



ProForest

Research for IFC Corporate Citizenship Facility and WWF-US:

Better Management Practices and Agribusiness Commodities

Phase Two Report: Commodity Guides

IIED, ProForest and Rabobank International
March 2004

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Preface

The International Institute for Environment and Development (IIED), ProForest and Rabobank International were commissioned by the International Finance Corporation (IFC)'s Corporate Citizenship Facility and WWF-US to research the environmental and social issues associated with the production of a wide range of agribusiness commodities. The project aimed to understand how useful the development and application of 'Better Management Practices' (BMPs) would be for these commodities. Specifically, the project has sought to provide guidance on:

- the commodities future initiatives should focus on;
- the potential partners for these initiatives; and
- the key opportunities and constraints associated with each commodity.

The first phase consisted of a scoping review, which involved the collection of basic data and industry intelligence on each of ten commodities (cocoa, coffee, cotton, oil palm, salmon, shrimp, soy, sugar, tea and timber pulp). At the end of the first phase, IFC and WWF-US selected four commodities (cotton, palm oil, soy and sugar) for further investigation, on account of the perceived magnitude of sustainability impacts, financial sector traction, and the potential added value of an IFC/WWF initiative for each commodity.

This report is the product of the second phase of the project and is intended as a basis for discussion regarding future work on BMPs and agribusiness commodities. For each of the four selected commodities, it sets out background information on the sector; key environmental and social impacts; prospects for tackling these impacts through the adoption of BMPs; and preconditions, risks and strategic choices in relation to developing a BMP approach. The four commodity-specific chapters are preceded by a summary of common themes and potential approaches that emerge.

The research focused particularly on production issues (rather than processing, trading or retail). Processing issues were addressed where they are integrated with primary production (e.g. carried out at the same location as production). However, where non-production issues have significant implications in terms of the potential for BMPs, the research also highlights these.

This report was written by IIED and ProForest in co-operation with Rabobank. Readers should note that the report is intended as a rapid, 'first-pass' assessment of these commodities, and, given the evolving nature of commodity production and trade, elements of the report may be inaccurate or out of date. Furthermore, it should be emphasized that Rabobank provided input for this publication and was not involved in the final editing or writing of the report. As such the report does not necessarily represent the views of Rabobank in all areas.

Chapter 1: Common themes and approaches

1. Common Themes and Approaches

1.1 Common themes

Although we have taken a commodity-specific approach to this work, there are a number of clear themes common to most or all of the four selected commodities, and beyond to many other commodities.¹

- **Potential of a BMP approach to achieve positive change:** Many of the key social and environmental issues associated with the production and processing of these commodities could be addressed by the application of BMPs. A BMP approach offers significant opportunities to align and simplify social and environmental expectations and interventions through the value chain. By clarifying and disseminating information on better practice, such an approach offers the prospect of focused, concrete improvements to production practices.
- **Value of ongoing initiatives:** There is a suite of existing initiatives that are developing criteria or BMPs for some individual commodities. There is significant potential to build on and drive forward this existing work.
- **Extent of agreement on BMPs:** For some commodities, there is considerable agreement among responsible producers and other experts on the BMPs that would mitigate many of the key environmental and social impacts. Again, this offers significant potential for moving forward through a BMP approach.
- **Links between financing and adoption of BMPs:** This report points to the emergence of various attempts to link finance with BMPs. So far the evidence on the efficacy of such arrangements is patchy, and the potential for financial actors to influence change will depend on the context. It is therefore impossible to draw general conclusions. However, given the potential leverage of the financial community in relation to the commodities covered here, this is clearly an area worthy of further investigation. Current activities indicate a growing interest among institutional investors in the agricultural commodities sector.²
- **Limits of a BMP approach:** However, some problems can't be solved by a BMP approach alone and would require flanking measures. This is particularly the case with impacts associated with the expansion of the agricultural frontier (such as habitat loss), and with macroeconomic issues such as terms of trade, subsidies, and structural oversupply.
- **Fluctuating and declining prices:** World prices for many commodities are on a long-term declining trend, often exacerbated by shorter-term imbalances in global supply and demand. It is often claimed that low prices lead to a prioritisation of short-term financial returns over investment in more sustainable production.
- **Lack of financial incentives to implement BMPs:** Any investment in promoting BMPs is likely to be wasted without creating sufficient incentives for adoption. Many of the potential savings through BMPs will only result where there is a cost associated with poor practice. Some BMPs will inevitably incur greater costs, at least in the short-run. For instance, some BMPs (e.g. Integrated Pest Management) can raise efficiency through minimising inputs. However, against a background of intense competition and declining prices, growers are unlikely to adopt BMPs unless this demonstrably contributes to productivity gains or reduced costs in the short- to medium-term. Furthermore, there is a risk that the burden of any associated costs will fall disproportionately on producers, with little if any compensatory financial return. The complexity and length of many commodity chains means that even if market premia existed at the consumption end of the value

¹ As is the case in the lists of issues and impacts in the commodity-specific chapters, the order of this list of themes is not intended to reflect an assessment of priority.

² For example, ISIS Asset Management recently carried out some work with ProForest on palm oil; and Insight Investment has recently been raising with retailers issues related to their sourcing of cotton and shrimp. In addition, the UK Social Investment Forum's *Just Pensions* project is looking at the impact of the food industry (retailers and processors) in emerging markets and developing countries, with a view to identifying management approaches and tools that are most likely to result in international development outcomes and financial benefits (www.uksif.org/J/Z/Z/jp/home/main/index.shtml).

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chain, without establishing separate, more direct chains, it is unlikely that much of this premium would filter back to the grower.

- **Small-scale production and level of mechanisation:** The existence of many small-scale growers in some sectors is a barrier to adoption, given that smallholders are less likely to be able to access technical knowledge, finance and other capacity for investing in BMPs. Some BMPs are associated with mechanised production systems and are inappropriate for labour-intensive systems. Appropriate BMPs for different production systems, as well as dissemination efforts and technical support, are therefore likely to be necessary for commodities where these are significant issues. Experience with developing private sector channels for providing extension and other services to small-scale growers has had mixed results. Linking BMPs to finance provided to processors, who in turn could pass on incentives, knowledge and skills to large numbers of smallholders, is an option worth exploring further.
- **Limited proportion of traded commodities:** For some commodities only a limited proportion of production is traded internationally, with the remainder consumed and/or processed into finished goods domestically. Thus, attempts to change production practices need to take into account domestic as well as international markets, where points of leverage may be quite different.
- **Lack of visibility at consumption level:** Many commodities are consumed as ingredients within processed products. This means that they are 'invisible' to consumers, and not bought as a discrete product, thus reducing scope for consumer-led pressure through the value chain. This was emphasised in a recent survey of companies using palm oil, or products containing palm oil, which showed that although the companies acknowledged that unsustainable palm oil presented a reputational risk, few were sufficiently concerned to have taken any action to even find out where the palm oil they used came from.³ Nevertheless, it is possible that further interest from financial institutions, institutional investors and NGOs may provide sufficient leverage to overcome the lack of visibility at consumer level.
- **Potential for exclusion from markets:** If a BMP becomes a market-entry standard, or a means to a premium, there is a risk of producers unable to implement it being excluded from markets. This is potentially particularly significant for small growers who may not have sufficient capacity, information or access to credit to implement or accede to a particular BMP. Any BMP approach should therefore be appropriate and realistic for both small and large growers, and backed up with necessary extension and support.
- **Compounding existing competition:** BMPs have the potential simply to increase the existing dichotomy between those who can compete at current world market prices and those who can't. Where growers go out of business or no longer have the resources to invest in sustainable production, this may have negative social and environmental impacts that outweigh the benefits of implementation of BMPs elsewhere.
- **Not tackling the worst producers:** As with any voluntary mechanism, there is a danger that a BMP approach simply recognises the existing good practice of responsible growers rather than tackling the worst practices of irresponsible growers.
- **Extent of traceability:** Relationships between growers and buyers range from direct business-business relationships, outgrowers and contract growing, informal arrangements with small producers, to commodity exchanges. In the case of commodity exchanges and informal buying relationships, there is less scope for traceability and market signals for the implementation of BMPs. In order to establish recognition in the market for a commodity grown according to BMPs, certification and segregated chains for sustainable commodities may be necessary. A future BMP initiative should consider the pros and cons of working with existing markets rather than investing in alternative supply chain structures or ensuring full chain of custody traceability. Several models exist, ranging from:
 - *certification and segregation* of sustainably-produced commodities. This provides the best guarantee that a commodity really does come from a producer or processor that implements BMPs, but runs the risks of losing the benefits associated with commodity markets (scale,

³ ISIS Asset Management & ProForest (2003). *New risks in old supply chains: Where does your palm oil come from?*

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liquidity and efficiency) and incurring the costs of establishing and monitoring a dedicated chain of custody within traditional complex supply chains;

- an *area-wide approach*, where production areas are targeted for BMP adoption and so the entire production of the area can be mixed and bulked. This allows most of the benefits associated with the commodity markets to be maintained, but runs the risk of unsustainably produced product entering into the 'sustainable' product; to
- a '*pool*' system, where a buyer pays the premium to the sustainable producer, but without taking physical delivery from that producer. Instead, the producer's commodity would be bulked with others in the normal way, and the buyer would buy from the 'pool' as usual (a mechanism analogous to that used in buying 'green' electricity). This has not yet been implemented for any commodity and may provide insufficient stimulus for widespread BMP adoption.

Although the cost of implementing traceable supply chain systems is often regarded as a barrier to the adoption of social and environmental practices within bulk commodity production, there are many situations in which traceability is being increasingly demanded and introduced for other reasons (see Box 1.1). In such cases, it may be possible to make use of emerging technologies and systems to encourage environmental and social BMPs.

Box 1.1 Identity Preserved schemes⁴

'Identity Preserved' (IP) commodity production uses a combination of contract farming, information and tracking technology⁵, production, processing and distribution technologies, and process standards. IP technology has so far largely been applied to managing risk, for example in excluding GMOs from supply chains, or ensuring quality, such as enhanced starch quality in maize. Once the technology and systems exist, there is the possibility of widening the set of attributes to include environmental and social issues more broadly. Use of this technology is growing. For example, General Mills announced in 2001 that half its total grain usage was expected to be identity preserved within the next few years.⁶

1.2 Common approaches

The following commodity-specific chapters highlight many of the issues and strategic choices in developing a BMP approach. But a key question in relation to all four commodities discussed here is the approach that an overall BMP-based initiative should take. This issue breaks down into four primary decisions:

- **National, regional or global?**

Although the most high-profile BMP-based initiatives are global, there may be more potential to drive change by working at national or regional level. This is likely to be more appropriate for location- or context-specific discussions on BMPs, and it may be more likely to attract the interest of key regional players, at a scale at which they feel able to exert influence for positive change. However, a wider approach may be necessary to engage global buyers and processors, and to develop a greater understanding of and dialogue around the macro-economic and political context.

- **Leaders or laggards?**

Similarly, a judgement needs to be made whether it makes more sense to work with a few leading companies, at least at first, rather than seeking to engage a whole sector. Working with both leaders and laggards is inherently difficult – both in terms of creating sufficient incentives for different companies to engage, and in moving the agenda forward. A sectoral approach runs the risk of moving only at the pace of the slowest. But by definition it is likely that there is greatest scope for social and environmental improvements through the application of BMPs by the 'laggards'.

⁴ Adapted from ProForest and IIED (2003) *Feasibility Study for a Generic Supply Chain Initiative for Sustainable Commodity Crops: Findings and Recommendations*, report to the Advisory Committee on Consumer Products and the Environment, which advises the UK Department for Environment, Food and Rural Affairs.

⁵ Such as that developed by IdentityPreserved (see www.identitypreserved.com) or efarm (www.efarm.com).

⁶ Ron Olson, General Mills Grain Divisions, September 2001, cited in Shipman (2002) 'The Need for Greater Product Differentiation in the Grain Industry - from a USDA Perspective'. *Agricultural Outlook Forum* www.usda.gov/agency/oce/waob/oc2002/speeches/shipman.pdf.

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- **Single or multi-commodity?**

Given the common issues, barriers, preconditions and risks identified above, it is clear that there could be significant synergies from an approach that maximises shared learning rather than addressing only one commodity in isolation. There are many examples of schemes and approaches that apply to several commodities, such as Fairtrade, organic and IPM. In these cases, a set of overarching principles operates in tandem with specific measures for individual commodities, sometimes expressed in a commodity-specific protocol. The logistics of managing such a process, and attempting to gain commitment from stakeholders, would undoubtedly be a significant challenge.

- **Separate process or links with other initiatives?**

A separate but related issue is the extent to which an approach should engage with existing initiatives. Where the key players are already engaged in a commodity-specific process (such as the Round Table on Sustainable Palm Oil), it could be counterproductive to establish separate processes. There are several initiatives involving other commodities that provide examples of innovative approaches and processes (see Box 1.2) – where possible, the insights from these should be fed into any parallel or overarching initiative. Finally, there are opportunities to engage with parallel multi-commodity initiatives, notably the IISD/UNCTAD Sustainable Commodities Initiative.⁷ Engaging and collaborating with other initiatives would have reputational, managerial and institutional implications, and care would need to be taken to ensure that the goals of each initiative are complementary. But failing to engage with these initiatives runs the greater risk of diluting energy and commitment among industry stakeholders, and of failing to develop an authoritative set of BMPs and agenda for implementation.

Box 1.2 Sustainable Smallholder Production Systems

Unilever is developing a new market in Allanblackia seed oil, for use in soap and food products. This tree crop occurs in natural high forest and forest-edge farmlands in west, central and east Africa. The crop has the potential to raise smallholder incomes, through wild harvesting and possibly eventual domestication. As well as investigating BMPs for environmentally sustainable production, Unilever is seeking to develop guidelines on socio-economic issues in order to maximise the poverty reduction potential of this new market. This work could provide valuable lessons for other commodities, particularly smallholder tree crops. It may also have implications for other edible oil markets.

Given the need to take these four key decisions, we have not sought to provide a shortlist of key players who should be involved in a BMP initiative. Rather, we have identified the range of actors involved in the production, trading and financing of each of the four commodities, on a regional basis where possible. In addition, we indicate significant end-users and other key stakeholders. However, these listings are broad and inevitably incomplete. We recommend that further elaboration of who should be involved in a future initiative takes place only once the above questions have been resolved, noting that different players will need to be involved to address particular issues and specific production locations.

⁷ Sustainable Commodities Initiative at www.iisd.org/trade/commodities/sci.asp. As a significant parallel initiative that is seeking to engage many of the key actors in the commodities covered by this report, the value of coordination and the potential for collaboration with the SCI is likely to be significant.