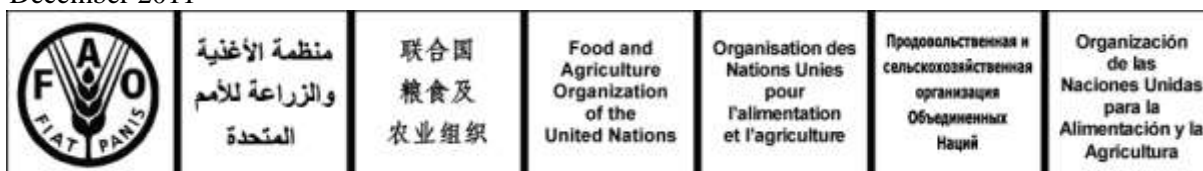


December 2011



COMMITTEE ON COMMODITY PROBLEMS

INTERGOVERNMENTAL GROUP ON TEA

TWENTIETH SESSION

Colombo, Sri Lanka, 30 January - 1 February 2012

CONTRIBUTION OF SMALLHOLDERS TO THE TEA SUB-SECTOR AND POLICIES REQUIRED TO ENHANCE THEIR LIVELIHOOD¹

I. INTRODUCTION

1. An important strategic priority of the Intergovernmental Group on Tea is the monitoring of the welfare of tea smallholders, particularly the impact of changes in the production and trade environment on their income and food security. This priority is in line with FAO's strategic objectives and an important millennium development goal (MDG). The last comprehensive review carried out by the Group was at its 12th Session in 1997 in Indonesia. At that review the analysis indicated that the welfare of smallholder tea producers was much greater than their counterparts in other agricultural enterprises in the countries that the Secretariat surveyed, namely Indonesia, Kenya, Sri Lanka, and Tanzania. This document looks in particular at the contribution of smallholders to the tea sub-sector and policies required to enhance their livelihood.

2. The Group is requested to review this document and guide the Secretariat in prioritising the areas that need to be analysed to evaluate the welfare of smallholders. In addition, suggest areas for further research to improve the participation of smallholders in the global tea economy and instruments to be analysed in support of enabling policies that may enhance their welfare.

3. Smallholders play an important role in the tea sub-sector worldwide. There are more than 400 000 smallholders in Sri Lanka who account for 76 percent of tea production, produced in 64 percent of the area under tea. In Kenya, an estimated 560 000 smallholders account for 62 percent of total tea production, while in China, the world's largest tea producing country (principally green tea) and in Vietnam, tea production is essentially dominated by smallholders. In Indonesia, smallholders account for 43 percent of the area under tea and 23 percent of production and in India, the world's second largest tea producing country and largest producer and consumer of black tea, an estimated 160 000 smallholders account for over 26 percent of

¹ This document is based on the study prepared by Mr Banerjee, Former Chairperson of the Tea Board of India. His study is available as CCP:TE 12/CRS 1.

its production. Smallholder growth in production has been significant in the last decade as tea area under smallholders in China increased by 73 percent from 1.1 million ha to almost 2 million ha between 2001 and 2010. During the same period production area under smallholders expanded by 34 percent in Kenya, from 85 511 ha to 115 023 ha and by 30 percent in Vietnam, from 101 884 ha to 132 000 ha. Between 1994 and 2005, tea area under smallholders increased by 48 percent in Sri Lanka, while in India, the share of output from smallholders increased from 11 percent to 26 percent.

4. Smallholder growth in production has been significant in the last decade as tea area under smallholders in China increased by 73 percent from 1.1 million ha to almost 2 million ha between 2001 and 2010. During the same period production area under smallholders expanded by 34 percent in Kenya, from 85 511 ha to 115 023 ha and by 30 percent in Vietnam, from 101 884 ha to 132 000 ha. Between 1994 and 2005, tea area under smallholders increased by 48 percent in Sri Lanka, while in India, the share of output from smallholders increased from 11 percent to 26 percent.

The definition of smallholder varies from country to country. In Kenya, it means a grower cultivating tea but does not possess his/her own processing factory; in Sri Lanka, an area of land less than 50 acres (20.2 hectares); in India, a holding less than 10.12 ha and does not possess his/her own tea processing factory; and in Indonesia, land size between 0.8 to 2 ha and sell tea leaves without processing. However, the average land holding in most countries, tend to be on the lower side. For example, the average size in Indonesia is less than 0.4 ha, 1.6 ha in India and more than 80 percent of small-holders in Sri Lanka hold less than 0.2 ha.

5. The alternative plantation model is of the large-scale corporate-estate with an integrated field and factory operation, which still accounts for the major share of production in India, though declining somewhat in recent years, and is also prevalent in Sri Lanka and Kenya. This is considered a high-cost model. However, the quality of their produce is considered superior in India. In Sri Lanka too, the corporate sector has a quality advantage since 90 percent of smallholder production is at medium and low-grown elevations, compared to 50 percent for the organized-estate sector, but the quality gap is much narrower than in India. The smallholder model in India is considered low-cost-low-quality production, catering largely to the lower-end of the domestic market, while in Kenya, the quality of smallholder tea is higher but productivity of the estates has always been above that of the KTDA/smallholders.

6. Smallholder production is seen as increasingly viable, contrary to the concept of economies of scale. In India, in the past decade, the two largest blending and marketing companies (Unilever and Tata Tea) have exited the estate-sector, preferring to turn buyers. There is also a trend towards investing in stand-alone factories but many are also increasingly sourcing their green leaves requirement from smallholders and processing them either separately or together with leaves from their own plantations. While this symbiotic relationship would bring down the cost of production for the estate, the flip side is that it affects the livelihood of employees of the estates and stand-alone processing factories.

II. MAJOR ISSUES

A. THE MARKET STRUCTURE FOR GREENLEAF

7. Smallholders as producers of green leaves are at the lowest level of the tea production system. Crop husbandry is undertaken, either by smallholders (who in some countries may be technically "owners" of cooperative tea processing factories as in Kenya) or within an "estate" or "garden" or "plantation" that is part of an integrated unit inclusive of a processing factory. Tea is processed from freshly plucked green leaves and shoots of the tea plant, in a factory located as close as possible to where it is grown. The green leaf is converted to a ready-to-drink state of "made tea" at this stage

itself. Thereafter, the primary marketing of "made tea" takes place either through auction or by private treaty.

8. The subsequent stages along the supply chain consist of blending, packing and marketing which are the most profitable. This value-addition mostly takes place by the importing companies in buyer countries. Thus there is an uneven value distribution along the entire supply chain, with the lowest value accretion to the smallholder.

9. Smallholders typically sell their green leaves through 4 possible channels, namely:

- Indirect through middlemen/leaf agents/collectors, or direct
- Stand-alone privately-owned processing units (known as Bought Leaf factories in India and usually a small/medium enterprise)
- Integrated plantation units (large tea gardens or tea estates plantations)
- Cooperative/collectively-owned units with smallholder participation.

10. In countries and regions where smallholders do not have collective ownership of factories and regulations and institutions do not intervene, they are left to the vagaries of an un-organized imperfect market for green leaves. The first-ever survey of small tea growers in Assam in North-East India, which is in this category, revealed that unregulated agents play an important role in the sector, selling 93 percent of the green leaf produced by small tea growers. There is an asymmetry of information leading to poor bargaining power of smallholders as they are not organized.

11. Many Governments have attempted to regulate the system of payments to smallholders by private processing factories, against those that are collectively owned as in Kenya. An example of a successful system is that found in Sri Lanka. India and Indonesia have also intervened with regulations that determine the relative shares of the smallholder and the private processing factory of the revenue from the sale of the *made tea*, based on market prices prevailing in the auction centre/primary market.

12. Sri Lanka had a system of support to smallholders since the 1970s. Their present scheme, evolved over the years, has been formulated by taking into account the cost of production and the profit margin of growers as well as the private processing factories. The price sharing ratio between smallholder and factory has evolved from the initial 75:25, which was revised to 70:30 and subsequently to 68:32. Implementation is through a system of "tea inspectors" who closely monitor the tea factories purchasing green leaves from smallholders and the price paid to them, based on the actual realization for the tea sold in the auctions.

13. The Tea Board of India introduced in early 2004 a price-sharing formula based on the Sri Lankan model, under its powers under a delegated legislation. The costs accruing to the small growers for producing green leaf, the cost of manufacturing "made tea" by the processing factories and the ratio of conversion of "green leaf" into "made tea" was considered and studied by a independent professional body. The price-sharing formula envisaged that the sale proceeds was to be shared between the smallholder and the manufacturer-processor in the ratio of 60:40 when the average price realized by the manufacturer for all teas during the reporting month is either equal to or less than the monthly combined average auction price for teas of the said growing region. Where the price realized by the manufacturer exceeded the monthly average auction price, the differential between the auction average price and the price realized by the manufacturer was to be shared in the ratio 50:50 as in Sri Lanka.

14. In Indonesia, there was a decree promulgated by the Minister of Forestry in 1998 setting the price of tea bought from smallholders, aimed at ensuring reasonable returns to the smallholder and prevent unfair competition among tea processing factories. The decree required that price setting be carried out jointly by tea processing companies and smallholders

or smallholder organizations with reference to a formula based on a conversion percentage of green leaf to made tea, weighed average export and local sale price of each company registered two weeks earlier.

15. However, attempts by India and Indonesia to regulate distortions in the market for green leaves have not been successful compared to Sri Lanka. Three major reasons include:

- The geographical compactness of the tea sector in Sri Lanka and the proximity of the grower to the factory;
- The efficiency and inclusiveness of the auction system at Colombo (accounting for 96 percent of all tea sold); and
- The strength of manpower and the institutional arrangements that have been put in place by the Tea Board and the Tea Small Holdings Development Authority (TSHDA) of Sri Lanka.

B. INSTITUTION BUILDING AND COLLECTIVE OWNERSHIP IN PROCESSING

16. Smallholders usually face high transaction costs and lack bargaining power in the green-leaf and input markets. Transaction costs are influenced by the regulatory environment and the prevailing institutional set-up. There is a supporting institutional framework in Kenya and Sri Lanka, but it is currently lacking in India and Indonesia.

17. In Kenya, small growers and the processing factories are integrated under one umbrella organization – Kenya Tea Development Agency (KTDA). The Kenya Tea Development Agency was formed after the independence of the country in 1963 with a view to promote the growing of tea in small farms by indigenous farmers. The KTDA has contractual agreements with the tea factory companies it serves as a management agent and caters to 560 000 small-scale tea growers attached with 63 factories.

18. In Sri Lanka, until the 1980s, smallholders suffered from inadequate advisory and technical support and there were poor facilities for collection and transport of leaves. Improvements were made with the establishment of the Tea Small Holdings Development Authority (TSHDA) which was set up in 1977 under legislation. The TSHDA provides subsidy for new planting, replanting, extension and advisory services, support services such as distribution of fertilizer, planting material, implements and transport facilities and undertakes the supervision of prices being paid by tea processing factories to small holders.

19. In India, smallholders were initially confined to the Nilgiris district of the State of Tamil Nadu in Southern India, which has a history of cooperative ownership of processing factories. Today, 17 such factories exist in different areas of the district under an apex organization, set up in 1965, known as INDCOSERVE. However, smallholders are not obliged to sell their green leaves compulsorily to any specified cooperative factory and many prefer to sell to privately-owned factories.

20. There is a need to form organizations such as KTDA and TSHDA in all other countries, in accordance with the special needs of each country, but with strong representation from the smallholders who are the principal stake-holders. In India, attempts are being made to empower smallholders through the formation and strengthening of small tea growers associations and self-help groups which would have better bargaining power to intervene in price fixation and enabling fairer terms of trade.

C. QUALITY STANDARDS AND OPPORTUNITIES FOR VALUE ADDITION

21. Smallholders typically engage family and agricultural labour on a casual basis. While this leads to a low-cost model, there is no livelihood security to the workers who may be on the look out to drop-out for other opportunities such as Governmental labour-intensive

welfare schemes. There is also a danger of lower productivity and poorer quality of leaf plucking (“coarse plucking”), which has an impact on price realization

22. Most of the smallholders in India and many emerging countries are new to tea, having shifted from food-crops and cash crops such as potato and pineapple into cultivating tea. With no specialized training and only generic knowledge of agricultural practices, they have often started with the wrong choice of planting material leading to the creation of poor field assets. The capacity levels of smallholders need to be enhanced with the introduction of modern farming methods to improve their farm productivity and quality of their produce.

23. Given the buyer-dominated structure of the international tea market, it is the standards of the importing countries, especially the European Union, which are followed by most tea-exporting countries. The *Maximum Residue Limits (MRLs)* for pesticides that are set and often changed periodically need to be implemented in the field if the product has to access specific markets. In addition, private labels (*Rainforest Alliance, Fair Trade, Ethical Tea Partnership etc.*) and quality standards {*Hazard Analysis Critical Control Point (HACCP), Good Agricultural Practices(GAP)*} imposed by major buyers in key markets are followed by all exporters. There is also a strong demand for organic tea duly certified by an agency that is acceptable to the international buyer. There is a need to develop strong partnerships with quality tea processing factories and with international buyers so that the smallholder could also fit into a high-quality supply chain with full traceability of his product.

24. The high economic growth rates in China and India which already have large internal markets, would translate in the medium to long-term to a sustained growth in the demand for better quality tea. Emerging international markets in the Middle East and Eastern Europe are also moving towards higher quality standards and food safety concerns that are prevalent today in economically advanced regions such as Western Europe, North America and Japan. Smallholders, in order to participate and compete in such markets have to develop capacities ensuring internationally acceptable and certified quality.

III. CONCLUSIONS AND POLICY ACTIONS TO ENHANCE AND SUSTAIN THE SUB-SECTOR

25. Smallholders represent the major part of the tea sub-sector across producing countries with high growth in the past decade, even in countries where the corporate estates is still of significance.

26. However, due to the small size of their average holding, high level of transaction cost, limited opportunities for capacity building and varying institutional back-up in different countries, coupled with poor bargaining power in the green-leaf and input markets, smallholders have not been able to reach full realization of their true worth.

27. Governments in producing countries need to formulate appropriate public policy that would enhance smallholders' skills and bargaining power. Policies have to be geared towards creating an enabling environment in which smallholders could access and compete in fully functioning and efficient markets, both for internal consumption and export. Capacity building for smallholders, either through Governmental or non-Governmental institutions, must not only include technical advice but also inputs on small enterprise management, finance and the wherewithal for them to set up self-help groups and other producers' organizations.

28. Proper contracts and their enforcement between smallholders and processing units that are not collectively owned by smallholders need close supervision and monitoring by regulators and small-growers' bodies or public institutions. Regulations relating to pricing of green leaves need to be strengthened so that distortions in the market due to the perishable nature of their produce (green leaves), presence of intermediaries and limited number of buying factories are to be ironed out. Use of information and communication technology

(ICT) tools, especially mobile telephone technology, in dissemination of market information should be encouraged.

29. Policies have to empower and not make smallholders dependent on Government-sponsored institutions or Non-Governmental organizations in the long run that may be required to be set up (or existing institutions reformed) in many of the producing countries.

Smallholders need to be well-represented in all institutions that are set up or are reformed.

30. An area of direct Government support could be in Research and Development and in extension services until there is sufficient capacity building in respect of private advisory services. Regulating these advisory services and encouraging private institutions by tax breaks and other means could be viable solutions to a felt-need. Government could also provide incentives to enhance infrastructure for green-leaf storage and transportation.

31. In countries which still have a large corporate sector, smallholders may be encouraged to set themselves up in a complementary role and enter into mutually beneficial partnerships. Similar partnerships with large international buyers and organizations encouraging socially and environmentally sustainable production of tea could also ultimately benefit the sub-sector.