



THE STATE OF SUSTAINABILITY INITIATIVES REVIEW

2014 Standards and the
Green Economy



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SSI STATE OF SUSTAINABILITY
INITIATIVES



A Joint Initiative of ENTWINED, IDH, IIED, FAST, IISD

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Note from the SSI Management Team

The State of Sustainability Initiatives (SSI) project is facilitated by the Sustainable Commodity Initiative and has been directly managed by the International Institute for Environment and Development (IIED), the International Institute for Sustainable Development (IISD), the Finance Alliance for Sustainable Trade, Environment and Trade in a World of Interdependence (ENTWINED), and the Sustainable Trade Initiative (IDH). The SSI project is motivated by recognition of the need for improved information exchange among stakeholders in voluntary sustainability initiatives and among voluntary sustainability standards themselves. The objective of the SSI project is to stimulate regular reporting on the state of play across voluntary sustainability standards, offering a framework for understanding the characteristics, important issues and market trends for select sustainability initiatives and standards operating in global markets. It is hoped that the Review can serve as a valuable tool for learning and strategic decision making between the private sector and the sustainability initiatives themselves.

The SSI management team

The Swiss State Secretariat for Economic Affairs is a founding and core donor of the State of Sustainability Initiatives project. Current funding for the SSI is provided as part of a larger initiative led by SECO entitled the “VSS Information System Programme,” which supports data collection and dissemination to enable more strategic decision making by investors and other stakeholders in sustainable supply chains.

SSI STATE OF SUSTAINABILITY INITIATIVES



Schweizerische Eidgenossenschaft
Confédération suisse
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Swiss Confederation

Federal Department of Economic Affairs,
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Shaping Sustainable Markets is the flagship research project for the Sustainable Markets Group at IIED. Can markets be “governed” to better benefit people and planet? This project explores the individual and combined impact of market governance mechanisms on sustainable development to find out what works where and why. We want to improve and broaden understanding of how market governance mechanisms can be designed and used to secure livelihoods and protect environments. Find out more about our work at <http://shapingsustainablemarkets.iied.org>.



This research was funded in part by aid from the UK Government; however, the views expressed do not necessarily reflect the views of the UK Government.



FOREWORD

In 1992 the leaders of the world came together at the first Rio Earth Summit, historically acknowledging the imperative of a needs-based approach to sustainable development. Although Agenda 21 and the corresponding Rio Declaration made a call upon all citizens of the world to play a role in ensuring sustainable development, the UNCED process primarily spoke to the aspirations and obligations of governments.

Now, some 20 years later, we are forced to make a further acknowledgement, namely that governments alone cannot be relied upon to generate coordinated action at the global level with either the precision or timeliness typically required by the plethora of sustainability issues facing the planet today. The recent growth in the number and use of voluntary sustainability standards can largely be traced to a growing recognition of the failure of public action in addressing a host of sustainability issues.

In a very real sense, voluntary sustainability standards allow the very actors implicated in the processes leading to sustainable development impacts to identify and implement the appropriate corrective measures while integrating them directly within their business models. The need and ability of private sector innovation and investment, not to mention allocative efficiency of the market, to provide a more targeted and nimble approach to the implementation of sustainable development also explains the recent emphasis put on the need for a “green economy.”

Both voluntary sustainability standards and policy measures aimed at promoting a green economy hold the promise of more efficient and effective implementation of sustainable development goals. The common logic underlying green economy and voluntary sustainability standards discussions points toward their potential to play mutually reinforcing roles.

However, if voluntary sustainability standards and the green economy are tied by a common potential, they are also tied by common challenges. Both efforts, by virtue of their voluntary and largely unregulated character, have the ability to “say more than they do”—that is, to market themselves beyond their actual capacity to deliver. In so doing, voluntary sustainability standards and related green economy measures have the potential to enable

a misguided sense of complacency—potentially leading to reduced vigilance when vigilance is needed most. Rather disconcertingly, the “danger” posed by such approaches grows in proportion to their acceptance—which speaks to the immediate importance of deepening our understanding of whether, how and where such initiatives are delivering the desired outcomes.

The *State of Sustainability Initiatives Review 2014* represents one small effort toward strengthening our understanding of how voluntary sustainability standards are developing over time, both in terms of the systems they deploy and the market impacts that they have. It is hoped that the ensuing data and analysis, when read in conjunction with the growing body of field-level impact data, will allow supply chain decision-makers to strengthen their own strategic decision-making processes in ways that provide optimal sustainable development impact.

The importance of improving our knowledge of the potential role of voluntary standards, however, goes beyond merely pragmatic questions of what the “most efficient means for achieving sustainable development” might be. The combined forces of globalization and trade liberalization have arguably established economic rationality as the supreme authority in international relations. When the very institutions that define “who we are” absorb and embody the vision of humans as *homo economicus*, we risk losing the capacity to care for those who lack economic “voice,” of which the poor and the environment are only too evident as examples.

Voluntary standards represent one of the most explicit efforts to balance purely “economic” interests with a deeper sense of human morality by asserting the primacy of care and compassion for others. In a word, the highest promise of voluntary standards may rest in their potential to make us more human. And so it is that we can also hope that by improving our understanding of the world of voluntary sustainability standards, we may also be able to improve our understanding of ourselves.

Sustainably yours,

Jason Potts, 2014



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Finally, the SSI Review would not have been possible without the monetary and in-kind contributions of the Swedish Foundation for Strategic Environmental Research (MISTRA) through the ENTWINED Research Consortium, UKAID, the Norwegian Agency for Development Cooperation (NORAD), and the State Secretariat for Economic Affairs (SECO). This report was also financially underwritten by IISD and IIED.

Data Sources and Disclaimer

One of the objectives of the SSI project is to contribute to the development of a more harmonized infrastructure for data collection and reporting. To that end, the SSI has worked in close partnership with a number of other leading organizations that share a similar objective, including, among others, the International Trade Centre (ITC), the International Social and Environmental Accreditation and Labelling Alliance (ISEAL), and the Research Institute of Organic Agriculture/Forschungsinstitut für biologischen Landbau (FiBL).

In particular, and in order to promote efficiency and accuracy, we have both fed data to, and drawn data from, the ITC's Standards Map Database wherever possible. For data not covered under the ITC Standards Map Database, we have relied primarily on direct communication with standard-setting bodies and on third-party literature. Below is a brief listing of data sources, unless otherwise specified in the report:

- Standard system data: ITC
 - Governance data: Standards bodies and ITC
 - Standard system content and criteria data: ITC.
- Note: Criteria coverage only reflects specific matching with SSI indicators and should not be understood to suggest a given initiative's entire treatment on a specific sustainability topic.

- Market data: Standards bodies and third-party literature.
- Note: SSI organic market data, unless otherwise specified, represents estimates made by the SSI drawing from FiBL and other data sources.

Unless otherwise reported, all of the market analysis and numerical representations of all data, regardless of the source, are strictly the work and responsibility of the SSI. Although we have done our best to ensure that our reporting reflects the data as provided by these sources as accurately as possible through a two-stage vetting process, the SSI takes full responsibility for all data and analysis contained within this report.

The Sustainable Agricultural Network (SAN) sets the standards for the Rainforest Alliance (RA) label. Therefore, the systems section of this review, with its focus on the standards bodies, refers to both SAN/RA; however, for simplicity, the market section refers to only Rainforest Alliance. Similarly, the systems section describes the work of the International Federation of Organic Agriculture Movements (IFOAM), which sets the standards for organic commodities. The market section uses "organic" to refer to commodities certified under any recognized organic certification, independent of whether or not they are actually compliant with IFOAM global standards.

Acronyms

ACP	African, Caribbean and Pacific	NGO	non-governmental organization
BCI	Better Cotton Initiative	OECD	Organisation for Economic Co-operation and Development
CAGR	compound annual growth rate	PEFC	Programme for the Endorsement of Forest Certification
CmiA	Cotton made in Africa	PPM	production and processing method
CoC	Chain of Custody	RA	Rainforest Alliance
COSA	Committee on Sustainability Assessment	RED	Renewable Energy Directive
CSPK	Certified Sustainable Palm Kernel	RSB	Roundtable on Sustainable Biomaterials
CSPO	Certified Sustainable Palm Oil	RSPO	Roundtable on Sustainable Palm Oil
ETP	Ethical Tea Partnership	RTRS	Round Table on Responsible Soy
EU-RED	European Union Renewable Energy Directive	SAN	Sustainable Agriculture Network
FAO	Food and Agriculture Organization of the United Nations	SFI	Sustainable Forestry Initiative
FAST	Finance Alliance for Sustainable Trade	SSI	State of Sustainability Initiatives
FIBL	Research Institute of Organic Agriculture	UNCED	United Nations Conference on Environment and Development
FLO	Fairtrade Labelling Organizations International (“Fairtrade” or “Fairtrade International”)	UNDP	United Nations Development Programme
FSC	Forest Stewardship Council	UNEP	United Nations Environment Programme
GMO	genetically modified organism	USDA	United States Department of Agriculture
GRASP	GLOBALG.A.P. Risk Assessment on Social Practice	VSS	voluntary sustainability standard
ICCO	International Cocoa Organization	WCF	World Cocoa Foundation
ICI	International Cocoa Initiative	WTO	World Trade Organization
ICO	International Coffee Organization		
IDH	Sustainable Trade Initiative		
IFOAM	International Federation of Organic Agriculture Movements (“Organic”)		
IISD	International Institute for Sustainable Development		
ILO	International Labour Organisation		
ISEAL	International Social and Environmental Accreditation and Labelling Alliance		
ISCC	International Sustainability and Carbon Certification		
ISO	International Organization for Standardization		
ITC	International Trade Centre		

Units and Measures

KG	kilogram
MT	metric ton
HA	hectare
US\$	U.S. dollar
USD	U.S. dollar
€	euro
£	pound sterling

EXECUTIVE SUMMARY

Voluntary sustainability standards have grown rapidly in number and importance in global commodity markets over the past decade. The growth of voluntary sustainability standards has occurred in parallel with growing recognition of the importance of economic drivers in implementing sustainable development, as evidenced by the global call for a green economy.

The *State of Sustainability Initiatives Review 2014* reports on systems and market trends across 16 of the most important standards initiatives operating across 10 key commodity sectors. Initiatives covered in this report account for an estimated \$31.6 billion in trade value, pointing toward their growing importance in defining terms of trade and opportunities for development across the commodity-producing world.

Key findings of the *SSI Review 2014* include:

Sustainability standards continue to experience exceptional growth: The average annual growth rate of standard-compliant production across all commodity sectors in 2012 was a stunning 41 per cent, significantly outpacing the annual average growth of 2 per cent in the corresponding conventional commodity markets. Growth in compliant production was strongest in the palm oil sector, which experienced 90 per cent growth in 2012. Other leading commodity sectors for production growth in 2012 were sugar (74 per cent growth), cocoa (69 per cent growth) and cotton (55 per cent growth).

Sustainability standards have forcefully penetrated mainstream markets: The Review documents a persistent trend in sustainable sourcing commitments by manufacturers, which is resulting in significant market penetration in several commodity markets. For example, standard-compliant coffee, which led in terms of market penetration, reached a 40 per cent market share of global production in 2012 (up from 15 per cent in 2008). Other commodities with significant market shares (in terms of global production) in 2012 include cocoa (22 per cent; up from 3 per cent in 2008), palm oil (15 per cent; up from 2 per cent in 2008) and tea (12 per cent; up from 6 per cent in 2008).

Sustainable markets continue to be defined by persistent oversupply of standard-compliant production: While standard-compliant production has reached significant levels across select commodities, actual sales of products as “standard compliant” have not grown as rapidly, resulting in significant oversupply (typically between one-third and one-half of total compliant production is actually sold as compliant). This situation means that companies have ample choice for sustainable sourcing (positive outcome), but also suggests that the market may be placing downward pressure on the prices of sustainable products due to oversupply (negative outcome).

Production for sustainable markets is concentrated in more advanced, export-oriented economies: Supply of sustainable products is concentrated in select regions with more developed production capacity. Across developing countries, sustainable production is concentrated in Latin America. When developed countries can supply sustainable markets (as in the forestry sector), they tend to dominate supply. In light of this, special investment will be necessary if voluntary standards are to effectively operate as tools for poverty reduction among those most in need.

Sustainability standards are creating new opportunities for stakeholder participation in supply chain decision making: Whereas conventional commercial relationships rely principally on agreement between buyer and seller, sustainability standards have done a good job at integrating non-traditional perspectives into supply chain decision making by the standard-setting and implementation process, as represented by board member representation. Although developed country representation is still dominant across most boards, developing country representation is significant and remarkable.

Sustainability standards are strengthening the reliability of market claims through increasingly independent monitoring and enforcement processes: All of the initiatives surveyed applied some form of third-party conformity assessment procedure. A full three-quarters apply third-party certification—which adds to the independence of claims. Some of the newer initiatives have focused on using only verification for conformity assessment in order to cut costs and allow for more rapid growth.

Average criteria coverage of voluntary sustainability standards is declining as standards target mainstream markets: An analysis of voluntary sustainability standard criteria suggests that newer, mainstream-oriented standards apply criteria of reduced depth and breadth as a means for allowing for more rapid uptake. Across the initiatives surveyed, negative rights related to ILO core labour standards, as well as environmental practices with direct quality and yield outcomes, show the greatest degree of coverage. Most initiatives contain few criteria related to economic sustainability, reflecting a general belief that economic benefits should follow automatically upon reaching compliance.

Voluntary sustainability standards offer an important contribution to the green economy but cannot be assumed to deliver sustainable development outcomes: Voluntary standards have a close relationship with efforts to build a green economy. On the one hand, sustainability standards can help the market better achieve full-cost accounting in the pricing mechanism. On the other hand, voluntary sustainability standards can facilitate investment in sustainable technologies and practices. The ability of voluntary standards to do so, however, depends fundamentally on the credibility and objective accuracy of such initiatives in linking product sustainability claims to truly sustainable outcomes on the ground. The report highlights the many ways in which such accuracy and objectivity can be challenged by market forces, signalling the importance of public policy and related “non-market” frameworks for creating a level and transparent playing field in the standards sector.

Overall, the SSI Review concludes that the opportunities for voluntary standards to enable transformational change across major mainstream markets are now well established and continue to grow, but that taking full advantage of them will require a better understanding of field-level impacts, as well as a host of strategic policy measures to ensure that such standards effectively serve public sustainable development objectives.

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1 VOLUNTARY SUSTAINABILITY STANDARDS AND THE GREEN ECONOMY

The origins of contemporary voluntary sustainability standards can be traced back to a combination of growing consumer awareness around sustainability issues, changing global trade patterns through globalization, and a growing recognition of the limitations facing intergovernmental collaboration for addressing global supply chain sustainability issues.¹ The two principal precursors to contemporary sustainability standards, namely boycotts and eco-labelling, responded to these changing conditions by providing companies with direct, but limited, incentives for either avoiding unacceptable practices or adopting best-in-class practices.² Voluntary sustainability standards, by contrast, have differentiated themselves from their predecessors by offering a *systemic* means for ensuring that certain specific sustainability practices or outcomes are attained through the production cycle. Voluntary sustainability standards, in principle, begin from the premise that *any and all* actors within a sector can (and ultimately should) seek compliance with a given set of practices (criteria) set forth under a given standard. Voluntary sustainability

standards are therefore unique in their ability to be generally applicable across entire markets. As such, voluntary standards are particularly well situated among private sector initiatives to play a systemic role the promotion of a green economy.

The UN Environment Programme (UNEP) defines the green economy as “one that results in improved human well-being and social equity, while significantly reducing environmental risks and ecological scarcities” (UNEP, 2011). Although economists have long maintained the importance of the free market as a vehicle for enabling optimal social welfare, the use of the term “green economy” owes its current usage largely to the publication of *A Blueprint for a Green Economy* (Pearce, 1989). Beginning from the perspective of economic analysis, the basic premise Pearce’s work is that the pricing mechanism, which is determined by the forces of supply and demand (as dictated by consumer preference and factor endowments), does not function optimally (i.e., produce optimal social welfare) when various capital inputs are not fully included in the equation. Following this approach, a green economy is fundamentally a system of economic interaction that fully recognizes, and accounts for, the costs associated with not only private capital, but also natural (and social) capital.

The implementation of a green economy therefore, typically implies some version of full-cost accounting as a means of internalizing the social and environmental costs of production.³ Voluntary sustainability standards themselves, through criteria-setting and auditing processes, rely upon metrics development and measurement at specific points along the supply chain as a tool for building market recognition and, ultimately, pricing that incorporates, among other things, non-product-related ecosystem services (e.g., natural capital) into the pricing equation. As such,

- 1 Although global recognition of the need to promote sustainable consumption and production can be traced back to Principle 8 of the Rio Declaration (1992), a more pervasive recognition of the limitations of global intergovernmental cooperation in promoting sustainable consumption can be attributed to the failure of international trade negotiations under the World Trade Organization in addressing such issues adequately. Civil society protests of the World Trade Organization ministerial in Seattle (1999) represented an apex of civil society discontent and perceived “alienation” resulting from the global trading system—a sentiment that, in its generalized form, can be considered one of the major motivating factors for the development and expansion of “private” instruments for managing sustainable trading relationships.
- 2 The practice of avoiding purchasing from companies with poor environmental or human rights records through boycotts was popularized over the 1980s and 1990s. Since the Rio Earth Summit, a number of national eco-labelling programs have been established with the intention of recognizing environmental leadership across specific product domains. Following this philosophy, eco-labels seek to provide incentives for companies to compete on environmental performance by restricting eligibility for the eco-label to a portion of the market in any given product category. Examples of national eco-labelling programs include Green Choice Philippines (NELP-GCP) and India’s “Ecomark.”

- 3 The Economics of Ecosystems and Biodiversity (n.d.), The Millennium Ecosystem Assessment (2005) and Bank of Natural Capital (n.d.) each represent important initiatives aimed at improving understanding and techniques for implementing a green economy through accounting systems that seek to establish prices for natural capital.



they potentially have an important, if not critical, role to play in the implementation of a green economy.

More recently, the concept of the green economy, largely inspired by the economic crisis of 2008, has emphasized the role of public and private *investment* in driving more sustainable production practices rather than implementing full-cost accounting per se. Under this rubric, green economy policy discussions have largely revolved around the creation of appropriate incentives to stimulate investment that promotes sustainable production and consumption. Following this line of thought, policy-makers have referred to the notion of “green stimulus” as the focal point for discussions on the green economy (see UNEP, 2009).

Voluntary sustainability standards also have a specific role to play in promoting investment in sustainable practices. By providing a basis for making (credible) market claims related to sustainable practice, voluntary standards can be regarded as tools for both brand development and risk management, thereby providing a basis for targeted investment into green supply chains. The potential of voluntary standards to operate as a stimulus to investment in green production systems is perhaps nowhere better evidenced than through the multitude of mainstream corporate commitments to adopt standard-compliant supply within the coming decade.⁴ Achieving such rapid and widespread adoption of compliant practices across many markets almost necessarily implies concordant investments at the level of production.⁵

Whether one considers a green economy in terms of corrections to the pricing mechanism or in terms of targeted investments for sustainable production and infrastructure, there can be little question that voluntary sustainability standards have the potential to offer a positive contribution. What remains less certain, however, is precisely what the boundaries of that contribution might be.

Notwithstanding the promise of sustainability standards through their applicability to entire markets, the relationship of such standards to the market more generally has, at best, been relatively opaque. At the most basic level, voluntary standards have, historically, focused on building their markets rather than measuring them. As a result, there has been, and continues to be, a rather startling absence of consistently reported information related to

the market performance of such initiatives. Similarly, there is little explicit recognition or research on the potential effects of voluntary sustainability standard systems on the pricing mechanism, despite the fact that, from an economic perspective, this represents one of the main pathways through which such systems operate.

At the same time, and equally importantly, voluntary sustainability standards offer a number of “non-market” pathways for promoting sustainability across global supply chains, through the provision of institutions for participatory governance, criteria development, education, technical assistance and so on. However, as market-based instruments, even these non-market pathways remain subject to market forces, raising the question of how, and to what degree, such pathways can be considered extensions of the market itself (see Box 1.1, Voluntary standards and the green economy: Potential contributions and constraints).

As market-based instruments, voluntary sustainability standards may be able to provide efficiency gains over more traditional command-and-control mechanisms for correcting for market failure. However, as instruments *of the* market, voluntary standards remain inherently challenged in their ability to fully “correct” for market imperfections (see Figure 1.1, Voluntary sustainability standards and the pricing mechanism.). This context provides the backdrop for supply chain decision-makers seeking to play a proactive role in the green economy and/or to understand the potential role of sustainability standards within a context of policy measures for promoting a green economy. It also provides context for understanding the role different implementation and content systems may have in contributing to the broader goal of building a greener economy.

Although the current review cannot hope to determine whether or when sustainability standards are effective at promoting a green economy, it does hope to provide a window into understanding the current state of play and issues related to the implementation of a green economy among 16 leading sustainability standards in the agriculture and forestry sectors. And if we are not able to find the perfect path to a green economy through our analysis, perhaps we can be contented by a greater awareness of the boundaries of that path.

4 Many leading retailers and product manufacturers have made public commitments to source 100 per cent of their supply from sustainable sources by 2020. Enabling such a widespread transition, particularly among developing country supply, may imply significant investments upstream in the supply chain. See Market Development sections of individual commodity market chapters.

5 Some voluntary sustainability standards, such as Fairtrade (through its Producer Support Network) and UTZ Certified (through its relationship with Solidaridad), have also played significant roles in raising affiliated investment in technical assistance to facilitate a transition to compliance. Increasingly, there is a trend to use certification as a component in broader sustainable supply chain investment strategies. Two important programs with an explicit mandate of facilitating investment in certified supply chains include the Sustainable Trade Initiative/Initiatief Duurzame Handel (IDH) and the Sustainable Commodity Assistance Network (SCAN). In 2012 the annual budget of IDH was €32.5 million (IDH, 2012).

Voluntary sustainability standards have the potential to contribute to a green economy in a variety of ways. Below we consider some of the main market and non-market means by which voluntary sustainability standards can contribute to the implementation of a green economy, as well as key constraints facing each pathway.

1 Perfecting the pricing mechanism

In theory, the “perfect market” provides optimal social welfare based on given factor endowments and, as such, represents a pillar of sustainable development. Indeed, it is widely recognized that many, if not most, of the sustainability challenges facing the planet today are the result of market imperfections. Accordingly, a logical starting point for promoting sustainable development rests with “perfecting” the market.

One of the four conditions of the perfect market is “perfect information,” which refers to the ability of buyers and sellers to know everything and anything about the relevant economic inputs to a given transaction.⁶ Historically, one of the reasons that sustainable practice has not formed an integral part of economic transactions is simply because no credible, recognized means for understanding or identifying such practice within the market has previously existed with any consistency. Voluntary sustainability standards, by both identifying sustainable practice (through criteria development) and credibly linking such practice to physical products (through conformity assessment systems), directly enable the market in communicating “non-product-related” production practices across the marketplace.⁷

As such, voluntary sustainability standards systems provide a means for integrating sustainable practice within the pricing mechanism in a way that conventional markets, in their absence, may not. This arguably represents one of the most direct and systemic manners in which voluntary standards may contribute to a green economy.⁸

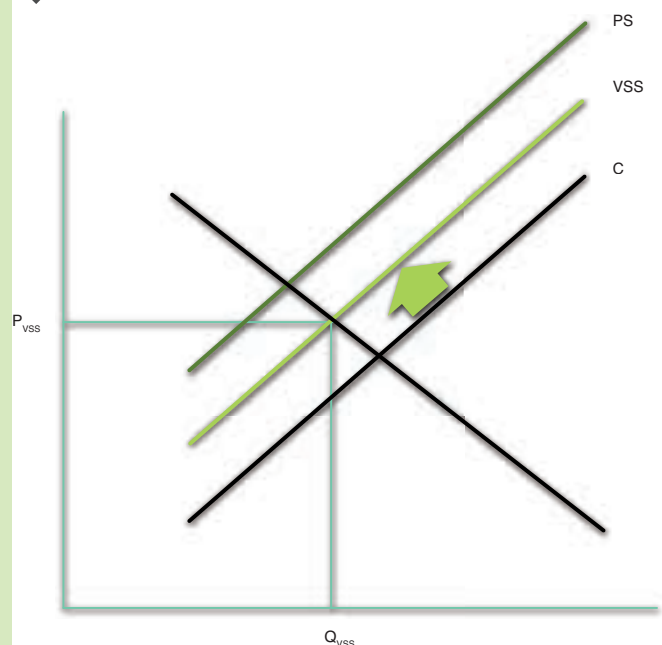
6 Imperfect information represents one of the sources of “market externalities” that leads to sub-optimal welfare outcomes through market interaction alone.

7 Non-product-related production and processing methods (PPMs) have earned considerable attention within the context of international trade negotiations. Because protectionism itself is one form of non-product-related PPM (i.e., a product’s place of production can be considered a part of the method of production), governments have been cautious to accept differential treatment based on non-product-related PPMs alone. To the extent that governments may have legitimate social or environmental reasons for selecting products based on specific PPMs, the ability to credibly link PPMs to specific products has potentially important repercussions for international trade policy as well (see Potts, 2008).

8 Although one of the most important practical accomplishments of voluntary standards has been their ability to credibly link sustainable practices to physical products, thereby allowing markets to more efficiently include such characteristics within the pricing mechanism, few voluntary standards initiatives advertise this achievement explicitly.

The degree to which voluntary standards are able to actually provide a “perfect” adjustment to conventional market conditions is constrained by a number of factors including, but not limited to, diversity of conditions for sustainable production across different producing regions and systems that decrease the appropriateness of global criteria for local conditions, the need to design rules capable of securing *voluntary* market acceptance, and imperfections in conformity assessment processes allowing for non-compliant practices to be communicated as “compliant” in the marketplace.

FIGURE 1.1 VOLUNTARY SUSTAINABILITY STANDARDS AND THE PRICING MECHANISM.



The light green line (VSS) in Figure 1.1 represents voluntary sustainability standard supply. The dark green line (PS) represents the perfectly sustainable supply curve. The black line (C) represents the conventional supply curve. The voluntary standard’s supply curve facilitates movement toward more sustainable equilibrium but faces barriers in achieving perfectly sustainable equilibrium due to system imperfections and/or political processes involved in establishing this curve. Because market acceptance is a major part of decision making, the standard may also face pressures to compromise in rule making, conformity assessment processes or other decisions that increase overall implementation costs. Voluntary standards may also have impacts on the supply curve, either by increasing efficiency of production (shift downward) or by increasing overall costs of production (shift upward). These effects are not represented in the diagram.

2 Promoting efficiency through the allocation of sustainable production

A common strategy for governments attempting to correct for market imperfections is to resort to the use of command-and-control mechanisms that require firms to comply with specified practices or performance outcomes.⁹ Command-and-control mechanisms are attractive because they allow policy-makers to achieve fixed performance outcomes. However, they may not do so in the most efficient manner possible, due to their requiring different market actors to attain equal levels of compliance.

Market-based instruments, including voluntary sustainability standards, have the advantage of allowing market actors to select their level of adoption of sustainable practices based on the relative costs (efficiencies) with which they are able to do so.¹⁰ Moreover, firms that can improve their efficiency in the adoption of sustainable practices (through the development of new technologies) have the potential of being rewarded by the market for doing so.¹¹ As such, voluntary sustainability standards have the potential to promote more efficient allocation of sustainable practices across a diverse base of firms and regions.

The degree to which voluntary sustainability standards are able to promote the efficient allocation of sustainable development efforts, however, may be constrained by barriers to entry in international markets and correspondingly different levels of development among producing regions and firms, thereby preventing otherwise “efficient” firms from gaining access to sustainable markets.¹²

9 For example, in regulations establishing maximum pollution levels applicable to all firms within a given region.

10 By allowing the market to determine the allocation of adopting sustainable practices, lower cost adopters will bear a larger share of the market for compliant products. In doing so, it is said that market mechanisms promote static efficiency in promoting given sustainability practices.

11 By rewarding firms that can “transition” to sustainable practices most efficiently, market-based systems promote innovative or “dynamic” efficiency.

12 The most obvious example of this comes in the form of less developed countries and producing regions. In Section 4 we observe a general trend toward the concentration of standard-compliant supply in more developed countries. The trend toward seeking efficient supply needs to be balanced against the interest in ensuring that international markets provide benefits to those “most in need.”

3 Correcting for collective choice problems

One of the most common sources of market failure is the inability of individual actors to know, or plan for, the actions of other economic actors in a manner that maximizes benefits for all. The “tragedy of the commons,” which results from individual, non-collaborative self-interest maximization, is a classic problem in sustainable development¹³ and provides the basic rationale for multi-party cooperation through international treaties, etc.¹⁴

Voluntary sustainability standards have the potential to offer a pre-competitive venue for the identification of common, collectively identified production rules for the entire supply chain, and in so doing can embody a soft form of collective action. To the extent that competitors agree upon basic practices, these practices may become integrated across entire markets, thereby being removed from the competitive equation altogether.¹⁵

The ability of voluntary sustainability standards to serve this function will be constrained by the degree to which standard systems represent “binding” commitments among competitors to comply with common rules (typically they do not include such commitments¹⁶) as well as by the degree to which *all* major competitors partake in the standards scheme. Initiatives with limited representation from market players in their governance process may be less likely to serve this particular function in the marketplace.

13 In the face of public goods where joint conservation of resources would result in improved overall welfare, individual self-interest-maximizing decision making results in the persistent overuse of the resource and correspondingly reduced total social welfare (see Hardin, 1968).

14 The solution to the “tragedy of the commons” is known as the “Nash equilibrium” and posits that each player’s optimal strategy is that which is subject to the constraint that other players’ strategies are also optimal. In tragedy-of-the-commons situations, some levels of individual constraints on the pursuit of self-interest produce outcomes that are better for all involved (Nash, 1950, 1951).

15 Note that to the extent that voluntary standards serve this function, they reduce the role of such practices as a basis for competition among actors. Even where common principles have been established, however, higher level standards may nevertheless be adopted as a means for improving competitiveness within the market.

16 Indeed, most national competition policies would prohibit such agreements among competitors due to the potential risks to the conditions of competition in the market (Potts, 2004).

4 Stimulating investment in sustainable production

Sustainability standards provide a framework for market recognition based on compliance with established criteria. As such, standards effectively have the potential of creating “new” markets. Recognizing this, firms can more safely invest in the adoption of sustainable practices within their product and brand development strategies.¹⁷ The more thoroughly and deeply companies build sustainable practices within their supply chains, the greater the potential gains offered by growing markets for sustainable products are likely to be. Following this logic, the infrastructure offered by voluntary sustainability standards provides a basis for increased investment in the adoption of sustainable practices through supply chains.

The degree to which voluntary sustainability standards are able to stimulate increased investment in sustainable practice is constrained by the market benefits available as a result of adopting sustainable practices. Persistent imperfections in the pricing mechanism therefore operate as constraints on the ability of voluntary sustainability standards to stimulate investment into sustainable practice. Even the mere absence of clear data or understanding of the market benefits of such investments can reduce the investment stimulus effect of standards.¹⁸

¹⁷ There are many rationales by which companies may choose to do so. One rationale is that given the link between social and environmental sustainability and actual physical outputs, firms may seek the adoption of sustainable practices as a means of managing physical risks. Firms may also adopt sustainable practices as part of a risk management strategy on the understanding that the failure to comply with publicly accepted norms may lead to reduced brand value. Finally, firms adopting sustainable practices may be able to secure market advantage by being first movers or otherwise contributing to brand development.

¹⁸ The Finance Alliance for Sustainable Trade (FAST) represents a group of leading social lenders seeking to create a better understanding of the impacts (and financial performance) of investing in agricultural small and medium enterprises. The general inability to collect such information through conventional sources or through individual data monitoring efforts provides the rationale for bringing such work together under a single dedicated umbrella organization (Larrea, Minteuan & Potts, 2013).

5 Promoting participatory governance

Participatory governance plays a role in ensuring that the parameters of a green economy respond to the diverse social, economic and geographic conditions of production. One of the main rationales for the adoption of voluntary sustainability standards has been the corresponding failure of public institutions at ensuring desired sustainability outcomes. One of the appeals of voluntary sustainability standards is the immense flexibility they provide in establishing common rules for supply chain management.

While the range of governance regimes for voluntary standards is more or less infinite, the credibility of such systems is increasingly understood as a function of the inclusiveness of their governance processes (see, for example, the ISEAL standard-setting code [ISEAL, 2012b]). Importantly, sustainability standards have the potential to integrate stakeholders that might not otherwise have a significant voice within international supply chains and within the voluntary sustainability standard decision-making process. Voluntary standards can therefore promote a green economy by improving participatory governance within economic decision making.

The degree to which voluntary sustainability standards can realize this potential may be constrained by the resources available to voluntary standards systems in managing international governance systems, as well as by the potential need to secure market acceptance and therefore disproportionately accommodate larger market players in decision-making processes (see Figure 1.1, Voluntary sustainability standards and the pricing mechanism.).

6 Changing consumer preference

A green economy is one that is under a continuous process of renewal toward increased sustainability, drawing from and stimulating new knowledge and innovation. Through their rule- and criteria-setting functions, sustainability standards can play an important role in building knowledge on what constitutes sustainable production practices for a given region or sector, which may differ according to situation and context. By doing so, these standards have the ability to increase global understanding of the meaning of, and solutions to, sustainable development challenges at the local and global scale.

The rules that are identified by voluntary sustainability standard systems can serve not only as a vehicle for allowing consumers to act on existing preference (see Figure 1.1), but also as a vehicle for modifying existing consumer preference to select for more sustainable practices. In so doing, the voluntary sustainability standard systems have the effect of adjusting the consumption function toward more sustainable practices.

The degree to which voluntary standards are able to meet this objective may be constrained by the depth and accuracy of the knowledge developed through the standards process itself (including a standard's ability to integrate continual improvement in its own knowledge and processes), as well as the resources available to invest in consumer education. Standards operating on business-to-business models may seek to exert influence on consumer preference through choice editing rather than direct education.

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