



## FAIR TRADE = DIRECT TRADE

### Understanding supply chains and how they affect pricing.

Many people are confused by the difference between Fair Trade and Direct Trade, but in most cases they are one and the same. Understanding the 'normal' supply chain for imported commodities may help you understand the difference, and also see why Fair Trade produce is often sold at market pricing, despite the price guarantees, social programs and high standards that are set in stone in Fair Trade trading relationships.

A local farm sells their carrots, potatoes and lettuce to a store in, for example, Nelson BC. The buyer and farmer discuss and agree on pricing and the sale is complete. Done deal! It would be nice if it was that simple, but for a small producer who is growing an export crop in a foreign country, it is a vastly different story.

The easiest way to demonstrate this is with two scenarios.

Rosa lives in Motupe, Peru. She is 56 years old. Her family has 10 acres of mango trees. Rosa is poor. She lives in a small adobe house with limited electricity, no internet, no cell phone. She has a bicycle and when she needs to go to the local town, she pays 60 cents and travels by moto – a little motorcycle taxi. She has a little garden with a few chickens. All year she looks after her orchard – she makes compost and compost tea to fertilize her trees. Every few weeks it's her turn to water and the local irrigation canal or creek is diverted to her orchard for a few hours. For the small amount of money she makes she also pays nearly \$2,000 a year for her organic and food safety certifications.

When her mangos are ready to pick a 'coyote' arrives. Here is the conversation: "Hello Rosa, is your fruit ready because we have good markets for it." Rosa replies: "Yes, but I got very little money last year and you paid me very late." The coyote, an impolite name for a local trader says, "last year was a very bad year, there was a lot of production, and problems at the packing plant so a lot of fruit wasn't sold. The price we got back was very poor, and that's why you only received 40 cents a case, and I didn't get paid myself until very late – three months after the season was over." To which Rosa responds, "but that is only 4 cents per mango – that's not fair - what will happen this year?" And the reply is "from what I hear there is less production, and we are using a new packing house, so I think this year you will get 2 or 3 times as much money." So Rosa, who has no way of knowing if she is hearing the truth or not agrees to sell her mangos to the same trader she sold to last year – it is always better to sell to the devil you know than the devil you don't. She has no option – no market intelligence, no system generated report showing her sales and deductions, and she doesn't know where her fruit was sold or who to. Rosa has lost complete control of her mangos right at her farm gate. The next day, a picking crew comes and takes her entire crop, loads it all into plastic crates and takes it to a packing shed. No money changes hands, nor an invoice. She may not even know how much fruit they took.

The packing shed packs her fruit in brand name boxes, usually with the name of the foreign importer on them - and stamped with a code that shows it is her fruit. 30% of the mangos will be culled out for quality reasons and sold in the domestic market in Peru. The coyote gets that rejected fruit back and sells it at prices so low to stores in Lima that there is no money left for Rosa.

The packing shed now “owns” her mangos, but there is no price agreement between the packing shed and the coyote who gave them the fruit. The packing shed has a relationship with importers in Europe and the US. They palletize the fruit, arrange for government inspections, and book containers to send the fruit by sea. The cost to take Rosa’s fruit, pack it, and put it on a sea container is about \$1.40, but they need a profit margin as well, so they are going to keep between \$1.80 and \$2.50 to pack each box.

Once the fruit is exported, it is now up to the importer to sell them – they have committed to 6 cans (containers) of fruit a week for five weeks and those orders are based on a ‘gut’ feeling based on last year’s sales, expected sales and some firm agreements with their customers. But nothing is etched in stone. Those importers only sell to independent wholesalers and distribution centers for major supermarket chains – they aren’t selling directly to retail stores. Between the time the packing shed puts the fruit on the water and it arrives, 2, 3 even 4 weeks have passed, and market conditions will have changed dramatically. Let’s flip to the end of that supply chain. AZ is a chain of supermarkets in Austin, Texas. To be competitive, they are only going to pay \$7.20 a case, and it is going to cost \$1.00 per case to truck them from L.A., so they agree to pay the importer \$6.20. When they arrive, and arrive in perfect condition, (a good arrival,) the market price in L.A. has dropped and they go back to the importer and ask for a price reduction to \$5.80 so they are competitive and can make their profit margin.

At the end of the season, the importer is going to add up all their sales for those 30 containers, after price reductions, losses because of quality (because they didn’t sell all the fruit in time), warehousing costs and the \$1.00 a box it cost for the sea freight and then deduct a reasonable profit margin (10-20%) and report back to the packing house (exporter) in Peru that their net return for the year is going to be \$3.20 a case. The packing plant is now going to deduct, say \$2.10 for packing the fruit, including their profit margin, and when they get around to it, they are going to pay the coyote \$1.10 a case. The coyote, after deducting their costs for harvest labour, transportation to the shed, and a profit margin, is now, this year, going to go back to Rosa and pay her, months after the season is over, 31 cents a case – or 3 cents a mango, and tell her that there was over-supply issues in Miami and L.A. and 4 containers were ripe when they arrived because of a port delay – not her fault, but she bears the cost.

Here’s the second Fair Trade scenario. Julio is a small mango grower in Chulucanas, Peru. He and 40 other growers are members of a long-standing cooperative. Over the years, they have made enough money to lease a building and install a packing line and cooler themselves – a \$50,000 investment partially paid for with Fair Trade social premiums and matching funds from their customers and the government. (10% of the total came from a bonus payment from Discovery Organics.) The cooperative knows they will have a total production of about 60 containers, and has pre-sold them to Fair Trade importers in Vancouver, Toronto, Rotterdam and Osaka. A minimum price ranging from \$3.60 to \$4.50 has been promised by the importers, and it is stated in a Fair Trade Supply Contract signed before the beginning of the season. All the fruit that is sold with a Fair Trade label will also generate an additional \$.56 a case for Social Premiums, much of which is spent on dental, health or education programs. The coop doesn’t need to worry about the up-front packing costs, buying boxes and pallets, or harvest labour, because each one of their Fair Trade partners has pre-financed the coop for a total of \$110,000 pick and pack months before the harvest begins - a little known but very important facet of Fair Trade.

The importers buying fruit from that coop are likely to only contract for exactly what they think they can sell, because if there is a price war, a supply glut, quality issues because they sat on the mangos for too long, Discovery Organics and other importers cannot cry the blues to the coop and make any

deductions. Discovery Organics brings the containers directly from Paita, the port closest to Chulucanas to Vancouver, and sells the mangos directly to retail stores. There is no middle-man importer, or expensive trucking costs from Los Angeles. At the end of the season, the reporting process is the same for Julio's mangos as Rosa's. Final selling prices less Discovery's margin, sea container costs etc. are added up and paid to the coop. If the final price is lower than the contracted price, it's too bad for Discovery, and if it is higher, then the "extra" goes to the coop. After harvest labour and packing costs are deducted (without any profit margin, because the coop owns their own packing line,) Julio, at a minimum will receive 18c a mango in the worst possible year, and in a good year that price could be as high as 35 cents. His coop has complete control of the supply chain – they own the means of production, and have a guaranteed sale and minimum price in place even before the fruit is off the trees.

That is the Fair Trade difference, and within that supply chain, Discovery has eliminated trucking costs from the U.S., an importers margin in L.A., a packing plant profit in Peru, and a coyote's markup for harvesting – and that is the direct trade advantage to a producer working within the Fair Trade system.

Shocking isn't it – Julio makes up to 10 times more money, but this scenario plays out for small producers of blueberries in Chile, orange growers in Africa, and nearly every small producer of an export fruit crop that is volatile (short storage life.) Because all this fruit, billions of pounds moving from poor countries mostly in the Global South is, in effect, sold on consignment, and passes through many, many hands, Rosa's story is not an anomaly, but exactly what happens for most small producers. Happy stories are few and far between, the opposite of direct Fair Trade relationships.

Oh, and one last thing. Julio's coop has a good track record, good accounting systems, and is a long-standing and well managed coop. Recently, as part of Japan's international development program, the coop was granted funds to install a mango drying plant at their facility. So the 30% of Julio's harvest that doesn't meet export standards is now being cut, dried and sold as Fair Trade dried organic mangos – far better than the big fat zero that Rosa gets for her cull fruit.