

**Fair Trade:
Overview, Impact, Challenges**

**Study to Inform DFID's Support
to Fair Trade**

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Thanks are due to all the individuals and institutions listed in Annex 2 who provided immense assistance through interviews and access to documents, both in the UK, during visits to the Netherlands and to the EC in Brussels, and for the case studies in Ghana and Tanzania.

Earlier drafts of the report were sent out to members of a reference group consisting of fair trade organisations, conventional businesses engaged in the cocoa and coffee sectors, and academics with an interest in fair trade. Initially, the Inception Report was circulated to all members of the reference group to provide an overview of the approach the consultants were adopting and to prompt a request for relevant information. The first draft of the report was circulated for comment initially to those organisations involved in fair trade that had supplied information for the study in order to check on issues of fact as well as to provide an opportunity for comment on the draft findings more generally. A meeting was then held with members of this sub-group and DFID staff to discuss more fully the comments that had been provided. Several issues were highlighted in this discussion, relating in particular to definitional issues, the underlying assumptions about market operations, and the interpretation of the case study examples. A second draft that incorporated factual corrections was then circulated to the whole reference group. Members of the reference group were also invited to supply additional case study information to supplement that provided by the consultants. The final report was prepared taking into account the comments received.

This consultation process generated valuable comments, discussions and additional insights as well as providing an opportunity for a better understanding of the objectives of fair trade organisations. We would particularly like to thank those members of the reference group who spent considerable time supporting this process.

The conclusions of this study are the consultants' alone and should not be attributed to DFID.

Executive Summary

The Fair Trade (FT) movement is dynamic and diverse. Although there is a lack of consensus on definitions and criteria the FT movement is united by the view that conventional trading relations between the South and the North are both unfair and unsustainable. The core of the FT movement comprises southern producer organisations, northern Alternative Trade Organisations (ATOs) that have their roots in the NGO sector, their umbrella associations, and labelling organisations. The FT movement is committed to the payment of minimum guaranteed prices and price premiums to southern producers, to direct and long term trading relationships, and the provision of pre-financing, information and training to southern producers and their organisations. FT concentrates on smallholder crops, plantation crops, and small-scale manufactured goods. There are significant overlaps between the FT movement and initiatives aimed at other ethical dimensions of trade, and environmentally sustainable trade.

The FT movement carries out four types of activity that are in practice closely linked, but which are logically distinct.

- ◆ As market participants, FT organisations seek to challenge and outcompete conventional profit-oriented competitors, and to create sustainable businesses.
- ◆ As agents of advocacy and awareness raising they attempt to secure changes to the international trading regime.
- ◆ As agents of redistribution they aim to pass on the benefits of price premiums that some consumers are prepared to pay to southern producers.
- ◆ As agents of empowerment, they aim to assist producers to develop their own capacity to engage on more favourable terms in international trading relationships.

Over the past decade the FT movement's commercial value and profile has risen, albeit from a low base. Since the early 1990s a number of trends in the FT movement have become discernible, including;

- ◆ Pressures for increased efficiency;
- ◆ The harmonisation of definitions, criteria and monitoring at the European level;
- ◆ Marketing through supermarkets;
- ◆ Increasing professionalisation; and
- ◆ Increasing emphasis on quality assurance.

Market liberalisation and associated reforms have generally been favourable to most export commodity producers, but there are significant problems with the way in which these markets operate. Newly liberalised markets, while often highly

competitive, exhibit pervasive market failures and have a limited capacity to support the emergence of the type of contractual arrangements that will improve quality, enable credit to be mobilised and used through the marketing chain, and enable producers and traders to manage the price risks they face.

Producer organisations (including marketing cooperatives) have a potentially important role to play in strengthening the functioning of agricultural marketing systems. FT initiatives, through providing support to producer organisations, may therefore have a significant role in a strategy to improve the functioning of markets for small producers.

The most promising framework for assessing the impact of FT initiatives consists of supply chain analysis in the relevant domestic and international markets, livelihoods analysis, and an analysis of the sustainability and cost effectiveness of FT. The consultants reviewed experience with FT initiatives, undertaking case studies of coffee in Tanzania and cocoa in Ghana. The main conclusions of the case studies were as follows:

- ◆ The quantities of cocoa and coffee designated as FT (i.e. attracting an FT premium) were only a fraction of the total quantities sold by the respective producer organisations. Therefore, it was not generally meaningful to separate the impacts of the FT and non-FT aspects of the producer organisation's activities.
- ◆ The effectiveness of producer control and the transparency of the management of the co-operatives will to a large degree determine the extent to which producers benefit from FT.
- ◆ In both cases, the liberalisation of domestic markets and the existence of private competition were viewed positively by farmers.
- ◆ The most important impact, and the area where there is the strongest case for donor support, relates to the capacity building and trade facilitation role, particularly in the context of marketing systems undergoing significant reforms.
- ◆ In both cases there are tensions between the realities of the relevant production, domestic marketing and international trade processes, and certain of the arguments advanced by the FT movement, in particular in relation to the use of the premium and price stabilisation support.

There are a number of tensions and dilemmas in the FT movement, each of which represents a potential conflict between profitability and development objectives.

- ◆ There is a tension between definitions of FT emphasising altruistic values and development objectives, and suggesting FT as a standard to which all businesses may aspire.
- ◆ There may be sensitivity amongst ATOs to fulfilling their commitment to sharing commercially valuable information between fellow ATOs in a tight market for FT products.

- ◆ The establishment of FT labelling creates an opportunity for new market entrants who may increase competition for established brands and ATOs.

There are a number of further challenges facing the FT movement.

- ◆ How to resolve the confusion generated by the lack of a single and consistently applied approach to defining FT.
- ◆ How to define the distinctive value-added of ATOs at a time when increasing numbers of mainstream processors and retailers are involved in ethical trade initiatives.
- ◆ How to promote the FT concept without using simplistic or potentially misleading messages.
- ◆ How to build attractive FT brands.
- ◆ How to get mainstream manufacturers to support FT values and activities.

Many of the challenges and dilemmas facing the FT movement are interrelated. For example, it may not be realistic to expect mainstream manufacturers to adopt some elements of the most used FT definitions, especially those related to pricing. Second, there are a set of issues around the governance of FT labelling which may deter conventional businesses. Third, mainstream processors generally do not see FT labelling as compatible with their overall brand management strategy, fearing that the adoption of a FT sub-brand will call in question the conditions of trade of their other brands.

However, FT has increased pressure towards the broader adoption of ethical codes of conduct by mainstream processors and retailers. The most important impact is likely to be through successfully enhancing the capacity of representative producer organisations to engage on more favourable terms in trading relationships. There is already evidence that this has occurred even where the volumes of FT produce as such are relatively modest. There is a strong case for continued donor support to such capacity building activities.

This report makes a series of recommendations, including the following.

- ◆ DFID support to for FT activities should be informed by a set of specified guiding principles.
- ◆ DFID should encourage efforts to improve the governance arrangements of FT labelling systems.
- ◆ DFID should explore new alliances involving ATOs to achieve mutually agreed policy reforms at the European and international levels.

- ◆ DFID should consider supporting specific capacity strengthening initiatives by ATOs, especially for producer communities that are disadvantaged within particular countries. Support should not be limited to co-operative or farmer controlled organisations.
- ◆ DFID should consider support for exchanging experience and forming new partnerships between ATOs and mainstream processors, especially with a view to improving the functioning of private trading systems emerging or expanding in the wake of market liberalisation.
- ◆ DFID should explore ways of supporting practical and cost-effective mechanisms for the provision of risk management facilities to small scale farmers and other participants in the marketing chain.

Fair Trade: Overview, Impact, Challenges

1. Introduction

1.1 Objectives and Report Structure

The objective of this study (see Terms of Reference, Annex 1) is:

“to inform DFID's policy of support for Fair Trade by assessing the benefits and costs of Fair Trade in comparison with more traditional trade patterns. It will look at the range of initiatives covered by the term 'Fair Trade'... It will look at how the Fair Trade movement has evolved and then examine the future prospects for transferring Fair Trade values and principles into the mainstream. It will also consider how Fair Trade complements the ethical trading movement.”

The report is structured as follows. Section 2 examines the characteristics of Fair Trade (FT) – definitional issues, organisations, activities, products, the size of the FT market and main trends. Section 3 places FT initiatives within a wider view of market reform processes. Section 4 reviews the impact of FT. Section 5 focuses on dilemmas and challenges facing the FT movement and links with the mainstream. Section 6 presents the conclusions of the study, and the final section (7) provides recommendations for DFID.

In addition, the following annexes have been prepared:

- Annex 1 - Terms of Reference for the Study
- Annex 2 - List of Individuals, Institutions and Documents Consulted
- Annex 3 - Case Study – Fair Trade Coffee in Tanzania
- Annex 4 - Case Study – Fair Trade Cocoa in Ghana
- Annex 5 - Summary of Main Features of Fair Trade Labelling
- Annex 6 - IFAT Code of Practice

1.2 Study Approach

The study is based on a review of experience with FT based on available literature and interviews. However, the study focuses principally on FT in cocoa and coffee, with specific examples drawn from case studies of FT initiatives for cocoa in Ghana and coffee in Tanzania. The case studies examine each initiative in the context of a broader overview of the characteristics of the international and UK market for each commodity.

The case studies were selected because they covered some of the commodities for which FT has been fastest growing and has achieved the highest profile. The Ghana case study also focuses on what is by some way the most important source of FT cocoa. Cocoa accounts for only 3.5% of Ghana's GDP, but over a third of export earnings. Tanzania is a small player in the international coffee scene, accounting for less than 1% of total production. However, coffee is the second most important source

of the country's export earnings, behind cotton, and it is estimated that around 10% of the population is involved in coffee production.

Coffee and cocoa are also commodities for which it is possible to make comparisons to mainstream trade with which FT products are in direct competition, and are produced in countries with a high incidence of poverty. They are therefore cases where both the FT movement's claims about the operation of mainstream markets can be most directly assessed, and the scope for "mainstreaming" FT ideas may be greatest.

The choice of case studies was also prompted by considerations about the potential case for DFID support for FT initiatives. Tropical beverage exports are of fundamental economic importance for many low income countries, especially in Africa. Recent economic reforms aimed at reducing direct state control over pricing and marketing have yielded important benefits for many producers. However, they have also highlighted severe weaknesses in the capacity of newly liberalised markets to support market access for remote producers, to enable producers to deal with market risks, and to sustain the growth of credit and input supply. The potential of FT initiatives to develop solutions to these problems is therefore a question of particular and immediate policy interest.

From the outset, it was recognised that the case studies are not representative of FT in the UK as a whole, as evidenced by the composition of FT sales (broadly defined). In particular, the study has not looked in detail at the handicraft sectors that have traditionally accounted for most FT sales. One important point is that handicrafts may in some cases target poorer groups than smallholder export crop producers will tend to be. There is therefore a limit to the extent to which general conclusions about the impact of the FT movement as a whole can be drawn from the case studies, though the consultants do not feel that this invalidates any of the conclusions or recommendations of the study. Indeed, the case studies provide important insights for the more general debate.

The study has not attempted to provide a comprehensive comparison between FT and conventional profit-oriented approaches to trade in order to assess which is preferable. Such a task would anyway pose immense conceptual and empirical problems. Instead, the focus has been on informing the case for providing support from a development agency to specific FT initiatives where these may assist the agency in achieving its poverty reduction objectives.

2. Fair Trade: Who Does What?

The complexity and diversity of the FT movement mean that any categorisation or generalisation can be contested. Nevertheless, this section explores what is meant by the term "fair trade". More specifically it examines some important definitional issues, and identifies six types of FT organisation, four main FT activities, and three main types of FT product. Finally, it considers the size of the FT market and the main discernible trends.

2.1 Definitional Issues

Fair Trade is a dynamic and diverse movement that fits within a wider trend towards an increased role in economic activity for private organisations that are not principally or entirely profit-driven. Since its emergence in the 1970s as a new way of supporting producers in developing countries, it has evolved from its origins in charitable and solidarity initiatives to an established, if still small, presence in some European markets. With the launch of FT labelling in the early 1990s, FT products have increasingly entered mainstream retail outlets challenging established products in markets that are often highly concentrated (most notably coffee).

FT is both a movement and a set of business initiatives. The FT movement is based on a critique of conventional trade policy and practice. It argues that the policies of both Northern and Southern governments and multinational corporate practices tend to disadvantage agricultural producers and small scale processors and craftspeople in the developing world. This analysis is generally applied to both earlier statist marketing arrangements and to the new marketing systems emerging from deregulation. As a business initiative, FT seeks to operate sustainably within this environment which it seeks to transform.

Advocates of FT approaches usually base their case on the view that:

- ◆ FT is both a meaningful **expression of solidarity** between relatively affluent consumers in the North and economically, politically and socially marginalised producers in the South and provides an effective way of enhancing the livelihoods of poor households;
- ◆ **International trading relations are unfair and unsustainable**, and that the process of globalisation is likely to exacerbate this state of affairs; and
- ◆ **Producer controlled marketing organisations** (for instance co-operatives) are **generally more equitable and potentially more efficient** than the alternatives facing small-scale producers (especially farmers).

Lack of consensus on definitions and criteria has contributed to confusion in assessing what might or might not validly be called "Fair Trade" – this is an issue of considerable importance given the value-laden connotations of the term.

A starting point are the **principles set out by IFAT** (Annex 6). The commitment of IFAT members to Fair Trade is interpreted as including the following undertakings:

- ◆ To trade with concern for the social, economic and environmental well-being of marginalised producers in developing countries - this means equitable commercial terms, fair wages and fair prices;
- ◆ Unfair trade structures, mechanisms, practices and attitudes will be identified and avoided;
- ◆ To cooperate and not compete;
- ◆ To promote fair trade and social justice in the interest of the producer, and;
- ◆ Not to maximize profit at the producer's expense.

A group of umbrella bodies and network organisations called **FINE¹** has recently defined FT as follows:

Fair trade is an alternative approach to conventional international trade. It is a trading partnership which aims at sustainable development for excluded and disadvantaged producers. It seeks to do this by providing better trading conditions, by awareness-raising and by campaigning.

According to FINE the goals of FT are:

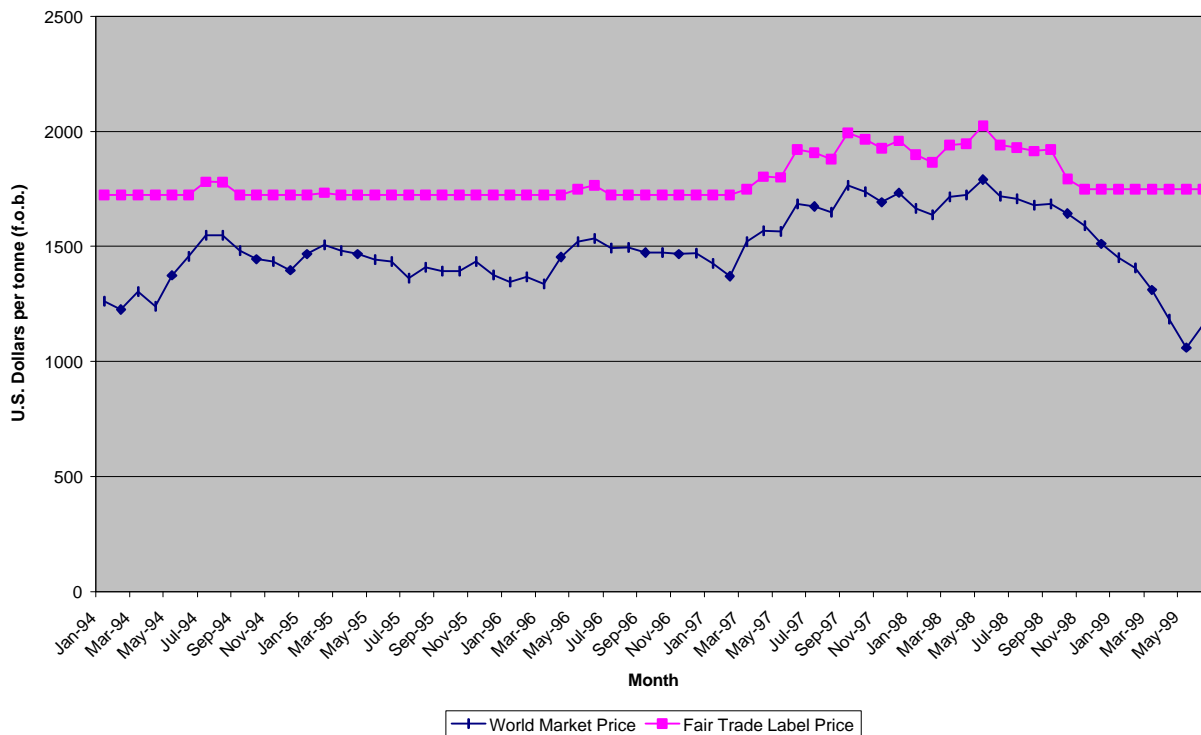
1. *To improve the livelihoods and well-being of producers by improving market access, strengthening producer organisations, paying a better price and providing continuity in the trading relationship.*
2. *To promote development opportunities for disadvantaged producers, especially women and indigenous people and to protect children from exploitation in the production process.*
3. *To raise awareness among consumers of the negative effects on producers of international trade so that they exercise their purchasing power positively.*
4. *To set an example of partnership in trade through dialogue, transparency and respect.*
5. *To campaign for changes in the rules and practice of conventional international trade.*
6. *To protect human rights by providing social justice, sound environmental practices and economic security.*

¹ FLO International, IFAT, NEWS!, and EFTA. The European Commission (1999) notes that this is the first definition to enjoy wide agreement across the movement.

Mainstream competitors to FT brands are increasingly contesting the claims of the FT movement especially in the absence of generally accepted definitions and standards of conduct.² They also argue that claims for the general superiority from the perspective of farmers of FT marketing arrangements are not necessarily well founded. The claim that FT is distinguished by its emphasis on working with the marginalised may also be contestable. If for example all smallholder producers in the coffee and cocoa sectors are regarded as marginalised then it may be difficult to claim a unique position for FT. **There is a real danger of a loss of consumer confidence if the claims of the FT movement cannot be shown to be well-founded.**

The criteria for acceptance onto FT registers provides a more stringent test than the FINE definition since these establish quantitative guidelines for accepted FT practice. **FT Labelling** represents an attempt to provide and validate a standard definition of FT practices, and to provide a route by which FT products can be brought into mainstream trade through identifying qualifying producer organisations (Annex 5). These criteria define both aspects of the terms under which transactions must take place and, for most labelled products, that purchases must be from producer organisations that are owned by their members (who must be predominantly small-scale farmers) and subject to democratic control. **The main criteria are:**

Figure 1: Comparison of World Market and Fair Trade Cocoa Prices



- ◆ **Adherence to a pricing formula** that for coffee and cocoa establishes both a minimum price (in the event of a fall in world prices) and the payment of a FT

² A further possible confusion relates to the responsibilities of the UK Government's Office of Fair Trading, concerned with regulating consumer protection (including misleading advertising and unfair contract terms), and competition policy to prevent monopolistic activities that harm the consumer interest (www.offt.gov.uk).

premium to producers if the market price is above the minimum. Where minimum prices are not defined these must be based on covering production costs as defined by the producer. For tea (reflecting the dominance of estate production methods), a social premium rather than a FT premium is payable. Figure 1 illustrates the relationship between the FT price based on this formula and the world price for cocoa over the last five years.

- ◆ Producers must be provided with **credit facilities** of up to 60% of the value of harvest.
- ◆ **Long-term contract arrangements** must govern relations between producers and buyers.

Several points can be made about approaches to defining FT – particularly relating to the need to distinguish between FT products and FT organisations of various kinds:

- ◆ Alternative Trading Organisations (see section 2.4) emphasise the values and objectives of the FT movement, in particular commitments to empowerment, working with the marginalised, and development, rather than profit-driven, goals. On this approach, it is by definition impossible for mainstream profit-oriented companies to aspire to engage in “Fair Trade” practices.
- ◆ FT labelling organisations provide, for certain commodities, verifiable criteria to justify the application of a FT label. According to this approach, mainstream profit-oriented business may participate in the FT marketing chain provided that they satisfy the labelling criteria, and FT labelled products can in principle be sourced from any small-scale producer (not necessarily those classed as marginalised).
- ◆ Typically, only a small proportion of the sales of producer organisations that are registered as satisfying the criteria to supply FT labelled produce is in fact sold under the FT labelling terms through ATOs to establish a distinct FT marketing channel.

It is also important to relate definitions of FT to other alternative trade approaches. **Ethical trade** (for instance as embodied in the Ethical Trade Initiative) focuses on the conditions of production.³ In particular, ethical trade promotes adherence to core labour standards for employees and currently has no specific concern with the terms of trade or seeking to overcome the marginalisation of producers.⁴ As noted by the European Commission (1999, p.4), the FT concept could be taken as applying to trading situations and commodities where social and environmental standards are not, or cannot be (because of the way in which production is organised), enshrined in law. **Environmentally-driven trade** is concerned with ensuring that traded products are produced using environmentally sustainable techniques.

³ However, in some of the literature “ethical trade” is used as an umbrella term covering both FT as described here and the labour standard concerns embodied in the ETI.

⁴ A group of FT NGOs participating in the ETI is currently lobbying for a broadening of the ethical trade concept to pay more attention to these issues (information supplied by Fair Trade Foundation).

There is a considerable overlap of issues and attitudes between different types of alternative trade. On the demand side, individuals and organisations sensitive to environmental issues are also likely to be concerned about social justice. On the supply side, there is a significant level of overlap between the standards of different parts of the alternative trade movement. In particular, FT labelling criteria relating to agricultural commodities produced on plantations (particularly tea) include stipulations regarding labour standards. About two-thirds of FT product lines are also certified as organic.

2.2 Six Types of “Fair Trade” Organisation

Noting the lack of definitional agreement, six main types of organisation that make claims to be regarded as engaged in FT can be distinguished.

First, there are Southern **Producers’ Organisations**. These are the core of the FT labelling system and the approaches of ATOs that emphasise the fundamental importance of democratically controlled producer organisations as a means of achieving a more equitable approach to trade relationships and producer empowerment. Any producer organisation that, for example, satisfies the requirements of FLO International (see Annex 5, page 5-2) in terms of its operations and objectives might therefore be regarded as a FT organisation. The extent of involvement of producer organisations with other types of FT organisation will vary considerably. Often, as with the Co-operative Unions in Ghana and Tanzania that are examined in the case studies, and with Maquita in Ecuador (Annex 4 Appendix 2), only a small proportion of total sales of these organisations takes place on FT label terms or to Northern ATOs. In some cases capacity building and trade facilitation activities provided by Northern ATOs (and the payment of price premia) have played a significant role in supporting an organisation’s origin and development.

Second, **Alternative Trade Organisations (ATOs)** participate actively in trading while undertaking other activities in varying degrees. Examples in the UK include Traidcraft, Oxfam Fair Trading, and Twin Trading. Normally these organisations are (or are closely identified with) development, political, or charitably based non-governmental organisations (NGOs) which have their origins in the North and have established a reputation for being pro-poor and pro-development in their outlook, campaigns and in the other work they undertake. The FT movement as normally understood has its origins amongst the ATOs.

Many ATOs are involved in work around ethical and sustainable trading initiatives as well as FT, and the products they trade typically include handicrafts, clothes, and food. They emphasise their close links with southern producers at grass roots level, and some have their own retail outlets in the North (e.g. Oxfam and Fair Trade Organisation). In the United Kingdom these organisations do not always use available FT labels. They often market FT products on the back of their own reputation and track record. However, in other countries (such as Holland) ATOs tend to use the available FT label whenever possible. As shown in the examples of Box 1, a common model is for the trading organisation to have a partner that undertakes capacity building and advocacy activities.

Box 1 Profiles of Selected Alternative Trading Organisations

Traidcraft: *There are two parts to the Traidcraft group. Traidcraft plc is a trading company, whilst Traidcraft Exchange is a charity. Traidcraft plc is an importer and distributor of fair trade products from over 100 producer groups. Its distribution network comprises over 5,000 individuals, as well as wholesalers and retailers. It was a founder, and is a co-owner of Cafédirect Ltd. Traidcraft plc's sales of products sourced from southern producer groups amounted to £5.4 million in 1998/99 (74% of all its sales) compared to approximately £4.7 million in 1995. The value of Traidcraft plc's purchases from southern producer groups grew by 11.6% in 1998/99 when food items accounted for approximately two thirds of such purchases. In 1998/99 Traidcraft plc's advances to southern producer groups amounted to £ 240,000 (26 groups) compared to £ 116,000 in 1995/96.*

Traidcraft Exchange receives funding from DFID, the EU and other funding sources. It builds the capacity of southern producer groups to engage in trade with the North, raises public awareness of fair and ethical trade, and seeks to influence the trading practices of the mainstream business sector in the UK.

Fair Trade Organisatie: *Fair Trade Organisatie (FTO) is based near Utrecht, and has its origins in the Roman Catholic Church. In 1997 it made a net trading profit of approximately \$750,000, although much of this profit resulted from an increase in the price of coffee (and the consequent increase in the value of coffee) which FTO had already bought. Its turnover was \$17,000,000 of which coffee accounted for just over 50%. Food in total accounted for 73% of turnover (including wine, tea, chocolate and honey) the remainder being handicrafts. FTO wholesales fair trade products from Culemborg, and has six of its own retail outlets. 43% of its sales are to World Shops, with sales to supermarkets accounting for only 3% of turnover. Bulk sales of fair trade tea and coffee accounted for 21% of turnover while European college organisations and its own retail outlets were responsible for 12% and 11% of sales respectively. FTO has a partner organisation, called Fair Trade Assistance (FTA), that undertakes capacity building activities.*

Third, there are a number of **Network and Umbrella Organisations**. Examples include the International Federation for Alternative Trade (IFAT), the European Fair Trade Association (EFTA) and the Network of European World Shops (NEWS). These organisations were established by ATOs to facilitate cooperation and information flows between organisations involved in FT in both the North and the South. Co-operation may take place in campaigning and awareness raising, the lobbying of national governments and multilateral organisations such as the European Union, and in monitoring of the activities of multinational business.

Fourth, **Fair Trade Labelling Organisations** manage registers of FT products and producer organisations in the South that meet labelling organisations' commodity specific criteria for being sources of FT products. Mainstream businesses are allowed to carry a FT label on their product, so long as a fee is paid for the use of the label, and the product so labelled has been sourced through an approved producer organisation in an approved manner. The first FT label to be established was the Max Havelaar label in the Netherlands in 1988. Similar initiatives followed in twelve other European countries, in Japan, the USA, and Canada. The United Kingdom's labelling

organisation, the Fair Trade Foundation (FTF) was established in 1994. In 1997, an international umbrella organisation, FLO International (FairTrade Labelling Organisations International) was established.

Fifth, Ethical Businesses are mainstream enterprises that also have explicit non-profit objectives and so engage in some FT activities. Examples in the UK include Green and Black's and the Bodyshop. Some of these (such as the Day Chocolate Company and Cafédirect) were established at the initiative of ATOs. They have established a reputation for conducting their business in a way that is intended to further many of the aims of the alternative trading movement. As with many of the ATOs there is a strong overlap between fair, ethical, and environmentally sustainable trading considerations. Whilst these organisations can and do make use of FT labels, not all of their products carry official labels.

Finally, a number of *conventional profit-oriented businesses* are, or make claims to be, involved in FT in some form. Some processors make use of FT labels and an increasing number of supermarket retailers stock FT goods. ATOs also use a range of conventional companies, for example, to pack and process their goods. Other companies make claims that their products are fairly traded, but do not carry official labels and are not associated with one of the ATOs. The use of the FT concept by ATOs has been strongly contested by some major mainstream companies who are facing a loss of market share to new FT brands. For instance, Nestlé (in its publication "A Partnership for Fair Trade") claims that its buying practices should be regarded as "Fair Trade". Nestlé argues, for example, that it buys a significant portion of its supply of coffee direct from producers⁵ (and pays a premium as a result), but that in many cases market intermediaries provide a valuable service for both producers and consumers.

The core of the FT movement is generally seen to comprise southern producer organisations, ATOs, their umbrella associations, and labelling organisations.

2.3 Four Elements of Fair Trade

The FT movement carries out four types of activity that are in practice (and in the discourse of ATOs) closely linked but which are logically distinct. The degree of complementarity or tension between these activities in particular cases is a central issue for assessing the impact of FT initiatives and the case for development agency support for them.

First, as *market participants*, the FT organisations seek to provide competition to the established mainstream marketing system. Through demonstrating the viability of alternative approaches to trading relationships (rather than those based on impersonal market exchange or exploitative patron-client or state-private relationships), they aim

⁵ A figure of 10% of total purchases in 1992 is quoted. This generally only occurs in markets where the level of domestic consumption of the processed commodity is sufficient to justify the TNC's operating a processing plant. Nevertheless it is claimed that the volumes of such direct purchases are many times greater than those undertaken by FT organisations.

to bring about changes to the mainstream system as well as creating sustainable business entities. The FT approach to marketing activities generally involves:

- ◆ An emphasis on **direct relationships** with producer organisations;
- ◆ The provision of some level of **support against price fluctuations**;
- ◆ The payment of either a **premium** passed directly to the producer or a social premium to be used for the benefit of the community rather than individual producers;
- ◆ The provision of **pre-financing** to producers as part of a stable, **long term business relationship** between the producer and the organisation he or she is supplying;
- ◆ **Provision of information** to producers on demand, rules and regulations and prices.

“Fair price” considerations are an important aspect of FT initiatives and are generally accorded the greatest prominence in advertising and promotion. For instance, Cafédirect’s packaging stresses that “This coffee is bought directly from growers’ cooperatives, not from middlemen. The price is never less than an agreed minimum – however low the world price. If prices go above this, Cafédirect pays an extra 10% social premium. The deal includes pre-payment, market price updates and a business development programme.”

Second, as *agents of advocacy and awareness raising* they attempt to secure changes to the international trading regime, to the operation of marketing arrangements for particular commodities. They also try to increase awareness of poverty and development issues in high-income countries. This involves raising awareness amongst Northern consumers and voters of the problems of southern producers, and the effect that consumption patterns and government and international initiatives (such as the international trade policy regimes) can have on the South. It can also involve putting pressure on the mainstream business community to act in a pro-poor and pro-development way. It should be emphasised that the stance of the FT movement regarding the international trade regime is not homogeneous. However the proposals put forward by EFTA (Box 2) are an example of the issues and positions of many in the FT movement.

Third, as *agents of redistribution*, FT organisations seek to capture and pass on to ultimate producers the premium that some consumers are prepared to pay for FT products. To the extent that FT organisations can provide a premium for producers compared to the mainstream, they are reliant on one or more of five possible sources. These are: profits foregone; higher margins paid by consumers; the donation of northern volunteer labour time; donor support; or tariff and tax privileges. FT also seeks to redistribute price risk away from vulnerable producers to others more equipped to bear it. A key issue (for assessing the efficiency with which resources are transferred from the giver to the receiver) is the proportion of the FT retail premium that is passed on to producers and the form in which it is passed on.

Box 2 Fair Trade and Advocacy

In its Fair Trade Yearbook (Towards 2000) the European Fair Trade Association (EFTA) provides a list of its proposals to the EU to promote equitable international trade, which can be summarised as follows:

- ◆ *Preferential treatment (such as reduced import duties and VAT rates) for products carrying a fair trade label;*
- ◆ *A coordinated approach to support fair trade by the EU and its member states;*
- ◆ *The recognition of fair trade labels by the EU, and the promotion of fair trade labelling within the WTO;*
- ◆ *The use of fair trade principles (including guarantees of minimum commodity prices) as a model for the EU's relations with all developing countries once the fourth Lomé Convention expires;*
- ◆ *The abolition of EU measures (such as the Common Agricultural Policy, quotas, and escalating tariffs) that frustrate the development of export markets in Europe by southern producers;*
- ◆ *The 'adoption of a system of preferences which takes account of the different level of development of producers in different developing countries';*
- ◆ *The representation of southern producer groups on international bodies such as the International Coffee Organisation, the WTO and UNCTAD;*
- ◆ *The rejection of proposals that the EU definition of what constitutes chocolate be amended to allow for the use of vegetable fats other than cocoa butter; and*
- ◆ *A European coffee agreement with the aim of stabilising the market through price controls.*

Fourth, as **agents of empowerment**, they aim to assist producers (mainly through cooperatives and producer organisations) to develop their own capacity to engage on more favourable terms in international trading relationships. This can take the form of training, credit, organisational development support, or the provision of information and marketing advice to producer groups that are properly accountable to their members.

2.4 Three Types of Fair Trade Product

A third set of distinctions relates to the way that FT products are produced. Three major types of product⁶ need to be distinguished.

- ◆ First, predominantly **smallholder crops** (such as coffee, cocoa and some food crops). FT activities have concentrated on supporting cooperative marketing arrangements among small producers. In many producing countries, substantial changes have taken place in recent years in the regulation of coffee and cocoa

⁶ There are however attempts to apply the FT concept in other areas. For example, the International Network on Fair Trade in Tourism (<http://www.tourismconcern.org.uk>) aims to promote FT tourism as involving: equality in trading partnerships between North and South; using income from tourism for the eradication of poverty through democratic decision-making structures; building a network of FT service provision across tourism operations; community control in tourism planning and decision-making; transparency, access to information and training and development for affected communities; ecological, social and cultural sustainability; diversification of local economies; respect for human rights.

markets. These reforms have tended to reduce the direct role of the state in purchasing and price setting and have opened up new opportunities for private trading activity, while potentially increasing the exposure of producers to international market price fluctuations.

- ◆ Second, predominantly *plantation crops* (such as tea and bananas) where employment standards (and hence the overlaps with ethical trade issues) are often of most significance. However, crops predominantly grown under smallholder production systems are produced on plantations in some countries (and vice versa).
- ◆ Third, *small scale manufactured goods* (such as handicrafts) which have historically been the most significant component of FT in the United Kingdom. While most agricultural products are traded through international markets with well-developed marketing institutions, most of the small scale manufactured goods are unstandardised and may not be saleable directly into a mainstream marketing chain. They are therefore unsuited to FT labelling. In many countries, activities like handicraft production are more likely to form an important part of the livelihood of the poorest people than is cash crop production.

This distinction is relevant for the form of impact assessment that is appropriate in a particular case. For this study, we have undertaken case studies of cocoa and coffee (and of specific FT initiatives relating to these commodities in Ghana and Tanzania). Changes in the marketing systems for these commodities in recent years also mean that there are new and major challenges facing producers that FT may potentially help to address. **Key features of the markets for both commodities are:**

- ◆ **Domestic and export marketing of coffee and cocoa has been substantially liberalised and privatised in many producer countries** (especially in Africa) over the last decade. As discussed in the next section, this has created both a need and an opportunity for new market entrants to take over roles that were formerly undertaken by the state. However, in many cases the environment for new private marketing activity is difficult because of high transactions costs, barriers to effective contract enforcement and continuing government interventions. One feature of liberalising reforms is that domestic producer prices are becoming more closely tied to the world price, where formally state interventions often provided some degree of stabilisation (though with on average high levels of implicit taxation).
- ◆ **International prices have been unstable around a generally declining trend.** Attempts to stabilise international prices through buffer stock activities have largely failed. Producers therefore face both a long-term decline in profitability (unless significant increases in productivity can be obtained) and a high level of year to year price instability.
- ◆ **International markets are highly developed.** Although international trade is dominated by a relatively small number of large companies, opportunities exist for hedging against price fluctuations.

- ◆ **Concentration is high** at the level of processing in the UK (and is much higher for coffee than in the UK than in most other European countries).

2.5 The Size of the Fair Trade Market and Main Trends

It is difficult to develop an accurate picture of the scale and trends in FT, due to a combination of definitional problems and a lack of consistent data. Such data as are available for Europe (based on labelled products) suggest:

- ◆ According to FLO International there are now **over 1,000 FT labelled products in 17 countries**. The value of FT goods sold in Europe is of the order of 200 million euros per annum although this figure has probably not been growing in recent years.⁷
- ◆ **Germany (21%), the UK (20%), the Netherlands (15%) and Switzerland (14%) between them account for more than 70% of the total.**
- ◆ **Coffee is the most important single FT commodity, and accounts for 1.7% of the European coffee market.** In the UK, the best known brand, Cafédirect, owned by a consortium of FT organisations, has around 2% by value of the roast and ground market and 1% of the instant coffee market.
- ◆ **Food products, including beverages, account for the bulk of sales in most European countries.**⁸ In the UK handicrafts have been the most significant sector, although the proportion of food is growing fast⁹.
- ◆ **FT labelled sales are stagnant in most of Europe but have been growing fast in the UK.** In the UK FT label sales grew by 50% in 1997 and by 40% in 1998.
- ◆ **In the UK, the most marked recent trend has been the growth of labelled sales** (of tea, coffee and chocolate primarily) through mainstream marketing. For instance, one major supermarket chain saw a 121% increase in the volume of FT products over the last year and now stocks 22 lines (compared to 12 the previous year). In that case, the growth was dominated by increased volumes of tea sales, while coffee sales fell slightly.

⁷ The EFTA 1995 Yearbook also states that in 1994 the value of fair trade retail sales stood at approximately 200 million ECU. EFTA (1998), 'Facts and Figures on the Fair Trade Sector in 16 European Countries' covers Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Luxemburg, Netherlands, Norway, Spain, Sweden, Switzerland, and the United Kingdom, and also estimates the total at around 200 million ECU. However the inconsistent presentation of data by country makes analysis or inter-country comparisons difficult.

⁸ In 1996/7, food and beverages accounted for 76% of FT retail sales in Switzerland (of which 28% was coffee) and 63% in the Netherlands (coffee alone 41%). In the UK the proportion was 27% (of which coffee was 5%).

⁹ In 1993/94 food products accounted for 10% of Oxfam's fair trade sales compared to 25% in 1998 (information supplied by Anne Tallontire).

- ◆ **Mainstream retailers consider that demand for FT products will continue to grow** steadily in response to consumer pressure, increased customer awareness, and NGO advocacy.
- ◆ The low level of current FT (averaging of the order of 60p per year per head in Europe) means that even with sustained and rapid growth, **the volumes traded are likely to remain small relative to general trade flows**. However, they may become significant for some southern countries with a high dependence on the exportation of particular commodities.

There have been important shifts from the early 1990s in the way in which ATOs and other organisations involved as market players in FT have operated. Many ATO companies have encountered financial difficulties and stagnant sales. In response ATOs have reacted by making significant changes in their mode of operation.

- ◆ Most ATOs face an intensely competitive marketing environment but have limited scope for covering losses, especially if their owners are charitable organisations. Hence there are already strong pressures on ATOs to adapt to market conditions and become **more efficient**.
- ◆ As shown by the FINE definition quoted above, there is a trend towards **harmonisation** of definitions, criteria and monitoring at the European level. This has been in part a response to concerns that continued lack of clarity in the use of the term “Fair Trade” will prompt a response from regulators concerned to avoid misleading claims and consumer confusion.
- ◆ **Marketing through mainstream retailers** rather than alternative outlets has become increasingly important for food and beverages. In Germany the number of retail outlets selling FT products is reported, by FLO International, to have risen from 300 to 30,000 over the last five years.
- ◆ There is an increasing emphasis on **quality assurance** to comply with supermarket requirements, which often means that, in practice, FT products have to be processed and packed in Europe rather than in the country of origin.
- ◆ There is an increasing **professionalisation** of FT activities. For example an increasing number of people employed by UK ATOs bring with them experience of the commercial sector. For example, in the Netherlands FT shops are moving into more prime retail areas, a strategy also being followed by Oxfam. Fair Trade Organisatie has started franchising its shops that have more paid staff and a more professional layout.
- ◆ **Capacity development activities have expanded** and become more systematic. Capacity development and trading activities are organisationally and legally separated in some significant operations. There is increasing emphasis by ATOs on assessing the existing business capacity of prospective producer groups.
- ◆ **Advocacy has focused on the reform of the world trading system.** Partly because of broader concerns about ethical practices in business, and partly

because of effective competition from FT brands in some markets, there has been greater attention from some mainstream traders and processors to FT issues. ATOs are increasingly concentrating on macro-level policy issues that inhibit southern participation in trade in general and block value added activities in the country of origin in particular (e.g. tariff escalation).

3 Commodity Markets and Fair Trade

This section examines the characteristics of agricultural commodity markets in developing countries, and the related policy challenges currently facing developing country governments and donors, in the wake of market liberalisation policies implemented over the last decade and more. The first purpose of this section is to provide a context for the consideration of the potential role and impact of FT initiatives of the type examined in the case studies in overcoming some of the key problems facing small-scale producers in improving their terms of access to markets. The second purpose is to assess claims advanced by FT organisations about the operation of markets.

3.1 The Policy Reform Context

The agricultural marketing systems of most developing countries have in the past been heavily influenced by government through macro-economic policy (particularly pervasive exchange rate overvaluation), the allocation of subsidies and the collection of taxes, administrative regulation, and the provision of marketing services and credit. The level of state involvement was especially strong in major traditional export commodities. This involvement derived from the commodity being a major source of taxation revenues, as well as to ensure credit and input supply to small producers, and to provide price stabilisation.

In a number of countries, independent producer organisations (cooperatives) played a major role in the establishment and development of export production, operating alongside and through a range of private marketing channels. This was the case, for example, for both coffee in Tanzania and cocoa in Ghana. However, as state involvement in marketing increased, the role of such organisations changed as they became agents of state control in systems that moved towards state monopoly over key marketing functions. In Tanzania, for example, the government followed a conscious policy of dismantling independent cooperatives (which were seen as having divisive social and economic consequences).¹⁰

By the early 1980s, it was clear that there were major problems with the pattern of state intervention in agricultural export markets in many developing countries but most especially in Africa. First, macroeconomic and taxation policies tended to create a pervasive anti-export bias as exchange rate overvaluation reduced the viability of export production. Second, state marketing agencies in many cases experienced sharp increases in their running costs as they became a focus for rent-seeking activities, and in the absence of effective competition or responsiveness to producer concerns. Third, financial and operating difficulties in many but not all cases severely impaired the ability of the state system to provide key services to producers as well as to provide effective price stabilisation.¹¹

¹⁰ See for example Jones (1999).

¹¹ For example, Knudsen and Nash (1990) conclude from their study (page 253) that 'for a few countries in the case of grains, and in a significant number for beverage and fibre crops, domestic real producer prices and incomes were less stable than if they had followed border prices'. A number of commentators make a strong case that individual farmers proved generally better able to manage

The poor performance of such marketing systems (reflected in declining production and export revenues) was a focus for the advocacy of market liberalisation by the World Bank and other international and donor organisations. The “market optimism” set out in, for instance World Bank (1981), suggested that market institutions either already existed (as parallel markets) or would emerge rapidly in response to appropriate incentives so that liberalising reforms would lead to rapid gains for producers.

Donors sought to promote liberalising reforms through the use of policy conditionality.¹² This has involved the ending of statutory monopolies over specific marketing functions, the reduction of both direct subsidies and implicit taxes, the removal of regulatory restrictions over private trade, and the provision of a stronger legal basis for independent producer organisations (replacing the state domination of the cooperative sector).

In fact, however, there were few significant changes in the policy environment governing export marketing of major traditional export commodities¹³ until the early to mid-1990s in most African countries (though macroeconomic reforms tended to yield some price benefits for export producers). In Ghana, since 1992/3, licensed buying firms have been able to compete on the local market to purchase cocoa. Exports have however remained a monopoly of the state marketing agency Cocobod. Indeed, in both the case study examples, considerable state control over key aspects of the export marketing system and high levels of implicit taxation remain.

Almost all Tanzania’s coffee is produced by smallholder farmers, who under the earlier stage of liberalisation could only sell to the local cooperative primary society. They in turn passed the coffee on to their cooperative union who sold it through the auction. The changes caused by liberalisation and the competition from private traders has increased the options available to farmers and is leading to radical changes in the cooperatives, who have lost considerable market share to private traders.

While the processes and experiences of marketing reform have been complicated and varied, and simple (often ideologically motivated) generalisations about the process need to be viewed with caution, **several reasonably robust conclusions can be drawn from the literature and experience:**

- ◆ **Marketing reform has led to increased competition, mainly through the expansion of small scale private trading and processing**, at some key stages of the marketing chain. This has tended to have a beneficial impact on marketing costs (especially for staple food products) and to increased marketing options at least for those producers with reasonably good access to transport infrastructure.

fluctuations in incomes arising from commodity price shocks than the state (see Ridler, 1988 and Bevan et al 1992).

¹² See Jones (1998) on the limited effectiveness of conditionality in bringing about these reforms.

¹³ Reforms were adopted much earlier for food marketing (where systems of state intervention had created a heavy fiscal burden) and for non-traditional export commodities.

Market liberalisation has benefited most strongly those producers who have had access to capital resources and markets.¹⁴

- ◆ There has been **some direct market entry by subsidiaries of multinational trading and processing companies** following liberalisation. However, this has generally been constrained by the difficult operating environment and high transactions costs involved.
- ◆ In some cases, the removal of subsidies to the state marketing system has led to a **sharp decline in market access for some groups of producers** (particularly those in remote and high cost locations).
- ◆ **Problems of high transactions costs and market failure are pervasive among liberalised smallholder marketing systems.** It is clear that the simple market optimism view heavily underestimated the problems of establishing and developing private marketing systems. Although markets are more competitive, many liberalised systems have shown to date a limited capacity to support the emergence of more sophisticated contractual arrangements to allow for producers to transfer market risks to specialist traders, and the development of credit relationships to support intensified production.
- ◆ In the case of coffee and especially cocoa, there are significant **concerns** among the Northern processors who are the main customers, **about the ability of liberalised marketing systems to mobilise credit and maintain consistent quality.**

The positive impact of reforms from a state monopoly marketing system and exchange rate overvaluation is illustrated by the recovery of cocoa production in Ghana. Production declined from 581,000 tonnes in the mid-1960s to 159,000 tonnes by 1983/4. Subsequent macroeconomic and sectoral reforms led to a gradual recovery. Production reached 408,000 tonnes in 1997/8. There has been evidence likewise of production recoveries in Tanzanian coffee.

3.2 *Fair Trade Perspectives on Markets*

The FT movement bases its approach on views about the way in which international and domestic markets for key commodities operate and their implications for small-scale and especially for marginalised farmers. The main elements of these views can be summarised (at the risk of over-simplification or generalisation) as follows:

- ◆ High degrees of concentration in Northern retail and processing markets and in international trade imply that **developing country exporters face a severe imbalance of market power** that adversely affects prices and other aspects of the trading relationship. This is exacerbated by import restrictions that are biased against (in particular) processed products from developing countries.

¹⁴ Food marketing reform has also tended to generate significant gains for low income consumers who tended not to benefit from past subsidy systems (see e.g. Jayne and Jones, 1997).

- ◆ Private sector trade at the farm level has **strong tendencies towards local monopoly**, and small-scale farmers are at a high risk of suffering from cheating and fraud from private traders.
- ◆ **International markets are prone to destabilising speculation and manipulation** which requires international public action (for instance through the WTO or through the revival of international commodity agreements).
- ◆ **Direct marketing links** that minimise the number of market intermediaries between producer and consumer and that are based on long-term relationships between producer groups and marketing organisations **are generally more efficient and more effective at engaging marginalised producers** than marketing channels involving private commercial intermediaries.
- ◆ **Prices should be based on a concept of “fairness”** (based either on guaranteeing that production costs are covered, or that the price is sufficient to provide an adequate livelihood for producers) rather than on market considerations.
- ◆ **Democratic and accountable producer organisations present the best opportunity for obtaining fair prices and for empowering producers** in other respects (for instance through access to credit on more favourable terms).
- ◆ The provision of a price premium and guaranteed prices that will provide adequate livelihoods (for which some consumers are prepared to pay), and capacity building for farmer organisations, may make **FT an effective means of promoting sustainable rural livelihoods and poverty reduction**. The lack of a need to earn a return on capital employed or pay dividends to shareholders also enhances the capacity of FT to provide a redistributive transfer from rich consumers to poor producers.

The case studies examine the specific features of the cocoa and coffee markets and the implications for the case for FT. To a considerable degree the view of how markets operate that is inherent in FT practice (if not always in some of the more simplistic marketing and advocacy messages) is close to the view presented in the previous subsection based on current research, theory and experience.

For example, in relation to the operation of international markets, the world cocoa market is characterised by a significant degree of volatility. This is the result of climatically induced production fluctuations and low price elasticities of supply and demand. Since 1984 world prices have fallen sharply, reaching a thirty year low in 1992. By 1998 they were at a level slightly above the 1992 low. Attempts to stabilise prices through a series of International Cocoa Agreements have collapsed because of difficulties of tackling the problem of long-term over supply. Likewise, international coffee prices are extremely volatile: during the 1970s and the first half of the 1980s the short term price instability for coffee was far greater than for other commodities and between 1980 and 1991 the real international price of coffee fell by two-thirds.

While market liberalisation and associated reforms have certainly in general been favourable to export commodity producers, there are significant and continuing problems in how markets operate.

It seems plausible that the highly charged nature of the claim of “fairness” for FT approaches (necessarily implying that other trading practices are unfair) tends to obscure significant fundamental agreement about the problems facing smallholder producers, if not complete agreement on the most effective solutions.

For instance, a credible commitment to a long term relationship with producers and to particular ethical business practices might be an efficient solution to the problems of market failure that bedevil many newly liberalised market environments. It is likely that commercial pressures will tend to lead towards stronger links between producers and the rest of the marketing chain (for quality assurance purposes) and the emergence of credit and other longer-term relationships.

Key issues in any analysis of the FT perspective include the following:

- ◆ The extent to which FT initiatives and approaches to improve the environment for mainstream commercial, profit-driven, trade should be seen as complementary or in conflict;
- ◆ How universal from the point of view of benefits to producers is the case for promotion of cooperative or similar collective marketing arrangements;
- ◆ To what extent the existence of a FT marketing chain (as opposed just to strengthening of the capacity of producer organisations) is necessary to enable empowerment of producers;
- ◆ The extent to which problems of international market instability can or should be addressed through regulation or supply control (using the considerable market power that producing countries either individually in some cases or collectively can exercise).¹⁵ An alternative approach would be based on measures to strengthen the ability of producers (and exporting countries) to hedge risk using market instruments;
- ◆ The relative significance of domestic macroeconomic and sectoral policies as compared to the operation of international markets in explaining the low prices achieved by producers.
- ◆ The relative importance of tariff escalation as against other obstacles to increasing value added in the commodity producing country.¹⁶

¹⁵ In practice, while there clearly have been short-term possibilities for prices to be boosted, the difficulty of exercising effective international supply control has tended to make such arrangements unstable.

¹⁶ Tariff escalation is one reason why processing is concentrated in consuming countries, but there are many others. For example, the demand in Europe and the United States is for blended coffee and chocolate. There are few countries, if any, which are significant exporters of coffee or cocoa, and would allow the formal importation of coffee and cocoa from other net exporters to facilitate blending. Chocolate factories tend to be located in or close to the biggest markets, and close to a reliable source of sufficient volumes of milk. Many African countries are neither a significant market for chocolate products nor significant producers of milk.

- ◆ The extent to which it is plausible or appropriate to expect prices to be based on production cost or livelihood considerations, or to regard market-based pricing as unfair.¹⁷

3.3 *The Agenda for Market Development and the Role of Fair Trade*

The key problem in most liberalising systems relates to the weakness of the physical infrastructure and institutional environment – particularly for contract enforcement and the supply of other key public goods such as market information¹⁸ - and uncertainty, not least about possible government interventions. In marketing systems (for instance in South Asia and Latin America) where the private sector is much better established, the domination of systems of market regulation by local and national elites can create pervasive inequalities in the terms of market access for different social groups.

Cooperatives and other forms of producer organisation can help small farmers to reduce per unit costs of information gathering and transport, increase their bargaining power, and sometimes to enable value-adding activities to be undertaken. Small, locally run cooperatives may be more sensitive to farmers' needs and circumstances than other institutional arrangements. Set against this, cooperatives and other farmer organisations often face major challenges. These include capacity to raise capital, finding and keeping competent managers, maintaining effective accountability to members, dealing with the risk of politicisation, and competing with private traders who will generally be less constrained by bureaucratic procedures and decision making (Abbott, 1993).

Whilst there are strong arguments against a return to pervasive statutory involvement in the agricultural markets of developing countries, the current situation in many countries calls for an active agenda of initiatives aimed at market development. The basic challenge is to combine the benefits for producers of access to a wider range of marketing channels with the need for a stronger institutional framework for private and collective initiatives. Such an agenda may include the following elements:

- ◆ Credible and consistent national marketing policies.
- ◆ Seeking to improve access to market mechanisms that may assist small-scale farmers (and groups of farmers) in managing their risks.¹⁹
- ◆ Improving market access for specific groups of marginalised producers.²⁰

¹⁷ There are formidable conceptual and practical problems in establishing and using such definitions of appropriate pricing. One relates to the problem of defining production costs or adequacy of income in the context of variation across several dimensions between producers. This includes the insights stressed by sustainable livelihood analysis that few households are entirely dependent on a single crop-based source of income, and the dubious validity of the concept of an average “cost of production”. The second relates to the implications for managing problems of oversupply if prices are set consistently out of line with demand.

¹⁸ See for instance Jaffee (1993).

¹⁹ The issues are discussed in the South African context in Bayley (2000).

²⁰ Risopoulos et al (1999) suggest that farmers can be remote from markets in one or more of three ways: if they are geographically distant from market centres; if they are relatively close to market

- ◆ Strengthening the capacity of private trade in terms of contract enforcement, dispute resolution and access to information.
- ◆ Improving the supply of infrastructure and key public goods (for instance through local government and effective marketing information schemes).
- ◆ Facilitating the development of farmer organisations.

From the perspective of a developing country government and donors seeking to support a strategy to improve the functioning of agricultural markets for smallholder producers, FT initiatives have a potentially important role. This relates principally to helping to strengthen the capacity and accountability of farmer organisations that may have a pivotal role to play in the development of an efficient marketing system that can improve incomes and assist in managing market risks.

It also suggests that there is no necessary conflict between the interest of smallholder producers in the development of strong producer organisations and the interests of conventional profit-oriented business including multinational processors and traders in marketing systems that are consistently and reliably able to supply high quality production. Both potentially stand to gain from institutional strengthening measures that enhance the ability of the marketing system to mobilise credit, ensure quality control and manage risk – though the relative market power of each will influence the distribution of the gains from an improved marketing system.

4 The Impact of Fair Trade

4.1 Issues for Impact Assessment

Assessing the development impacts of FT is now at the top of the agenda for many ATOs.

“There is growing awareness that statements about the benefits of fair trade are often being made without rigorous baselines in place or the necessary downstream data - beyond the anecdotal - to demonstrate how benefits are distributed and how (or whether) this leads to positive development impacts at local level. Most fair trade organisations are only now coming to terms with the challenges of developing a system for monitoring their impact in a more structured way. Other studies suggest a real need to explore the distribution of benefits, both within producer communities and along the supply chain. Pressures are mounting for a more concerted approach to impact assessment.”²¹

There are at least four main motivations for greater attention to impact assessment. Each of them has different implications for the way in which assessment is carried out.

- ◆ Producers may have an interest in developing monitoring systems both to improve management of their enterprise and to assess the extent to which non-commercial objectives are being attained. However, in practice many producer organisations are reluctant to spend the necessary time on such activities.
- ◆ Poverty focused impact assessment is necessary to judge the relative effectiveness of using donor resources to support FT compared to alternative uses of these resources to improve livelihoods and reduce poverty.
- ◆ FT certification, labelling and accreditation require regular monitoring.
- ◆ ATOs that have credibility with the public because of their ethos and past record need to make sure that nothing happens to damage that credibility. They will also want to assess how they can improve their impact, and understand how effective their activities are, for instance in reaching marginalised producers.

In the context of decisions about donor support, it is appropriate to use criteria relating to the impact on livelihoods and poverty reduction. However, there may be a tension between the ideas that each organisation has to be understood within its own context and the need for policy evaluation purposes to be able to compare different FT initiatives. Central **elements of an assessment of impact will include:**

- ◆ The structure and workings of the international market for the product in question and the international policy environment;

²¹ Robins, Roberts and Abbott (1999) p 49.

- ◆ The domestic policy environment in the southern producer country at the macro and sectoral levels and its effect on the supply chain up to the point of export;
- ◆ The structure, coverage and workings of the marketing chain in the southern producer country for the product in question, between (potential) producers engaged in conventional trade and the point of export or processing;
- ◆ The socio-economic context, in particular the poverty profile and livelihood opportunities of households engaged in FT;
- ◆ The structure and workings of the marketing chain in northern markets up to the point of purchase, and the impact of northern government policy.

FT impact has to be assessed at many different levels (policy, organisational, developmental and operational). In addition, many of the key benefits are intangibles (such as improving the confidence of producers and their understanding of market operations) which are difficult to measure. In principle the impacts of the different types of activities carried out by FT organisations also need to be separately identified. In the absence of baseline data, analyses of the benefits are going to have to rely heavily on qualitative rather than quantitative indicators.

4.2 Evidence on the Benefits and Costs of Fair Trade

As a result of these considerations, it is difficult to make generalised assessments of benefits and costs of diverse FT initiatives. Boxes 3 and 4 below summarise the main results of evaluations of some Traidcraft and Oxfam initiatives. These suggest that **it is the capacity building, and related trade facilitation element of FT initiatives that is most amenable to impact assessment.**

As discussed below, **mainstream market operators facing competition from FT brands have been forced to respond in a number of ways.** This has included a stronger emphasis on justifying and making more transparent their own trading practices, as well as contesting some FT claims. As a result, ATOs can justifiably claim to have prompted initiatives (like the Ethical Trading Initiative) that would not otherwise have happened.

The second element whose impact it should be relatively straightforward to assess is **the FT price premium:** both in terms of the level and the variability of prices received. In many cases, as in the two case studies undertaken by the consultants, the price premium is not passed on to the producer but is pooled at the level of the farmers' organisation and used to fund social infrastructure or market development activities.

When the premium is pooled, there will be no impact on price variability and on production incentives at the farmer level. Instead, the price premium is best seen as equivalent to a charitable transfer to fund particular projects whose value should be assessed on a case by case basis. Key issues here (particularly in large organisations) will be the effectiveness of producer control over the use of the premium (i.e. the strength of the governance structures) and the extent to which the interests of

relatively poor and marginalised producers are reflected in decisions about social investment.

Box 3 Impact Evaluation and Traidcraft Exchange. *Rather than trying to provide support services directly from the UK, Traidcraft Exchange (TX) has worked with and through partner organisations to provide business services in Tanzania, The Philippines, South Africa, India, Bangladesh and Zambia. Evaluations of the work of TX and its partner organisations over the past two years have centred on reviews of reports and the use of semi-structured interviews, and generally concentrated on impact at the institutional rather than the household level. TX states that it is now pursuing a more rigorous approach to baseline studies and the use of monitoring indicators.*

Many of the themes arising out of TX's work with its Southern partners mirror the experience of mainstream small enterprise development. In particular TX concludes that:

- ◆ *Organisational governance structures are crucial;*
- ◆ *Marketing services are vital;*
- ◆ *Government funding arrangements do not always promote the necessary security and stability of relationships needed for institution building; and*
- ◆ *Some business development services cannot necessarily be expected to be self sustaining and need long run government or donor support.*

*In Tanzania, AMKA was established as TX's partner agency for stimulating and supporting the export of crafts and food products from small producers. An evaluation in July 1998 concluded that some small groups had been introduced to the export market for the first time, whilst some groups which were already involved in exporting had made breakthroughs to bigger orders. AMKA's client partners tended to be smaller and more rural than other Tanzanian exporters, and although their average sales volumes had not grown much over four years this performance was considered to be better than many Tanzanian exporters which had seen their exports fall over the same period. An evaluation of the **Philippines** Fair Trade Programme (PFTP) was also positive.*

*However, a review of Just Exchange's (JX) work in **South Africa** was less so. Although JX did instigate sales close to the project target of Rand 6 million most of these sales were attributable to four farm businesses rather than community based craft businesses. Whilst the evaluation acknowledged the difficult environment within which JX had had to operate, it concluded that the project's outreach objectives had not been achieved, and that headline sales success could not hide 'very weak' performance with respect to capacity building among organisations involved with export and business development. In addition it was felt that the capacity of JX had not developed as envisaged, that JX targets for cost recovery had not been met, and that there significant concerns regarding the efficiency of JX.*

*An evaluation of Zambili d'Afrique in **Zambia** was generally very positive but concluded that TX (at the request of Zambili management) had been playing too many different roles at the same time without recognising the potential conflict between them. These roles included being project manager, a channel for donor funds, building technical capacity in the UK and Zambia, providing marketing support in the UK to Zambili and its partners, mentoring Zambili staff in its provision of organisational development support, and finally Executive Committee member.*

Box 4 Impact Evaluation and Oxfam Fair Trade. *Prior to its Fair Trade Impact Assessment, which began in 1999, Oxfam Fair Trade (OFT) expressed the concern that 'information that demonstrates impact or the role that FT plays, or could play, on poverty alleviation is minimal. Evidence of the impact of our work has not been systematised and most currently available analysis and communications materials are based on anecdotal evidence. Research on the effects of our interventions and analysis of the role of FT as a development tool has been almost non-existent'.*

In 1993 external evaluations of Oxfam Bridge activities in India and Philippines generated anecdotal evidence of the impact of FT on poverty and the positive impact of FT on the quality of life of (particularly women) producers. In 1998 SJMA consultants undertook a survey of four producer groups. Two of these groups were coffee marketing co-operatives in Costa Rica and Nicaragua (both with between 2,000 and 3,000 individual members). The third was a marketing outlet for 30,000 poor artisans in Bangladesh, whilst the fourth was charitable organisation providing housing and occupational training for 260 physically handicapped artisans in Kenya. The survey concluded that three of the four organisations were dependent on FT for most of their sales. Although the market for FT coffee was held to be stable, the market for FT crafts was shrinking.

OFT is currently managing a study covering 20 producer groups spread amongst Africa, South and South East Asia, and Latin America. It considers the 'claim that FT has an impact on poverty and the well being of producers and their families and (will) provide qualitative and quantitative data from a variety of sources which would allow it to understand how to make FT more effective in alleviating poverty'. In particular the study seeks to:

- ◆ *Consider whether and how OFT interventions have resulted in changes in the lives of producer group members (and the extent to which such benefits are sustainable, differ by gender, ethnic and social group, and result in negative environmental or social impacts);*
- ◆ *Generate and test user friendly participatory tools/indicators to measure the impact of FT and OFT activities;*
- ◆ *Establish and suggest baseline indicators on livelihoods;*
- ◆ *Highlight critical issues for OFT's programme; and*
- ◆ *Suggest ways that OFT's assessment methods might be improved.*

The capacity of FT organisations to provide price stabilisation and price premia above market rates will be limited. FT pricing therefore generates rents for selected producers but cannot significantly boost prices overall. Paying premium prices (particularly providing guaranteed floor prices when world prices are depressed) may compromise the profitability of FT companies. As a result, FT organisations' capacity to procure may fall when prices are very depressed, reducing the value of the price guarantees that are provided.

4.3 Case Study Findings on Impact

For the case studies, the consultants developed and attempted to apply a methodology based on comparison of costs and shares of income at each stage of the FT marketing chain with a mainstream marketing chain, with impact assessed at the household level using a broader livelihoods framework. The case study commodities were selected

because (unlike for example handicrafts) the existence of well-developed markets and relatively standardised commodities made price comparisons and the testing of FT claims relatively straightforward.

The framework consisted of three main parts:

- ◆ commodity chain analysis;
- ◆ livelihoods analysis; and
- ◆ analysis of the sustainability and cost effectiveness of the impact of fair trade initiatives.

Commodity Chain Analysis

An analysis should go beyond a consideration of margins, prices and costs down the marketing chain to consider the value of price stability and guarantees of minimum prices, timely payment, and the provision of credit. The operation of marketing chains for a particular commodity in a particular country should therefore be informed by the spectrum of experiences with different marketing arrangements.

Livelihoods Analysis

The livelihoods approach is increasingly being used, both by DFID and more widely, as a framework for assessing the impact of development initiatives.²² The sustainable livelihoods framework provides a useful conceptual tool to assess the poverty impact of fair trade initiatives, and would suggest an investigation of:

- ◆ The impact of fair trade on community and household assets;
- ◆ The influence of policies, institutions and structures on livelihoods;
- ◆ The nature of the “vulnerability context” faced by poor producers and traders, particularly seasonal and exogenous price movements and climatic variability; and
- ◆ The interrelationship between these assets, processes and vulnerabilities and their effective impact on livelihood options and outcomes.

Sustainability and Cost Effectiveness of Impact

To the extent that producers receive additional benefits from engaging with FT organisations:

- ◆ What are the origins of those benefits?
- ◆ To what extent are FT marketing chains subsidised?
- ◆ What percentage of the benefits (including any subsidy element) of FT reach the target group?
- ◆ Within the target group, how are the benefits distributed?

²² See D. Carney (ed), “Sustainable Rural Livelihoods: What Contribution Can We Make?”, Department for International Development, 1998.

- ◆ What is the poverty profile of the target group?
- ◆ How viable are the existing institutional models for fair trade compared with the possible alternatives?

In practice this methodology proved difficult to apply mainly because of a lack of data and within the resource constraints of the case study. A further reason was the difficulty of drawing a distinction between the FT and mainstream marketing chains at the farmer and farmer organisation level, since only a small proportion of the sales of producer organisations took place on FT terms.

The key features of the organisations focused on in the case studies were the following. **The Ghana cocoa case study** concentrated on Kuapa Kokoo Limited (KKL) which was formed in 1993 and became a cooperative in 1996 as Kuapa Kokoo Union (KKU). In 1999 KKU had 462 member societies, representing more than 30,000 farmers. Technical assistance was provided by TWIN and other FT organisations with DFID support to assist in building KKU's capacity. Kuapa Kokoo is the only source of FT cocoa in Ghana, the only major cocoa producer cooperative, and has generally provided almost two-thirds of the international supply of FT labelled cocoa. Initially FT sales amounted to up to 15% of KKU's total sales. However, FT sales have been stagnant (between 300 and 600 tonnes per year) while KKU's total sales have grown to around 18,000 tonnes. FT sales currently account for around 2% of KKU sales. Only a small proportion of the price premium on fairly traded cocoa sourced from Kuapa Kokoo has been paid out to farmers. The majority is paid into the Kuapa Kokoo Farmers' Trust which is used to fund community development projects.

The Tanzania study focused on cooperative unions supplying FT coffee. In contrast to the Ghana case, the Tanzanian cooperatives were long-established organisations that had played a pivotal role under the state controlled marketing system. They have faced increasingly intense competition from private trade as the market has been liberalised. FT organisations have been buying coffee from Tanzania via parastatals since the 1970s. Since direct purchase became possible in the early 1990s, a range of European, North American and Japanese FT organisations have bought coffee from four Tanzanian cooperatives.

The main conclusions of the case studies about the impact of the FT initiatives examined are:

- ◆ The quantities of product designated as FT (i.e. attracting the price premium) were modest and represented only a small fraction of the total quantity sold by the producer organisation, although FT cocoa did provide an initially important market for Kuapa Kokoo. It was therefore **not meaningful to separate at the producer level the impacts of the FT and non-FT aspects of the producer organisation's activities**. The only difference at the farmer level was the payment of the premium and this was not passed on to producers so it had no impact on production incentives.
- ◆ **In each case, the effectiveness of producer control and the transparency of management for the cooperatives and cooperative unions will be a key issue for the future operation of the marketing system.** The money from the price

premiums are generally paid into a cooperative union fund and used to support union services or community projects, rather than shared out with all the members, since the individual payments would be so small that they would be essentially meaningless. The extent to which individual farmers have benefited from FT therefore depends on the effectiveness of the cooperative, the way in which they use their relationship with FT organisations, and the extent to which they pass back benefits to their members. At present, the future of the cooperatives in Tanzania is uncertain but it seems important that the services that FT organisations have been providing aimed at increasing the capacity of farmers to understand and engage in international trade is continued in some form.

- ◆ In both of the case studies, recent domestic market liberalisation (with continuing important restrictions on export participation) meant that farmers now had access to private commercial buyers as well as the traditional marketing routes that had enjoyed a statutory monopsony in the past. These were the cooperative unions in Tanzania and the Produce Buying Company in Ghana. **In both cases, the existence of private competition was viewed positively by farmers.** This was particularly because of its capacity to pay promptly. However there were concerns about the risk of sharp practice (for instance in weighing) and unequal access to information and about the availability of reliable sources of credit and input supply. FT was seen as having a positive role in helping to regulate the private market.
- ◆ **The most significant impact of FT market participation appeared to be to assist in improving information and market transparency although as noted FT provided an important initial market for KKL.** The major impact of FT initiatives in the coffee sector in Tanzania was judged to be the contribution to increasing the capacity of the cooperatives to understand, and engage in, international trade and to act as a benchmark in setting standards and providing information. As well as purchasing coffee, FT organisations have provided cooperatives with equipment, provided them with market information, helped develop business and technical skills and facilitated trade with other FT organisations and profit-making companies. In each case, market reforms had brought about a substantial change in the organisation of the marketing system. This had the effect of providing new market opportunities for private trading activity. However, the weakness of the institutional and infrastructural environment meant that there were significant obstacles to smallholder producers being able to obtain benefits from the more liberalised marketing system.
- ◆ **Although Kuapa Kokoo's emergence was not dependent on assistance from TWIN, it was significantly assisted by capacity building and trade facilitation.** These activities had been funded directly by donor agencies. However, in principle, many of these capacity-building initiatives could have been carried out independently of the sale through FT channels.
- ◆ **In both cases there are tensions between the realities of the production, domestic marketing and international trade and certain of the arguments advanced by the FT movement** – in particular in relation to the use of the premium and price stabilisation. Some of the publicity and information material

used to support the Ghanaian FT initiatives contained inaccuracies and risked presenting a simplistic view of the issues involved in international trade.

- ◆ In principle it would be possible to compare the livelihoods impact of the opportunity to be part of an effective producer organisation (as distinct from the engagement in a specific FT initiative) with producers who are not part of such organisations. Such an exercise was however well outside the resources available for this study. Likewise, the claim to be working with relatively “marginal” producers is difficult to assess empirically.

As noted earlier, caution must be applied in generalising the conclusions drawn from the case studies even in relation to the specific commodity sectors that are covered (although as noted Kuapa Kokoo is by some way the most significant supplier of FT cocoa). In particular, coffee cooperatives in Latin America that are engaged in FT are likely to show a somewhat different pattern of impact. They are smaller and are likely to pass a greater proportion of the price premium directly on to producers and to work more explicitly with marginalised producers. However, there is a lack of well-documented studies about these examples from which firm comparative conclusions can be drawn.

5. *Dilemmas, Challenges and Links with the Mainstream*

While the FT movement has had some notable successes as outlined above, the future of the movement is still not assured and there are several dilemmas that will need to be resolved. Leveraging impact beyond the relatively small quantities of FT sales will also require bringing about changes to mainstream trade practices.

5.1 *Dilemmas in Fair Trade Practice*

There are a number of tensions and dilemmas in FT as it is currently defined and operates through ATOs (for example see Traidcraft, 2000). Each of these dilemmas represents a potential conflict between profitability and hence financial sustainability and development objectives, particularly the strong focus on working with the “marginalised” as a defining aspect of FT. These tensions and dilemmas have much to do with the trend for ATOs (such as Traidcraft, Oxfam Fair Trade, and Fair Trade Organisation) to concentrate on trading southern products whilst leaving the development work to their respective partner organisations.

- ◆ In selecting producer groups with whom to work, **ATOs need to focus on potentially viable groups**. These are likely not to include the poorest and most marginal of producers. Giving practical content to the claim to be working with the marginalised might be seen as requiring, for example, ATOs to actively seek to enable producers who are not currently part of the conventional supply chain to join the mainstream.
- ◆ Similarly, **there is a tension between a definition of FT based on values and objectives** (which may tend to limit the range of organisations who may claim to be engaging in it), **and using FT as a standard to which all businesses may aspire**. The latter, for example, is the purpose in relation to labour standards of the Ethical Trade Initiative.
- ◆ There may be **sensitivity to sharing commercially valuable information between ATOs in a tight market** even though ATOs emphasise the need to work together for information dissemination and mutual learning. **Market pressures may also threaten the sustainability of long-term relationships with producers**. Given that the market for FT products remains a relatively small (though growing) niche, FT brands are often in direct competition with each other.
- ◆ **The establishment of FT labelling and directories of FT producers creates an opportunity for new market entrants who may increase competition for established brands and ATOs**. Sourcing from FT directories may also threaten the close relationship with the producer organisation, which the ATOs consider to be a defining feature of the FT movement. If FT labelling criteria are too strict this may deter their use by the mainstream. If the criteria are relaxed then the potential benefits to producers are diluted accordingly.

5.2 Challenges for the Fair Trade Movement

FT products appear to generate a high degree of credibility among a relatively small though increasing number (in the UK) of supportive customers. This appears to be based on consumer of brands associated with particular ATOs rather than the labelling system as such. This reputation (brand recognition) has enabled some FT products to counter the significant barriers to entry into new markets such as instant coffee. The scope for new products is still regarded as substantial. FT bananas have recently been introduced into mainstream retailers, while Twin is examining the potential for FT cotton.

Several major **challenges** face the companies who currently dominate the market for FT products:

- ◆ **How to resolve the confusion generated by the lack of a single and consistently applied approach to defining FT.** The terminology of “Fair Trade” makes claims that are contestable so long as the criteria on which they are based lack transparency or testability – the great advantage of the registers is that they do provide clear criteria of this type.
- ◆ **How to define the distinctive value added of ATOs at a time when increasing numbers of mainstream processors and retailers are involved in ethical trade initiatives** (such as the Tea Sourcing Partnership) or the development of codes of conduct. Wider and more systematic use of ethical certification and standards may be a competitive threat to traditional FT activities and claims.
- ◆ **How to promote the FT concept without using simplistic or potentially misleading messages** especially as competitors are increasingly challenging FT claims.
- ◆ **How to build attractive FT brands** associated with high quality products, something that Cafédirect has successfully achieved. Labelling only provides a technical foundation - it does not guarantee commercial success.
- ◆ **How to get mainstream manufacturers to support FT values and activities.** Product labelling is unattractive to most mainstream companies and some are openly hostile to FT organisations. However, rapid growth of trade through ATOs is unlikely and small changes in mainstream manufacturers sourcing policies could have far greater impact on farmers’ livelihoods. The challenge is for FT and mainstream manufacturers to overcome their concerns about each other and begin looking at ways that they could work together which would lead to benefits to farmers. Some mainstream companies are already involved in direct sourcing and farmer extension and FT organisations are involved in trading and product manufacture. Both have an interest in the long-term supply of quality goods, so there should be ways of using each other’s skills to serve the interests of both.

- ◆ **How to respond to technological developments affecting retailing**, particularly the opportunity for strengthened direct links between consumers and producers through internet commerce. These have the potential to radically affect the market environment. There are already some initiatives based on direct marketing by Southern producers.

5.3 *Bringing Fair Trade into the Mainstream*

There are **three main routes** by which the currently limited scale and impact of FT activities can be increased beyond the volumes currently flowing through FT channels.

- ◆ **First, by demonstrating the basic viability of the FT model and progressively taking market share away from mainstream marketing channels.** There has been some success in establishing brands and lines that have been able to compete within mainstream retail outlets. There is considered to be continued scope for expansion, particularly into new products.
- ◆ **Second, through using the Register and labelling system to encourage mainstream producers to launch FT brands.** The FT label is theoretically open to any company. However, none of the key manufacturing companies operating in the sectors for which FT labels exist, such as Cadbury, Nestlé, Mars or Unilever, have chosen to source any of their inputs through FT channels or develop their own sub-brand of 'fair trade' products. Commercial companies that have made use of the label have tended to be smaller companies who have used it for a niche range of their products. Perhaps the largest mainstream player in the UK to have made use of the FT label, is the tea company Ridgeways, a subsidiary of Premier Brands, which also supplies Typhoo and Co-op 99 tea. The relatively low take up of the FT label mirrors the experience of environmental labelling, with very few big-name brands applying for ecolabels for any of their products. Much of a company's marketing strategy is focused around reinforcing brand loyalty. There is therefore a fear that labelling a product sub-range as environmentally friendly or fairly traded can lead to negative spill-over, leading consumers to focus on the fact that the rest of their brand does not meet the label's criteria.
- ◆ **Third, the capacity development activities carried out under a FT banner are a way of empowering farmer groups to engage with non-FT marketing channels on a more favourable basis** (thereby reducing dependency on FT channels). However, such capacity development could potentially be carried out in other ways, rather than being linked to active participation in trading.

An important issue is the governance of the FT labelling system. The FT movement has in the past sought to avoid official regulation or definition of FT claims. FT labelling can be seen as part of a broader move to the use of verified social labels as a means of communicating ethical trade. There is an agenda of issues for improving governance and for linking to broader ethical trade certification. There are moves towards local certification that should reduce costs. **However there are a number of problems with the current operation of the system.**

- ◆ First, **the criteria set to qualify for a FT label are contestable**. The criteria have been determined by FT organisations and the system of governance for the FT registers may need both to be strengthened and made more cost-effective.
- ◆ Second, **there is an issue about whether FT labelling is necessary for effective marketing purposes in a situation where promotion is based on a strong brand identity** which gives customers confidence in the claims that are being made on behalf of the product. Association with well-known ATOs and charitable organisations is particularly important in this respect. Unless agreement can be reached on a universally accepted (and not excessively restrictive) definition of FT practice, it may be that labelling will be increasingly replaced by brand identity, based on the validation of more specific claims.
- ◆ Third, **access to registers is not open to all producer organisations meeting the criteria** – restrictions are maintained in order to protect the share of FT labelled volumes for existing producer organisations. In addition regulation of registration is not independent of the ATOs who use the register.
- ◆ Fourth, **some elements of the most used FT definitions**, most notably in relation to pricing, **make it difficult to regard it as a standard to which all businesses should aspire**, in contrast to ethical and environmental trading principles.

6. Conclusions

Over the past decade, the FT movement has moved from an aspirational alternative to conventional trading practices between North and South to a commercial reality, though on a relatively modest scale. Emerging out of a frustration with the inability of both governments and business to tackle the problems faced by marginalised producers in the South, FT has now become part of both the policy and marketplace ‘tool kit’ for achieving a global trading system geared towards poverty elimination. In the process, FT has brought a range of benefits to producers and communities in the South; it has also generated a reaction from established processors who are challenging many the movement’s claims and assumptions.

As FT moves from its pioneering phase and becomes an established feature within mainstream retailing (particularly of food products) so it faces a new range of challenges and dilemmas - most notably how to maintain its distinctiveness and vitality at a time when ‘ethical trading’ is rising up the corporate agenda. Central to the consumer appeal of FT has been the putative link between purchasing decisions in the North and tangible livelihood gains for producers in the South. This assessment has shown that these improvements may be real, but often have more to do with overall capacity building and trade facilitation than with income benefits linked to the provision of a ‘fair price’ - a central plank of the FT marketing proposition.

The fair price concept can be a source of deep confusion. The concept of fair pricing being based on ideas of ensuring an adequate livelihood to producers, or on covering costs is an elusive and highly contestable one. As noted above, it is impossible to derive robust quantitative measures of such concepts because of variation between producers, so any formula adopted to define a fair price must be contestable. This approach to pricing also ignores the important role of prices in signalling to producers trends in demand. It also begs questions about the sustainability of trade based on prices that are insufficiently market related – particularly if the demand for FT produce is regarded as constrained by the high level of current premiums. It also bears no relationship to concepts of fair trading as they are embodied in UK consumer law. One alternative approach to pricing premiums that avoids such emotive terminology would treat them as a transfer (equivalent to a form of charitable donation either direct to the producer or to fund services or social infrastructure). Another approach would stress the commercial case for paying premium prices to cement a relationship with producers so as to guarantee future supply and to encourage quality. The key issue about pricing and marketing relationships should be whether they provide benefits to producers compared to alternatives, rather than whether they are fair.

This section draws together the conclusions of the report as a whole. It looks first at the contribution made by FT in its four main roles – as agents for market transformation, awareness raising, redistribution and empowerment – and then at the possible contribution that FT could make to changing conventional practices in the future.

6.1 *Agents of Change*

a. **Market Transformation**

A range of FT products now has an established presence in mainstream retail outlets. This is an achievement in itself, given the degree of market concentration for key commodity-based products – and represents an impressive example of market innovation. While sales of FT coffee have stagnated (or fallen in some supermarkets), sales of other FT products are growing rapidly, and there is scope for new product categories to be introduced.

At the producer end of the trading chain, FT initiatives can act to complement ongoing liberalisation efforts in many developing countries. The main factor leading to the sustainable improvement of producer livelihoods in the context of liberalising marketing systems will be a strengthening of the performance of market institutions in a context of pervasive market failure. FT activities offer one way of encouraging a diversity of competing marketing channels and the provision of marketing information, which is at least in part a public good. The presence of FT companies in the marketplace has also served to provide a watchdog role – as illustrated in the Tanzanian coffee sector - helping to improve the trading practices of other market actors to the benefit of producers.

b. **Advocacy**

The FT movement has engaged in two main types of advocacy and awareness raising activities: first, stimulating public demand for FT products; and second, lobbying governments for policy reforms that would support producers in the South. One indicator of the success of this strategy on the policy front is the recent EU Communication on FT. As with any form of advocacy activity, the messages advocated by the FT movement have received a mixed response from government and business. Many, though not all, of the advocacy positions are consistent with current UK government policy.

One weakness that has been observed is the simplification of the ‘unique selling proposition’ of FT to one focused on price and income benefits to farmers, and exaggerated criticism of market intermediaries. There is an important role for the FT movement to communicate the complexities of trading relations through education and awareness raising activities that go beyond simple sound-bites.

c. **Redistribution**

In general, producers engaged in export sectors (including smallholders) are unlikely to be among the poorest people in a given country - the poorest will be those excluded by a lack of access to productive resources and/or employment opportunities. However, within the sectors in which FT initiatives operate, these initiatives may have a significant role in improving the transparency with which markets and producer organisations operate, to the likely benefit of smaller and more marginalised

producers. The direct poverty impact may be greater in the case of other FT products, such as handicrafts, and this is worthy of further analysis.

In some cases, the provision of premium prices and price guarantees can make a significant direct contribution to producer livelihoods. However, the nature of the price guarantee and the size of the market willing to pay the premium means that this is likely to be of limited value to the vast majority of southern producers. The premium will tend to provide a rent to particular producers who have access to this market. To the extent that the premium is pooled rather than being passed directly to producers, its income stabilisation effect is limited, acting more as a social transfer. Further work is required to assess the distribution of value within FT marketing chains compared with conventional chains to improve understanding of the links between premium prices paid by consumers in the North and benefits to producers in the South. Other factors also need to be explored, such as the role of economies of scale in determining final prices of FT products. In addition, it would be useful to assess how FT activities fit within the broader livelihood strategies of smallholder farmers engaged in export production.

d. Empowerment

The case studies suggest that the most important impact of FT initiatives lies in their work to strengthen the capacity of producer organisations and increasing their bargaining power. Successful capacity building, organisational development and marketing support provided as part of FT initiatives can have an impact far beyond the value of products traded by ATOs. This may be particularly valuable during and immediately following the reform of marketing and trading arrangements, as illustrated by the experience in the Ghanaian cocoa and Tanzanian coffee sectors. FT activities in this regard go beyond the provision of information and traditional business development support and include facilitating greater participation and confidence in civil society structures that emphasise accountability and transparency. The FT relationship can also provide a solid platform for producers to innovate – for example, converting to organic farming methods.

Empowerment through participation in FT marketing channels is only one route to capacity strengthening. A number of ATOs are also working to enable producers to operate more effectively in mainstream markets: the potential synergies and tensions between these two roles deserve further enquiry. Given the likely demand-side limitations on FT products, ATO support for accessing the mainstream is an area of work worthy of greater attention and support in the future. While producer controlled co-operatives may play an important role in improving producer livelihoods, there is room for greater flexibility in the FT movement to encourage a diversity of marketing channels - a reality that has already been faced in sectors not reviewed in this study, such as tea and handicrafts. Furthermore, indicators of empowerment are still hard to come by, and more work is required to evaluate the institutional as well as individual gains, such as growth in producer self-esteem. Finally, there is scope for more work to empower Southern producers to become more engaged in the governance of FT labelling and standard setting initiatives.

6.2 Broadening the Impact

The existence and demonstration effect of FT brands – as well as advocacy activities – are clearly prompting mainstream processors to justify their practices and to develop their own initiatives for improving producer livelihoods and sustainability. The dual focus of FT activities on ‘conditions of production’ and ‘terms of trade’ poses a particular challenge as most mainstream ethical trading activities focus solely on setting criteria for production. As a result, **there is a strong case for encouraging the adoption of some aspects of the FT approach as part of a general strengthening of ethical business principles in mainstream marketing channels.** These would include the provision of support and information to improve market transparency and the capacity of producers to engage in an informed way in the market. Other aspects are also consistent with good practice trends such as strengthening links between suppliers and their customers, as well as improving quality and traceability through the marketing chain. **However, an insistence on formula-based price premiums or minimum prices is unlikely to be a generalisable approach.**

Although the FT label is theoretically open to large-scale multinational corporations none has chosen to apply for the label, or develop their own brand of FT product. By comparison, ‘environmentally friendly’ eco-labelled products have at best achieved market shares around 15-20%. This is considerably higher than the market shares achieved by FT labelled products to date. One potential constraint on the growth of FT derives from the limited capacity of labelling compared with the creation of brand values to achieve market success, and the fear that FT products might have a ‘negative spillover’ on conventional lines. In the case of FT labelling, there could be additional ‘political’ barriers to wide adoption due to the exclusive management of the labelling system by NGOs. For example, it has taken considerable effort for the Forest Stewardship Council to be accepted by business, despite its multi-stakeholder governance structure, due to its origins as an NGO initiative. The greatest barrier to widespread adoption of the FT concept as it stands is the emphasis on the price premium and minimum prices.

As ethical business practices spread, the distinctive role of FT could become focused around two roles, which mainstream processors are unlikely to fulfil:

- ◆ first, working in a more targeted way with disadvantaged producers within a particular sector or country; and
- ◆ second, seeking to improve operating efficiencies in order to pass a greater proportion of value to producers.

Beyond this, ATOs also face a major opportunity to act as brokers of information and capacity between producers and the mainstream.

6.3 Summary of Specific Questions from Study Terms of Reference

This sub-section summarises the findings of the study in relation to other specific questions posed in the terms of reference.

Can the costs of FT regulation and certification be reduced?

Costs of regulation and certification can be reduced to some extent by moves towards local certification and increasing volumes. In the cases quoted in Table A4.6 for chocolate, the cost of the licence fee is equivalent to two-thirds of the premium received by producers.

To what extent is the FT premium for producers payable as a result of efficiency in the supply chain?

Insofar as data is available, the margin paid by consumers appears to exceed the premium received by producers. In the example quoted in the Ghana case study (Table A4.6), 45% of the premium paid by the consumer is passed to the producer (or rather to the producer organisation). This does not take into account, however, non-price benefits received by producers or their organisations. In principle, however, there are strong reasons to expect that there are potential “efficiency” gains (including in relation to improved quality and credit relationships) through the development of long-term relationships between producer organisations and purchasers.

Could FT supply chains be made more efficient through competition?

In many respects FT supply chains are highly competitive – with brands competing for a relatively small, though growing, niche market. It is also important to note that the bulk of sales by registered FT producer organisations are into the mainstream commercial trade and not through a FT supply chain.

Are barriers to entry to the FT supply chain significant?

The costs of certification do pose a constraint especially for small producers and traders. In addition, access to registers is managed rather than based purely on meeting qualifying criteria and ability to pay for certification.

Is “direct” purchasing from small farmers efficient?

There are generally several different marketing routes – all of which may have advantages to both producers and purchasers in particular circumstances. It is also important to note that under conditions of pervasive market failure, focusing just on prices and output marketing costs rather than other aspects of the marketing relationship may be misleading. First, even MNCs may in some circumstances operate local buying companies that purchase direct either from farmers or from farmers’ organisations. Second, market intermediaries of various kinds may play an important role in providing services to small farmers. Third, increasing pressures to maintain the ability to trace products along the marketing chain (for quality control and public health reasons) is creating increased commercial pressures for direct links to farmers.

7. Recommendations for DFID

Broadly, there are two possible rationales for donor support to FT initiatives. The first is based on a market failure argument. The second depends on the poverty impact of support to FT initiatives.

As discussed above, the study has concluded that the development and poverty impact of the FT price premium and price stabilisation model is limited. The price premium is best regarded as a form of charitable transfer that ought to be sustainable without external support, and which should be judged on efficiency and effectiveness grounds depending on how it is managed. The case for support to advocacy depends on the degree of congruence between the advocacy positions of the FT movement and those of donor organisations. As commercial ventures, FT initiatives ought also to be commercially viable without donor support – although there are some externalities such as the contribution to market transparency noted in the Tanzania case study which could provide a case for selective support at particular points in the marketing chain.

It is therefore the empowerment (capacity building and trade facilitation for producer organisations) that is likely to have the greatest potential poverty and development impact. There is a strong case on market failure grounds for providing support to institutional development in the context of market reform (since there are likely to be considerable difficulties for farmers in dealing with the transactions costs of organising collective actions). The poverty impact could also be substantial, depending on:

- ◆ the potential to leverage impact beyond the FT part of the marketing chain (particularly the capacity to develop replicable models for other institutions to follow).
- ◆ the relationship between the production and marketing system and the livelihoods of the poor.

Developing a Strategy

To date, DFID's support for FT initiatives has been provided by a number of different units and funding sources for a range of different activities – including loan guarantees, development education and capacity building. However, there has been no overall strategy to provide guidance towards FT initiatives.

Recommendation 1: Within DFID, a focal point for FT policy and the assessment of proposals for support to FT initiatives should be established.

Recommendation 2: A policy document setting out DFID's strategy with regard to FT should be developed, as part of DFID's broader policy of promoting trade reforms that benefit low income countries and developing engagement with the private sector. This document should be based on active consultation with FT organisations,

mainstream businesses, other donor agencies²³ (including the European Commission), as well as Southern governments and producer organisations in DFID target countries. The process of strategy development should be explicitly directed at achieving consistency of approach with like-minded donor agencies and at building consensus about the definition and role of FT.

Underlying Principles

Beyond defining a clear strategy towards FT, the conclusions of this study imply that DFID should also consider providing selective support to specific FT initiatives as one way of achieving its poverty reduction objectives.

Recommendation 3: DFID support for FT should be based on the following principles:

- ◆ Support for FT initiatives should be seen as part of its overall commitment to improving the operation of national and international trade and marketing systems to the benefit of the poor.
- ◆ The need for the adoption of a clear and practical definition of FT and an emphasis on supporting complementarities between FT initiatives and the mainstream in order to achieve the greatest positive impact on rural livelihoods.
- ◆ Support should be placed in the context of a broader strategy to improve market access and opportunities for disadvantaged producers. The strategy should be based on a livelihood analysis for the target group and viewed in the larger context of national policy and international market environment.
- ◆ Support should be targeted to deal with specific market or institutional failures. FT initiatives that build the capacity and accountability of producer organisations to provide farmers with market access, information, and means for managing price risks, may be particularly valuable in the context of market liberalisation.
- ◆ Support should aim to ensure that FT initiatives are market-led, driven by the needs of smallholder producers, and sustainable at the end of any project. Donor support should focus on enhancing the impact of initiatives that have proved their market viability, and should in general avoid supporting the promotion of particular products, brands or enterprises. Rather it should focus on enhancing the positive externalities associated with capacity building activities at the producer organisation level.

Labelling

FT labelling has opened up new opportunities for ATOs and producers to enter mainstream retail outlets. However, the labelling system is hampered by a lack of

²³ It is understood that several other donor agencies and European governments are in the process of developing policies or commissioning studies (including France and the European Commission). There is a very strong case for active cooperation and information sharing.

separation between the standard setting, verification and capacity building roles that occurs in other systems (such as FSC or organic). Its attractiveness to mainstream processors may also be limited by its current governance structure which excludes the business community. Finally, the role of Southern producers in standard-setting appears relatively limited.

Recommendation 4: DFID should encourage efforts to improve the governance of the FT labelling systems, particularly in terms of Southern participation. There is a case for assistance to establish a common basic standard to justify FT claims. This should ideally take place at the level of the European Union as has been proposed in the recent EC “Communication on Fair Trade”. In providing support to labelling initiatives, donors should press for transparency and inclusiveness in the way in which they operate. Donor support should also be seen as assisting labelling initiatives to become self-sustaining and so should be based on an exit strategy for donor support.

Advocacy and Awareness Raising

The practical experience of FT offers many insights into the ways in which trade and other policies need to be reformed to support poverty elimination. FT also offers a way of communicating positive messages about North-South interdependence in a direct way to a broad spectrum of the public.

Recommendation 5: DFID should explore new alliances involving ATOs to achieve mutually agreed policy reforms at the European and international levels, such as reducing tariff barriers to processed agricultural imports. DFID could also support efforts to disseminate the lessons of best practice, and communicate the complexities of North-South trade to the public.

Capacity Strengthening

Capacity strengthening emerged as the greatest impact of FT activities and the area where the case for donor support is probably greatest.

Recommendation 6: DFID should consider supporting specific capacity strengthening initiatives by ATOs, especially for producer communities that are disadvantaged within particular countries. Support should not be limited to co-operative or farmer controlled models.

Mainstreaming

Areas of common ground do exist between ATOs and mainstream processors – and some transnational corporations are starting to take a more proactive approach to their responsibilities, for example, through the Sustainable Cocoa Initiative.

Recommendation 7: DFID should consider support for exchanging experience and forming new partnerships between ATOs and mainstream processors, as well as to initiatives that aim to improve the practices of mainstream business and in particular of the private trading system that is emerging or expanding in the wake of marketing liberalisation. One starting point would be to set out clearly the different norms

and values that drive FT business compared with conventional production and trade at each stage of the supply chain.

Price Stabilisation

The FT price premium is unlikely to provide a very effective mechanism of price stabilisation. Producers and producer organisations as well as private and continuing state marketing systems need to develop a capacity to use market-based instruments such as options and futures to manage price risk on a sustainable basis.

Recommendation 8: DFID should explore the feasibility of options and futures as a practical and cost-effective way of providing risk management for poor farmers. This could involve cooperation with the World Bank's International Task Force on Commodity Risk Management for Developing Countries. This initiative is seeking to explore market based approaches to managing price risk, and is working in consultation with UNCTAD and several FT organisations.

Research

A number of themes for further research emerge from this study.

Recommendation 9: DFID should consider supporting efforts that enable cost-effective assessment of capacity strengthening provided by ATOs to producer organisations.

Recommendation 10: DFID should consider supporting studies focusing on the potential role of FT in handicrafts, plantation crops and other areas.

Annex 1: Terms of Reference for Fair Trade Study

June 1999

1. Background

The UK Government's White Paper on International Development commits DFID to the elimination of poverty. DFID is committed to strengthening support for trade which contributes to sustainable development. DFID recognises that pro-poor trade measures can play an important role within the wider range of instruments required to integrate poor countries into global trading patterns. Support at the macro level for trade policy reforms and at the meso level for trade capacity and promotion support will have wide systemic effects but the development of models which assist poorer producers (and traders) to access new global opportunities can also be significant, particularly where there are opportunities for replication. The White Paper commitment is being taken forward through a number of different areas of work and policy initiatives:

- ◆ Support at the international policy level to improve the trading environment for the poorer countries, particularly through building the capacity of developing countries to negotiate in key trade rounds and to reflect the interests of the poorest countries in the development of trade policy.
- ◆ Support at country level -usually national or regional level -to build trade policy capacity and to support the trade infrastructure (e.g. through work with customs organisations, with licensing, letter of credit processes, trade promotion organisations etc.) The beneficiaries of these processes include larger and smaller firms and single traders.
- ◆ Support for more 'responsible' models of trading through work (mainly with larger importers) on codes of conduct and responsible sourcing. For example, DFID is providing support for the Ethical Trading Initiative and for civil society organisations to monitor codes of conduct. DFID is also involved in a range of projects to develop and extend models of pro-poor trade which concentrate on assisting poor producers either to access new trade opportunities, to participate in higher value added activities, or to receive a better deal from the marketing chain.

2. Objectives

The objective of the study is to inform DFID's policy of support for fair trade, by assessing the benefits and costs of fair trade in comparison with more traditional trade patterns. It will look at the range of initiatives covered by the term 'fair trade', from the more rigid definitions used by the Fair Trade Labelling Organisations to the looser usage in fair trade

handicrafts, tourism etc. It will look at how the fair trade movement has evolved and then examine the future prospects for transferring fair trade values and principles into the mainstream. It will also consider how fair trade complements the ethical trading movement.

3. Scope of Work

The study will be undertaken in two stages. The first stage will involve desk research and interviews with key organisations involved in and affected by fair trade (including fair trade organisations, mainstream manufacturers, supermarkets, representative organisations of producers/workers and government). A number of case studies should be identified to illustrate the issues and to provide analytical rigour. The second stage will involve field work to explore two case studies in further detail.

A. Benefits and Costs of Fair Trade

The study will involve a thorough review of the fair trade system and market for fair trade products, including: the extent to which fair trade presents an efficient and sustainable way to improve incomes for poor producers, particularly in the context of a wider movement towards liberalised marketing in agricultural commodities identification of the actual benefits (financial and non-financial) of fair trade at the micro, meso and macro levels, and any unintended consequences or costs the extent to which fair trade can/does act as a wider catalyst for reform in trading systems and so have a wider impact beyond its own market size whether the fair trade system can be made more efficient. For example:

- ◆ Can the costs of regulation and certification be reduced?
- ◆ To what extent is the fair trade premium for producers payable as a result of efficiency in the supply chain ?
- ◆ Could fair trade supply chains be made more efficient through competition?
- ◆ Are barriers to entry to the fair trade supply chain significant?
- ◆ Is 'direct' purchasing from small farmers efficient?
- ◆ The extent to which fair trade prices are affected by commodity price fluctuations the size, profitability, growth potential and limits to growth of the fair trade market, including the constraints on its regulatory capacity.

B. Fair Trade in the Mainstream

The study will also explore how the lessons from fair trade can be transferred and adopted by mainstream commercial organisations. In particular:

- the extent to which the principles/values of fair trade can be applied outside the commodity sector and to products which are not necessarily produced by small producers;
- whether it would be desirable for large/mainstream firms to participate in fair trade through 'direct' purchasing from small producers or whether alternative models exist, or should be developed.

The study will also examine the common criticisms of the fair trade movement made by the mainstream and the extent to which they have validity e.g.:

- the 'market' price is a fair price fair trade can only be for niche players,
- large players can not deal directly with small farmers, as intermediaries are a necessary part of the supply chain
- mainstream companies sponsor many projects in developing countries, financing agricultural extension, research and development
- the greatest contribution mainstream companies have made to trade with developing countries is to expand the market for end-products.

C. DFID support for Fair Trade

The study will examine how best DFID should continue to support fair trade and make recommendations. It will provide specific guidance on the economic rationale for DFID support. Recommendations should include the identification of priority areas for further research work in this area.

4. Outcomes and Deliverables

An overview report not exceeding 30 pages in length (plus additional annexes) and using summary tables as appropriate to present clearly key points and lessons.

5. Competency and Expertise Requirements

The consultants shall have experience of working on trade issues, particularly fair trade. They should have strong analytical abilities on the economic and social aspects of trade.

6. Timetable and Reporting

The consultancy is expected to be completed over a period of 12 weeks, commencing in September 1999. It shall be a study involving desk research and field work using personal contact, published literature and reviews, supported by consultation and interviews with the various organisations. The consultants will attend an inception meeting with Business Partnership Unit (BPU) and Enterprise Development Department (EDD) staff to discuss the Terms of Reference, agree a timetable for the work and finalise arrangements for the conduct of the consultancy. The consultants will present their draft findings to DFID (including representatives from BPU, EDD, Social Development, Natural Resources and Economics) and submit a draft report to DFID in the first week of December and a final report to reflect any comments made by 30th December 1999.

Annex 2: List of Individuals, Institutions and Documents Consulted

List of Individuals and Institutions consulted

In Europe:

Ms C. Wills, *IFAT*.

Mr R. Lake, *Traidcraft Exchange*.

Mr P. Williams and Ms R. Wilshaw, *Oxfam Fair Trade*.

Ms A. Chipchase, Ms L. Roberts, and Ms P. Booth-Smith, *Oxfam Activities Ltd*.

Mr A. Tucker and Ms A. Lavender, *TWIN*.

Mr P. Wells, *Fair Trade Foundation*.

Ms E. Omen, Co-ordinator, *NEWS!*

Ms R. Oppenhuizen, Public Relations, *Max Havelaar*, Holland.

Mr P. Logli, Mrs Honorez, Ms A. Davison, (all DG Development), Ms C. Humphrey (DG Consumer Safety), Mrs Spatolisano (DG Trade), *EU Commission*.

Ms H. Stafleu, *Fair Trade Organisatie*, Culemborg, Holland.

Ms L. Fullelove, *Sainsburys*.

Mr M. Blowfield, Ms A. Tallontire, and Mr C. Collinson, *Natural Resources Institute*, Chatham.

Mr P. Wilkes, Chair, *Coffee Trade Federation*.

Ms P. Newman, Managing Director, *Cafedirect*.

Mr C. Lodder, Ms J. Serpa, Mr D. Seudieu and Mr Dubois, *International Coffee Organisation*.

Mr R. Hide and Mr A. Carlton, *TWIN Trading*.

Mr J. Smith, *Comic Relief*.

Mr C. Newell and Mr J. Weaver, *TWIN*.

Ms S. Trenshaw and Ms P. Tiffen, *Day Chocolate Company*.

Ms R. Foppen, Co-ordinator, *FLO Cocoa Register*.

Mr J. Currah (Commodities Development Manager), Dr D. Murphy (Supplier Development Division), Dr M. Gilmour (Cocoa Field Projects Manager), Ms S. D'Arcy (External Relations) *Mars UK*.

Mr J. Lunde (Director International Environmental Programs) *M&M Mars*.

Mr B. Hamilton (Commodity Purchasing Manager), Ms H. Parson (Corporate Affairs Manager), and Ms V. Roy (Social Policy Analyst) *Nestle*.

Mr T. Lass, Cocoa Technical Manager, *Cadbury International Limited*.

Mr C. Sams, *Green and Blacks*.

In Tanzania:

Mr . T.S. Zallawahe, Coffee Management Unit (CMU) *Ministry of Agriculture*, Overseeing the use of STABEX funds (Dar-es-salaam).

Mr. Sabatucci, *EU representative* overseeing the use of STABEX funds (Dar-es-salaam).

Mr. A. Mapunda, Officer in charge department of Cooperative development under the *Ministry of Agriculture* (Dar-es-salaam).

Mr. G. Ulomi, Export marketing Manager *Kilimanjaro Native Co-operative Union* (KNCU) (Moshi).

Mr. Kimiti, Chairman of committee overseeing the use of premiums from fair trade initiatives under *KNCU* (Moshi).

Mr. J. M. Kanjagaile, Exporting marketing Manager *Kagera Co-operative Union* (Moshi).

Mr. J. Lefroy, Director of *African Coffee Company* (ACC) (Moshi).

Mr. F.S. Mpangile, Director of Operation and Planning, *Tanzania Coffee Board* (TCB) (Moshi).

Mr. A. Daya, Manager of coffee buying operations for *Dorman (T) ltd* (Moshi).

Mr. Munuo, Marketing manager for *Arusha Co-operative Union* (Arusha).

Mr. A. Mirisho, *Co-ordinator OXFAM partners in Tanzania* (Arusha).

Mr and Mrs Nkya , *Small Farmers in Machame* (Moshi).

In Ghana:

Mr. Oheneng-Tinyase (Managing Director) and Ms A. Antwi (Gender and Community Development Officer), *Kuapa Kokoo Ltd*.

Members of the *Kuapa Kokoo Primary Society, Mim*.

Members of the *Kuapa Kokoo Primary Society, Amankwantia*.

Members of the *Kuapa Kokoo Primary Society, Baniekrom.*

Cocoa Processing Company, Ghana.

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Annex 3: Fair Trade Case Study – Coffee in Tanzania

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1. Introduction

Coffee is by far the most important fair trade (FT) product, accounting for almost 30% of all European FT sales¹. This case study looks at the international market dynamics of the coffee sector and then focuses in on Tanzania and the role that FT initiatives have played in the coffee sector there. The aims of the case study are:

- ◆ To provide a more detailed context for discussing the role, prospects and significance of FT initiatives.
- ◆ To illustrate the issues associated with an assessment of the impact of FT initiatives, in the context of DFID policy objectives.

The case study is structured as follows. Section 2 looks at the international market dynamics of the coffee sector and is based on the work of Dr. George Mavrotas. Section 3 looks at the UK market for coffee and the role of FT in this market and is based on work by Sarah Roberts. The remaining sections focus on the coffee sector in Tanzania and are based on research carried out by Dr. Anna Temu and Sarah Roberts. Section 4 describes the structure of the Tanzanian coffee sector and the changes since liberalisation. Section 5 looks at the development of FT in the Tanzanian coffee sector and section 6 considers the impact on Tanzania's coffee farmers.

Coffee prices are notoriously volatile, due to the failure of supply management initiatives, speculation, mismatches between supply and demand, and climatic factors, causing serious instability for producers. Prices declined significantly during the 1980s and while they have picked up again in the 1990s there is concern that an over-supply situation is developing due to a faster increase in supply than demand.

The Tanzanian coffee sector, which has traditionally been subjected to significant political interference, is now adjusting to the changes relating to liberalisation in the early 1990s. Competition from private traders and withdrawal of state financial support is leading to a significant shake-up of the co-operative sector which had previously been the only sales route for farmers' coffee.

FT organisations have played a significant role in developing the capacity of Tanzanian co-operative organisations to engage in international trade, through FT purchases, information provision, skills development and trade facilitation. Because FT sales only make up a small proportion of the co-operatives' total purchases from farmers, the price premium, although welcome, does not amount to a significant sum. It is generally paid into a fund at the level of the co-operative union rather than being distributed directly to members. Most farmers are therefore only vaguely aware of FT and the extent to which they benefit is dependent on the effectiveness of the co-operative and the manner in which it uses the relationship with FT organisations and passes benefits on to its members.

¹ EFTA 1998.

Although it is likely that the coffee sector will continue to change in the aftermath of liberalisation, it seems important that the provision of information and support aimed at improving the capacity of farmers to understand and engage in international trade currently provided by FT organisations is continued.

2. The World Market for Coffee

2.1 World Coffee Production

Arabica and robusta are the most important species of coffee, with arabica being grown throughout Latin America, in Central and East Africa, in India and to some extent in Indonesia, while robusta is grown in West and Central Africa, throughout South-East Asia, and to some extent in Brazil.

Coffee production reached almost 100 million bags in the 1997/98 crop year (October-September), implying an upward trend since 1992/93. The supply of coffee is heavily dominated by Brazil, the largest producing country, accounting for 24% in 1997/98 and Colombia (c. 12%), followed by Indonesia (7.3%). In recent years, Vietnam has become one of the main producing countries with a market share of about 7% in the 1997/98 crop year. Vietnam is now the fourth-largest coffee producer and the third-largest coffee exporter in the world.

2.2 World Coffee Consumption

Global consumption exceeded 100 million bags in the coffee year 1997/98 implying an upward trend since the 1994/95 crop year. The United States, the largest consuming country in the world, accounted for more than 18% of world consumption in 1997/98, followed by Brazil (11%), the largest coffee consumer from producing countries. Germany (9.3%) and Japan (6%) are the other dominant consumers in the world market. The United Kingdom has a rather small share of the world consumption (2.4% in the 1997/98 coffee year) well below France, Italy and Canada. In terms of per capita consumption of coffee, Finland dominates the scene with 10.56 cups per day in 1998 followed by Norway (9.55), Denmark (9.36), the Netherlands (8.76), Belgium-Luxemburg (8.46), Sweden (8.24), Austria (8.14) and Germany (6.59). The U.K. has a rather small per capita consumption (2.49 in 1998) which is almost half of the European Community average.

2.3 Concentration in the Supply Chain

While the wide geographic spread of coffee production tends to result in intense competition among producers, large multinational corporations have built up considerable market power on the demand side. They have also come to dominate sales of roast and soluble coffee, marketed under apparently competing trade names in virtually all developed countries.

Indeed, recent years have witnessed a growing concentration amongst trade houses, roasters and the distribution networks for coffee as consumers have become more price conscious and the markets have become more competitive and volatile. This increasing industry concentration is illustrated by the fact that while in 1989 the largest four traders (excluding companies buying directly for the roasters) accounted for 31% of the world coffee trade, in 1994 the same companies accounted for more than 40% of the global trade with the upward trend continuing in recent years.² As well as the importers, around 25 large commodity funds and several significant individual speculators are heavily involved in the coffee futures markets (ITC 1997).

The degree of industry concentration varies between markets. Where soluble coffee is the preferred beverage markets tend to be more concentrated than those where roast and ground coffee are more dominant. The US coffee market is more concentrated than that of Europe and Japan, with just three roasters accounting for almost 75% of consumption. Industry concentration has important implications for coffee growers:

- ◆ Growing concentration may result in a reduction in competition and lower prices being paid to coffee producers;
- ◆ Smaller producing countries could be marginalised as traders seek to deal with origins that can guarantee coffee throughout the year; and finally
- ◆ A number of traders have established subsidiaries at origin to compete with local exporters. While this may raise producer prices, it makes difficult for local exporters to compete.

2.4 International Prices

Producer prices are determined by, and fluctuate daily with, changes to the New York futures price (for arabica coffee) and the London futures price (for robusta coffee). The producer price is determined by near dated futures prices plus or minus an origin price differential minus international and domestic marketing costs and taxation. As a result, factors affecting domestic marketing costs (such as the level of competition and export taxes) as well as international aspects of the coffee market have an important impact on prices paid to coffee growers.

The world market for unprocessed coffee has been traditionally subject to substantial short term price fluctuations for a number of reasons.

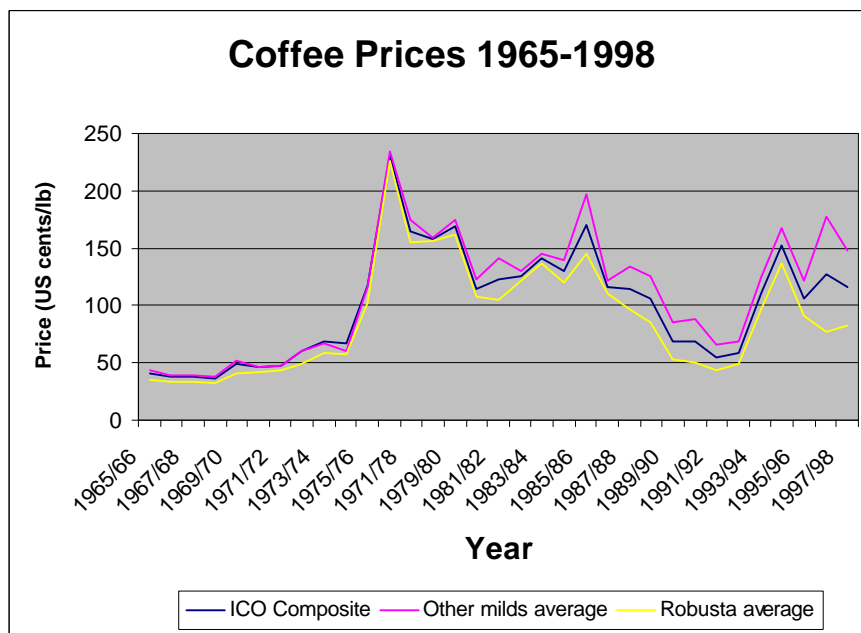
- ◆ As with other tropical beverage crops, demand and supply are characterised by low price elasticities so that variations in price are substantially greater than in physical supply.
- ◆ The susceptibility of coffee to damage by frost is another factor affecting the world coffee market. Occasional seasonal frosts in some of the main coffee growing areas of Brazil may result in fears that the coming harvest is likely to be short, a sentiment which induces sharp rises in coffee prices in the main trading centres in advance of

² The four largest coffee roasters account for almost 50% of sales in coffee importing countries.

the harvest for that year. Serious frost damage, as in 1975 and more recently in June 1994, can result in significant shortfalls in world coffee production, which may take several years to rectify.

- ◆ Finally, there is a biennial cycle in yield from coffee trees and bushes, which may or may not coincide with the fluctuation in supply resulting from the gestation period of new plantings, therefore adding to uncertainties in the market and large price fluctuations.

During the 1970s and the first half of the 1980s, the amplitude of short term price instability was almost double that for primary commodities, excluding fuels, taken as a whole, and far exceeded that for the great majority of other traded commodities. The annual average deterioration in real coffee prices exceeded 20 per cent a year from 1986 to 1991, the level in 1991 being only one third of the corresponding 1980 level.



The higher prices since the 1993/94 crop year until 1999, compared to the depressed levels of the 1989/90-1992/93 period reflect a combination of events associated mainly with the producing countries:

- ◆ Reduced production in many countries;
- ◆ The implementation of the coffee retention scheme (see below), and
- ◆ Bad weather conditions in Brazil in June 1994 (the Brazilian frost).

These events created a deficit in the supply side of the market which in turn exerted a positive influence on the international price, although prices started falling again in early 1999. An important related issue, suggested by some authors (e.g. Vogelvang, 1988), is that the demand for coffee shows a degree of irreversibility against price changes.

A high price leads to a loss of demand which is not recaptured once prices fall back to their original level.

2.5 The Role of the International Coffee Agreements

The large fluctuations in coffee prices provided the rationale in the postwar period for the adoption of an international stabilising mechanism. The outcome was a series of International Commodity Agreements (ICAs) for the world coffee market in the postwar period (1962, 1968, 1976, 1983).³ The 1983 Agreement collapsed in July 1989, during a period of oversupply when coffee prices were falling in spite of two successive cuts in the global export quota. The collapse of the 1989 Agreement reflected a fundamental difference of view between producing and consuming member countries concerning the essential functions of an international commodity agreement. More precisely, the main coffee consuming countries argued strongly for a reduction in the agreed price range to be defended in the light of the changes in the market situation, whereas producing countries wished to restrict supply further in order to safeguard the minimum price of the agreed range.

The current coffee agreement was negotiated in 1993 and came into force in October 1994. The International Coffee Agreement of October 1994, a purely administrative one, has the following objectives (ICA, *Article 1*, ICO).

- ◆ 'To ensure enhanced international co-operation in connection with world coffee matters'.
- ◆ 'To provide a forum for inter-governmental consultations, and negotiations when appropriate, on coffee matters and on ways to achieve a reasonable balance between world supply and demand; this will function on a basis which will assure adequate supplies of coffee at fair prices to consumers and markets for coffee at remunerative prices to producers, and which will be conducive to a long-term equilibrium between production and consumption'.
- ◆ 'To facilitate the expansion of international trade in coffee through the collection, analysis and dissemination of statistics and the publication of indicator and other market prices and thereby to enhance transparency in the world coffee economy'.
- ◆ 'To act as a centre for the collection, exchange and publication of economic and technical information on coffee'.
- ◆ 'To promote studies and surveys in the field of coffee'.
- ◆ 'To encourage and increase the consumption of coffee'.

The failure of the 1983 ICA to stabilise the coffee market and the sharp deterioration of export earnings for producing countries since 1986 resulted in the adoption of supply

³ A comprehensive discussion of the ICAs and their role in the world coffee market can be found in Gilbert (1987), Maizels (1992), and Maizels, Bacon and Mavrotas (1997). Akiyama and Varangis (1989) and Lord (1991) also discuss the issue though with a focus on particular agreements.

management policies on behalf of coffee producers in the beginning of the 1990s. A coffee retention scheme was implemented in October 1993 by the Association of Coffee Producing Countries (ACPC) with 29 member countries (with Tanzania one of the member countries), in an effort to raise the depressed levels of coffee prices and export earnings in recent years. The Association requires its member countries to withhold up to 20 per cent of their exportable production. The new scheme is based on target price ranges of the 20-day moving average of the ICO composite prices for “Other Milds and Robustas” and “Robustas”.⁴

It is notable that ACPC’s functions have been limited by a series of factors:

- ◆ The shipping targets are voluntary and no penalties are imposed on countries who over ship;
- ◆ A number of key producers such as Guatemala, Vietnam, Mexico and India have remained outside the agreement. This implies that while member countries have held coffee, these countries have continued to ship coffee in increasingly large volumes in recent years; and
- ◆ In countries that have adopted liberalisation programmes in the coffee sector, there are no formal mechanisms open to them to restrict shipments.

As a result it is clear that the scheme cannot by itself solve the problem of chronic coffee oversupply in the world market. Indeed, by supporting prices at levels higher than would otherwise be achieved, supply management could encourage, rather than discourage, a further expansion in production. Progress towards the achievement of a better long-term balance between world supply and demand depends heavily on substantial diversification away from coffee-growing in the main producing countries, a process which will, of course, require considerable financial support from both internal and external sources⁵.

⁴ Concerning Arabica coffee, when the indicator price is below 75 cents per pound, a 20 per cent retention of exports is required, 10 per cent when the price is between 75 to 80 cents and no retention when the price is between 80 to 85 cents. If prices rise above 85 cents per pound, there would be a controlled release of stocks. Turning to Robusta coffee, the scheme requires a 20 per cent retention in case the price is below 60 cents per pound, 10 per cent retention when the price is between 60 to 65 cents and no retention when the price is between 65 to 70 cents. Finally, if prices exceed 70 cents, there would be a controlled release of stocks.

A monitoring system for the satisfactory operation of the scheme has also been adopted. Documents on controls relating to the retention scheme include:

- weekly information concerning the volume of sales, giving quantities and shipment dates;
- a list of approved warehouses;
- reports on the volume of coffee retained during the month and a copy of the deposit certificates, within 15 days of the end of each month;
- copies of inspection reports within 15 days of the inspection date;
- reports on the volume of exports to all destinations due each month, within 15 days of the end of the month.

⁵ Some commentators argue for an agreed financial linkage between the proposed retention scheme and the diversification programmes of coffee producers, for example, the transfer of the increase in coffee export earnings that will result from the scheme to a common diversification fund.

2.6 The Effect of Policy Reforms in Producer Countries

The liberalisation policies adopted in some coffee producers (most of them in Africa) have had an impact on producer prices. It can be argued that the increased competition through liberalisation has led to a reduction in taxation and marketing costs and to a higher proportion of the export price being received by growers. In addition, producers now receive prompt payment for their crop in cash, whereas in many producing countries before liberalisation, farmers had to wait many weeks, if not years in certain cases, to receive full payment. Following liberalisation, producer prices are much more flexible in their response to international price movements. This suggests that producers can benefit in times of rising prices but will face a reduction in their income as international prices fall⁶.

2.7 Mechanisms to Manage Price Risk

In general, exporters and local traders in the coffee market face three types of risk:

- ◆ *Price risk* - that the price of coffee may fall between the time of buying it and selling it;
- ◆ *Performance risk* - that a supplier will renege on a contract, will deliver late, or deliver sub-standard quality; and
- ◆ *Differential risk* - that the price difference between the futures market and the specific coffee being sold by the exporter changes between the time of buying the coffee and selling it.

Farmers face four main risks:

- ◆ *Price risk* - that the price which they realise for their coffee differs significantly from the price signals prevailing when the farmer takes decisions to invest time and money in coffee production;
- ◆ *Disease risk* - that crops may fail because of blight, fungi, insect attack, tree die back etc.;
- ◆ *Quality risk* - that the value of the crop may fall due to reduced quality; and
- ◆ *Weather risk* - that crops may fail because of frost, drought.

Regarding the management of price risk, exporters who are either subsidiaries of international coffee traders or clearly linked to them use the New York or London futures markets to hedge their risk. However, small local exporters tend not to hedge

⁶ However, the distinction between countries which are small and large producers is important. In the case of countries which are small coffee producers, falling international prices can be particularly hazardous as traders may decide not to export and concentrate on the marketing of other crops. A good example of the above situation is the Ghanaian coffee sector in 1996 when exporters, in the light of falling coffee prices, resorted to purchasing cocoa for sale on the domestic market and did not consider trading coffee.

their price risk in the above futures markets. In some cases they use back-to-back trading methods whereby coffee is sold as it is purchased from growers, or they simply speculate on international price movements. In other cases, the regulatory system prevents exporters and other marketing participants from covering their risk.

2.8 The World Coffee Market: Future Prospects

World coffee production is estimated to grow by 2.7% annually from 1993-95 (base period level) to 2005. On the consumption front, world coffee consumption is projected to increase by 1.75% annually to reach 74 million tonnes (112 million bags) by the year 2005. This growth rate is much lower than the 2.3% per annum growth rate achieved during the previous decade. This decline can be partly explained in terms of the saturation of consumption in some traditional markets in North America and Western Europe.⁷ In the case of the UK consumption is projected to increase by 1.86% annually to reach 180,000 tonnes by the year 2005.

On the basis of the ICO-FAO model, by the year 2005, world coffee exports are projected to reach 5.7 million tonnes (95 million bags) while imports are estimated to be 5.15 million tonnes, equivalent to 86 million bags). The dominant region in exports will continue to be Latin America and the Caribbean accounting for 66% of global exports in 2005. On the import side, import demand by North America is projected to grow only moderately whereas imports into Europe are projected to rise by 1.3% annually to reach 45.6 million bags (2.74 million tonnes) by the year 2005.

The above projections seem to suggest that at constant prices there would be a significant oversupply of coffee at the world market by the year 2005. Obviously, this will constitute a clear departure from the picture that has emerged in the last 4-5 years.

Needless to say, the above projections are subject to weather conditions and the biennial nature of the coffee crops. Furthermore, it is widely known that these estimates should be considered with caution given that they are model driven, i.e. the model structure (and, thus, model solution and estimates) dominates the projections made. Nevertheless, the above projected trend may well indicate that oversupply of coffee will depress prices and lower prices could increase consumption.

3 The UK Coffee Sector and Fair Trade

3.1 The UK Coffee Market

The coffee market in the UK is extremely concentrated. Just two companies, Nestle and KraftJacobsSuchard (KJS), which is owned by Philip Morris, account for the manufacture of over 70% of the coffee sold in the UK. Nestle is the dominant player

⁷ Regarding developing countries, the projected growth rate of coffee consumption is 2.5% during the projection period (1995-2005); this is equivalent to a 30% increase of their world share in coffee consumption in 2005.

with over half the market, followed by KraftJacobSuchard and own label brands with around a fifth of the coffee sold in the UK.⁸

Table 3.1 Manufacturers Shares (by value) in the UK Coffee Sector

Manufacturer	1995	1996	1997
Nestle	51.6	51.2	51.3
KJS	19.8	20.7	20.8
Own label	19.0	19.2	19.4
Douwe Egberts	2.7	2.7	2.8
Paulig	2.0	1.5	1.6
Van den Bergh	2.2	1.7	1.7
Other	2.7	3.0	2.4

1997 figures are provisional

Source: Coffee International 1998.

Nearly 90% of coffee sales in the UK are through supermarket chains. The two dominant roasters Nestle and KJS control over three-quarters of these sales, however retailers own label coffee brands have been one of the most dynamic sectors of the market in recent years and currently hold nearly one fifth of the market⁹. The table below shows two FT brands, Cafedirect developed by a consortium of four FT organisations and Percol, a commercial company with a FT sub-brand.

Table 3.2 Market Shares by Brand in UK Instant Coffee Market, 1997

Brand	Owner	% Share (Value)	£ million
Nescafe	Nestle	58.4	369.6
Own Label	Various Retailers	16.7	105.9
Kenco	KJS, owned by Philip Morris	9.3	58.6
Maxwell House	KJS, owned by Philip Morris	6.3	39.8
Carte Noire	KJS, owned by Philip Morris	2.4	15.5
Mellow Birds		1.7	10.8
Red Mountain		1.4	8.6
Café Hag	KJS, owned by Philip Morris	1.0	6.5
Cafedirect	Oxfam/Traidcraft/Twin/Equal Exchange	0.5	3.1
Percol	Food Brands Group	0.2	1.0

Source: Nestle 1998

The picture is somewhat different in the roast and ground market where own label brands dominate. It is in this section of the market that FT brands have made the most headway.

⁸ Coffee International 1998.

⁹ Coffee International 1998

Table 3.3 Market Shares by Brand in the UK Market for Roast and Ground Coffee

Brand	Owner	% Share (Value)
Own label	Various Retailers	49
Douwe Egberts	Sara Lee	10
Lyons	Paulig	9
Kenco	KJS, owned by Philip Morris	9
Lavazza	Lavazza	5
Camp		4
Cafedirect	Oxfam/Traidcraft/Twin/Equal Exchange	2
Others		8

There were significant price rises in the UK retail prices of coffee between 1993 and 1997.

Table 3.4 Consumer price for soluble coffee

Year	Price per 100g (current terms)
1993	£1.24
1994	£1.82
1995	£1.93
1996	£1.87
1997	£2.09
1998	£1.97

Source: European Coffee Federation 1998

Table 3.5 Consumer prices for roasted coffee

Year	Price per 100g (current terms)
1990	£1.28
1991	£1.29
1992	£1.24
1993	£1.22
1994	£1.80
1995	£1.92
1996	£1.82
1997 (June)	£2.01

Source: Coffee International 1998

Conditions for the use of the FT labels on coffee products.

Organisations that use FT labels on coffee products must fulfil the following requirements:

- ◆ All green coffee processed to be sold with a Fair Trade Label must be purchased directly from organisations of small coffee producers inscribed in the FLO-International coffee Producers' Register.
- ◆ The purchasing price must have been fixed in accordance with the conditions established for this effect by FLO-International. FT prices are calculated as being the established market price¹ plus a premium of 5 U.S. cents per pound of coffee. An additional 15 U.S. cents per pound is payable on certified organic or biological coffee that is to be sold under the FT label. Furthermore, whatever happens to international coffee prices producers supplying coffee that is to carry the FT label must be paid at least the specified minimum price. Minimum prices vary by the type of country and the port of origin and are summarised in table 2.1.
- ◆ 'The roaster/buyer is obliged to facilitate the coffee producers access to credit facilities at the beginning of the harvest season, up to 60% of the value of the contracted coffee at Fair Trade conditions, at regular international interest rates. The credit will be cancelled upon shipment of the coffee'.
- ◆ 'Producers and roasters/buyers depend on reliability and continuity. For that reason, relations between both should be based on long term contracts (1 to 10 years).
- ◆ 'Coffee roasters have to accept and facilitate external control on the compliance with these conditions'.

Criteria stipulated by the FLO-International Coffee Producers' Register

Coffee producer organisations must fulfil a number of criteria if they wish to apply for inclusion on the FLO International Coffee Producers' Register.

- ◆ The majority of the organisation's members are small-scale producers of coffee. The Coffee Producer's Register defines small-scale producers as being 'not structurally dependent on hired labour, managing their own fields mainly with their own and their families' labour-force, except in labour intensive peak seasons'.
- ◆ The organisation is democratic, is run in an accountable and transparent manner, and is controlled by its members.
- ◆ The organisation does not engage in political, racial, religious or sexual discrimination, and is open to new members.
- ◆ The organisation subscribes to the same general principles and objectives as FLO International. More specifically, it is motivated by a desire for solidarity, improvements in the quality of production, and economic, organisational, social, and sustainable development.

Responsibilities of the National FT Initiatives and FLO International

The national FT initiatives and FLO International make a number of commitments:

- ◆ That they will promote the FT label, and the values behind the label, with consumers;
- ◆ That they will maintain the producers' register, and in particular maintain contact with, and extend assistance to, registered producer groups; and
- ◆ That they will verify that organisations using the FT label comply with the requirements of the labelling organisations.

Note: The New York 'C' market is the basis of the price established for Arabicas, whilst the London 'LCE' market is the basis of the price established for Robustas. In both cases the established price is the market price 'plus or minus the prevailing differential for the relevant quality, basis F.O.B. origin, net shipped weight'.

3.2 Fair Trade Coffee in the UK

Coffee has been sold by FT organisations in the UK for decades. In the 1970s and 1980s it was primarily marketed on solidarity grounds and sold through Oxfam shops and mail order channels. However, in parallel with developments in other European countries, the 1990s saw the focus shift to broadening the awareness and sales through the development of a clearly branded FT product sold through mainstream as well as alternative outlets. One major retail chain stocks 10 types of FT coffee across its mainland UK stores.

Coffee is one of the commodities for which there is an international fair trade register, operated under the auspices of the Fair Trade Labelling Organisation (FLO) International. Organisations who purchase all the coffee for a particular product through the fairtrade register and meet the conditions set out below can label those products with the Fairtrade label.

Table 3.6. Guaranteed minimum prices (U.S. cents per pound F.O.B.) for FT coffee as specified by FLO-International.

Type of Coffee	Regular		Certified Organic	
	Central America, Mexico, Africa	South America, Caribbean	Central America, Mexico, Africa	South America, Caribbean
Washed arabica	126	124	141	139
Unwashed arabica	120	120	135	135
Washed robusta	110	110	125	125
Unwashed robusta	106	106	121	121

Source: FLO-International.

By far the most significant FT brand is Cafédirect, which has developed a small but enduring niche in both the instant and roast and ground market. Set up by a consortium of four FT organisations, it is now probably the most consumer oriented of all the FT organisations in the UK. Its managing director has a marketing background and has been successful in developing Cafedirect as a distinctive brand in its own right, as well as a figurehead for the FT movement. Initially it sold a blended brand but is now developing a range of products, including single origin Kilimanjaro coffee which it purchases from KNCU in Tanzania and organic Machu Picchu, from Peru.

Having successfully developed mainstream distribution channels, Cafedirect now faces challenges common to many small businesses; maintaining shelf space and decent margins in the face of increasingly cut-throat competition in the retail sector and pressure from the dominant brands in their sector.

Historically, there has been a high degree of hostility between FT organisations and mainstream coffee players. The large companies resent the implication that in comparison to FT products theirs are 'unfair'. Indeed Nestle has produced a

publication entitled Nestle: A Partnership for Fair Trade, setting out its perspectives on good trading practice. However, compared to other sectors there seems to have been little serious effort by mainstream companies to assess the ethical issues involved in their supply chain or to develop guidelines or codes of conduct on social and environmental issues. According to the Coffee Trade Federation some of its members are beginning to evaluate whether the Tea Sourcing Partnership holds lessons for coffee sector¹⁰.

Disagreements between FT and non-FT organisations centre round a number of issues:

The benefits of direct sourcing: FT aims to cut out intermediaries, so that farmers receive a higher proportion of the market price and the supply chain becomes more transparent. While companies such as Nestle do buy directly from farmers in some instances, generally in countries where they undertake local processing, direct sourcing makes up a very small proportion of their overall purchases. Most large companies feel purchasing a greater proportion of coffee directly is impractical and that intermediaries have a very useful role to play in the coffee chain.

The impacts of speculation. Coffee is one of the cash crops produced in developing countries for which prices are most volatile and where speculators have been most active, particularly since the collapse of the International Coffee Agreement in 1989. The British Association of Fair Trade Shops argues that the activities of speculators intensify the degree of price instability, and that coffee farmers 'hardly see any of the benefits of speculation'. However, speculation can fulfil an important economic function, providing liquidity to markets which, in principle if not always in practice, allow those involved in the production, trading and processing of coffee to manage their price risk.

Barriers to an expansion of coffee processing in producer countries: BAFTS quotes the example of the European Union which implements an escalating tariff regime for coffee. While escalating tariff regimes do hinder the establishment and expansion of coffee processing activities in producer countries, processors cite many other reasons for processing coffee in the developed world: the benefits of being closer to markets, the blending of coffee which is hindered by import restrictions in many producer countries and the better investment climate.

4. Coffee Production and Marketing in Tanzania

4.1 Production and Exports

Tanzania became a substantial producer of coffee between the First and Second World Wars. The country produces both high-grade mild arabica coffee and robusta coffee. The geographical focus of the mild arabica coffee industry has traditionally been Arusha and Kilimanjaro regions¹¹.

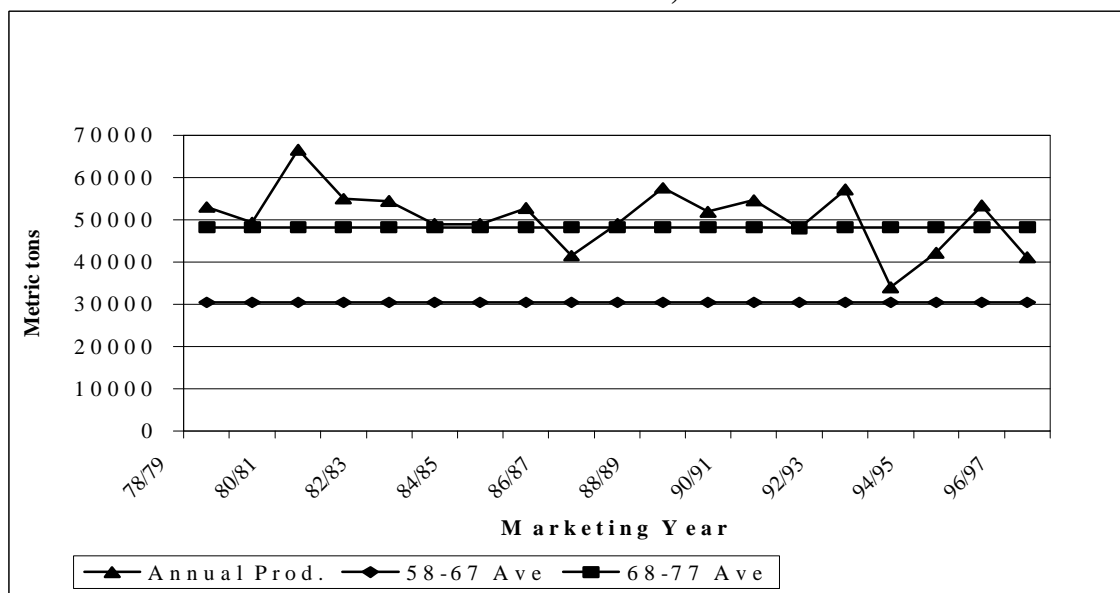
¹⁰ Interview, December 1999

¹¹ It is notable that the coffee year in Tanzania runs from July to June and not from October to September as in most of the coffee producing countries.

The once estate-oriented industry is now dominated by smallholders who are organised into large co-operatives and now account for about 86% of the area harvested. New coffee areas for smallholders have been opened up in the south of the country since the construction of the Tazara Railway (which connects Zambia with the port of Dar es Salaam). Industry sources estimate that the Tanzania coffee sector employs approximately 10% of the total population¹².

In global terms, Tanzania is a small player, accounting for about 1% of the global production in 1979 and about 0.7% in 1999 (see Table on the Tanzanian coffee sector, Appendix I). The trend in production levels since 1971 has been irregular and erratic, not only from year to year, but from region to region as well. Coffee production in Tanzania remained stagnant after the significant decline in the 1980s when international prices plummeted following the breakdown of ICA. In recent years production has declined from 862,000 bags in the 1989/90 crop year to 773,000 bags in 1999/00. This decline has occurred despite the steady increase in the area under production since the late 1970s, due to poor farm husbandry (low use of inputs, limited replacement of old trees) leading to decreasing yields.

Table 3.7 Tanzania Coffee Production Levels, 1978/79 to 1996/97



Since liberalisation the downward trend in production has been reversed, in spite of difficulties with input credit. It is expected that production will increase from the 1998/99 level of 43,000 tons to an average of 60,000 tons in 1999/2000 and 2000/2001 seasons.

About 80% of Tanzania's total foreign exchange earnings are related to exports of agricultural commodities of which cotton, coffee, sisal, cloves, tea, tobacco, livestock products, oil seeds, nuts and kernels are the main foreign exchange earners. Coffee has been Tanzania's most important export crop since the mid-1970s, when it took

¹² UNCTAD 1993 and Tallontire, 1999

over from cotton and sisal. Tanzania's coffee exports reached a peak in the boom years of the 1970s, accounting for 41% of total Tanzanian exports (equivalent to US\$ 223 million). In the 1980s, coffee comprised between 40% and 65% of mainland Tanzanian export revenue. However, cotton overtook coffee as the most important export crop in 1991, largely because of low international prices for coffee.

Export marketing is implemented through regular auctions in Moshi organised by the Tanzania Coffee Board (TCB) and attended by private exporters, many of whom are linked to multinational coffee companies.

4.3 Co-operatives and the Tanzanian Coffee Market

Tanzania's coffee market has been organised along co-operative lines for much of the 20th century. Co-operatives were first established in Tanzania in the 1920s, with a view to providing farmers with an alternative to private traders. Since Independence, government policy has had a profound effect on the structure and performance of co-operatives. The promotion of the Ujamaa villages in the 1970s led to the replacement of co-operative unions by crop authorities, and primary societies by village governments. Government involvement in co-operatives in the late 1970s and early 1980s resulted in a highly politicised co-operative structure. The failure of these approaches led to the re-introduction of member-based co-operatives through the 1991 Co-operative Act. This development coincided with the adoption of coffee market liberalisation policies and the entry of private traders into the coffee market.

Since liberalisation, private traders have purchased a growing proportion of Tanzania's coffee crop. Their market share has increased from less than 10% in 1993/94 (the first year of liberalisation, when the co-operative unions were at the peak of their financial problems), to more than 70% in 1998/99. There are now around 20 private traders operating most of whom are vertically integrated from parchment buying at farm gate level, through to the point of export. Many are subsidiaries or agents of multinational companies, and such relationships are felt to represent a barrier to other potential exporters.

Table 3.8 Tanzania: Shares of Auction Deliveries by Organisational Type from 1994/95 to 1997/98 (%)

Year	Co-operatives Unions	Private traders	Others	Total
94/95	58	13	29	100
95/96	44	40	16	100
96/97	22	68	10	100
97/98	27	67	6	100

Source: Analysis of Auction Deliveries, Anna Temu.

The co-operatives suffer from the following disadvantages.

- ◆ *The high cost of domestic capital relative to foreign capital.* Generally, the cost of domestic credit in Tanzania is higher than the cost of capital to which traders and

exporters have access through their offshore pre-financing arrangements, whilst accumulated debts make co-operatives relatively unattractive to commercial banks.

- ◆ *High operating costs.* Co-operative unions use costly old processing technology and have made significant losses in input distribution following the breakdown of the links between the markets for credit, inputs, and agricultural products.
- ◆ *Limited connections to the export market.* Historically, co-operatives focused on the marketing functions between the farm gate and the auction. As a result they have little experience of exporting coffee.
- ◆ *Social focus of the co-operative system.* There can be a tension between the co-operatives traditional social focus and the imperatives for economic efficiency that result from market liberalisation, and that it takes time for co-operatives to commercialise their operations.

The poor performance of the co-operative unions compared to private traders since liberalisation has manifested itself in delays in payments by co-operatives to farmers, failures to make second payments to farmers, and difficulties in disbursing input credit. These factors have also encouraged coffee exporters to start sourcing directly from farmers.

Prior to liberalisation two major arrangements were prevalent in the coffee market. The first was the three-part payment arrangement and the second the connection between the markets for input-credit and coffee. Before liberalisation, co-operative unions used to perform all domestic marketing functions on behalf of their members. In addition, co-operative unions used to distribute farm inputs to members on credit and collect repayment from producers' coffee proceeds. Producers received advance prices at delivery and then additional payments after their coffee was sold to exporters, less the input credit¹³. However, whilst the three-part payment system lowered the unions' cost of capital, it transferred all the market risk down to the farmer, with the performance of co-operative unions in marketing coffee and distributing inputs directly influencing the level of net producer prices.

The interlocking of input-credit and output markets was only possible when authorisation to buy coffee from farmers was limited to the co-operative unions and the liberalisation of the coffee market has signalled the end of this type of arrangement. Now that producers can choose where they market their coffee co-operatives cannot be sure that input credit will be repaid.

In order to avoid a situation whereby farmers received incomplete payments for their coffee from traders, regulations were instituted through the licensing system requiring traders to pay farmers a full and final price at delivery. Although the regulation related only to private traders, unions were *de facto* forced to raise their advance

¹³ The three-part payment arrangement was considered to be important to farmers in areas where banking services were not available. Co-operatives used to distribute second and third payments at times where farmers were in need of lump sum payment to meet expenses such as school fees.

payment to compete. As a result, producers selling to unions started receiving negligible second and third payments.

The failure of the input-credit market due to the breakdown of interlocking exchange has been a concern to producers, many of whom not considered credit worthy by commercial banks¹⁴. The lack of credit facilities for farmers is held to be one of the reasons behind the limited improvement in yields and the decline in the proportion of high quality arabica coffee in Tanzania.

4.4 Market Performance and Trends in Producer Prices

Notwithstanding the problems experienced in providing input credit, liberalisation has resulted in an improvement in the competitiveness of the domestic coffee market and exporters' effectiveness in supplying coffee to the international market. The involvement of exporters in domestic marketing has facilitated the inflow of physical, human, and financial capital¹⁵.

The links between the private coffee buyers and foreign companies mean that they are supported by improved communication and information systems, and have an improved capability to analyse market information and use market mechanisms for the management of price risk. There has been investment in the latest technology in curing (curing factory capacity has more than doubled since liberalisation) and improved management of the factories. The involvement of exporters in domestic trading has led to the improved availability of low interest credit facilities for the purchasing of coffee and other offshore services such as port and shipping insurance.

Since liberalisation farmers have been paid promptly by private traders and in a more timely manner by co-operative unions. The proportion of the auction price transferred to producers has increased from around 50% in 1990/91 to around 70% in 1998/99¹⁶. Generally, margins on domestic marketing (net of costs, taxes, and levies) are fairly low ranging from 0% to 8%, although policy makers and participants in the domestic market allege that margins are unfairly high in the international market due to high market concentration¹⁷.

Producer prices were significantly higher between 1995/96 to 1997/98 but dropped by more than 50% in 1999/2000 season.

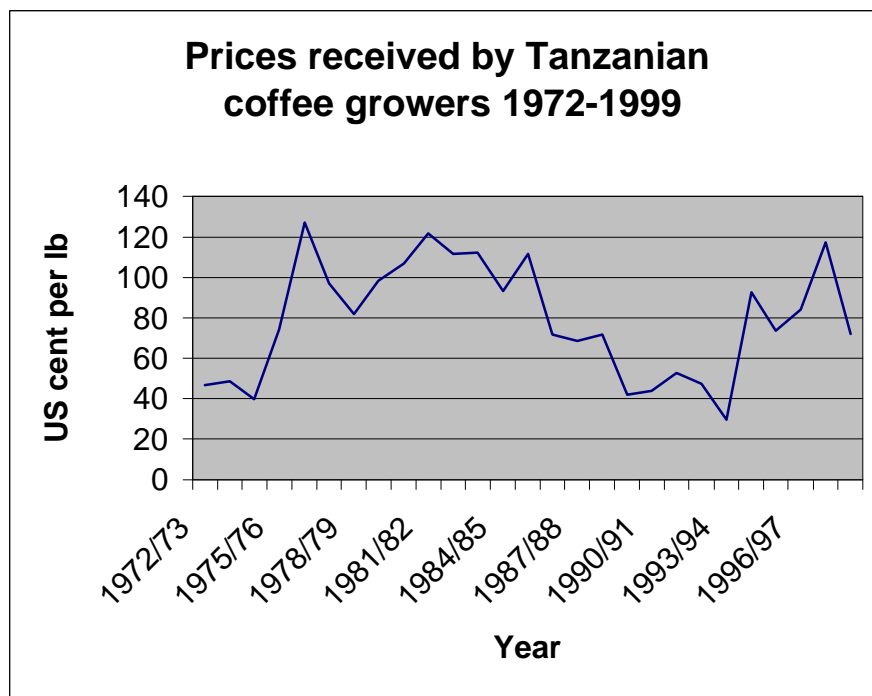
The way that the Tanzanian auction markets function has changed due to the vertical integration of exporters. Coffee purchased from the farm-gate by an exporter is, in most cases, based on a supply contract with an international buyer which sometimes

¹⁴ This prompted the introduction of a National Input Voucher Scheme in 1996. The scheme ensures pre-payment by producers for subsequent seasonal input requirements by forcing farmers to receive some proportion of their coffee proceeds in vouchers. This means farmers collect input vouchers proportional to the amount of coffee sold. Farmers are then required to use the voucher for buying inputs from registered input stockists. On average this system accounts for 20% of farmers' total input requirement. It has not fulfilled farmers' demand for input-credit.

¹⁵ The increased investment in coffee marketing coincided with high international coffee prices during the 1995 to 1997, and may not, therefore, be due to liberalisation alone.

¹⁶ Temu, 1999; Interviews-FTI (1999) - Discussion with TCB official and EU representative.

¹⁷ Interview -FTI (1999) discussion with EU and TCB officials, 1999.



includes pre-financing. In such cases, domestic traders are unwilling to sell such coffee at auction. Indeed, auction data shows that private traders have been repossessing (a seller and a buyer is the same company) more than 80% of their coffee, a condition that could lead to anomalies in the operation of the auction. As a result, there are claims that auction prices, and therefore producer prices, do not properly reflect market conditions. Co-operative unions sell more than 90% of the coffee purchased from the farm gate at the auction. Any malfunctioning of the auction system would, therefore, represent a threat to the welfare of farmers. However, the important question is whether auction prices of coffee that is not repossessed are linked to world market prices (New-York futures prices) or not. Temu (1999) shows that, from 1994/95 to 1997/98, Tanzania auction prices for coffee that was not repossessed did effectively track the New-York futures prices for arabica coffee.

5. Fair Trade in the Tanzanian Coffee Sector

FT organisations have been buying coffee from Tanzania since the 1970s when they bought from government parastatals.¹⁸ Since 1990 it has been possible to purchase direct from co-operatives and a range of European, North American and Japanese FT organisations have purchased coffee from four Tanzanian co-operatives. In two cases, initial sales to one FT organisation has opened trading channels to a range of other FT and commercial organisations.

The *Kagera Co-operative Union* (KCU) was the first co-operative in the country to export through FT channels when they sold 3 containers to Fair Trade Organisation in 1990. Since then KCU has been selling coffee to a whole range of European alternative trading organisations and companies carrying the Fairtrade label who buy their coffee through the FT register. Over the last 6 years, FT sales have accounted for

¹⁸ Tallontire 1999

between 6 and 11% of KCU's sales and in 1998/99 KCU's largest FT buyer was A. van Weely, a Dutch company a commercial company who buys some coffee through the FT register. FT exports have also opened the doors to trade with commercial companies. In 1998/99 KCU exported over one-fifth of their coffee to commercial companies.

Table 3.9 The Volume of KCU's Sales (tonnes) to Different Markets

Year	Auction Sales	Commercial Exports	Fair Trade Exports	Total
1993/4	5,028 (80.5%)	654 (10.5%)	564 (9.0%)	6,246
1994/5	9,318 (85.5%)	1,040 (9.5%)	536 (5.0%)	10,894
1995/6	6,782 (83.2%)	848 (10.4%)	524 (6.4%)	8,154
1996/7	7,689 (84.2%)	769 (8.4%)	675 (7.4%)	9,133
1997/8	7,642 (81.2%)	990 (10.5%)	774 (8.2%)	9,406
1998/9	7,304 (77.4%)	1,530 (16.2%)	600 (6.4%)	9,434

Source: KCU records.

Table 3.10 The Value (\$ million) of KCU Sales to Different Markets

Year	Auction Sales	Commercial Exports	Fair Trade Exports	Total
1993/4	6,520 (73.4%)	1,271 (14.3%)	1,093 (12.3%)	8,884
1994/5	25,659 (83.4%)	3,391 (11.0%)	1,729 (5.6%)	30,779
1995/6	12,506 (76.0%)	2,433 (14.8%)	1,509 (9.2%)	16,448
1996/7	11,941 (73.8%)	2,276 (14.1%)	1,957 (12.1%)	16,174
1997/8	11,936 (76.8%)	2,021 (13.0%)	1,580 (10.2%)	15,537
1998/9	9,710 (67.9%)	2,850 (19.9%)	1,741 (12.2%)	14,301

Source: KCU records.

KCU buys robusta coffee from about 40,000 farmers in the Bukoba and Muleba districts of Kagera, round Lake Victoria. Despite the expansion of private trading since liberalisation, KCU is still purchasing around 70% of the coffee from farmers in its area.

Initially KCU sold arabica coffee bought from other co-operatives to FT organisations as well as robusta from its members. By 1993, some FT organisations had begun to feel that this was not appropriate since the benefits of trading arabica coffee were not being channelled to the arabica producers or their co-operative. In 1993, the

Kilimanjaro Native Co-operative Union (KNCU) started exporting arabica coffee through FT channels and KCU now only exports robusta produced by its members.

KNCU has 96 primary societies scattered across the slopes of Kilimajaro. Since liberalisation the proportion of coffee sold by Kilimanjaro farmers to the KNCU has declined to about 50% of total production. The union estimates that for the last few years they have sold around 10-15% of the coffee that they purchase from the primary societies to a range of FT organisations in Europe, the USA and Japan.

Table 3.11 Breakdown of KNCU Costs

Year	1998/99 (estimate)	1998/99 (actual)	1999/2000 (estimate)
Quantity (kgs)	4,000,000	2,582,000	3,200,000
Marketing Costs TSh/kg			
Bank interest	50	126 (24%)	91.5
Input fund	50	105 (20%)	100
Processing (including VAT)	46	64 (12%)	64.8
Self reliance fund	50	50 (9%)	50
Local government levy	50	50 (9%)	50
Union levy	20	30.97 (6%)	20
PCS Levy	30	30 (6%)	30
Transportation cost	15	30 (6%)	20
TCB auction levy (1.5%)	15	18.75 (4%)	18.75
Finance handling cost	6.4	6.4	6.4
Insurance for product	8	5.22	6
Insurance for finance	8	5.22	6
Education levy district	3	3	3
Education levy union	3	3	3
Member training	3	3	3
Industry Reseach levy (0.25%)	2	2	2
Total Marketing cost	359.4	532.56	474.45
Adv. Producer Payment	1000	1150	1000
Total cost	1359.4	1682.56	1474.45
Price at Auction	1600	1695.53	1500
Net returns per kg	240.6	12.97	25.55

Notes: The PCS is the primary co-operative society, there are 96 in KNCU.

Net returns are distributed as a second payment to farmers if they are positive, if negative no payments are made and the loss is recovered in subsequent years.

Source: KNCU Records

KNCU's marketing costs were 31.4% of the auction price in the 1998/99 season leaving 68.6% for the farmers (see Table 3.11.). Of these marketing costs the most important was financing (24% in the 1998/99 season).

Kilimanjaro coffee has a reputation for high quality and often fetches significantly higher prices than the base arabica price. This can pose problems for FT organisations who find it difficult to meet these high prices and FT purchases have declined in recent years.

FT organisations have played a significant role in developing KNCU's export capacity. Twin helped set up KNCU's export office and train their export manager as well as assisting the co-operative to access grants to set up and equip a liquoring department. They have recently hosted KNCU's liquorer in London as part of his training and are trying to facilitate trade between KNCU and commercial coffee companies.

Table 3.12 KNCU Sales through Fair Trade Channels

Year	Volume (tonnes)
1996/7	3348
1997/8	1173
1998/9	2582

Source: KNCU

KNCU see the organic market as an attractive one, especially if they can combine it with FT. Fair Trade Organisatie (FTO) will be supporting initial training for interested farmers and they are seeking funding to support certification. FTO and Gepa are both interested in purchasing any certified organic product.

The *Karagwe District Co-operative Union* (KDCU) split from KCU in 1990 and operates solely in the Karagwe district near the Ugandan border. In 1997, several members of the KDCU's management team and board were charged with corruption and arrested and the organisation was suspended from the Fairtrade Labelling Organisation register. In 1998, a new management team and board were appointed and KDCU was readmitted to the FLO register. Due to its recent internal upheavals KDCU is now facing stiff competition from private traders and is only purchasing a small proportion of coffee produced in Karagwe. Its sole exports at present are to Twin and one commercial buyer.

The *Arusha Co-operative Union* (ACU) got involved in FT through KCU who introduced them to Max Havelaar. Max Havelaar provided them with potential trade contacts and in 1996 they exported 1 container (18 tonnes) to Theobrama who sell FT labelled coffee. For the last two years ACU has faced considerable difficulties as they were unable to get credit from the banks and in 1998 they were only able to purchase 141 tonnes of coffee from their members. The banks now consider them to be creditworthy again and they are hoping to purchase around 700 tonnes (40% of their members production) this year and resume some international trade. ACU has sent samples to four FT organisations and is keeping Max Havelaar informed of their progress.

The *African Coffee Company* is a private coffee trader whose main business is selling coffee to European commercial companies but who also exports roasted coffee carrying the Transfair mark directly to Europe and are experimenting with what was termed 'unofficial fair trade'. In this case ACC is buying a small amount (around 50 tonnes) directly from primary societies. ACC pays at least the FT minimum price but feels that it is not worth going through the bureaucracy involved in getting the label for such a small amount of coffee.

6. Impact of Fair Trade Initiatives in the Tanzanian Coffee Sector

In the Tanzanian coffee sector, all FT organisations work through the Co-operative Unions who buy coffee from primary societies in their area. Most co-operatives therefore buy indirectly from tens of thousands of farmers. Since FT organisations deal with the co-operative unions, most farmers will be at best dimly aware of FT and any impact that they feel from FT is mediated by the unions. The extent to which farmers benefit from FT is therefore dependent on the way that the union functions, and the use to which they put the premium prices and increased business and trading knowledge and skills that the relationship with FT organisations can bring.

The interviews that the study team carried out in Tanzania in November gave clear insights into the impacts of FT on the coffee unions in Tanzania which is discussed in more detail later on in this section. Assessing the impact on individual producers would be a much more complex task and given that the relationship with FT organisations has been at the level of the unions would be unlikely to yield much meaningful information.

Even for those co-operatives who have had a relatively longstanding relationship with FT organisations, the volumes traded through FT channels are small, around 10% of their total coffee purchases. However, union staff who have had direct relationships with FT organisations were all clear that the benefits go far beyond the relatively small price benefits and include trade facilitation, prefinancing and capacity building.

Price

The fact that FT guarantees a minimum price to farmers and pays a premium if the market price is higher than the FT minimum is probably the best known aspect of FT. However, although these are welcome they probably have less impact than another price benefit, that FT helps raise the overall price that all traders pay farmers for their coffee. FT has given co-operatives access to direct export channels and when the co-operatives are buying back their members coffee at the auction to fill these orders private traders are forced to offer a better price if they want that coffee. Some co-operative union members estimate that they can see price rises of around 3% on the days that the unions are bidding for their members coffee.

The guarantee of a minimum price is very important when the market price is low. Currently, the FT minimum price is \$138.89 for 50kg of arabica coffee and \$116.84 for 50kg of robusta coffee. If the market price is above this, which it is at the moment, FT purchasers pay an extra \$5.51 per 50kg. While the extra money is very welcome

the co-operatives are aware of the constraints on FT organisations and know that if the market price is very high the FT organisations will struggle to buy at all.

As the volumes sold through FT channels are fairly low, most co-operative unions feel that to simply divide it between its members would not be the best use of the premium, although KCU usually puts around half the premium into its second payment fund. Most unions put the premium towards union services or development programmes, such as schools, processing facilities and farmer to farmer training programmes.

KNCU's use of the FT premium: In KNCU the use of the premium is determined by the Fair Trade Development Committee which consists of 12 people elected by the chairs of the district primary societies. The committee asks the primary societies to make suggestions for how the money should be spent. Initially most primary societies wanted the money to go directly back to farmers but the amount per farmer would have been so small that committee decide that this would not be a good use of the funds. In its three years of operations the premium has been used to fund or part fund a variety of activities including the production of a book on quality husbandry, a study tour of Kenyan coffee farms by 50 of the co-operative's members and farmer to farmer extension.

Prefinancing

All the co-operative unions saw prefinancing as a very important part of FT. The cost of credit is very high in Tanzania and being able to access cheaper finance at the beginning of the season is important. Since state support for co-operatives has been removed and some are now struggling to get bank financing, the prefinancing offered by FT organisations has become even more significant. However, such finance accounts for only a small proportion of the finance that co-operatives require to purchase their members coffee.

Capacity Building

FT organisations have built the capacity of the co-operative unions in a wide variety of ways. The most obvious is the increase in trading knowledge and skills that co-operative union staff have gained through interaction with FT organisation staff enabling them to understand and engage in international trade themselves. This has happened through a range of activities including information provision, equipment donation (such as IT and liquoring equipment) and direct training to individual union members (such as the union liquorer). One of the most important aspects of the capacity building has been the focus on quality improvement.

Trade Facilitation

From our study, trade facilitation emerged as perhaps the most significant impact of FT. Initial exports to one FT organisation opens the door to all the other FT organisations, the FT register and can lead directly to trade with commercial organisations. KNCU and KCU now sell to a range of European FT organisations and KNCU started trading with a US FT organisation through contacts made at the Fair Trade Labelling Organisation's conference.

Selling through FT channels can also lead to sales to profit making companies. In some cases this is through the FT register where the companies commit to FT conditions but FT organisations such as Max Havelaar and Twin also actively try to facilitate commercial relationships. Two of the co-operatives we spoke to felt that their relationship with FT organisations had given them the skills, confidence and credibility to trade with commercial companies directly. For instance, KNCU was had been approached by non-FT roasters who had seen their name on FT products such as Cafedirect. In 1998, 20% of KCU's sales last year were to commercial companies.

Acting as a watchdog

This was the role most frequently mentioned in conjunction with FT organisations by government and private sector players in the coffee industry. Even those who thought that FT organisations had little other impact thought they played a useful role in this respect and that a more exploitative trading situation might exist if FT organisations were not active in the country.

7. Conclusions

The coffee sector has gone through major changes in the last ten years which is requiring significant adjustments from farmers, now that they are no longer obliged to sell through co-operatives. Co-operatives have suffered from government interference, financial instability and, in some cases, corruption but had a mandate to represent farmers and provided them with a range of services from education and training to agricultural inputs. The competition from the private traders and the removal of financial support from the government has placed considerable pressure on the co-operatives and it at this stage it is not clear whether they will collapse, restructure into more effective organisations or whether some other type of farmers organisations will emerge. The most desirable outcome from the farmers point of view would be that liberalisation leads to competition between leaner, more effective farmers organisations and private traders.

In Tanzania, FT organisations have played a significant role in developing the capacity of co-operative organisations to engage in international trade, through FT purchases, information provision, skills development and trade facilitation. Because FT purchases only make up a small proportion of the co-operatives total volume, the price premia, although welcome do not amount to a significant sum and generally go into a fund at the level of the co-operative union rather than being distributed directly to members. Most farmers are therefore only vaguely aware of FT and the extent to which they benefit is dependent on the effectiveness of the co-operative and the manner in which it uses the relationship with FT organisations and passes benefits onto its members. Although it is likely that the coffee sector will continue to change in the aftermath of liberalisation, it seems important that the provision of information and support aimed at improving the capacity of farmers to understand and engage in international trade currently provided by FT organisations is continued.

Appendix I: Data on Coffee in Tanzania

**DATA ON COFFEE IN TANZANIA
CROP YEARS 1964/65 TO 1998/99**

Crop Year	Gross opening stocks	Total Prod'n	Domestic Cons'n	Exportable production	Exports	Area planted (1,000 ha.)	Prices to growers US cents/lb
			(000 bags)				
1964/65	136	528	4	524	522	n.a.	n.a.
1965/66	138	762	7	755	588	n.a.	n.a.
1966/67	305	844	8	836	859	n.a.	n.a.
1967/68	282	628	8	620	801	n.a.	n.a.
1968/69	101	951	12	939	856	n.a.	n.a.
1969/70	184	599	14	585	702	n.a.	n.a.
1970/71	67	907	16	891	681	n.a.	n.a.
1971/72	277	907	18	889	671	n.a.	n.a.
1972/73	495	1,124	22	1,102	1,104	n.a.	46.64
1973/74	493	488	16	472	825	n.a.	48.52
1974/75	140	929	21	908	788	n.a.	39.69
1975/76	260	954	20	934	1,037	n.a.	74.48
1976/77	157	805	25	780	745	n.a.	127.14
1977/78	192	839	25	814	773	n.a.	97.07
1978/79	233	849	12	837	961	n.a.	81.94
1979/80	109	757	13	744	691	n.a.	98.31
1980/81	162	1,062	20	1,042	782	n.a.	107.02
1981/82	422	957	20	937	933	n.a.	121.83
1982/83	426	993	17	976	948	196	111.72
1983/84	454	838	15	823	908	196	112.44
1984/85	369	825	17	808	792	196	93.21
1985/86	385	832	16	816	776	196	111.57
1986/87	425	677	4	673	820	196	71.76
1987/88	278	772	8	764	616	198	68.52
1988/89	426	931	10	921	827	200	71.66
1989/90	520	862	7	855	925		41.96
1990/91	450	932	4	928	970	n.a.	43.69
1991/92	408	791	4	787	808	n.a.	52.66
1992/93	387	786	19	767	954	n.a.	47.43
1993/94	200	736	18	718	879	n.a.	29.81
1994/95	39	680	18	662	614	n.a.	92.43
1995/96	87	897	14	883	935	n.a.	73.77
1996/97	35	765	17	748	768	n.a.	84.07
1997/98	15	624	17	607	606	n.a.	117.43
1998/99	16	739	17	722	725	n.a.	72.16
1999/00	13	773	106	667		n.a.	

n.a. = not available

Source: International Coffee Organisation (ICO) and United States Department of Agriculture (USDA)

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1. Introduction

This paper considers the development of Fair Trade (FT) in Ghanaian cocoa within its broader national and international context. It was prepared by Brendan Bayley, Dr. George Mavrotas, and Dr Victor Nyanteng. The paper has two objectives.

- ◆ To provide a more detailed context for discussing the role, prospects and significance of FT initiatives.
- ◆ To illustrate the issues and problems associated with an assessment of the impact of FT initiatives, in the context of DFID poverty objectives.

This case study is structured as follows. Sections 2 and 3 consider the main features of the international and Ghanaian cocoa markets respectively and the degree to which the realities of these markets are consistent with the arguments advanced in favour of FT initiatives. Section 4 reviews FT in cocoa internationally. Section 5 considers the development of Kuapa Kokoo and FT in Ghanaian cocoa. Section 6 examines the relationship between the FT and mainstream supply chains and other issues including assessing the impact of FT initiatives. Section 7 outlines conclusions. Appendix 1 presents summary information on the world cocoa market and Appendix 2 summarises experience with another Fair Trade initiative in Ecuador

The experience with Kuapa Kokoo suggests that initiatives aimed at building capacity and promoting organisational development amongst southern market intermediaries, particularly in the context of moves away from state controlled marketing regimes to more liberal marketing arrangements, can be of real value in improving the marketing opportunities available to farmers. However, the case study highlights the need to distinguish clearly between the FT marketing chain (linking consumers to producers with FT labelled products) and producer organisations that qualify for the FT register, but only a very small proportion of whose sales may be on FT terms.

2. The World Market for Cocoa

2.1 The Cocoa Market: General Features

Cocoa beans can be processed into a variety of products. These include: *cocoa butter*, which is used in the manufacture of chocolate as well as in cosmetic products such as moisturising creams and soaps; *cocoa powder*, an ingredient in many foodstuffs; and *cocoa liquor*, which is used with other ingredients to produce chocolate (Adomako, 1995). Only a small proportion of final consumption (no more than 12%) takes place in producing countries. The balance is traded in the form of beans or cocoa products.

The world cocoa market is characterised by a significant degree of volatility which is a function of a number of market features:

- ◆ The cocoa market has always been vulnerable to sudden and unpredictable changes in output resulting from climatic variations in different producing countries, changes in the business cycle, and the changing use of cocoa substitutes in a relatively small number of consuming countries. The concentration of production and consumption

in a few countries implies a substantial degree of uncertainty and instability for the cocoa market.

- ◆ The low price-elasticities of both demand and supply result in disproportionately large price movements for any given changes in output or exports. Time lags in the supply response to increases or decreases in market prices tend to result in price cycles and consequently uncertainty, particularly where demand is itself subject to short-term variability.
- ◆ Finally, the flow of speculative funds into and out of cocoa futures contracts traded on the terminal markets (mainly London and New York) contributes significantly to short term fluctuations in international cocoa prices. To the extent that speculators follow a “herd instinct” and buy (sell) when prices are rising (falling), they will amplify the price fluctuations arising from fluctuations on the supply and demand sides of the “real” market for physical cocoa.

2.2 Production

Apart from the international prices for cocoa, the production of cocoa is affected by a number of factors, among them government schemes (e.g. Indonesia in the 1990s), alternative crops (in the sense that land suitable for cocoa is also able to support other crops), yield (which depends on the age, type planting distribution of trees and level of inputs needed), tree stock characteristics (i.e. the production capability of the trees and their ability to resist disease), environmental influences as well as costs (which apart from the central labour input include fertilisers and pesticides).

Several factors contributed to the sharp expansion of cocoa production in recent years.

- ◆ The high prices for cocoa in the second half of the 1970s provided a substantial incentive to traditional cocoa producers to implement major expansion programmes which involved the introduction of high-yield varieties.
- ◆ The introduction of diversification programmes (e.g. Malaysia) including the development of new cocoa plantations had similar expansionary effects on the level of world cocoa production.
- ◆ The general increase in prices paid to cocoa farmers as part of a package of incentives to expand output and exports within the context of structural adjustment programmes implemented in a number of cocoa-producing countries in the 1980s has resulted in a supply response. Since the export expansion programmes have been applied in a number of important cocoa producers simultaneously (e.g. Cameroon, Ghana and Nigeria), their net effect has been to add to the total of unsold stocks and thus to the downward pressures on world cocoa prices. Since the structural adjustment programmes implemented in the early 1980s cocoa prices have fallen sharply from 260 to 120 cents per kilogram.

World cocoa production fluctuated dramatically in the last decade and finally grew about 10% between the crop years 1989/90 and 1997/98 to reach 2,747 thousand tonnes in the 1998/99 cocoa year (see Summary Table in *Appendix I*). Cocoa production is dominated by small holders in Africa, whereas in Indonesia and Malaysia larger estates

can be found.¹ Cote d'Ivoire, currently accounting for 42% of world cocoa production with 1,150 thousand tonnes in 1998/99, became a major producer during the past two decades, moving ahead of Ghana in 1978 as the world's leading cocoa producer. Cote d'Ivoire also dominates world cocoa exports. Ghana is the second-largest cocoa producer in the world, accounting for 13.5% of the global production (370,000 tonnes) in 1998/99. Other major cocoa producers are Indonesia, with 13% of world production in 1998/99, Nigeria, with 7% of the world market, and Brazil, with a 5% market share the same year.

2.3. Consumption

World grindings have followed an upward trend in recent years to reach 2,790 thousand tonnes in the 1998/99 crop year (see Table, *Appendix D*). The Netherlands is the world's largest cocoa grinder (accounting for 15% of world grindings in the 1998/99 cocoa year), followed by the United States with a 14% market share. Other dominant players in the market include Cote d'Ivoire with 8% in 1998/99 (the largest grinder of the cocoa producing countries), Germany (7.3%), Brazil (6.8%), United Kingdom (6%), France (3.8%) and Malaysia (3.5%).

In recent years the cocoa processing industry has become more concentrated. Numerous mergers and acquisitions have resulted in four large independent cocoa processing companies; ADM (includes ED&F Man), Barry Callebaut, Cargill and the German Hosta Group. These processing companies account for almost 40% of world cocoa processing capacity. If the major chocolate companies are taken into account, nine multinational firms together account for 70% of cocoa processing capacity and well over half of cocoa bean grindings. In terms of cocoa beans ground, ADM led in 1995 with up to 400,000 tonnes of beans, followed by Barry Callebaut, Cargill and Nestle with 150,000 tonnes, Blommer, Hershey, Cadbury and Philip Morris with 100,000 and a group of 8 companies with less than 50,000 tonnes (Isaac, 1997).² Three companies (Nestle, Mars and Philip Morris/KJS) accounted for about one quarter of world sales of confectionery in 1995, with Nestle being the leader in the market with about 10% market share that year.

The demand for cocoa is characterised by relatively low income elasticities (on average 0.75) in the main consuming countries. The United States is the world's largest consumer, accounting for 24% of final demand in the 1997/98 cocoa year, followed by Germany (11%), United Kingdom and France with 7% each and the Russian Federation, Japan and Brazil with about 4% market share each. In terms of per capita consumption, the top group in 1997/98 included Belgium/Luxembourg with 6.109 kilograms, Iceland (5.357), Denmark (4.613), Germany (3.526), Switzerland (3,357), United Kingdom (3.242) and France (3.013). The UK confectionery market generated sales of £ 5.5 billion in 1999, 70% of which was accounted for by chocolate sales.

¹ In Cote d'Ivoire only 5% of cocoa production comes from plantations larger than 40 hectares, while the figures for Indonesia and Malaysia are 50% and 85% respectively.

² The group includes Unicao, Ferrero, Mars, Chadler, Stollwerck, Schokinag, Cantalou and the Ghanaian company Portem-Ghana.

2.4. Price Issues

International cocoa prices fell sharply after 1984 to reach their lowest point for more than 30 years in 1992 with the daily price of cocoa beans (annual average) determined at the level of 49.87 US cents/lb that year (see Summary Table, *Appendix I*)³. The dramatic decline in cocoa prices since the mid-1980s has been mainly due to the faster growth of world production than that of world consumption, which was responsible for a rapid accumulation of stocks. It is notable that between the mid-1980s and the end of the decade, production rose by some 900,000 metric tonnes, whereas the rise in consumption (as measured by grindings) was only half that amount. From 1993 onwards, cocoa prices have started to recover steadily reaching 76.02 US cents/lb in 1998, to decline this year at 52.70 UScents/lb (June 1999 estimate).

The time-lags in the interactions between production (supply), demand and prices in the cocoa market are of a paramount importance in understanding price fluctuations and the functioning of the overall market. In the case of the supply-price relationship, prices may stimulate or depress investment in cocoa production (new plantings of cocoa trees) and this effect takes several years to be fully reflected in the level of production. With regard to the demand-price relationship, it usually takes about a year for prices to feed through the system to affect final cocoa consumption. Finally, prices react rather immediately to changes in the supply-demand balance and often react in anticipation of likely changes in the demand-supply balance, with a time-lag being negative in this case and of the order of a few months.

2.5 International Commodity Agreements and Cocoa

The International Cocoa Agreements (ICAs) in the past (1972, 1975, 1980 and 1986) had two main objectives:

- ◆ first, to prevent excessive fluctuations in cocoa prices which were felt to adversely affect the long term interests of both consumers and producers; and
- ◆ second, to achieve a balanced expansion of the world cocoa economy, including the alleviation of serious economic difficulties which might arise if adjustment between production and consumption cannot be affected by normal market forces as rapidly as circumstances require.

However, most of the ICAs (including the 1986 Cocoa Agreement) failed to stabilise the market for a number of reasons:

- ◆ *first*, the inadequacy of ICAs as a mechanism for short term stabilisation when the underlying problem is a persistent oversupply in the world market;

³ It is important to note that the ICCO prices for cocoa beans are not related to a specific grade of cocoa but to the prices on the London and New York Terminal Markets. At LIFFE, the London Terminal Market, and at the CSCE, the New York Terminal Market, different grades of cocoa can be delivered against contracts, but each lot of cocoa is sampled and graded by Exchange graders and price adjustments may be made for imperfections according to established standards.

- ◆ *second*, a difference of view between producing and consuming countries on the function of the price range to be defended by ICAs;⁴ and
- ◆ *finally*, the reluctance of the governments of some of the larger consuming countries to support the concept of market regulation any longer, even if confined to short term stabilisation, so that they are generally averse to the continuance of the traditional form of ICAs.

In July 1993 at a conference in Geneva, a new International Cocoa Agreement was adopted to replace the previous 1986 one, which expired on September 30, 1993. The new agreement, which came into force in 1994, has a duration of five years with provisions for two yearly extensions.⁵ The new agreement is based on production management and consumption promotion, rather than the utilisation of a buffer stock scheme that was the main tool for price stabilisation in the previous agreement. In 1998 at the meeting of the ICCO, cocoa producing and consuming countries agreed to adopt a Production Management Plan (PMP) to stabilise the market and raise prices. More precisely, the PMP sets specific targets related to cocoa production, consumption and stock levels, which are expected to raise the average cocoa price. The above targets are to be achieved in 4 years i.e. 1998-2002. Under the above scheme, production will be reduced gradually for a total cut of 257,000 tonnes by the year 2000/01. ICCO estimates that this production cut will result in 2,787,000 tonnes world output in 2000/01, whilst world consumption is expected to reach 2,780,000 tonnes by the same year. This would result to a reduction of world cocoa stocks at the end of 2000/01 to 948,000 tonnes, well below 1998/99 level (1,153,000 tonnes). This would also affect the stock-to-grind ratio to 33.9% from 1998/99 level (41.3%).⁶

2.6 Future Prospects

According to short term projections by the World Bank and the ICCO, cocoa prices are expected to increase to 145 cents/kg for 2000 to reach 160 cents per kg in 2001 (in current US\$). More long term projections estimate prices to reach 200 cents per kg by the year 2005 and 210 cents/kg in 2010.

The Economist Intelligence Unit (EUI) projects cocoa grindings to reach 2,845 thousand tonnes in the 1999/2000 cocoa year and 2,905 thousand tonnes by the year 2000/01. The UK's grindings are expected to be at the level of 175,000 tonnes in both years. Production is projected to reach 2,901 thousand tonnes in 1999/2000 (a 4.2% change from current year) and 3,010 thousand tonnes by the year 2000/01. These projections clearly suggest that the phase of structural deficits in the world cocoa market is probably over.

⁴ As in the case of coffee agreements, in periods of falling prices, the producers argue that an ICA should be used to support the minimum of an agreed price range; on the other hand, the consumers argue that the price range should be reduced to accord with the change in market conditions.

⁵ Note that the United States and Indonesia are not members of the new agreement.

⁶ The new ICA clearly emphasises the need to boost cocoa consumption and recognises that cocoa substitutes may prejudice this. However, this may cause some problems within the European Union, since currently cocoa butter substitutes can be used only in Austria, Finland, Denmark, Ireland, Portugal, Sweden and the UK.

The clear upward trend of international prices in the 1990s does not necessarily guarantee excellent prospects for the cocoa market in future years, given that the prices remain low compared to the highs of the 1970s and the first half of the 1980s. And with relatively low prices in coming years there is not much incentive for investment in new plantings which may in turn result in an ageing tree-stock in the coming years. The final outcome, according to ICCO (1993), would be an ageing stock which will not respond with the same vigour to improvements in husbandry and, therefore, will result in a more dampened response to price increases.

3. Fair Trade in Cocoa

3.1 Fair Trade Labelling and Cocoa

The first FT label to be established was the Max Havelaar label in the Netherlands in 1988. Similar initiatives followed in 12 other northern countries, and in 1997, an international umbrella organisation, FLO International (Fair Trade Labelling Organisations International) was established. The United Kingdom's labelling organisation, the Fair Trade Foundation (FTF) was established in 1994.

These organisations run registers of producer organisations in the South which meet the labelling organisations' commodity specific criteria for being sources of FT products. Organisations are allowed to carry an FT label on their product, so long as the product so labelled has been sourced through an approved producer organisation in an approved manner. As with a number of other commodities FLO International has established a cocoa register.

Conditions for the use of the fair trade labels on cocoa based products

Organisations that make use of FT labels on cocoa products must fulfil a number of requirements.

- ◆ 100% of the commodity that is processed to be sold under a FT label has to be purchased directly from an organisation that appears on the FLO International producers register for the commodity in question.
- ◆ The purchase price must be fixed in the way that is specified by FLO International. Producers are guaranteed a minimum price which is calculated so as to cover production costs. If the world price rises beyond the minimum price level a premium becomes payable. Table A4.1 illustrates the different price arrangements that are specified for cocoa and cocoa products.
- ◆ On request of the seller, the buyer shall make available up to 60% of the minimum value of the contract in credit facilities in favour of the seller at least six weeks prior to shipment.
- ◆ Buyers and sellers intend to establish a long term and stable relationship in which the rights and interests of both are mutually respected to allow for long term

planning. Long term agreements should be confirmed by the exchange of binding letters of intent not later than three months before harvesting time.

Table A4.1 Price arrangements specified by FLO International as conditions for the use of fair trade labels

Commodity	Minimum price for standard quality (fob) inclusive of FT premium.	FT premium over world price	Minimum price for organic quality (fob) inclusive of FT premium.	Organic (additional to FT) premium
Cocoa	U.S.\$ 1,750 per MT.	U.S.\$ 150 per MT.	U.S.\$ 1,950 per MT.	U.S.\$ 200 per MT.
Cocoa butter	U.S.\$ 4,200 per MT	U.S.\$ 360 per MT.	U.S.\$ 4,680 per MT	U.S.\$ 480 per MT.
Cocoa powder	U.S.\$ 875 per MT	U.S.\$ 75 per MT.	U.S.\$ 975 per MT	U.S.\$ 100 per MT.

Source: Fair Trade Labelling Organisations International.

- ◆ The payment of a fee for the use of the FT label. The UK's Fair Trade Foundation charges a 2% levy on the value of wholesale turnover for the use of its label. This covers its monitoring and support operation internationally and contributes towards the cost of the Fair Trade Foundation's UK monitoring and awareness raising work.

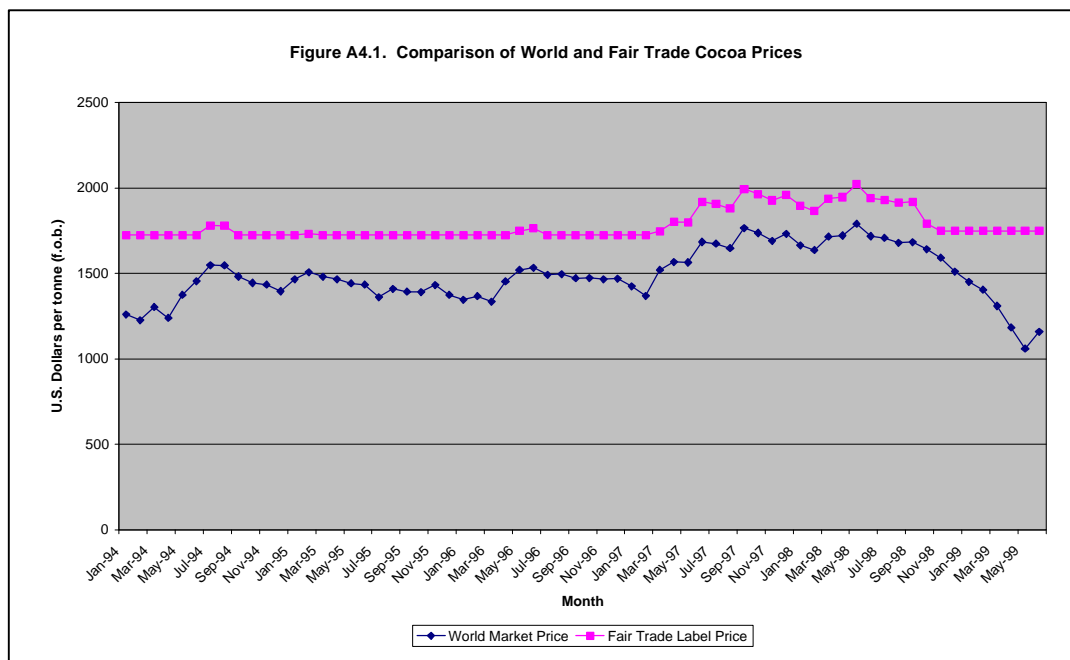


Figure A4.1 compares the f.o.b. prices for cocoa that FT purchasers have been required to pay before they can use FT labels and the world prices prevailing at the time. For much of the time world prices have not been high enough to trigger a movement of official FT prices for cocoa above the specified minimum of US\$1,750

per tonne (\$ 1725 per tonne prior to August 1998). When world prices did rise high enough to trigger the payment of a price premium between May 1997 and September 1998, FT price movements mirrored world price movements, albeit at a higher level.

The FLO Cocoa Producers' Register

Cocoa producer organisations must fulfil a number of criteria if they wish to apply for inclusion on the FLO International Cocoa Producers' Register.

Table A4.2. Producer Organisations Listed on the FLO International Cocoa Register.

Organisation	Country	Key Characteristics
Kuapa Kokoo	Ghana	A central co-operative made up of 462 primary societies and with a total membership of c. 30,000
MCCH ⁷	Ecuador	Exports the cocoa of 1,017 affiliated smallholder growers on fair trade terms.
El Ceibo	Bolivia	A central co-operative with a membership of 36 primary co-operatives. 65% of its production is certified organic.
TCGA	Belize	A 'company not for profit' with 126 members.
Conacado	Dominican Rep.	A federation comprising 126 village associations which have between 20 and 80 members each.
MACEFCOOP	Cameroon	A central farmers co-operative with about 750 farmer members
Cacaonica (<i>currently applying for registration</i>)	Nicaragua	Co-operative comprising 8 committees with a total of 115 producer members, 83 of whom are certified organic.

Source: FLO International

- ◆ The majority of the organisation's members are small-scale producers of cocoa. The Cocoa Producer's Register defines small-scale producers as being 'not structurally dependent on hired labour, managing their own fields mainly with their own and their families' labour-force, except in labour intensive peak seasons'.
- ◆ The organisation is democratic, is run in an accountable and transparent manner, and is controlled by its members.
- ◆ The organisation does not engage in political, racial, religious or sexual discrimination, and is open to new members.

⁷ See Appendix 2 for a profile of MCCH.

- ◆ The organisation subscribes to the same general principles and objectives as FLO International⁸.

There are currently six producer organisations on the FLO Cocoa Register, with a further organisation in the process of applying (see Table A4.2). They range in size from Cacaonica of Nicaragua which has 115 members to Kuapa Kokoo of Ghana which has approximately 30,000 members. Table A4.3 shows that there has been a gradual growth in the number of countries supplying fair trade cocoa through the FLO Cocoa Register. However, between 1994 and 1999 Kuapa Kokoo's share of fair trade cocoa sales has fallen below 65% only once.

Table A4.3. Mass of Fairtrade Cocoa (mt) Exported by Country Since 1994.

Country	1994	1995	1996	1997	1998	1999
Ghana	284	550	792	598	350	851
Ecuador	60	24	36	35	-	65
Bolivia	91	211	118	83	127	65
Belize			25	24	30	23
Dominican Rep.				22	134	234
Cameroon						12
Total	435	785	971	762	641	1250

Source: FLO International.

The National Fair Trade Initiatives

The national FT initiatives and FLO International make commitments to promote the FT label and the associated values to consumers; maintain the producers' register, and in particular maintain contact with, and extend assistance to, registered producer groups; and verify that users of the FT label comply with the labelling requirements.

Table A4.4. Mass of Fair Trade Labelled Products (mt) Sold in Europe by Country.

Country	1994	1995	1996	1997	1998	1999
Netherlands	124	148	188	177	172	179
Switzerland	83	171	180	124	141	162
Germany			311	331	329	300
UK			22	24	81	214
Austria				38	26	57
Luxembourg				14	16	15
Italy					46	103
Sweden					7	17
Denmark						19
Total⁹	207	319	701	708	818	1066

Source FLO International.

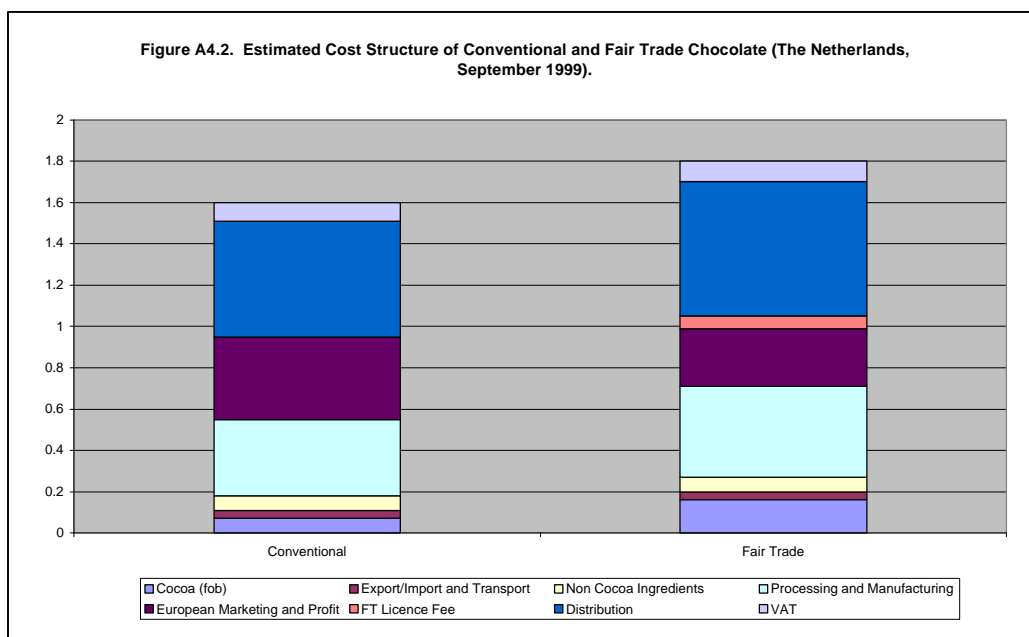
⁸ More specifically, it is motivated by a desire for solidarity, improvements in the quality of production, and economic, organisational, social, and sustainable development.

⁹ The discrepancy in the annual totals relates to cocoa bought at FT prices but not sold with a FT label. Since the ratio of cocoa butter and powder produced from FT cocoa does not always match the requirements for FT labelled products, some FT cocoa goes back into the conventional supply chain.

Table A4.4. shows that since the mid 1990s the Netherlands, Switzerland and Germany have accounted for the majority of FT labelled cocoa products sold in Europe, although the market in the UK saw significant growth in 1999.

Savings, Premiums and Costs in the Fairtrade Supply Chain

Both commercial and fair trade chocolate companies are reluctant to give information on their margins. However, FLO International has made estimates of the different costs in the marketing chains for conventional and fair trade chocolate in the Netherlands in September 1999 (see Figure A4.2 and Table A4.5). FLO is careful to describe these estimates as tentative, but they do give an indication of the order of magnitude of the various additional premiums, savings, and costs that may be associated with fair trade.



Source: FLO International.

Table A4.5. Estimated Cost Structure of a 75 gram Fairtrade Labelled Chocolate Bar (The Netherlands, September 1999).

	Conventional market		Fairtrade	
Retail Price in Dutch florins	1.60	100%	1.80	100%
VAT @ 6%	0.09	6%	0.10	6%
Distribution/Retail	0.56	35%	0.65	36%
Fairtrade Licence Fee	-	-	0.06	3%
Marketing Costs and Margin in Europe	0.40	25%	0.28	16%
Processing and Manufacturing Costs	0.37	23%	0.44	24%
Cost of Non Cocoa Ingredients	0.07	4%	0.07	4%
Export/Import and Transport Costs	0.04	2%	0.04	2%
Cost of Cocoa (fob)	0.07	5%	0.16	9%

Source FLO International

If the world price for cocoa falls below the minimum price (\$1,750 per tonne) then the impact of fair trade on the fob price will vary with the gap between the world price and the minimum price. Currently, the world price for cocoa is low (between \$800 and \$ 900 per tonne). Consequently, the fairtrade premium is currently fluctuating between \$ 850 and \$ 950 per tonne, putting FT manufacturers and marketers under pressure¹⁰.

Based on the figures in Table A4.5, Table A4.6 provides a summary of the different additional premiums, savings, and costs associated with fair trade. These figures (also tentative) suggest that in the example used, the higher fob cost of fair trade cocoa accounts for approximately 28% of all the additional costs associated with fair trade chocolate (and 45% of the fairtrade premium paid by the consumer).

Table A4.6 Analysis of Distribution of FT Premiums/Savings and Additional Costs.

	Florins	Percentage Share
Source of Fairtrade Savings and Premiums		
Retail Premium	0.20	62.5%
Lower Advertising Costs and Manufacturing Profit	0.12	37.5%
Total	0.32	100%
Additional Costs Associated with Fairtrade		
VAT	0.01	3.1%
Distribution/Retail	0.09	28.1%
Licence Fee	0.06	18.8%
Processing and Manufacturing Costs ¹¹	0.07	21.9%
<i>Higher fob price in country of origin</i>	0.09	28.1%
Total	0.32	100%

3.2 The UK Fair Trade Chocolate Market

As of November 1999, the following chocolate products (using cocoa sourced from Belize, Bolivia, the Dominican Republic and Ghana) carried the Fair Trade Foundation label.

- ◆ The Divine milk chocolate bar marketed by the Day Chocolate Company.
- ◆ Equal Exchange plain chocolate-covered Brazil Nuts and organic cocoa.
- ◆ Green and Black's milk chocolate, Maya Gold chocolate, and cocoa (all of which are also organic).

¹⁰ Indeed there is a lively debate within FLO as to whether FLO minimum prices for FT cocoa should be reduced in a bid to increase the volume of FT labelled cocoa used.

¹¹ The ratio of cocoa butter and cocoa powder produced from cocoa beans doesn't necessarily coincide with the ratio needed for fairtrade chocolate production or even all fairtrade cocoa based products taken together. As a result, it is not unusual for the producers of fairtrade cocoa products to pay a fairtrade price for cocoa beans but then have to sell on a proportion of the cocoa butter or cocoa powder originating from such beans on to the mainstream at mainstream prices. Increased co-operation between the different FT European cocoa users could reduce some of the associated costs.

- ◆ Hambledon Herbs Organic Cocoa.
- ◆ Oxfam Masca chocolates (Cappuccino, Milk, Orange Milk and Plain).
- ◆ Traidcraft's organic chocolate bars (including Milk, Plain, Cappuccino and Praline).

However, the FT market for chocolate is still smaller than the organic market. At a recent meeting of the FLO International Cocoa Producers¹² it was reported that total European sales of products made from organic cocoa stood at approximately 3,000 metric tonnes in 1999. The figure for FT cocoa in the same year was a little more than 1,000 metric tonnes.

The Day Chocolate Company

The Day Chocolate Company (DCC) was founded in 1998. The company attracted a total of £1.15 million of finance. Its £ 500,000 financial facilities with the National Westminster Bank are 80% underwritten by a DfID loan guarantee (implemented in October 1999). The company became fully operational from mid 1999. TWIN has a 52% shareholding, the Kuapa Kokoo Union has a one third shareholding, with the Body Shop owning the balance of the shares.

DCC markets two products under the Divine label, which compete in the UK mass market; a 150g milk chocolate bar and a 45g bar. DCC reports that its Divine chocolate bars are now available in 4,500 retail outlets in the UK (all Iceland stores, most Co-op and Sainsburys' stores, some independent supermarkets, RSPB cafes, NUS canteens, and from the Salvation Army).

DCC further reports that the UK chocolate market is very competitive. Others within the FT movement suggest that the FT market for chocolate is in certain respects even more competitive than the conventional market¹³. The three biggest chocolate producers enjoy the benefits of economies of scale and spend between £ 5 million and £ 9 million p.a. per brand on promotion and advertising. Nevertheless, in the six months to March, DCC sold approximately £ 0.5 million worth of chocolate (wholesale prices).

Comparing the 150g Divine bar with a similar 200g bar produced by one of the industry leaders, the former retails at £ 1.19 per bar, and the latter at £ 1.10 per bar, implying a FT premium at the retail level of 36.5p (or 44%) per 150 grammes of chocolate. DCC states that FT sugar is not used in Divine because of a concern that Divine should be affordable and mainstream¹⁴.

¹² May 22nd to 24th 2000 in London.

¹³ This is because there is a belief that there is only room in the UK chocolate market for one significant FT brand (the analogy is drawn with Cafedirect's position relative to other FT coffee brands). As a result, a number of FT chocolate producers are vying for the position of lead FT brand.

¹⁴ As of May 2000, the world price for sugar stood at approximately \$ 220/t compared to the FT price stipulated by the FLO register of \$ 520/t.

3.3 *The International Cocoa Market and Fair Trade*

BAFTS¹⁵ identifies several key issues about the operation of the international cocoa market from a FT perspective:

- ◆ The low level of prices following the breakdown of ICAs.
- ◆ Domination of the market by transnational corporations with EU and US support.
- ◆ Processing and storage takes place overwhelmingly in the North.
- ◆ Discriminatory EU import taxation against processed cocoa.
- ◆ Threat of changes to EU legislation to allow for greater use of cocoa fat substitutes in chocolate production.
- ◆ The need for WTO to take action to stop speculation and price fluctuations.
- ◆ The low proportion of the world price of cocoa products that cocoa producers receive.

Internationally, there is concentration amongst cocoa processors and chocolate manufacturers, and significant speculation takes place in the international cocoa markets. Furthermore, the way in which industrialised countries manage their trade regimes for cocoa and cocoa products gives rise to tariff escalation. For example, the tariff on imports of cocoa beans, cocoa butter and cocoa powder into the European Union are 1.5%, 9%, and 12% respectively. Finally, as with many other agricultural commodities, demand for cocoa is subject to substitution by other commodities. A particularly high profile example of this, which has been championed by the FT movement, has been the debate as to whether the European Union should allow the limited use of non-cocoa vegetable fats to substitute for cocoa butter in the manufacture of chocolate.

However, the following points can be usefully made in relation to the arguments advanced by the advocates of FT.

- ◆ It would be difficult for even the largest trans-national companies to manipulate commodity markets and control commodity prices on a sustained or long-term basis. The principal points of reference for agricultural commodities such as coffee and cocoa are near dated futures contracts traded on markets in London and New York. The volumes of coffee and cocoa traded on these futures markets are many times higher than the volumes traded physically in spot markets around the world. The result is that even if a company processes 10% of the world's cocoa, if it fully hedges its physical positions it will only account for approximately 1% of the futures contracts traded in cocoa. Although sometimes destabilising, speculators play a vital role in maintaining the liquidity of world derivatives markets which allow market participants to manage price risk. Potentially, this opportunity exists for farmers (indirectly through market

¹⁵ British Association for Fair Trade Shops, "Cocoa".

intermediaries) and exporting countries – though support is likely to be needed to enable them to benefit.

- ◆ Trans-national processors do undertake direct purchasing of cocoa from producers in some markets. This generally only occurs in markets where the level of domestic consumption of the processed commodity is sufficient to justify the TNC's operating a processing plant. The existence of a processing plant means that it is possible to post factory gate delivery prices and makes sense to appoint local buying agents and arrange local buying points.
- ◆ Over and above the existence of tariff escalation there are many potential commercial reasons that may explain the reluctance of TNCs to invest in cocoa processing facilities in countries of origin. First, the demand in Europe and the United States is for blended chocolate. There are few countries, if any, which are significant exporters of cocoa, and permit the formal importation of cocoa from other net exporters to facilitate blending. As with investments in direct purchasing, investments in processing will be discouraged if government policy is not consistent and credible, or the general business climate poor. Second, chocolate factories tend to be located in or close to the biggest markets, and close to a reliable source of sufficient volumes of milk. Third, chocolate production, for example, is intensive in its use of machinery, much of which is made in Europe, giving rise to a maintenance issue. Furthermore, such machinery can only be used efficiently if it has access to a reliable power source.
- ◆ The implementation of the 1994 GATT agreements has actually resulted in modest reductions in the level of tariffs collected on imports of cocoa and cocoa products into industrialised countries.
- ◆ The ICAs collapsed because the floor prices were set too high. These prices encouraged producers to expand production. Nevertheless, market mechanisms for the management of price risk do exist. Put options, for example, offer producers the opportunity to buy their own price floor (without limiting the potential for benefiting from prices above that floor) for a specified quantity of cocoa for a full and final one off payment which is analogous to an insurance premium. The challenge is to create the conditions for small farmers to understand, trust and benefit from such facilities, whether directly, or through market intermediaries.

There are a number of further concerns that relate to tensions between the FT movements' own rules and underlying principles, and the way that FT is implemented.

First, the Fair Trade Foundation reports that the addition of new producer groups to the FLO register is often subject to restrictions for most commodities, including cocoa. In principle such restrictions are temporary and arise in the context of a market that is expanding too slowly to absorb all of the potential supply. Restrictions are applied if it is felt that additional groups may undermine the position of already registered groups who are a higher priority in development terms. However, such managed access is at odds with the notions of transparency promoted by the FT

movement, and is not consistent with the FLO register's requirements that producer organisations must be open to new members.

Second, the FT movement emphasises increasing the value-added in countries of origin. Yet chocolate in Divine products is made in Germany rather than using existing chocolate production facilities in Ghana. Set against this concern is the fact that Ghanaian cocoa farmers, through their membership of Kuapa Kokoo Union, and its share of the Day Chocolate factory, have an interest in the success of the Divine brand, and a recognition that this may be more valuable than the production of chocolate in the country of origin *per se*.

Third, the FT discourse emphasises co-operation between different parts of the FT movement. There may be a tension between the ethical (and commercial) imperatives to co-operate, and the commercial imperative to be the dominant FT chocolate brand in what is currently a relatively small market niche.

4. Cocoa Production and Marketing in Ghana

4.1 The Production and Consumption of Ghanaian Cocoa

Agriculture accounted for 40.5% of Ghana's Gross Domestic Product in 1998. Although provisional estimates are that cocoa production and marketing contributed only 3.5% of Ghana's GDP in 1998, it accounted for 34.1% of export earnings.

Cocoa production in Ghana is dominated by small-scale producers. Many farmers have two or more cocoa farms, which often measure 1-2 hectares each and are separated by significant distances (sometimes they are in different districts and even regions). Many of the farm owners employ the services of caretakers to manage some of the farms. The number of cocoa farm owners is estimated at about 265,000. Together with sharecroppers /caretakers, the number of cocoa growers is estimated to be around 500,000. The cocoa farmers and their caretakers are typically illiterate, over 50 years old, and male, with relatively large families. Cocoa farmers are being encouraged to rehabilitate their farms with short duration hybrid varieties that begin producing fruits after 3 to 4 years.

Until the early 1960s cocoa farmers were considered to be among Ghana's richest citizens. However, the decline in both nominal and real producer prices eroded the purchasing power of cocoa farmers and by the late 1970s many of them had become poor. Many farmers either reduced the amount of time spent looking after their cocoa trees, or abandoned their cocoa farms altogether, shifting their scarce resources, particularly labour, to the cultivation of other crops.

A 1990 World Bank study¹⁶ indicates that in the late 1980s, those classified as poor received 21% of their income from cocoa (and the hard core poor 16.8%).¹⁷

¹⁶ A poverty profile for Ghana, 1987-88 (Social dimensions of adjustment in Sub-Saharan Africa Working Paper no.5 World Bank (1990) E. Oti Boateng, Kodwo Ewusi, Ravi Kanbur and Andrew McKay).

¹⁷ The poor considered to be the poorest 35.9% of all Ghanaians (32,981 cedis per person per annum). Hard core poverty the bottom 7.4% of Ghanaians (16,491 cedis per person pa).

However, only 24.1% of cocoa revenues went to the poor and 75.9% went to the non-poor. As a result, for every extra cedi paid per bag of cocoa, one quarter of the benefit went to the poor. Put another way, for every cedi in extra revenue that went into the fiscus from cocoa taxation one quarter represented a tax on the poor.

A 1999 report by Ghana Statistical Services¹⁸ indicates that the proportion of the Ghanaian population defined as poor fell between 1991/92 and 1998/99 from 51% to 43%. During the same period the incidence of poverty amongst persons classified as self employed producers of agricultural exports (many of whom are cocoa producers) fell from 62% to 39%. Relative to the rest of the population the situation of agricultural exporters has improved during the 1990's. Nevertheless, in 1998/99 35% of Ghana's poor lived in the rural forest areas (which contains 30% of Ghana's population).

The production of cocoa in Ghana began in the last quarter of the 19th century, and reached a peak of about 581,000 metric tonnes in the 1964/65 season. Production then fell to a low of about 159,000 metric tonnes in the 1983/84 season (about 28% of what was produced in the mid 1960s), before output gradually recovered, reaching 300,000 metric tonnes in 1988/89 and 408,000 metric tonnes in 1997/98.

Improved price incentives have generated short and medium run supply responses. In the short term improved husbandry practices (weeding, spraying, pruning, more thorough harvesting) has increased production. In the medium term, there has been a rehabilitation and replanting of old farms and the establishment of new farms.

The total area of land under cocoa production in Ghana is estimated at about 1.2 million hectares. This is about 33% lower than the area cultivated in the 1980s (Ministry of Finance, 1999). Of the area current area under cultivation, it is estimated that about 30% contributes very little to the quantity of cocoa produced due to the age, condition and low density of trees. However, the Ghanaian government believes that the capacity exists to increase national cocoa production to about 500,000 mt by the 2004/05 season, and about 700,000 mt by the 2009/10 season (Ministry of Finance, 1999).

Exports of cocoa beans have fluctuated in the last three years from 344,000 tonnes in 1995/96 to 266,000 in 1996/97 and 348,000 tonnes in 1997/98 (see Table A4.7). During the 1997/98 cocoa year, Ghana's earnings from exports of cocoa beans were about US\$700 million. Ghana also exports cocoa butter, accounting for about 5% of the world production in 1997/98 (21,400 tonnes). Ghanaian exports of cocoa powder have also increased recently from 5,000 tonnes in 1995/96 to 17,100 tonnes in 1997/98. Finally, exports of cocoa paste/liquor rose from 7,500 tonnes in 1995/96 to 11,000 tonnes in 1997/98, which is equivalent to 4.2% of world total that year. Currently, the total installed capacity of the cocoa processing factories is 84,000 mt per annum, and there are plans to increase the installed capacity to 150,000 mt in the medium term (Ministry of Finance, 1999). If the installed capacity is increased to 150,000 mt in the medium term and the production target of 700,000 mt is achieved, Ghana would be in a position to process 21.4% of the cocoa output.

¹⁸ Poverty Trends in Ghana in the 1990s (November 1999).

Cocoa Processing Company, Ltd (CPC) is the only company producing chocolate in Ghana. It produced 1,034 metric tonnes of chocolate in 1998/99, but its main business is the production of intermediate cocoa products for export (butter, liquor and powder). CPC produces chocolate mainly for the Ghanaian market, although it is aware that a number of individual traders buy small quantities for export to neighbouring countries. In addition there are two importers in the United States of America and one in Nigeria who import chocolate that is produced and packaged by CPC to their specifications.

Table A4.7. Output of Cocoa Beans, Exports and Domestic Processing, 1980/81-1998/99.

Cocoa Season	Beans Output (000 mt)	Beans Exports (000 mt)	% Exports of Total Output	Domestic Processing (000 mt)	% Domestic Processing of Total Output
1980/81	258	231	89.6	27	10.4
1981/82	225	194	86.3	31	13.7
1982/83	179	183	91.1	16	8.9
1983/84	159	144	90.6	15	9.4
1984/85	175	155	88.6	20	11.4
1985/86	219	197	90.0	22	10.0
1986/87	228	205	89.9	23	10.1
1987/88	188	163	86.7	25	13.3
1988/89	300	280	93.3	20	6.7
1989/90	295	271	91.9	24	8.1
1990/91	293	263	89.8	30	10.2
1991/92	243	220	90.5	23	9.5
1992/93	312	282	90.4	30	9.6
1993/94	255	209	82.0	46	18.0
1994/95	309	254	82.2	55	17.8
1995/96	404	344	85.5	60	14.5
1996/97	323	266	82.4	57	17.6
1997/98	408	348	85.3	60	14.7

4.2 Cocoa Marketing and Pricing Policy in Ghana

At the farm level the pod is picked and broken, the cocoa beans removed and subjected to two levels of primary processing. After the cocoa beans have been fermented¹⁹ and dried,²⁰ they are then ready for sale.

Cocoa is assembled at three points before it is exported. It is first assembled at the society levels (primary assembling points) where the estimated 265,000 cocoa farmers in the country take their cocoa to sell to purchasing clerks (PCs) of the

¹⁹ To induce fermentation cocoa beans are heaped together (at least 50kg) in a pile. This results in the generation of heat which kills the cocoa seed and breaks down the enzymes within the beans. This process takes at least 5 or 6 days and if not done fully the quality and potential chocolate flavour are negatively affected.

²⁰ In Ghana, cocoa is often sun-dried often on palm leaf matting. The beans are turned regularly and require some ventilation. Drying takes between 1 week to 10 days.

Produce Buying Company (PBC)²¹ and licensed buying companies (LBCs). There are an estimated 2,708 societies and therefore, primary assembling points in the country. The buying companies move their purchases to district depots (secondary assembling points) which number about 116. The movement of cocoa up to this stage is referred to as *primary evacuation*.

From the district depots, cocoa is moved to three designated points where the Cocoa Marketing Company, a subsidiary of the Cocobod takes over. One of the takeover points is inland at Kaase near Kumasi and the remaining two are the ports at Tema and Takoradi. The movement of cocoa from the district depots to the takeover points is referred to as *secondary evacuation*. From the takeover points CMC supplies the domestic processing firms and manages exports. Quality is checked by the Cocobod's Quality Control Department at the primary, secondary and tertiary assembling points.

Table A 4.8. Changing Marketing Arrangements in Ghana's Domestic Cocoa Market.

Period	Market Structure	Number of Buying Firms	Reason/s for Change
Up to 1947/48	Competition	20 European trading firms	
1947/48-1961/62	Competition	39 European and Ghanaian firms	
1962/63-1965/66	Monopsony	1 buyer, United Ghana Farmers Cooperative Council (UGFCC)	Political
1966/67-1976/77	Competition	16 Licensed Ghanaian firms, the number reduced to 8 in 1973/74	To enhance efficiency
1977/78-1991/92	Monopsony	1 buyer, a subsidiary of the Ghana Cocoa Board)	Licensed firms diverted financial advances made to them to buy cocoa, causing delays in paying farmers.
1992/93 to date	Competition	19 Licensed private firms along with Produce buying company, a subsidiary of the Cocobod	To enhance efficiency in the internal buying system by reducing PBC monopoly and increasing competition.

The internal arrangements for buying cocoa have changed a number of times, alternating between monopsonistic and competitive arrangements (Table A4.8.). Until 1961/62, the crop was purchased by many European trading firms. When the Ghana Cocoa Marketing Board was established in 1947, the number of cocoa buying companies increased to 39 with many of the new buyers being Ghanaian companies. From 1961/62 to 1965/66 internal marketing was handled solely by the United Ghana Farmers Cooperative Council (UGFCC).

²¹ PBC is currently owned by Cocobod, although at the time of writing shares in the PBC are being advertised in the national press.

From 1966/67 to 1976/77 many firms were again licensed to buy cocoa on behalf of the Cocobod. The monopoly buying system was again introduced for the period 1977/78 to 1991/92 but since 1992/93 many companies (currently 19) have been licensed to buy cocoa on behalf of the Cocobod. The re-introduction of competition in the internal marketing of cocoa was based on the assumption that farmers would receive higher prices as the buyers compete to buy the cocoa. The producer price announced by government is now regarded as a floor price.

External trade in cocoa has been the preserve of the Cocoa Marketing Company since 1947/48. It is possible that the external cocoa trade will be liberalized in the near future, although the exact speed and extent of any such liberalisation is not yet clear. The option currently under consideration is to allow LBCs to export 30% of their purchases with the remaining 70% exported by the CMC. This is to test whether complete liberalization of the external trade will be in the best interests of the country (Ministry of Finance, 1999).

The LBCs that would be allowed to export would be those that purchase 10,000 mt each in two previous cocoa seasons and can demonstrate appropriate export know-how (Ministry of Finance, 1999). The LBCs which purchase less than the required volume of cocoa before export is permitted, would be able to negotiate with other LBCs or CMC to export on their behalf.

Table A4.9 shows how the Produce Buying Company's share of the main crop has declined since the domestic marketing of cocoa was partially liberalised. In 1998/99 it handled slightly less than 60% of main crop cocoa. Cashew and Spices Co. Ltd accounted for just over 15% of the same crop, whilst three other companies (including Kuapa Kokoo) each had market share of over 5%. A further seven LBCs were active buyers of the 1998/99 main crop accounting for just under 5.6% of the market between them.

Table A4.9 Market Shares (%) of Licensed Buying Companies for Main Crop Cocoa

Company	1993/4	1994/5	1995/6	1996/7	1997/8	1998/9
Produce Buying Company	79.17	77.15	74.74	67.92	68.69	59.33
Cashew and Spices Co. Ltd	10.39	14.34	16.04	17.34	16.84	15.43
Adwumapa Buyers Ltd	0.69	1.88	1.45	2.82	4.03	6.54
Federated Commodities Ltd	-	-	-	-	3.21	7.90
Kuapa Kokoo Co. Ltd	0.69	0.83	1.24	2.32	3.33	5.20
Universal Crop Protection Ltd	8.96	3.15	3.00	6.08	-	0.81
Others	0.11	2.65	3.53	3.51	3.91	4.78

Notes: During the period 1994 to 1999 inclusive, the value of the light crop fluctuated between 7.8% and 16.9% of the value of the preceding main crop.

Minimum (pan-territorial) producer prices in Ghana are set each year by the Cocobod's Price Review Committee. Producer prices take into account total production costs, including the full unsubsidised price of insecticide, plus a margin for the farmer. It is notable that recently the Cocobod has completely removed the

subsidy on inputs for cocoa cultivation. The price per litre of cocoa insecticide, for the control of cocoa pests, increased from the government-approved price of 1,500 cedis to 20,000 cedis.

The gap between the minimum producer price and the price which LBCs are paid for cocoa they deliver to any one of the Cocobod's three depots is calculated on the basis of the LBC's estimated costs, plus a profit margin of 15% over these costs.

Transporters are paid according to the region from which they transport a given load of cocoa. Transport rates paid by Cocobod are based on estimates of costs incurred plus a profit margin. Once all these payments and the Cocobod's costs have been deducted from the fob value of the cocoa, the residual goes to government as an export tax.

Table A4.10 Real Producer Prices (1997/98 prices²²) of Cocoa in Ghana, 1983/84-1997/98.

Season	Real Producer Price	% change in Real Price	% Share of Producer Price in Fob Price
1983/84	734,477	-25	21.3
1984/85	788,859	7	23.8
1985/86	1,334,842	69	24.5
1986/87	1,625,383	22	24.5
1987/88	2,051,770	26	28.9
1988/89	1,718,764	-16	39.2
1989/90	1,449,889	-16	33.9
1990/91	1,356,725	-6.	41.2
1991/92	1,288,694	-5	45.1
1992/93	1,203,113	-7	44.9
1993/94	1,149,598	-4	30.4
1994/95	2,092,286	82	41.8
1995/96	1,574,251	-25	38.9
1996/97	1,534,603	-2	43.0
1997/98	1,800,000	17	54.0

Source: ISSER (1999) The State of the Ghanaian Economy in 1998.

Ghana's cocoa marketing system has had a number of implications, some of which can be highlighted as follows.

- ◆ *As a proportion of fob price, the domestic producer price has historically been very low.* From 1983/84 to 1989/90, the producers' share of fob price was less than 40%. In the period from 1990/91 to 1996/97, the producers' share of fob price exceeded 40% but did not go beyond 45%. In 1997/98 the share increased to 54% and in 1998/99 it increased further to 56%. It is now the policy of Government to increase gradually by 2 percentage points each season (except in the 1999/2000 season when the increase would be 4 percentage points) the proportion of the producers' share of fob price till it reaches 70% in the 2004/05 season (table A4.11). By increasing the producers' share of the fob price, the

²² In May 1998 the exchange rate stood at \$1 = 2315 Cedis.

operational expenses of Cocobod and the taxes on cocoa will be reduced gradually.

- ◆ *Notwithstanding movements in the world price for cocoa, real producer prices in Ghana have more than doubled between 1983/84 and 1997/98.*

Table A4.11 Distribution of Fob Price of Cocoa in Ghana, 1998/99 to 2004/05.

Season (Crop Year)	Producer Share	Marketing /Cocobod Operations	Government Tax
1998/99	56	18.2	25.8
1999/2000	60	16.5	23.5
2000/01	62	16.2	21.8
2001/02	64	15.9	20.1
2002/03	66	15.6	18.4
2003/04	68	15.3	16.7
2004/05	70	15.0	15.0

Source: Ministry of Finance (1999).

- ◆ *Table A4.10 demonstrates that the marketing system has not been managed in a way that has protected Ghana's cocoa farmers against real price instability. As farmers command a higher proportion of the export value of their crop, they will be exposed to greater price risk arising from world price and exchange rate volatility, as opposed to inconsistencies in government policy.*
- ◆ *The process by which marketing and transport cost calculations are made is reportedly the subject of intensive lobbying by those concerned. KKL is the only LBC to offer farmers even a small premium over the government minimum price. However, until recently the PBC still handled approximately 70% of the Ghanaian cocoa crop. This can be explained by the fact that the money that Cocobod makes available to LBCs to finance their purchases to farmers has been rationed, and, with the exception of the PBC, limited by the extent to which LBCs can provide collateral. As a result, PBC has had a structural advantage over its private sector competitors, although the indications are that moves to privatise PBC mean that this may well change in the near future.*
- ◆ *CMC sells cocoa to domestic processors at discounts of fob price, 11% for the main crop and 20% for the mid crop. These discounts have tended to lower the weighted average of fob price used to derive the producer price. It has been recommended for approval of government that cocoa beans be sold to domestic processors at fob price (Ministry of Finance, 1999).*
- ◆ *The quantity of cocoa produced in the country is estimated by the purchases which reach the Ghana Cocoa Board (Cocobod), the ultimate internal buyer of the cocoa - this may be misleading. The volume of cocoa which reaches the Cocobod is affected, positively or negatively, by smuggling which goes on between Ghana and its neighbours, the Republic of Togo and Cote d'Ivoire. The factors influencing the direction of smuggling include the relative producer price levels in the three countries, the proximity of buyers across the national borders*

and in the early 1980s in particular, the availability of household consumables which were available in the neighbouring countries (World Bank, 1998).

Despite the limited nature of the competition that partial liberalisation has introduced, The Kuapa Kokoo farmers encountered by the consultants were very positive about the liberalisation of the domestic market for cocoa as they now have a choice as to who to deal with. If they feel that they are being cheated in terms of the weight of cocoa for which they are paid, or a particular buyer is unable to pay cash on delivery, they can take their cocoa elsewhere

A number of distinctions can be drawn between the general arguments advanced by the FT movement that relate to marketing at the national level and the situation in the Ghanaian cocoa market. *First*, it has been the statutory marketing system in general and the Ghanaian government's policy of export taxation which resulted in inefficiencies and welfare transfers to the detriment of cocoa farmers, rather than middlemen and speculators. *Second*, although it is clear that many Ghanaian cocoa farmers are poor, it is equally the case that over the course of the period of market deregulation, the poverty profile of Ghanaian cocoa farmers (and their share of the international price) has improved even as international cocoa prices have fallen in real terms. *Third*, although a significant number of Ghanaian cocoa farmers are reliant on family labour, many are clearly structurally dependent on labour from outside of the family. This need not be a problem, except for the fact that the caretaker system contradicts FLO's own definition of small farmers.

5. Fair Trade in Ghanaian Cocoa

Against the back-drop of the liberalisation of Ghana's internal cocoa marketing arrangements in 1992, and the provision that was made for the operation of Licensed Buying Companies (LBCs), Kuapa Kokoo Limited (KKL) was formed as a private company in 1993. Initially the prevailing legislation prevented Kuapa Kokoo from being set up as a co-operative, but in 1996 the Kuapa Kokoo Union (KKU) was established. A Kuapa Kokoo Farmers Trust was formed to receive all FT premiums and KKU was admitted to the FLO International Register. KKU is the only organisation which qualifies as a source of fairly traded Ghanaian cocoa in terms of FLO's criteria. In 1998, KKL took up a one third shareholding in the Day Chocolate Company which markets chocolate made from cocoa sourced from KKL.

KKU is a co-operative farmers' association with three tiers. The primary societies operate at the local level and appoint their own executive committees. Representatives of the primary societies meet to appoint their representatives at the regional level, which in turn appoint representatives to the KKU Board. Whilst the KKU owns Kuapa Kokoo Limited, KKL has its own management structure that is separate from the KKU. KKL purchases cocoa from KKU members and non members alike, but recognises new clients as potential new members of the KKU.

The Kuapa Kokoo Farmers Trust Board has 14 members who are appointed by the KKU, the KKL and Kuapa's foreign FT partners. The funds of the trust are applied to meet the felt needs of the KKU. Projects submitted to the KKFT for funding have to meet the following criteria:

- ◆ The proposal should originate from the society and should reflect the needs of the society/community.
- ◆ Proposals should be commented upon by the relevant Regional Executive Committee of KKU.
- ◆ The society and community should demonstrate how they will contribute to the execution of the project (through the provision of labour, materials and money).

A society proposing a project should be a registered member of KKU and in good standing²³.

Table A4.12 The Expansion of Kuapa Kokoo's purchases and membership

	1994/95		1995/96		1996/97		1997/98		1998/99	
Society	Bags	<i>Socs</i>	bags	<i>socs</i>	bags	<i>socs</i>	bags	<i>socs</i>	Bags	<i>Socs</i>
Ashanti	18,291	18	30,063	18	63,297	46	96,974	75	128,004	95
B/Ahafo	13,253	10	12,573	11	16,446	14	32,564	35	38,639	44
Western	943	1	10,359	9	27,821	28	48,880	45	58,527	59
Credit	-	-	-	-	-	-	2,967	9	n/a	n/a
Central	-	-	-	-	-	-	11,322	23	32,299	40
Eastern	-	-	-	-	-	-	-	-	22,430	27
Total	32,487	29	52,995	38	107,564	88	192707	187	279,899	265

Source: Kuapa Kokoo Ltd

Notes: Bags denotes 62.5kg of cocoa purchased from farmers. 'Socs' denotes primary societies.

For the first few years the Trust built up its funds and during the past two years has made 16 allocations of money. Of the first eight allocations, six villages have benefited from the installation of piped water, one village had a KVIP Latrine installed, and a palm nut cracker was given to a women's group in another village.

KKU has expanded rapidly since its creation in 1996 as evidenced by the figures in table A4.12. There are now 462 primary societies in the KKU with a total membership of approximately 30,000 farmers.

Cocobod has a monopoly over exports of cocoa from Ghana, but has instituted a special arrangement that facilitates sales of cocoa by KKL to FT partners in the North. All cocoa originating from KKL is marked as such. When an order is placed for fairly traded Ghanaian cocoa, Cocobod ensures that KKL cocoa is supplied. Cocobod is paid the market rate for the cocoa it supplies whilst the FT premium is paid into the Kuapa Kokoo Farmers' Trust.

FT sales accounted for 14.7% of the volumes handled by KKL in the 1994/95 season. However, FT sales have since declined as a proportion of total sales (see Table A4.13). This is because the amount of cocoa supplied on FT terms has not grown

²³ Implying that all dues should be paid, all minutes of meeting and expenditure accounts submitted in a timely fashion, no money owing to KKL, no record of delivery of substandard cocoa or short weight bags, and that the society should demonstrate the establishment of a Society Development Fund and evidence of good management of this fund.

whilst KKL's overall volumes have grown impressively. Kuapa Kokoo reports that FT orders for cocoa are erratic.

Table A4.13. Kuapa Kokoo's Fair Trade Sales

Marketing Year	Total National Production (metric tonnes).	Total KKL Sales (metric tonnes)	FT Sales (metric tonnes)	FT Sales as a % of KKL total sales.	FT Sales as a % of total national production
93/94	255,000	1,267	50	3.9%	0.02%
94/95	309,000	2,377	350	14.7%	0.11%
95/96	404,000	4,328	600	13.9%	0.15%
96/97	323,000	6,952	650	9.3%	0.2%
97/98	408,000	12,187	400	3.2%	0.1%
98/99	370,000	17,698	300	1.7%	0.08%
99/00 to date *	n/a	14,275	300	2.1%	n/a

Source: Kuapa Kokoo Ltd

* As at 2.12.99.

Table A4.14 provides a summary profile of a number of KKL's primary societies. The majority of KKL members tend to be male. Figures for per capita deliveries to KKL generally represent underestimates of per capita production of cocoa, because a proportion of KKL members may deliver some or all of their cocoa to other LBCs, but show a wide variation around the mean.

Table A4.14. A Summary Profile of Some of KKL's Primary Societies during the 1998/99 season.

Society	Aboabo Camp	Amoaya	Kwapong	Kwamang	Abuchensu
District	Assin-Foso	Inakoso	Kwapong	Offinso	Suhum
Region	Central	Western	Brong Ahafo	Ashanti	Eastern
# Members (of which % female)	119 (29%)	50 (24%)	63 (46%)	169 (23%)	158 (20%)
Total deliveries to KKL (kg)	111,820	56,131	53,500	298,087	193,000
Average KKL deliveries per capita (kg)	1315.5	1,122.6	849	1,764	1,221
Lowest individual delivery (kg)	35	85	125	19	67
Highest individual delivery (kg)	4,650	8,284	3,750	6,630	2,500
# members using hired labour	69	30	20	124	108

Source: Kuapa Kokoo Limited.

6. Key Issues

6.1 Comparing the Fair Trade and Mainstream Supply Chains

It is important to stress that while KKL is a registered FT organisation, only a small proportion of its sales take place on FT terms. Most of its sales, as with other LBCs, go into the mainstream marketing channel through Cocobod. Kuapa Kokoo Ltd is the only source of FT cocoa but all cocoa handled by KKL is dealt with in the same way, whatever its final destination.

Several distinctions can be drawn between the operations of KKL and other (private commercial) LBCs:

- ◆ KKL does not employ purchasing clerks (in the way that the other LBCs do) at its buying points. Instead it pays a per bag commission to each member of the primary society's executive committee on every purchase. In the 1996/97 marketing season the official prices allowed buyers 36,573 cedis per tonne to cover staff costs (apart from office costs). In spite of two years of inflation the 1999/2000 season the commissions per bag payable to KKL primary society committee members, and labour amount to only 28,800 cedis per tonne²⁴. Many farmers emphasise the fact that they felt cheated when dealing with the PBC because they felt their cocoa was under-weighed by the purchasing clerks. However, whether or not a farmer sells to KKL is often determined by whether or not KKL has cash available. If it does not, even farmers who are members of KKL may be forced to sell their cocoa elsewhere.
- ◆ KKL is the only trader to pay farmers more than the government guaranteed purchase price, although the premium is very modest. The premium during the current season is 500 cedis per bag (less than 1% of the government minimum price). To the extent that KKL makes a profit it may pay farmers an end of year bonus as it is doing for the 1998/99 season (700 cedis per bag). KKL also pays 400 cedis per bag to the primary societies to fund co-operative development.
- ◆ Revenue from fairly traded cocoa is used to fund community projects via the Kuapa Kokoo Farmers Trust. KKL is not the only LBC to fund community projects.²⁵ Commentators on the Ghanaian cocoa sector report that the Cocobod's own Produce Buying Company (PBC) used to do likewise, and that as a result, since the reforms of the early 1990s, most LBCs have felt obliged to match this aspect of PBC's operations. The Kuapa Kokoo Trust paid out money to fund community projects for the first time in the 1998/99 season. Sixteen community projects have been funded among the 462 member societies, and 200 cedis per bag contribution was made to the 700 cedi per bag bonus paid out by KKL.

²⁴ Cedis 800/bag to the recorder, cedis 500 per bag to the treasurer, cedis 200 per bag to the President, and cedis 100 per bag to the secretary. Every time a bag is loaded or unloaded from a vehicle the labour involved receives cedis 200 per bag.

²⁵ Many of the farmers encountered expressed a preference for receiving the benefits of the FT premium in the form of a higher price or bonus rather than in the form of community projects (although spreading the FT premium amongst all KKL members would only marginally increase the net per bag price to the producer).

Within the constraints of this case study it was not possible to compare the performance of KKL-financed and other projects.

- ◆ Farmers enjoy a sense of empowerment through their ownership stake in the company and their say in how it is run. At KKL's Annual General Meeting, representatives of each farmers' society discuss and formulate company policy.

6.2 The Role of DFID Support

DFID support to the FT cocoa marketing chain between Ghana and the UK has moved through four distinct phases:

- ◆ A grant to TWIN of £125,000, from DFID's SED division, for work in Ghana and Tanzania, supplemented by TWIN's own reserve and loan funds, and co-financing and technical assistance from the Dutch volunteer organisation SNV, Max Havelaar and Comic Relief. Technical and financial assistance was provided to the nascent Kuapa Kokoo Ltd and the Kuapa Kokoo Farmers Trust in the context of changes to the Ghanaian domestic marketing system for cocoa which allowed organisations other than the parastatal marketing board to buy and sell cocoa. TWIN contends that this external support is reflected in, among other things: the successful establishment of a commercially viable LBC along co-operative principles, and the development of links between Kuapa Kokoo and FT organisations in the UK and the rest of Europe, and the development of a joint venture with the Day Chocolate Company.
- ◆ The provision by DFID's Business Partnership Unit of a loan guarantee for up to £400,000 for the Day Chocolate Company, and a further grant of £100,000 to TWIN to cover impact assessment. Its main aims are twofold: to increase the degree to which Kuapa Kokoo Union and its members are informed about, and integrated with, the upstream uses of cocoa; and to create greater consumer awareness of FT approaches to trade.
- ◆ DFID's Enterprise Development Division has approved a Credit and Savings Feasibility project. It is envisaged that a revolving loan fund will be designed by KKL in association with TWIN and capitalised with £20,000.
- ◆ Comic Relief, which has endorsed the Divine chocolate bar, is planning to associate itself with another forthcoming DCC chocolate snack. Meanwhile, Comic Relief is approximately one third of the way through implementing a two year (£200,000) FT education and awareness raising project, funded by the Development Awareness Fund of DFID's Information Department, that consists of the following activities.
 - ◆ Market research with UK teachers and pupils relating to their attitudes to, and level of knowledge concerning, FT and its place in the classroom.
 - ◆ Running a competition, the Comic Relief chocolate challenge, in conjunction with the television show, *Alive and Kicking*, to design a

wrapper for the new DCC chocolate snack²⁶. The winner will visit Ghana in April with the trip being featured on a September programme of *Alive and Kicking*.

- ◆ Making available free school information packs on ethical trade and FT.
- ◆ Public relations and popular education activities linked into the chocolate challenge.
- ◆ Building a FT element to the Comic Relief web site that is informed by inputs from children at schools in both Ghana and the UK.

A number of points can be made in respect of the development of DFID's support to FT in Ghanaian cocoa. *First*, each stage of support has been funded by a different part of DFID. *Second*, the way that the funding has developed suggests that it is possible for DFID to discriminate between different aspects of FT. *Third*, there are a series of concerns related to linking a credit project with Kuapa Kokoo especially since KKKU primary societies currently use their funds to allocate loans to members without clear mechanisms for recovering these funds. It is important that revolving loan fund money is distinguished from existing 'loan' arrangements. *Fourth*, although Comic Relief stresses the need for education issues (such as FT) to be firmly rooted in the real experiences of young people as consumers, there is a fine line between funding awareness raising around the FT concept and supporting a particular brand. *Finally*, the promotional material relating to Comic Relief's Chocolate Challenge is inaccurate, and therefore misleading with regard to the way that members of KKKU benefit from FT²⁷. Comic Relief acknowledges the error. It states that although it is too late to correct the promotional material, the error will be corrected in the information pack it is planning to distribute to schools.

6.3 Impact Assessment

Any attempt to assess the impact of a given FT initiative needs to begin with an appreciation of the workings of the international market and of the national marketing system for the product in question, and the importance of the production of that commodity to the situation of individual households. In particular, what is the marginal impact of FT initiatives on household incomes or the asset base upon which the household relies? A further important consideration relates to the extent that the FT initiative in question is reliant on an element of donor subsidy.

²⁶ Although the winning design will not necessarily be used on the wrapper.

²⁷ Under the heading 'Fair trade - the real story', Comic Relief's promotional material states the following. 'Lameck is 12 and lives in Ghana where his dad Francis is a cocoa farmer in the Kuapa Kokoo co-operative. Kuapa pays £ 150 a tonne more than the usual price for Francis' beans, used in fairly-traded Divine chocolate, which you can go out and buy. The extra money pays for Lameck to go to school and for other things the family needs. So, fair trade means you get great chocolate and Lameck and Francis get a great deal'. In fact, for all the cocoa it supplies for fair trade labelled products (including Divine chocolate), Kuapa Kokoo receives a premium of \$150 a tonne, and only a very small proportion of this is paid out to farmers per tonne they delivered to Kuapa. In the 1998/99 season Kuapa Kokoo did pay approximately £7 per tonne in supplementary payments to Kuapa Kokoo farmers on every tonne they delivered to it, out of the fair trade premiums it received, but the bulk of the fair trade premiums were paid into the Kuapa Kokoo Farmers' Trust.

In the case of initiatives like Kuapa Kokoo the extent to which individual farmers benefit from FT is dependent on the way that the KKL and KKL function. Therefore, it appears to make more sense to concentrate impact assessment initiatives at the institutional level rather than the level of the farm household.

- ◆ Without FT in Ghanaian cocoa, would KKL exist or be as effective?
- ◆ Without donor support, would KKL exist?
- ◆ Even if not, would other LBCs be in a position to fulfil the role played by KKL?

Whilst it is true that KKL represents a different model for organising the operations of LBCs and therefore provides farmers with a choice, the most significant benefits from the KKL/KKU model are likely to be concentrated among the following groups.

- ◆ Members of the executive committees of the primary societies who receive commission per bag handled by their society and who receive training from KKL.
- ◆ Senior staff and KKL Board members who benefit directly from capacity building initiatives and their increased exposure to other parts of the cocoa supply chain (e.g. through KKL's links with Day Chocolate Company).
- ◆ Communities where KKL funds a project.
- ◆ Women's income generating groups which receive assistance and training.

A possible negative impact would be the crowding out of other potential LBCs because of unsustainable donor subsidies (particularly related to credit), although this does not currently appear to be an issue in the case of KKL.

7. Conclusion

The experience with Kuapa Kokoo suggests that initiatives aimed at building capacity and promoting organisational development amongst southern market intermediaries, particularly in the context of moves away from state controlled marketing regimes to more liberal marketing arrangements, can be of real value. While the entry of new private licensed buyers has increased the marketing options available to farmers, KKL is an extremely important new initiative. International experience suggests that there are challenges involved in maintaining effective governance of producer organisations as they grow (particularly if they become channels for the provision of government or donor subsidies). However, the existence of alternative marketing options for farmers is likely to improve the effectiveness, efficiency and accountability of all market participants.

Although there is substance to some of the arguments advanced by the FT movement in respect of cocoa, real tensions exist between the realities of the production,

domestic marketing and international trade in Ghanaian cocoa and certain of the arguments advanced, and standards promoted by the FT movement.

Furthermore, the volumes of fairly traded Ghanaian cocoa (in the sense of cocoa that is sold through a FT marketing channel) represent only a small proportion of Kuapa Kokoo's turnover, and a tiny fraction of Ghana's cocoa production. Even very marginal changes in many factors at the international and national level would be far more significant for the welfare of Ghanaian cocoa farmers than the transfers associated with FT; in particular the extent to which the returns to cocoa producers are taxed by the Ghanaian government. What would be of significant importance is the scope for a continued expansion of KKL's operations, or the development of additional (potentially competing) cooperative organisations.

The benefits to producers from the price premium depend upon the way in which Kuapa Kokoo functions, and the use to which it puts the premiums and increased business skills that the relationship with FT organisations can bring. Therefore impact assessment could more usefully focus on the impact of FT and FT related initiatives at the institutional level rather than the household level.

APPENDIX 1 **The World Cocoa Market**

Crop Year	Gross Crop	Cocoa Grindings	End-of-season stocks (as a % of grindings)	Annual average of Daily Prices
1960/61	1172	1102	45.5	
1970/71	1554	1418	35.0	24.43
1971/72	1580	1527	35.0	29.15
1972/73	1409	1544	24.9	51.29
1973/74	1452	1497	21.7	70.74
1974/75	1538	1476	25.2	56.49
1975/76	1499	1497	24.0	92.76
1976/77	1343	1426	18.4	171.86
1977/78	1504	1382	26.8	154.33
1978/79	1509	1476	26.3	149.32
1979/80	1671	1489	37.1	118.06
1980/81	1695	1556	43.4	94.19
1981/82	1732	1607	48.7	79.01
1982/83	1531	1629	41.1	96.10
1983/84	1512	1703	27.2	108.67
1984/85	1952	1859	28.9	102.27
1985/86	1974	1847	34.9	93.81
1986/87	2011	1910	38.0	90.55
1987/88	2197	1985	46.1	71.88
1988/89	2464	2131	57.4	56.30
1989/90	2407	2203	63.7	57.53
1990/91	2506	2335	66.3	54.21
1991/92	2278	2322	63.8	49.87
1992/93	2485	2402	64.1	50.68
1993/94	2435	2508	57.5	63.33
1994/95	2348	2530	48.9	65.01
1995/96	2916	2713	52.0	66.03
1996/97	2713	2736	49.8	73.43
1997/98	2683	2795	43.8	76.02
1998/99 forecast	2747	2790	41.3	52.70 June estimate

Notes: Years in the Table represent cocoa years (1 October to 30 September); production and grindings are in thousand tonnes. The daily price of cocoa beans is the average of the quotations of the nearest three active future trading months on the London Cocoa Terminal Market and on the New York Coffee, Sugar and Cocoa Exchange at the time of the London close. The London prices are converted into United States dollars per tonne by using the current six-month forward rate of exchange in London at closing time. The time of shift to the next three-month period is the fifteenth of the month preceding the nearest active maturing month.

Source: *Quarterly Bulletin of Cocoa Statistics* (various issues), International Cocoa Organisation, London.

APPENDIX 2 Fair Trade in Ecuadorian Cocoa²⁸

Whilst cocoa is responsible for only 0.6% of Ecuador's GDP, it accounts for between 3% and 5% of total export earnings. 54% of cocoa producers work with land holdings of less than 10 hectares, and many have poor access to markets. The Ecuadorian cocoa system is notable for its openness. There are no monopolies or cartels, there is little vertical or horizontal integration, barriers to entry are low, and the government does not interfere in cocoa marketing. Local price movements are generally closely related to world price movements. Although information on the cocoa market is readily available through the media there are still concerns that many small farmers suffer as a result of information asymmetries, and have poor bargaining power with local traders.

Agroexportadora Maquita (shortened here to Maquita) is the most successful of the alternative trading organisations that participate in the Ecuadorian cocoa sector. It is part of Maquita Cushunchic Commercializando como Hermanos (MCCH), a church based development organisation. Maquita began to export cocoa in 1992 and is now one of Ecuador's top 5 cocoa exporters.

Maquita pays a preferential price (typically between 8% and 15% higher than the standard price paid by other exporters) to the members of a number of affiliated smallholder co-operatives. The criteria for affiliation by these co-operatives is that they should operate in remote areas and their members should have less than 7 hectares each. In this way, Maquita deals with just over 1,000 farmers (c. 3% of Ecuador's smallholder cocoa farmers). However, Maquita also buys cocoa from conventional traders (55% of its purchases in 1999) at market prices in order to generate economies of scale for its export operation. The vast majority of Maquita's sales are into conventional markets. Although fair trade accounted for 4% of its sales in 1996, this figure was well below 1% in 1998.

Apart from the **price benefits** to farmers arising out of Maquita's work it has a number of other benefits.

- **Transparency.** Maquita is notable for the precise methods it uses in weighing and grading cocoa, and calculating the price for the farmer.
- **Influence on other traders.** Maquita's activities have forced other traders to be more competitive in their pricing practices.
- **Training.** The proportion of Maquita's profits not retained for re-investment is paid to MCCH for farmer training and other socially beneficial activities.

Maquita has received some donor assistance (for investment in its marketing operations and farm level improvements in bean quality), but this is a recent development and did not play a role in the company's establishment. However, the effectiveness of Maquita appears to be largely a function of the drive and ability of one man, which calls into question the extent to which it may be possible to replicate Maquita's work.

²⁸ Source: Collinson and Leon (2000) and Nelson and Galvez (2000).

Annex 5: Summary of Main Features of Fair Trade Labelling

The use of FT labels allows for the continued specialisation of labour along the value chain whilst ensuring that the organisations that use the label, and the producer groups from whom they purchase raw materials, comply with specified conditions. These conditions are set in such a way that, so far as is possible, they reflect the spirit of the fair trade movement's origins.

Conditions for the Use of FT Labels

Whilst the precise conditions (particularly those relating to producer prices) that organisations must meet in order to qualify to use the fair trade label vary by commodity, the following generalisations are possible.

- ◆ 100% of the commodity that is processed to be sold under a fair trade label has to be purchased directly from **an organisation that appears on the FLO International producers register** for the commodity in question.
- ◆ The purchase **price** must be fixed in the way that is specified by FLO International. For all of the seven commodities for which a FLO International label has been established, producers are guaranteed a minimum price which covers production costs. If the world price rises beyond the minimum price level a premium becomes payable to producers for certain commodities. For other commodities social premiums may also be specified, either instead of, or in addition to, producer price premiums. Table A5.1 illustrates the different price arrangements that are specified for the seven commodities.
- ◆ Producers must be provided with access to **credit facilities**, when harvest begins, up to a value of 60% of the contract value.
- ◆ Relations between producers and buyers must be based on long term contracts.
- ◆ A fee should be paid to FLO International/the national organisation for use of the label.
- ◆ The organisation using the label must facilitate the monitoring of compliance with specified conditions.

Conditions for Inclusion on the Producers' Register

The conditions set by FLO International for inclusion on the producers' register illustrate how much overlap exists between fair trade, ethical trade, and sustainable trade. The producers of all labelled commodities must satisfy a number of conditions that relate to environmental and other sustainability concerns. Where the production of a commodity involves plantations or factories (such as tea), the producer is obliged to demonstrate that certain minimum employment standards have been met (resulting in considerable overlap with ethical trade).

For the majority of commodities¹ for which FLO International has labels producer organisations are typically required to meet the following conditions:

- ◆ The majority of the organisation's members are small-scale producers;
- ◆ The organisation is democratic, is run in an accountable and transparent manner, and is controlled by its members;
- ◆ The organisation does not engage in political, racial, religious or sexual discrimination, and is open to new members; and
- ◆ The organisation subscribes to the same general principles and objectives as FLO International².

Where a commodity³ is produced on a plantation the conditions that the producer organisation must meet include the following:

- ◆ Employees should be paid a minimum wage (set by a competent body), benefit from any other minimum working conditions that are specified by government, and have the opportunity to be represented and engage in collective bargaining;
- ◆ The organisation should not engage in political, racial, religious or sexual discrimination;
- ◆ No children under the age of 14 should be employed;
- ◆ The use of the fairtrade premium should be determined jointly by representatives of the organisation's management and representatives of a majority of the workers.

Responsibilities of the National Fair Trade Initiatives and FLO International

The national fairtrade initiatives and FLO International commit themselves to:

- ◆ Promoting the fairtrade label, and the values behind the label, with consumers;
- ◆ Maintaining the producers' register, and in particular to maintaining contact with, and extending assistance to, registered producer groups; and
- ◆ Verifying that organisations using the FT label comply with the requirements of the labelling organisations.

¹ Coffee, cocoa, honey, sugar cane.

² More specifically, it is motivated by a desire for solidarity, improvements in the quality of production, and economic, organisational, social, and sustainable development.

³ Such as tea, orange juice, and bananas.

Table A5.1 Price Arrangements Specified by FLO International as Conditions for the Use of FT Labels

Commodity	Minimum Price	Fairtrade Premium over World Price	Organic (additional to FT) Premium	Social Premium
Coffee	Yes, differentiated by type and origin of coffee.	5 U.S. cents per pound.	15 U.S. cents per pound.	No
Cocoa	U.S.\$ 1,750 per MT (fob), inclusive of fairtrade premium.	U.S.\$ 150 per MT.	U.S.\$ 200 per MT.	No
Cocoa butter	U.S.\$ 4,200 per MT (fob), inclusive of fairtrade premium	U.S.\$ 360 per MT.	U.S.\$ 480 per MT.	No
Cocoa powder	U.S.\$ 875 per MT (fob), inclusive of fairtrade premium	U.S.\$ 75 per MT.	U.S.\$ 100 per MT.	No
Tea	Price must cover costs of production (as specified by the supplier).	No	No	Premium of DM 1/kg or DM 2/ kg paid to fund jointly controlled by tea estate management and worker representatives
Honey	Price to cover all production costs ⁴ , and no less than U.S.\$ 1,650 per MT (fob) for A quality.		U.S.\$ 200 per MT.	Yes, see footnote.
Cane Sugar	U.S.\$ 480/MT for semi-refined brown sugar U.S.\$ 520/MT for white refined sugar ⁵		U.S.\$ 120/MT	
Orange Juice	Varies according to origin and destination and has to cover costs of production and processing.			Included in calculation of minimum price
Bananas	U.S.\$ 7.25 per 40 pound box			U.S.\$ 1.75 per 40 pound box

⁴ 'Including a comparatively good remuneration of labour, allowing members and their families adequate living conditions and leaving producer organisations with a margin to pay for supporting services to beekeepers and social development activities within the community'.

⁵ These minimum prices would be reviewed if the price for white refined sugar rises above U.S.\$ 400/MT.

Fair Trade: Overview, Impact, Challenges
Annex 5: Main Features of Fair Trade Labelling

Fair trade principles and values are now being applied to products which are not necessarily produced by small producers. Fair trade labelling criteria differentiate between tea, orange juice and bananas that are produced by small producers and plantations. Where they are produced by plantations an additional set of requirements are specified by FLO which relate to labour conditions and the way that the use of the fair trade premium is determined. As a result the distinction between fair trade and ethical trade becomes that much more blurred.

Fair trade principles can be applied to non-commodity products. However, it is not clear that it is possible to generate a set of labelling criteria for such products. Because the market for craft products is so differentiated, there are no benchmark prices that can be used as the basis for setting minimum guaranteed prices or price premiums. If such products were to be labelled then not only would there need to be regular monitoring of the producer groups to ensure that they comply with FLO International's criteria, but there would have to be regular revisions of the calculations as to what constitutes a fair price, so adding to the per unit costs of labelling. One proposal under discussion is that there should be one pan European fair trade label for food products and a non product-specific label for shops.

Annex 6: IFAT Code of Practice

The International Federation for Alternative Trade (IFAT) aims to improve the livelihood of disadvantaged people in developing countries by linking and strengthening organizations that offer just alternatives to unfair trade structures and practices. IFAT members come together in solidarity and mutual cooperation to create an alternative and fairer way of doing business. IFAT is a federation to promote fair trade and a forum for the exchange of information to help members increase benefit to producers.

IFAT members share the following practices:

1. **Commitment to Fair Trade** - To trade with concern for the social, economic and environmental well-being of marginalized producers in developing countries. This means equitable commercial terms, fair wages and fair prices. Unfair trade structures, mechanisms, practices and attitudes will be identified and avoided. To cooperate and not compete. To promote fair trade and social justice in the interest of the producer, and not to maximize profit at the producer's expense.
2. **Transparency** - To openly share financial information; management policies; business practices; product sources; production, marketing and development program plans on a regular basis. This enables both members and the public to assess IFAT's, and each organization's, social and financial effectiveness. This openness is tempered with respect to sensitive commercial or political information.
3. **Ethical Issues** - To reflect in their structures a commitment to justice, fair employment, public accountability and progressive work practices. To seek the greatest possible efficiency at the lowest cost while involving workers in decision-making and management as appropriate to each organization. To aim for adequate income for workers to meet their basic needs, including health care, education and the capacity to save.
4. **Working Conditions** - To ensure a safe working environment that satisfies at a minimum all local statutory regulations. To provide the opportunity for all individuals to grow and reach their potential. To ensure that work is carried out under humane working conditions, using appropriate materials and technologies, while following good production and work practices.
5. **Equal Employment Opportunities** - To oppose discrimination and ensure equality of employment opportunities for both men and women who suffer from the exploitation of their labor and the effects of poverty and racial, cultural or gender bias.
6. **Concern for People** - To promote development which improves the quality of life and which is sustainable for and responsible to both people and the natural world. There will be no exploitation of child labor. Trading activities should not violate indigenous peoples' claims on land or any resources of vital importance to their way of life.

7. **Concern for the Environment** - To encourage the trading of goods which are environmentally friendly. To manage resources sustainably and to protect the environment.
8. **Respect for Producers' Cultural Identity** - To encourage production and development of products based on producers' cultural traditions and natural resources. To promote producers' artistic, technological and organizational knowledge as a way of helping preserve and develop their cultural identity.
9. **Education and Advocacy** - To promote fair trade by encouraging people to change consumption patterns based on issues of social justice and concern for the environment. To support campaigns or campaign for national and international policies that will improve the living conditions of the poor in developing countries. To increase public and corporate consciousness of alternative trade as an effective means to change unfair international trade structures and attitudes. To increase awareness of cultural and traditional values of the South in order to promote intercultural understanding and respect.

Working Relationships

Organizations participating in fair trade shall establish their relationships within a framework of solidarity, trust and mutual respect, avoiding prejudice or harm to their colleagues' images and reputations. These relationships are based on reciprocal benefits and fair exchanges and should be of a nature that extends beyond trading itself. IFAT members and observers agree to negotiate our differences through open and direct dialogue.

1. Relationships between Alternative Trading Organizations (ATOs) and Consumers - ATOs both provide consumers with high-quality, fairly priced products and educate and inform. ATOs recognize that good customer care--including respect for the customer, honest marketing techniques and provision of information--is both an ethical issue and a means of benefiting all parties in the trading cycle. Through consumer feedback ATOs will receive market and product information.
2. Relationships between ATOs - As representatives of the producers, ATOs should make efforts to coordinate their activities and help each other achieve commercial efficiency at the least possible cost in order to open up markets to benefit the producers. Their cooperation and commercial transactions shall be based on a clear and efficient work division according to their different geographical locations and resources. ATOs cooperate with each other by exchanging information about products and market needs and ways of meeting them, including joint supply and marketing. They seek to avoid both duplication and exclusivity in agreements for marketing and representation. They also aim to cooperate by obtaining funding for themselves and producer organizations through credits, loans and working capital and optimizing existing resources.

3. Relationships between ATOs and Producer Organizations - The function of the ATO is to buy and sell and the function of the producer organization is to produce and sell. Their commercial relationship should be complemented with other actions addressing the overall situation. Market information, product feedback, financial support and other relevant services are available according to members' and observers' capability. Taking into account the skills and resources of producers, ATOs and producer organizations seek to improve the quality, acceptability and range of their product offerings. Both ATOs and producer organizations agree to be responsible and professional in meeting their commitments in a timely manner.
4. Relationships between Producer Organizations - Cooperation between producer organizations should be frank, open and based on mutual respect to benefit their members. They avoid competition by not duplicating the designs or patterns of another group without permission. They exchange information, have joint training workshops, take collective action and will, where possible, meet to discuss common issues.

IFAT members include southern and northern alternative trading organizations (ATOs) and producer organizations, and also organisations which support the objectives of IFAT but are not directly involved in trading.

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