

**PRIVATE VOLUNTARY STANDARDS AND DEVELOPING COUNTRY
MARKET ACCESS: PRELIMINARY RESULTS**

Linda Fulponi¹, Senior Economist, Directorate for Trade and Agriculture, OECD, Paris.

Communication from OECD

The following communication, received on 23 February 2007, is being circulated at the request of the OECD.

Introduction

1. Access to OECD markets remains one of the leading demands of developing countries in the negotiations for agricultural trade liberalization. While tariffs can be important for market access, attention is now focussed on possible effects of standards on trade, in particular those set by private firms. Products must now meet not only the importing country regulations, but also satisfy requirements of private voluntary standards schemes (PVS), which are often more complex and stringent than those of governments (OECD, 2006; Henson and Reardon, 2005). Although these private standards are voluntary and not required by law, they are required for doing business, thus de facto mandatory (Henson and Northen, 1998; Fulponi 2006). The increasing use of private standards has raised concerns about market access for developing country producers, in particular small and medium producers, who may be capital constrained at the farm level and operating in countries whose lack of adequate infrastructure and services make compliance difficult and costly.

2. A recent OECD study identified three key developments in the food sector over the past decade: (1) the move to voluntary management systems for the monitoring of product and process attributes; (2) the emergence of coalitions of firms for setting private collective voluntary standards and (3) the increased use of global business to business (B2B) standards. Moreover, these developments are taking place in a socio-economic and institutional setting that is characterized by the increased voice of civil society in the governance of the food system, and by the integration of food firms within world financial markets. This implies continued pressure on firm financial performance and a permanent need to meet societal expectations as well as the expanding regulatory configurations. According to interviews with major retailer firms reputation in terms of safety and quality as well as developments in the legal and institutional frameworks for food safety, were seen as key factors motivating the development of private standards schemes (Fulponi 2006; OECD 2006).

¹ This paper is based on work carried out at the OECD, 2005-2006, but is under the sole responsibility of the author. It does not express the views of the OECD or its member countries.

3. Lead retailers are increasingly dominating the agro-food landscape in OECD countries and use specific PVS schemes in sourcing fresh products.. They can thus essentially decide what, how, who and when much of a specific produce is shipped to North countries and at what price (Nadvi and Waltring, 2003). Given the expected evolution of PVS schemes, it is important to reconsider these developments for impacts on market access of developing country exports.

4. To understand the possible impacts of private voluntary standards and developing country access to global value chains four case studies were undertaken. These were based on interviews with producers and exporters of fruits and vegetables in: Chile, South Africa, Peru and Ghana regarding their experience in the application of PVS for export markets. The fruit and vegetable (F&V) sector was chosen because these are high-value products with favourable export growth prospects and allow developing countries to exploit their abundant resource, labour. Moreover, trade in F&V has become increasing subject to private voluntary standards which appear to be increasing in scope and stringency.

A. SOURCING ALONG THE CHAIN

5. Trade in the fresh produce sectors is increasingly managed by global buyers who are linked to major retail chains.² Though these retailers only source about 25 per cent of their fruits and vegetables from the developing countries, off-season and tropical products, their imports are sizeable, thus providing a significant earnings opportunity for those developing countries who can comply with the standards (OECD, 2006). These are not the only markets available for developing countries.

6. Developing country producers are linked to retailers either directly or through exporters dealing with retailers or global buyers/importers. Exporters are responsible for ensuring that products meet quality, private standards' requirements, volumes and delivery schedules set by the buyer. While exporters may simply fulfil the task of a trader, many are also closely involved either in their own production and/or via out-growers who are generally small-scale operators. Thus they often have the key role in integrating small and medium size producers into export markets. Where small producers dominate production, such as in much of Africa and parts of Latin America, the exporter role is a combination of a farm manager, safety inspector and trader. They often provide inputs, supervise or perform chemical applications, undertake field level record-keeping, do necessary product testing, and ensure that all PVS requirements are met. In this hands-on management model they are the drivers behind the certification process for small and medium size producers.

7. Even where small producers are able to produce to quality standards, it is not clear they can retain their access to exporters given their size it may be simply too costly, in terms of transactions/management costs, for exporters to deal with many small producers. The Kenya green bean experience is often cited as an example of the results on small farmer access to markets due the rise in standards.³

² Procurement of fresh F&V has been consolidating with the rest of the food chain, centralized distribution centres have begun to serve chains over wide geographic areas. International trade in F&V is also handled by fewer agents as alliances between traders and grower-shippers (integrators) across continents begin to emerge in part to counter-balance the market power of the retailers (Cook, 2003). At the same time specialization is also emerging where a specialised seller will provide year-round availabilities of products following strict criteria from quality, to food safety and traceability.

³ Green bean production for UK markets began in the 1970s-80s with small farmers who delivered their production to local markets where exporters purchased them. As food safety standards rose and supermarkets gained a larger share of fresh produce sales, making quality and scheduling of quantities imperative, wholesale markets were no longer a reliable source for green beans of the quantity and quality desired. Direct purchases through integrators/exporters increased in the 1990s, and the UK Foods safety Act of 1990 spurred large retailers to develop written procedures laying out their requirements. These were then

B. WHICH PRIVATE STANDARDS?

8. All case studies found that the dominant private standards required at the farm level correspond to "Good Agricultural Practices" (GAP) schemes. These also incorporate regulatory requirements, particularly where their application is intended to facilitate trade.

9. EurepGap was the most frequently cited standard demanded by buyers. This supports the growing global reach of the standard and its importance in sourcing by lead retail chains. But not all retailers require it nor do all importers. Nonetheless its expansion is due to the large share of fruit and vegetable sales destined to the European market, in particular the United Kingdom and Netherlands in our sample. EurepGap standard was originally developed by the Euro-retailers fresh produce working group in order to harmonize minimum food safety standards.^{4,5} Though harmonization of requirements facilitates trade, the levels at which these are set can in the short run make compliance difficult and exclude some players. Nonetheless where exports have several destinations they must frequently comply with different standards simultaneously, due to differing regulatory frameworks and/or PVS. This is costly in time and money. Where some processing is undertaken by either exporter or producer, such as packaging, washing and cutting, firms must also comply with additional manufacturing standards.

C. COSTS OF COMPLIANCE, AUDITS AND CERTIFICATIONS

10. To comply with PVS requirements, investment in equipment and buildings for chemical storage, hygiene and temperature controlled facilities, are needed. For farms that are able to benefit from economies of scale, these are simply requirements for doing business. For small-scale growers where there are no economies of scale to be had, the costs may be prohibitive for them to enter the chain.

11. The most binding constraints to meeting the PVS are the upfront costs necessary to upgrade the farm itself to be compliant. This can include buildings for chemical storage, toilets, changing facilities and dining rooms, as well as the upgrading of packing and washing facilities. These costs will vary according to the standard adopted but also the initial conditions of the farm. For instance, in Ghana, EurepGap compliance costs for a 15-20 acre pineapple farm were about US\$ 400-500 but for large farms they are more substantial. For example, a 1000-acre pineapple exporter/producer has spent US\$ 80,000 to be EurepGAP ready.

12. Survey results indicate that once farms are compliant, the recurrent audit and certification costs of private standards were not excessive in relation to sales. For Chile, they amounted to one per cent or less of sales and in South Africa about four per cent. In Peru, these costs varied between four to 15 per cent of the farm gate price for mangoes, thus volumes will be a determinant of profitability as a portion of these costs is fixed irregardless of size. Even for Ghana, costs of audit and certification were relatively limited, US\$ 50 for an eight ha farm with sales of US\$ 20,000 and for a 400 ha farm with sales of US\$ 1.2 million, costs amounted to US\$ 12,500. EurepGap now provides for group certification and this reduces recurrent costs substantially.

followed up with audits of products and farms. The retailers also began to use annual contracts which gave suppliers and farmers stability and incentives for investments to upgrade. Consequently, those small holders unable to meet new retailer requirements were no longer able to supply the United Kingdom and other similar demanding markets and were marginalised. Only those that could remain tightly integrated with large exporters through contracts remain linked to the lead retailer trade. (Jensen, 2004, Dolan and Humphrey, 2000)

⁴ Other stakeholders in the chain now participate in the formulation of its requirements.

⁵ To meet such double or triple certification problem, Chile's exporter association, ASOEX, developed ChileGap, incorporating requirements of the US voluntary GAP and the EurepGap standard requirements.

13. Record keeping at the farm level has become complex because more and more information is being required by importers to satisfy retailers. Traceability requirements down to the field/orchard level often with a chemical application history are often being required. Though such is not required by regulations, some buyers may view it as a way to decrease risk and liability. This has meant that many farms must have managers to undertake the detailed record-keeping and these increases costs. Small scale growers are generally assisted by exporters who do this for them and debit their account. With new ICT technologies almost everything can be tracked and traced, but is it necessary?

D. INFRASTRUCTURES AND SERVICES

14. The case studies all concurred on the importance of good infrastructure and services for the development of a competitive fresh produce export sector. Telecommunications, energy supplies, roads, ports, rail and air systems with adequate cold storage facilities must be reliable in order to deliver the product to the buyer, intermediary or final. Where countries are inherently deficient in these, then meeting market requirements are frustrated and access to foreign markets difficult. This is particularly important for the high value fresh fruits and vegetables export sector which demands substantial coordination of production, transport, storage and delivery.

E. CHALLENGES AND BENEFITS OF PVS

15. There are both benefits and challenges to the emergence of PVS as an instrument for governing the food chain. Among the most difficult requirements or challenges cited by *exporters* were: recordkeeping by producers/out-growers; chemical use verification; management of different standards systems and their compliance; certification, in particular for attesting to good manufacturing practices; transforming the mindset of producers, particularly small and medium producers and meeting diverse country regulations.

16. For producers the main constraints voiced in the interviews were more related to changes required at the producer level, for instance in agronomic practices. These included: meeting food quality and safety standards, chemical use; worker hygiene; harvest and post harvest operations and accessing the cold chain. Both exporters and producers found that requirements related to maximum residue levels (MRLs); micro-biological contaminant prevention; pesticide selection, application and post harvest testing; record keeping and traceability at the field level were frequently costly and difficult to satisfy. For many of these requirements skilled labour is needed and it is often costly due to its scarcity. Investments required in buildings and equipment: chemical storage, hygiene facilities; as well as information on foreign market regulations and private standards compliance, can exclude certain producers that are the small scale growers without access to finance and skilled labour.

17. But there are also benefits from complying with PVS and these include: (1) access to the global value chain, which is essential for commercial exports to developed countries, and the possibility to develop longer term trading relationships; (2) improved efficiency in operations: reduced costs through better use of chemicals, organization of tasks, increased information on proper use and storage of pesticides to improve worker safety; (3) increased information on proper use and storage of chemicals decreased negative effects and (4) improved worker safety through proper attire for chemical use as well as through changes in storage procedures and separation of different tasks.

F. MEETING THE PRIVATE STANDARDS CHALLENGE

18. Private standards are here to stay and large retailers with market power will enforce them along with other commercial requirements such as volumes and flexible delivery schedules. In this environment producers/exporters in developing countries will need to be able to adapt to the rising standards. The largest and most able producers operating in countries with a good infrastructure,

services and experienced industry associations will fare quite well, even if there may be periodic adjustment costs. These demands are just a business requirement.

19. But for a very large segment of producers, that is small scale growers, in many developing countries, these may be too costly and difficult to satisfy. Some of the constraints are internal to the farm/farmer such as lack of physical and human capital which can be relaxed through finance and education. Some are external and relate to economy wide infrastructure and services, such as; lack of reliable energy supplies, low quality transport and telecommunications systems, lack of laboratories, lack of cold storage facilities and insufficient technical extension assistance. As a consequence, unless this segment of producers are able to operate around these constraints, often through producer associations, they may thus be excluded from markets linked to lead retailers in OECD countries. This does not mean being excluded from export markets in general.

20. In all likelihood, PVS will continue to increase in scope and stringency overtime (OECD, 2006). Coupled with trends in global sourcing, can small-scale growers be integrated and remain in the global supply chains over time? Given the sums necessary to be certified under the PVS schemes and the management efforts required, some may ask about development strategies postulated on small holder production of high-value F&V for export. Some suggest that there should be a greater push for trade between South-South countries, whose demands at present may be less stringent than those of the North. Others suggest greater assistance in upgrading these producers to meet the standard and the new competitive economic environment.

21. Though the sample is quite limited it provides initial empirical work across different countries using a common framework. These preliminary results suggests that: (1) compliance with PVS schemes are increasingly mandatory for accessing lead retailer supply chains; (2) exporters are the key link between importers/buyers and producers as they are responsible for transmitting demand specifications to all producers and frequently also for organizing, financing and overseeing production and certifications of small scale producers; (3) infrastructures and services at the macro and sector level, such as transportation and telecommunications systems, energy supplies and testing facilities, are indispensable for meeting commercial export demands; (4) small-holders have an increased risk to be excluded from lead retailer chains due to human and physical capital constraints in complying with PVS, and (5) government's role is viewed in the higher income countries as one of accompanying the producer and export industries through the provision of an appropriate infrastructure that enables industry to operate competitively.

22. This first attempt to understand the impacts of PVS on developing country access was to fill the gap on understanding how these may operate through the supply chain in developing countries. Further work will be carried out in this vein, through further work on Africa to be integrated into the programme of work on standards and trade and non-tariff measures. Such analysis needs to be empirical and to understand the specific and general conditions of the countries involved.

References

Fulponi,L., (2006) "Private voluntary standards in the food system: the perspective of major food retailers in OECD countries", *Food Policy*, 31:1 1-13.

Henson, S.J. , and J. Northen, (1998) "Economic Determinants of Food Safety Controls in the Supply Retailer Own-Branded Products in the UK", *Agribusiness* 14:2 113-126.

Henson, S.J. and T. Reardon (2005), "Private agri-food standards : Implications for food policy and the agri-food system" , *Food Policy*, 30:3 242-253.

Nadvi, K., and F. Waltring, (2003) "Making Sense of Global Standards" in H. Schmitz(ed) *Local Enterprises in the Global Economy: Issues of Governance and Upgrading*, Elgar: Cheltenham.

OECD, (2006) *Private Standards and the Shaping of the Agro-Food system*, Paris.

OECD, (2006) *Private Standard Schemes and Developing Country Access to Global Value Chains: challenges and opportunities emerging from four case studies*.
