CHAPTER 7

THE CONTRIBUTION OF FAIR TRADE TOWARDS MARKET ACCESS BY SMALLHOLDER BANANA PRODUCERS

GONZALO LA CRUZ

Representative of Solidaridad for Latin America
Address: Casilla 18-0562, Lima 18, Peru
E-mail: gonlacruz@yahoo.com

Abstract. Smallholder banana producers meet four major constraints to enter the international banana market: quality, logistics, finances and trade regulations. The quality standards are set by retailers and supermarkets and are difficult to meet by smallholders, mainly due to fungal diseases in banana. Logistics depend on availability of timely vessels over which smallholders have no control. Funding is needed for infrastructure and pre-export operations but smallholders have little access to appropriate credit schemes. The EC tariff-quota regime discriminates against non-ACP banana producers making their bananas more expensive and limiting the establishment of new import distributing companies. Fair trade (FT) is based on cost-internalization paying sustainable production practices that incorporate social rights and environmental protection. FT does not protect inefficiencies but aims to overcome the mentioned obstacles by transparent partnership between the chain partners. FT is based on higher prices paid by consumers that allow an equitable distribution of gains from trade over the chain partners. Less regulation of trade will increase the market share of FT bananas in Europe. An example of the FT organization at two levels, Agrofair and Biorganika, is given to show potential benefits and problems in developing a sustainable chain of FT and organic banana.
Keywords: quality; logistics; trade regulations; partnership; equity

THE BANANA MARKET

The export market of bananas is fully dominated by Latin America, which is responsible for 80 % of all banana exports between 1998 and 2000. In the same period the Far East, Africa and the Caribbean had shares of 13, 4 and 3 % of the export, respectively. Import markets are more diverse with the United States of America (USA) and the European Community (EC) in leading roles, responsible for 33 and 26 %, respectively, of the imports in the same period. Shares of 8, 6 and 4 %, respectively, were found for Japan, Near East, and China and Latin America (Arias et al. 2003).

R. Ruben, M. Slingerland and H. Nijhoff (ed.), Agro-food chains and networks for development, 69-78.

The three largest banana trade companies are Chiquita from USA (25 %), Dole from USA (25 %) and Del Monte from United Arab Emirates/Mexico (15 %). Smaller companies are Noboa from Ecuador (11 %) and Fyffes from Ireland (8 %), while 16 % of banana trade is taken care of by a multitude of smaller companies (Chambron 2000).

Today banana trade can be divided into three major groups: conventional, 11 million tonnes; organic, 120,000 tonnes; and Fair trade (FT), 113,000 tonnes (FAO and FLO statistics).

MAIN CONSTRAINTS MET BY RURAL SMALLHOLDERS FOR ENTERING INTERNATIONAL MARKETS

The four major constraints limiting smallholders to enter international banana markets are quality, logistics, finance and trade regulations.

Quality

Quality specifications are defined by the supermarkets and retailers. Quality specifications as targets are therefore exogenous factors on which producers have little or no influence. In the banana sector, quality is defined in terms of size/diameter, age, appearance (such as colour and shine), finishing (such as free of scars and spots), flavour and smell. Quality can only be achieved through effective management of the appropriate technology throughout the entire supply chain from farming till final distribution to markets. Failing to meet the quality standards means suffering losses. Seconds cannot be exported, boxes will be dumped at port of destiny and claims will follow from ripeners and supermarkets receiving insufficient quality. One of the major constraints to meet the quality standards of the supermarkets is the lack of effective control of fungal diseases, in particular in organic banana.

Logistics

Effective logistics assure timely supply of fruit of required quality to the market. This includes all operations to achieve this objective. In the producing country, it deals with aspects from farm to port of delivery and is composed of farming, harvesting, processing, packing, palletizing, cooling, road transport and loading the vessel. Overseas logistics deal with sea transport to point of sales including unloading the vessel, transport, ripening, re-packing and delivery to shops. A critical and crucial factor is the availability of timely vessels. The smallholder producer has no control over timely sea vessels, which makes this factor a major constraint.

Finance

Funding is necessary to invest in basic facilities and infrastructure. Required funds should be available as long-term credit against reasonable interest rates. Funding is also needed as working capital for pre-export operations. It takes on average 7 weeks between the dispatch of bananas and the balance of sales from the importer. To solve this gap in time many importers make a prepayment against documents of exported fruit. Lack of funding is an important constraint.

Trade regulations

Banana imports are concentrated in two main markets with very different features:

- the USA: a free market
- the EC: a highly regulated market

Each of these markets captured around one third of the imports between 1985 and 2000 (Arias et al. 2003).

In 1993, with the establishment of the single European market, the EC put in place a regulatory regime concerning the import of bananas with the following components (European Commission 1993; 2004):

- Access to markets is regulated by a tariff-quota system.
- Quotas are allocated according to the historical volume imported by established operators
- 96.5 % of the quotas were allocated to traditional operators and 3.5 % were reserved to new ones. In 2002 new operators increased their access to quotas up to 17 %.
- Defined quota imposed a system of import licences.
- Bananas from ACP countries (Africa-Caribbean-Pacific: mainly former French and British colonies) have duty-free access to all EC member states.
- Bananas from non-traditional ACP countries (Dominican Republic and Ghana) and third countries, the so-called dollar bananas, are subject to a tariff (75 to 680 euros/tonne) according to the imported volume.
- Bananas from EU producers (mainly Canary Islands, Martinique and Guadeloupe), covered by internal aspects of the common market, enjoy an income support.

This regulated import regime has many consequences. The price of bananas for EC consumers increased by about 0.50 euro per kg since the quota reduced the volume of imported bananas. The tariff-quota system generated a market of tradable licences with the cost of a licence between 2 and 3 euros per box. The total cash value of the licences was calculated to be over US$ 1bn annually (Van de Kasteele 1998). Traditional operators benefited from this trade of licences instead of developing the banana sector. ACP countries and EC banana regions benefited from market incentives and direct subsidies.

The EC import regime favours trade of ACP bananas at the expense of the dollar bananas from non-ACP countries like Ecuador, Colombia and Costa Rica. Due to the quotas, tariffs and direct subsidies, bananas from non-ACP countries became more expensive than bananas from ACP countries.

The regulations made the entrance of new traders almost impossible. New traders need to buy licences and/or organize expensive and complex bank collaterals in order to be granted free licences by the EC. The regulated regime also increased the margin of retailers and supermarkets.

The USA and Latin-American countries, in particular Colombia, Costa Rica, Nicaragua, Venezuela, Ecuador, Mexico, Guatemala, Honduras and Panama, issued demands against the EC. Bilateral negotiations and WTO negotiations that have cost millions of euros to the EC, resulted in a modification of the tariff-quota regime so as to increase the access to import licences by dollar-banana-exporting countries. In the near future, 2006, the EC banana market will be liberalized whereby the current tariff-quota regulation will be replaced by a tariff-only system. A tariff preference will continue to be granted to ACP countries until 2008.

In summary, the major constraints are that the EC tariff-quota regime discriminates against non-ACP banana producers, making their bananas more expensive, and that the regime creates serious obstacles to new banana trade chains wanting to establish new import distributing companies.

CONTRIBUTION OF FAIR TRADE TOWARDS INCREASED ACCESS TO MARKETS

The FT system is based on the principle of cost internalization, e.g. the costs of social rights and environmental protection are included in the price paid by the consumers.

Two main separated components together contribute to FT in fruit markets:

- The rules of the game: the standards and rules for FT certification, inspection and operation. Examples are FLO, IFAT, CTM, SA 8000.
- The FT partners: the network of producers, traders, ripeners and retailers.

As an example, the FT criteria under the certification by the FT Labelling Organizations (FLO International 2004) are given. Producers are guaranteed a **minimum price** that is calculated to cover full production costs plus a reasonable margin to meet basic needs and environmental standards. The smallholder producers or workers on plantations are paid a **social premium** for further social and environmental improvements as a group. Consumers can identify a FT product (properly labelled) and pay a **higher price** for a clean and responsible product. Since 1997 FT banana knows 17 certified producers, 24 active traders and sales in 15 countries.

The FT certification, its principles and rules, can contribute towards increasing the competitiveness of the produce. FT bananas are sold to consumers at higher prices than conventional bananas. But FT can work only for a produce that has the potential to be competitive in international markets. FT does not protect inefficiencies. FT rules are a necessary but not sufficient condition. The FT scheme can set the foundation on which main constraints can be reduced so that smallholder producers can enter the market. Quality bottlenecks, weak logistics, insufficient funding and a discriminatory trade regime (Section 2) cannot be modified by FT

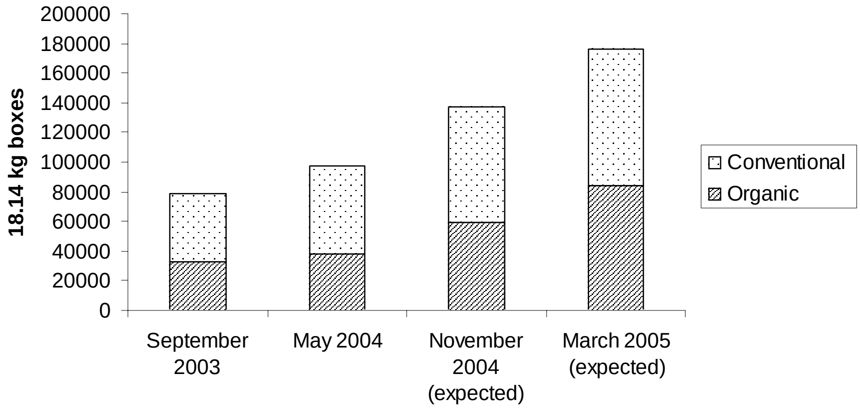

Figure 1*. Market share of Fair-trade organic versus Fair-trade conventional banana (Source: FLO – number of boxes per week)*

rules alone. True and transparent partnership between producers, traders and retailers is the key solution for tackling main obstacles to trade.

- Traders know about quality standards and solutions so they can provide information and technical assistance to producers.
- Retailers can modify and adapt quality requirements to existing circumstances.
- Traders (exporters and/ or importers) can help in solving logistic and sea transport problems.
- Traders can provide finance (prepayment before export and mid-term debts particularly those originated on quality claims).

FT not only corrects the price paid to producers and the price paid by consumers, transforming the chain into a feasible business, but it also allows an equitable distribution of gains from trade.

Figure 2 presents the cost structure of one box of FT conventional bananas throughout the entire chain. It is remarkable that supermarkets / retailers nearly double the cost of purchase of FT bananas to set the retail price for consumers. Therefore, about 45% of retail price is the margin of supermarkets that includes all operational and fixed costs plus their profit. On the other end of the chain, producers receive about 11% of final value paid by consumers. The US$ 1.75 premium per box (4%) is on top of all incurred costs. On average about US$ 1.5 per box could be regarded as the net extra income per box for producers due to FT.

The margin for exporters is rather small in comparison to what accrues to the other stakeholders. The net profit for exporters is somewhat between US$ 0.05 and 0.25 per box in the good cases, but there are exporters who operate close or below the break-even point.

The margin of importers is much less than the 2% of retail value indicated in Table 2. The net profit for the importer is rather variable but in any case significantly less than the net income obtained by producers due to FT and immensely less than the profit of supermarkets with FT bananas.

The FLO's national initiatives (NIs) charge importers various amounts per FT box depending on the European market, but on average US $ 0.80 per FT box. Any cost reduction during the repacking at the ripener or in the purchase of licenses mitigates this cost. Otherwise, the payment to the NIs is absorbed as an extra cost by the importer. Recently FLO is introducing a scheme of charges to producers and exporters (in addition to existing charges to importers).

In sum, FT is a system that redistributes income from traders to producers while allowing larger margins and profits to supermarkets.

Payment for fruit to producer	USD	3.45		8%
FT Premium - Investments in social and environmental programme	USD	1.75		4%
Subtotal benefit for producer	**USD**	**5.20**	**11%**	11%
Package, local logistics and exporter's margin	USD	1.80		4%
Subtotal FOB	***USD***	***7.00***		15%
Sea transport and insurance	USD	3.20		7%
Harbour handling	USD	0.50		1%
Overhead, financial costs and importer's margin	USD	1.00		2%
Subtotal packaging and logistic		**6.50**	**14%**	14%
Subtotal T1		***11.70***		26%
Import duties, licences, clearance	USD	5.00		11%
Subtotal import duties and licences	**USD**	**5.00**	**11%**	11%
Transport from harbour to ripener	USD	0.80		2%
Ripening	USD	1.50		3%
Packaging/pricing of clusters (USD 2.50 if applicable)	USD	2.50		6%
Distribution to DC's	USD	0.80		2%
Subtotal ripening (+packaging)		**5.60**	**12%**	12%
Total (is referential yellow-price for retailer T2)	**USD**	**22.30**		49%
Sales price to consumer per kg (2 Euros for FT)	USD	2.50		
Sales price per box of 18.14 kg	USD	45.35		100%
Tax VAT per box	**USD**	**2.72**	**6%**	6%
Retailer's margin per box	**USD**	**20.33**	**45%**	45%
Costs for retailer unknown (distribution, waste, store, etc.)				
Total return per box in USD at retail price		**45.35**	**100%**	100%

(*) Data obtained as average estimations of diverse Latin-American sources of Agrofair
Weight per box 18.14 kg

Figure 2. *Value chain analyses for one conventional fair-trade (FT) box*

Switzerland enjoys the largest market share of FT bananas in Europe. Figure 3 shows that in 2001, nearly 15% of total bananas sold in the Swiss market were FT. UK follows with 13%, The Netherlands with 12.5% and Finland with 6.5%. In recent years, the market share of FT bananas has increased in Switzerland since Coop, the supermarket chain, decided in 2004 to sell only FT bananas. It is important to note that in Switzerland the difference in price for consumers between FT and conventional bananas is very small since this country does not have the complex and regulated import regime of the EC countries and the supermarkets strongly support the FT of bananas.

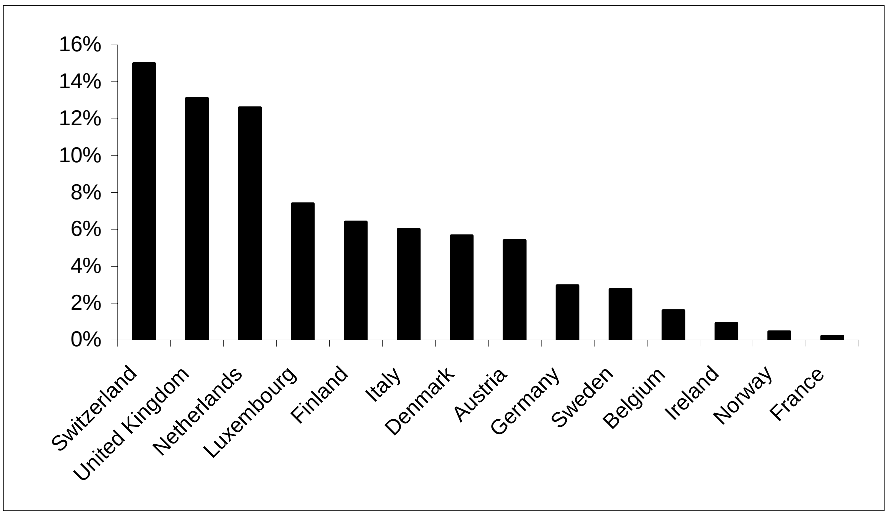

***Figure 3**. Market share of fairtrade bananas in Europe*

FLO data show that the largest volume of FT bananas (both organic and conventional) was sold in Switzerland (data of May 2004), 39,000 boxes per week (b/w) followed by the UK with 27,080 b/w and the USA with 6,650 b/w. Other countries sell less than 4,000 b/w.

A CASE STUDY: AGROFAIR AND BIORGANIKA

In this section an example of a FT organization at two levels will be given: AgroFair Europe BV, the importer and distributor of FT fresh fruit in Europe, and Biorganika, the exporter of Peruvian bananas.

AgroFair

AgroFair Europe BV is a private trading operator that allows producers to sell their fruit directly to supermarkets. Eight producer groups from Latin America and Africa own 50% of AgroFair's shares. Foundations and NGOs (Solidaridad-Netherlands, Twin-Trading-UK and CTM-Italy) own the other 50%. In 2003 AgroFair traded 1,406,764 boxes of bananas, getting a net turnover of € 26,593.000, allowing to distribute € 200.000 as dividend for producers and NGOs.

Biorganika as exporter is a subsidiary of Agrofair in Peru. The connection between AgroFair and Biorganika is given in Figure 4.

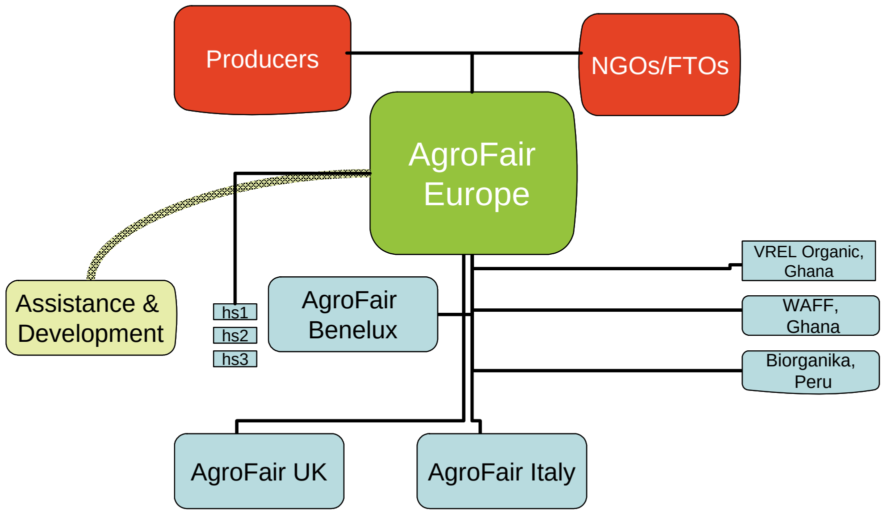

Figure 4. *Organizational structure of the holding with the position of Biorganika indicated*

Trade volumes grew rapidly from almost 60,000 boxes in 1996 to 286,000 in 1997 and 551,000 boxes in 1998. It took until 2002 before another doubling was achieved with 1,160,000 boxes. In 2003 Switzerland was responsible for 31 % of sales with Italy (28 %) in second place and UK (14 %) third. The remaining 27 % were divided over Finland (10 %), Belgium (6 %), Austria (5 %), The Netherlands and Denmark (3 % each).

Biorganika

Biorganika is a limited company acquired by AgroFair Europe BV in July 2002, owning 99 % of the shares and 1 % owned by Solidaridad. In 2003, the turnover was US $ 1.101.560 and the number of boxes traded was 125,220 equal to about 2,408 boxes per week. The company consists of 10 employees and 172 farmers (120 active). Organic banana is planted on 151 hectares, the average farm size being about 0.88 ha. BCS Oeko Garantie from Germany provided the organic certification.

Biorganika's break-even level of operation is 4,500 boxes per week providing that quality claims be kept at a minimum. During year 2004, Biorganika and the producers are working hard towards this target. It is likely that the total export for year 2004 will be about 200,000 boxes but still below the break-even point. Therefore, Biorganika will continue carrying forward losses with Agrofair's support.

What does all this mean to the smallholder producer? The minimum price for fairtrade banana was US$ 2.20 per box with an additional social premium for the Valle de Chira Association of producers of US$ 1 per box sold as fairtrade. In 2003, the Valle de Chira Association produced on average 1,035 boxes per producer. The gross annual family income originating from banana exported by Biorganika was US $ 2,590. This meant for every family an increase in income of US$ 321 per year. The social premium to the producers was US$ 80.050 for 2003 and would be twice this amount in year 2004.

MAIN CONCLUSIONS AND CHALLENGES

Looking at the constraints and the few examples of successful practices of FT, leads to the formulation of the following conclusions and challenges.

Conclusions

FT does not protect inefficiencies. Adequate quality and timely logistics are preconditions for FT: *a fair price for a fair quality product*. The FT rules of the game establish the incentives for developing trade of a produce of the highest potential. Smallholder producers can gain access to markets by means of true partnership between producers, traders and retailers (pro-active networks).

The EC import regulatory system discriminates between smallholder producers of the south by benefiting ACP countries and traditional traders. The EC import regulatory system protects inefficiencies at the expense of consumers. Less regulated markets are needed to allow further development of FT.

Challenges

Policies for FT should focus more on the compliance of minimum social and environmental standards and less on setting and manipulating prices. Policy-making on the import regime in the EC should not be based only on political criteria and relations of power among countries but policy-making should incorporate criteria of sustainable development. The EC policy should favour trade of those bananas grown under true (not artificial) sustainable and fair practices in developing countries.

Everybody can cooperate to develop FT: as consumers and/or active participants in pro-FT networks. Activities can consist of providing assistance to the development of FT chains, raising public awareness and facilitating information.

REFERENCES

Arias, P., Dankers, C., Liu, P., et al., 2003. Overview of world banana production and trade. *In:* Arias, P., Dankers, C., Liu, P., et al. eds. *The world banana economy 1985-2002*. FAO, Rome, 7-12. FAO Commodity Studies no. 1. [http://www.fao.org/documents/show_cdr.asp?url_file=/docrep/007/y5102e/y5102e00.htm]

Chambron, A.C., 2000. *Straightening the bent world of the banana*. EFTA.

European Commission, 1993. *Council Regulation (EC) No. 404/93 of 13 February 1993 on the common organization of the market in bananas*. EU, Brussels. Official Journal L 047.

European Commission, 2004. *Communication from the Commission on the modification of the European Community's import regime for bananas*. European Commission, Brussels. EC 02/06/2004 COM(2004) 399 final.

FLO International, 2004. *Fairtrade fresh fruit: guarantees a better deal for producers*. Available: [http://www.fairtrade.net/sites/products/freshfruit/why.html].

Van de Kasteele, A., 1998. *The banana chain: the macroeconomics of the banana trade*. IUF, Amsterdam. [http://bananas.xs4all.be/MacroEconomics.htm]