

DFID AND FAIR TRADE

DRAFT PAPER FOR DISCUSSION

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A. EXECUTIVE SUMMARY

1. If the Millennium Development Target of halving the proportion of people living in extreme poverty by 2015 is to be achieved, trade has a crucial role to play. DFID's latest White Paper supports the creation of a fairer international trading system that helps make globalised markets work better for the poor. Collaborating with donors, governments, the private sector and civil society, DFID seeks to assist enterprises in poor countries to capitalise on the opportunities, and defend themselves from the threats, resulting from globalisation.

2. Fair trade (FT) is a small but significant part of the international trading system that seeks explicitly to achieve these goals. It aims to build more equitable trading partnerships between north and south, by securing the rights for, and offering better prices to, disadvantaged southern producers. The purpose of this position paper is to understand the current status of the FT movement, and to determine how DFID can best support these objectives.

3. Sales growth of FT products in developed countries over the past five years has been dramatic. There is every indication of this trend continuing, as more FT standards are agreed, and more products become available. The ongoing success of companies such as Café Direct underlines the maturing of the FT market 25 years after its creation. Some companies that started out with significant levels of donor support now operate independently, by targeting consumers who are prepared to pay a premium. As a developmental tool, FT does bring income benefits to poor producers. Furthermore, case studies highlight the positive impact on producer groups of the related non-commercial capacity-building and empowerment FT activities.

4. However, throughout the industry, many core FT activities are still supported primarily by donors, and lack sustainability. These activities include capacity-building, the development of the FT label, marketing campaigns, and in some cases, price subsidies. Moreover, FT is still only a very small, niche market in the context of north-south trade. Even given sustained growth, the volume of FT trade is dwarfed by overall trade flows. *The key challenges to the industry are therefore to maintain high product quality and ethical standards, to increase the size of the FT niche, and to catalyse reforms to the pattern of trade in mainstream markets.* This will encourage more businesses to adopt similar practices, benefiting many more small-scale producers.

5. DFID has supported FT initiatives for a number of years, through direct support to the FT movement, development education in the UK, and its regional programmes. There is strong justification for continued support for the industry-wide elements of FT. The experience of DFID and other agencies suggests that a combination of measures – research and communication of best practice; stronger product marketing; refinement of the FT label; strengthening development and independent monitoring of FT standards; and continued commercialisation of the industry - are all needed to advance this mainstreaming process.

6. *This paper advocates continued support to FT, but suggests DFID should not single out the sector for special attention. Instead, it should support FT where this complements existing private sector development programmes, builds on the comparative advantage of specialist agencies, feeds into Whitehall initiatives, and joins up DFID's work with other donors.* DFID therefore proposes to support FT where:

- It assists southern producer groups to meet changing market demand and brings about sustainable improvements to their livelihoods
- It catalyses improved trading relationships for poor producers and employees in mainstream supply chains
- It complements existing DFID programmes that tackle wider issues of trade policy or market access for the poor
- It promotes learning between the FT movement, mainstream companies and donors, and co-ordinates FT support more effectively

7. Specific activities that DFID proposes to support are:

- Impact assessments that test the claims of the FT movement, identify best practice, and lead to improved pro-poor impact
- Capacity-building programmes for business service providers in developing countries that link producer groups with domestic and international markets
- North-south business linkages between FT organisations and buyers seeking to trade more ethically
- Marketing campaigns to promote the principles of FT as part of wider efforts to integrate poor countries into international trade
- Development of internationally agreed FT labels by FLO, including initiatives to increase the participation of southern producers in setting and monitoring of FT standards
- Strengthening independent auditing of the FT label to ensure the validity of the guarantee they represent to consumers

B. FAIR TRADE AND GLOBALISATION

8. For better or worse, poor people's livelihoods are increasingly influenced by the workings of a global market for goods and services. The FT movement is a dynamic and diverse grouping of companies, NGOs, alternative trading organisations and producer groups. It was founded upon a sharp critique of the global trading system, but works to reform it from within. FT institutions campaign to highlight exploitative practices, whilst showing how trade - fair trade - can positively impact the lives of the poor. The key challenge facing FT organisations today is how to use the experience and knowledge gained over the past 25 years to promote fundamental change in mainstream markets.

9. The purpose of this position paper is to establish the relative importance of FT in the context of international trade, and how DFID should work with the movement in support of these objectives. The remainder of this paper provides: an overview of FT;¹ its principal achievements; debates within the FT movement; key principles that should guide DFID's support; and recommendations for future activities.

C. THE FAIR TRADE MOVEMENT

Definitions

10. The following definition of FT was agreed at a conference held in Arusha, Tanzania in June 2001 by the International Federation of Alternative Trade:

*Fair Trade is a trading partnership, which seeks greater equity in north-south trade. It contributes to sustainable development by offering better trading conditions to, and securing the rights of, disadvantaged producers in the South. The Fair Trade movement is actively engaged in supporting producers, in raising awareness, and in campaigning for changes in the rules and practice of conventional international trade*²

11. This definition defines four distinct elements of FT activity:

- As Market Participants: FT organisations engage in a trading partnership with producers. By demonstrating the viability of longer term, more equitable trading relationships (rather than those based purely on commercial transactions), FT organisations aim to bring about changes to trading systems, whilst creating sustainable businesses.
- As Agents of Redistribution: FT organisations seek to capture and pass on to primary producers a premium that increasing numbers of consumers are prepared to pay for fairly traded retail products. By

¹ This overview is drawn from the DFID-funded study by OPM (2000) concentrating on FT in the UK and, to a lesser extent, Europe. FT organisations in the Americas, Japan and Australasia were not included.

² IFAT is a network of FT organisations.

pressing importers and processors to guarantee producers a minimum price, FT transfers price risk from the most vulnerable producers, to intermediaries higher up the supply chain that are better resourced to bear it.

- As Agents of Empowerment: FT organisations seek to assist producers to engage in international commerce on more favourable terms. This comprises training, trade credit, organisational development, or marketing advice.
- As Agents of Advocacy: FT organisations campaign to secure changes to international trade in specific commodities. They raise awareness amongst northern consumers about problems faced by southern producers, and the effect of consumption patterns and international trade policy on the south. Many northern FT organisations are also engaged in development education, producing information packs for school and college curricula.

FT Labelling

12. A tighter definition of FT emerges from scrutiny of the international FT standards. To date, these standards have been developed for seven different product categories (chocolate, coffee, tea, honey, bananas, sugar and orange juice).³ Many criteria are product-specific, but the following principles apply:

- Producer organisations must be owned by and accountable to their members (predominantly smallholder farmers)
- Plantation or factory workers must be free to participate in trade union activity and enjoy decent wages, housing, health and safety standards
- Relationships between producers and buyers must be long-term, based on contracts that encourage long-term planning and sustainable production practice
- A pricing formula must be established guaranteeing a minimum price payable to members, plus a social premium paid to producers' organisations for capacity-building or community projects⁴

13. Maintaining high FT standards is crucial. Use of an FT label guarantees to consumers that a product is sourced from an approved producer, in an approved manner. FLO International develops and maintains these standards, accrediting producer organisations and managing registers that list them. In the UK, the Fairtrade Foundation is responsible for certifying specific products, raising awareness about the FT mark, and ensuring compliance with it. Manufacturers pay a license fee for use of the label on their products, as a contribution towards auditing and monitoring costs.

³ There are plans in 2002 to develop further product standards for cut flowers, dried fruits, and rice. There are currently no international FT standards for handicrafts.

⁴ See Annex 1 for further information on the main features of FT labelling.

Other Trade Movements

14. Close links exist between FT and other trade movements and initiatives:⁵

- Ethical Trade (as in the DFID-funded Ethical Trading Initiative in the UK) focuses on workers' conditions and rights. It responds to the risks to companies' reputation and productivity posed by bad employment practice. Companies seeking to trade ethically establish minimum employment standards that must be met by their suppliers. In contrast to FT, ethical trade initiatives do *not* aim to change terms of trade, nor proactively to reach marginalized producers.⁶
- Environmentally-Driven Trade focuses on ensuring that traded products are produced by environmentally sustainable methods. Eco-labels abound. Examples include the Forest Stewardship Council label for timber and the "Conservation" label for coffee and cocoa, which signifies that the crop has been grown under forest canopies that support biodiversity.

15. These different types of alternative trade overlap considerably. From the perspective of consumer demand, individuals and organisations sensitive to environmental issues are also commonly concerned with social justice. On the institutional supply side, there is significant overlap in the standards set. For example, the FT labelling criteria for tea grown on plantations match many of the ILO's core labour standards adopted by the ETI.

D. ACHIEVEMENTS OF THE FAIR TRADE MOVEMENT

Sales Growth

16. According to EFTA, annual FT sales in Europe in 2000 reached Euros 200m.⁷ Historically, handicrafts were the most important FT sector. However, the strongest recent growth has been in food and beverages, with total FT label sales in the UK increasing 34% in 1998 and 26% in 1999, to £23.2m.⁸ As illustrated below, four product categories – chocolate, tea, coffee and (most recently) bananas account for most UK sales.

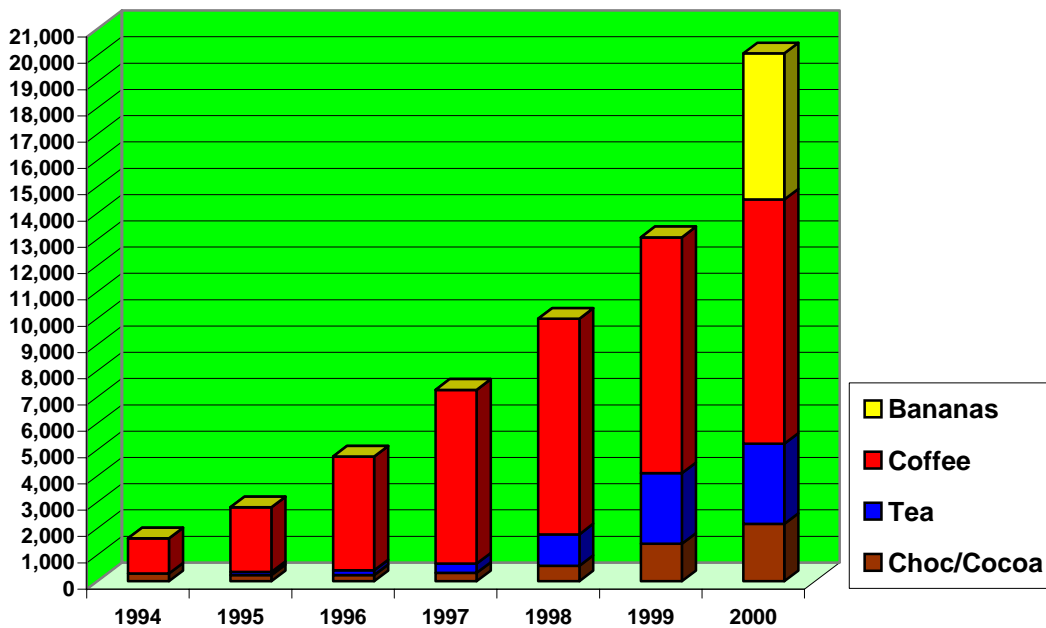
⁵ FT has no connection with the UK's Office of Fair Trading, which is concerned with consumer protection

⁶ See Annex 2 for distinctions between FT and Ethical Trade.

⁷ Source: OPM (2000:13). The Fairtrade Foundation estimated *global* retail sales of FT goods in 2000 at Euro 232m. This indicates the underdevelopment of FT markets outside Europe.

⁸ Source: Fairtrade Foundation 1999/2000 Annual Report

UK Fairtrade Product Annual Sales Growth by Value (£'000)



17. Whilst in the past FT products were sold only through dedicated FT outlets, nowadays handicrafts, foods and beverages are found in an increasing number of department stores and supermarkets. The Co-operative Group (CWS Ltd) reported year-on-year increases in FT sales of 71% in 1998 and 85% in 1999, and last year became the first supermarket multiple to launch its 'own label' FT product.⁹

Café Direct shows how FT brands can rapidly gain market share. Established in the UK by a consortium of four ATOs (Oxfam, TWIN Trading, Traidcraft and Equal Exchange) the company sources coffee from 18 small-scale farmer associations in nine developing countries. Café Direct's expanding coffee range is now stocked by all major supermarkets. Owing to high product quality, successful advertising and widespread availability, Café Direct now claims 4% by value of the UK roast and ground coffee market, with sales of over £6 m per annum.¹⁰

Growing Consumer Awareness

18. UK consumer surveys indicate that a growing percentage of the public are now aware of FT issues. Clearly this is in part cause, in part consequence of the increased visibility of FT products on supermarket shelves. Campaigns such as the DFID-funded FT Fortnight, co-ordinated annually by the Fairtrade Foundation, alert potential customers to the products available and where they can be bought.

⁹ An FT milk chocolate bar from the Co-op, produced in association with the Day Chocolate Company was launched in March 2000.

¹⁰ Source: 1998-99 Café Direct Factsheet

19. Non-FT companies are responding to increasingly knowledgeable consumers in a number of ways. Some have made their own trading practices more transparent, in order to offset the risk of adverse publicity. Others have gone further, and have begun working with FT organisations to source new products. Traidcraft, for example, has been approached by buyers to identify FT suppliers of specific products. FT campaigning agencies now play an important role in highlighting the exploitative practices of certain TNCs, promoting greater corporate social responsibility and the development of voluntary networks such as the Ethical Trading Initiative.

International Advocacy

20. Individually and collectively, FT organisations are pressing governments and multilaterals for changes to the international trading system. The European Fair Trade Association (EFTA) has lobbied for the recognition of FT labels by the EU, and the abolition of measures such as Common Agricultural Policy, escalating tariffs and quotas that frustrate the development of European export markets by southern producers.

21. Whilst FT lobbying has met with a mixed response, Article 23 of The Cotonou Agreement between ACP countries and the EU does commit signatories to support '*trade development, including the promotion of fair trade*'.

Empowerment of Southern Producers

22. Interestingly, case studies suggest that the most important contribution of FT initiatives in developing countries has been to strengthen capacity of producer groups and to increase their bargaining power. Successful organisational development and marketing support, provided as part of the FT package, can generate gains far beyond the commercial value of the products traded through FT channels. It is worth noting here that the quantities of product designated 'FT' (i.e. attracting the price premium) may represent only a small proportion of the total volume sold by a producer group. For example, Kuapa Kokoo, a co-operative of smallholder cocoa growers in Ghana, sells less than 5% of its cocoa to FT buyers.

23. Northern FT organisations frequently go beyond the provision of market information, technical advice and traditional business development support, and focus on facilitating greater participation and self-confidence in civil society structures that emphasise accountability and transparency. The FT relationship can also provide a solid platform for producers to innovate - for example, converting to organic farming methods.

The Kilimanjaro Native Co-operative Union (KNCU) comprises 96 coffee grower societies around Mt. Kilimanjaro in Tanzania. Although only 10-15% of the coffee KNCU purchases from members is sold to FT

organisations, this has played a big part in developing KNCU's exports. Twin helped set up KNCU's export office, trained their Export Manager, and linked KNCU with commercial coffee companies. Fair Trade Organisatie, a Dutch ATO, is assisting KNCU farmers to convert to organic farming, and obtain organic certification.

Poverty Impact

24. Marketing of FT is founded on a simple message: "buy fair trade products and help reduce poverty in developing countries". However, the reality is more complex. FT-labelled goods have higher retail prices than equivalent non-FT goods. The amount of the price differential that actually reaches producers is hard to calculate. Diseconomies of scale mean that FT businesses face higher unit processing, distribution and retail costs vis-a-vis their larger commercial competitors. In addition, they must pay the FT license fee. As a result, the premium is never passed on entirely to the producer group.¹¹

25. Evaluations indicate that for many small-scale farmers, the income benefits of FT may only be small when commodity prices are buoyant. They become significant when commodity prices slump (as at present, with coffee and cocoa prices at 30-year lows). Where the volumes sold through FT channels are small, many co-operative unions opt not to pass their FT premium direct to members. Instead, premiums are used to finance improvements in health and education (as with Kuapa Kokoo) or improved agricultural extension services (with KNCU). However, even where direct income gains from FT are low, marketing knowledge gained through partnerships with FT organisations, and the presence of FT buyers on auction floors can help local producers secure higher prices from mainstream customers. Although it is difficult to quantify the extent to which this occurs, producer groups argue that these benefits far outweigh the value of the FT premium.¹²

26. In the handicrafts sector, the positive impact of FT on poverty appears more clear-cut. Here FT employment is often timed to coincide with the agricultural off-season, providing important alternative income opportunities for the rural poor. In areas of high unemployment and for certain types of worker (e.g. women and the disabled), such employment may be the only source of income, thus helping marginalised groups escape extreme poverty.

Donor Support

27. Several European donors support FT, although the level and type of that support varies. The EC provides funds to FT labelling organisations to promote new product lines, and supports research and advocacy by EFTA, as

¹¹ Mainstream and FT companies are reluctant to provide information on their operating margins. FLO has compared costs in the supply chains of conventional and FT chocolate [source: OPM (2000)]. According to these estimates, the higher f.o.b. cost of FT cocoa accounts for about 45% of the additional premium paid by consumers for an FT bar of chocolate.

¹² Point highlighted by Raymond Kimaro of the KNCU at the FTF Assembly, London, Sept 2001.

the umbrella body for European FT organisations. The Dutch Ministry of Foreign Affairs funds programmes to increase consumer awareness, including TV advertising to support the national FT label. The Belgian government, meanwhile, is establishing a guarantee fund to secure advance payment by importers of FT products to suppliers from developing countries. DFID's programme is varied (see paragraph 37) but seeks to enhance lesson learning, and establish coherent FT policy amongst European donors.

E. CHALLENGES FACING THE FT MOVEMENT

Growth, from a Low Base.

28. According to the Fairtrade Foundation's Annual Review, total FT label sales in the UK reached £23m in 1999/2000. Oxfam estimates total UK FT sales (i.e. including non-FT label crafts) at £50m per annum. By comparison, the mainstream market for goods where a FT alternative exists is massive, estimated at no less than £15bn per annum.¹³

29. FT's growth over the last three years has been dramatic. It shows every indication of continuing, as more FT standards are agreed and more products become available. However, FT remains a niche market and even with sustained future growth, the volumes traded are likely to remain very small relative to overall trade flows. The challenge is for FT to catalyse wider change in mainstream markets as more businesses adopt ethical or "producer friendly" practice.

Market Focus.

30. Expanding FT practice highlights the trade-offs inherent in FT activities. One of the goals of the FT movement is to redefine the terms under which trade is conducted. By agreeing higher prices with producers and entering long-term contractual relationships, FT organisations protect vulnerable partners from conventional market forces. But this can lead to dependency. There is growing recognition within the FT movement of the need to become more market-oriented, helping producer groups develop new products and expand into new areas. This is particularly true for handicrafts, where changing fashions demand that suppliers adapt quickly to new customer tastes.

Sustainability

31. There are legitimate concerns over the scope and sustainability of capacity-building or marketing services provided by FT organisations linking disadvantaged producers to international markets. Targets have often proved

¹³ Source: Oxfam "Rethinking Fair Trade" (2001)

over-ambitious, and the wider changes predicted in mainstream markets have failed to materialise. It is important therefore that support to FT organisations is based on a realistic assessment of what FT initiatives can achieve, and where their comparative advantage lies.

32. Even as trade volumes increase, licence fees charged by FT labelling organisations are still insufficient to meet the full cost of promoting, monitoring and developing FT standards. Critics also question the sustainability of offering producers significantly above-market prices for crops, when (for example for coffee) much of the present difficulty is the result of chronic over-supply. *The sustainability of FT rests on consumers' continued willingness to pay a voluntary subsidy for a product that they feel guarantees better prices for producers.* The recent growth in demand for such products indicates that more consumers are now willing to pay this subsidy, although decline in product quality or adverse publicity for FT could easily reverse this behaviour.

Labelling Schemes

33. FT labelling schemes have enhanced the penetration of FT goods into the market. However, a number of problems regarding the use of these labels need to be addressed.

34. First, there is the question of **scope**. As already mentioned, international FT criteria have been agreed only for a narrow range of products, and the FT Mark cannot be used on handicrafts or other food products. FT organisations buying and supplying goods not covered by the FT mark therefore cannot use the label, and market the product instead under their own brand name.¹⁴ This leaves consumers confused.¹⁵

35. Second, there is the question of **FT criteria** set by FLO. If they are defined too strictly, this deters mainstream buyers from dealing with FT suppliers. If less rigorous criteria are used, there is a risk of diluting potential benefits to producers. The process by which criteria are determined is also important, with many arguing that producer groups need a greater voice.¹⁶

36. Third, some **FT registers** (notably for coffee) are reluctant to accept new producer groups. This is principally because the FT market for certain products is expanding too slowly to absorb all the potential supply. FLO argues that a balance must be struck between maximising the number of producers, and avoiding spreading services too thin amongst individual smallholders for whom the benefits might be insignificant. Registering as a new FT producer does not guarantee that producer new sales, and might raise false expectations whilst also adding to the costs of maintaining the register. All these factors reinforce the need to expand the range and penetration of FT through strong marketing.

¹⁴ This is a particular problem for Traidcraft and Oxfam in the UK.

¹⁵ FLO and its members wish to streamline development of new standards so that more products can be labelled.

¹⁶ The first FLO Fairtrade Forum in Germany in September 2001 was attended by 100 producers across all FT product categories. The event elected the supervisory board of FLO on which producers are now represented. In addition, regional producer assemblies will give producers direct input into formulation of FLO policy.

37. Finally, there is the question of **verification**. To be successful, FT labels must be rigorously and consistently verified. FT audits are usually performed by northern FT labelling organisations. There is a need for local certification capability to be strengthened, both to reduce costs and to increase local participation in the process.

DFID's Support for FT

38. DFID's support for FT should be seen in the context of its wider commitment to reforming national and international trade to benefit the poor.¹⁷ Its current FT programme may be summarised as follows:

- Traidcraft Exchange (TX): TX provides business support agencies and individual enterprises in developing countries with exporting, wholesaling and importing facilities, linking them to commercial buyers in Europe. DFID country programmes have provided support to TX partners in Malawi, Zambia, Tanzania, India, and the Philippines.
- TWIN: In 1999, DFID provided the start-up costs of the Day Chocolate Company (DCC), which manufactures and markets fairly traded chocolate in the UK. This company is part-owned by northern ethical investors including TWIN, and part by Kuapa Kokoo, the Ghanaian farmer co-operative from which DCC sources its cocoa.
- Oxfam: Oxfam has recently carried out an EDF-funded feasibility study on a new FT tea brand, sourced from smallholders in India and Sri Lanka.
- Research Studies: DFID has commissioned several studies on FT, including an impact assessment study as part of the Enterprise Development Impact Assessment Information Service (EDIAIS). In addition, DFID is assessing the feasibility of incorporating FT products into own-label supermarket brands and food outlets.
- Raising Development Awareness: Through its Development Awareness Fund, DFID is supporting the media campaigns of FTF, and an educational pack for UK schools developed by Comic Relief and DCC describing the impact of FT on Ghanaian cocoa growers.

F. PRINCIPLES UNDERLYING DFID'S SUPPORT OF FT

39. DFID therefore proposes to support FT where:

- It assists southern producer groups to meet changing market demand and brings about sustainable improvements to their livelihoods

¹⁷ Annex 3 provides an overview of current DFID programmes to improve trading opportunities for the poor.

- It catalyses improved trading relationships for poor producers and employees in mainstream supply chains
- It complements existing DFID programmes that tackle wider issues of trade policy or market access for the poor
- It promotes learning between the FT movement, mainstream companies and donors, and co-ordinates FT support more effectively

G. SPECIFIC RECOMMENDATIONS

40. Specific activities that DFID proposes to support are:

- Impact assessments that test the claims of the FT movement, identify best practice, and lead to improved pro-poor impact
- Capacity-building programmes for business service providers in developing countries that link producer groups with domestic and international markets
- North-south business linkages between FT organisations and buyers seeking to trade more ethically
- Marketing campaigns to promote the principles of FT as part of wider efforts to integrate poor countries into international trade
- Development of internationally agreed FT labels by FLO, including initiatives to increase the participation of southern producers in setting and monitoring of FT standards
- Strengthening independent auditing of the FT label to ensure the validity of the guarantee they represent to consumers

H. LIST OF ABBREVIATIONS

ATO	Alternative Trading Organisation
DCC	Day Chocolate Company Limited
DFID	Department for International Development
EDF	Enterprise Development Fund
EDIF	Enterprise Development Innovation Fund
EDIAIS	Enterprise Development Impact Assessment Information Service
EFTA	European Fair Trade Association
ETI	Ethical Trading Initiative
FLO	Fair Trade Labelling Organisations International
FT	Fair trade
FTF	Fairtrade Foundation
IFAT	International Federation for Alternative Trade
ITD	International Development Target
NEWS	Network of European World Shops
TNC	Trans-National Corporation
TX	Traidcraft Exchange
WTO	World Trade Organisation

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