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## UNFSS Discussion Papers

No. 6

### Assuring Coherence between the Market-access and Livelihood Impact of Private Sustainability Standards

Ulrich Hoffmann and Frank Grothaus



UNITED NATIONS

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## Assuring Coherence between the Market-access and Livelihood Impact of Private Sustainability Standards

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## Preface

Private sustainability standards (PSS) have been rather successful in facilitating access to the quickly growing international markets for such certified products. Many PSS have also been an effective tool in improving product quality, driving up the scale of production and easing the control of international supply chains, all elements that are of key importance for traders, processors and retail companies. The market-access impact has however not been in lock step with the income and livelihood impact at producer level, in particular for small-scale producers. The main challenge for PSS is how to scale up standard-compliant production, reaching beyond a relatively small number of larger, more developed and logistically better placed producers, aimed at deepening the developmental impact so that it is more transformative of livelihoods. This will require pro-active engagement of standard setters, donors, capacity-building NGOs, and in particular governments of developing countries that goes beyond market mechanisms. Furthermore, there is the need to level at least part of the economic playing field between conventional and PSS-compliant production.

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## Abstract

Private sustainability standards (PSS) have been rather successful in facilitating access to the quickly growing international markets for such certified products. Many PSS have also been an effective tool in improving product quality, driving up the scale of production and easing the control of international supply chains, all elements that are of key importance for traders, processors and retail companies. The market-access impact has however not been in lock step with the income and livelihood impact at producer level, in particular for small-scale producers. The main challenge for PSS is how to scale up standard-compliant production, reaching beyond a relatively small number of larger, more developed and logistically better-placed producers, aimed at deepening the developmental impact so that it is more transformative of livelihoods. This will require pro-active engagement of standard setters, donors, capacity-building NGOs, and in particular governments of developing countries that goes beyond market mechanisms. Furthermore, there is the need to level at least part of the economic playing field between conventional and PSS-compliant production.

## I. Introduction

Increasing globalization and the related emergence of international value chains has increased the awareness, concern and interest of consumers, primarily in developed countries, to limit the risks of outsourcing environmental and social problems through imported goods and services.<sup>1</sup> PSS are one of the tools that respond to these concerns by improving the sustainability management of international supply chains.

There are many different kinds of PSS, and the distinctions between them are not always clear. By definition, all sustainability standards are designed to contribute to 'sustainability', but they aim to do so in different ways. It is not necessarily the case that they will be treated identically in relation to national or international trade rules, or will have the same impact in terms of achieving public policy objectives. It is worth being aware of the differences, as criticisms of one type of PSS may not apply to all voluntary sustainability standards. Different kinds of standards may be appropriate for different purposes, or in different circumstances. In discussions, it may be necessary to be specific about the kind of standard that is being referred to, and to determine the characteristics of this particular standard, before deciding if it is suitable or unsuitable for a particular purpose.

There has been considerable debate as to whether PSS should be thought of as opportunities for or barriers to development. It is clear that they should create additional value in a supply chain, but it is equally clear that they would be expected to result in additional costs. If some producers are able to expand their market share by meeting sustainability standards, it is likely that the market share of others will shrink. Which participants in the supply chain capture any available increase in value, how costs and benefits are distributed at different points along the supply chain, which participants are most likely to benefit and whether others might also lose out from the introduction of standards – all these critical issues are uncertain. So long as the use of a particular PSS adds value in a supply chain, that added value might be of benefit to developing countries. However, there is no guarantee that this will be the case. And, conversely, if PSS are harder for producers in developing countries to meet than for those in developed countries, developing countries may lose market share.

How do these conflicting tensions work out in practice? It is unlikely that PSS will always turn out to be either an opportunity or a barrier. More likely is that the impact will depend on the context. An important quest may be to better understand the conditions that maximize the benefits of a

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<sup>1</sup> By way of illustration, for the European Union countries it is estimated that on average about 40% of total CO<sub>2</sub> emissions are embodied in goods imported from both within the EU and from the rest of the world. In some cases, the percentage of imported CO<sub>2</sub> emissions is over 50%, for instance for Austria, Belgium, the Netherlands, Denmark and Sweden

particular standard in a particular national context. Doing that requires the ability to evaluate the financial, social and environmental impacts of different standards.<sup>2</sup>

## II. PSS expansion, market share and growth rates

In recent years there has been a rapid expansion of PSS, which typically deal with production and processing methods related to environmental, social/ethical, health, food and occupational safety and animal welfare issues, in particular in the agricultural sector. Aiming to address such issues, these standards have the potential to support the achievement of public policy objectives related to sustainable development, including better market access and enhanced competitiveness as well as to contribute to sustainable market transformation, improved rural livelihoods and poverty alleviation. To date more than 450<sup>3</sup> sustainability schemes exist across economic sectors and are most prevalent in international agri-food supply chains (as can be seen in figure 1 below) and are either communicated to end-consumers via eco-labels or operationally between supply chain actors (business-to-business standards). The pace of their introduction accelerated considerably as the more frequent establishment of PSS in the last two decades illustrates.<sup>4</sup> Although compliance with PSS is voluntary they have in many cases become *de facto* requirements for market entry and a license to operate in important export markets; and they are becoming increasingly important in a number of domestic markets. Many PSS are also trendsetters for regulation and thus have considerable indirect effects on public policy mechanisms that should not be overlooked.

Their multiplicity and increasingly stringent, complex, multi-dimensional as well as often overlapping requirements have created confusion at both producers' and consumers' end. They have posed a number of systemic challenges in particular to small-scale producers in developing countries *inter alia* due to the associated high compliance costs and the risk of marginalization of smallholders and less developed countries. Besides, there is a risk that PSS are used as anti-competitive instruments for achieving vested commercial interests and their proliferation may jeopardize the integrity of their sustainability objectives. It also has to be noted that many PSS are part of an export-led approach, which poses a challenge to reflecting national priorities and respecting appropriate trade intensity of exporting countries. Moreover, most PSS tend to be one-dimensional on addressing environmental risks, economic or social challenges (for an overview also see box 1 below), which implies a challenge of assuring a holistic approach<sup>5</sup> (for a more elaborate analysis of this issue, see below).

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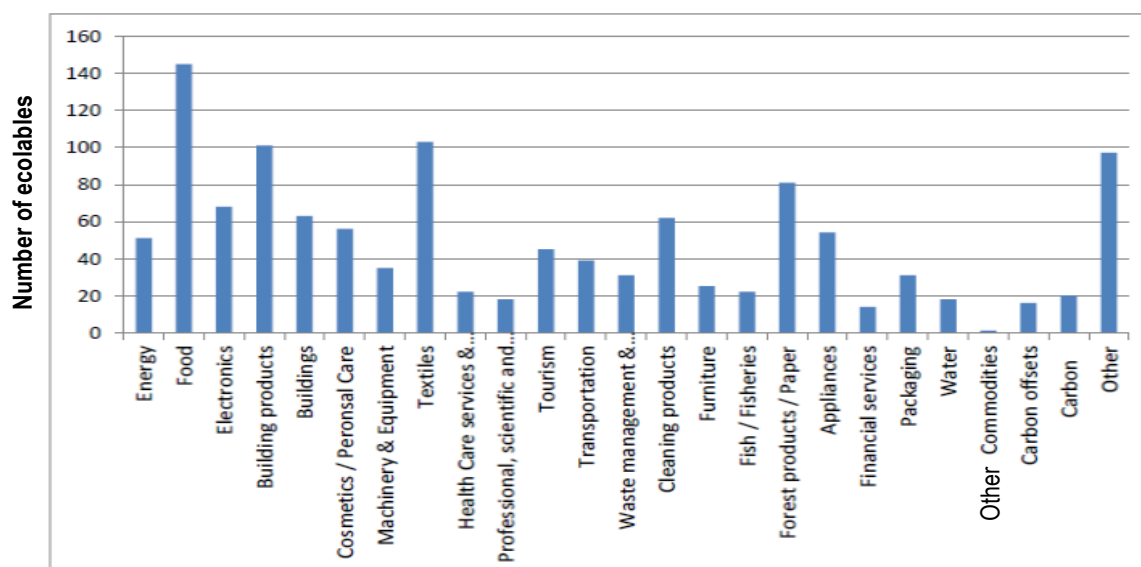
<sup>2</sup> For a more elaborate analysis, see UNFSS (2013).

<sup>3</sup> For an overview see: [www.ecolabelindex.com/ecolabels/](http://www.ecolabelindex.com/ecolabels/)

<sup>4</sup> Marx and Wouters (2014), page 3, Graph 1.

<sup>5</sup> Also see ITC (2013).

**Figure 1: PSS Distribution across economic sectors**



Source: Ecolabel Index Database (N=1218)

These systemic challenges point to the need of more closely analyzing not only the impact of PSS on trade and market access but also on achieving development objectives with a view to assuring a coherent development policy. On a positive note, these standards have already generated new and more stable market opportunities<sup>6</sup> and overall better export performance for those - often larger - producers who were able to fulfill the requirements of these new dynamic markets and entered associated international supply chains (see also Schuster and Maertens, 2014).

The uptake of PSS has increased both in terms of the **share of global food markets** and dynamic augmentation in **annual growth rates**. In sustainable agricultural markets the share of standard-compliant production as a percentage of global production doubled, tripled or even increased 7-fold for some commodities mainly driven by sustainable sourcing commitments of major food producing companies and moderately increased for others between 2008 and 2012 (see table 1).

**Table 1: PSS-compliant production as a percentage of global production for selected cash crops in 2008 and 2012**

Commodity	2008	2012
Coffee	15%	40%
Cocoa	3%	22%
Palm Oil	2%	15%
Tea	6%	12%
Cotton	1%	3%
Bananas	2%	3%
Sugar	<1%	3%
Soy Beans	2%	2%

Source: Potts et al. (2014: 90, figure 4.2).

As to the performance of single standards in the most dynamic sectors, the production of UTZ<sup>7</sup> and Rainforest Alliance (RA) certified cocoa surged at average annual rates of 363 per cent and 223 per

<sup>6</sup> For more detail, see Loconto and Dankers (2014: 33).

<sup>7</sup> UTZ was established in 2002 as UTZ Kapeh, which means “good coffee” in Mayan language.



cent respectively since 2009.<sup>8</sup> In coffee, production volumes of 4C Association (4C) compliant coffee increased by 49 per cent annually since 2008<sup>9</sup> and Fairtrade Labelling Organizations International (FLO) compliant production volumes increased by 13 per cent annually.<sup>10</sup> Impressive growth rates could also be observed for RA certified tea (its production volume surged about 190 per cent between 2010 and 2012 and RA certified land area coverage grew by 365 per cent); Fairtrade and UTZ certified tea production grew in the double-digit range.<sup>11</sup>

The figures above show a trend of rising market shares and annual growth rates for standard-compliant production in recent years. But as will be discussed below, it is arguable whether this is only due to the realization of “low-hanging fruit” or whether this trend can be sustained beyond these margins without watering down standards criteria to an extent that diminishes their impact, when more remote and, in terms of infrastructure, less connected smallholders are to be reached. The trend towards mainstreaming and rapid proliferation of certain standards, e.g. RA certified cocoa and tea or 4C coffee, has also to some extent been achieved at the expense of other standards of more transformative nature and with more demanding requirements (also see box 1 below). While RA certified cocoa production surged in recent years, the production (and sales) of organic cocoa considerably slowed down since 2009.<sup>12</sup> Similarly, while 4C compliant coffee production has increased since 2008, the share of organic coffee production declined and is now only on fifth place among relevant standards with production growth considerably below average compared to other standards in the sector.<sup>13</sup> Growth in organic tea production has only been 6 per cent annually since 2009, compared to 21 per cent annual growth between 2004 and 2009.<sup>14</sup>

### III. PSS-compliant sales and oversupply

In order to shed light on the income and livelihood effects of the trends described in the previous section, it is instructive - apart from looking at the development of production - to also take into account the actual standard-compliant sales volumes. Recent data on the sales of standard-compliant products disclose a discrepancy between the production volumes of standard-compliant products and the volumes of these products actually sold as PSS-certified. Across those commodities with the highest market penetration of standard-compliant production, only about one third to half of compliant production is actually sold as such (see table 2).

At the level of single standards, for instance, there has been a rapidly increasing oversupply of 4C certified coffee in recent years, with a production of 1,782,058 metric tons in 2012 compared to sales of 152,708 metric tons.<sup>15</sup> For UTZ certified coffee production, the ratio of production being sold as certified remained relatively constant, i.e. did not significantly improve (25 per cent in 2008 vs. 27 per cent in 2012), with both production and sales growing at similar rates, but at different levels (UTZ certified coffee production in 2012 amounted to 715,648 metric tons, sales to 188,096 metric tons).<sup>16</sup> In tea, standard-compliant production of organic slightly increased, whereas Fairtrade and UTZ-certified significantly increased and RA even skyrocketed since 2008<sup>17</sup> due to sustainable sourcing commitments, while sales remained relatively constant at low levels (except for RA with a dynamic sales increase).<sup>18</sup>

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<sup>8</sup> Potts et al. (2014: 136, figure 7.4).

<sup>9</sup> Ibid. pp. 167 and 168, figure 8.7.

<sup>10</sup> Ibid. p. 170.

<sup>11</sup> Ibid. p. 303.

<sup>12</sup> Ibid. p. 142, figure 7.10.

<sup>13</sup> Ibid. p. 172.

<sup>14</sup> Ibid. p. 308.

<sup>15</sup> Potts et al. (2014: 168, figure 8.7).

<sup>16</sup> Ibid. p. 176 and figure 8.15.

<sup>17</sup> Ibid. p. 302, figure 14.4.

<sup>18</sup> Ibid. p. 302, figure 14.5 and p. 304, box 14.1.

**Table 2: Sustainable markets: Standard-compliant production versus standard-certified sales for 2012**

Commodity	Production	Sales
Coffee	40%	12%
Cocoa	22%	7%
Palm Oil	15%	8%
Tea	12%	4%
Cotton	3%	2%
Bananas	3%	3%
Sugar	3%	<1%
Soybeans	2%	1%

Source: Potts et al. (2014: 91, figure 4.3).

The only considerable exception to this trend is organic cocoa production where, in 2011, 75 per cent of total (compliant) production was sold as certified owing to its high quality and suitability for entering niche markets.<sup>19</sup> For bananas and cotton - both commodities with relatively low levels of PSS-certified market penetration - the ratio of production to sales is more balanced. In bananas, both standard-compliant production and sales constitute 3 per cent of global production; for cotton, production is 3 per cent and sales are 2 per cent.<sup>20</sup>

Thus, there is a persistent oversupply of sustainable produce across a large number of agricultural commodities and in particular those with high market shares, with no signs of a trend towards narrowing or closing the supply-demand gap. This may exert downwards pressure on **prices** for standard-compliant products (and associated **price premiums**), and ultimately producers' income.

There is the suspicion, however, that part of the discrepancy between standard-compliant production and sales' volume seems to be an indication of over-estimation of the standard-compliant market share. The concerned production and sales' data do not allow excluding overlap between the standard systems so that double and triple certification is not properly reflected. Organically certified coffee, for instance, is estimated to also have double certification under FLO to the extent of 50-70% (Panhuysen and Pierrot, 2014: 13).

Besides, surges in production (and sometimes even in sales, e.g. RA tea) are in most cases associated with commitments of major companies to source according to certain standards (by 2015/ 16 or 2020) and associated expectations of future sales. While such commitments are in principle positive steps in the right direction it appears that these commitments are not necessarily associated with more stringent, multidimensional or transformative standards (for example for coffee compliant with the 4C Association Code of Conduct<sup>21</sup>, which has a comparatively low level of ambition across sustainability dimensions - see Box 1 below, production increased almost five-fold between 2008 and 2012<sup>22</sup>). It also remains to be seen whether this anticipated demand alone is quantitatively and sustainable enough to not only pull sectors beyond niche markets but also to significantly narrow supply-demand gaps and to achieve broad-based sector transformation towards sustainability and developmental effects. Furthermore, in commodities like bananas, where over 80 per cent of total

<sup>19</sup> Ibid. p. 142.

<sup>20</sup> Ibid. p. 91, figure 4.3.

<sup>21</sup> The 4C Code of Conduct sets baseline criteria for sustainable coffee production and a major food company is among its founding members. The 4C Association also coordinates with and its code is applied by other major industry players. For more information see: [www.4c-coffeeassociation.org/news/current-news/article/4c-association-applauds-kraft-foods-commitment-to-sustainable-coffee-farming.html?PHPSESSID=d1ucusvrnvgsjk5n3ipekf51i7#2](http://www.4c-coffeeassociation.org/news/current-news/article/4c-association-applauds-kraft-foods-commitment-to-sustainable-coffee-farming.html?PHPSESSID=d1ucusvrnvgsjk5n3ipekf51i7#2)

<sup>22</sup> Potts et al. (2014 : 168, figure 8.7).

production are consumed domestically, sector transformation will require introducing PSS to domestic markets.<sup>23</sup>

The analysis in this section also discloses that differentiated production-sales ratios exist among PSS, which not only makes general conclusions difficult but also points to the need of more in-depth research aiming at a better understanding the root causes of large production-sales gaps that can be observed in certain PSS. An enhanced understanding of the phenomenon that some PSS are able to reach large production capacities despite insufficient market demand would be important for donors and developing country governments designing development strategies.

#### IV. Prices, premiums and productivity

Premiums of between 5 per cent (UTZ certified) up to 18 per cent (organic) were realized for certified cocoa over the past years.<sup>24</sup> However, more recent data show that premiums have declined to about 6 – 9 per cent across standard initiatives<sup>25</sup> (the same trend applies to organic<sup>26</sup>), which is in part attributable to the general increase in global cocoa prices.<sup>27</sup> The latter have also made the Fairtrade minimum price inapplicable.<sup>28</sup> Tea prices were also relatively high but volatile in recent years and premiums between 1 and 20 per cent have been achieved in past years.<sup>29</sup> When a fall in tea prices occurs, the Fairtrade minimum price can prevent losses. More recent premiums paid by buyers for standard-compliant tea amounted to 5 – 15 per cent over international market prices (RA in 2011) and only 1-2 per cent over global tea prices in the case of UTZ certified in 2012.

Global coffee prices are highly volatile and show a long-term declining trend<sup>30</sup> which can be attributed to oversupply and low price elasticity of demand. Premiums for certified coffee ranged from 1 to 30 per cent in 2011-2012.<sup>31</sup> The highest premiums were realized for Fairtrade/ Organic double certified, with cumulative Fairtrade minimum price, Fairtrade social premium plus the organic premium. In Fairtrade certified, in the period 2010 to 2013 when coffee prices were above the Fairtrade minimum, only the social premium applied, which makes a 13 percent premium. Due to mainstreaming and market entry of competing standards, organic premiums declined from 25-35 per cent in the mid-2000s to 10-15 per cent more recently. UTZ premiums for certified coffee slightly declined between 2009 and 2012.<sup>32</sup> RA premiums were 8 per cent in 2009 and 4C premiums amounted to 1-2 per cent in 2012.<sup>33</sup> For certified bananas, high price premiums of up to 75 per cent were achieved for organic produce<sup>34</sup> and 30 per cent for RA certified, which is made possible by the rather narrow supply-demand ratio for standard-compliant bananas.<sup>35</sup> A relatively high ratio of demand to supply across initiatives is also a driver for fairly high premiums for standard-compliant cane sugar (10 per cent for organic, 21 per cent for Fairtrade/Organic double certification), even though it is only a minor component of the end product and not much visible to consumers.<sup>36</sup>

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<sup>23</sup> Ibid. p. 116.

<sup>24</sup> Ibid. p. 151.

<sup>25</sup> Ibid. p. 151, table 7.12.

<sup>26</sup> Ibid. p. 152.

<sup>27</sup> According to one project report on cocoa in Ghana, price premiums for UTZ and RA-certified produce have fallen to almost negligible levels. However, the intensity of external input use of chemical fertilizers and pesticides increased, which boosted yields, but also led to a (not unproblematic) higher external input use than for uncertified cocoa (personal communication with Christian Schader, FiBL, 28 April 2015).

<sup>28</sup> Potts et al. 2014 : 152.

<sup>29</sup> Ibid. p. 318.

<sup>30</sup> Ibid. p. 155.

<sup>31</sup> Ibid. p. 160.

<sup>32</sup> Ibid. p. 181.

<sup>33</sup> Ibid. p. 182.

<sup>34</sup> Ibid. p. 101.

<sup>35</sup> Ibid. p. 114.

<sup>36</sup> Ibid. p. 293.

In sum, most of the major commodity markets are characterized by declining or modest price premiums. Higher premiums can be realized in the case of low supply-demand ratios. Where price premiums exist, these often do not reach small-scale producers to an appropriate extent and thus not necessarily imply increasing their profit.<sup>37</sup>

First of all, this can be traced back to asymmetries in supply chain power structures, i.e. the concentration of large buyers negotiating prices with largely unorganized smallholders, which points to a lack of producer organization and is prevalent in a number of sectors (e.g. in cocoa, farmers may only receive 40 per cent of the market price due to reduced bargaining power<sup>38</sup>, in the banana case, organic producers may receive a lower percentage, 17 per cent, of the retail price than conventional producers, 21 per cent, or slightly higher, 22 per cent, in the case of Fairtrade/ Organic bananas<sup>39</sup>). The coffee sector in Ethiopia is a case in point: according to a study of the International Food Policy Research Institute, a great part of the added profit from premium status does not reach the producers. It is rather set aside to the benefit of retailers or unions.<sup>40</sup>

Secondly, the costs associated with certification (*inter alia*, the costs of meeting the standard's substantive requirements, the cost of inspection, auditing and certification, transaction costs for traders, costs payable to scheme owners and costs of maintaining traceability throughout the supply chain, if this is part of the standard's criteria) diminish at least part of the premiums.<sup>41</sup> For example, in the case of palm oil certification under the Roundtable on Sustainable Palm Oil (RSPO) standard in Indonesia, the farmers' costs related to the implementation of the criteria imposed by the standard significantly exceeds the premium palm oil growers receive from downstream supply chain actors.<sup>42</sup> In the cases of palm oil and coffee, smallholders' profits in Indonesia under certification schemes were only marginally higher than those of conventional producers, which is not a satisfactory result for certified producers.<sup>43</sup> As a recent FAO literature review points out, while certified organic production positively bears on profitability in the majority of cases owing to the relatively high prices for organic products, with regard to Fairtrade, where one would expect comparatively good premiums and income effects owing to its approach, "there is consistent evidence that Fairtrade commands, on average, a higher price for its products, yet profitability is less apparent, with more than half of the studies showing either no significant effect from certification or a negative effect".<sup>44</sup> Thus, costs have a significant bearing on producers under Fairtrade certification, "while the additional income from Fairtrade is relatively modest" with often even greater benefits for non-certified producers.<sup>45</sup> Besides, the use of double certification for enhancing export opportunities through the ability of using alternative certificates (e.g. Fairtrade/ Organic double certification) depending on market demand can have a significant bearing on costs.

It also should not be overlooked that it is sometimes argued that the guaranteed Fairtrade premium would prevent producers from switching to other crops in times of overproduction of and low prices for certain commodities, e.g. coffee, and encourage additional market entry thus putting downwards pressure on the price for non-Fairtrade coffee.<sup>46</sup> While this example of a guaranteed premium puts the overall developmental effect of such an instrument into question, a counter-argument is that

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<sup>37</sup> UNFSS (2013: 30).

<sup>38</sup> Potts et al. (2014: 131).

<sup>39</sup> Ibid. p. 114, Box 5.1.

<sup>40</sup> Minten (2014).

<sup>41</sup> UNFSS (2013: 31).

<sup>42</sup> Ruyschaert and Salles (2014), "Towards global voluntary standards: Questioning the effectiveness in attaining conservation goals: The case of the Roundtable on Sustainable Palm Oil (RSPO)", in *Ecological Economics* 107, page 441.

<sup>43</sup> Glasbergen (2014), "Smallholders do not eat certificates. On the transformative capacity of private sustainability standards and certifications", paper presented at the Leuven workshop on VSS effectiveness, 1-3 October.

<sup>44</sup> Loconto and Dankers (2014: 46).

<sup>45</sup> Ibid. p. 46.

<sup>46</sup> UNFSS, 2013: 32.

this instrument provides an incentive for more producers to also adopt more sustainable production practices.<sup>47</sup>

The systemic challenges and trends described in this section to a large extent explain the rather modest increases in available household incomes, which are a key indicator of food security as well as livelihood improvements and pro-poor effects, despite increases in yield through enhanced productivity at farm-level. As the Committee on Sustainability Assessment (COSA) study on PSS impacts, which focuses on coffee and cocoa in twelve countries, shows, net income only increased by 7 per cent and yield increased by 14 per cent when certified producers are compared to uncertified producers.<sup>48</sup> Productivity increases and decreasing prices are inherent characteristics of the current system since only in this way certified products can compete with conventional products in the market and may thus increase their sales; and larger producers are in a better position to achieve this. In this context it also has to be noted that productivity increases of (often large-scale) farmers under certification schemes, which have a correlation with income increases through increased yield, will in the long run lead to lower prices for certified products. This has in particular a bearing on producers who wish to newly enter certification and related supply chains due to the additional difficulty or prevention of entry through lower margins for premiums that cannot cover certification costs (both upfront/ initial and ongoing yearly costs).

According to the first global COSA report, the most significant impacts of certification were identified in the areas of training (pertaining to good agricultural practices, improving farm operations, record keeping, fertilization, environmental resource management, health and social issues, marketing and financial literacy skills<sup>49</sup>), followed by water preservation and quality improvement, soil conservation and improvement of soil health and biodiversity conservation and protection (in particular plant diversity and tree density).<sup>50</sup> While not being of direct significance for farmer livelihoods, these factors might nevertheless contribute to the improvement of living conditions in the long term and through indirect pathways.<sup>51</sup>

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<sup>47</sup> Ibid., p. 33.

<sup>48</sup> COSA, 2014: 41, figure 5.4.

<sup>49</sup> Ibid. p. 53 and figure 5.19.

<sup>50</sup> Ibid. p. 60, table 5.3.

<sup>51</sup> For example, the case of Farmer Field Schools for smallholder tea producers in Kenya shows the potential for increasing average yield and income diversification through training (Waarts, 2014).

### Box 1: Private Sustainability Standards and public goods

There are different kinds of PSS with divergent relevance for the achievement of public policy objectives and sustainable development goals in developing countries ranging from PSS with a specific focus, more multidimensional packages, to the ones supportive of systemic change.<sup>a</sup>

The *4C Association standard* is specific in terms of focusing on one commodity, i.e. coffee, and ranks relatively low among PSS in terms of social, environmental and economic indices covered. *Good Agricultural Practice (GAP)* is mainly a business-to-business standard in the context of conventional agriculture and an example of a specific focus on quality control, food safety, consumer protection and corresponding management of supply chains as a prerequisite for entering food export markets and supermarket shelves, in addition to some environmental considerations (water, soil, waste and safe agro-chemical management related to food safety). The *Forest Stewardship Council (FSC)* standard has a focus on the environmental pillar of sustainable development, i.e. sustainable forest management/ biodiversity, GMO prohibition and soil. The *Rainforest Alliance (RA)* standard is also mainly an environmental standard, but also with strong presence of social criteria (labour and human rights, health and safety, employment conditions, community involvement and animal welfare).

*UTZ certified* is more multidimensional and balanced in its coverage, containing economic (minimum wage and price premiums), social (labour and human rights, health and safety, employment conditions) and environmental criteria (water, soil, synthetic inputs and energy) with the overall aim of promoting sustainable farming. *Fairtrade* – with the overall aim of creating a more equitable international trading system - while encompassing quite a number of social and environmental criteria, has the most systemic focus on economic criteria, such as minimum wage, price premiums, buyer/ seller contracts, through its system of minimum prices and social premiums, which attempts to address power imbalances along supply chains and aims at improving incomes and generating related pro-poor development effects.

The International Federation of Organic Agriculture Movement (IFOAM) is the international umbrella organization that sets or supports standards and quality assurance systems for *organic standards*. Besides having a number of economic indices, the organic standard is the most comprehensive standard in terms of triggering systemic change by embedding an “agro-ecological or eco-functional intensification” approach and promoting a shift from “conventional, monoculture-based and high-external-input-dependent industrial production towards mosaics of sustainable, regenerative production systems” that provide a number of public goods and services (e.g. water, soil, landscape, energy, biodiversity, and recreation).<sup>b</sup>

Policy-makers need to appreciate these differences in terms of more holistic change and real contribution to sustainable development when they engage in integrating sustainability standards into national trade and development strategies, which may aim at broader rural development or sustainable agricultural transformation. There is a need to carefully evaluate and balance the role of standards in serving private interests or addressing public concerns and public goods with a view to designing a strategy that best reconciles both facets.

<sup>a</sup> For a general overview of PSS coverage across sustainability dimensions also see Potts et al., 2014: 71, table 3.8, p. 73, table 3.9 and p. 76, table 3.10.

<sup>b</sup> Also see UNCTAD (2013).

## V. Upscaling the impact of private sustainability standards for market transformation and pro-poor development

The past results in gradually increasing the market share of PSS, based on a strong proliferation of (often competing) standard schemes, gives rise to the belief that the continuous scaling up of sustainability markets will on its own bring about more in-depth sustainability impact and transformational change, including an improvement of rural livelihoods and alleviating poverty. There are, however, several reasons for doubt whether such automatism will actually happen:

- The competitive pressure under which key corporate players are in global supply chains might limit their interest in and preparedness for upscaling the reach of PSS beyond a certain critical mass of better organized and logistically well-located producers.
- Many sustainability standards are unlikely to create on their own sufficient impact and leverage for real transformational change.<sup>52</sup> They have however been very successful in facilitating market access and responding to specific consumer or civil society concern, for instance on certain environmental or social issues.<sup>53</sup>
- The pressure of conventional markets on costs of production that do not internalize environmental damage or true social costs and the additional costs of sustainability-standards-compliant producers, in particular for inspection and certification, remain a serious hurdle for increasing the market share of PSS beyond a certain threshold.

### A. The attractiveness of better-organized producers

Competitive pressure in international supply chains requires continuous improvement of the quality and productivity of production. This is easier to achieve with producers that are better organized, managed and have access to adequate physical and information infrastructure. The higher the competitive pressure in the supply chain and/or the lower the international price of the concerned product or commodity, the more the propensity of international corporate buyers to rely on and work with a relatively small, but well manageable number of producers or producer groups that can realistically achieve the quality and productivity improvements without disproportionate additional investment or support of buyers. Such well-managed producers, though small in number, may well account for a significant and increasing share of total supply.<sup>54</sup> The transformational development impact of sustainability standards at macro-economic level however remains limited.

There is undoubtedly a commercial attractiveness of such focused approach as it remains under the direct control of corporate buyers, can be stepped up as required and allows good management of

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<sup>52</sup> Transformational change, as distinct from incremental improvements, refers to the effectiveness of standards in overcoming major social, environmental or economic problems that prevent true sustainability of local development, supply chains and life cycles of products. By way of illustration, in agriculture transformational change is the concrete contribution of PSS to secure truly sustainable and resilient food systems, based on agro-ecological intensification and closed nutrient cycles that strengthen the reproductive capacity of the system.

<sup>53</sup> To refer to just one very prominent case: various PSS have been successful in reducing the public concern regarding illegally and/or inappropriately harvested timber and thus kept access to international markets open.

<sup>54</sup> A recent study of FAO (Loconto and Dankers, 2014: 55 and 59) on the impact of PSS on smallholder market participation concludes that "there is some evidence of economies of scale in certified markets and a tendency for self-selection in these systems as farmers and exporters who have the means to make the initial investments are the first to join. Some studies have shown that the ability of exporters and farmers to meet requirements set by voluntary standards largely depends on greater financial, environmental, physical and human capabilities at farm level. Self-selection is strongly related to the evidence of exclusion found in standards that focus primarily on good agricultural practice and general food safety.... The most strongly supported conclusion from this study is that smallholders can access certified markets only through group certification. They thus need to form associations or cooperatives, or be part of an outgrower scheme in a contract farming situation. This conclusion is linked to the importance of economies of scale and the tendencies towards vertical coordination found in certified value chains. Vertical coordination puts additional demands on producers and exporters requiring organizational and financial strength or support from other actors (inside or outside the chain)".

related transaction and support costs. Furthermore, as already highlighted above, increasing productivity of standard-compliant supply leads to cost cuts and a supply volume that might go beyond existing demand.<sup>55</sup> While this is beneficial to the buyers' side, for standard-compliant producers it implies that profit margins remain under pressure and costs have to be extremely well managed.

This makes it difficult to extend the coverage of such approach to larger numbers of small-scale producers or farmers in areas not close to or remote from logistic centers. Without the existence of well-organized producer associations or strong supportive farmers assistance networks, such as the Kenya Tea Development Agency<sup>56</sup>, more sophisticated and multi-dimensional sustainability standards will lead to marginalization of large parts of smallholders.

Price premiums, either offered by corporate buyers, for instance for organic produce, or in the context of fair-trade schemes play potentially an important role for allowing small-scale producers to become certified members of PSS. Some commodity boards, which survived the era of deregulation, may also offer *de facto* price premiums by maintaining guaranteed purchasing price policies, such as the ones implemented by the Ghana Cocoa Board or the Federal Agricultural and Marketing Authority in Malaysia. It should however not be overlooked that with the mainstreaming of sustainability markets, price premiums tend to shrink and might even disappear, thus aggravating the competitive position of small-scale producers to accommodate the management, adaptation, inspection and certification costs to comply with PSS. What is more, for small producers it is much more difficult, if not impossible, to overcompensate additional compliance costs by cost cuts related to higher productivity, efficiency or product quality.

## **B. The insufficient leverage for transformational change**

According to the emergent critical mass of research on impact assessment of PSS and related sustainability standard theories of change, "sustainability standards alone will not be able to deliver the scale and depth of impacts required to lift millions of smallholders and workers from poverty, nor deliver on environmental, inequality, climate change and employment challenges. While there is ample evidence ... that sustainability standards unlock benefits for workers, producers, their organisations, communities and environments, it is rarely the case that they have a transformational poverty impact" (Nelson and Martin, 2013: 104). The same conclusion is drawn in a study by Kleemann and Murphy-Bokern (2014: 21), which reviews the use of Corporate Social Responsibility schemes and related PSS for reducing greenhouse gas emissions in the food sector. According to the authors, "the great majority of firms are focused on incremental product or process improvement.... Strategies that support radical change are confined largely to companies in niche areas, particularly those associated with the organic sector.... Thus, tipping point change with large-scale emission reduction cannot be expected from firms' existing Corporate Responsibility strategies"<sup>57</sup> (on the impact assessment of PSS: Incremental versus transformational change- see box 2 below).

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<sup>55</sup> Brazil's 40% standard-compliant coffee production relies heavily on 4C certification. 23 large cooperatives are the main supplier base for 4C-certified coffee (Panhuysen and Pierrot, 2014: 13).

<sup>56</sup> The Kenya Tea Development Agency (KTDA) provides assistance to more than 565,000 small-scale tea farmers who cultivate over 100,000 hectares. The approach of KTDA includes (i) making small-scale farmers the shareholders in the tea companies and processing factories that are critical in the tea value chain, thereby increasing their buy-in and returns; and (ii) providing farmers with comprehensive services to grow, transport, process, and market tea. Services include finance, input procurement, agri-extension, processing, logistics, and marketing. For more information, see: [www.ktdateas.com](http://www.ktdateas.com).

<sup>57</sup> Glasbergen (2014) reaches the same conclusion. He stresses that "for a social and environmental benefit to be achieved in agriculture, a more structural or drastic change is ultimately required: certifications and voluntary standards alone cannot achieve the expected outcomes".



## Box 2: Impact assessment of PSS: Incremental versus transformational change

The benefits of PSS use may arise at different levels: (i) enterprise level; (ii) sectorial level; (iii) national level; and (iv) international level. Depending on the focus of the concerned PSS, the impact may be limited to one or a small number of sustainability issues or dimensions (e.g. some social conditions, occupational safety, deforestation, reduced fertilizer and agro-chemical use etc.) or be multi-dimensional (see figure below).



Source: Giovannucci (2014).

Therefore, conceptually the effectiveness of the impact of PSS can be measured differently. On the one hand, effectiveness can be evaluated on the basis of achieving individually set goals (i.e. incrementally improving certain aspects of sustainability, which may be particularly important for consumers or corporate buyers). On the other hand, individual multidimensional PSS and PSS taken collectively should also contribute to transformational change, which is for instance much required in global agriculture (this concerns agro-ecological intensification, much-reduced resource and external input use, structural change, in particular the reduction of industrial livestock production, the promotion of rural livelihoods, enhancing the resilience of agriculture, and the promotion of sustainable and resilient food systems, including processing, transportation and consumption).

There are cases, where PSS focusing on individually set goals may contradict much-required transformational change. By way of illustration, PSS-compliant production of protein-rich crops for concentrate animal feed production, such as soy beans, can prevent deforestation, optimize agro-chemical use and encourage intercropping of soy. This, however, does not alter the more systemic problem of industrial livestock production, for which protein-rich concentrate feed is an essential element. Industrial livestock production is the environmental hotspot of agricultural production as regards greenhouse gas emissions, nitrogen overuse and dumping of liquid manure.

The same ambivalence may occur between the impact of PSS at micro- and macro-economic level. By way of illustration, certain PSS might overcome the problem of child labour at company level. This may however lead to the occurrence of family-related poverty problems at regional or macro-economic level either temporarily or permanently. Therefore, it would be misleading to simply aggregate the company-level impact of PSS and take them as synonymous for macro-economic effects.<sup>58</sup>

<sup>58</sup> According to the analysis of Schader et al. (2014), the sustainability assessment approaches to food the authors reviewed “mix the social and the business perspectives of sustainability and do often not consciously distinguish between them. The two perspectives.... can employ the same impact categories or indicators. For instance, protecting soil and water resources is beneficial to both the individual farm and the society. Whether the operation of a single farm can be sustained is of “private business interest”, but the operational sustainability of the single farm might not necessarily be of “societal interest”. Thus, the business perspective does not always correlate with the sustainability of a society.”

It should also not go without comment that the costs and benefits of PSS use might arise at different points and levels. Those bearing a significant part of the costs might not necessarily earn a commensurate share of the benefits of PSS compliance. Thus, it is a prime task of governments (locally, nationally, but also internationally) to even out the concerned challenges and contradictions as a function of governmental priorities regarding improving public goods or services.

In sum, it is safe to say that there is a serious lack of information and analysis, including appropriate methodologies, on sustainability impact assessment in the context of PSS use.<sup>59</sup> Furthermore, governments need to properly study and address the evening out of cost and benefits of PSS use as a function of government-pursued objectives.

The term “sustainability standards” is generally loosely defined, so that almost any management approach and technology can accommodate it. Most PSS focus on exported cash crops (which often are the former ‘colonial’ crops) that almost exclusively represent mono-crops. By the very definition, a mono-crop, in particular when planted at large scale, is anything but truly sustainable for agriculture.<sup>60</sup> Therefore, many of the concerned PSS deal with limiting or managing the environmental and social damage caused by large-scale mono-crops, rather than making agricultural production truly sustainable. This, of course, limits the potential of the standards to contribute to the much-required fundamental transformation of agriculture, which would have to be largely based on mosaics of highly diversified, integrated (i.e. combining crop production and animal husbandry) and largely autonomous (closed nutrient-cycle-based) agro-ecological production systems, in which smallholders play a pivotal role both for environmental and social sustainability.<sup>61</sup>

Although there is a rising number of multi-issue or multi-dimensional sustainability standards, as can be seen in box 1, many are still dealing with one or only a few issues, such as safe agro-chemical use or proper labour rights. This runs the risk of horizontal problem shifting as more attention is given to the easier to deliver benefits. In some cases, because of crowding out of financial and managerial capacity for standard compliance or the one-sided focus of PSS, by plugging one hole PSS may create two or more others.<sup>62</sup> This raises the issue of the holistic and cross-cutting nature of the sustainability impact of PSS.

According to the study of Nelson and Martin, “there are also thematic areas where sustainability standards are not tackling poverty or broader sustainability issues adequately as part of their required standards – e.g. greenhouse gas emissions and climate change adaptation, gender issues, and living wage” (Nelson and Martin, 2013: 88). Without the adequate tackling of some key structural or socio-economic issues, such as insecure land tenure, gender equality or access to

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<sup>59</sup> Currently, it is estimated that for food systems some 30-40 sustainability assessment programs exist that regularly publish results. A considerable part of them is primarily used for research, others for policy advice, producer monitoring, self-monitoring, for certification, for consumer information and landscape planning (for an overview of existing food-related sustainability assessment programs, see Schader et al., 2014). For the comparison of impact assessment approaches it is necessary to review methodological questions of the scope of sustainability assessment approaches (i.e. primary purpose, level of assessment, geographical, sector and thematic scope as well as the perspectives on sustainability), the precision of the approaches, the assessment results and their interpretation.

<sup>60</sup> Multifunctional agro-ecosystems should be designed to be both sustained by nature and sustainable in their nature (Tittonell, 2014:53). They should guarantee the reproductive function and capacity of the concerned agro-ecological system.

<sup>61</sup> Such smaller production units not only have a higher productivity of the entire production system (not an individual crop), but also a higher profitability, because of the low-external-input dependence. For more information, see: UNCTAD, 2013.

<sup>62</sup> Prominent examples in this regard are PSS for biofuels and concentrate animal feed. The hype of biofuels, for instance, has boosted land prices and land speculation in several countries. Among other things, this has put tremendous pressure on the profitability of agriculture, including organic production. Organic producers have consequently found it increasingly difficult to expand their cropping area and, in some countries, the area under organic production decreased although demand for organic products kept increasing.

adequate finance, PSS are unlikely to harness their full potential or remain limited to 'better-developed and manageable exclaves'.

As highlighted by Kleemann and Murphy-Bokern (2014: 23), it should also not go without comment that, in a not small number of cases, the use of PSS as governance tools in international supply chains is motivated by the objective of corporate buyers to reduce risk, costs and enhance profit generation.

PSS mostly apply to purchases for international value chains. However, the lion's share of small-scale producers and farmers generate their income on local markets. An excessive export-orientation and the support by the donor community of the integration of smallholders in global supply chains may therefore underutilize the potential of local markets for pro-poor development, food security and food sovereignty as well as rural livelihoods.

### C. The cost-internalization dilemma

PSS and sustainability markets are not functioning in clinical isolation from conventional markets, in which global cost pressure requires producers to maximize economies of scale. Whereas conventional producers are not charged or penalized for unsustainable environmentally or socially-problematic production methods and their direct and indirect impact (or damage) and also often continue to benefit from significant direct and indirect subsidies<sup>63</sup>, PSS-compliant producers have to cope with additional compliance, inspection and certification costs (that for small producers might be as high as 50% of total costs) and are only rarely publically awarded for providing public services or goods (such as better water, landscape and soil quality or biodiversity preservation). What is more, as already flagged above, the cost cuts resulting from higher productivity, effectiveness and quality of PSS-compliant producers are generally insufficient to compensate for higher management and compliance costs. Therefore, without adequate price premiums or a quasi-permanent financial support of PSS-compliant producers, sustainability markets are unlikely to significantly scale up. As price premiums tend to shrink or entirely disappear as sustainability markets get mainstreamed or as a result of the above-analyzed supply-demand discrepancies, regular donor support becomes imperative.<sup>64</sup>

As can be seen from figure 2, the first global report of the Committee on Sustainability Assessment (COSA) concluded that the yield, price and income impact of the investigated PSS is by far the lowest of all sustainability impacts. This corroborates that the assurance of appropriate rural livelihoods remains a key challenge for PSS.

Dietz and Auffenberg (2014) point out that "governance costs required for keeping up with the enforcement of standards reduce a product's potential proliferation due to its higher price. On the other hand, certification schemes with more flexible standards and loose enforcement mechanisms had bigger market shares. Therefore, the capacity to motivate both consumers and producers through certification to maintain high sustainability and social standards was restricted by the high governance costs that cannot be fully compensated by the market".

As already flagged in box 2 above, it should also not be overlooked that the impact and the benefits of PSS arise at different levels (i.e. at producer, local, national, sectorial or global level) and with a time lag. Moreover, those incurring the compliance, inspection and certification costs may not necessarily be the ones obtaining most of the PSS benefits. Therefore, it is in the public interest and

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<sup>63</sup> In agriculture of developed countries, subsidies are often equivalent to 20-40% of total production costs. In a few countries, like Germany, up to 50% of farm income is derived from public support (Die Zeit, 2015: 13).

<sup>64</sup> Paradoxically, many donor projects in support of PSS implementation aim at making such schemes commercially viable after some time. If donor support is then discontinued, such projects often fall apart, not because they are ill-managed, but because of the systemic problem that the considerable environmental and social costs of competing conventional production remain externalized.

from a management point of view essential that governments even out the interests among the generators and the beneficiaries of the sustainability impact.

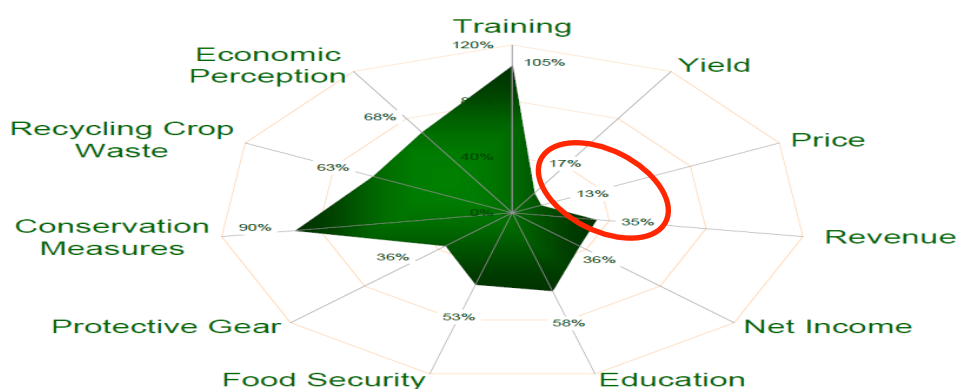
In this regard, it is worth underlining that PSS support and implementation need to be contextualized into the macro-economic development perspective, not limited to a commercial (market access and market shares) agenda. Public money, be it from donors or developing country governments, should focus on the role of PSS in supporting public interest and the related creation of public goods or delivery of public services.

**Figure 2:**

**Weight of measured sustainability impact of PSS for coffee and cocoa in 12 developing countries (percentages)**



**Certified vs. Uncertified: key indicators**



Source: COSA, 2014.

**D. The need for greater coherence and policy intervention**

The analysis above has shown that PSS are a step in the direction of more sustainable production methods and desirable social production conditions. However, on the one hand, many PSS are systemically insufficient on their own to lead to transformational market changes.<sup>65</sup> On the other hand, it is an illusion to assume that PSS-compliant markets can be mainstreamed on the basis of past strategies, which mostly assume that scaling up PSS-compliant market shares will naturally follow from a higher dose of capacity-building support.

Rather, what is required to maximize and scale up the market-transformational impact of PSS is a coordinated public, civil society and private engagement at various levels:

- a) At farm level, capacity-building support needs to be provided to create efficiently organized and managed producer organizations that achieve a sufficiently high productivity, efficiency and quality level.<sup>66</sup>
- b) At local and national levels, it is important to overcome capacity gaps as regards physical infra-structure, inspection and certification institutions as well as addressing legal and

<sup>65</sup> Standards on organic agriculture, for instance, are one of the exceptions.

<sup>66</sup> Referring to the example of the Ghana Cocoa Board, Nelson and Martin (2013: 90) recommended that “more governments should consider some level of state involvement without returning to state control, by instituting this kind of joint governance system which benefits all the producers of a particular commodity”.

governance issues on land tenure systems, gender equality, hired labour and working conditions as well as access to finance.

- c) At supply chain level, one needs to promote transparency and inclusiveness and keep power-asymmetries in check.

Moreover, PSS need to reduce their level of complexity, proliferation and overlap, as well as their conformity-assessment costs, while sustaining their integrity.

Such set of support and flanking measures may however still be insufficient to mainstream sustainability markets without at least some tangible progress on internalizing true social and environmental costs of competing conventional production. Alternatively, one may conceive of international accords that levy a fee on conventional products that is then being used to incentivize and support polluters, in particular small-scale producers, to improve their production methods and comply with relevant PSS.<sup>67</sup>

The above illustrates that without the pro-active engagement of governments in supporting PSS mainstreaming, it is unlikely that these standards can reach market shares much greater than the present level. This is the background against which the UN Forum on Sustainability Standards (UNFSS) conducts analysis and provides data for an informed dialogue among key public and private decision makers on the required level, forms, and tools for pro-active government policies to maximize the public benefits and reduce the costs of PSS for sustainable and pro-poor development.

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<sup>67</sup> One proposal made in this regard is the conclusion of International Commodity-related Environmental Agreements (ICREAs), which link PSS-compliance assistance to an international support fund that is fuelled by a fee levied on conventional products traded among members of such agreements. For more information, see: Kox, 1993.

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