PRICE IN GLOBAL COMMODITY VALUE CHAINS

KEY TO ACHIEVING LIVING INCOME AND LIVING WAGE

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INSTITUT FÜR ÖKONOMIE UND ÖKUMENE

Solidaridad

CONTENTS

EXECUTIVE SUMMARY

Low prices and price volatility negatively impact producers' and workers' livelihoods and are a root cause for human rights violations and environmental degradation. Solidaridad's mission is to enable farmers and workers to earn a living income, shape their own future, and produce in balance with nature by working throughout the whole supply chain to make sustainability the norm. It recognizes that farm incomes depend on many factors including farm size, the type and mix of products, productivity, output prices, production costs, market access and taxes or subsidies. In this mix of factors that determine income and wages, the price received by producers for their products is crucial. Longer periods of low prices as well as price volatility negatively impact producers' and workers' livelihoods and are also a root cause for human rights violations and environmental degradation. Closely linked to prices, the fairness of trading practices also influences producer's income and the business case to invest in sustainable production practices.

Improving producer and worker livelihoods requires complementary strategies in which prices are an **important component.** Despite their relevance, prices and trading practices are often not included in the mix of strategies to improve producer and worker livelihoods. Many development initiatives tend to focus on productivity and quality, while prices are still felt as highly complex and sensitive topics. However, in the pursuit of more sustainable value chains, they need to be included in the mix of strategies. Therefore, they deserve a closer look. This paper, written by Aidenvironment and SÜDWIND Institute, aims to create a better understanding of the factors which drive price setting and proposes policy interventions that can be taken from a European perspective and which can contribute to improved prices for producers outside Europe. It focuses on six of the commodity sectors in which Solidaridad is active: palm oil, coffee, cocoa, cotton and textiles, and artisanal and small-scale gold mining (ASGM).

Prices of international commodities are fundamentally driven by supply and demand, but also by private sector purchasing practices, public policies and some broader contextual factors. Producer prices very much depend on the global prices. These prices are fundamentally governed by supply and demand dynamics and how market actors react to these. Key variables that influence supply include technology, weather and crop diseases, and the elasticity to adjust production output. Key variables in demand include demographics, consumer preferences and purchasing power, and the availability of substitutes. The presence and management of stocks also influence prices. However, prices are not only about these market fundamentals. Prices paid to specific actors across the value chain also depend on the nature of the trading relationships between these actors and the power relations that exist between them. They can lead to a situation where in similar market circumstances one actor is paid a different price than another. In addition, supply and demand, as well as the actions of value chain actors are influenced by a range of public policies which can include measures to support or restrain supply and demand or influence price-setting, price discovery and trade flows. Examples of influencing factors in the broader context include infrastructure and transportation costs, currency exchange rates, financial speculation on commodity markets and the presence of informal markets.

Despite having little influence over global prices, some options in producing countries exist to create a better price environment for producers. For the six commodities, individual producers have no influence on export prices and what price they receive. Globalization has created a complex web of interdependencies in which prices paid to producers very much depend on developments beyond the borders of an individual country. Despite these limitations, strategies exist to support producers in obtaining higher and more stable prices. Producers could be supported in increasing their negotiation power, the quality of their produce, or in value addition. However, the success of this very much depends on the type of market access and whether the market is willing to pay for quality and additional value, and whether its remuneration is bigger than the investment needed. Governments in producing countries have a range of policy options to influence how the export price translates into a producer price. In the agro-commodities, existing policies include fixed farm-gate prices, fixed margin distribution and floor prices which create some guarantee or stability on prices received. Governments can also work on trade policies, price discovery mechanisms (e.g. auctions) and supply management.

Companies, and particularly downstream companies, can take much more responsibility for paying prices which enable producers and workers to earn a living income and to mitigate human rights violations and environmental degradation. In most contexts, downstream companies have the most power, set trading conditions which trickle down through the whole value chain, and capture most of the value. Despite current sustainability claims and producer support projects, the prices they pay do not consider nor enable them to cover the cost of sustainable production, including the ability to earn a living income and living wage. The UN Guiding Principles on Business and Human Rights as well as the OECD guidance for the agricultural and garment sectors clearly state that companies have to take responsibility for human rights across the whole value chain. This will require building transparent, direct and long-term relationships within value chains as a basis for risk and value sharing. Prices should be a part of this. While individual companies may not be able to influence global market prices, they could decide to deviate from them. They have various options at their disposal, including paying prices or premiums which are informed by the cost of sustainable production and living income and living wage benchmarks. This has to be complemented with other responsible purchasing practices such as long-term sourcing contracts, fair payment terms, and no unilateral changes to supply agreements.

The EU and its member state governments should create mandatory regulation and incentives for companies to adopt responsible purchasing practices, facilitate pre-competitive action and support investments in producing countries. European governments have various instruments to create direct incentives, such as incorporating the topic of prices in corporate sustainability due diligence regulation, regulation around unfair trading practices, and through adapting competition law, trade agreements, tariffs, taxation, public procurement practices and sector-specific strategies. Furthermore, they can promote private sector commitments and use development cooperation to invest in strategies which support producer prices.

Civil society organizations should highlight the link between prices and human rights in their advocacy efforts, supported by evidence. They can also promote responsible purchasing practices. Civil society organizations should take a strong position that living income and living wage are human rights, and continue to stress the importance of the role of price in human rights due diligence. In support of this position they should collect evidence on how producer prices influence human rights violations and other externalities. This can be done in cooperation with, for example, research institutes. By supporting data collection on costs, prices, income and value distribution, they can contribute to a more objective public debate around prices and provide sector-wide benchmarks for private and public sector strategies. Through their partnerships and implementation of programmes they can make prices a more explicit topic in their engagement and interventions to support producers and value chain actors in developing strategies which aim to obtain higher and more stable producer prices.

OVERALL KEY MESSAGE


**GERT VAN DER BIJL AND CATARINA VIEIRA,
EU POLICY ADVISORS**

There are clearly considerable differences between the 6 different sectors in the research. But there are also apparent similarities:

- Producers receive a small and diminishing share of the value created in the supply chain.
- Sustained periods of low prices and price volatility have a direct influence on the well-being of producers and workers, undermining their ability to obtain a living income or to pay living wages. It also disincentivizes and disables making investments which improve the viability and resilience of the farm or enterprise and to improve social and environmental sustainability.
- Willingness among companies in different sectors to pay a better price is minimal at best. And prices are seldom part of the sustainability debate in the sector.
- In all sectors it is difficult or impossible to imagine how the major sustainability issues throughout the whole supply chain can be solved without paying higher prices.
- In several sectors, better prices need to be complemented by sound policies from governments in both producing and consuming countries.
- Paying higher prices alone will not solve all problems. And there can be unforeseen negative consequences. But this can never be an excuse for companies to avoid discussions about it.
- What is needed in the end is to redefine the business model of companies in different sectors away from searching for the lowest price (with sustainability requirements added) towards equal partnerships that include payment of fair prices. That can only be realized if the subject of pricing is part of the debate.

INTRODUCTION

WHY THIS RESEARCH?

Solidaridad's mission is to enable farmers and workers to earn a living income, shape their own future, and produce in balance with nature by working throughout the whole supply chain to make sustainability the norm. It recognizes that farm incomes depend on many factors, including farm size, the type and mix of products, productivity, production costs, output prices, market access and taxes or subsidies. In addition, inherent power imbalances in commodity sectors and their supply chains, lack of transparency and dependency relations throughout the chain provide context-specific challenges to fair value distribution and the degree of influence smallholder producers and workers have. This leaves them vulnerable and reliant on protection from unfair trading practices. Similar and other factors are also valid for artisanal and small-scale gold miners as well as the factories in the garment and textiles sectors. Nonetheless, in the mix of factors that determine income and wages, the price received by producers for their products is a crucial one. Longer periods of low prices as well as price volatility negatively impact producers' and workers' livelihoods and are also a root cause for human rights violations and environmental degradation. Closely linked to price, the quality and reliability of trading practices also influence the business case to invest in sustainable production practices. Unfair trading practices, like short contract terms, excessive payment terms, or sudden cancellations of orders can undermine this.

Despite these facts, prices and trading practices are often not included in the debate on how to achieve sustainable value chains. Many stakeholders, including not only companies and governments, but also NGOs and providers of extension services are of the opinion that market prices are a given and interventions in price setting systems are a no-go. Moreover, in the voluntary sustainability standards (VSS) and certification schemes around which stakeholders organize themselves, price is structurally omitted and therefore the topic is not addressed. Four common arguments to explain this viewpoint are: first of all, neoclassical economic theory claims that the market always knows better. Second, price interventions in the past, and specifically in European agriculture, have led to frustrating results due to market distortions. Third, prices as well as trading practices are at the core of companies' business models and competitive strategies, and companies prefer to keep full autonomy over these and keep them well shielded from the competition. Fourth, even when companies would like to discuss sustainability initiatives which touch upon prices, this is seen as a potential violation of competition law and therefore companies refrain from it (EC, 2021). Current institutions and the existing regulatory framework for global trade do not (yet) allow or enable necessary checks and balances for fair trading practices, equal value distribution and transparent analysis of (sustainability) costs.

Meanwhile, many development organizations, including Solidaridad, have refrained from structurally addressing the topic of prices apart from some niche activities or the promotion of Fairtrade and similar approaches working with minimum prices and premiums. Instead, the core focus of many poverty alleviation strategies is productivity improvement and nowadays also livelihood diversification. Price is still felt as a highly complex and sensitive topic, which their corporate partners show little eagerness to discuss. An exception is the attention for True Price methodologies and living income and living income benchmarks, which are being picked up and tested by frontrunner corporates, and to some extent financial sector and accounting firms.[1] While the calculations and the analysis behind this can be insightful,

1 True pricing enables to make hidden social and environmental costs visible by means of monetization, showing the so-called True Price of products (see **https://trueprice.org/**). Living income and living wage benchmarks are methodologies to determine income levels for producers and workers that allow for a decent standard of living for all members of their household (see **https://www.living-income.com/** and **https://www.globallivingwage.org/**).

this exercise is often disconnected from market reality, stays in niche markets and does not translate to necessary changes in the supply chain.

Nonetheless, prices and trading practices have a material effect on all efforts to support and improve the situation of producers and workers in value chains. For example, producers might introduce better production practices which reduce costs of production and increase productivity, but due to declining prices they do not earn a higher net income. In 2016 the cocoa and coffee sectors saw a price decline of approximately 30% within a few months due to oversupply. Many projects which wanted to support farmers to earn more experienced this as a massive setback in their efforts to make a living income or a living wage in the supply chains possible. Even many companies at that time stressed that the price decline was the worst thing that could happen to the investments made into a more sustainable supply chain.

In other words, it makes sense to include prices and trading practices in the mix of interventions to promote living incomes and living wages as well as to mitigate human rights violations and environmental destruction. On the one hand, many people and companies are still reluctant to talk about prices and trading practices, but on the other hand, they see the necessity to do this. The UN Guiding Principles on Business and Human Rights (UNGP), legislation on human rights due diligence of companies in some EU member states (including France and Germany) and the upcoming EU legislation on human rights due diligence put pressure on all sectors to rethink their positions. Companies know from their own experiences how influential prices and trading practices are for creating space for social and ecological improvements. It is their daily practice to negotiate prices and to calculate what these prices mean for the processes within their value chain. In other words, the time is opportune to discuss these things. This paper provides inputs to this discussion.

SCOPE AND APPROACH

With the ambition to strengthen the position of smallholder producers and workers in global supply chains, Solidaridad Europe asked Aidenvironment and SÜDWIND-Institute to enhance their understanding of the factors which drive price setting, and which policy interventions can be taken from a European perspective that can contribute to improved prices for producers outside Europe. This paper presents the outcomes of this exercise, focusing on six commodity sectors: palm oil, coffee, cocoa, cotton, garment and textiles, and artisanal and small-scale gold mining (ASGM). These commodities are targeted by the Policy Influencing (PI) team of Solidaridad Europe in the context of their RECLAIM Sustainability! programme. The PI team advocates for inclusive policies, rules and regulations in both the public and private sector, particularly in the EU, with the aim to foster sustainable production and consumption through inclusive and sustainable supply chains. Their work is complementary to the producer support, corporate engagement and policy influencing by other Solidaridad teams across the world.

The six commodities all have their own very specific context. Within commodities there also exists significant variation between countries and market segments. There can be great variation in the nature and impact of price-related issues and solutions to mitigate them. Whilst recognizing the need for context-specific perspectives, this paper tries to generate general insights which are at least partially applicable to the six commodities. They can form a basis for more tailored in-depth research and strategy development. The analysis explores price influencing factors and strategies on how these can be influenced. The findings of this research lead to recommendations on how to create a better price environment for producers.
As market forces alone so far have not been able to solve this, the recommendations include actions for political actors and civil society. The paper summarizes the present debate about pricing and this might open a window of opportunity for all stakeholders to combine existing efforts in a more holistic approach, including pricing factors as part of the discussion.

The structure of this report is as follows. Chapter 1 describes briefly the context of the six target commodities and elaborates the case of why it is important to look at prices in addition to other strategies to promote producer income. Chapter 2 attempts to create a better understanding about the factors which influence commodity prices. Chapter 3 presents a range of strategies to influence prices, while chapter 4 takes a closer look at what European actors could do. This paper ends with key insights and recommendations to inform future action to create a better price and trading environment for small-scale farmers.

A Note on Pricing Terminology: Throughout this document we use terms like 'fair price', 'higher price' or 'better price'. Pricing and pricing practices are a complicated topic, varying from commodity to commodity and region to region. Our pricing research is about how pricing practices impact the lives of smallholder farmers and workers working across a variety of important commodities. As such we can't talk about one policy that would solve all problems in these chains, in the same way that we can't say for all of them that a 'higher price' is the solution, or that a 'fair price' is sufficient. The term varies depending on the context, but whether we are talking about a higher price, a fairer price or a better price, we are always talking about the 'best price' and pricing practice for the commodity in question.

COCOA

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For living income to become a reality for cocoa farmers, action is necessary on three separate dimensions simultaneously: good agricultural practices, good governance policies, and good purchasing practices. Any corporate or government effort that offers less will not be an adequate response to the challenge. Living income will not be reached by project-based approaches; it will require a systemic approach, a systemic change.

As a first step, corporations need to start taking major steps forward on good purchasing practices. Likewise, governments (and corporations) need to make serious work of good governance. These actors must take their responsibility before asking farmers to invest effort and money in improving their productivity.

Image source: Cocoa Barometer 2022, The VOICE Network. Published under Creative Commons License Attribution-ShareAlike 4.0 International.

Furthermore, all stakeholders in the cocoa value chain need to prioritize living income as it is a human right, and a necessary precondition to address all the other sector challenges. Living income must become mandatory, and therefore enshrined in upcoming due diligence regulations.

In all this, there is currently very little conversation about the industry's business model, including how they set the prices they pay. As a result, most farmers are still not earning a living income, and not a single stakeholder group is currently doing what they should be doing to ensure farmers achieve a living income.

1. WHY DO PRICES MATTER?

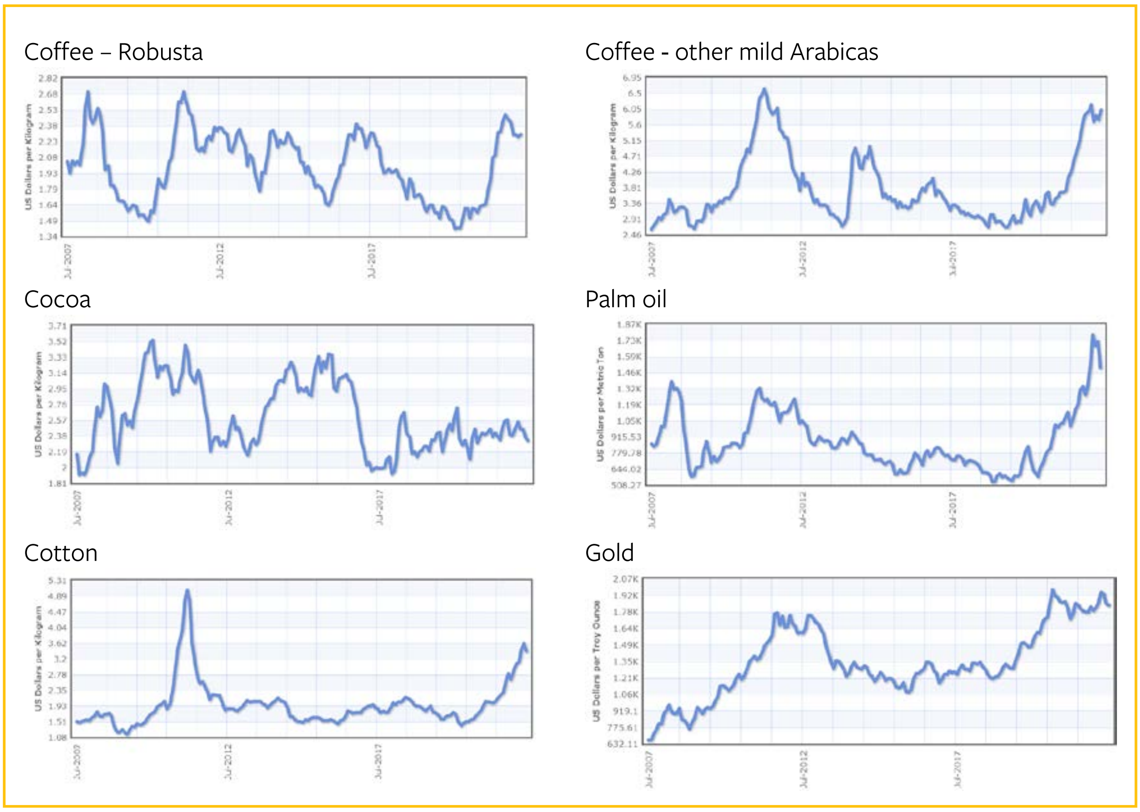
This chapter provides some arguments on why prices and trading practices should be in the mix of interventions to promote living incomes and wages as well as to mitigate human rights violations and environmental destruction.

1.1 PRICE TRENDS

Producer prices very much depend on global prices, over which producers have no control. With the exception of the garment and textiles sectors, all commodities have international reference prices. These form the basis for export contracts which largely determine the prices received by producers. For cocoa, coffee, palm oil and cotton there are one or more future and derivative markets. Standardized qualities of the respective commodities are traded on these markets. For example, the New York futures market is the reference for Arabica coffee, and the London one for Robusta. Prices on these future markets reflect the estimated availability and demand for coffee of the Arabica or Robusta type. These prices are typically used as a reference price for export contracts, which in turn serves as a basis for price negotiation based on other factors such as quality, risks, etc. (Waarts & Kiewish, 2021). In cotton, the most widely used reference price for international trade is the Cotlook A - Index, which is formed from the average of the five lowest quotations from a basket of the 18 most important internationally traded upland cotton wools of a certain quality. In gold, the London Bullion Market Association (LBMA) gold price is used as a benchmark for traders, banks, and refineries, influencing prices all the way to mine sites across the world. In other words, export and producer prices depend on these international reference prices. This also implies that producers themselves have no influence over these prices, and that their production costs or sustainability investments do not have any direct influence on these prices.

For most commodities, real prices have declined in the past decades and volatility can be high. The following figures show the nominal price developments in coffee (for Robusta and Arabica separately), cocoa, palm oil, cotton and gold. It is striking that inflation-adjusted prices for cocoa, coffee and cotton were significantly lower during the last decade than three or four decades before. Palm oil has a similar long-term trend despite the most recent price hike. Only gold prices move more or less in line with inflation. There is no international reference price for garment and textiles, which can be explained by the lack of standardized products. Although global reference prices are absent, prices for textiles and garment have declined significantly in the past decades (Ryan 2021). The figures below also show high volatility with periods of low prices alternated with booms.

FIGURE 1: GLOBAL NOMINAL PRICE DEVELOPMENTS BETWEEN 2007 AND 2022



Source: https://www.indexmundi.com

1.2 THE IMPACT OF LOW PRICES AND PRICE VOLATILITY

Sustained periods of low prices and price volatility have a direct influence on the well-being of producers and workers. In many contexts, prices are too low to cover the costs of production and are far from enabling producers to earn a living income or to pay a living wage to workers. This disincentivizes and disables investments that can improve the viability and resilience of the farm, mine or factory, including measures that avoid human rights violations and environmental degradation. Long periods of low prices even lead to a situation where human rights violations like the use of child labor are the only option for families to earn the financial means for basic needs including food. The ICO (2019) states that the impact of prolonged periods of low prices on coffee producing countries is severe and ranges from increased poverty rates, food insecurity, and erosion of labor standards to social unrest, political instability and even international migration. These dynamics are not exclusive to coffee. In the garment sector, low prices are seen as an important cause of low wages for workers and increased work intensity (Chua 2022) and poor working conditions. The growing awareness of these challenges has contributed to more attention for the role of prices in cocoa, coffee, cotton, garment and textiles. In palm oil and gold, low prices have so far received less attention, which could have to do with the relatively good profits made by producers. Nonetheless, price volatility is an important concern to producers in both commodities, as is the case in the other commodities. It can have severe temporary impacts on producers' profitability and creates significant barriers to invest in productivity, quality and sustainability.

1.3 PRICE VERSUS OTHER STRATEGIES TO IMPROVE PRODUCER INCOME

The impact of low and volatile prices on producers' and workers' livelihoods can be significant. All stakeholders in the value chains are aware that low prices have a significant influence on the well-being of many millions of producers and workers. However, opinions differ to what extent increasing prices are a realistic way out of poverty. Prices are indeed not the only factor influencing the net income of the small scale farmers, miners, or workers in the textile value chain. Particularly in the agricultural space, the focus on improving farm income has been on productivity and to a lesser extent on quality. In recent years, farm diversification has become another important strategy to increase income and improve climate resilience. In addition, there are voices which state that farms need to grow bigger to increase income. Whilst all relevant, experience shows that there are also important limitations to using these levers to increase income.

The road of productivity and quality improvement to raise producer income is paved with multiple challenges. An often heard argument is that even if prices would significantly increase, it would not get most producers out of poverty, because they produce so little volume. A recent study by the Sustainable Trade Platform (2020) in Colombia found strong positive correlations between costs of production (e.g. investments in the farm) and productivity and margin. It concluded that for the specific Colombian context, productivity improvements have a larger impact on income than price improvements. Waarts and Kiewisch (2021) also argue that the positive impact of price premiums in cocoa in West-Africa is much larger for those farmers who produce more, and conclude that in the context of significant resource inequality, price and premium mechanisms are not the most appropriate tools to address the needs of the poorest and most vulnerable households. There is a mixed bag of evidence and opinions about the effectiveness of productivity improvement, as well as quality improvements, with the aim to improve producer incomes. What is clear is that there are important limitations to this strategy in the context of small-scale producers.

Investments in productivity and quality do not always pay off, partly because of low commodity prices. The first limitation can be the poor business case for productivity and quality improvement. The required good agricultural practices will need additional investments in terms of labor input and inputs like new planting material, fertilizers, pesticides and better tools to work with on the farm. The recent explosion of fertilizer prizes, which are often needed to increase productivity, makes it impossible for many farmers to use these. More intensive practices may also require a change from family labor to more hired labor, which adds to the upfront costs. Meanwhile, the risk is with the farmer since there is no guarantee that these investments will be effective (e.g. due to weather events, inappropriate use or bad quality of inputs, and/or the lack of market access). Price also plays a role here, because farmers usually don't know which price they will receive after harvest, which makes it difficult to calculate the business case for productivity and quality improvements beforehand. In addition, farmers have no guarantee they can access markets for high-quality agricultural products, which tend to remain niche. As a result, significant volumes of quality coffee, cocoa and cotton are sold as conventional products and producers are not rewarded for quality improvements. Even in the coffee sector with its highly differentiated specialty market, the prices for these coffees do not always cover the cost of production and are extremely volatile (SCA, 2019). The same is true in the garment and textiles industry, where a strong trend is present towards cheaper clothes of lower quality. These limitations and uncertainties make investments in productivity and quality a risky business.

When producers want to make investments to increase productivity or quality, they may not have the means to do so. In case there is a positive business case for investments in productivity and quality, small-scale farmers and gold miners often do not have the savings or access to credit to make these investments. Where they have access to credit, they often pay excessive interest rates. Failure in harvest or a decline in prices can get them in a debt trap, which eventually could cost them their production capacity. The textile sector functions differently, but in many steps of the value chain increases in productivity require massive investments. In combination with the trend of declining inflation-adjusted prices, this leads to high risks for producers.

Productivity increase can even contribute to lower prices as world market prices strongly react to oversupply. If only a small percentage of producers would significantly increase their productivity, prices can decrease significantly as well. In the cocoa sector for example, an oversupply of only 7% led to a price decrease of more than 30% in the harvesting season 2016/17. The coffee sector has experienced similar developments for a couple of years. To avoid this, productivity increases must be accompanied with supply management. This currently does not exist in all six commodities.

Farm size is a critical factor for farm income, but difficult to increase and can introduce new challenges of paying living wages to workers. The above-mentioned study by the Sustainable Trade Platform (2020) shows that even with the exceptionally high 2020 prices, 75% of the Colombian coffee farmers with less than five hectares of coffee earned less than the living income, and 44% found themselves below the poverty line. This shows the importance of farm size in generating a living income and fuels the assumption that enlarging farm size will lead to a higher net income. However, calculations to prove this are often missing. In many contexts, options to enlarge farm size are limited. Where options exist, producers may not have the means to make such investments (e.g. for buying or leasing land, farm inputs and labor) and remain uncertain whether the investments will yield any profit. For example, it is striking that globally most cocoa farmers work on plantations smaller than 3 ha. Many of them have access to at least some additional land not used for the plantation, but they are not converting it. This might be connected to labor input per hectare, as bigger plantations cannot be run by family labor anymore, and farmers cannot afford hired labor. A single orientation to farm size also creates a significant challenge. A study of cocoa and tea farmers in Africa shows that for farmers to achieve a living income – when all other variables remain constant – farm sizes would need to increase on average four to eight times in Côte d'Ivoire, Ghana and Kenya (Waarts et al. 2021). The study does not consider if families can manage the additional workload, but it does raise the question whether farmers can really achieve additional net income if they have to pay hired workers a living wage.

Farm diversification can contribute to a more stable income, not necessarily a higher income. Objectives around living income, climate resilience and food security have increased attention to the role of farm diversification. Small-scale farmers often practice some degree of diversification through intercropping or crop rotation practices. These crops can be used directly for their own consumption, meeting direct household needs for daily food, or create an additional source of income when the produce is brought to market. Cotton farmers in West Africa usually grow at least half a dozen crops, whilst cocoa and coffee farmers generally also cultivate multiple crops. In most cases, the main cash crop is the export crop. Diversification is practiced as a way to increase food security, to spread income over the year and to have alternative income in case of yield and price drops of the main cash crop. However, farmers produce the cash crop because it is the most profitable option to them. Replacing it with less profitable crops would not increase their income. As prices for alternative crops are also too low to achieve a living income and pay a living wage to workers, farm diversification is not a viable strategy to significantly raise incomes. Similar to other investments, diversification can create additional challenges in making the needed investments (e.g. labor and inputs) and new uncertainties (e.g. no guarantees for market uptake or price levels). For example, it is unclear whether farmers have surplus family labor to increase the production of diversified products. In cocoa, figures collected by companies and scientists on the necessary labor days per hectare of cocoa differ massively and it is not clear whether farmers have the potential to increase net income by diversifying into other products than cocoa (Fountain/Hütz-Adams 2020). Farmers in West Africa already raised the question: "Why should it not be possible to live from selling cocoa?" If the idea behind diversification is to pay a low price for cocoa seeing as farmers have an additional income from other sources to subsidize the cocoa production, then this is the wrong motivation. The focus should be to pay full-time farmers a price which allows them to earn a living income from the respective crop.

Improving producers' and workers' livelihoods requires complementary strategies, in which prices are an important component. The argumentation above shows that the call for productivity, larger farms and diversification are not necessarily a solution to achieve living incomes and living wages. Necessary investments are often out of reach for producers, the impact on net income of these investments is insecure, and without supply management, productivity increases might lead to lower costs for buying companies, and not to living incomes and living wages for producers and their workers. In other words, there is no silver bullet to improve producer income. Depending on the context and the commodity, it requires attention to productivity, quality, farm size and prices with an understanding of how these factors influence each other. To create a positive impact on these factors, many more conditions need to be in place (e.g. producer organization, service delivery, access to finance, infrastructure, land use policies, supply management). Nonetheless, from whatever perspective you look at it, price is a critical component in the mix of solutions.

PALM OIL

MARIEKE LEEGWATER AND MICHEL RIEMERSMA, POLICY ADVISORS PALM OIL

Under the right conditions oil palm farming can generate a living income for smallholders. However, sustained periods of low prices and price volatility have a direct influence on the well-being of producers and workers, undermining their ability to obtain a living income or to pay living wages. It also disincentivizes and disables making investments which improve the viability and resilience of the farm or enterprise. The fact is, data clearly shows that there is an unfair value distribution in the sector, and so far strategies to tackle this have been insufficient.

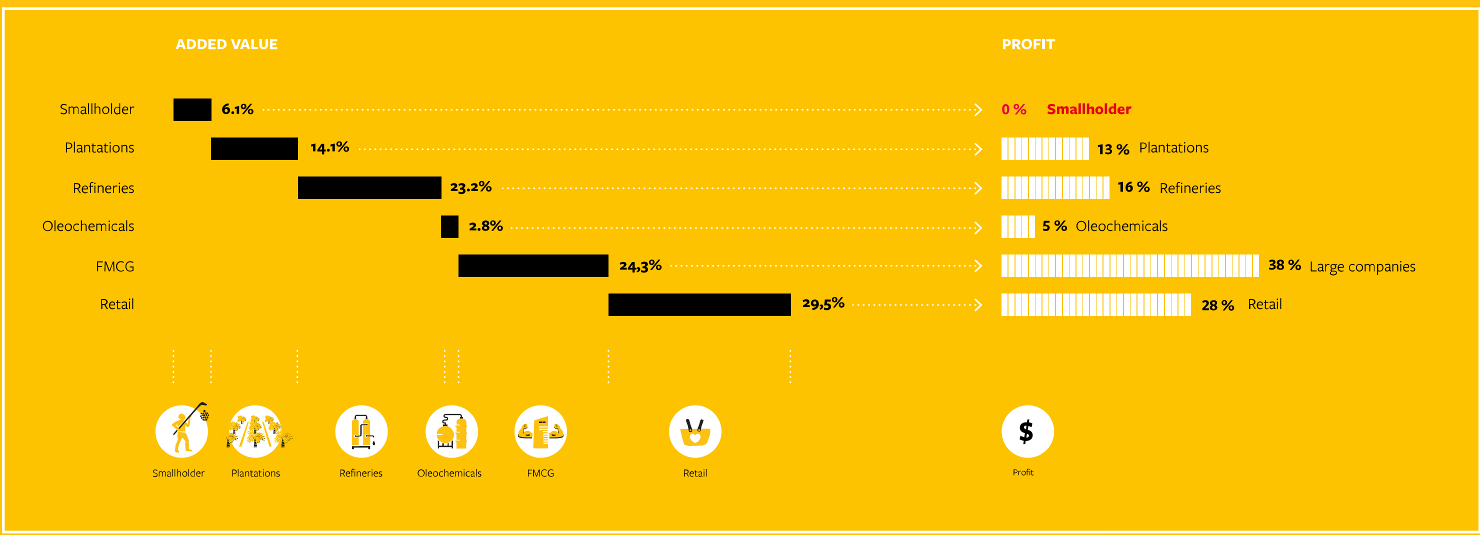


Image source: Palm Oil Barometer 2022. Data source: Rijk, G., Wiggs, C. and Piotrowski, M. (2021). FMCGs, Retail Earn 66% of Gross Profits in Palm Oil value chain. Chain Reaction Research.

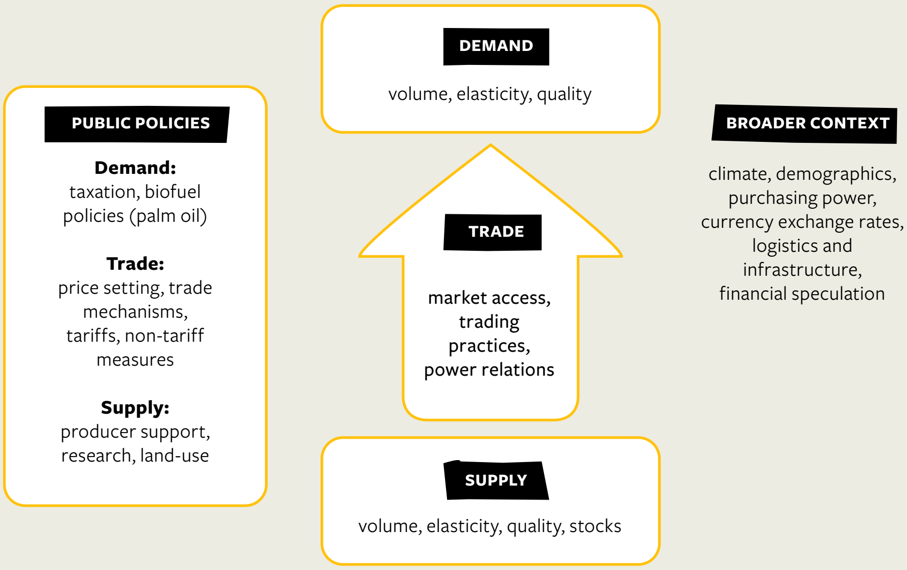
To ensure smallholder inclusivity and drive fair value distribution, good governance and good purchasing practices must be prioritized:

- **Downstream companies should review their sourcing practices and how these impact farmers.**
- **FMCGs and retail need to review the impact of their sourcing practices and new Due Diligence requirements on smallholder inclusivity, and assess how they can contribute to ensure implementation with genuine impact.**
- **Authorities need to ensure national pricing formulas are in place and work to benefit the producers.**

2. WHAT INFLUENCES PRICES?

In this chapter we present a range of overarching, commonly known price influencing factors. These factors are discussed to reflect on the different ways in which price formation takes place. On the one hand, the aim is to better understand price formation, and on the other hand, to understand critical points or factors that influence price in favor of the position of producers and workers. The figure below shows which factors will be discussed in this chapter.

FIGURE 2: PRICE-INFLUENCING FACTORS AT LOCAL, NATIONAL AND GLOBAL SCALE



Prices of international commodities are fundamentally driven by supply and demand, but also by actions of individual value chain actors. Supply and demand are called market fundamentals. Under free market conditions, a relative increase of supply compared to demand will reduce the price, while a relative decrease of supply compared to demand will increase the price. Movements in stocks influence the quantity of products on the market and hence the price. However, prices are not only about market fundamentals. Prices paid to specific actors across the value chain can also depend on the nature of the trading relationships between these actors and the power relations that exist between them. They can lead to a situation in which one actor in similar market circumstances is paid a different price than another.

Supply, demand and trade are affected by other factors, including public policies, private sector purchasing practices and some broader contextual factors. The below sections will explain the price influencing factors, drawing from the findings of the six target commodities: coffee, cocoa, palm oil, cotton, textiles and garment, and artisanal and small-scale gold mining (ASGM). While many of the factors are relevant to the six commodities, the degree of relevance can vary significantly for specific commodities, contexts (e.g. geographies or market segments), and the point in time.

2.1 SUPPLY FACTORS

Production output

Changes in production output of key producing countries can have substantial impact on global prices. World market prices tend to have a dominant influence on the prices that producers receive. This implies that domestic fluctuations in production have little influence on global prices, unless a country produces a substantial proportion of global output. Cotton, cocoa, coffee and palm oil are produced in a limited number of countries, which dominate production and export. Fluctuations in production output in these countries, often linked to weather conditions or the incidence of pests and diseases, usually have a significant impact on world market prices. Political disruptions can also influence production output. Another factor which affects production output is the cost-efficiency of production (e.g. cost of labor, inputs and technology). Lower production costs generally result in higher output at the same price levels. In coffee, palm oil and cotton, small-scale producers compete with often more efficient large-scale producers, which regularly pushes production volumes up and prices down. In gold, artisanal and small-scale gold miners are not so much in direct competition with large-scale mines. The situation is rather that, as the gold price falls, the proportion of gold production from ASGM will grow (Telmer, 2013). This strengthens an overall trend of ASGM replacing large-scale mines driven by opportunities for ASGM to exploit deposits which are less easy to extract. In addition to that, ASGM offers better income opportunities than agriculture (IGF, 2017). As with agricultural commodities, ASGM also depends on labor costs and a stable political context; as well as rainfall as this influences the access to mines and the available water needed for processing.

Recycling of gold and potentially cotton and textiles influences supply. The proportion of recycled gold varies between 28% and 37% of the total global gold supply (IRBC, 2019). The proportion of recycled gold is expected to stay high and might even increase, which is expected to have a depressing influence on the price of gold. In garment and textiles, the fiber-to-fiber recycling ratio is still below 1%, but this may grow over time (Ferenschild & Mürlebach 2021). The quality of fast fashion products is low and hampers possibilities for recycling and reuse. The mixing of materials also makes recycling harder. However, the use of synthetic substitutes has a much stronger influence on cotton prices than the potential of recycling (see section 2.3).

Elasticity of supply

The perennial nature of some crops as well as a lack of alternative livelihoods limit the opportunities to adjust supply to demand. Cotton farmers can quickly react to price dynamics by planting more or less cotton in the next growing season. This is not possible for tree crops which require several years after planting before they become productive. Even in times of declining prices farmers are reluctant to cut down trees in which they have invested many years of labor and money. Consequently, there is a notable time lag between changes in price and the output response for these commodities, and hence a low price elasticity of supply. Still, farmers of these perennial crops can make management decisions which have short-term implications on production output, such as changing the intensity of harvesting or input use. While artisanal gold miners can scale down production, the reality is that they generally do not have better alternative livelihood opportunities, and therefore production often remains relatively stable. This lack of viable alternative income opportunities is also applicable to most farmers in the agricultural crops. In the garment and textiles sector there is a huge overcapacity in production, which makes the supply of textiles rather elastic. In contrast to the more capital-intensive production at the spinning, weaving and processing units, sewing units can be easily relocated to new locations if the industry would incentivize this.

Quality of produce and value addition

Prices can be higher for quality products, but buyers often do not pay for it. For agro-commodities quality parameters may depend on the varieties planted, weather conditions, the prevalence of pests and diseases, the timing and quality of harvesting, and post-harvesting processes. Gold prices depend on its purity, which is greatly influenced by the extraction rate and technologies for extraction and purification. In cotton, prices are determined by fiber length, uniformity, fineness, maturity, and impurities. Producer prices can depend on these quality parameters. In oil palm, higher oil extraction rates of the oil palm fruit can result in higher prices, while in cocoa and coffee the type of bean or degree of post-harvesting processing can influence the price. However, such quality differentiation is not applied or rewarded everywhere. In some contexts, no price differentiation exists for oil palm fruit of different quality. While certain Arabica coffee and cocoa fine flavor varieties can fetch higher prices in the market, it depends on the type of market access whether the farmer receives higher prices. The market for fine flavor cocoa is still very small, which limits the options for producers to sell the product at premium prices. In contrast, the specialty coffee is significant and still growing. However, the price premiums paid at retail level are not always reaching the farmers, or only to a limited extent. Consequently, large volumes of high-quality cocoa and coffee are traded as bulk products, and farmers only receive the price for standard quality. Companies claim they are not in a position to pay more as there are not enough customers who reward better quality. In other instances, companies just make higher margins on premium products without compensating farmers for it. In the garment sector, the rise of fast fashion drove the demand towards low-quality and low-priced products.

In other words, producers are price takers despite their efforts to differentiate on quality. The only way in which producers can get rewarded for the high quality of their product is if supply chain actors share the value of better quality with producers. This requires more efforts by buyers and higher awareness among consumers for appreciating and rewarding quality.

Stock movements

Stock levels and movements influence price levels. The availability of products on the market partly depends on how much of the product is being taken in stock. The presence of stocks relates negatively to price levels: higher stocks result in lower prices and the other way around. Often a few sources of trusted inventories are used as a reference for price formation (e.g. palm oil in Malaysia, coffee in Brazil and cotton in China). These inventories can be held by both public and private actors. In cocoa, the stock to grinding ratio is still used as an indicator for price development, but became less important as company mergers, improved transport facilities, modern communication technology and a more efficient stock exchange reduced the need for stockpiling in warehouses. Stock movements also influence prices by adding or withdrawing volumes on the market. In gold, central banks can be considered as stockholders. Central banks have tried to manage their gold sales in a cartel-like fashion to avoid disrupting the market too much, which is known as the Central Bank Gold Agreement. This agreement signifies the importance of gold as a global monetary reserve and secures the stability of the gold price by limiting sales (Emspak, 2021).

2.2 TRADE FACTORS

Market access

The quality of market access for producers determines whether producers can sell all their produce, and whether they can sell to markets which pay better prices. Market access for small-scale producers often depends on whom they can sell their products to. The implications for producer prices can be large as some buyers add value and ensure producers receive better prices, while others capture a significant 'unfair' part of the margin at the expense of the farmer, worker or miner. In palm oil, the ability to deliver fresh fruit bunches (FFB) to a mill on time will determine the quality of the product and hence the price. Poor road infrastructure (particularly in the rainy season) and long waiting lines (or even refusal of access) at mills can cause FFB quality to deteriorate or force smallholders to sell their FFB at a discount.

Trading practices

The quality of upstream and downstream trading practices can have a dominant effect on price transmission in value chains. The degree of governance prescribing certain rules and norms in trading practices is sector and location specific (or at times absent altogether). Such rules of the game ideally provide guidance and security at both sides of the transaction; for example, by improving transparent access to reliable information about market price, quality parameters, terms and conditions, and on the required degree of formality for buying and selling, contracting and financing arrangements. However, such governance is often absent or heavily in favor of the more powerful actor. For example, in gold, miners are vulnerable to exploitation due to the absence of reliable weighing and testing facilities, and a lack of knowledge of international prices. These factors can have a significant impact on pricing and affect the price received by the miners (Hunter et al., 2021). These issues also exist in agricultural commodities. For example, calibrated scales which cheat farmers are a massive problem in the West African cocoa sector. In case farmers are part of contract farming schemes, which are frequent in the oil palm and cotton sectors, the real price they receive will also depend on the fairness of the fees they pay for the services they receive from their buyer.

Trading practices further downstream can also impact producer prices. Sourcing practices of downstream actors can squeeze margins of each actor in the value chain, including producers. Unfair trading practices which exist across commodities include price rebates, short delivery times, long payment terms, unilateral and unjustified change, or breach of contract terms. Such practices are frequent in the textile and garment sector (ILO, 2016 & Traidcraft Exchange et al., 2021), but also exist in other sectors. In the gold sector, additional issues related to the incidence of criminality and violence can further depress prices for artisanal and small-scale gold miners; while smuggling, which avoids paying taxes, and money laundering could increase prices (Hunter et al., 2021).

Currently, small-scale producers are mostly not capable of defending themselves against unfair practices because of lack of institutional arrangements, capacity to enforce existing rules, and limited access to grievance redress mechanisms.

Power relations

Power asymmetry puts producers in a vulnerable place when it comes to value distribution, price formation and the fairness of trading practices. The extent to which value chain actors can determine prices and other trading practices for producers or vice versa, depends on the relative power they have over each other and how this power is used. Asymmetry in bargaining power can lead to the imposition of unfair trading practices on suppliers. Due to their weaker position, suppliers, and particularly farmers and small-scale operators in the value chain, are often de facto forced to accept unfair practices in order to continue to sell their products and maintain commercial relations with their buyers (European Commission, 2019). In the textile value chain, buyers set the conditions, and a considerable asymmetry of power exists between the global buyers and suppliers. This contributes to low prices, short delivery times and poor payment terms for suppliers (ECDPM 2019). The power of purchasing brands in the garment sector is based upon the ability to move from one processing country to another to get the lowest production and labor costs. This contributes to significant marked power asymmetries between buyers and suppliers. In gold, the relative bargaining power of actors increases as gold moves along the supply chain, with miners having relatively little bargaining (Hunter et al., 2021). In the agricultural sectors, most power is with traders and manufacturers which often have their own stocks, hedge prices at the stock exchange, blend products from different origins, change recipes of end products, or invent production methods which allow to use less or lower quality raw material. Retailers, who sell most of the finished products like chocolate, coffee or palm oil based products, usually also have the power to put a lot of pressure on suppliers of their private brands and on manufacturers who want to place their brands on the shelves. Prices at the beginning of the value chain which allow a living income and/or a living wage are not part of their calculations.

There is collective agreement among stakeholders that in these commodities the vast bulk of the profits is captured by downstream companies. This affects the income of producers and their ability to invest in a sustainable future for their business. There is, however, less agreement on how these power relations play out in sector-specific realities of market concentration and how this affects price formation and value distribution. Most commodity supply chains are shaped as an hourglass, including many producers at the beginning of the chain, then narrowing down to comparatively few actors who control trade and manufacturing, and subsequently widening again to a larger group of actors in retail. The largest concentration can be found in cocoa (trade, brands), coffee (trade, brands) and palm oil (trade). The garment and gold sectors are least concentrated. In coffee, some studies suggest that the market liberalization and higher concentration in the downstream supply chain segment led to increased market power of traders and roasters, which in turn led to farmers facing a disadvantaged position. However, other studies have shown that the decline in producer shares is likely the result of increasing costs of processing, marketing and distribution, rather than the result of monopoly-monopsony power of downstream value chain actors. Still, some studies show that an increase in green coffee prices is passed on to consumers more rapidly than a corresponding decrease (ICO, 2019). The markets are also highly competitive. For example, inflation-adjusted chocolate prices decreased significantly. A luxury product in the past, chocolate is nowadays often a special offer to attract customers to visit a supermarket. This is accompanied by rising costs for advertisements. According to market sources, the costs per bar of chocolate spent on advertisements is significantly higher than the cost of cocoa, at least for brands of standard chocolate.

In conclusion, the influence of power relations is not always crystal clear, but it is something which should be considered when working towards better and more stable producer prices and responsible trading practices.

2.3 **DEMAND FACTORS**

Volumes and quality

With the exception of cotton and gold, all commodities show a long-term growth trend in demand, though its positive influence over prices is partly outweighed by a demand for lower quality. The nature of growth differs per commodity. The growth in demand for coffee and cocoa has been quite stable and driven by demographic trends and purchasing power. However, as coffee production can vary from year to year, the coffee market finds itself in a persistent disequilibrium of demand and supply, moving cyclically between surplus and deficit (ICO, 2020). A similar dynamic exists in cocoa. As mentioned earlier, the increasing demand for specialty coffee (and to a lesser extent fine flavor cocoa) can but does not always increase prices. However, an opposite development also exists in both sectors: the coffee and chocolate industries have adopted production technologies, blending practices and marketing strategies which allow them to absorb products of poorer quality. This continues to push for a race to the bottom of low-quality and low-priced farm products. Moreover, for many years, the growth in supply of quality products has been outpacing the growth in demand.

The demand for palm oil has strongly increased in the past decades. As an important basic food product, demand for palm oil is driven by demographics of Asian consumers in particular. Increasing versatile use of palm oil across various industries and its use as feedstock for biodiesel further increased demand.

Garment and textiles have also experienced a very strong growth in the last decade. For example, consumers in Europe are buying 40% more clothing items than 20 years ago. However, they also spend only a fraction per item of what they paid 20 years ago (Richero & Ferrigno 2016), while the average number of times a garment is worn has decreased significantly over the last decades (Mizrachi & Tal 2022). This happened because a lot of production has moved to cheaper producing countries and the nature of the demand changed to lower quality and cheaper fast fashion. This massive increase in garment and textile consumption did not result in an increasing demand for cotton. This remained stable, because of the presence of alternative fibers. The increasing call for sustainable clothing may eventually reverse this trend.

Unlike the other commodities in this research, gold itself is not consumed, though there are consumers of, for example, jewellery. Instead it is particularly used as an investment, a safe haven, especially during periods of financial and economic stress. Many factors impact the demand for gold, including central bank monetary policy, currency exchange rates, inflation and the performance of stock markets and bonds. During economic recessions or political tensions, the price of gold usually goes up.

A common feature among the six commodities is that the EU's share in global consumption is declining in favor of emerging economies, and particularly Asia. While the EU imports around 40-50% of global trade in cocoa, garment and textiles (the proportion of global consumption is much less), its shares in coffee (25%), palm oil (9%), cotton and gold are much smaller. This may reduce the lever of influencing prices through demand-driven strategies.

Elasticity of demand

The elasticity of demand in the targeted commodities largely depends on the presence of substitutes. The influence of price fluctuations on the demand for coffee and cocoa is limited as consumers have few alternative options for these products. Still, compared to producers, manufacturers have the option to react to price increases by, for example, changing the cocoa content of their products or market products through adding less cocoa. Palm oil and cotton have clear alternatives. The demand for palm oil partly depends on the price of other vegetable oils, notably soybean oil, or crude oil, which competes with palm oil for fuel. The most recent price hike is linked to the shortage of vegetable oil due to blocked transports of sunflower oil from Ukraine and for which palm oil is used as a substitute. Cotton is in fierce competition with the much cheaper synthetic fibers, which have been putting pressure on the price of cotton for decades. The massive increase in garment and textile consumption is largely fed by a higher supply of synthetic fibers rather than of cotton.

2.4 PUBLIC POLICY AND REGULATION

Policies affecting supply

Public policies in producing countries can have an important influence on production and thus on prices. In the agri-commodities, government-owned extension services, input subsidies, tax benefits, price support policies, income subsidies and land reforms can support production output; meanwhile, forest moratoria can, for example, put a strain on the expansion of the production area. For instance, income subsidies for cotton farmers in the US and Europe support production output which inclines a downward pressure on world market prices. The development of better planting material or farming and processing technologies can also increase supply and reduce production costs. An example is mechanization in the coffee and cotton sectors, which has reduced the costs of production and pushed prices down, making small-scale producers less competitive. In the often informal ASGM sector, policies to formalize miners can result in more service delivery to miners and higher production. In textiles and garments, the establishment of special economic zones with supportive infrastructure and tax incentives is a strategy adopted by countries to attract investors and boost production. The enforcement of labor policies (e.g. minimum wage) or environmental regulation can influence production costs and thereby influence production output across all commodities.

Policies affecting trade

Governments in producing and consuming countries can influence trade in the target commodities through price-setting, price discovery mechanisms and trade policies. Motivations behind such policy measures can differ. These can include serving national interests to secure government income through tax, ensuring stabilization of supply, or genuine social protection for producers or consumers. In the agri-commodities several producing countries have mechanisms in place which fix farm-gate prices. In Indonesia, Malaysia, India and several Latin American and African countries farm-gate prices for oil palm are set as a percentage of the export price. In cocoa, at the start of each season the main producers Ghana and Côte d'Ivoire set prices and margins between farm-gate and export. They can do this as they pre-sell a significant part of the expected harvest prior to the start of the harvesting season. In cotton and coffee, similar policies can be found in several countries. Another instrument is a guaranteed purchasing mechanism. For example, cotton farmers in India can always sell to state-owned agencies at a minimum support price. Coffee farmers in Colombia have a similar option.

Some countries have policies which oblige actors to trade through mandatory auctions or marketing agents. For example, Ethiopia, Kenya and Tanzania have export auctions for coffee. Such mechanisms influence price discovery and price transmission which can result in higher prices paid to producers; though when poorly designed or implemented, they can also lead to the opposite effect.

Other policies that have an influence on prices received by producers are taxes and export tariffs. They influence the value which remains available to share between producers and other value chain actors. In general (but with some exceptions), export tariffs are quite low across all commodities. For example, to protect its domestic consumption, Indonesia sets its export tariffs for palm oil in relation to the development of world market prices: the higher the prices, the higher the export tariffs. In response to the recent price hike, they even installed a temporary export quota. Cote d'Ivoire also has a significant tax on cocoa.

Importing countries can influence prices through import taxes. Some producing countries have installed import tariffs or import quotas to protect domestic producers and industry (e.g. processed coffee in Brazil, palm oil in Ghana, cotton in China, as well as various gold producing countries). Indonesia, Malaysia and India also regularly change trade tariffs for palm oil, either to support farm-gate prices or to reduce prices for processing industry and consumers. Bringing down trade deficits can be another reason to increase import tariffs (e.g. something which was recently done in India). Import tariffs by the EU or US are generally low for agricultural commodities, though some tariffs may exist for processed goods to protect the (food) manufacturing sector and incentivize value addition to take place in Europe. In the textiles and garment sector tariffs are more common, but there are numerous bilateral, regional and multilateral trade agreements with preferential market access. In contrast, trade disputes can contribute to tariff escalation. For example, the recent US-China trade dispute resulted in punitive import tariffs by China of US imports which had a significant impact on trade flows and prices of cotton (Robledo 2020).

There are also various non-tariff measures which may directly or indirectly influence trade flows and prices. They can consist of quality or sustainability requirements or bureaucratic export or import procedures. In gold, a whole strain of anti money laundering and counter terrorist financing measures tries to get gold out of the informal sector.

Policies affecting consumption

An important instrument to influence consumer behavior is the Value Added Tax (VAT) or other taxes.
For example, in Germany, a historical coffee tax is applied which, depending on the type and brand of coffee, can add up to more than 25% of the retail price. The biofuel policies set by different countries also influence the demand for and thus the prices of palm oil.

2.5 BROADER CONTEXT

There are many factors in the broader context which influence prices for producers, traders, manufacturers, and consumers. This chapter already referred to factors such as climate, conflicts, demographics, purchasing power, inflation. This section discusses some additional factors.

Currency exchange rates

As most commodities are traded in US dollars, the volatility of national currencies against the dollar can have a significant impact on the real prices that producers receive. A weaker national currency means that producers earn less with the same amount of volume. Weaker currencies can also make countries more competitive (i.e. cheaper) which could contribute to greater export opportunities. For countries with a textile industry that are dependent on cotton imports, a depreciation of its currency can lead to significant additional costs. In some cases, currency exchange rate dynamics cause export prices to be delinked from global prices. In Ethiopia, there are instances where exporters buy coffee above world market prices to sell at a loss on the world market but use the foreign currency to make bigger profits on the imports of other goods. A similar dynamic exists in the gold trade, where in some origins, prices paid are above world market prices. This can also indicate that gold trade is being used to launder money. The existence of the black market to exchange currencies can have a positive impact on producer prices as exchange rates on the black market are generally much better than the official ones.

Logistics and infrastructure

Supply chain costs are key factors determining producer prices. As export prices often depend on world market prices, any money spent on getting the product to the point of export will reduce the potential amount left for producers. This is partly why coffee farmers in Latin America receive a much higher proportion of the export price than coffee farmers in East Africa. The competitiveness of cotton producing countries also depend on the quality of infrastructure, transport costs and energy costs. This is also valid for textiles and garment, where some countries have much better infrastructure (e.g. roads, railroads, ports) than others. As a consequence of the COVID-19 pandemic and the sanctions against Russia, the international freight costs have also increased significantly, causing increases in retail prices, but also additional pressure on margins across the whole supply chain, including producers.

Financial speculation

International commodity exchange markets are important price discovery mechanisms and instruments for market participants to buy products or hedge price risks, but there are concerns that increasing speculation distorts prices. Over the past two decades the main exchanges in coffee and cocoa have been subject to a process of 'financialization', that is, a significant increase in the trading activity compared to the growth in the physical market. The increased participation of investors or speculators in the futures markets may exacerbate price movements caused by fundamental factors (e.g. price and demand fluctuations). Various research in the coffee sector suggests that the activity of non-commercial traders can initially exacerbate upward and downward price swings, even while market fundamentals of demand and supply prevail in the long run (ICO, 2019). In cocoa, speculation is also reported to amplify price fluctuations, with potential negative consequences for countries which pre-sell their harvest based upon future prices.

2.6 WHAT DOES THIS TELL US FOR POTENTIAL PRICE INTERVENTIONS?

The overview in this chapter shows that many factors influence prices leading to the following overall observations.

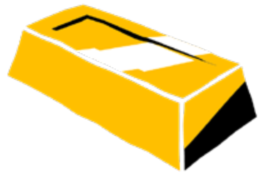
Producers have no influence on what price they receive. Anonymous transactions, often at the commodity exchange, cannot be influenced by primary producers. Supply and demand, exchange rates, costs for logistics and speculation further influence the daily life of producers as these factors impact their net income. They may get better prices by increasing their negotiation power, the quality of their produce or value addition, but in general their prices move in line with the fluctuations of global prices, on which they have zero influence.

Globalization has created a complex web of interdependencies in which prices paid to producers very much depend on developments beyond their borders. Since the abolishment of the international commodity agreements such as those in coffee, cocoa and textiles, only a few dominant producing countries may have a significant impact on commodity prices. In coffee, Brazil and Vietnam are such countries, and the prices received by farmers in East Africa very much depend on what happens in these two countries. In other words, very few countries have any meaningful influence on their export prices. Even larger producer countries often have limited influence on world market prices, for example, Côte d'Ivoire and Ghana in cocoa.

Public policies have the opportunity to influence how export prices are translated into producer prices. Whilst many producing countries have little influence on their export prices, they can influence how an export price translates into a producer price. In agri-commodity sectors, there exist many examples of fixed farm-gate prices, fixed margin distribution and floor prices which create some guarantee or stability on prices received. In garment and textiles and gold no such mechanisms exist. Commodity export also enables countries to collect the much needed tax money as they may have little viable alternatives for this, although this most probably reduces producer prices. On the other hand, tax money could be reinvested in the respective sector to strengthen the position of producers.

Producer prices also depend on the practices of individual value chain actors with downstream companies having most influence. Except for garment and textiles, the other commodities under review have good price discovery mechanisms through international reference prices. They often form the basis for individual transactions along the value chain, in which downstream companies are often most powerful. The prices that end users are willing to pay as well as the terms of trade they impose (e.g. payment terms) also determine the space for upstream actors to pay producers better prices. Currently, neither the costs of production nor the well-being of producers or workers play a role in price-setting.

GOLD



BOUKJE THEEUWES, HEAD OF POLICY INFLUENCING

Artisanal and small-scale mining (ASM) is a largely informal sector in many countries, and it will not go away. We should not be marginalizing the ASM sector but working with ASM miners, supporting them to join the formal supply chain. Of course there are risks, and companies involved with this sector have to resolve and address these issues, rather than walk away from the ASM sector altogether.

It is good to remember that ASM employs about 45 million miners globally, including many women. ASM is the second largest employer globally after agriculture, and gold mining not only has a significant share of this, it also provides a vital source of income that helps to lift local communities out of poverty.

Despite significant contributions to major global mineral supply chains, artisanal and small-scale miners are some of the world's most marginalized workers, and their contribution to the global economy receives little attention.

Artisanal and small-scale gold mining (ASGM) is an opportunity to gain a relatively high income for people who do not own land, capital or have a formal education, as they can directly participate in acquiring a share of the wealth – contrary to many rural agricultural opportunities. The price obtained by ASM gold miners is often greater than 80% of the international spot price.

To improve the livelihoods and working conditions of miners, two key interventions should be prioritized:

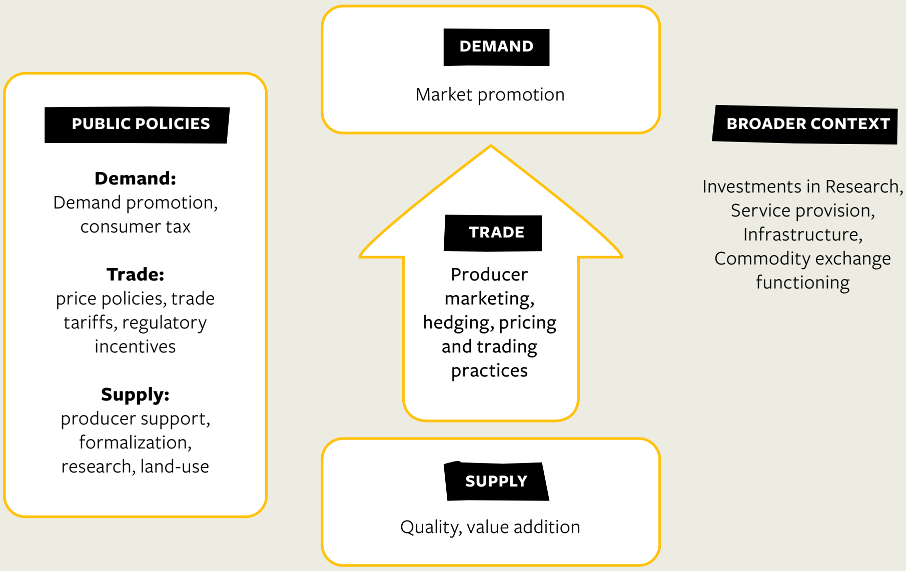
- Formalization: this remains a key precondition to improve ASM gold producers' livelihoods;
- Access to better technology and other services for ASM gold miners, including access to finance.


SACOS MINEROS

3. HOW TO INFLUENCE PRICES?

There are many different ways in which prices can be managed or influenced. Prices can be influenced directly (e.g. through price-fixing regulation) or indirectly (e.g. through supply management). This chapter presents a range of interventions in support of higher and/or more stable prices for producers. We structured them according to strategies which influence supply, trade and demand. Whilst presented as a general set of strategies applicable to all target commodities, their relevance and feasibility will vary per commodity, geography and market segment. This implies that price influencing strategies need to be tailored to the specific context. Furthermore, below strategies should not be considered in isolation as pricing is one part of the larger picture of competitiveness and depends on capacity and resources of actors (including producers, value chain actors, governments) to effectively manage that mechanism within complex and dynamic markets.

FIGURE 3: STRATEGIES TO INFLUENCE PRODUCER PRICES AT MULTIPLE SCALE LEVELS: LOCAL, NATIONAL, GLOBAL



3.1 STRATEGIES TARGETING SUPPLY

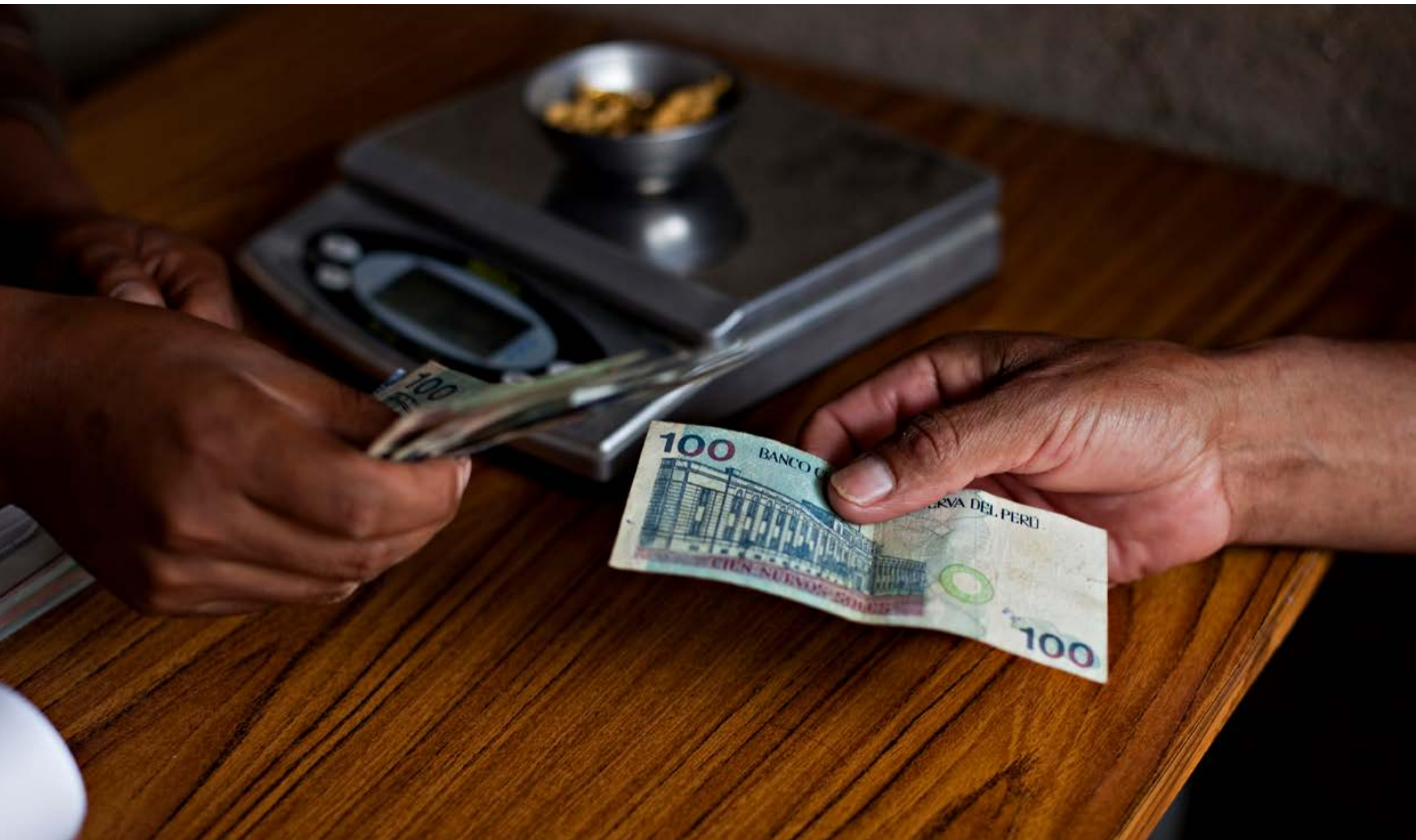
Although producers have little influence on what price they receive, there are strategies which can contribute to realizing a better price for producers:

- **Quality enhancement and value addition:** Producing good quality can result in higher prices. For example, technology adoption in artisanal gold mining can increase extraction rates. In the agricultural crops practices such as planting the right varieties and adopting good management practices on pests and disease management, harvesting and post-harvesting also improve quality. Producers can also invest in value addition through product differentiation (e.g. on origin or sustainability) and vertical integration (e.g. invest in processing, trade and marketing). However, the success of this strategy very much depends on the type of market access and whether the market is willing to pay for quality and additional value and that this remuneration is bigger than the investment needed.

Governments in producing countries can also adopt measures which create more favorable supply conditions:

- **Formalization:** Particularly relevant to artisanal gold mining, the formalization of artisanal mines can reduce operational risks and have a stabilizing and positive effect on the gold price. However, when not carefully designed, this can also have an opposite effect due to the negative impacts of bureaucracy, tax burden and corruption.
- **Supply management:** Supply management is an important complementary measure to any attempt to increase prices. This is because when successful, higher prices incentivize higher production - e.g. through expansion and intensification of existing producers or the influx of new producers - which can drive prices down again. Strategies which can contribute to supply management are land use management, licensing policies, the introduction of production quotas and strategic buffer stock management (see text box below). There are, however, important challenges to supply management strategies. In these globalized sectors, only dominant countries will be able to influence world market prices. For smaller origins, such measures would be effective only if this is coordinated with other producing countries. Previous experience with international commodity agreements in coffee and cocoa has shown that realizing such supply management strategies can be a challenge. Even for larger origins, the impact of supply management may only be temporary as higher prices could incentivize production in other origins. Supply management measures can also be unpopular to implement. Despite these challenges, supply management should be part of the strategy mix, or most attempts to increase prices will be undermined by a higher production.

Furthermore, governments in producing countries can create enabling conditions for improved quality and value addition by producers through various **public investments**. This could include investments in research, extension and finance. It can also incentivize the private sector to invest in service delivery models for small-scale producers. Governments in consuming countries can orient their **development cooperation** in support of producers of these investments (e.g. capacity building services, technology transfer, finance mechanisms), possibly through public-private partnerships.



SUPPLY MANAGEMENT AS COMPLEMENTARY STRATEGY TO INCREASE PRICES

To mitigate risks that higher prices result in oversupply which will drive prices down, various strategies to limit supply can be considered. These strategies need to be enforced by the governments or state-sanctioned governance mechanisms.

- Land use management: A straightforward measure is to ensure that protected areas are not encroached on by producers. Governments can also introduce land-zoning to restrict the area where a crop can be produced. This zoning can take into account the suitability from an agro-economic perspective, positively influencing productivity, quality and profits for producers.
- Licensing policies: Governments can restrict the number of farms, mines or factories by issuing a limited number of licenses.
- Production quotas: Countries can also introduce production quotas to curb the volumes produced. There are many failed attempts in history of this measure because of management issues, but in some contexts, they are successful. For example, production quota is one of the pillars for supply management in the dairy sector in Canada to regulate milk production, which successfully reduced volatility and delivered positive net returns for farmers each year.
- Strategic buffer stock management: Strategic buffer stock management is a mechanism that attempts to offset price movements by removing from, or releasing into the market, (part of the) commodity supply. An example is Brazil's options programme in 2013, where the Brazilian government offered contracts to producers to sell up to three million bags of coffee beans to the government at a fixed price. The Brazilian government sold off the beans acquired in the 2013 programme when prices recovered and, by 2017, had eliminated its coffee inventories (Teixeira, 2019).

3.2 STRATEGIES TARGETING TRADE

There are a few options for producers to improve their terms of trade:

- **Strengthening producer marketing:** This could be an option through organizing small-scale producers in groups and strengthening their collective marketing and negotiation skills. This should include physical price risk management strategies, such as better practices on procurement, sales, price-fixing and financing. In support of this, producer groups may need access to services like capacity building, financing and market information. In garment and textiles, one can improve the bargaining power of workers for better wages and working conditions, and voice these in the contract negotiations between the factories and their customers.
- **Hedging:** Small-scale producer organizations can also engage in financial markets as a form of risk management. Hedging is applicable to those producer organizations directly exposed to international price fluctuations (e.g. those involved in exporting). Futures contracts and options can act as insurance against future price changes and margin protection, but they come with costs and require management capacities that may be beyond the reach of many producer organizations. Therefore, a better strategy could be that buyers of producer organizations hedge themselves and offer an 'insured price'. Due to the absence of commodity markets, hedging is not relevant to the garment and textiles sector.

Value chain actors further down the value chain have more options to consider:

- **Price and premium management:** Companies along the value chain can adopt pricing and premium models which benefit producers. They could pay a premium above the conventional price linked to quality, sustainability or benchmarks on living incomes, living wages or the costs of externalities or ecosystem services (e.g. carbon credits). The responsibility to pay such premiums should be with downstream companies. In order to avoid premiums escalating throughout the supply chain (because each actor is putting a margin on top of it), premiums could be paid directly to the producers. Companies could also introduce minimum prices, or ignore the commodity exchange prices and develop alternative pricing models. An example of such a model is cost-plus-margin pricing, which is based on the costs of sustainable production, including a certain margin for the producer. Companies can also lock prices for a season or over a longer timeframe. In general, these kinds of measures require good traceability between end producers and end users.
- **Responsible trading practices:** Complementary to price policies, companies can build more stable and direct relationships with buyers by removing redundant intermediaries and ensuring fairness in trading practices. For example, long-term purchase commitments, particularly in combination with minimum or stable prices, provide producers with a predictability that incentivizes investing in their farm, mine or factory. Other responsible trading practices include realistic sourcing plans, short invoice payment periods, no excessive contract terms such as bonded contracts and exclusivity contracts, no misuse of unspecified, ambiguous or incomplete contract terms, no excessive transfer of costs or risks to its counterpart, the facilitation of technical and financial services (e.g. pre-finance and price insurance) and equitable information sharing, including market information.

It should be noted that in most value chains the feasibility of these strategies depends on downstream actors as they have the most power, value capture and connection with the consumers. They largely determine the terms of trade in the rest of the value chain.

Governments in producing countries have a wide range of strategies which directly or indirectly influence producer prices:

- **Pricing regulations:** Governments can introduce policies which directly influence prices. For example, producers can be guaranteed a certain percentage of the export price. Another strategy is to introduce minimum prices in combination with guarantee purchasing systems where state agents buy and stock the unsold produce. Instead of a minimum price, governments can also introduce price stabilization funds which compensate producers if prices fall below a certain level. Public price intervention strategies require a strong technical basis for decision making, such as macroeconomic modeling. It also requires transparency and accountability in its management and a sound funding strategy to support the guarantee purchasing mechanisms and price stabilization funds (Molenaar et al, 2017).
- **Trade tariffs and quotas:** Producer countries with domestic markets can play with import tariffs and quotas to protect domestic producers. Keeping export tariffs low is also a way to create more opportunities for producer value capture, while import tariffs can protect domestic markets.

TEXTILES

TAMAR HOEK, POLICY ADVISOR SUSTAINABLE FASHION

Brands need to work towards responsible purchasing practices, and implementing sustainable costing is one aspect of that. At the same time, the business model needs a restructuring towards equal partnerships and a focus beyond only the lowest prices. The current implication is that paying insufficiently to the first stakeholder in line means that increasingly less is received by those further down the supply chain.

We see that the problem is not just pricing and that very low prices are paid for garments; it is the whole system and the current business model. If we do not look at purchasing practices and the implications of the whole critical path of buying, or the equality in the relationship and how the current business model within fashion is shaped, then raising prices or working towards sustainable costing will not have any impact.

MULTIPLE EXAMPLES EXIST OF GOVERNMENTS CREATING SAFEGUARDS TO PROTECT PRODUCER PRICES

In numerous palm oil producing countries, there are regulations in place which guarantee oil palm farmers a certain percentage of the export price. Farm-gate prices are often set at a weekly or monthly basis by a multi-stakeholder based committee. Overall, these systems work pretty well, although there are some reservations about its nation-wide implementation (Bachtiar et al., 2019) and the lack of small-scale producers in the process of setting these prices.

In cocoa, Côte d'Ivoire and Ghana also fix farm-gate prices. Forward sales through government-managed auctions allow both countries to fix farm-gate prices for a whole season. This protects producers against price volatility during the season. The knowledge of the price at the start of the season also informs their farm management decisions. In 2019, both governments introduced a Living Income Differential (LID) of 400 US dollars per tonne of cocoa on top of the market prices in the forward sales for the upcoming season. Many companies welcomed the decision as a pre-competitive measure, making cocoa more expensive for all buyers. Nonetheless, several companies have tried to avoid or undermine the LID model.

In Costa Rica, coffee farmers are also guaranteed 80% of the export price. In addition, it has a Stabilization Fund which compensates farmers when coffee prices fall below cost price. This is combined with research, extension and market promotion activities in support of productivity, quality and market reputation. In Colombia, a purchase guarantee mechanism allows growers to sell their coffee against a daily price which is based upon current market conditions.

In cotton, multiple countries have installed minimum prices or other price support mechanisms and/or input subsidies. If well designed, such policies can result in higher living standards for cotton farmers than is the case in countries without such mechanisms (Living Income Community of Practice, 2021).

Governments in importing and consuming countries have fewer opportunities to have a direct influence on pricing but can still influence trade and therefore prices indirectly:

- **Auctions:** (Mandatory) auctions or other trade platforms can solve issues associated with the lack of price discovery, matching supply and demand and incentivizing quality, which can potentially result in higher prices. However, depending on how transparent and efficient these mechanisms are, they can also have the opposite effect. Depending on their design, auctions can facilitate or impede traceable supply chains and direct trade.
- **Import tariffs:** Low import tariffs could create financial space to pay producers more. However, for most goods import tariffs are already low, and without additional safeguards, producers may see no benefits from such measures.
- **Regulatory incentives for higher prices:** Additional requirements imposed on companies could function as a safeguard to ensure low import fees and taxes benefit producers, whereby only companies that can show good practices on prices and wages as well as other sustainability criteria are eligible for these low import fees and taxes. The aspect of pricing and wages could also be incorporated into Human Rights Due Diligence regulation, as low prices increase the risk of human rights violations. Another strategy is to incorporate minimum prices and/or living wages as conditions into bilateral and multilateral trade agreements.
- **Banning unfair trading practices:** One option is to enforce the translation of the EU directive on Unfair Trading Practices into stricter legal requirements. There is also scope to improve the directive itself, for example through adding the prohibition of selling below cost price.

BANNING UNFAIR TRADING PRACTICES

With the objective to improve the protection of farmers and small and medium-sized suppliers and to provide mandatory rules that outlaw certain unfair trading practices, the EU has adopted a Directive that bans and restricts 16 unfair trading practices. A recent assessment of this regulatory model shows that it does address some asymmetries of power between buyers and suppliers, and increases attention for conditions in global value chains. However, it does not address directly the issue of low prices, a major issue in global value chains. Therefore, it is recommended to include the prohibition of buying or selling below the cost of production in the entire supply chain in the EU Directive (Fair Trade Advocacy Office and Sustainable Food Lab, 2022).

The public sector can also invest in a more enabling environment which can indirectly result in better or more stable prices for producers:

- **Investments in infrastructure:** Governments of producing countries can invest in energy, road, rail and port infrastructure, hereby reducing transaction costs which could result in higher producer prices.
- **Development cooperation:** Funding and partnerships made available by consumer countries can support these investments in physical infrastructure as well as contribute to the institutional capacity for sustainable sector development, and help to create an enabling environment for inclusive and sustainable economic development.
- **Improving functioning of stock exchange:** Another option is to reduce the financialization of the commodity exchanges. Extreme volatility and fluctuations could be reduced by limiting the speculative behavior of financial funds that aggravates price peaks and troughs. Re-establishing the connection between price and product quality could increase prices by more accurately acknowledging quality and origin differences (TCLI, 2020).

3.3 STRATEGIES TARGETING DEMAND

Companies and governments can invest in demand creation and value addition linked to the payment of better prices to producers:

- **Market promotion and value addition:** Both value chain actors and governments can play a role in this. Companies can invest in product development and marketing strategies which make consumers willing to pay more and share this value with producers. This could be linked to quality, product differentiation and other innovations. Governments in producing and consuming countries can also invest in the marketing of products in domestic and export markets. For example, Brazil has been successful in growing domestic coffee processing and consumption, and Costa Rica and Colombia are consistently promoting their coffee in export markets. Public institutions around the world can also influence consumption by setting conditions regarding prices and/or wages related to their own procurement practices.
- **Consumer taxes:** Similar to tariffs, consumer taxes such as VAT could be reduced for products which respect certain criteria on prices and/or wages received by producers.

COFFEE

ANDREA OLIVAR, STRATEGY AND QUALITY DIRECTOR SOUTH AMERICA

Coffee farmers' livelihoods are impacted by both macro and micro economic contexts. The two main macroeconomic elements are **international coffee prices**, which are characterized by volatile boom and bust cycles, and the **efficiency of exporting structures**, which determines the percentage of FOB prices that farmers receive. The latter differs significantly between producer countries, with a value of 85-95% of export price captured by producers in Vietnam, Brazil, Colombia and Peru; 70-75% in Tanzania, Ethiopia, Nicaragua and Honduras; and only 40% by producers in Kenya.

But ultimately, microeconomic factors have a greater impact on producers' livelihoods. The size of a farm is the most determinant factor on producers' income, followed by productivity and labor. Price is in fourth place.

Price is an important factor but not the first or only answer to ensure that producers have a positive net income that results in a living income. The industry must address the following priorities:

- Understanding which suppliers (producers) are economically inviable. Coffee producers are diverse and responses to address income issues are not the same for everybody.
- Focusing on increasing productivity, reducing costs of production, and providing sustainable prices. This work should be supported by the promotion of diversification as coffee producers are rarely only coffee producers.
- Companies should commit to offer sustainable trading practices, including long-term contracts, providing pre-finance facilities, and reducing payment periods.
- inefficiencies of exporting systems. Consumer countries should support those producing countries that face inefficiencies.

4. WHAT CAN EUROPEAN ACTORS DO?

The previous chapter presented a wide range of potential strategies to influence producer prices and wages directly or indirectly. Their relevance and feasibility will vary per context. This chapter will focus specifically on what European actors can do to increase and/or stabilize producer prices and wages. We distinguish the roles of the private sector and public sector, and present a range of supportive initiatives in which other stakeholders can also play a role.

4.1 PRIVATE SECTOR

Companies have to change their sourcing models in order to take responsibility for how their actions influence producer and worker livelihoods. Particularly downstream companies, including retail, have an important role to play. In most contexts, downstream companies have the most power, set trading conditions which trickle down through the whole value chain, and capture most of the value. Despite current sustainability claims and producer support projects, the prices they pay do not consider or enable to cover the cost of sustainable production and the ability of producers to earn a living income and living wage. The UN Guiding Principles on Business and Human Rights, but also the OECD guidelines for the agricultural and garment sectors clearly state that companies have to take responsibility for the whole value chain. Their relative power and value adding put downstream companies in a good position to do this in an impactful way. This will require a change of sourcing models. Rather than buying anonymously on commodity markets or shifting between suppliers based upon cost advantages, there is a need for de-commoditization, including the building of transparent, direct and long-term supply relationships with actors along the value chain. These relationships should include mechanisms to share risks and value. To mitigate human rights and environmental risks and to contribute to living incomes and living wages, pricing has to become an integral part of responsible purchasing practices. While global prices are set by market forces, companies can decide to deviate from this and set prices or premiums on the basis of the cost of sustainable production or living income and living wage benchmarks. This has to be complemented with other responsible purchasing practices such as responsible contract and payment terms, pre-finance or price insurance. This may require a fundamental review of business models, including margin setting in support of fairer value sharing and incentive mechanisms of procurement staff (e.g. by remunerating different forms of stakeholder value).

To support higher prices, companies could also put more attention on the **development of end products with a higher value**, rather than focusing on reducing costs and thereby fueling a race to the bottom (Aidenvironment, 2018).

" To mitigate human rights and environmental risks and to contribute to living incomes and living wages, pricing has to become an integral part of responsible purchasing practices."

EXAMPLES OF COMPANIES PAYING HIGHER AND/OR MORE STABLE PRICES

Multiple companies already apply strategies which ensure that producers receive higher prices. In the higher value coffee segments, companies like Nespresso and Starbucks pay premiums above the mainstream market prices. In the meantime, at a much smaller scale, they implement strategies to stabilize farmers' income through, for example, weather insurance or emergency relief funds. In its San Francisco Bay Coffee sourcing programme, Costco ignores market prices and pays its suppliers on the basis of a cost-plus model. In cocoa, Tony's Chocolonely pays premiums which enable farmer households to earn a living income and run healthy farms, in combination with long-term contracts and capacity building. Several other companies have joined Tony's Open Chain and nowadays procure cocoa following the same sourcing principles.

Despite these examples, the uptake of similar pricing strategies is limited so far, as companies are not willing to change from business-as-usual, or cannot make it work commercially. An additional challenge with paying producers' prices above conventional market prices is that when each intermediary in the value chain adds a margin to the purchasing price, this can inflate the consumer price significantly in comparison to the premium received by the producer. This could be avoided by end users paying premiums directly to producers, which either demands full traceable supply chains or a certificate trade system (i.e. Book & Claim).

An alternative model is to decouple premiums from commercial price negotiations. An example can be found in the garment sector, where some factories are paid a premium to enable them to pay living wages to workers, irrespective of the price negotiated for the produce.

4.2 PUBLIC SECTOR

The EU and its member state governments need to introduce regulation for companies to adopt responsible purchasing practices, complemented with support to pre-competitive action and investments in producing countries. Most relevant public sector solutions are within the countries of origin where most opportunities exist to directly influence producer prices. This does not mean that EU member countries and their governments do not have a role to play. On the contrary, they have various options, including:

- **Incorporate the topic of income and prices in the EU's Corporate Sustainability Due Diligence Directive (CSDDD):** The EU regulation on human rights and environmental due diligence should recognize that producers' income and workers' wages are conditions to meet human rights and environmental objectives, and that prices are one important factor in accomplishing these. The implication would be that companies need to assess the human rights and environmental impacts of their purchasing practices and the prices they pay. The transparent calculation and payment of prices, and working towards paying at least the cost of sustainable production and living income and living wage reference prices should become an integral part of the CSDDD obligations for companies. The scope of CSDDD should also be extended across the full value chain (not only to 'established business relations') and include small and medium-scale enterprises. The improved CSDDD should also be incorporated in the EU's conflict mineral regulation.
- **Improve the regulation against unfair trading practices:** This refers to a continuation of the process of translating the existing "EU Directive on unfair trading practices in the agricultural and

food supply chain" into national regulation within member states. An important improvement of the Directive would be the prohibition of buying or selling below the cost of (ultimately sustainable) production in the entire supply chain. Furthermore, the scope of the regulation should be extended to the non-agricultural sector, including garments and textiles, and gold.

- **Adapt competition law to promote pre-competitive action:** Current competition law and particularly antitrust policies are a critical factor why prices are not on the agenda of sustainability initiatives. In order to encourage companies to jointly invest, identify solutions, produce, and distribute sustainable products, more guidance is needed on the circumstances in which such cooperation complies with antitrust rules (European Commission, 2021). In 2022 the European Commission published a draft version of the horizontal guidelines for consultation, which offers some improvements. For example, it states that competition law shall not apply to agreements, decisions and concerted practices of producers of agricultural products that relate to the production of, or trade in, agricultural products, and that aim to apply a sustainability standard higher than that mandated by the European Union or national law. Some member states are already further ahead. For example, in the Netherlands, the ACM leads the way with detailed guidance on sustainability and the notion of fair share (Burnside, 2022). On top of this, it is recommended that the calculation of living income and living wage for whole sectors should be treated as pre-competitive. Additionally, paying prices which enable a living income and a living wage should be treated as a precondition to fulfil their HREDD obligations, and not as a violation of antitrust laws.
- **Tailor development cooperation to support producer prices:** This could include investments in infrastructure, market governance and value addition in producing countries, as well as setting conditions on pricing/trading practices for funding private sector initiatives.
- **Create incentives for better prices through trade agreements, tariffs, taxation, and public procurement:** Prices and trading practices, or objectives on living incomes and living wages, can feature more prominently in bilateral and multilateral trade agreements. They can also become conditions for other regulatory incentives like tax exemptions, tariff reductions or public procurement.
- **Ensure the topic of pricing and trading practices is included in sector strategies:** Opportunities for this exist in the EU Strategy for Sustainable and Circular Textiles, and the EU's Farm-to-Fork strategy.

WHAT IS HUMAN RIGHTS AND ENVIRONMENTAL DUE DILIGENCE (HREDD)?

HREDD is a continuous six-step process for companies to adopt responsible business policies, identify and assess adverse impacts in own operations, value chains and business relationships; cease, prevent or mitigate identified actual or potential adverse impacts; track implementation and results, provide for or cooperate to provide adequate remedy, and finally, transparently communicate about the process. It does not directly refer to prices, but has the potential to be one of the building blocks in reaching the living incomes and wages in global value chains.

While HREDD has existed as a voluntary tool for companies for several years, national governments and the European Union have started to move towards introducing mandatory HREDD for companies operating in their markets. At the EU level, this is being done through the Corporate Sustainability Due Diligence Directive (CSDDD), which is currently under development.

In order to be impactful, HREDD should be conducted in line with the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises. As such, the diligence process must cover all human rights – including living incomes and wages – and environmental risks in the entire value chain, and not be limited to only certain tiers of the chain or certain business relationships, which could mean those who are most vulnerable are left out. It is also crucial that the due diligence process includes engagement of relevant stakeholders, including smallholders and workers. If they are meaningfully engaged, then living income and wages will likely arise as salient issues.

Moreover, in performing their due diligence, companies should consider their own pricing models and purchasing practices, and how those can impact people and the environment in their value chains. In order to produce a positive impact, companies should be willing to pay prices which enable living incomes and wages, and stop unfair practices such as insufficient lead times, last minute changes to orders, prices that undercut the costs of sustainable production, long payment terms and fraudulent quality complaints.
The CSDDD should include provisions to guarantee that companies are required to conduct their due diligence in an impactful manner, as laid out above. It should also create due diligence obligations for companies of all sizes, including SMEs, and ensure that both living wages and living incomes are included in its Annex of rights which companies must respect.

Relevant resources:
Guiding steps towards living income in the supply chain: The Role of Governments in Enabling living income in Global Agriculture Value Chains, Guidance for public policy makers. Published by: Sustainable Food Lab, Fair Trade Advocacy Office and GIZ (July 2022); URL: **https://www.living-income.com/_files/ugd/0c5ab3_fb2a775c2b714d9d99616aa02569408a.pdf**

More information on Solidaridad's position on the EU's Corporate Sustainability Due Diligence (CSDD) Directive: 10 changes needed for the EU's CSDD to have an impact on the ground (April, 2022); URL: **https://www.solidaridadnetwork.org/news/10-changes-needed-for-the-eus-csdd-to-have-an-impact-on-the-ground/**

https://www.solidaridadnetwork.org/publications/joint-paper-on-legislating-for-impact/

4.3 SUPPORTIVE ACTIVITIES

There are a range of activities which European stakeholders could undertake to promote a better price environment for producers.

Multi-stakeholder platforms can create commitment and alignment: National or international multi-stakeholder platforms within the EU can support the creation of company commitments around living incomes and living wages. Several country initiatives already exist, for example, in cocoa. Through joined research, alignment and collaborative action, these initiatives could support companies in adopting and implementing more progressive sourcing policies. However, there is also skepticism on the effectiveness of platforms as they can create a tendency to converge towards the lowest bar possible and restrain progressive action by individual participants. Civil society organizations have an important role to play in pushing these platforms and individual members to make meaningful progress.

Create transparency on costs, prices, income and value distribution: It will be important to increase transparency on the costs of production (including externalities), costs of living (e.g. living income benchmarks), prices, wages and incomes, as well as value distribution. This applies to each of these sectors. This data could help objectify the highly sensitive and often subjective discussions on prices and provide crucial input to private and public sector strategies. Various stakeholders can invest in creating this transparency, including the public sector, individual companies, multi-stakeholder initiatives, development organizations and the research community.

Campaigns with a focus on producer prices: There is a role for civil society to continuously highlight the importance of producer prices in relation to poverty alleviation and mitigation of human rights violations and environmental externalities. This claim should be substantiated by evidence that low or unstable prices contribute to these issues. Therefore, they should engage with research partners in collecting such evidence.

Incorporate the topic of prices in projects which try to improve producer income or wages: Development organizations should refrain from projects which only look at productivity improvements. In order to make a sustained impact, projects should also look at prices and the fairness of trading practices. This expansion of scope also relates to the corporate partnerships of these organizations. In addition to co-investments in producer support, these collaborations should look at how companies can improve their own purchasing practices in support of better producer prices. As the transformation away from "business as usual" by companies can be an uncertain and unsuccessful process, development organizations can, and should, co-invest in developing and testing new models at a smaller scale.

Incorporate prices and trading practices in the scope of voluntary sustainability standards: Voluntary sustainability standards exist in all targeted commodities with a varying scale and degree of effectiveness. However, many of these initiatives focus on what producers should change, and do not address the trading practices of value chain actors. In recognition that many producer investments depend on these trading practices, these initiatives should pay more attention to supply chain dynamics in their systems, including responsible trading practices, payments of premiums, minimum prices and flexible premium models. Whereas Fairtrade has always incorporated these topics in their system, and Rainforest Alliance has started doing so recently, many other sustainability schemes hardly pay any attention to this.

CREATING TRANSPARENCY ON COSTS OF PRODUCTION AND LIVING

There is an increasing number of tools and data available, creating more transparency on the costs of production and the costs of living of producers. For example, the global living wage coalition has published living wage/income benchmarks and reference values in over 43 countries. Other benchmark studies have been published by other entities, such as the living income Community of Practice, or national commodity-specific studies. The best resource available among global benchmarks is the ALIGN Tool database (Fair Trade Advocacy Office and Sustainable Food Lab, 2022). There are also an increasing number of tools which can help companies to achieve living income or living wage goals (for example, Fairtrade and IDH have published such tools). Furthermore, True Price is a methodology to determine the social and environmental costs of a product. Solidaridad and others have published various studies showing these costs.

Link to online report: The True Price Price of Climate Smart Coffee (March 2019); URL: **https://www.solidaridadnetwork.org/publications/true-price-how-much-should-we-pay-for-coffee-to-ensure-our-cup-in-the-future/**

COTTON

TAMAR HOEK, POLICY ADVISOR SUSTAINABLE FASHION

The cotton supply chain is a complex one, with many players involved from cotton farming all the way to the end product. On top of that, the price of cotton depends on a variety of factors. **The complexity of the supply chain and the lack of transparency of stakeholders in the cotton sector are now influencing the debate and hinder companies from improving what is most important. Namely, making sure that farmers receive a fair price for their cotton and are able to earn a living income.**

If brands don't pay a fair price to the Ready Made Garment factory, how can the factory pay a fair price for the raw materials? The cotton sector is getting used to certification to 'guarantee' sustainable farming, but these certifications (as the bare minimum) are complicated and expensive. The industry is not willing to pay for these costs on a massive scale. It is about time we make sure that premiums are paid for premium materials and farming practices, that farmers are being supported in the transition, and that we start to actually facilitate a living income.

5. KEY INSIGHTS AND RECOMMENDATIONS TO INFORM FUTURE ACTION

Sustained periods of low prices and price volatility have a direct influence on the livelihoods of producers and workers. Real producer prices have been declining for most of the targeted commodities. Longer periods of low prices as well as price volatility negatively impact producers' and workers' livelihoods and are a root cause for human rights violations and environmental degradation. They disincentivize and disable investments which improve the profitability, sustainability, resilience of the farm or enterprise. Closely linked to prices, the fairness of trading practices also influences producers' income and the business case to invest in sustainable production practices.

Although price is one factor which determines producers' income and the ability to pay workers a living wage, it has been ignored for long. Producers' income does not only depend on prices. In agriculture, key variables include productivity, cost-efficiency, quality, farm size and the mix of farm products and off-farm income. For example, in artisanal gold mining and textiles and garments, technology and labor costs are important variables. So far, many poverty alleviation strategies, including those set up by companies and development organizations, focus on productivity improvement, market access (without addressing price issues) and livelihood diversification (the latter is particularly relevant to modern agriculture). Price is still felt to be a highly complex and sensitive topic. However, to improve producers' and workers' livelihoods and mitigate human rights violations, price needs to be included in the mix of strategies.

Prices depend on many factors related to supply and demand, the way trade is done, market power of specific participants in the value chain, as well as public policies that influence these factors. In general, global market prices have a preponderant influence on producer prices. This paper shows that global prices depend on many factors. Prices of international commodities are fundamentally driven by supply and demand, but other factors also have influence. Prices are influenced by practices of individual value chain actors, which partly depend on the power relations between them. Supply, demand and trading practices are affected by other factors, including public policies and broader contextual factors.

Despite the complexity, different levers exist to influence producer prices. Producers have no influence on most price influencing factors. In fact, in these globalized commodities, there are very few individual actors who can influence global market prices. However, there are various levers that could influence producer prices. Some opportunities may exist in strengthening and empowering producers which could result in higher or more stable prices for their products. For larger scale impact, governments in producing countries have numerous policy options to redistribute the value between export and producers, and could also work on supply management and demand promotion. Another important lever is the purchasing practices of individual value chain actors, which very much depend on the decisions of the manufacturers and retailers. Governments in consuming countries can set the conditions which obligate companies to adopt more responsible purchasing practices, or support producing countries in making certain investments.

Because a living income and a living wage are human rights, and prices are closely linked to human rights violations, actors need to start working together on strategies which improve and stabilize producer prices.

There are important roles for European stakeholders in this, such as:

- **Companies need to take responsibility for producer and worker livelihoods through responsible purchasing practices.** The UN Guiding Principles on Business and Human Rights, as well as the OECD guidance for the agricultural and garment sectors, clearly state that companies have to take responsibility for the whole value chain. This will require building transparent, direct and long-term relationships within value chains as a basis for risk and value sharing. Prices should be a part of this. While individual companies may not be able to influence global market prices, they can decide to ignore them. They have various options at their disposal, including paying prices or premiums which are informed by the costs of sustainable production, and the living income and living wage benchmarks. This has to be complemented with other responsible purchasing practices, such as long-term sourcing contracts, fair payment terms, and no unilateral changes to supply agreements.
- **The EU and its member state governments should create mandatory regulation and incentives for companies to adopt responsible purchasing practices, facilitate pre-competitive action and support investments in producing countries.** European governments have various instruments to create direct incentives, including the incorporation of the topic of prices in corporate sustainability due diligence regulation, regulation around unfair trading practices, and through adapting competition law, trade agreements, tariffs, taxation, public procurement practices and sector specific strategies. Furthermore, they can promote private sector commitments and use development cooperation to invest in strategies which support producer prices.
- **Civil society organizations should highlight in their advocacy the link between prices and human rights, supported by evidence.** They can also promote responsible purchasing practices with producers and value chain actors. Civil society organizations should take a strong position that living income and living wage are human rights, and continue to stress the importance of the role of price in human rights due diligence. In support of this position they should collect evidence on how producer prices influence human rights violations and other externalities. This can be done in cooperation with other actors, for example, research institutes. By supporting data collection on costs (including externalities), prices, income and value distribution, they can contribute to a more objective public debate around prices and provide sector-wide benchmarks for private and public sector strategies. Through their partnerships and implementation of programmes they can make price a more explicit topic in their engagement and interventions to support producers and value chain actors in developing strategies which aim to obtain higher and more stable producer prices.

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CUATRO

APPENDIX 1: KEY CHARACTERISTICS OF THE COMMODITIES

	COCOA	COFFEE	PALM OIL	COTTON	TEXTILES / GARMENT	GOLD
Production system	Perennial crop	Perennial crop	Perennial crop	Annual crop	Processing	Mining
Producer type	>90% smallholdings (5-6 million farmers)	Smallholding (25 million farmers) + large plantations	Smallholding (3 million farmers) + large plantation	Smallholding (100-150 million farmers & workers) + mechanized large farms	Small to large-scale factories (75 million workers)	Artisanal and small-scale gold miners (ASGM) (40,5 million people) + industrial mines
Geographical concentration production	Côte d'Ivoire and Ghana produce 64%. Top 5 countries produce 81%	Top 5 countries produce 70%	84% from Indonesia and Malaysia	Top 5 countries produce 80%	China dominates production	Top 5 countries produce close to 50%
Geographical concentration consumption	Almost 50% in EU	EU: 24%, US: 16% Emerging markets: 46%	EU: 9% 2/3 in Asia	Top 5 countries *import* 80%	Top 10 EU largest importer	Dominated by the Middle East and Asia (84%) vs. West (16%). China and India 56% in 2017.
Production trend	Strong growth (~2% per year). Doubled in the last 30 years.	65% growth in the last 20 years	Tripled in the last 20 years, but growth slows down	Stable in last decade	Strong growth	ASGM shows strong growth, replacing large-scale mining
Demand trend	Strong growth (~2% per year)	Grows by 2% per year. Emerging markets grow fastest	Strong growth, particularly in Asia	Stable in last decade	Strong growth and expected to more than double by 2030	Stable, but increasing as a result of recent crises
Market concentration:						
Production	Low	Low	Medium: Top 13 companies produce ~25%	Low	Low, though some large players	Low
Trade	High: top 6 companies trade/ grind ~60 %	High: top 5 companies roast trade ~50%	High: top 7 companies refine ~50%	Medium (~500 companies)	Low, many intermediaries	Medium
Processing	High: top 6 brands ~60 %	Medium: top 10 roast ~35%	Low: top 25% processes 9%	Not applicable	Medium (few large brands)	Low
Distribution/ retail	Low, with a few big players	Low, with a few big players	Low, with a few big players	N. A.	Medium (few large retailers)	Low

A few observations can be made on the basis of the table above which are relevant to the pricing discussion in this paper:

- Of the six commodities, four (coffee, palm oil, cotton, gold) **co-exist with large-scale producers**. The performance of these large-scale producers has an important impact on the prices received by small-scale producers.
- With the exception of cotton and gold, **total production and demand have increased** significantly in recent decades. Whilst gold production is relatively stable overall, small-scale mining increased at the cost of large-scale mines.
- **Most commodity supply chains are shaped as an hourglass, with many producers, a concentration in trade and manufacturing, and diversity in retail.** The largest concentration can be found in cocoa (trade, brands), coffee (trade, brands) and palm oil (trade). The garment and gold sectors are least concentrated.
- **The EU's share in global consumption is declining in all commodities in favor of emerging economies**, and particularly Asia. While the EU imports around 40-50% of global trade in cocoa, garment and textiles (the proportion of global consumption is much less), its share in coffee (25%), palm oil (9%), cotton and gold is much smaller.

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