The Costa Rican Experience of Fair Trade Coffee

Impact on producers and producer organisations

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Preface

Thanks to Fair Trade and the consumers who would like to see another system we have hope for a better future.
(Arias, 20061201)

This paper discusses Fair Trade and analyses its impact on producers and producer organisations. Fair trade was developed in reaction to the situation on the market for conventional coffee. Coffee prices on the international market fluctuate sharply and have shown a decreasing trend. In 2001 prices reached their lowest level in 30 years. The decline in prices received by producers has increased rural poverty and had negative economic, social and environmental consequences. Fair Trade affects the quality of life of producers through social, organisational and environmental work and reduces the fluctuation of prices and secures the livelihood of producers. Fair Trade is an opportunity for the most marginalised producers in the South. However, this paper also discusses the challenges of the movement.

This is a case study of Fair Trade impact in Costa Rica and mainly focuses on the experience of Coocafé, a Fair Trade coffee consortium made up of nine primary level coffee cooperatives. The study is based on fieldwork conducted during a two-month period in Costa Rica in 2006/ 2007. It was made possible through the financial support of The Swedish Agency for International Development Cooperation (SIDA).

A special acknowledgement is due to the staff of Coocafé and to the primary level cooperatives who participated, LlanoBonito, CoopelDos, CoopeSantaHelana and CoopeSarapiquí. I also want to greatly acknowledge CooproNaranjo, CoopeTarrazú, SINTERCAFE, Marco Araya Molina at ICAFE, Carlos Lopez at Cafécoop, Rocío Hartley at UNA, Rafael Díaz Porras and the always so helpful staff of the CINPE library. I would also like to thank Denis Seudieu, Martin Wattman and Pascale Evans at the International Coffee Organisation (ICO). A special thank you to my supervisor, Yves Bourdet.

Any mistakes in the thesis have been made by the author only and the author retains responsibility for all material contained herein.

Keywords: Costa Rica, Coffee, Fair Trade, Coocafé

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Abbreviations

CIMS	Sustainable Market Intelligence Centre
CINPE	Centro Internacional de Politica Económica
COOCAFÉ	Concorcio de Cooperativas de Caficultores de Guanacaste y Montes de Oro
FLO	Fair Trade Labelling Organisations International
FONECAFE	National Fund for Coffee Stabilization
IADB	Inter-American Development Bank
ICA	International Coffee Agreements
ICAFE	Costa Rican Coffee Institute
ICO	International Coffee Organisation
ILO	International Labour Organisation
ILOLEX	Database of International Labour Standards
INFOCOOP	Instituto Nacional de Fomento Cooperativo
ITC	International Trade Centre
GIO	Geographical Indicators of Origin
SCACR	Speciality Coffee Association of Costa Rica
SIDA	Swedish Agency for International Development Cooperation
SINTERCAFE	Semana Internacional de Café
UNA	Universidad Nacional de Costa Rica
UNCTAD	United Nations Centre for Trade and Development
UPANACIONAL	Unión Nacional de Pequeños y Medianos Agricultores Costaricenses
USAID	United States' Agency for International Development

Measures and Currency Conversions

Kg is used with the exception of coffee prices per libra. All prices are in American dollars as this is the second most common currency of Costa Rica.´

1 MT=	16.7 bags	
1 bag=	60 kg	
1 fanega=	6459.6 km^2	
1 libra=	46.04 kg	
1 basket=	2.3 kg	
1 kg of roasted coffee=	1.19 kg green coffee	
1 kg of instant coffee=	2.6 kg green coffee	
100 Sek= 10.63 Euro=	7.11 Great Britain Pounds=	13.94 United States Dollar

1. Introduction

Approximately 100 million people are directly economically affected by the coffee trade.[1] Coffee production has a particularly large role in poor countries and amongst poor producers in these countries, who often have to struggle to make a living. Their position on the market is weak due to lack of information, bad access to markets, fluctuating prices and lack of credit. Fair Trade works to improve producers´ quality of life and situation on the market. Coffee was the first product certified as Fair Trade and still represents the backbone of the movement. As such, the development of Fair Trade coffee in many ways illustrates the development of Fair Trade itself.

Fair Trade was developed in the 1980s to create an alternative that promoted solidarity and sustainability to prevailing international trade. Fair Trade addresses market failures and their social impact at source. It is a market based mechanism that relies on the support of consumers. In 2005 it benefited approximately one million workers and farmers and four million dependents in 58 developing countries.[2] The demand for Fair Trade coffee has grown at an exceptional rate and global retail sales were estimated at US$ 382 million in 2005, an increase of 38 percent from the year before.[3]

The aim of the thesis is to study Fair Trade and its impact in Costa Rica on producers and producer organisations. Both direct and indirect impacts will be analysed. The indirect impact on the community and the coffee sector will also be discussed briefly. While direct impact is easier to measure and principally financial, the indirect impact is more difficult to quantify and can mostly be derived from externalities. Nevertheless, the indirect impact is important to evaluate the effects of Fair Trade and therefore also an important part of this analysis. It will be shown that Fair Trade offers a range of opportunities for producers and producer organisations in Costa Rica. However, this paper also addresses challenges for the Fair Trade movement as a whole and for the Costa Rican Fair Trade cooperatives.

The study was conducted over a 2 month period in Costa Rica, during which material and data were collected and interviews with managers, staff, producers and collectors were held during visits to cooperatives.[4] The participating cooperatives were chosen as they are different in terms of geography, size and experience. Most of the information was collected

[1] Giovannucci, Lewin, and Varangis, (2004) p. xi
[2] FLO homepage: www.fairtrade.net
[3] Fair Trade Foundation (2005123) p. 3
[4] Cooperatives visited were: CoopelDos, CoopeSantaHelena, CoopeSarapiqui, CoopeLlanoBonito, CoopeTarrazu, CooproNaranjo. The four first mentioned belonging to Coocafé.

during visits to cooperatives of Coocafé, which is a second level cooperative and the biggest exporter of Fair Trade certified coffee in Costa Rica. Coocafé was for a long time the only cooperative certified as Fair Trade, but it should be noted that there are now 6 others certified, though they are still new in the Fair Trade network. Visits and interviews with people, cooperatives and organisations not belonging to Coocafé also took place and I found these very rewarding due to the fact that, as stated by Nicholls and Opal (2005), many studies compare the direct impact through income received by Fair Trade vs. non-Fair Trade farmers, but few compare the indirect impact of Fair Trade on producers, communities and organisations to those which are not Fair Trade certified.[5] By meeting people from both the Fair Trade and the conventional market I found it easier to distinguish the direct and indirect impact of Fair Trade from the impact of other sources.

Costa Rica is a typical developing country when it comes to the paucity of data available to support policy and the lack of an established practice for stakeholder participation.[6] Nevertheless, the choice of turning focus to Costa Rica can be motivated by the fact that the country has a long history of coffee production, an export market orientation and relatively healthy institutions. Costa Rica has enjoyed concerted Fair Trade intervention since 1989 and is one of the few countries where Fair Trade has been present in a systematic way for a substantial amount of time. Costa Rica can be seen as a pricetaker on the conventional world market and the so called small country assumption can be applied. As the country is unable to affect the on-going world market price, no matter how much it sells or purchases, the price of coffee or other tradables destined for the international market is viewed as given, compared to the price of non-tradables (such as coffee destined for the domestic market), which is determined by supply and demand on the Costa Rican market.

I will start with some introductory economics behind the notion of Fair Trade. Thereafter I will explain the development and structure of the world market and the Costa Rican market for conventional coffee. That is followed by a fourth chapter on Fair Trade, with the same design as afore mentioned. In the fifth chapter, I will analyse the direct and indirect impacts of Fair Trade on producers, producer organisations and the coffee sector in Costa Rica. This includes both financial and non financial aspects, as well as both direct and indirect impacts. In the sixth chapter I will go deeper into the future opportunities and challenges of Fair Trade in coffee. The seventh chapter concludes the study.

[5] Nicholls, and Opal, (2005) p. 204
[6] Díaz (2003) p. 3

2. The Economics of Fair Trade

Fair Trade was developed to address market failures on the market for conventional coffee. The figures below show how a rapid increase in supply affects the equilibrium on the conventional and the Fair Trade markets. The vertical axis shows prices. The horizontal axis shows quantity. Figure 1 shows what happens when supply increases rapidly, through a bumper harvest in Brazil for example, or through the entrance of a new actor on the market, like Vietnam on the coffee market in the late 1980s. When supply increases, competition increases and prices fall. Supply then decreases while demand increases until the economy reaches a new equilibrium where prices have reached a level where demand equals supply. What makes coffee special is that both supply and demand tend to be inelastic in the short run and demand even in the long-run. This means that demand does not increase as much as expected when prices fall. There are several examples of people consuming coffee even in harsh economical, political or natural circumstances. Supply does not decrease as much as one would predict as trees are productive for over 20 years and many farms are ill suited for production of other crops. Willingness to diversify production depends on how risk averse producers are and on the size of entry costs on other markets. It is important to keep in mind that at low prices many producers live on or below poverty line and might not be able to afford the risks of diversification or to pay for entry costs in new sectors. On the other hand when prices are high producers might respond with increased planting of coffee trees. However, response is not shown in the short run as it normally takes about 3 years before a tree gives a good harvest and investments actually pay back. Hence supply tends to be elastic in the long run but the response is too big and too late and therefore gives rise to famous cycles of high and low, i.e. volatile prices.

The coffee commodity chain further includes various actors. While the producers mostly consist of poorly organized small scale farmers in the developing world that lack information or communication to cooperate, most of the coffee on the world market is roasted and commercialised by a few multinational firms in the industrialized world, where most of the coffee is consumed. The further up the chain the more advantages the actors have from scale, information, infrastructure and market access. These actors in industrialized countries also gain the most income, bargaining power and market power along the coffee commodity chain.[7] Many analyses show how producers struggle to survive while retail sales have increased from US$ 30 to 80 million since 1998.[8] Hence many actors have managed to continue to make big profits even when producer prices have been below the cost of production.

Figure 1: Impact of a rapid increase in supply

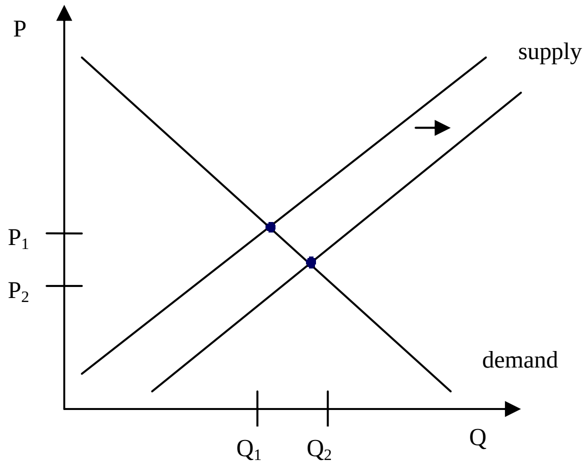
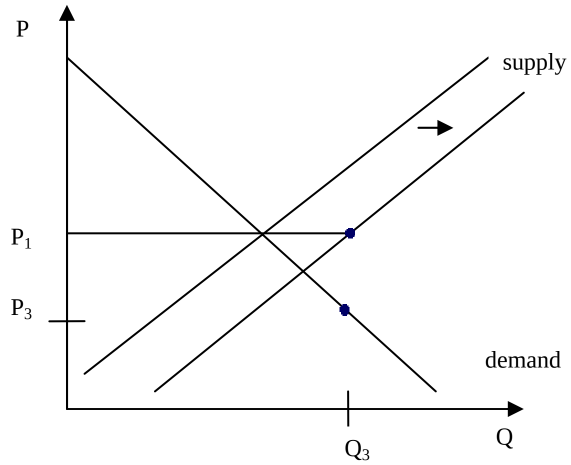


Figure 2: Fair Trade impact



This means that an increase in supply increases competition among producers and, as shown in figure 1, this makes producer prices decrease from P_1 to somewhere closer to P_2. However, the consumer demand is inelastic and the few multinational actors in the industrialized countries do not have to lower the consumer prices. Instead they can enjoy bigger profits. Consumer prices stay at, or close to, the same level as before, P_1, and the increase in production from Q_1 to Q_2 is not followed by an increase in consumption of the same amount.

Figure 2 shows what happens on the Fair Trade market when there is a rapid increase in supply. Producer prices never fall below the minimum price and therefore the rapid increase in supply does not decrease producer prices from P_1 to P_2. Classical theory would leave us far from equilibrium where producer prices stay constant while consumer prices fall to a level of P_3, even below the point of the post equilibrium shown in figure 1. The quantity consumed and produced would be at the same high level, shown as Q_3 in figure 2, as there would be no incentives for producers to cut down production. However, contrary to theory consumer prices are likely to stay close to P_1 as actors further up the chain make use of their market power and the inelasticity of demand. As consumer prices will not decrease as much as

[7] Market power is defined as deviation from marginal cost pricing. See Ronchi (2006) p. 14
[8] For more information see the documentary Black Gold by Marc and Nick Francis: wwwblackgoldmovie.com or the report by Oxfam (2002). To learn more about the coffee commodity chain see Talbot (1997) for more information about the income share and see Kaplinsky (2004), Kaplinsky and Fitter (2001) for more information about the power and governance relationship.

predicted, consumption is not likely to increase to Q_3. Neither is production likely to be influenced by the minimum price and thereby reach the higher level of Q_3. This is because the minimum price does not give rise to profits as it is no higher than what is needed to cover the cost of production and basic needs. Further, Fair Trade production normally only accounts for about 30 percent of the production and the remaining 70 percent has to be sold on the conventional market at world market prices. Hence, producer prices will not go below P_1 on the Fair Trade market, consumer prices will stay between P_1 and P_2 and quantity consumed will stay between Q_1 and Q_2 and give rise to growing stocks.

Of course the model is a simplified version of reality and we have made the assumption that we start at equilibrium and that the Fair Trade price floor will be equal to equilibrium prices. This might not be the case. However, even at a different starting point the discussion behind the model holds.

That actors further up the chain do not respond to changes in market conditions implies imperfect competition. The market in consuming countries is dominated by large multinational firms who collectively benefit from their oligopoly position. They know what the other firms are doing and act accordingly. That the share of income and bargaining power of producers have decreased due to lack of information, coordination and unbalances can be seen as a market failure. Fair Trade addresses these failures by setting a producer price floor, facilitating information exchange and capacity building in producer organisations and making the commodity chain shorter and easier to follow. One part of capacity building is to organise producers into cooperatives. This is a crucial part of Fair Trade work to alleviate poverty as being poor should not only be seen as having an income below the poverty line but also, as stated by the capability approach developed by Amartya Sen, as the inability to shape one's own destiny.[9] Individual freedom is increased by cooperatives as the organizational form empowers producers and gives them increased possibilities of affecting the outcome of their work. Fair Trade often increases cooperatives´ ability to follow the commodity chain and thereby further facilitate an increase in bargaining power and income.

There is a rich empirical literature dealing with the efficiency of cooperatives in relation to other organisational types.[10] Cooperatives have been perceived to be an inferior form of organization due to monitoring, horizon, common property, no transferability and control problems. This might give rise to incentives to free-ride, generate under-investments and introduce an undesirable political element into management decisions. Further it has been

[9] For more information about Amartya Sen and his definition of poverty see *Development as Freedom* (1999).
[10] See for example Porter and Scully (1987) Desrochers and Fischer (2005) and Ronchi (2006)

stated that the cost of control might be higher. However others, including Robert Mosheim, state that the cooperative forms of organisation are in many cases at least as efficient as conventional profit maximizing firms, this because cooperatives often have a high degree of vertical and horizontal integration and are at least as technically and allocatively efficient as independent firms. Mosheim further shows that prices paid to producers in Costa Rica are higher from cooperatives than from private firms and that cooperatives have helped to maintain a strong family based agricultural sector.[11]

[11] Mosheim (2002)

3. The Conventional Market

Coffee is produced in over 50 developing countries and is an important source of income for 20-25 million families world-wide.[12] In spite of the rapid increase of speciality coffees in general and Fair Trade in particular, 90 percent of the traded coffee is still for the conventional market. This chapter gives a general picture of the structure and performance of the world market for conventional coffee and ends with an introduction to the Costa Rican coffee market. This is to give a background for the following chapter on the Fair Trade market and an understanding of the conditions under which Fair Trade was developed.

3.1. The World Market

More than 80 percent of the coffee production is traded internationally. Historically, crude oil is the only primary product traded more than coffee.[13] Coffee is produced in the South by poorly organised small scale producers and exported to the North where value is added by large multinational firms in countries where most of the coffee is consumed. Hence coffee should be seen as a typical primary product produced in the periphery and traded to the core for processing and consumption.

Supply

There are two main different types of coffee supplied on the market: Arabica and Robusta. The former is famous for its high quality and the latter for being more resistant to bad weather, cheaper, but also of lower quality. The main coffee exporting countries are Brazil that produces both Arabica and Robusta coffee, Colombia that only produces Arabica coffee and Vietnam that only produces Robusta coffee. The three account for more than half of the world coffee output. In 2005, the Central American countries together exported almost as much as Colombia and more than Vietnam. Hence the 5 countries together constitute the third biggest exporter.[14] However, separately they are relatively small actors on the world market.

Table 1 gives a good picture of the coffee supply and market shares of producing countries, as well as changes that have occurred during the past 25 years. It is striking that the

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[12] Giovannucci, Lewin, and Varangis (2004) p. 1
[13] Baffes, Lewin and Varangis (2005) p. 297 However, Kaplinsky (2004) writes that in the late 1990s the value of global exports was exceeded by aluminium, wheat and coal. See p. 8
[14] The five countries are: Costa Rica, Guatemala, El Salvador, Honduras and Nicaragua.

total production has increased by more than 30 percent, of which the main three exporters account for almost 80 percent. Brazil has been among the top coffee producers for the last millennium and during the eighties increased its share by about ten percent. From the table it should be noted that Vietnam practically from nowhere entered the coffee market and became the second largest coffee producer in only ten years. Both Brazil and Vietnam have increased their shares at the expense of other smaller producer countries. The relatively large amount of "others" includes over 40 coffee producing countries. Even if these countries are small producers on the world market, coffee may still represent an important share of their exports.

Table 1: Coffee supply and market shares, selected crop years

(Numbers in thousands of 60-kg bags)

	1980	Share	**1990**	Share	**2000**	Share	**2005**	Share
Brazil	17 307	0.214	27 321	0.293	34 100	0.297	32 944	0.309
Colombia	13 069	0.162	14 231	0.153	10 532	0.092	11 550	0.108
Vietnam	73	0.001	1 390	0.015	14 930	0.13	11 000	0.103
Indonesia	5 044	0.062	7 441	0.08	6 978	0.061	6 750	0.063
India	1 962	0.024	2 829	0.03	4 516	0.039	4 630	0.043
Ethiopia	3 304	0.041	2 909	0.031	2 768	0.024	4 500	0.042
Mexico	3 871	0.048	4 674	0.05	4 815	0.042	4 200	0.039
Guatemala	2 770	0.034	3 271	0.035	4 940	0.043	3 675	0.035
Honduras	1 301	0.016	1 568	0.017	2 667	0.023	2 990	0.028
Costa Rica	2 157	0.027	2 562	0.027	2 253	0.02	2 157	0.02
Others	29 851	0.369	26 346	0.283	26 383	0.23	22 094	0.207
Totals	**80 726**	**1**	**93 291**	**1**	**114 882**	**1**	**106 490**	**1**

Source of data: Compiled from ICO homepage: www.ico.org

Costa Rica has managed relatively stable production volumes but in general the supply and market shares of coffee producing countries have changed considerably during the past 25 years. The changes have mainly been a result of the many market interventions coffee production has been subject to, international intervention in general but domestic intervention in particular. Brazil has been the main top producer and as such changes in Brazilian production, caused by bad weather conditions and government intervention, have had implications for world coffee prices. Brazil has been aware of its position as a pricesetter and has destroyed millions of bags on several occasions to increase coffee prices at the market. Recently the production capacity of the country has increased enormously and the cost of production has been lowered by improved technology and mechanical harvesting.[15] In the

[15] Baffes, Lewin, Varangis (2005) pp. 297-308

future it is unlikely that Brazil will decrease its share of world coffee output. The increase in market share of Vietnam has slowed down but the technological development continues and even if Vietnam has traditionally been specialized in low cost production, it has taken several measures to improve the quality of production and of the coffee produced.

The opening of markets in the late 1980s and the export orientation of many countries that wanted to speed up growth led to an increase of production of the most important products. However, the increase in production took place at the same time as quotas were abolished. The result was declining prices and declining terms of trade and producers lost most due to liberalization. Table 1 shows that after the millennium the trend of increasing production was put to an end and volumes started to fall in almost all coffee producing countries. This was because for years the increase in supply was remarkably higher than the increase in demand and growing unbalances in the coffee value chain resulted in a steady decline in prices received by growers.[16] Both countries and producers have also increased their efforts to differentiate their production out of coffee to decrease dependency and to be less vulnerable to rapid decreases in prices.

Demand

While the less developed countries in the South account for the production of green coffee, it is the industrialised countries in the North that account for most of the consumption and value added. Coffee is regularly consumed by more than 40 percent of the world's population and it fills about 400 billion cups a year.[17] Table 2 shows how the import of coffee has increased dramatically in the last 25 years. The US and EU account for almost all imports of traded coffee (about 90 percent). This is also where consumption is biggest.

From tables 1 and 2 it is evident that since the millennium demand has not stagnated though supply has decreased. What is not shown in the table is that even if most producing countries produce for export, demand has further increased as domestic consumption has been triggered. The most successful example is Brazil that now accounts for 10 percent of overall coffee consumption, second after the US (18 percent).[18] Costa Rica is the producing country

[16] This period, which started at the end of the nineties and was not to an end before the 2003/2004 harvest, is also known as the "coffee crisis". However it is important to keep in mind that it was mostly a crisis in terms of prices paid to producers as many actors, especially in consuming nations, continued to make big profits.
[17] Kaplinsky (2004) p. 8
[18] Baffes, Lewin and Varangis (2005) p. 297

with the second highest per capita consumption,[19] though without showing signs of any further increase.

Table 2: Imports and share of imports by main importing countries, selected years (numbers in thousands 60 kilo bags)

	1980	Share	**1990**	Share	**2000**	Share	**2005**	Share
EU	32 775	0.56	45 071	0.6	53 021	0.62	59 895	0.64
France	*5 825*	*0.10*	*6 301*	*0.1*	*6 643*	*0.08*	*6 013*	*0.06*
Germany	*8 959*	*0.15*	*13 671*	*0.2*	*14 382*	*0.17*	*17 013*	*0.18*
Italy	*3 725*	*0.06*	*5 242*	*0.1*	*6 344*	*0.07*	*7 308*	*0.08*
Spain	*1 595*	*0.03*	*3 053*	*0*	*3 820*	*0.04*	*4 433*	*0.05*
United Kingdom	*2 195*	*0.04*	*2 898*	*0*	*3 096*	*0.04*	*3 340*	*0.04*
U.S.A.	19 787	0.34	21 007	0.3	23 822	0.28	23 191	0.25
Japan	3 234	0.06	5 330	0.1	6 908	0.08	7 507	0.08
Övriga	2 593	0.04	1 912	0.03	2 107	0.03	2 382	0.03
Totals	**58 389**	**1**	**73 320**	**1**	**85 585**	**1**	**92 975**	**1**

Source of data: Compiled from ICO homepage: www.ico.org

Prices

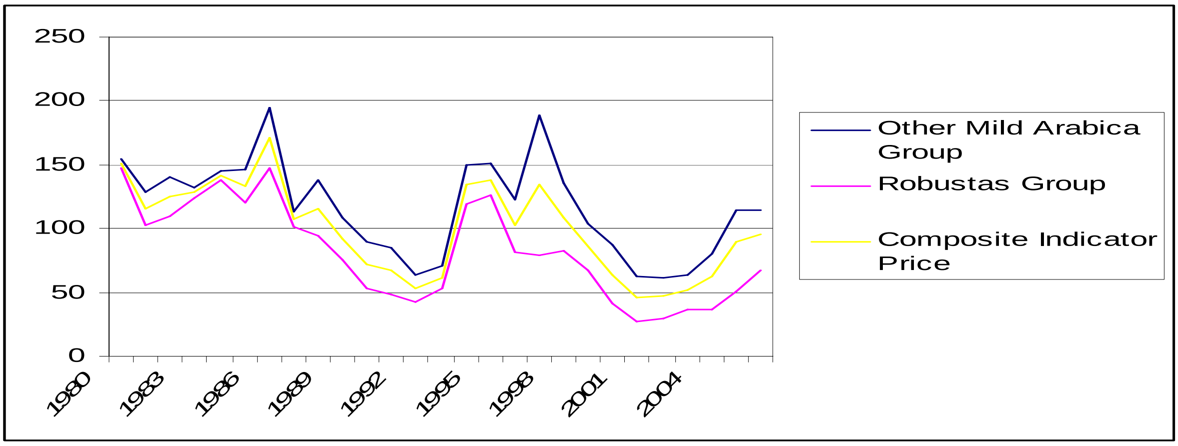
Until the millennium there was more coffee on the market than could be absorbed. Just as predicted by neoclassical economics the liberalization of the market led to a decline in world coffee prices. One important factor for the decline in producer prices is that no international supply control mechanism continued the work after the abolition of the International Coffee Agreements (ICAs) in 1989. Another is the increased production in Vietnam and Brazil and that domestic policies in many producing countries have slowed down the exit of uncompetitive producers from the market.

While demand follows a relatively steady trend, supply has at many points changed rapidly as a result of bad harvests, frost or drought or development of new regions with fast growing producers. This has made prices fluctuate sharply in the short term. In the longer term prices fluctuate due to the fact that it takes time for supply to respond to changes in demand and prices. As explained in chapter 2 there is a time lag since it takes several years for trees to mature, which causes the response to changes in price to be postponed and bigger than necessary. This has caused cycles of high and low, i.e. volatile, prices. A coffee tree can

[19] 3.23 kg/person compared to 1.7 as an average for the other four Central American countries. For more information see Castro, Montes, and Raine (2004) p. 65.

bear fruit for more than 20 years and, therefore, in spite of no new trees being planted, diversification out of coffee is slowed down even where it might be possible to produce other crops and where production is uncompetitive.

Figure 3: Prices on world coffee market, in US$ cents/ lb



Source: compiled from data at ICO homepage: www.ico.org

Figure 3 shows that the price of coffee on the international market has been extremely volatile and that price has followed a decreasing trend. The impact on producers of the decreasing price trend is further strengthened by the declining producer share of final retail price. This reduction is in part because of the market failures explained in chapter 2. Three important peaks and two deep downturns can be seen in the figure. The peaks have arisen from weather conditions in Brazil- the drought in 1986, the frost damage in 1994 and the drought in 1997. The first downturn derived from the 1989 collapse of the ICAs and the end of the work by ICO to try to adjust supply by the use of quotas. The second downturn derived from what most writers call an oversupply of coffee.[20] In 2001 this resulted in 9 percent more supply of coffee than could be absorbed by the market.[21] In October 2001 prices plummeted to US$ 45¢/lbs, the lowest level in 30 years, or a hundred if adjusted for inflation.[22] However, since

[20] The word oversupply is not part of the neoclassical economic vocabulary, but reflects the relationship discussed in chapter 2 where a rapid increase in supply does not lead to an increase in demand of the same amount. Demand does not increase in the same amount mainly due to the fact that prices on the consumer market do not decline proportionally because of unbalance in the coffee commodity chain and inelastic demand and inelastic supply of coffee which has resulted in a supply that has been way above demand, and not responded to changes in price. Nevertheless the word is used by for example Diaz (2003), IADB, USAID, World Bank (2001), Kaplinsky (2004), Kaplinsky and Fitter (2001), Lewin, Giovannuchi and Varangis (2003), Ponte (2001) and (2002).

[21] Díaz (2003) p. 103

[22] Lewin, Giovannucci, Varangis (2004) xi

the 2003 harvest the opposite relationship has prevailed and, as demand has become bigger than supply, stocks have started to decrease and prices have begun to recover.[23]

The volatility makes it difficult for producers to make predictions for the future and also hampers long-term investments. The decline in coffee prices has had severe implications in producing countries, both from a national point of view and for individual coffee farmers. In coffee producing countries coffee often plays a significant role for rural employment and revenue earned by coffee producers, thus equally so for the scope, depth and development of rural poverty. In these countries a decline in coffee prices has negative economic, social and environmental consequences. Further, the effects on Central American coffee farmers must be seen in a broader context as a part of a depression in the rural sector, caused by weather shocks and catastrophes, low international agricultural commodity prices and the global recession. These additional changes in the rural sector have worsened the odds for farmers to find good alternative options and possibilities of exiting the market.

3.2 The Costa Rican Sector

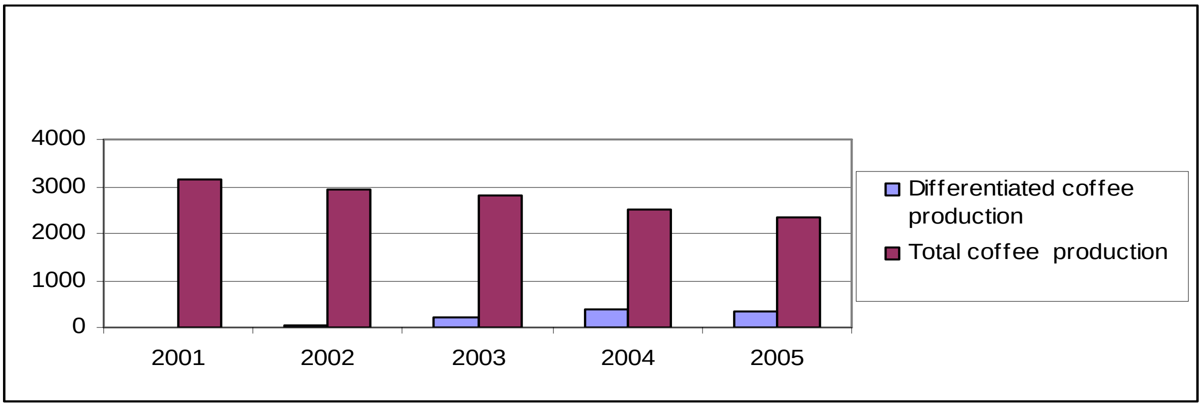
Costa Rica produces only Arabica coffee. Any production of Robusta is prohibited by law. Almost 80 percent of the coffee is exported. About half of the production goes to the US and the rest is divided between various EU countries, Japan and Canada.[24] Costa Rica is a small producer on the world market, and as seen in table 1 the country only accounts for 2 percent of the world's coffee supply. Nevertheless coffee has played an important historical role for the country's economy and still plays an important role for rural employment. Castro, Montes and Raine show that 28 percent of the economically active rural labour force in Costa Rica derives some employment and income from coffee production and harvesting.[25] Over 90 percent of the coffee farmers are considered small scale producers and together they produce 42 percent of the Costa Rican coffee output.[26] However, the number of coffee producers has decreased drastically. There are now just over 55 000 producers, more than 20 000 less than ten years ago. As the number of producers has declined so has the amount of production, as shown in figure 4.

On the other hand, the production of differentiated value added coffee has increased and now represents about 14 percent of the total. It is a national strategy to diversify the

[23] For a complete picture of the balance on the coffee market see annex 9 in ICAFE (2005)
[24] ICAFE (2006) pp. 26, 29
[25] Castro, Montes, Raine (2004) p. 62
[26] Small scale producers include all coffee farmers producing less than 100 fanegas annually. Figures are from ICAFE (2006) p. 23.

coffee with quality as the base. Brands like La Minita and Tarrazú have already established considerable credibility in the gourmet market. Costa Rica's Café Britt is another good example of a brand that has achieved a measure of market recognition and success, mainly focusing on high quality coffee for tourist consumption. However, Costa Rica does not export certified eco-friendly coffee, relatively little organic coffee and Fair Trade coffee only represents about 1 percent of the total coffee export. It is a common opinion that Costa Rica is not well suited for organic production, but both the number of certified organic and Fair Trade producers are increasing. The development is important as brands are a symbolic embodiment of reputation and certification is another way to transfer information to consumers. Both are of great magnitude in a highly competitive market for traded coffee.

Figure 4: Total coffee production & differentiated coffee production (in 1000 fanegas)



Source: Compiled from data in Icafe (2006) pp. 21, 25

In Costa Rica the coffee produced is of high quality and the producers are getting credit for the value added. Costa Rican producers have managed to attain among the highest prices on the market. However, the costs are also higher. The average wage in the Costa Rican coffee sector is between the two and four times higher than the wage in the other Central American countries.[27] The variation reflects differences in the official minimum wage[28] and to some extent development. Wages also, as economic theory predicts, reflect productivity and as such Costa Rica's high yield per unit. In Costa Rica the higher productivity is partly due to a remarkably higher proportion of technified methods and widespread use of agrochemicals, pesticides and fertilizers.

[27] In the period 2002-2003 the average wage per labour day in the Central American coffee sector varied as much as between US$ 1.57 to US$ 8.08. See Castro, Montes, Raine, (2004) p. 20

[28] Although there are reports of wages for coffee labour being lower than the minimum rate, for example see Varangis, Siegel, Giovannucci, Lewin (2003) p. 47

To make production more technology intensive has been a way to substitute or complement labour and has made it possible for many producers to stay in the sector and decrease costs that otherwise would have been too high.

Organisations and Institutions

One of Costa Rica's main features is that the coffee sector is regulated by law and that several coffee organisations have been established. The implementation of decisions and the supervision of laws are taken care of by el Instituto de Café de Costa Rica (ICAFE). This makes it possible for the country to centralize and coordinate the decision-making,[29] which is very important as the coffee sector is made up of many small and independent coffee farmers. The national coffee sector also includes processing factories, roasters and exporters. The last mentioned being the only group liberalized and hence not regulated by ICAFE. Processing factories can either be independent (private), owned by a cooperative of producers or tied to the exporter. In Costa Rica about 65 percent are independent, though only processing slightly more than 20 percent of the coffee. The remaining share is quite equally distributed between processing factories owned by cooperatives and tied to exporters.[30]

Following the crisis due to the collapse of the International Coffee Agreement in 1989, the National Fund for Coffee Stabilization (FONECAFE) was created in 1992. The main task for FONECAFE is to compensate the farmers when the final price is more then 2.5 percent below the price of production. At the moment producers have to pay US$ 4.75¢/ lb of their producer price and have accumulated US$ 23 million in the fund, which has been invested in shares of Banco de Costa Rica and Banco Nacional de Costa Rica.[31] This program is important as the coffee prices received by growers are very volatile and also as many coffee producers suffers from lack of credit in times of bad income.

Many coffee producers are highly indebted, estimated at US$ 120 million. However, La Unión Nacional de Pequeños y Medianos Agricultores Costaricenses (UPANACIONAL) has agreed with the government to restructure the debts of coffee producers with millers and banks. UPANACIONAL is a National union of 19 000 small and medium-scale farmers in Costa Rica that was established in 1981 to help members improve their productivity through comprehensive training activities.[32]

[29] For more about the ICAFE activities visit their homepage: www.icafe.com
[30] Figures from ICAFE (2006) p. 29
[31] Varangis, Siegel, Giovannucci, Lewin (2003)
[32] ICAFE homepage: www.icafe.se

The high producer prices have been maintained through good reputation and an overall high standard. The establishment of the Speciality Coffee Association of Costa Rica SCACR symbolises an important development in Costa Rica. The organisation works to provide high quality coffee utilizing their specific GIO, and get credit for their work by establishing and increasing the reputation. The organization was established by eight growers in 1999 and now comprises 35 grower cooperatives, associations and organisations. At the time when coffee prices reached their lowest levels, SCACR growers were able to sell beans at more than double the prevailing world price. Systematic attention is given to quality procedures throughout the growing links in the chain, with growers paying independent inspectors to check all parts of the production process.[33] The establishment of the SCACR is worth noting as it includes many of the big coffee organisations, including Coocafé. Its strategy to focus on process, product and functional upgrading is also interesting as it in many ways can symbolize a national strategy or a deliberate direction taken by most domestic actors.

[33] For more information see SCACR homepage: www.scacr.com

4. Fair Trade Market

Fair Trade has grown into one of the biggest alternative movements to address the bad and often worsened conditions for primary product producers. Fair Trade aims at achieving more solidarity, quality and justice. There are Fair Trade standards for 18 different product categories, most of them include food and drinks, but also cotton, flowers and sport balls.[34] While Fair Trade products still only represent about 1-4 percent of the respective markets, Fair Trade coffee is the fastest growing segment of the speciality coffee industry in the USA and the UK.[35] It brings benefit to 5 million people in Africa, Latin America and Asia.[36] Coffee was the first product certified as Fair Trade and is still the highest value Fair Trade product. In 2002 Fair Trade brought in US$ 30 million to coffee producers worldwide.[37] Fair Trade certified coffee producers are small scale farmers that are organized into cooperatives.

The first Fair Trade label was created in the Netherlands in 1988 with the Name Max Havelaar. The initiative grew and today there are 14 sister organizations in Europe,[38] and more recently organizations have developed in the US, Canada, Japan, Australia and New Zealand. On average the estimated retail value increased by 37 percent between 2004 and 2005, from US$ 634 million to US$ 871 million respectively.[39]

The five guarantees behind the Fair Trade label are[40]:

• Farmers receive a fair and stable price for their products.

• Farmers and plantation workers have the opportunity to improve their lives.

• Greater respect for the environment.

• Small-scale farmers gain a stronger position in world markets.

• A closer link between consumers and producers.

Fair Trade was created to address market failures and their social impact at source. It offers a new model of the producer-consumer relationship that connects production in the South and consumption in the North and distributes its economic benefits more fairly. It attempts to address the gross imbalances in information, bargaining and market power that typify the commodity chain and does so by countering the current market failures.

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[34] For full list of certified products see FLO homepage: www.fairtrade.net
[35] Nicholls, Opal (2005) pp. 5, 191
[36] Wills, (20050622)
[37] Nicholls, Opal (2005) p. 201
[38] Representing Austria, Belgium, Denmark, Finland, France, Germany, Great Britain, Ireland, Italy, Luxemburg, the Netherlands, Norway, Sweden and Switzerland.
[39] FLO (2005) p. 4
[40] For a detailed description of certification, policies and aims see the homepage of FLO: www.fairtrade.net

Fair guarantees an agreed minimum producer price and a social premium, by focusing on development, sustainability and technical assistance. It attempts to improve the producers' position by shortening the commodity chain, providing market information, capacity building in organisations and advance payments.

4.1. The World Market

Almost all coffee sold as Fair Trade is consumed in industrialized countries. The demand for Fair Trade coffee is growing rapidly but is still far from absorbing all certified coffee on the market. However, as opposed to the market for conventional coffee, there may be positive effects from the so-called oversupply. This is as competition remains despite the floor price provided by the Fair Trade, which otherwise could have decreased incentives for uncompetitive producers to exit the market.

Supply

The supply of Fair Trade coffee and the number of suppliers are rapidly increasing. 112 000 MT certified Fair Trade coffee is already being produced annually. [41] There is a total of 586 Fair Trade certified producer organisations of which 231 are coffee producer organisations.[42]

In table 3 it is evident that almost 80 percent of the coffee producer organisations labelled as Fair Trade are situated in Latin America, with Mexico, Peru and Colombia having most Fair Trade organisations. Mexico, Peru and Guatemala are also the countries that gain most from Fair Trade and together they export more than 50 percent of the Fair Trade coffee in the region. Brazil and Vietnam, the two biggest coffee producers, have 6 and none Fair trade producer organisations respectively. The likely reason is that both countries are characterized by large scale farming.

It is not likely that the supply of Fair Trade coffee will grow in the years to come. There is an estimated 80 percent of excess producing capacity of Fair Trade coffee.[43] As shown below there is already about 40 000 MT coffee that is certified but not commercialised as Fair Trade, and that would be enough to satisfy a possible increase in demand. On average only an estimated 30 percent of the coffee certified as Fair Trade is actually exported to Fair Trade markets.

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[41] Cims (2003) p. 27
[42] www.fairtrade.net
[43] Ronchi (2006) p. 5

Table 3: Number of Fair Trade producers, production and exportation per country in MT

Country	No	Production	Export	Country	No	Production	Export
Bolivia	18	2 414	1 176	Indonesia	3	Na	Na
Brazil	6	3 420	6	Ivory Coast	1	Na	Na
Cameroon	2	Na	Na	Laos PDR	1	Na	Na
Colombia	24	3 378	2 892	Mexico	38	12 210	6.934
Congo	1	Na	Na	Nicaragua	13	3 868	1 193
Costa Rica	6	3 312	1 655	P. New Guinea	4	Na	Na
Dominican Republic	3	674	86	Peru	25	16 026	2 279
East Timor	1	Na	Na	Rawanda	5	Na	Na
Ecuador	1	182	19	Tanzania	7	Na	Na
El Salvador	7	606	472	Thailand	1	Na	Na
Ethiopia	3	Na	Na	Uganda	10	Na	Na
Guatemala	22	12 367	3 329	Venezuela	2	335	12
Haiti	7	294	156	Zambia	1	Na	Na
Honduras	19	4 182	445	Total	231	63 268	20 654

Source: Number of organisations compiled from FLO, May 2006: www.fairtrade.net. Production and export volumes is for 2002 from CIMS (2003) p. 28

Demand

Demand has rapidly increased both in already established markets, but especially so in new markets. However, far from all Fair Trade coffee supplied is absorbed by the market. Fair Trade certified coffee was sold in the industrialized world to an estimated value of US$ 871 million, an increase of 40 and 37 percent respectively from the year before.[44] As can be seen in the table below, almost 34.000 MT was sold in 2005, more than double the volume of only four years earlier. About 98 percent of the Fair Trade coffee is sold in the markets of industrialized countries.[45]

The countries of the European Union account for about 50 percent of the Fair Trade market and the US for a third. Holland was the first country to commercialize coffee as Fair Trade and still accounts for a big percentage. However, Holland and Italy are the only countries where the sales volumes are actually decreasing. On the other hand there are new markets that are sky rocketing. Both US and Canada for example have increased their sales by 70 percent, and due to a large and rapid increase in demand in France the country is now the single biggest market in Europe and second biggest in the world.

[44] FLO (2005) pp. 5-6
[45] CIMS (2003) p. 31

Table 5; Sales volumes of Fair Trade certified coffee by main countries (in MT)

Country	**2001**	**2002**	**2003**	**2004**	**2005**
EU	11 307	11 887	13 789	14936	18 378
France	*950*	*1 386*	*2 364*	*2 784*	*5 342*
Germany	*3 129*	*2 942*	*2 864*	*2 981*	*3 278*
Holland	*3 105*	*3 140*	*3 096*	*2 982*	*2 860*
United Kingdom	*1 554*	*1 954*	*2 889*	*3 339*	*4 482*
Sweden	*254*	*289*	*294*	*375*	*520*
Switzerland	1 306	1 246	1 550	*1 462*	1 487
U.S.A.	1 263	1 854	3 574	6 577	11 240
Canada	277	426	625	826	1 401
Others	186	241	335	421	1 485
Totals	**14 339**	**15 654**	**19 873**	**24 222**	**33 991**

Source: Compiled from ITC, chapter 03.06.03

The amount sold, 34.000 MT in 2005, can be compared with the amount produced, 112 000 MT reported 2 years earlier. It is likely that the difference is even bigger as the number of certified producers is increasing rapidly. That the supply of Fair Trade certified coffee is bigger than the demand so that only 30 percent of the production is absorbed on the Fair Trade market might, however, also be seen as a way not to distort the market. Fair Trade makes a difference for producers even if they only sell 30 percent of their coffee on the market. The remaining 70 percent is sold on the conventional market and this helps maintain incentives to exit the market for uncompetitive producers, and also maintains incentives to diversify the coffee into a higher value product to increase competitiveness for the producers who remain in the sector.

Prices

While there is a rapid growth in most social certification systems and labels, Fair Trade is the only one guaranteeing a minimum price paid to coffee producers. The floor price is structured using the following formula:[46]

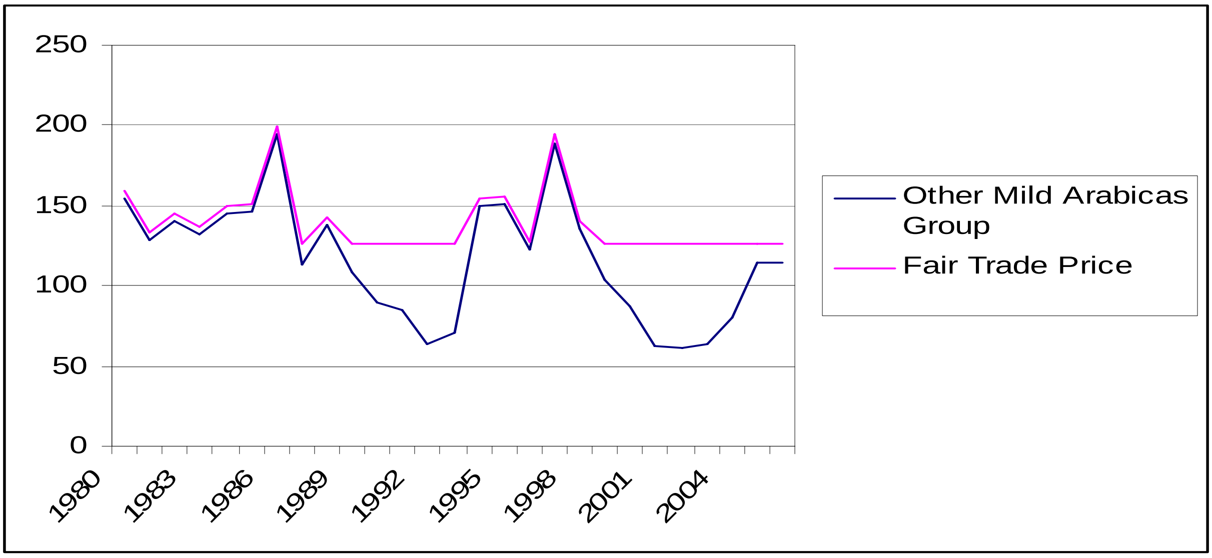
Fair Trade floor price= cost of production+ cost of living+ cost of complying with Fair Trade standards

While the cost of production and cost of living differ greatly between different continents and countries,

[46] Formula from Nichols, Opal (2005) p. 41

the minimum price for Arabica coffee is the same all over the world, though it is higher than the floor price for Robusta and an additional premium is given for organic production. However the difference can be substantial even between two neighbouring countries, Costa Rica and Nicaragua for example. Costa Rica having a much higher cost of living with a GDP four times higher in terms of purchasing power,[47] and a cost of production between 22 and 33 percent higher than Nicaragua.[48] At the moment the Fair Trade market guarantees a minimum export price of US$ 1.26/ lb and US$ 5¢ as a premium when prices are above the floor price. However from the 1st of June minimum price and the social premium will be changed for the first time for 15 years. The new floor price for Fair Trade Arabica coffee will be US$ 1.31/lb with a social premium of US$ 10¢.

Figure 5: Comparison of market price for conventional coffee and Fair Trade coffee 1980-2006



Source: Compiled with prices for conventional coffee from ICO homepage: www.ico.org

As was seen in the previous chapter, coffee prices are extremely volatile and have occasionally been below production costs in for example Costa Rica. The volatility makes coffee producers very vulnerable, especially as coffee producers often are among the poorest in the producing countries and rarely have access to credit. The above figure shows that the price on the world market has been below the Fair Trade producer price floor for fourteen years since the 1980s. It is obvious that the volatility in prices is decreased with a floor price, and being Fair Trade certified can be seen as a security. Even in times of low prices producers

[47] Nichols, Opal (2005) p. 41
[48] Castro, Montes, Raine (2004) p. 41

are guaranteed the minimum price at least for the share of their production which they can sell on the Fair Trade market.

The social premium is to be used collectively by the cooperative on social or environmental development projects in the community. In developing countries, and particularly in rural areas, governments are usually poor at supplying health services, education, infrastructure etc. The Fair Trade premium can be seen as a saving rate among farming communities that makes it possible for producers to jointly decide upon investments to improve their social conditions or the natural environment.

4.2. The Costa Rican Sector

Costa Rica was one of the first countries that enjoyed a concerted Fair Trade intervention effort when Coocafé first entered the Fair Trade market in 1989, only one year after the foundation of the consortium.[49]

However, discussion about paying producers a fair price started earlier in Costa Rica. During the first half of the 20th century, when the coffee sector went through a series of changes, the small and medium sized coffee producers required a fair price from the processors and exporters. Thereby the producers started to become more organized to defend their interest. La Asociación Nacional de Productores de Café, that later became ICAFE, implemented a series of reforms and laws. The institution of ICAFE was developed with a philosophy to ensure a fair relationship between producers, millers and exporters of coffee.[50] However, many producers say that ICAFE was mostly a public organisation governed by exporters, processors and not representing the small individual coffee producers until recently when the organisation of the institute changed and producers for the first time gained a majority of the seats on the board.[51]

In 2005 20 percent of all the processing factories in Costa Rica were owned by producers organised into cooperatives and 40 percent of all the coffee processed can be attributed to cooperatives. The number of cooperatives and their share of coffee decreased slightly from the year before.[52] Many cooperatives in Costa Rica have been established to improve the producers' situation and their bargaining power and to increase participation, democracy and the distribution of wealth. This is also the motive of Fair Trade. Coocafé is a

[49] Ronchi (2006) p. 18
[50] Zamora (1997) p. 88
[51] This opinion was for example expressed by Arias, interview 20061130.
[52] ICAFE (2005) p 29, ICAFE (2004) p. 23

second level certified cooperative that is owned and controlled by 9 cooperatives from three different regions of the country. For many years Coocafé was the only Fair Trade participant in the country on the Fair Trade market. However, during the last couple of years more cooperatives have become interested in Fair Trade certification. There are now 7 producer operators certified as Fair Trade in Costa Rica,[53] although due to, for example, larger size or already developed market relations, they are not part of Coocafé.

Coocafé was founded in 1988 as a result of a series of workshops aimed towards improving the quality of life of small coffee producers in Guanacaste.[54] Coocafé works to improve the social situation for small coffee producers. Their associated cooperatives are situated in the most vulnerable parts of the country and are among the smallest in number of associates and in area per producer. Collectively cooperatives of Coocafé are responsible for 2.5 percent of Costa Rica's National output.[55] Nevertheless, Coocafé is the biggest exporter of Fair Trade coffee[56] and the international link that gives financial, administrative and technological help to the associated cooperatives. Coocafé is also important in commercialising the coffee, accounts for a large part of the value added and gives advance payments to their associates and hence to the producers.

Main Participating Cooperatives

The Coocafé cooperatives participating in this study are CoopelDos, CoopeSantaHelena, CoopeSarapiquí and CoopeLlanoBonito.

CoopelDos is situated in Guanacaste and is a founding member of Coocafé. It has 430 members producing 6.9 MT. The cooperative has coffee as its main activity but also runs 2 supermarkets, 2 cafés, a forest tree nursery, coffee tours for tourists, two projects with combustible service for its members and the CNPE (Consejo Nacional de Producción) for production of finalised products. CoopelDos sells coffee to FEDECOOP, directly to Starbucks and also has the Utz Kapeh certification. 23.000 kg of the production is also

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[53] These are CoopeTerrazu, CoopeAgri, CoopeSanvito, Cooperativa de Caficultores de Sabalito, Cafecoop RL, Asociacion Alianza de Familias Productoras Organicas de CR, Coocafe. The first mentioned is participating in this study. 4 first mentioned belong to Cafecoop RL which is a second level exporter comparable to Coocafe. Cooperatives belonging to Coocafe are: CoopelDos RL, CoopeSantaElena RL, CoopeLlanoBonito RL, Coopesarapiqui RL, CoopeMontesdeOro RL, CoopeCerroAzul RL, CoopePilangosta RL, CoopeAtenas RL, CoopePueblos RL. 4 first mentioned participating in this study. Full list can be found on FLO homepage: http://www.flo-cert.net/lop.html However, this page mention 2 more producer operators that in fact are not producer organisations but a trader and exporter.

[54] Ronchi (2002) p. 5

[55] Ronchi (2006) p. 22

[56] Molina et al (2006) p. 6

certified as organic and the cooperative received help from Coocafé with the transformation. Its nearest competitor is situated 15 km away.[57]

CoopeSantaHelena was established in 1971 but did not enter the coffee market until 1988. The cooperative has 45 associate producers. It is also situated in Guanacaste but the conditions for local sales are special due to the fact that the cooperative is located in one of the areas with the highest rate of tourism in the country. CoopeSantaHelena sells almost 20 percent of its coffee with Geographical Indicactor of Origin (GIO) *Monteverde* to tourists and also collects income from agro-tourism, a souvenir shop and a café. It is one of two cooperatives that belong to the consortium that sell all their coffee for export, about 50 percent of total production, as Fair Trade through Coocafé.[58]

CoopeSarapiquí was established 1969 and has 170 associated producers. It is one of the smallest cooperatives, but nevertheless it has two supermarkets and one shop with fertilizers and pesticides. It is situated in one of the poorest areas in the country and was the only Fair Trade certified cooperative and also the only cooperative, out of 7 in the area, that survived the decline in coffee prices a few years ago. CoopeSarapiquí is the other cooperative of the consortium that sells all its coffee for export, about 70 percent of total production, as Fair Trade through Coocafé. To increase the local consumption of quality coffee from the cooperative, CoopeSarapiquí has started the project Mi Cafesito; for one basket of coffee the producer is given one kilo of roasted and packaged quality coffee. CoopeSarapiquí also produces banana and yucca chips for export through Coocafé.[59]

CoopeLlanoBonito was established in 1972 and currently has about 600 associates. Coffee generates the only income for the cooperative and in the future CoopeLlanoBonito would like to increase its incomes by shortening the commodity chain and creating its own virtual store on the Internet. Since the association with Coocafé all their coffee is shade grown, but they have no other certifications. However, CoopeLlanoBonito is looking for a GIO certification together with two other cooperatives in Tarrazú, Los Santos. It is the only cooperative of Coocafé situated in the traditional coffee region of Los Santos.[60]

[57] Information collected at the time of the visit and through interview with Molina and Ulate 20061206

[58] Information collected at the time of the visit and through interviews and discussions with Vargas G. 20061206 and 20061208 and with Vargas N. 20061207, 20061208, more information at www.cafemonteverde.com

[59] Information collected at time of the visit and through interviews with Membreño Bustos 20061218

[60] Information collected at the time of the visit and through interview with Cabezas Varela 20061201, more information at www.coopellanobonito.com

5. Fair Trade Impact in Costa Rica

Fair Trade coffee is sustainable coffee and has environmental, social and economical effects on producers and producer organisations.[61] The Fair Trade impact on producers and producer organisations can be seen through its work to improve the quality of life of producers by the use of a price floor and a social premium, and by offering support service to producers and their organisations. The Fair Trade certified cooperatives also gain from long-term relationships with buyers in industrialized countries, a shorter coffee commodity chain and credit provision. This not only helps them in Fair Trade sales but also in their long-term overall performance.

Ronchi (2002) has written about the impact of Fair Trade in Costa Rica and divided it into direct impact on producers and the producer organisations and indirect impact on producers, producer organisations and the market as a whole. This distinction is also used here. While direct impact is easier to measure, indirect impact is more difficult to quantify. Nevertheless, the externalities that can be derived from Fair Trade are important for the analyses of its impact and will therefore also be an important part of this chapter.

5.1 Direct Impact on Producers

The most direct impact on producers is the guaranteed minimum price and the distribution of the premium. In 2002 FLO estimated the income benefit to Fair Trade coffee producers at US$ 30 million.[62] In 2005 the benefit was US$ 12.67 million.[63] The estimation is calculated as the difference between the Fair Trade floor and the world market prices of coffee, multiplied by the volume traded. It becomes clear that the income benefit has decreased sharply. The direct economic gain only from the price floor and premium is still substantial, but in spite of a rapid increase in sales volume it has more than halved due to an increase of the market price for conventional coffee.

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[61] The term sustainable coffee includes Fair Trade, Rainforrest Alliance, Utz Kapeh, Birdfriendly, Shade or Eco-friendly and organic coffee. Fair Trade is the widest certification including most perspectives.

[62] Compared to US$ 37 million for Fair Trade certified coffee, tea, cocoa, suger, rice, fruit, honey and juice producers all together. See Nichols and Opal (2005) p. 201

[63] This calculation is based on Fair Trade sales volume from the FLO Annual Report, 2006 and an annual average of US$ 1.15/lb for Other Mild Arabicas, from ICO monthly prices at ICO homepage: www.ico.org. The Fair Trade minimum price+ social premium used is US$ 1.26/lb.

During the 2006/2007 harvest the average price of coffee in Costa Rica was US$ 1.27/lb,[64] about the same price as for Fair Trade certified coffee. In times when the market price for conventional coffee is close to the minimum price of Fair Trade coffee, many producers and consumers question the importance of Fair Trade certification. Some cooperatives can find as good prices by selling to other buyers and many producers also complain about the floor price being too low. Nevertheless, as was seen in figure 5, since 1989 when Coocafé first started exporting Fair Trade certified coffee, the world market price has been below the minimum price for fourteen years. Coffee prices are extremely volatile, which increases producers vulnerability, but it is a widely held opinion among managers that, "Fair Trade can be seen as a security… not so important in good times but can be a matter of survival in bad times".[65]

The importance of the minimum price and the social premium is further enhanced as the number of certifications and number of certified producers increase. The competition in the differentiated market tightens and there is a risk that the "natural" price premiums will decline.[66] Further, many producers find the many different possibilities confusing. Hence the vulnerability increases when the outcome of an expensive certification is unknown.

In Coocafé half of the premium is divided equitably among the nine cooperatives and the other half is distributed to the cooperatives in ratios based on their average volume of production during the last three harvests. 30 percent of the premium goes to a capitalization fund from which the cooperatives can borrow and the rest goes to a producer fund. At the end of the 20th century the Producer Fund distributed over US$ 1.25 million Fair Trade coffee export revenues to some 4 000 affiliated coffee producers.[67]

The producers of Coocafé also gain from the two foundations established by the consortium and financed by the social premium; Hijos del Campo and Café Forestal. The former mentioned is responsible for scholarships for secondary and university studies and has financed investments in rural schools, educative infrastructure and public service. This is a very important project as the most neglected schools and students who do not continue to secondary school can be found in rural areas. During the last ten years 2 333 students have benefited from scholarships and 230 schools have received financial help from the program to

[64] Barquero S (20061216) 25A
[65] This opinion is for example held by Membreño and Vargas, Guillermo and Carlos.
[66] By "natural" I mean premiums that are derived from market conditions and hence not decided by rules or regulations. Such premiums can, for example, be due to high quality, for GIO and brand recognition.
[67] Ronchi (2002) p. 7

an estimated value of about US$ 361 666.[68] Primary school is compulsory, but in many of the rural and remote areas a substantial number of the students do not continue school past the age of 12. However, often it is not only lack of money that makes it difficult to continue to secondary school but also distance and bad communication, as many producers are situated in the mountains and often in areas where infrastructure is most poorly developed.[69]

Café Forestal was established in 1993 by Coocafé to invest in sustainable coffee production. Café Forestal promotes agro-forestry, organic fertilizer production, agricultural diversification, training and systematization. The foundation invests in activities that focus on the protection and conservation of the communities' biodiversity, soil, and water and funds environmental education and provides training and encouragement to its members to help them convert to sustainable coffee production. The foundation's income is generated from the contribution made by consumers as the foundation receives US$ 1 for every kilogram of sold roasted Café Forestal coffee.[70] The foundation helps producers make the shift from traditional to sustainable production and this might be important when selling remaining coffee to conventional markets as certified sustainable coffee can obtain a better price on the market than traditional coffee.

Indirect Impact

The unpredictability of prices limits farmers' access to credit for improved production and may lead them to adopt low-yield, low-cost production techniques that limit their ability to improve their living standards.[71] The lack of credit constitutes a challenge for producers on the conventional coffee market and will as such be discussed in the following chapter. Fair Trade facilitates access to credit and guarantees overall higher and more stable prices to producers. This may improve producers' quality of life and also stimulate production and higher quality production. The indirect effect of Fair Trade pricing is that it enables producers to plan and to make long term investments in their plantations. This implies that Fair Trade pricing may indirectly give rise to higher yield and higher quality coffee.

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[68] Anchia, interview 20061127

[69] This was confirmed by Jasmin Jeminez Bonillo, 12 years, who was the only child of 5 in the family who did not collect coffee but was in school at the time of the visit to CoopeLlanoBonito. We met her on her long walk home and when given the question of whether she was going to continue to secondary school next term she answered "Maybe, but I might not." This, I was informed, was a common answer and meant that she could not continue her studies without financial help to buy books, transport, clothes, etc.

[70] To learn more about Café Forestal see: www.coocafe.com

[71] Giovannucci, Lewin and Varangis (2004) p. 21

Indirectly the producers also gain from non-financial services of the cooperatives and Coocafé. Many cooperatives have complementary businesses such as supermarkets and agricultural input outlets, agricultural, technical, organic and environmental support.[72] According to Ronchi (2002) none of these services were developed or available at CoopeLlanoBonito at the time of her study. She claims that this was due to the fact that they were a new associate of Coocafé and lacked resources. Four years later Cabezas[73] said that if it was not for Fair Trade the cooperative would not have survived the so called coffee crisis, and they have transformed their whole coffee production to be shade-grown. This is a result of Coocafé promoting shade grown coffee as part of Café Forestal. The shade increases the quality of the coffee but external benefits are also gained from progressive plantations. By promoting the use of shade trees a natural shade canopy is maintained which often is home for several animals, insects and birds. Trees are important to prevent water derogation, to protect the coffee plantation from wind and often bear fruit for domestic consumption. The trees add natural nutrients to the soil and make it possible for producers to reduce the use of chemicals to create a safer environment for fauna, especially for species of native and migratory birds.

Fair Trade has helped many producers to be able to stay in the coffee sector. CoopeSarapiquí is a good example, now being the only cooperative in the area that had 8 before the coffee crisis. Without Coocafé and the Fair Trade certification there would probably be no cooperative at all left in the area and thereby barely any coffee producers as most of them rely on the cooperative. During the coffee crisis many producers did leave coffee, in part because of low and fluctuating prices. It might be argued that Fair Trade prevents uncompetitive producers from exiting the market. However, Coocafé works to facilitate diversification into other crops and further, by guaranteeing a minimum price on the Fair Trade coffee market the future of producers becomes more predictable and hence possibilities of trying other businesses might improve. The investments and programs in education may also improve those possibilities, the self-esteem of producers and net-works needed to enter other sectors. To facilitate diversification out of coffee is, however, an important challenge both for the coffee sector as a whole and for the Fair Trade movement and will as such be discussed in chapter 6.

[72] Supermarkets: CoopeSarapiqui, CoopelDos, input outlets: CoopeSarapiqui, organic support: CoopelDos. All four cooperatives stand for technical, agricultural and environmental support.

[73] At an interview held 20061201

The number of Costa Rican families living in urban zones has doubled in eleven years.[74] Fair Trade is important to prevent coffee farmers from leaving for the city. When migrating to San Jose, the capital of Costa Rica, many face a harsh reality and unemployment as “the city does not have work for all”[75] Many coffee growing areas are situated close to San José and many producers have also left coffee production as the city expands and increases the value of land in the area close to the city. At CoopeLlanoBonito for example many of the producers had earlier migrated to the United States and many of the young people now wanted to do the same. However, it is difficult to know exactly how many coffee producers have left the sector in the last years as the taxes on coffee producers are high and therefore the registration may not be reliable.

Fair Trade is important in providing hope to producers. This is also reflected by Gerardo, though in a dejected sentence. Producers are aware of the imbalance in the coffee commodity chain and the unwillingness of the roasters and commercialisers to change the prevailing systems creates frustration. Fair Trade helps consumers to affect trade and to put pressure on actors further up the chain, and thereby enables change and may also make it easier to carry out reforms by governments and international organs. However, a transformation takes time and presumably many coffee producers in Costa Rica will have exited the market when it takes place, if it ever will take place.

5.2. Direct Impact on Producer Organisations

The direct impact on Coocafé from being certified as Fair Trade is that networks are facilitated, the position on the world market is strengthened and information flows facilitated.

The direct Fair Trade impact on the nine cooperatives is mostly through support from Coocafé. The support is given both non-financially and financially in the form of loans. Increased access to credit is one of the principles of Fair Trade, but it has not always been successful for Coocafé. Probably the widespread acceptance of giving credit and loans to the producers and producer organisations was one of the reasons for Coocafé’s bad economical situation that almost led them to bankruptcy in 2006. Many employees from within the organisation say that the break up of two of its cooperatives CoopeTilas and CoopeBuena was another big decisive issue. Now Infocoop has become an associative in Coocafé and the acceptance of loans seems to have diminished and they are better controlled.

[74] Programa Estado de la Nación (2006) chapter four
[75] Carlos Lopez, interview 20061118

Nevertheless, the loans are still important for many cooperatives to be able to pay the producers in advance. Cooperatives are obliged by law to pay part of the harvest in advance but competition from private processing factories can be strong and those often pay producers entirely in advance. To manage the competition CoopeSantaHelena is just one cooperative that tries to pay a larger share in advance than appointed by the law. The loans from Coocafé have the advantage of accepting coffee as collateral. There are different opinions about the difference in the interest rates of Coocafé and the official banks. Guillermo Vargas from CoopeSantaHelena says that the interest rate from the bank is about the same or lower but that it is more difficult, time consuming and bureaucratic to obtain a loan.[76]

Coocafé also helps the cooperatives with technical assistance, to incorporate norms from FLO of quality and to improve environmental and productive levels. Since 1997 Coocafé has been an exporter and helps cooperatives to gain access to new markets. This is very important for the cooperatives. As they are small they often lack the possibility of creating, maintaining and developing relationships with roasters and commercialisers in the United States and Europe. Coocafé centralises the export, performs a second quality control and packages the coffee. Coocafé also commercialises roasted coffee, the most important being Café Forestal. By doing this, Coocafé increases the value added to the coffee. Further, Coocafé is important in generating markets for new products, the latest being banana and yucca chips and handicrafts.

A cooperative is an association of individuals that jointly own and democratically control the enterprise to meet economic, social and cultural needs. When it comes to coffee, Fair Trade producers must be organised into cooperatives.[77] In Costa Rica cooperatives in general pay 15 percent more to coffee growers and Fair Trade cooperatives in particular pay 25-35 percent more than private companies.[78] Hence, being organized into cooperatives matters and being a Fair Trade certified cooperative has an even greater impact.

For the main participating cooperatives of Coocafé the organizational benefits are derived by producers from the producer cooperatives and by the cooperatives from Coocafé. The organisational form is relatively common among small scale producers in Costa Rica and has both social and economic impacts as seen in the figure below. The social impact is the impact of a democratic organisation and decision making and is in line with the Costa Rican culture and its principles. The economic effects of the organizational form are that small scale

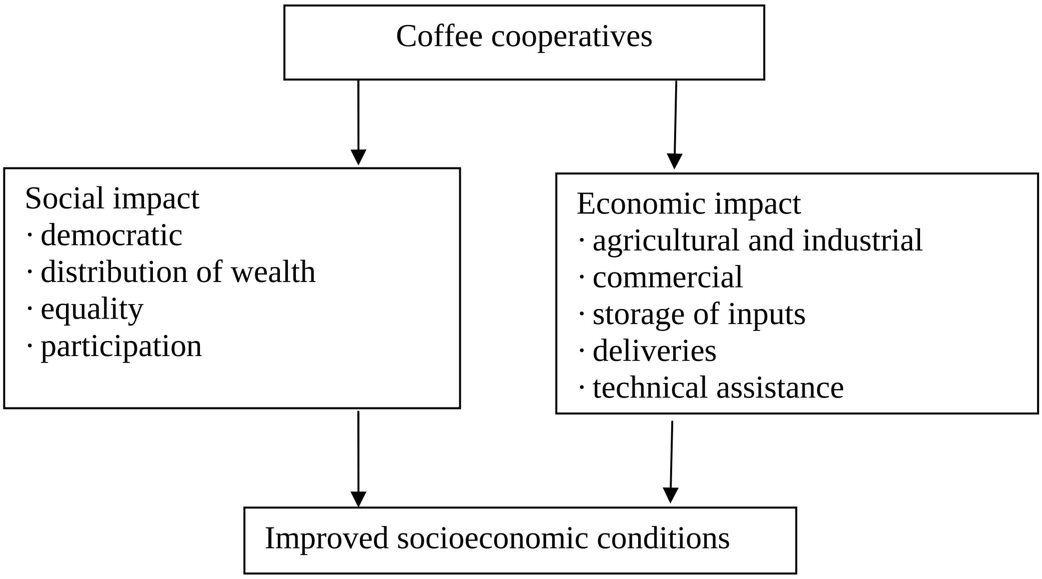
[76] Vargas, G. interview 20061208

[77] There are different rules for different commodities. Banana producers for example do not have to be small producers nor organised into cooperatives.

[78] Vargas, G. interview 20061208

producers and smaller and remote cooperatives gain from coordination and economy of scale from the first and second level cooperatives. Together they can obtain agricultural and industrial advantages. The producers own the processing factory and the cooperatives own the factory where the coffee becomes ready for exportation and can undertake projects to improve their standard. Further, it is easier to make use of positive spillovers from one firm to another and from one cooperative to another. It is easier to spread knowledge as well as technical assistance within the cooperatives. Together they can afford to commercialize the coffee and decrease costs for storage of inputs and deliveries.

Figure 6: Impact of Cooperatives



An important consequence of being Fair Trade certified is that it creates a new set of trading partners. Thus Coocafé has been able to create and develop relationships with partners that are not only commercial but also in many ways ethical. For example their British partner, Twin Trading donates an important part of its profit to support its producer activities, the total amount being US$ 266 000 in 2005.[79] It is also important as it promotes Fair Trade coffee in the British and international markets.

Indirect Impact

The indirect benefit of being organised into cooperatives is improved socioeconomic conditions. The organizational form is also important to empower producers. To be part of an

[79] Twin and Twin Trading Ltd (2005) p. 19

association that is commonly owned and where decisions are taken democratically helps producers gain self respect and raise social trust in the community. The organizational form may increase the social and political freedom of the individual and this is often strengthened by the fact that the cooperatives enable the community to improve local infrastructure and education. Seeing poverty in a wider term than income, cooperatives may be a way to speed up development.

Coocafé has an important role as a second level cooperative. The consortium integrates various activities and projects of the cooperatives in the consortium and there is scope for gains from further centralization. Efficient mechanisms of information exchange and provisions for long term investments have often eluded small scale cooperatives but these have been key factors in the success of Coocafé.[80] The provision of information exchange and provision for long term investments can both be derived from Fair Trade certification. Information exchange has increased through Fair Trade and the contacts made through Fair Trade networks and long term investments have been secured through long term relationships and the security of the producer price floor and social premium. To belong to Coocafé and to have the Fair Trade certification within the consortium have further given the small cooperatives some of the advantages of larger ones. A second level cooperative can internalize costs and benefits, increase possibilities of gaining from increasing returns to scale and increase technical and allocative efficiency. The nine associative cooperatives are situated in the most remote areas but belonging to Coocafé gives them infrastructural support. Indirectly Coocafé is very important as the consortium has created new jobs and keeps jobs in the cooperatives and the coffee sector. Coocafé is thereby indirectly responsible for decreasing the social difficulties in the cooperatives and the rural zones under its influence.

5.3. Impact on Community and Coffee Sector

The Fair Trade social premium and projects by Fair Trade cooperatives often benefit the entire communities. For example if investments are made to repair roads the transports made by the neighbouring shop-owner are facilitated, and if the school is renovated even children who do not have parents producing coffee benefit. Many cooperatives have supermarkets, cafés and fertilizer outlets that are open for everybody.

[80] Mosheim (2002) p. 313

Indirectly the whole country gains from reforestation. Café Forestal stands for 500 000 newly planted trees.[81] It is an important project that has increased the number of shade grown plantations. Further the education given by Café Forestal and the changes taking place toward a more environmentally sustainable production for cooperatives might spur the development of other producers. The projects made possible through Fair Trade show that another way to produce is possible and the efforts to shorten the commodity chain show that there are options to conventional trade. To let other producers see that there are alternative ways to produce and trade might inspire and hasten changes in other coffee growing communities.

The Fair Trade impact on the Costa Rican coffee sector on the whole is mostly indirect. Fair Trade producers do sometimes pay prices above the minimum price to collectors, which might have an impact on other producers. For one basket equivalent to 2.3 kg, the collector earns between 1 and 2 dollars of the 5 dollars earned by the producer. One dollar tends to be the most common at the peak of the harvest and is also just slightly over the minimum price by law. A collector can pick between 3 and 15 baskets a day depending on season and the hours of work. As there is a shortage of coffee collectors, competition strengthens when someone raises wages and this, subsequently might drive up wages from other producers. As many producers depend on seasonal labour, the motive to pay higher wages may be to secure the harvest by attracting more workers and not based on moral and ethical principles.

Many conventional producers have not heard about Fair Trade certification and when mentioning it a common phrase is: “My coffee is fair. But what is Fair Trade? What do you mean by fair? Fair to whom?” This question is not without ground and the problematic use of the word has been addressed by Opal and Nichols and according to them *fair* in many ways means *alternative*. However alternative might bring wrong associations. Fair could also mean ethical, but there is a slight difference even between those two.[82] The reason why conventional producers do not get the right associations of the word is lack of information. Further, no certified Fair Trade coffee is sold on the domestic market, hence the certification does not get into other producers´ field of vision. Another reason might be that ICAFE promotes high quality production more than certification for sustainable production.

Many coffee producers are also frustrated due to the large number of certifications available and their role as an entry barrier, necessary to obtain to gain access to the market. “If you are not certified they won’t buy your coffee. The buyers can not promise any stability to the producers as the relationship can be broken any time and there is no minimum price, other

[81] Anchia, Interview 20061127
[82] Nicholls and Opal (2005) write about the meaning of the word Fair (Trade) on pp. 12-13

than for Fair Trade."[83] When certifying the coffee the producer has to take into account the cost of certification and the administration. Many times the idea behind the certification is to provide consumers with information and to facilitate their shopping, more than to improve the situation for producers, and as a result the premium might not outweigh the cost. According to many non-certified producers, Fair Trade just adds one certification to the list of many. Further "premium for high quality is more important than the Fair Trade premium."[84] When looking for a way to stay competitive, the premium and market demand tend to be the most important especially for the bigger producers or cooperatives that are not in as great need of organizational support. Many producers feel like they are forced to certify their production to get access to the market, but certifications are in most cases expensive and the outcome might be unknown. Information is insufficient about what is demanded on the consumer market and where gains are biggest. Certifications are often not seen as an opportunity but as an obligation to gain market access and stay competitive.

[83] Arias, interview 20061130
[84] Corrales, interview 20061122

6. Opportunities and Challenges for the Future

This chapter explains the challenges on the market for conventional coffee and the opportunities provided by Fair Trade. However, this chapter also highlights several challenges that the Fair Trade movement has to face, both internationally and in Costa Rica. Here the situation in Costa Rica is focused on the experience of Coocafé.

6.1. Challenges in the Coffee Sector

The drop in earnings from agricultural commodities originating in developing countries constitutes one of the most important causes of world poverty.[85] In 2002 the developing countries would have earned US$ 243 billion more if the retail prices of ten of the most common tropical agricultural products had remained as high as in the 1980s. Among 12 of the most common tropical agricultural products coffee shows the greatest fall.[86] It should be noted that Costa Rica has the highest productivity among the producing countries and increases in productivity may outweigh a decline in prices. However, many small-scale producers living in remote areas in other countries still use antique production techniques and have not seen the same increase in productivity. The situation is further worsened as the average volatility of coffee prices at the end of the last millennium was still among the highest of all agricultural commodities.[87] With sharply fluctuating prices the predictability for coffee producers declines.

Diversification out of coffee is important as the quantity of coffee produced has to decrease if prices are to rise in the long term. It is not likely that demand for coffee in the North will rise and even if it does, it would probably not be sufficient to raise prices. The growing non-traditional markets are demanding cheap low quality coffee in soluble form.[88] This speaks against Costa Rica producing high quality Arabica coffee. Another challenge is that roasters have become better at removing the harsh taste of Robusta coffee and more flexible in their ability to switch between coffee types.[89] A strategy in many coffee producing countries is to increase local demand by increasing the quality of local coffee consumed. About 75 percent of the local coffee in Costa Rica is blended with sugar to hide bad quality and to increase

[85] Osorio (2004) p. 1
[86] Lines (2004) p 6
[87] Ronchi (2006) p. 8
[88] Baffes, Lewin, Varangis (2005)
[89] IADB, USAID, World Bank (2002)

received prices.[90] However, even if much can be done to increase the quality of the coffee for the domestic market, it is not likely that this will increase the demand as the consumption per capita is already the second largest in the world among the producing countries.

Appropriate diversification at both the farm and national levels is also suggested by many researchers to decrease dependency on coffee.[91] In search of higher and/ or more stable incomes, diversification has been the solution with which the producer, and a country dependant on revenues from coffee, can shield himself from negative income chocks. As mentioned before the decrease in the number of producers in Costa Rica has been significant and the average age of coffee producers is high. However, while there is support to farmers to differentiate in value added coffee there is less support to diversify out of coffee into other crops. Still the most common alternative to coffee production seems to be migration to the city. Support has to be increased but when promoting diversification strategies it is important to keep in mind that for many producers coffee does not only represent a commodity or a way to earn a living but also a culture. Producers have often been involved in coffee production for decades and hence they have the best knowledge about coffee production. To diversify into other crops requires a lot of information about natural conditions, future demand, market requirements and new networks. Hence, diversification includes risk and a starting capital, neither of which the poorest producers can afford.

As coffee is harvested only once a year farmers often can not wait for good prices and often sell their coffee at the peak of the season even if that is when prices are lowest. Lack of credit is a serious problem on the markets for conventional coffee and credit rationing makes producers vulnerable to negative income shocks. Access to credit enables producers to smooth consumption, make predictions and investments for the future and improve their bargaining power. Production is more stable and sustainable even in the long run. Credit is important both to enable diversification out of coffee for uncompetitive producers and to enable the producers that stay in the sector to look for new alternatives to be more competitive, for example through quality upgrading or certification.

Producers often have bad access to markets due to lack of information and infrastructure. The rural areas are often the less developed in the Southern producing countries and when the coffee sector was liberalized many governments lost incentives to support farmers. Instead of providing services they began to take levies.[92] This had important

[90] Eugenia, and Villegas (1999) p. 65
[91] Dubois (2006) p. 10
[92] Seudieu, interview 20070329

implications as the public sector plays a vital role for the coffee production. The public sector must make sure that macroeconomic conditions and the legal framework are conducive for domestic and foreign firms in order to increase the number of alternatives and possibilities for diversification out of coffee. It has to eliminate distortionary signals to enable producers to make the right decisions when choosing to diversify or specialise their production, and it also has to provide the infrastructure and information needed. Constraints such as low soil fertility, lack of available water and electricity for irrigation, uncertain land rights, poor infrastructure etc are less common in Costa Rica than in many other producing countries. But those factors are highly important for successful coffee production and diversification into other crops and conditions must be addressed and improved by the governments.

Many producers are small scale farmers and as such are poorly coordinated. This, together with the loss in bargaining power and the bad market access, makes the market power and share of income of producers small. The commodity chain seems to be buyer driven as it in many cases is governed by the wholesalers, retailers and brand name companies that are closer to the final customer. The closeness makes it easier to attain knowledge about consumer preferences and changes in demand, which casts light upon the importance of shortening the chain. Producers also remain poorly organised and often situated in remote areas characterized by bad or no information systems, whereas the actors on the top of the chain are few and have access to all the new information through all the new systems. The latter further have the advantage of being close to the final market and can easily respond to changes in demand and new niche developments. While producer prices have shown a long-term declining trend and high volatility both in the short and long term, other actors further up the chain have continued to make big profits.

Another important task to deal with for the coffee sector is the lack of labour for the collection, which according to Eduardo Esteve[93] is the biggest future threat to the coffee sector in general, and which without doubt already is a great threat to the Costa Rican coffee sector in particular. About 200 000 people participate in the collection and an estimated 50 percent are foreign workers.[94] The coffee sector in Costa Rica is totally dependent on seasonal migration from Nicaragua and Panama for the coffee collection. There are numerous reports of abuse and immigrants risking their lives when crossing the border. No abuse of immigrants was observed at any of the cooperatives visited, though immigrants were hired seasonally for the collection and there might be reason for moral questions in the Costa Rican

[93] Speech 20061113
[94] Barquero S. (20061216) 25A

coffee sector as a whole. Costa Rica does attract collectors from Nicaragua, which is a big coffee producing country and also has a lack of coffee collectors. Costa Rica attracts labour from the less developed Nicaragua by offering higher wages, though wages are still far below average in Costa Rica.

6.2. Fair Trade Opportunities

Since the abolition of the ICAs several options to influence the coffee sector have been proposed. However, most have been difficult to implement, monitor and finance.[95] Fair Trade is the most important movement that has been able to operate in the political, economic and technical conditions of today. Fair Trade is a kind of market intervention, but is different from many others as it works from within the system and the market. It addresses the market failures on the market for conventional coffee, reduces the fluctuation in prices by offering a minimum price and provides a social premium that makes it possible for the producers to invest in rural development projects to improve infrastructure, education, the environment and social circumstances. Possibilities of making investments are further improved as Fair Trade facilitates access to credit. It is often possible for producers to use coffee as collateral. This is important as official banks usually do not accept coffee as mortgage for a loan and coffee producers thereby seldom fulfil their requirements. In Costa Rica many independent processing factories pay producers for the whole harvest at once while cooperatives may pay in periods during the year. When producers are unable to smooth consumption due to lack of collateral or other forms of credit rationing the latter may be preferable. With access to credit producers can more easily make prediction for the future and are less vulnerable to negative income shocks.

A big challenge for the conventional coffee market is how to promote sustainable diversification. Coocafé has made several attempts to export macadamia nuts and chips of banana, yucca and potato. However on producer level the diversification often means production of other crops for family consumption, turning to tourism, selling the land to real estate agencies and migrating to the city. Costa Rica is characterized by high levels of urbanization. The Fair Trade price floor does not increase incentives for producers to exit the coffee sector, but gives Fair Trade producers a safety net while they are able to develop their capacity to either improve their competitiveness on the market or explore other markets. The

[95] To read more about those options see Ponte (2001) 24, and for more information about International Commodity Agreements see Bohman, Jarvis, Barichello (1996)

establishment of Coocafé and entrance to the Fair Trade market can both be seen as a vital strategy to hinder or slow down forced diversification out of coffee. The higher price paid to Fair Trade certified producers might slow down the diversification out of coffee, but still there is no evidence presented in this study that it will stop it. Instead Fair Trade should be seen as a way to give producers time to adjust according to the market. Further Fair Trade might make diversification easier by allowing a higher income to producers that makes it possible to explore alternative income generating projects. Fair Trade gives producers hope and has prevented several producers from leaving the coffee industry and the rural areas for the uncertainty of San José. In Costa Rica it has decreased poverty and improved the quality of life for many producers of the Coocafé cooperatives.

The reason why Fair Trade does not seem to stop diversification out of coffee is likely to be that the floor price is set to equal production costs and basic needs, which is enough for producers to stay in the business in the short run but does not encourage any investments or increased production. However, it should be noted that the floor price is equal for all producers in all countries though production costs and costs of living differ and are among the highest in Costa Rica. Therefore, the impact of the floor price on diversification out of coffee in Costa Rica may differ from the impact seen on diversification out of coffee or other products in other countries.

As a result of continuing diversification out of coffee, the producers of Coocafé present coffee as a dying activity. The average age of the coffee producer part of the consortium is 53 and many of the producers say that their children do not want to take over their farm when they retire.[96] Cesar Hidalgo says that "when getting up at 3 and going to bed at 7 one is his one chief but it is a hard life. I do not want anything else. I want to be a farmer. But my children don't. They want something more interesting. Maybe the tourism industry might open up possibilities."[97] Tourism is seen by many as a way to increase earnings. It is common that cooperatives have, or are trying to develop, tourist attractions in the form of coffee tours or cabins and Coocafé plans to make a plaza that could gain all associated cooperatives. To commercialise Fair Trade for tourists is a strategy for the cooperatives to increase regional demand for Fair Trade coffee, but also for Coocafé to increase national demand. By selling the coffee directly to tourists it is further possible to shorten the chain and integrate the whole process within the company. Selling coffee as a finalized product is seen as a way to break the coffee commodity chain.

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[96] Average age calculated from figures in Zamora, Romero (2006)
[97] Santa Maria Hidalgo, interview on 091206.

The technological development has made it possible to pack toasted coffee and to store it for three years without losing quality, in contrast to earlier 3 months.[98] Coocafé is now trying to sell coffee as a finalized product in order to gain a larger share of the final price. So far only a small share of coffee exported by Coocafé is already toasted, but through increased information about consumer preferences and a wider contact net it hopes to increase the share of toasted coffee for export. However, to succeed requires information about the consumer, the coffee in the consuming country, taste of package, financial and commercial, contacts and there are several barriers such as language and culture that limits opportunities.[99] Further the export of finalised products is hampered by border protection and high tariffs.[100]

Fair Trade acknowledges the imbalances in bargaining and market power. It has encouraged new actors to enter the market in industrialized countries and also works to improve the situation of producers by facilitating information flows and by shortening the commodity chain. The latter decreases the distance between the producer and the consumer and it is easier for producers to obtain information and change their production and diversify their coffee according to demand. Fair Trade provides a link between the producer and consumer and makes consumers question how the products from the South that they consume can be so cheap and if that is morally and ethically defendable. This is also the hope of many producers: "The consumer doesn't think about where the coffee comes from. He has to know more about the conditions of the producer to be able to drink his coffee and feel good at heart."[101] Fair Trade relies on consumers and this is also what most producers, workers and managers at the cooperatives visited say is most important; that the coffee sectors need a change that is driven by demand and not by the multinational firms, because producers fear that it multinationals would collect the profits at the expense of the producers.

6.3. Fair Trade Challenges

Fair Trade still only represents a fraction of the coffee market and many producers do not find enough consumer demand for their certified products. The Coocafé cooperatives sell approximately 30 percent of their coffee to the Fair Trade market. This is in line with other cooperatives around the world. To increase the demand for Fair Trade as a whole is a question of increasing the credibility of the certification. It is important to keep in mind that it is the

[98] Cabeza, interview 20061127
[99] Gomez, interview 20061204
[100] The European Union has a zero tariff and VAT on coffee as an intermediate product (i.e. green coffee) and a 7.5 tariff and VAT on coffee as a finalised product (roasted coffee). See ICO (2007)
[101] Lopez, interview 20061118

independent Fair Trade Labelling Organisation International (FLO) that is responsible for the certification and addresses the issues of social and economic development, environmental management and labour conditions on Fair Trade farms. These Fair Trade standards are subject to an ongoing review and improvement. However, the entrance of big companies such as Nestle and Starbucks on the Fair Trade market may make consumers question its purpose and reliability.

In 2006 Nestlé had a net profit of over US$ 11 billion[102] and Starbucks consolidated net revenues were US$ 7.8 billion for the fiscal year.[103] There are several people talking about a contradiction. It is hard to tell exactly how much of their profit that comes from coffee sales. However, the contradiction lies in the fact that these companies are commercial and represent the interest of their stakeholders. While Fair Trade should be about long term relationships and about improving the conditions for the poor producers in the South, many are scared that price and profit will always be most important for this kind of multinational firm. At the same time Nestlé for example provides "a lucrative market"[104] and as Carlos Vargas says, the goal of Fair Trade must be to make it the norm and not an exception, and to manage this, the volumes must be bigger and the powerful actors must accept it. "The multinationals are a risk for Fair Trade, due to their way of negotiating. However, they could also be the solution for Fair Trade to grow and further increase the market." [105] But it is important that the initiative comes from the consumers and not from the multinationals or the latter could use Fair Trade only to benefit financially from goodwill.

For Coocafé to maintain its strong position on the market it is important to work to increase demand for their coffee by diversification of the coffee produced and by adding value to it. Coocafé produces high quality Fair Trade certified coffee. However, it faces increased competition both nationally and internationally as more producer organisations become certified. Higher labour costs, the shortage of labour and unwillingness of young people to enter the business make the outlook poor. Further, the competition in the Fair Trade market is increasing as more producer organisations in poorer countries become certified, and consumers might choose to support those that they believe live under the worst conditions. The importance of ideology grows. "If the quality of Costa Rican and Nicaraguan coffee is the same, consumers are going to choose the Nicaraguan coffee, because the producers are

[102] Press release Nestlé, Vevey, 20070222
[103] Press release Starbucks, Seattle; 20061116
[104] Membreño, interview 20061218
[105] Interview 20061214

poorer."[106] For Costa Rica to stay strong on the market they have to differentiate their coffee and the higher the quality of other coffees the more important it is. Coocafé has worked hard on maintaining and improving its coffee quality. There is still coffee of the type Catamora on the farms, implemented by ICAFE but now famous for its bad quality, but the cooperatives of Coocafé are attempting to replace the plants. Another problem for Coocafé seems to be the competition from other processing factories and other exporters. There are also reports of some cooperatives selling their highest quality coffee to the highest paying and that Coocafé in those cases would receive the second best coffee. Coocafé has implemented principles of solidarity and faithfulness, though this might not be enough.

The number of certifications has grown as a way to differentiate the coffee but in many cases it has become an entry barrier. Now only one certification might not be enough on the market. In 2002/2003 there was 9 877 MT Fair Trade coffee with double or triple certification while there was 10 777 MT coffee certified as only Fair Trade[107] and the difference is likely to have decreased since then. There is a growing demand for organic Fair Trade coffee. Over 30 percent of the coffee commercialised as Fair Trade is already commercialised as organic coffee. However, in Costa Rica only about 10 percent of the Fair Trade coffee is certified as organic coffee.[108] Nevertheless, organic production has increased rapidly in Costa Rica and tripled from the year 2000 to now be at 15 450 fanegas annually.[109] However, maybe due to lack of comparative advantages on the organic market the increase seems to have stagnated. CoopelDos managed to transform a large part of its production to organic production but the change was costly and did not encourage further expansion. In spite of the rapid growth of organic production it is a widely held opinion that Costa Rica has an important disadvantage in organic production. Their coffee sector is relatively capital intensive and characterized by intensive technology and use of agro-chemicals as opposed to the production in many less developed countries where production might be more labour intensive. The price premium is not obtained until the third year and even when obtained it is said not to compensate the loss in yield and increased labour costs. In other countries, often less developed, certifying the production as organic might be a way to gain profit for a way of production that has been in use for years, and might also facilitate an increase in yield and quality. This is not the case in Costa Rica.

[106] Díaz, interview 20061121
[107] Cims (2003) p. 22
[108] CIMS (2003) p. 29
[109] ICAFE (2006) p. 24

Fair Trade has the lowest certification fee among sustainable coffees but it is still costly for small scale producers. Annual producer certification fees range from US$ 2,500 to US$ 10,000 based upon the size of the producer group and the complexity and length of time the inspections take.[110] Even the lowest amount is huge for a small scale cooperative. The cooperatives of Coocafé have the advantage of bearing the certification in the second level cooperative, but nevertheless the sum is likely to be impossible to carry for many producer organisations. Certification can often be seen as an investment to gain access to higher-priced Fair Trade markets, but even if it is a worthwhile business move in the long run, the fee is likely to function as an entry barrier for the producers that are in the greatest need of certification. Especially when bearing in mind that those small scale farmers often find it difficult to obtain loans.

FLO has developed producer certification grants that are partially funded by the European Union for the smallest producer groups that find the certification to be entry barrier. This way producer groups can have up to 75 percent of the certification fee covered by these grants.[111] However, this requires information, bureaucratic paper work and is time consuming. Those lacking the credit to afford the certification are likely to be the same producers that lack information about Fair Trade. Fair Trade aims at making all trade fair. However in the meantime, there is a risk of polarization between different producer groups and the question arises: Are the producers that obtain Fair Trade certification the ones that need it the most?

Also the situation of seasonal workers might cast doubt about the fairness of Fair Trade. With wages being too low to attract national workers the Costa Rican coffee sector relies on immigrants during the harvest and there have been several reports of workers risking their lives when crossing the borders and the salary they get can sometimes be morally questioned. Coocafé did not seem to focus on the collectors and did not have any particular projects to improve their situation. This can be compared to the newly Fair Trade certified CoopeTarrazú that has a shelter for seasonal workers who can not find work or accommodation. CoopeTarrazú also has projects to reduce illiteracy among the indigenous.

A problem with the seasonal labour in Costa Rica is that foreign collectors often bring their children to the field as it tends to be safer than to leave them alone in the home country or outside their care in the new country. Fair Trade standards follow the ILO conventions 29,

[110] www.transfairusa.org
[111] www.transfairusa.org

105, 138 and 182 on child labour and forced labour.[112] I did not see any forced or bonded child labour in Costa Rica. Neither did I see that any work in the coffee sector performed by children jeopardised their social, moral or physical development or their health or safety. However, children did work and did get paid, though mostly through their parents. “Coffee is not only a product, it is a culture” and therefore not only the coffee sector on the whole but also the Fair Trade cooperatives have some problems upholding the abolishment of child labour.

As collecting coffee is not only seen as a way to earn a living but also as a way of life, a tradition and the engine of many small rural villages, to prevent children from taking part in the activities would be to prevent them from being familiar with their roots and that can be seen as a loss of culture. This view is further strengthened by the decreasing influence coffee has on the young to stay in the countryside and in the agricultural business.

[112] To read ILO conventions go to ILOLEX at www.ilo.org. For information about FLO standards on child labour read article 4.1 of “Generic Fair Trade Standards for Small Farmer´s Organisations”, available at www.fairtrade.net.

7. Conclusion

Fair Trade addresses market failures on the coffee market and aims at improving the situation of producers. The market for conventional coffee is characterized by sharply fluctuating prices. This makes producers vulnerable. The short term volatility is partly due to unpredictable weather conditions in Brazil. Further, demand is inelastic and so is even supply in the short run, which make it even more difficult for prices to reach a stable equilibrium. The producers' situation is worsened by insufficient information and problems of poor infrastructure, market access and coordination. The structure of the world market and the unbalances in, for example, concentration, bargaining power and market power make the producers' share of the final retail price small. Fair Trade addresses market failures and aims at increasing the share of income to some of the most marginalised producers in the South through millions of consumers in the North that want to see another trading system in the coffee market.

Fair Trade is a sustainable certification in three ways. It promotes environmental sustainability. This can be seen in Costa Rica through the various programs to improve reforestation and natural fertilizers, and decrease the use of strong chemicals. It promotes social sustainability by allowing for investments in education, infrastructure and public goods. It promotes local democracy through its organizational form and organizational support service. It also promotes economic sustainability through securing the livelihood of producers. It decreases the fluctuation in prices and thereby increases predictability, improving opportunities to try other income generating projects and facilitating long term investments.

In Costa Rica the five guarantees behind the Fair Trade label are met. In other words farmers receive a more stable price, increased opportunities for improvements in quality of life, improved environmental conditions, a stronger position on the world market and a closer link to consumers. Fair Trade has a positive impact on producers and the producer organisations in Costa Rica. It also has a positive impact on the community in which it works. However, the effects on other producers seem indistinct.

In ten years the number of Costa Rican producers has declined by 20 000. The reasons for diversification are several, but the most important is probably the volatile and declining coffee prices. Many producers leave their land for migration to San José. Urbanization is extensive and the capital can not absorb all the labour. The volatility of prices is decreased by

Fair Trade as is the uncertainty about the future. If it was not for Fair Trade many of the cooperatives of Coocafé would not have existed and many more producers would probably have left the rural areas for urban zones. Hence Fair Trade has had an indirect impact on urbanization in Costa Rica and on diminishing social difficulties in the cooperatives and the rural zones under its influence.

Fair Trade makes prices received by growers fluctuate less by guaranteeing a minimum price. This is important as it allows producers to explore other income generating projects and to improve the coffee produced. In Costa Rica Fair Trade might both facilitate diversification into value added coffee and the diversification out of coffee. It might slow down exit from the market as a whole as producers are not forced out of coffee to survive, but works as a safety net that can help producers adjust to prevailing market conditions and make diversification out of coffee sustainable where production is uncompetitive. In Costa Rica there has been no sign that Fair Trade may stop diversification out of coffee or decrease incentives to improve or add value to the coffee produced. However, it should be noted that Fair Trade may have another impact on diversification out of other Fair Trade certified products or in other countries.

Fair Trade strengthens communities by assuring producers a social premium that works as a savings rate, which they can use to make long term investments to improve social or environmental conditions. The use of the social premium has to be decided upon democratically among producers. Producers are also organised democratically into cooperatives which further strengthens the position of the producer. With a cooperative the producer gains more individual freedom, and hence decreased poverty. A cooperative might improve social and political conditions but also give pure economical advantages of increased scale and allocative and technology efficiency.

More directly Coocafé has had a vital role in diversifying the coffee within the consortium, adding value to it and commercialising it on the world market. Through Fair Trade and Coocafé the small cooperatives have won advantages that otherwise would have been reserved only for bigger producers or producer organisations. Coocafé has also, through the Fair Trade premium, been able to increase education and the environment in rural coffee growing areas with their social and environmental projects. These are projects that benefit the coffee growing families directly and whole communities indirectly. Often the Fair Trade cooperatives have other activities or income generating projects that also benefit the community as a whole.

To continue the increase in importance of Fair Trade, the organization has a number of challenges ahead. At the moment Fair Trade certified coffee producer groups on average only sell about 30 percent of their coffee to the Fair Trade market. Supply is increasing but so is the number of certified producer groups and the number of certifications. To increase demand further, Fair Trade has to increase knowledge among consumers about the producer situation and increase their credibility. Consumers may see a contradiction in that profit maximizing multinationals are entering the Fair Trade market. What may be another reason for consumers to question the credibility of Fair Trade is that children might be working in the fields and also that wages paid to collectors are low. However, in the future payments to collectors are likely to rise both within the conventional and Fair Trade markets, especially in Costa Rica as the coffee sector depends on seasonal labour to secure the coffee harvests.

A challenge for the Fair Trade movement in Costa Rica is the increased competition from less developed producing countries that might find it easier to find demand for their products due to consumer ideology. Competition is further strengthened by increased certification. Double and even triple certifications are becoming more common on the market. The coffee sector in Costa Rica in general receives higher prices than the average on the world market, and it does so by obtaining quality premiums or increased diversification into speciality coffee. The cooperatives of Coocafé have not been able to increase the number of certifications of the second level consortium. There is reason to believe that the 9 cooperatives would gain from internalizing more activities in the second level cooperative, Coocafé.

These programs, institutions and organisations are aimed at helping the coffee producers to reduce their vulnerability and risk. However, one should also bear in mind that this kind of soft budget restriction, where producers can rely on external sources of funding in case of financial difficulties, probably influences the way the farms are managed. There is a risk that farms under soft budget constraints have weaker incentives to raise efficiency, tighten financial discipline and avoid losses. I have not found any evidence indicating that this would be the case in Costa Rica as many producers still feel that they are living on the margin. The various measures have probably slowed down the diversification out of coffee. However, as producers are decreasing the various programs can instead be seen as a way to decrease adjustment costs and give the producers time to find an alternative livelihood. Nevertheless, the possible negative effects of soft budget restrictions might be useful to keep in mind in adopting the system to, or analyzing the impact on, other coffee producing countries.

Producers in Costa Rica gain from the fact that the coffee sector is regulated by law, the several available producer organisations, a culture of cooperativism, a relatively developed public system, better functioning institutions and a welfare state with a long history. This support to producers and producer organisations does not exist in many producing countries, partly because the incentives for governments to support producers decreased when the sector was liberalized. Therefore, Fair Trade may be even more important in other coffee producing countries. Still, the Fair Trade impact is greatly significant in the certified cooperatives in Costa Rica. Fair trade increases the information available to producers and the capacity building in organisations, decreases price volatility and advocates long term relations. Producers' bargaining power increases and long term investments are facilitated. Fair Trade has been important for the survival and development of the participating coffee cooperatives and has facilitated quality upgrading and increased environmental concern.

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