidence has prevented the use of the precautionary principle and lacks criteria to prevent risks to the environment, public health and workers' rights. As a result, WTO panel rulings could charge that environmental and social concerns incorporated into national standards constitute a trade barrier. It is not clear whether the WTO allows all kinds of labelling related to social and environmental aspects the production process. New discussions in the WTO on whether private standards from EurepGAP, which are higher than governmental standards, are inconsistent with the SPS agreement might raise new challenges.

### **EU standards difficult to meet by many developing country FFV producers**

EU food standards protect the health and safety of European consumers by setting EU-wide principles for food legislation and standards on food safety, pesticides, traceability, quality, irradiation, phytosanitary regulations and organic production. In some cases, even higher standards are allowed in individual EU members. Although EU standards constitute a lowest common denominator, they are still very high and difficult to implement for many developing country FFV producers since little technical assistance and financial resources are being provided despite promises made by developed countries.

### **Unfair trade liberalisation structures in the WTO**

Trade liberalisation in the FFV sector has been slow because developed countries, especially the EU, were reluctant to reduce their high and complex tariffs on temperate zone FFV products. Tariffs for tropical products have been lower. Complex tariffs in the North favour the more established and sophisticated FFV traders and lead to the dependence of small FFV producers on retail chain supply networks. Preferential access for poor countries' FFV products is continuously eroded by WTO rules and liberalisation. Moreover, some export subsidies for Northern FFV exports have resulted in unfair competition on developing country and international markets, with negative effects on small farmers.

The WTO agricultural liberalisation negotiations that began in 2000 have shown very slow moves by major Northern countries such as the US, EU and Japan to lower their tariffs and cut their trade-distorting subsidies. The tortuous negotiations leave little room to take account of the poorest countries' interest, sustainable agriculture in North and South, human rights and fair incomes.

### **Trade patterns resulting from WTO liberalisation disadvantage many Southern producers**

In the long term, liberalisation of developing country markets for FFV will increase cheap imports. This is likely to lead to structural changes and increase concentration in production, leaving small and poor FFV farmers with less possibilities to produce and trade in North and South. Moreover, WTO rules reduce government measures to promote local and sustainable production and to reduce oversupply. This is a major challenge for food security and poverty eradication as other income-earning opportunities are not always available. The WTO's safeguard mechanisms against destructive and subsidised imports have failed to protect developing countries and their vulnerable producers.

In the future, trade policy may become less important in structuring trade as increased globalisation of supply chains blurs borders. Phenomena other than trade liberalisation, such as the upgrading in sanitary and food safety regulations already play a role in the growth of FFV trade.

### **GATS rules and negotiations in distribution services restrict government interventions**

Because wholesale traders, transporters and retailers have an important impact on the FFV chain, the WTO agreement on trade in services (GATS) has an important influence on the market structure and trade of the FFV sector. Retail services are covered by the GATS as distribution services. When distribution services are liberalised under GATS, GATS rules undermine government's ability to take national measures against excessive expansion, or in favour of compulsory sourcing of supermarkets from local suppliers. GATS does not have an article that restrains worldwide concentration and buyer power malpractices, major problems for FFV producers.

Current GATS negotiations to liberalise distribution services take place without accounting for potential negative consequences such as the disappearance of wholesale (FFV) markets and many small shops, and the need for new and renewed legislation to ensure benefits to consumers and the rest of society. The EU has requested that 60 countries liberalise their distribution services under GATS. Through a newly agreed plurilateral negotiation method the EU far-reaching liberalisation in distribution services and some other services sectors. GATS negotiations on rules (e.g. on domestic regulation) are likely to further restrict government's ability to introduce new laws that are necessary to limit negative consequences for FFV producers. At the same time, Northern governments reject the agreement on GATS emergency safeguard measures that could prevent the worse case scenarios. This is partly the result of aggressive lobbying by mainly European retailers to which the European negotiators lend a very favourable ear.

### **Much needs to be done to adapt competition policy to the needs of FFV producers**

Competition policy aims to limit concentration of a sector in the hands of one or a few companies, and to prohibit abusive behaviour by large, dominating companies in order to promote economic efficiency and fair pricing. However, supermarkets often engage in below-cost selling or predatory pricing in order to push competitors out of the market. The benefits from low consumer prices for FFV that result from buyer power have made many legislators reluctant to deal with this malpractice and the imbalances between producers and supermarkets that dominate FFV sales to customers. However, some countries have laws, such as in France and South Korea, and other measures such as the UK's supermarket Code of Practice, against buyer power and other retailer malpractices. If small producers organised to set prices, this could be considered a crime under competition law. National competition laws have hardly stopped FFV producers, traders and retailers from expanding and 'consolidating' (see chapter 2) but have prevented them from taking excessive national market share. A challenge for national competition authorities is to assess how large a company can become in light of national, regional and international competition.

Developing countries do not all have the necessary competition laws. 'Progressive' competition laws include the objectives of socio-economic equity and development, increasing the number of small and medium-sized enterprises, and zoning laws. There is evidence that foreign supermarkets lobby against such progressive laws.

Regional competition authorities are most developed at the EU level. They have the power to deal with large mergers and acquisitions and have intervened against a few mergers that would result in some supermarkets gaining an unfairly large share of the EU market.

At the international level, there are no binding competition rules yet, while the WTO is aiming for a worldwide free market for FFV products through the agreement on agriculture. Developed countries have given in to the business lobby against such binding rules and are more interested in using competition policy to open up developing countries' markets without taking into account the special needs of those countries. Cooperation ('comity') agreements between developed countries allow for cooperation and information

exchange to tackle cross-border competition malpractices. This could be a basis for expanding cooperation on competition policy issues and enforcement among many more countries. First, a lot of awareness raising activities at national and international level need to be undertaken.



- <sup>1</sup> The Codex Alimentarius website has two lists of membership with one indicating 170 members, the other 172: see <http://www.codexalimentarius.net/web/members.jsp?lang=EN> (4 April 2005)
- <sup>2</sup> The Codex system: FAO, WHO and the Codex Alimentarius Commission, <[http://www.fao.org/documents/show\\_cdr.asp?url\\_file=/docrep/w9114e/W9114e04.htm](http://www.fao.org/documents/show_cdr.asp?url_file=/docrep/w9114e/W9114e04.htm)> (4 April 2005)
- <sup>3</sup> "Codex Import Standards(CODEX)", <[www.american.edu/TED/codex.htm](http://www.american.edu/TED/codex.htm)>
- <sup>4</sup> "Codex Import Standards(CODEX)", <[www.american.edu/TED/codex.htm](http://www.american.edu/TED/codex.htm)> (13 Octobre 2005)
- <sup>5</sup> "Codex Import Standards(CODEX)", <[www.american.edu/TED/codex.htm](http://www.american.edu/TED/codex.htm)>: "Richard Wiles, an official with Public Citizen's environment group, claims that 'the Codex today permits the use of 40 pesticides for which the U.S. permits no residues on perishables. Wiles said of these 40 chemicals, the Environmental Protection Agency classifies six as carcinogens.' "
- <sup>6</sup> The Codex system: FAO, WHO and the Codex Alimentarius Commission, <[http://www.fao.org/documents/show\\_cdr.asp?url\\_file=/docrep/w9114e/W9114e04.htm](http://www.fao.org/documents/show_cdr.asp?url_file=/docrep/w9114e/W9114e04.htm)> (4 April 2005)
- <sup>7</sup> FAO/WHO evaluation of the Codex Alimentarius, Foodaware: the Consumers' Food Group, July 2002, <[www.net-consumers.org/food/15\\_02.htm](http://www.net-consumers.org/food/15_02.htm)> (13 April 22004)
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- <sup>9</sup> "SPS Ctte considers private sector standards," in Bridges Weekly News, 7 July 2005.
- <sup>10</sup> "Market access - Submission by Cuba, Dominican Republic, El Salvador, Honduras, Kenya, India, Nigeria, Pakistan, Sri Lanka, Uganda, Zimbabwe", WTO document G/AG/NG/W/37, 28 September 2000 <[http://www.wto.org/english/tratop\\_e/agric\\_e/ngw37\\_e.doc](http://www.wto.org/english/tratop_e/agric_e/ngw37_e.doc)>; "SPS Ctte considers private sector standards," in Bridges Weekly News, 7 July 2005.
- <sup>11</sup> See for instance "The PPMs Issue": WTO website, "Labelling requirements for environmental purposes", <[http://www.wto.org/english/tratop\\_e/envir\\_e/envir\\_backgrnd\\_e/c3s2\\_e.htm](http://www.wto.org/english/tratop_e/envir_e/envir_backgrnd_e/c3s2_e.htm)> (September 2005)
- <sup>12</sup> "Issues at stake relating to agricultural development, trade and food security", Report of the FAO symposium on Agriculture, trade and food security: issues and options in the WTO negotiations from the perspective developing countries, 1999, Paper No. 4, <<http://www.fao.org/docrep/meeting/X2998E.htm>> (November 2005) and <[http://www.fao.org/documents/show\\_cdr.asp?url\\_file=/docrep/003/X4829e/x4829e04.htm](http://www.fao.org/documents/show_cdr.asp?url_file=/docrep/003/X4829e/x4829e04.htm)> (September 2005)
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- <sup>15</sup> CBI, AccesGuide, Food legislation in the European Union : MRLs in food - (pesticide) residues (<http://194.247.99.13/accessguide/summary.asp?Number=1&Theme=2&TypeOfInfo=1&ProductGroup=1&Country=6>)
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- <sup>17</sup> For example: <http://www.foodcomm.org.uk/Irradiation%20images/leaflet.pdf>
- <sup>18</sup> For example: <http://www.citizen.org/documents/IrradiationFrench9-04.pdf>
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- <sup>26</sup> A. Rae, "International trade in fruits and vegetables: barriers to trade, WTO proposals for reform and modelling alternative outcomes," abstract for the report on 'XV International Symposium on Horticultural Economics and Management, September 2004, <[http://www.actahort.org/books/655/655\\_53.htm](http://www.actahort.org/books/655/655_53.htm)> (September 2005)
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- <sup>35</sup> Market access - Submission by Cuba, Dominican Republic, El Salvador, Honduras, Kenya, India, Nigeria, Pakistan, Sri Lanka, Uganda, Zimbabwe, WTO document G/AG/NG/W/37, 28 September 2000, p.2 <[http://www.wto.org/english/tratop\\_e/agric\\_e/ngw37\\_e.doc](http://www.wto.org/english/tratop_e/agric_e/ngw37_e.doc)>
- <sup>36</sup> See for instance: S. Murphy, *The WTO agreement on Agriculture - basics*, Cancun paper nr.2, IATP, 2003, p. 6.
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- <sup>75</sup> SOMO calculations based on WTO documents <<http://tsdb.wto.org/wto/Public.nsf/FSetPredefinedReport?OpenFrameSet>> and <[http://www.wto.org/english/thewto\\_e/acc\\_e/completeacc\\_e.htm](http://www.wto.org/english/thewto_e/acc_e/completeacc_e.htm)>; the services commitments made by Georgia are not available.
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- <sup>85</sup> Ibidem
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- <sup>98</sup> T. Fox, B. Vorley, Concentration in food supply and retail chains, DFID & IIED, London, August 2004, p.22.
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## Chapter 7

# Recommendations

The SOMO sector report on Fresh Fruit and Vegetables (FFV) has identified critical issues in different areas of the sector. These critical issues range from the production, trade and market structures, to issues of corporate social responsibility (CSR) and trade-related issues.

A number of recommendations can be made, based on some of these critical issues, aimed at sustainable development and poverty eradication. They focus on equitable purchasing and trading conditions as well as better social and environmental conditions throughout the whole FFV chain.

This report has shown that current regulations, as well as voluntary corporate initiatives in the area of corporate social responsibility (CSR) have resulted in few improvements and failed to address the many problems related to production, trade and distribution of FFV. The international system needs to develop better guarantees for compliance with minimum internationally-agreed social and environmental standards in FFV production, retailing and trade. Therefore, corporate initiatives as well as consumer incentives needs to be complemented with regulatory measures to deal with market failures that result in unsustainable and unfair conditions, together with an imbalance of power between different links in the FFV chain.

The recommendations follow three key themes:

- ❑ Market concentration, shown by the trend towards fewer and more integrated companies in the FFV chain from production to trade and retail;
- ❑ Downward pressure on prices, especially for the poorer and smaller producers;
- ❑ Small farmers, who become more marginalised from the trade and supermarket supply chain.

The recommendations should not be considered individually, but should, rather, be seen as a comprehensive package in the areas of national and international regulation, corporate initiatives and responsibility, consumer incentives, and governmental or non-governmental support.



## 7.1 Dealing with the trend towards increasing market concentration

### Important trends and critical issues are:

- ❑ The demands by supermarkets for low prices, high quality and safety standards, as well as high volumes and supply throughout the year, are important factors that contribute to market concentration.
- ❑ Vertical integration of FFV companies resulting in diminishing wholesale trading in developed and developing countries, leaving fewer outlets for small producers. For example in the European Union (EU), only ten to 15 FFV providers may remain in the coming years.
- ❑ Large multinational producers of bulk fruits are acquiring many parts of the chain for other FFV products.
- ❑ The lack of capacity and concentration of sea transport can become a bottleneck that effectively decides who can export FFV.
- ❑ Supermarkets have effectively become the main gatekeepers of market access to FFV markets in the North.
- ❑ Supermarkets prefer to have the smallest number of suppliers.
- ❑ Market concentration and vertical integration increases the leverage and possibilities for big players to influence the social and environmental conditions under which FFV production takes place; they engage in such abusive practices as buyer power. On the other hand, they can take CSR initiatives that have a wide effect.
- ❑ There is a limited group of internationally operating supermarket chains that appears in the top ten for market share on all continents.
- ❑ There are limits to what can be expected from consumers when it comes to making ethical choices.

### Recommendations:

- ❑ **Incorporating producer wealth and worker wealth assessments in competition policy**

The current focus of competition regulation on consumer protection and economic efficiency needs to be reoriented towards including fair production conditions.

Both Non-governmental organisations (NGOs) and farmers organisations should conduct activities to raise awareness among competition authorities and policy makers about the failure of current competition law and merger regulation to stop abuses of buyer power. Such abuses exploit the imbalance between farmers, producers and suppliers on the one

side, and supermarkets, their buying desks and trans-national FFV chains on the other side. This reduces the bargaining power, profit margins and ability to set prices by the weakest players. Principles of distributive fairness and operational fairness should be included in purchasing or trading practices between producers, suppliers and retailers through competition policy. The UK's 'Breaking the Armlock Alliance' is a good example of raising awareness and proposing regulations geared towards changes in practice.

At a national level, authorities should carry out more monitoring, investigation and sharing information with the public about the FFV sector. This should highlight such concerns as the concentration of ownership, malpractices of dominating FFV companies and retailers, and the consequences of mergers for workers and tax payers. This could be done through the establishment of an independent retail supervisor and regulator. This could then lead to appropriate legislation about buyer power, and other related supermarket malpractices, towards domestic and foreign suppliers. For instance, anti-cartel laws could be made less stringent for small agricultural producers and mergers of retailers should not be prohibited they cover 20% of the market.

In addition, competition policy makers should encourage and allow measures to support local shops and improve their bargaining position. Other policy makers could be involved such as those on employment.

The United Nations Conference on Trade and Development (UNCTAD) and the Organisation for Economic Co-operation and Development (OECD) need to conduct more international monitoring of the concentration and behaviour of transnational companies involved in agricultural trading and food retailing. UNCTAD should be given the task of collecting information, researching policy advice and developing standards of corporate behaviour.

Discussions need to be held at the international fora of the OECD (e.g. OECD Competition Law and Policy Committee, OECD Global Forum on Competition), UNCTAD and the International Competition Network. These should consider the inclusion in competition policy and merger notification, of protection against malpractices against agricultural suppliers, small producers and workers. This protection should be at both national and international levels. Criteria need to be developed too about what are acceptable levels of concentration in global markets. For example is 20% of global market share acceptable? Proposals from these fora need to be discussed by both politicians and the general public in all countries.

NGOs in Europe should support the EU Parliament in submitting a 'Written Declaration' that would trigger a debate in the Parliament and a reaction from the European Commission. Ultimately, new EU legislation on competition and mergers needs to be introduced to deal with concentration in the European market and buyer power against domestic and foreign suppliers. Forms of 'comity' agreements by the EU, in which the authorities of one country take the interest of another country into account or take action against malpractices that affect another country, could help in dealing with malpractices against suppliers from developing countries.

□ **Building capacity on competition policy in developing countries**

In the light of the increasing liberalisation and concentration of foreign FFV producers, traders and retailers, developing countries need to build up their human and financial resources to implement adequate competition policy laws and enforcement that can achieve sustainable, social and economic development. The capacity to achieve a fair competition policy could be built into regional trade blocs, with mechanisms to monitor and exchange information about legislation that deals with anti-competitive behaviour from a broad perspective that includes social and environmental aspects. Such regional mechanisms could evolve from first supporting competition policy development to enforcing regional competition policy.

In addition, trade and co-operation agreements between developed and developing countries need to include co-operation mechanisms to deal with buyer power, malpractices, concentration and undue lobbying by foreign owned FFV producers, traders and retailers.

Such co-operation should take away the mistrust of developed countries competition authorities towards those from developing countries. If regional agreements include competition policy they should provide for special and differential treatment for developing countries.

□ **Incorporating competition policy into CSR initiatives**

The current CSR initiatives in the FFV sector focus mainly on the environmental and social standards of the producers. This report shows that the level of concentration of the market is also an important element which puts social and environmental standards under pressure. Dominance by a small number of players at certain stages in the chain may be hampering fair and equitable trading and pricing practices.

Therefore, competition issues should be addressed in initiatives aiming to improve social and environmental conditions, and incorporated into existing codes of conduct and guidelines. The International Set of Restrictive Business Practices and the OECD Guidelines chapter on competition should be used as the normative framework to draft such CSR policies by the private sector itself as well as by governments in their CSR policies (such as public procurement, criteria for subsidies and export credits, etc).

□ **The General Agreement on Trade in Services (GATS) negotiations should provide better rights to introduce regulations, not more rights to a few already dominant Northern supermarkets**

Opening up new markets for supermarkets under the GATS negotiations will largely benefit just a few Northern supermarkets who operate internationally. Therefore further liberalisation under GATS needs to be questioned. Developed countries should not ask for the market in distribution services to be opened up in countries that have not offered to open up those services markets in the GATS negotiations. They should first be allowed to experience the consequences of unilateral liberalisation.

WTO members should take into account that regulation is needed before opening up the distribution services sector and that GATS rules (Art. VI, XVI, XVII) limit the space countries have to introduce regulation and policies. GATS negotiations have to clarify and enshrine in law governments' rights to regulate. GATS rules must be clear that governments can impose new measures to protect poorer consumers and producers, promote social development and eradicate poverty. The United Nations (UN) Covenant on Economic, Social and Cultural Rights as well as different International Labour Organisation (ILO) Conventions should be used as criteria to judge governmental regulations.

Negotiations should not take away the right of authorities to apply existing or new economic needs tests, zoning laws that prohibit supermarkets from being launched near town centres, nor exclusion of FFV products from GATS liberalisation. Testing the economic need for the establishment of a new service company, e.g. a supermarket, should include the impact on small agricultural producers, including small producers of fruit and vegetables.

GATS negotiators and the ministries that are in charge of trade should be transparent and introduce rules about the lobbying by business. They need to ensure much more information and more debate in public and in parliament, with special attention to affected groups such as marginalised stakeholders. GATS negotiations should be entirely based on an assessment of the broad impact of the liberalisation of services, such as distribution services, by all countries.

## 7.2 Dealing with downward price pressures

### **The important trends and critical issues are:**

- A strong downward pressure on prices in agricultural commodities in general. Fortunately real prices for most selected FFV have decreased little (see chapter one);  
When there are too few facilities for overseas transport, the transportation prices shoot up, leaving little profit for the producer and therefore new export opportunities cannot be exploited;  
Consolidating supermarkets, the growth of discounts, and buyer power are keeping prices low throughout the FFV chain ensuring the consumer remains happy with the low prices, high quality and choice;  
The low prices paid to producers make it difficult to comply with international social and environmental production standards. CSR initiatives impose additional standards on suppliers and small farmers that result in additional costs. This may exclude small farmers from such schemes and jeopardise labour standards in an attempt to lower production costs.

## **Suggested recommendations:**

### **□ Prohibiting the buying and selling of products below the production costs**

All countries should follow the example of those that have laws regulating buyer power and other abusive relations between suppliers and retailers. These laws include:

- 7.3 the banning of selling below the cost price;
- 7.4 laws against predatory pricing and price discrimination;
- 7.5 laws on just and fair contracts; and
- 7.6 laws regulating dependency in trade relations.

In addition, the above recommendations related to competition policy and buyer power should avoid supermarkets and others in the chain from using buyer power to keep prices down unfairly for FFV producers.

On an international level, the World Trade Organisation (WTO) and other trade agreements need to immediately prohibit dumping and all export and domestic support subsidies by developed countries, which distort trade. In addition developing countries should be allowed to protect their country against subsidised imports or imports that threaten food sovereignty. This means the developing countries' demands in the WTO's Doha round of negotiations on agriculture, in which they called for special products and a simple safeguard mechanism, have to be fully accommodated. Such concessions should not be exchanged for other concessions by developing countries in the agricultural or other sector negotiations such as GATS.

### **□ Dealing with oversupply**

More international co-operation among international institutions and countries is needed to avoid an oversupply in FFV, such as bananas for which prices have decreased significantly over the last four decades, and which puts downward pressures on the income of many farmers and farm workers. Many different instruments and regulations might need to be put in place to stop oversupply, achieve fair pricing and halt an orientation towards industrialised FFV production and trade dominated agribusiness. More political will, corporate initiatives and public attention is needed to start discussions and proposals to handle this problem beyond the market-oriented instruments currently promoted

### **□ Managing trade rather than trade liberalisation**

Trade liberalisation means more competition and thus more downward pressure on prices. But it can also open up new markets for exports. Negotiations on the agreement on agriculture have to take into account the market structures and corporate concentration that have an influence on who can benefit from trade liberalisation and how prices are being set by the leading corporations. No liberalisation should be encouraged in sub-sectors whose markets are dominated by a few companies. For example where four companies have a 60% share of the world market.

More fundamentally, the focus in agricultural trade negotiations should be food security and a countries' sovereign right to regulate and provide support for local or regional sustainable production. It should be noted that only a small part of FFV production is being traded, i.e. 5.4% of world FFV production in 2003. Full liberalisation does not always lead to better incomes for farmers and agricultural workers. Trade agreements should not therefore give priority to the trade and export interests of large farmers and agribusiness. In order to re-orient the current WTO negotiations towards vulnerable farmers, farm workers and consumers, decision-making needs to be urgently made more democratic and transparent both within a country's negotiation mandate as well as within the WTO negotiations.

Developed countries that put into practice sustainable agricultural production and rural development should still import FFV from developing countries. But it should be at prices that do not undermine their sustainable production and rural development, for example through some quantitative restrictions or specially targeted preferences for the most vulnerable countries. At the same time, the special import procedures and complex tariff structures for FFV products need to be simplified in order to allow poorer farmers the chance to export at beneficial prices.

#### ▣ **Identifying export opportunities for developing countries and crop diversification**

Since the prices for most FFV have declined a little over the last decade and the share of developing countries in EU FFV imports is growing, more developing countries could assess the benefits of starting or increasing exports of FFV in order to capture, a share, or increase their share, of this lucrative market. A good strategy for the least developed country exporters and producers to receive a good price and avoid a fall in prices due to oversupply could be to focus on :

- 'niche' FFV markets;
- 'non-traditional' tropical fruits, such as mangoes and papayas,
- organic FFV markets as many small-scale farmers in developing countries already avoid the use of pesticides;
- FFV off-season markets when local supply or supply from dominant exporting countries is low.
- different FFV (crop diversification) to avoid vulnerability from crop diversification, volatility of world market prices

The benefits from such exports however need to be assessed and balanced against:

- the need for measures to facilitate such exports such as investments in infrastructure and production including training and the formation of cooperatives (see below: recommendations for small farmers);
- concrete possibilities to enter the Northern, or mainstream FFV markets, some of which are dominated by supermarkets that have specific supply chains;
- the possibility to maintain small holder participation instead of moving towards mechanised large scale production.

□ **Incorporating economic aspects into CSR initiatives on trading practices**

Apart from the fair-trade initiatives in the FFV sector, most CSR initiatives do not seek to integrate economic aspects such as pricing, and trading practices (delivery times, contracts) into the systems. Therefore, suppliers are often required to make changes that result in real costs for them, without getting better prices and improved trading conditions. They have to cover the costs for improvements as well as the certification of practices (the audit costs), without any assurance of future sales, nor increased prices to cover the costs of the required changes. The focus of CSR initiatives should shift to their responsibilities at the top of the supply chain rather than pressing suppliers to comply with improved practices as most initiatives currently do. Such a supply chain responsibility implies a commitment by retailers to reward sustainable practices in their supply chain with better prices and long term contracts, and not to take high profit margins while producers' margins are very low.

Economic aspects such as wages, transfer pricing, payment of taxes, corruption, competition and contributions to local economies, should be integrated into the CSR policies of governments and agri-businesses in the FFV chain. The abuses in those areas are often part of the root cause of unfair and unequal distribution of income within the supply and value chains. Civil society organizations working in the area of CSR should address these economic aspects in their CSR lobbying towards national and international governments, as well as call for the incorporation of such elements in the CSR initiatives they participate in.

□ **Adopt WTO interpretations to allow discrimination on the basis of social and environmental performance of corporations**

The principles of non-discrimination, such as the National Treatment and Most Favoured Nation principles of the WTO should not undermine CSR initiatives or regulation that favour companies with good supply chain responsibility.

The WTO rules should not prevent governments from adopting social and environmental regulations applying to companies even if they have an effect on trade.

The WTO members should adopt the necessary interpretations that will allow governments to use article 20 of the WTO's basic rules (GATT 1994) and article 14 of the GATS that lay down the criteria for not having to apply WTO rules. This would promote the introduction of social and environmental regulations that improve pricing conditions for weaker links in the FFV supply chain.

□ **Labels and measures to encourage consumers to buy sustainable FFV produce**

In order to encourage consumers to pay a good price for their FFV produce, CSR initiatives and labels should inform consumers about the social and environmental conditions and prices of production. In order to guarantee the reliability of labels,

governments might have to be involved. Because the WTO Agreement on Technical Barriers to Trade (TBT) is not clear about whether such government involvement would be allowed, WTO members should adopt the necessary interpretation of this WTO agreement that allows governments to introduce, permit and monitor social and environmental labelling.

## 7.7 Support for small farmers

### **Important critical issues:**

- ❑ Small farmers are squeezed out of the market because of the demands for high quality and volume at low prices, lack of transport and storing facilities, diminishing wholesale trading, increased traceability and food safety requirements, the growing number of integrated companies, fewer outlets after supermarkets have taken more of the market share in food distribution in different countries. This is happening mostly in developed countries but also increasingly in developing countries.
- ❑ There are examples in the FFV sector where small farmers have been able to maintain a place within the chain of multinational supermarkets due to certain products and niche markets. In some countries, extensive export production has been set up in such a way that smallholder production remains unaffected and new jobs are created.
- ❑ There remain questions over whether public support and subsidies for small producers is justified and is efficient in its effects on poverty reduction and sustainable development. Smallholder production is considered to be more labour intensive (it creates jobs in rural areas), more flexible, more able to reduce the environmental impact of production, and it leads to greater food security. However many governments do not have the necessary financial and human resources to provide the many necessary supportive measures and national policy interventions in order to maintain small farmers in important supply chains. Also, such measures can be opposed by international financial institutions and donors.
- ❑ International structures such as international trade rules, concentrated or closed supply chains and a lack of international regulation of transnational producers, traders and retailers, make it increasingly difficult for small farmers to benefit from trade liberalisation negotiations.

### ❑ **Improving traditional markets and delaying the pace of supermarket penetration**

In order to avoid supermarkets and consumers quickly bypassing traditional wholesale and wet markets in search of higher FFV quality at supermarkets, there is a need for more



support to improve wholesale markets, wet markets and traditional retailers. Governments can invest in making small scale open markets attractive so that there remains easy outlets for small FFV producers. They should research the advantages and disadvantages of keeping small farmers instead of moving toward large scale industrialised production. At the same time, where FFV sourcing by supermarkets leads to restructuring of the FFV production chain, governments should implement measures that slow the pace of supermarket penetration and consolidation and that give domestic producers the possibility of adapting to the new sourcing methods. Such measures can range from limiting the size of supermarket stores and regulating the place where large supermarkets can locate, known as zoning, to effective competition policy that limits concentration.

#### **□ Establishing multi-stakeholder initiatives in the FFV chain**

While this report has identified the limitations of current CSR initiatives, it is recognized that CSR initiatives can be meaningful, if certain key principles are taken into account. First, the CSR initiatives need to be based on internationally agreed-upon guidelines and standards, such as the ILO core conventions, the Universal Declaration of Human Rights, The Rio Declaration and the OECD Guidelines. Secondly, supply chain responsibilities should be defined, and supermarkets and retailers at the top of the supply chain should take responsibility for the conditions under which FFV is produced and enable suppliers to comply with CSR standards. Such a multi-stakeholder initiative should include NGOs and trade unions in its governance structure and involve local (workers') organizations in the monitoring and verification processes. An model alternative to the current initiatives focusing on food safety, such as the EurepGAP standards for good agricultural practices (GAP), needs to be developed that is considered credible and independent by all stakeholders.

#### **□ Assistance by governments, or by the private sector in raising standards in order to decrease barriers to trade for small farmers**

Small farms need to invest in quality and should seek to unite or co-operate in corporations, marketing associations or cooperatives in order to achieve the requested larger volumes and economies of scale. Governments, NGOs and private sector initiatives should promote and facilitate their formation and link different actors in the chain from production to marketing. They should provide ways and means to allow small Southern producers to comply with reasonable food quality and safety standards through:

- training by specialised, preferably local organisations financed by governments and the industry;
- training local trainers in GAP, traceability, food quality and safety;
- Investing in infrastructure such as roads, public packing houses and storage facilities;
- mechanisms to include in prices the costs of complying with food safety standards;
- fair contracts about pricing and payments within a short period of time;
- support, especially for women, for better access to credit, since commercial banks are not keen to provide credit to small farmers, an important CSR

issue for the banking sector. Credit facilities could come from state agencies, from integrated producer companies such as Capespan, from wholesale trade business such as Fyffes, and from supermarkets in cases where they have direct relations with producers.

The evolution and functioning of some fruit companies could be considered a collaborative business model, rather than a co-operative. These companies allowed small producers to integrate into a larger company which has different functions from supporting producers over wholesale trading to distributing to supermarkets, rather than just supporting production or collective selling. Examples that could be assessed as to whether they provide an additional model to traditional co-operatives are The Greenery (Netherlands), Sunkist (United States) and Capespan (South Africa).

**□ Ensuring possibilities for group certification of EurepGAP and including ILO Conventions into the standard**

Supermarkets can support small farmers by a commitment to source from local producers and by providing them with the means to do so. One particular initiative would be to deal with the current requirements for group certification under EurepGAP, which are often too complicated and expensive. As a result, small farmers are often not able to obtain EurepGAP certification. Individually, this would be too expensive. The small farmers often lack the administrative capacity for registration and record keeping. In order to ensure groups of small farmers can apply for EurepGAP certification, EurepGAP needs to be pressured to evaluate and adjust the group certification requirements so as to accommodate the specific local situation in developing countries.

Currently, the EurepGAP standard is very weak on labour standards. If EurepGAP is going to be used as a CSR tool by retailers, then the EurepGAP standard should be extended to include the ILO core labour standards, as well as respective ILO Conventions on hours of work, (living) wages, health and safety and security of employment. In this way, the normative framework is raised up to the level of most of the state-of-the-art CSR initiatives on labour rights. At the same time, raising the standard up to the level of internationally agreed standards must not make it even more difficult for small farmers to get certified. Therefore, inclusion of labour standards in EurepGAP must be accompanied by measures that enable and support producers to improve labour conditions.

**□ Measures to avoid excluding small farmers because of requirements for traceability and food safety**

The administrative costs of traceability requirements can be a barrier for small farmers. Also illiteracy can be a problem. Governments, the EU civil society and the industry should investigate the effects of traceability on small producers and where necessary provide means to assist small farmers in complying with traceability requirements. Also all parties to buying and regulation should seek to harmonise traceability requirements worldwide as there is no standard international definition of what constitutes a traceability system.

Additionally governments should finance research into the setting of the maximum residue levels (MRL) for substances that are of little or no commercial interest to the agro-chemical industry but are used in developing countries.

#### **□ Reforming international standard setting**

At an international level decision-making on standards needs to be more balanced, taking into account all stakeholders. At the European and national level, better consultation mechanisms with developing countries need to be established to incorporate their concerns when new standards are set.

At the EU level, the incorporation of legitimate health and environmental concerns in EU standards need to be matched with mechanisms that allow developing country producers to meet the standards.

In Codex Alimentarius, decision-making should be made more transparent and participatory so that not only can businesses and consumers have their voices heard, but also small producers that have to comply with the new regulations, as well as government representatives of developing countries. There should be an equal representation, up to a maximum of ten consumers and business representatives. No country should be represented by company representatives alone.

If Codex Alimentarius is not the appropriate place to include the precautionary principle and so-called non-scientific social and environmental aspects in food standards and their management, the WTO needs to recognize that the Sanitary and Phytosanitary (SPS) and TBT agreements can take account of social and environmental criteria developed in other UN and international organisations or treaties. Judgements of the WTO panel on disputes over the SPS and TBT agreements should balance prevention of undue trade distortion with the prevention of negative environmental and social impacts. An international mechanism or arbitrator should be established to deal quickly with agricultural imports that are unduly stopped at the border for health and safety reasons.

#### **□ International co-operation and support for standards in developing countries**

More financial and technical support is needed in order for developing countries to participate in Codex decision-making on standards, to allow democratic decision-making within developing countries on their positions, to implement the TBT and SPS agreements and to enable implementation of Codex standards by all FFV producers. This should facilitate the arguments of governments or civil society in FFV producing countries that food safety standards should take into account local circumstances in producing countries, for example not insisting on toilets on smallholder farms or washing of FFV with water of western drinking water quality where there is no such water available. Resources are also needed for developing countries governments to monitor the application of the FFV standards so that they are not faced with unnecessary non-tariff barriers to trade in FFV products.

There should be more international co-operation to achieve an equivalence of standards and their monitoring rather than harmonisation of standards, given the different

environmental and social conditions existing in many countries. However this should not be a plea for lowering necessary standards.

## Annex 1

# GATS rules and market access commitments: general explanation

The GATS agreement has different ways to liberalise a range of services.

Firstly, the agreement covers different ways ("modes") by which foreign services are supplied. The definitions of "trade in services" are as follows:

- ❑ Mode 1: cross-border movement of the service or "cross border trade": e.g. a wholesale firm established abroad is allowed to provide services to nationals in the given country such as contracting transport for import, or a retailer abroad is allowed to provide e-commerce services such as delivering food in homes abroad ordered through internet;
- ❑ Mode 2: cross-border movement of the service consumer or "consumption abroad": e.g. a Dutch tourist goes to France to enjoy a good meal in a French restaurant.
- ❑ Mode 3: cross-border movement of the corporate service provider through investment, or "commercial presence": e.g. a country allows foreign retailers to buy up domestic supermarkets or open new stores in its territory.
- ❑ Mode 4: "cross-border movement of persons": e.g. a Brazilian manager of a Dutch retailer is allowed to work at the offices of the Dutch stores in Amsterdam or New York.

Secondly, one part of the GATS agreement deals particularly with liberalisation of services, i.e. opening up markets to allow foreign services and services providers to enter the country, including distribution services. A country has to decide which (sub)sectors it liberalises, i.e. "makes commitments" in, by adding them to its GATS list ("schedule"), and which (sub)sectors it does not liberalise at all. For instance, a country can fully or partly liberalise its distribution services under GATS. The country's GATS schedule has to specify which (distribution) sub-services are liberalised for which "modes", and can include exemptions to some GATS rules. A country can decide not to make a commitment in distribution services by not adding financial services to the schedule.

Thirdly, the text of the GATS agreement with GATS rules is based on the assumption that many barriers to trade in services and limitations on the operation of foreign services' firms come from government regulations, measures and administrative decisions. The GATS agreement has a set of rules and obligations that governments have to implement to allow foreign service providers to operate more freely. The GATS rules include the following disciplines, which also apply to distribution services:

General obligations that a country has to implement even if it has not liberalised any (distribution) services under GATS:

- ❑ **MFN:** treating all foreign (distribution) services equal (Most Favoured Nation/MFN) (Art. II);
- ❑ **transparency:** all measures and laws related to (distribution) services have to be transparent and notified to other WTO members (Art. III);

'**development**': the increasing participation of developing countries in world trade in services is to be facilitated through specific negotiations, and through contact points in developed countries (Art. IV).

Specific obligations, imposed on governments, which apply to (distribution) services that have been liberalised, i.e. committed in the GATS schedules of WTO members:

- ❑ **domestic regulation:** due treatment of foreign services suppliers when taking administrative measures or giving authorisation to supply a (distribution) services (Art. VI.1.,2.,3.); standards, licensing and qualification requirements should not constitute a barrier to trade (Art. VI.4.,5.);
- ❑ **free capital movement:** no restrictions can be imposed on international payments for current transactions related to committed (distribution) services (Art. XI), except in case of balance of payment problems (Art. XII);
- ❑ **market access:** no measures should limit the operation or ownership of (distribution) services (Art. XVI);
- ❑ **national treatment:** equal treatment of foreign and national financial service providers (Art. XVII);

**permanent commitments:** a GATS commitment to liberalise can only be reversed by a country after three years and after compensation has been negotiated with the WTO trading partners that request compensation (e.g. through market access in other (sub)-sectors) (Art. XXI).

## GATS negotiations in practice

Each WTO member is responsible for negotiating new GATS rules and liberalisation commitments, but many least developed or developing countries do not manage to have any or enough representatives to do so. The European Commission (EC) is the official negotiator for the 25 EU member states in the WTO. The EC's Directorate General (DG) for trade is responsible for the GATS negotiations. The EU member states can influence the EC's position in the GATS negotiations through the mandate they give the EC at the beginning of the negotiations. Once a mandate is given, they can only observe the WTO negotiations and influence the EC through regular meetings at the Committee 133, where trade officials or diplomats of all EU member states discuss upcoming negotiation issues. All DGs can also influence DG Trade's position, including DG Enterprise which is responsible for EU policy relating to the commerce sector.