Fairtrade, the Windward Islands and The Changing EU Banana Regime

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Background

The Caribbean banana market, and Windward Islands producers in particular, stand at a major crossroads – between a major liberalization abroad in the very near future, and a radical structural shift at home in the not-so-recent past. This note provides a background to these changes, an assessment of their potential impact, and the scope for reform and donor-funded assistance.

In December 2009, the European Commission (EC) and the major Latin American exporters signed an agreement to end decades of dispute over the EC banana trade regime, that benefitted Windward Islands producers (Dominica, Grenada, St Lucia and St Vincent and the Grenadines). The EC had been providing, through a complex system of quotas, licenses and tariffs, an incentive for traders and retailers to import bananas from the African, Caribbean and Pacific group of countries (the "ACP" countries) over their lower-cost competitors (largely in Latin America – the so-called "dollar bananas"). With each round of World Trade Organisation (WTO) litigation, this system was successively weakened, abolishing country-specific quotas, gradually reducing tariffs, and opening the European market to dollar bananas at the expense of their higher-cost counterparts in the Caribbean.

In the latest initiative, the EC and the Latin American producers have agreed to a deal whereby the latter would definitively cease their litigation, in exchange for a reduction in the EC banana tariff from its current level of €176/ton to €114/ton by 2017. In addition, the EC has undertaken a number of free trade negotiations that will likely result in duty-free, quota-free access for major producers in Central and South America, where even lower tariffs of some €75/ton have reportedly been agreed to by the EC. For the Windward Islands producers, whose smaller non-plantation farms, higher wages and difficult topography constitute a significant cost disadvantage, this market opening in Europe constitutes a formidable challenge, given that many producers are facing financial difficulties even at current prices.

At home, the Windward Islands' banana industries have undergone a significant liberalization that has substantially changed the nature of banana production. Most small Caribbean producers have seen precipitous drops in production (or ceasing of production entirely), due to a combination of factors. First, the WTO 'banana wars', coupled with stagnant real prices and rising costs, created a significant disincentive to enter and invest in the industry. Second, nearly every major banana marketing company fell into severe financial difficulties due

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to inconsistent supply levels, rising input costs and lack of effective financial management. Third, the industry struggled with an ineffective response to numerous pest infestations, decimating production levels over time. Finally, these unfavourable circumstances led to a wave of bankruptcy and, for those companies that survived, a privatization and liberalization process that saw the industry gradually fall from government control. While the privatization process created some successful increases in production in other Caribbean countries such as Belize and Suriname, in the smaller islands it often created multiple players fighting for a share of a shrinking market, in the process foregoing many of the benefits of economic scale that allowed the inherently uncompetitive industry to survive.

Fairtrade and the Windward Islands Banana Industry

In the face of the deteriorating market prospects, the Fairtrade movement has virtually single-handedly maintained a viable market opening for Windward Islands bananas, particularly to the United Kingdom. Briefly, the Fairtrade movement ensures that certified producers comply with key environmental, social and ethical practices; in return, these producers receive a higher-than-market price for their bananas – the Fairtrade price premium – that ensures their survival against unsustainable drops in the market. In the UK – the export market of CARICOM producers – bananas are the third most valuable item (after petrol and lottery tickets) sold in national supermarkets. According to the UK-based Fairtrade Foundation (www.fairtrade.org.uk), nearly one in every four bananas sold in the UK are labelled as Fairtrade, and the UK market for Fairtrade bananas has increased from 5,500 tonnes to 193,000 tonnes in 2008 with a total value of £150 million (nearly one-third of the total industry). In 2006, the Sainsbury's supermarket chain – already the UK's leading Fairtrade retailer – announced its plans to convert its banana stocks to 100% Fairtrade, leaving retail prices unchanged and aiming for a five-fold increase in volumes purchased by the chain. The Fairtrade market (which, apart from bananas, includes a wide range of goods including cocoa, coffee, cotton, flowers and clothing) extends to other large European markets, including the Netherlands, Germany, France and Switzerland.

The benefits for small Windward Islands producers are numerous. First, the Fairtrade label guarantees a minimum price (specified on a per box basis) to be paid to certified farmers. These prices, set at the minimum cost of production for Windward Islands producers, are often well above non-Fairtrade market prices, thus providing a price premium for Windward Islands producers that ensures their viability in a competitive retail market where bananas are often a "loss-leader" for large retail chains. Second, on top of this minimum price, a one-dollar-per-box 'social premium' is paid to the farmer's National Fairtrade Organization; a steering committee then votes for social projects to be undertaken within the banana-producing community or within the industry itself. Third, Fairtrade certification brings minimum standards with respect to treatment of labour, environmental care (particularly with respect to the prohibition of certain pesticides and other chemicals), record-keeping and traceability. Fourth, given their first-mover advantage over other producers (particularly those in Latin America) and the high media visibility of the WTO banana wars, Caribbean producers have long been associated in the public mind with 'ethical' consumerism and the need to support small producers. The combination of these multiple benefits and price supports have led to an exodus of banana growers in the Windward Islands away from the traditional banana companies and towards Fairtrade-certified bodies, particularly those falling underneath the Windward Islands Farmers' Association (WINFA) and its associated National Fairtrade Organizations. In the new liberalized and privatized Windward Islands banana reality, Fairtrade-certified organizations have achieved a near monopoly position in terms of number of growers registered and particularly with respect to export to the EU.

A Tightening Banana Market

Despite the optimism generated by the Fairtrade movement for Windward Islands bananas, the changing European market provides a number of warning signs for future production, employment and economic welfare in the Caribbean, including:

- An increasingly consolidated banana market, dominated by large plantation-based multinationals and monolithic European retailers who are competing in a highly price-conscious EU retail market, where small Caribbean producers have little to no say in market forces which determine supply and demand levels;
- Low market growth, particularly in mature Fairtrade markets such as the UK, Germany, France and the Netherlands, coupled with

strong price competition from other, emerging low-cost Fairtrade-certified producers in Latin America;

- Strong competitive pressures from producers in Latin America, Asia, and Africa, with significant potential for new production and export in India and Brazil;
- Continued retail price wars over bananas, where major retailers (e.g. Tesco, Sainsbury's, Asda, Aldi) are willing to drive down banana prices (even incurring significant per-box losses) in order to continue to attract new customers; and
- Variable and unstable US dollar to Euro and Pound Sterling exchange rates.

Within the context of this tightening and increasingly uncertain market, the EC-Latin America banana deals could exert significant pressure on prices affecting the Windward Islands. Based on the assumption of the full impact of any EC tariff cuts being fully passed on to the consumer, the EC-Latin America banana deals and any potential free trade agreements *could cause the wholesale banana prices in the EU to fall by at least US$2.58 per box.* The estimated impact on wholesale prices, shown in Table 1 (based on an assumption of 18.5kg/box and a constant exchange rate of US$1.38/euro), gives a likely minimum for future price decreases, given that supply conditions and stronger price competition may push prices down further than those envisaged by the EC tariff cuts.

Table 1: Estimated Price Decreases (Per Box) from EC Tariff Cuts

EC-Latin Banana Deal (€176/ton to €114)	
Decrease EUR/box	1.15
Decrease US$/box	1.58
EC-Latin FTAs (€114/ton to €75)	
Decrease EUR/box	0.72
Decrease US$/box	1.00
Total decrease US$/box	2.58

Source: Author's estimates.

A Future for Windward Islands Bananas?

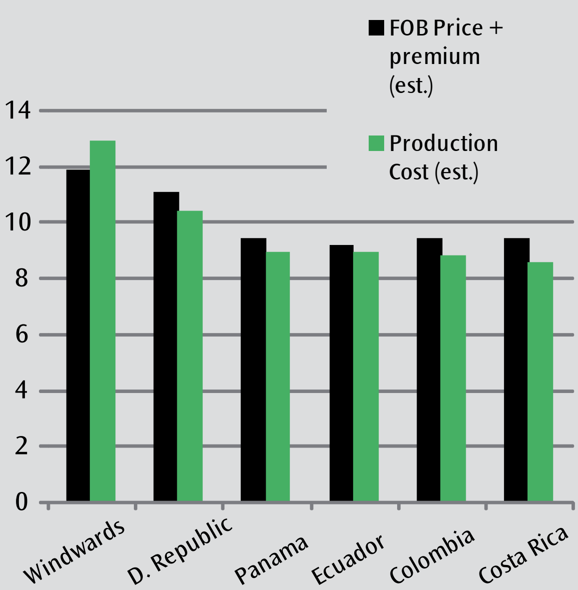
The impact of this general market price fall on the Windward Islands is not precisely clear, given that Fairtrade minimum prices are set according to a complex back-and-forth process between the certified producer organizations, exporters, importers and major EU retailers. The fallout of lower market prices will largely depend on the dynamics of future Fairtrade price reviews. This process has, thus far, provided a vital mechanism for balancing the high Windward Islands production costs with the realities of market competition. The objective of the Fairtrade price review process is to establish an agreement between producer organizations, market buyers and the various Fairtrade organizations as to what constitutes a 'sustainable' minimum price per box of bananas. The innovation of the Fairtrade banana price review process, last held in October 2009, lies in the fact that it brings *all* major market participants together in a common forum, to agree on a set of minimum prices that will apply across all producing regions, with stakeholders including officials from the Fairtrade Labelling Organizations International (FLO), serving as a coordinator of the process, representatives from the various producer organizations (e.g. the National Fairtrade Organizations, WINFA), and representatives from importers and buyers (e.g. Winfresh, Sainsbury's). While individual costs of production are the key basis for minimum prices, the Fairtrade process has also provided an incentive for all producers to maintain a stable market. For example, in 2009 there was an agreement between banana producers to ensure that the minimum prices were set in such a way that, after considering tariffs, shipping costs and the crossing of the Panama Canal (for Peru and Ecuador), there would be a general equality of prices at the retail level – i.e. to ensure a viable market for all producers and avoid 'unfair' competition between Fairtrade producers.

The EC tariff cuts however present a serious challenge to the Windward Islands and their viability in the Fairtrade process. At present, the current combination of production costs across the industry, the current EC tariff of €176/ton and the current transportation costs to the EU market have created a sort of equilibrium where EU wholesale prices can be more or less equalized through the Fairtrade price review process. The combined impact of the EU-Latin American banana deal and upcoming free trade agreements will likely destabilize this careful equilibrium through a number of channels. On one hand, the deals will lower the cost of importing non-Fairtrade bananas by the US$2.58 per box estimated above, making Fairtrade bananas more expensive by comparison, and creating strong profit pressures from EU supermarkets and buyers to increase their purchases of non-Fairtrade bananas. Second, the deals will lower the cost of importing Latin American Fairtrade bananas, making Windward Islands Fairtrade bananas prohibitively expensive by comparison, and potentially undermining the producer solidarity that has thus far provided crucial support to the Windward Islands' requests for high prices.

These trends suggest that in the next Fairtrade price review, there will be strong pressure on the Windward Islands producers to either freeze their Fairtrade minimum prices, or exit the Fairtrade process completely. The Windward Islands, as shown in Figure 1 below, are the only major group of Western hemisphere Fairtrade producers whose estimated production costs are above their minimum price plus the US$1.00 per box social premium. More worryingly the Windward Islands' efforts to reduce industry-wide costs face a number of obstacles. High production costs are tied to low plant productivity levels (which in turn raise the costs of inputs used to produce individual boxes of fruit) and low labour productivity. This low productivity is in turn constrained by a deep-rooted 'semi-professional' approach to banana production in some Windward Islands farms – where decisions with respect to production are not consistently viewed through a commercial lens – and the aging of the banana labour force, wherein low wages, low profits and high entry costs (esp. land) discourage younger entrants.

In order for the Windward Islands to remain in production as viable Fairtrade exporters, there is a pressing need for exit of less productive farmers. At present, Windward Islands farmers are caught in a double bind of high input costs and low yield/productivity per acre. With rising input costs (leading to higher minimum prices) and falling prices for other Fairtrade competitors arising from EC tariff cuts, producers in the Windward Islands will likely need to contemplate a scenario wherein less productive farmers – i.e. those whose farms lie on less productive land, or who have faced chronic difficulties in fully adopting agricultural best practices and new market standards – exit banana production and export and allow a "core" of commercially viable farmers to continue supplying

Figure 1:
FOB Prices Plus Fairtrade Premiums / Production Cost Comparison (US$)



Source: Fairtrade Labelling Organizations International (FLO).

the EU Fairtrade market. Such a reduction in numbers, likely applied through minimum yield requirements, would allow producer organizations (such as WINFA and the National Fairtrade Organizations) to provide a higher level of service and productivity-enhancing investments using social premium funds, rather than being burdened by excessive debts from less productive farmers who are unable to adequately pay for inputs. Analysis and consultations undertaken by the Commonwealth Secretariat in 2010 *suggest that only growers whose productivity lies above a threshold of 12-15 tons/acre were likely to continue commercially viable export.*

Based on stakeholder consultations, the number of commercially viable farmers is estimated at between 30-60% of current levels. The impact on production however is unlikely to be as strong, given that the present commercial core of farmers produces the majority of banana output. Any drop in grower numbers will inevitably have a negative additional impact on banana-related employment. The reduction in both grower numbers and production is likely to lead to severe associated falls in non-grower banana-related employment, both direct (e.g. distribution, harvesting, packing) and indirect. Based on stakeholder consultations, the fall within individual countries is feared to be about 20%.

Conclusion

In order to ensure the continued viability of Windward Islands export under the Fairtrade label, a much more vigorous policy and support measures will be needed in assisting Windward Islands producers in the production, export and price review during every stage of the Fairtrade process.

First, governments and development partners should assist efforts to identify the core of 'commercially viable' farmers on each island, and then put into place adequate support measures to ensure their viability and economic health. These measures include detailed assessments of farm-level conditions, support for stronger pest control, rebuilding of extension services and infrastructure, increased farmers' grounding in basic business concepts, stronger insurance coverage against natural disasters, and a closer look at the feasibility of joint purchasing arrangements for fertilizer and pesticides. For those farmers who choose to diversify into other crops or agriculture-based activities (e.g. agritourism), or choose to leave the industry, donors and national governments should be ready with adequate financing and support programs to minimize potential decreases in rural employment and social well-being. Only when these support programs have been identified and put into place will the Windward Islands be able to focus resources on commercially viable production.

Second, development partners should sensitize their lending programs to the unique challenges posed by the Fairtrade price review process, with a view towards strengthening the position of Windward Islands producers and ensuring that their needs are adequately considered when setting minimum prices. The most important intervention by far is the strengthening of both WINFA and the National Fairtrade Organizations to support their members through each stage of the Fairtrade price review. A key determinant of prices received by the Windward Islands producers is the capacity of their representative organizations to clearly articulate and argue the need for higher price premiums based on their relatively higher-cost production structure, and more importantly secure long-term commitments from EU supermarkets in favour of small and/or high-cost suppliers. In order to reinforce WINFA's negotiation capacity, there is an urgent need to support stronger and more frequent economic analysis of what constitutes "sustainable" costs of production in the Windward Islands, better analysis of the costs of certification and production (including production forecasting, quality management and other certification-related data analysis), and ongoing support for meetings of regional and international producer associations and participation of CARICOM delegations at Fairtrade price reviews.

Third, and perhaps most importantly, there is a need to ensure that donor funding reflects the new economic reality of banana production in the Caribbean. Now that the industry has largely passed into private hands – particularly in the case of the Windward Islands and the National Fairtrade Organizations – there is little reason for, year after year, millions of Euros to pass from the EC funding instruments in Brussels to Caribbean national governments, many of whom have significantly divested themselves from the sector, and whose objectives may or may not be fully aligned with those of the producers "on the ground". Given the challenges facing the sector, is it absolutely essential that any development cooperation funds destined for bananas (or banana-related adjustment) reach the producers as quickly and directly as possible, with a minimum of transaction costs. The most important step in achieving these targeted interventions will be to build the capacity of producer organizations (such as WINFA) to directly channel and administer donor funding, establish Project Management Units (or PMUs) directly within their offices, and tender and manage projects according to their own needs and objectives. Only when producer organizations are adequately strengthened – through proper staff numbers, IT infrastructures, adequate budgets and proper accounting and financial controls – and are prepared to make difficult choices commensurate with the new commercial reality of the global banana industry, will the Windward Islands banana industry be able to truly overcome the challenges posed by recent changes in the market.

International Trade & Regional Co-operation Section at the Commonwealth Secretariat

This Trade Hot Topic is brought out by the International Trade and Regional Co-operation (ITRC) Section of the Economic Affairs Division (EAD) of the Commonwealth Secretariat, which is the main intergovernmental agency of the Commonwealth – an association of 54 independent states, comprising large and small, developed and developing, landlocked and island economies – facilitating consultation and co-operation among member governments and countries in the common interest of their peoples and in the promotion of international consensus-building.

ITRC is entrusted with the responsibilities of undertaking policy-oriented research and analysis on trade and development issues and providing informed inputs into the related discourses involving Commonwealth members. The ITRC approach is to scan the trade and development landscape for areas where orthodox approaches are ineffective or where there are public policy failures or gaps, and to seek heterodox approaches to address those. Its work plan is flexible to enable quick response to emerging issues in the international trading environment that impact particularly on two highly vulnerable Commonwealth constituencies – least developed countries (LDCs) and small states.

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ITRC undertakes activities principally in three broad areas:

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- It conducts policy research and consultations that increase understanding of the changing of the international trading environment and of policy options for successful adaptation.
- It contributes to the processes involving the multilateral and bilateral trade regimes that advance the more beneficial participation of Commonwealth developing country members, particularly small states and LDCs.

ITRC Recent Activities

ITRC's most recent activities focus on assisting member states in the WTO Doha Round and the Economic Partnership Agreement (EPA) negotiations involving the African, Caribbean and Pacific countries (ACP) and the European Union (EU), undertaking analytical work on a range of trade policy and development issues, and supporting workshops/dialogues for facilitating consensus-building on issues of Commonwealth members' interest, exchange of ideas, and disseminating results from informed analysis.

Selected Recent Meetings/Workshops supported by ITRC

28 June 2010: Consultation Meeting on WTO Accession, held in Brussels, Belgium

26 June 2010: Workshop on Policy Barriers in Intra-regional Trade in South Asia, held in Dhaka, Bangladesh

14-15 June 2010: High Level Workshop on Aid for Trade in East African Community countries, held in Dar-es-Salaam, Tanzania

3-4 June 2010: Trade policy Workshop with the Members of Parliaments in the Pacific, held in Samoa

27-28 May 2010: Trade policy Workshop with East African Members of Parliaments, held in Arusha, Tanzania

4 May 2010: Workshop on Potential Supply Chains in South Asian Textiles and Clothing, held in Colombo, Sri Lanka

3-4 May 2010: Commonwealth Investment Experts Group Meeting for the Pacific, held in Port Vila, Vanuatu

3 April 2010: Workshop on Developing Supply Chains in the Textile and Clothing Industries in South Asia, held in Dhaka, Bangladesh

15-16 March 2010: Commonwealth Roundtable - Regional Trading & Integration Arrangements, held in Hampshire, UK

2 November 2009: High-Level Meeting for WTO Representative of ACP Missions, held in Geneva, Switzerland

26 October 2009: Discussion meeting with the WTO's Geneva Week Participants, held in Geneva, Switzerland

Selected ITRC Publications

Cali, M with Kennan, J (2010). 'The Global Financial Crisis and Trade Prospects in Small States', Economic Paper, London: Commonwealth Secretariat.

Milner, C et al. (2010). Policy Responses to Trade Preference Erosion: Options for Developing Countries. London: Commonwealth Secretariat

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Mbirimi, Ivan (ed) (2007). After Hong Kong: Some Key Trade Issues for Developing Countries. London: Commonwealth Secretariat.

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- Commonwealth Investment Framework Agreement
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- Issues of investment within SADC and COMESA regions in relation to ACP-EU Arrangements
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