

# RETHINKING PRICE – THE HEART OF THE MATTER

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## 1) Economics as if nobody else mattered

Banana prices have hit the news headlines in recent weeks. In the UK a ferocious ongoing price war between the leading supermarkets has stripped more than half the total value out of the banana chain. However, the retailers claim that cheap bananas are not at the expense of producers and intermediaries, as the cuts have come out of retail margins. But for how long?

At a historical low of 40 euro cents per kilo (60 US cents), it is probable that the likes of Aldi and WalMart are selling at a loss in the UK. If prices remain at these rock-bottom levels, the key question is what happens next time the retailers renegotiate prices with their suppliers? Who can say they will not look for lower prices from suppliers?

To make matters worse, the world's largest retailer has taken the price war to its home ground. In late October, WalMart cut its banana retail price by over a quarter across the USA – to the equivalent of 85 cents per kilo. This suggests a corporate pricing strategy that goes beyond dealing with competitors in the UK market. Is the whole world banana market about to see its value stripped out?

Renwick Rose, the chief executive officer of Winfa – the Windward Islands Farmers Association, whose 4,000 banana farmers export almost exclusively to the UK, has described the price war as "*a scandalous way of doing business at the expense of farmers*" and warned it will plunge banana growers into a "*race to the bottom*" that will benefit no one in the long term.

Plantation workers have been feeling the effects of the price wars since the millennium, as the banana companies have sought to reduce cost as much as possible. Banana Link calculates that prices paid to suppliers of UK supermarkets are one-third lower than seven years ago. At the same time, few plantation workers now earn anything like a living wage<sup>1</sup>.

"*Do these guys not realise what they're doing to us?*" a spokesman for the Coordinating Body of Latin American Banana Workers' Unions told the British media. "*They are putting all the costs of the 'crisis' in Britain on our backs.*"

If those who supply supermarkets are not able to make a living, whether in Britain or on the other side of the world, then the consequences are unemployment and poverty. Taken to its logical conclusion, this would mean that those affected cannot afford to buy the products they need, in some cases in the very same supermarkets that have put them out of business. So, the price wars seem not just pointless in the short term and damaging to growers and workers in the medium-term; for retailers, in the long term, they could be self-defeating.

## 2) Taboo in the name of competition policy

In the past, it was the big banana companies that more or less determined their selling price to importers and wholesale markets in the consumer countries. But with the rise in buying power of

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<sup>1</sup> See "COLLATERAL DAMAGE", Banana Link 2006; and "THE REAL WAGE SITUATION OF MALE AND FEMALE WORKERS IN ELEVEN BANANA PLANTATIONS IN COSTA RICA, IN COMPARISON TO A 'SUSTAINABLE LIVING WAGE'", Aseprola (Costa Rica) 2004.

the supermarket chains, and the rapid concentration in the food retail sector, wholesalers have become a residual market. Most fruit is now sold directly by importing/ripening companies to retailers.

Competition policy was designed and implemented with the aim of preventing collaboration between suppliers over price. On various occasions in the last two decades, the big banana companies have fallen foul of competition authorities on both sides of the Atlantic over price cartels. As recently as 2008, several companies were ordered to pay tens of millions of euros in fines by European Union authorities for collusion over banana prices.

However, existing competition law has not yet evolved to contemplate abuses of buying power at the top of the supply chain. Because retailers' prices are visible in-store to all consumers, supermarkets can adjust their prices at an hour's notice in response to price moves by their competitors, without risking allegations of collusion. But if retailers were to sit down and share information on prices paid to their suppliers, they fear that competition authorities would step in. As yet, few countries have any legislation that seeks to control purchasing practices by buyers, even though it is well-known that retailers effectively impose purchasing conditions that directly affect the prices suppliers receive.

In a situation of intense price wars, such as the UK has experienced at regular intervals since 2002, some retailers have come to accept that there is a level below which prices paid to suppliers become "unsustainably low". Some have ceased to deny that there are almost inevitable consequences back down supply chains, especially for those with the least bargaining power at the beginning of the chain. Plantation workers and small-scale growers have been able to demonstrate to some buyers that it is they who bear the burden of price cuts passed back down the supply chains. But this is where we hit a major taboo.

In practice, retailers fear that, however ethically well-intentioned their motives may be, any discussions amongst competing companies about price and its relationship to sustainable production practices, fair prices for growers or living wages for plantation workers would somehow violate competition laws. This is particularly the case in cut-throat food retail markets like the current UK market where national competition authorities are watching retailers very closely in the wake of strong pressure from public opinion and suppliers and are seeking to control any abuses of market power by the big supermarkets.

Real or imaginary, this taboo surrounding discussions of price has so far prevented retailers from engaging in any meaningful way with their competitors about how to break out of what they recognise to be a destructive cycle of price wars. At the same time, major suppliers with large market shares remain very sensitive about such discussions because of having had their fingers burned by European competition or US anti-trust laws. Meanwhile, an infernal cycle of destruction of value proceeds apace.

### **3) Fair pricing – an example of what is possible**

Over ten years ago, the Fairtrade Labelling Organisations International (FLO) put in place an innovative system of banana pricing which now applies to some 2% of world banana trade. For each of the countries where FLO has certified Fairtrade producer organisations, it has set minimum Fairtrade prices that are based on a calculation of "sustainable costs of production". These costs are arrived at in consultation with producer themselves and by using other available industry data.

The guiding principle of the "sustainable costs of production" calculation is to internalise the costs of compliance with decent social and environmental standards and to generate a reasonable profit with which producers can invest in the long-term stability of their activity. In practice, many traders pay above the minimum Fairtrade prices set by FLO.

FLO sets minimum "ex-works" (farmgate) prices and FOB prices for eight producing countries in South and Central America, the Caribbean and West Africa. It also sets differential prices for organic and conventional bananas. On top of this, traders pay a premium of one US dollar to the

producers' or workers' organisation over and above the price.

From 1<sup>st</sup> January 2010, minimum farmgate prices for conventional bananas will range from \$5.30 per standard 18.14kg box to \$9.00, whilst minimum FOB prices will range from \$8.20 to \$12.30 per box. The differential between organic and conventional prices is in the range of \$2.00-2.20 per box. The overall increase in Fairtrade minimum prices compared to 2006 is 21%. Additionally, for the first time, FLO has set Fairtrade minimum prices for ten producing regions of the world, so that new certified producers do not have to wait whilst a price is calculated for their country<sup>2</sup>.

Although there are certain to be imperfections in the process of calculating “sustainable costs”, it is a model of partial concertation over price formation that has the potential to change the way prices are seen in the overall banana economy. The process of price review needs to become more regular, even permanent. Now that cost information can be gathered and shared quickly thanks to information technology minimum prices could be more responsive, especially if and when conventional market prices rise above Fairtrade prices or there are significant increases in input costs. The model also needs to contemplate how to incorporate labour costs, which should be moving towards living wages for all hired workers, rather than just being calculated in relation to actual wages and legal national minimum wages.

What is clear however is that this model of fair pricing is put under pressure when the conventional market is in oversupply and prices at FOB level are particularly low or when there is a downward spiral of retail prices through fierce inter-firm competition. The price differential for traders between conventional bananas available on, say, the spot market in Ecuador and Fairtrade bananas from more expensive origins like the Caribbean becomes very substantial. Similarly, at retail level, conventional and Fairtrade price divergence at a time of price wars can threaten to undermine consumers' willingness to pay a fairer price<sup>3</sup>. The risk of a new “race to the bottom” in the Fairtrade market where retailers and traders chase cheaper Fairtrade bananas cannot be discounted.

#### **4) A new paradigm for banana pricing**

If, just for a moment, we think outside the 'box' of existing market realities, then we might agree that in a sustainable banana economy price is, ideally, the result of a democratic process of concertation between producers, distributors and consumers. At each stage of the chain the value of hired labour would also be the result of free collective bargaining or, put another way, a democratic process of concertation. Such processes of concertation focused on democratic price formation could become the new economic mode. Legislation at national, regional and/or international level would be the framework in which all players operate. Competence – doing the job well, innovating etc - could be the basis of a new model of competition.

Is it impossible to imagine that a successful multi-stakeholder approach could result in the creation of mechanisms of concertation that generate fair prices along the whole chain? Not only would all the current financial costs – land, agricultural inputs and infrastructure, plantation labour, maritime transport and labour, refrigeration and insurance, import tariffs, port handling, transport, ripening and distribution – need to be put in the equation, but methods of internalising any environmental and social costs that are not included in these financial costs need to be agreed.

This would require imagination, innovation and a high level of trust between actors at all stages. It would also mean bringing representative consumer organisations prepared to develop such new methods of concertation into the permanent multi-stakeholder forum. The process would also depend on the gathering and sharing of information about costs of production, volumes and trade flows by a kind of market observatory body that is trusted by all actors.

The Fairtrade model has shown that it is possible, even with the current market realities, to develop

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<sup>2</sup> FLO standards announcement: banana price, Bonn, 27<sup>th</sup> October 2009

<sup>3</sup> “FAIRTRADE FIGHTS BANANA PRICE WAR”, FLO Standards Unit, Bonn, 27<sup>th</sup> October 2009

a model of concertation that sets fairer minimum prices at one stage of the chain. In 2010, FLO plans to “organise round tables that will bring together all actors across the supply chain; retailers, exporters/importers, and producers to develop a better long-term strategy” and secure a sustainable supply. “FLO also calls on industry and government to offer sustainable prices to all banana producers around the globe”<sup>4</sup>.

If we take a concrete example from the world's biggest banana exporting country, we can see that the potential for price concertation exists, although the current mechanisms need to be considerably refined before a consensus can be achieved even at the level of one producing country. In late October 2009, the Ecuadorian government issued a decree not only requiring exporters to pay the minimum reference price to producers, but also requiring producers to have paid their employer contributions to the national social security system before being eligible to sign contracts with exporters.

Currently around half of the volume exported from Ecuador is subject to contracts between exporters and producers that are concluded at the national minimum reference price or higher. This reference price is the result of regular negotiations between government, exporters and producers. However, the government wants all banana exports to be covered by contracts, including for the fruit produced by small- and medium-scale growers who at present sell on a weekly basis on the so-called spot market. Although the decree is clearly well-intentioned, the producers concerned complain that they are being squeezed between the entirely reasonable requirement to comply with labour and social security legislation and real weekly prices which are too low to allow them to comply<sup>5</sup>. It seems possible that some more flexible mechanism that allows smaller producers to become eligible to sign fixed-price contracts could be designed.

An additional problem in Ecuador is that plantation workers' wage bargaining power is extremely limited because of very low levels of worker organisation and an almost total absence of collective bargaining in the sector. Wage levels at best equate to around half the level of the government's minimum household food basket. Again, mechanisms for cross-sectoral bargaining could be envisaged, with the support of exporters who see the longer-term benefits for a sustainable banana economy.

In short, even in the country with the greatest diversity of banana producers and exporters, it is far from impossible to imagine that an improved level of concertation between workers, producers, exporters and government – maybe through the creation of a broad-based national banana forum – could generate a consensus that could feed into international multi-stakeholder discussions on price.

With sufficient goodwill and mutual trust, one of the most basic roles of a permanent World Banana Forum that is focused on a transition to a sustainable banana economy could be to rethink the whole question of price. If the different actors can agree to abandon futile price-cutting that risks stripping value out of the whole chain from the top down, can find ways of overcoming the taboo surrounding ill-adapted competition policy tools, can learn from the example of fair price formation in the Fairtrade sector and can exercise sufficient imagination to generate consensus within and between banana producing and exporting countries, then bananas could show the way for the rest of the world economy. A shift in paradigm is not just necessary, but eminently possible. Let's dare to be wise.

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<sup>4</sup> Fact Sheet “FAIRTRADE STANDARD FOR BANANAS”, FLO Standards Unit, Bonn, 27<sup>th</sup> October 2009

<sup>5</sup> “DECRETO DE LA ESCLAVITUD”, communication from the Asociacion de Bananeros Orenses, Machala, Ecuador, 30<sup>th</sup> October 2009.