



# Trading Practices for a Sustainable Coffee Sector

## Context, Strategies and Recommendations for Action

Jason Potts  
with  
Guido Fernandez and Christopher Wunderlich

Prepared as a Background Document for the  
Sustainable Coffee Partnership  
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# 1. Introduction

Coffee producers, like others dependent upon agricultural commodities for their income, face a wide variety of obstacles in their efforts to secure sustainable livelihoods. Over the past several decades, concerted efforts have been undertaken to design standards-based supply chain systems aimed at improving the sustainability of coffee farms by specifying verifiable production criteria that are socially and environmentally sustainable.<sup>1</sup> Dealing with the economic component of sustainability has, however, posed a far more significant challenge. On the one hand, it is not entirely clear what the ideal relationship between ensuring “sustained livelihoods for producers” and ensuring market efficiency through the promotion of market competition should be in any given case. On the other hand, economic relations, as a form of social contract based on specific social histories and factor endowments, makes the specification of a generic list of “sustainable” economic practices a difficult and highly questionable endeavour. Both challenges render the identification of a clear and static set of “sustainable trading practices,” inappropriate if not impossible.

Notwithstanding these challenges, it is nevertheless the case that economic sustainability deserves central attention in the context of any efforts to promote overall sustainability since it forms the basic prerequisite for maintaining sustainability along the social and environmental pillars. In a similar manner, the economic sustainability of *producers*, as the poorest segment of the coffee supply chain, merits targeted attention in the context of a needs-based approach to sustainable development.<sup>2</sup> The fact that the economic sustainability of coffee producers plays a pivotal role in determining the sustainability of the coffee supply chain at large, provides the basic rationale for an investigation into the potential of trading practices to contribute to producer economic sustainability. Developing the appropriate mechanisms for promoting economic sustainability at the producer level within the context of competitive free markets and economic efficiency is a challenge that has haunted sustainability initiatives throughout their development and implementation.<sup>3</sup> This paper, based on

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- 1 Examples include: IFOAM, Rainforest Alliance, Fair Trade, Forest Stewardship Council.
  - 2 According to the Brundtland report: “Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs. It contains within it two concepts: 1. the concept of ‘needs,’ in particular the essential need of the world’s poor, to which overriding priority should be given; and 2. the idea of limitations imposed by the state of technology and social organization on the environment’s ability to meet present and future needs.” World Commission on Environment and Development (WCED), 1987. *Our Common Future*, Oxford University Press, Melbourne, at 43.
  - 3 Most standards initiatives specify some degree of economic requirements as part of their standards process. To date, however, such criteria have remained generic and/or simplistic in character. One of the rationales for this investigation is to determine whether or not more specific guidance can be provided in the area of sustainable trading practices with respect to a larger package of sustainable production and consumption.

stakeholder consultations conducted through the Sustainable Coffee Partnership<sup>4</sup> and a series of targeted interviews with professionals in the field, provides a preliminary analysis of the challenges and opportunities facing the strategic promotion and implementation economic sustainability for producers through selected supply chain practices.<sup>5</sup>

Following an analysis of the current context of trading relationships, we provide a short overview of a range of positive trading actions and arrangements that can be used to promote economic sustainability, particularly at the producer level. This analysis is complemented with “comments from the field” generated through a series of interviews with roasters, traders and producers. A key thread underlying the discussion on available “best practices” is the fundamental importance of two prerequisites, trust and knowledge, for the effective application of best practices in the promotion of “sustainable trade.” With this in mind, the third section provides an overview of specific strategies for building core trust and knowledge attributes pertinent to sustainable trading relationships. Finally we conclude with a specific list of key activities for roasters, traders, producers, producer organizations and policy-makers in the promotion of sustainable trading practices.

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- 4 The Sustainable Coffee Partnership is a multi-stakeholder initiative promoting sustainability in the coffee sector at the global level jointly facilitated by IISD and UNCTAD. The Steering Committee of the SCP consists of representatives from: International Coffee Organization; Sustainable Agriculture Initiative Platform; Centre de Coopération Internationale en Recherche Agronomique pour le Développement; ANACAFE; World Bank; Federación Nacional de Cafeteros; United Nations Conference on Trade and Development; Empresa Brasileira de Pesquisa Agropecuária; Junta Nacional de Café; Inter-African Coffee Organization; Sustainable Agriculture Network; Common Code for the Coffee Community Initiative; Commission for Environmental Cooperation; Specialty Coffee Association of America; United States Agency for International Development; Eastern Africa Fine Coffee Association; OXFAM; and Technoserve.
  - 5 The purpose of adopting an economic focus is not to ignore or suggest priority over the essential undertakings which producers must also make in the implementation of sustainable supply chains, but rather to avoid the detailed and technical discussion on the appropriate social and environmental standards associated with such producer undertakings. The point of departure for our analysis takes, as a given, the necessity of producer commitments to sustainable production practices (leaving the definition of such practices to the side), and focuses on the question of how trading practices might be able to ensure a more sustainable economic setting for producers who do in fact adopt sustainable production practices. The content of socially and environmentally sustainable production practices is a discussion that has reached fairly advanced levels through a variety of different labelling and certification systems for sustainable coffee. Given the complexity of that discussion, we leave it to the province of standard-setting organizations, rather than treating it further in this paper.

## 2. Principal Challenges to the Economic Sustainability of Producers

The effectiveness of specialized trading practices as a tool for improving the economic sustainability of producers logically depends on the ability of such practices to respond to the principal economic challenges that producers face on a daily basis. Although actual economic challenges facing producers can be expected to vary according to local political infrastructure, geographic location and producer size, the following is a list of common economic challenges faced by producers as a group.

### 2.1 Declining Prices

Over the past two decades, commodity prices as a whole have consistently decreased.<sup>6</sup> Throughout the 1980s, commodity prices fell by an average of five per cent a year. By 1990 they were 45 per cent below their 1980 level, or 10 per cent lower in real terms than in the midst of the Great Depression in 1932.<sup>7</sup> Coffee prices have followed the overall trend in declining commodity prices with nominal coffee prices having declined almost 70 per cent over the last two decades alone.<sup>8</sup> The principal cause of declining prices is a chronic oversupply of coffee on world markets resulting from demand growth which is less than growth in overall production. While producers might logically be expected to leave coffee production as coffee prices decline, higher productivity levels—partially due to more intensive farming practices—combined with limited opportunities to switch to alternative crops, often leads to a situation in which coffee farmers remain trapped in a cycle of poverty and dependency.

### 2.2 Market Instability

The coffee sector has a long history of market instability. Over the past several decades, global export revenues from coffee have fluctuated between \$5 and \$14 billion per annum.<sup>9</sup> Price volatility on international markets is a result of variations in the relationship between supply and demand and is principally caused by climatic variability. While there is evidence that global warming is giving rise to a greater frequency and force of extreme weather events, increasing volatility in international coffee markets since the 1980s has also been attributed to:

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- 6 Although recent market trends suggest growing prices in many commodity markets for the foreseeable future, it is not clear what impact, if any, this can be expected to have on coffee prices.
  - 7 The South Centre, *International Commodity Problems and Policies: the key issues for developing countries*, 1996.
  - 8 ICO statistics, 1980 to 2004 accessed at <http://www.ico.org> on August 25, 2005.
  - 9 International Trade Centre, *Coffee – An Exporter’s Guide*. (ITC, 2002), at 3.



- reduced cooperation at the international level;<sup>10</sup>
- increased speculative activity by large funds in commodities markets;<sup>11</sup> and
- deregulation in national markets.<sup>12</sup>

The impacts of volatility in international coffee markets on smaller producers has been exacerbated over the past two decades by the dismantling of national marketing boards and related institutions in producer countries. Market instability translates into revenue instability for producers and adds to the uncertainties they face as a result of local environmental conditions, making it particularly difficult to ensure sustainable livelihoods.

### 2.3 Poor Access to Market Information

Access to accurate and relevant market information is a virtual prerequisite to sustainable planning, production and trade, particularly within the context of market volatility. As smaller producers become increasingly exposed to international markets, there is a corresponding urgency in having up-to-date market information. The International Coffee Organization, as well as the major coffee exchanges (e.g., LIFFE and NYBOT), have played an important role in rendering market information more accessible to producers around the world through online, real-time information services.<sup>13</sup> To date, the market information provided by such institutions has, however, been limited principally to the four major coffee “commodity categories” (Colombian Milds, Other Milds, Brazilian and Natural Arabicas, Robustas) with little to no attention to markets for specialty and other differentiated markets. Given that differentiated markets are the fastest growing markets and promise the highest returns for producers, improved information on their behaviour offers an obvious opportunity for improving producer sustainability through market information. Even where market information is available, the

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10 The elimination of economic clauses from International Coffee Agreements since 1989 has reduced the effectiveness of international cooperation for stabilizing prices. See, for example, R. Bates, *Open-Economy Politics: The Political Economy of the World Coffee Trade*. (Princeton University Press, 1997).

11 Increased activity by large funds in commodity futures markets over the past two decades has led to a weakening of the connection between price determination and market fundamentals giving rise to greater price uncertainty. UNCTAD, *New types of Non-trade Related Participation in Commodity Futures Markets* UNCTAD/COM/83 (UNCTAD, 1996).

12 Stefano Ponte, *The ‘Latte Revolution’? Winners and Losers in the Restructuring of the Global Coffee Marketing Chain*. (Centre for Development Research, 2001).

13 The LIFFE exchange publishes a variety of market related statistical information on the Robusta coffee market at <http://www.liffe.com/reports/commodity?item=Coffee>. The NYBOT exchange publishes similar information on the Arabica coffee market at: <http://futures.tradingcharts.com/marketquotes/KC.html>

absence of appropriate training and infrastructure for responding to expected market conditions can render it difficult for producers to use information available in the most effective manner possible.

## 2.4 Limited Savings and Capital

Seventy per cent of world coffee production is made up of small producers with less than five hectares of land. The community of small coffee producers is defined, in large part, by its limited savings and capital which ultimately increases the economic vulnerability of producers. Savings and capital are necessary buffers to market uncertainty allowing producers both to hold out over low price cycles and take advantage of new market opportunities through new investments. Limited capital is also a major obstacle to securing reasonably-priced financial services.

## 2.5 Limited Access to Financing

Farm productivity is largely a function of the ability of farmers to make pre-harvest investments. The need for inputs prior to revenue generation often puts producers in a situation where financial assistance in the form of loans is necessary to ensure productive output. Similarly, producers need to make long-term investments in the infrastructure of the farm over the course of the farm's productive life in order to maintain maximum profitability over the course of changing market and supply chain demands. The absence of capital or other collateral to borrow against, typically renders it impossible to receive loans from conventional financial service providers. Non-conventional service providers, on the other hand, such as "Coyotes," are renowned for the high interest rates they demand. The fact that many producers only have access to above-market rates, renders it all the more difficult for producers to move out of the cycle of dependency and poverty that is often associated with coffee production.

## 2.6 Limited Bargaining Power

Although futures markets are responsible for establishing the general pricing context for physical transactions, the ability of producers to command prices that meet local costs of production and/or the costs of maintaining sustainable livelihoods is also dependent upon their ability to negotiate desirable conditions with buyers directly. The natural threats to producer bargaining power generated by their economic circumstance become all the more pronounced in the face of high levels of concentration on the buyer side of the supply chain, particularly among traders, roasters and retailers. With limited ability to hold out, and limited options in the way of buyers, producers are generally price-takers with little ability to influence the terms of trade they face.

## 3. The Trading Context

Trading relationships are principally social and economic relationships between two or more parties built around the sale and purchase of a product. In the coffee sector, as in other sectors, such commercial relationships are heavily coloured by the market context within which they operate. The coffee market is primarily defined by actions undertaken in two distinct but inter-related markets: futures markets and physical markets.

Futures markets are built on the trade of *contracts* for future delivery of coffee (rather than the coffee itself) and, as such, are principally used as a basis for financial management (via speculative or hedging activity). Although contracts in futures markets specify obligations for the delivery of coffee, they are rarely “called” for actual delivery, with the majority being traded for complementary obligations contained in other futures contracts. Although very little physical coffee is actually traded on futures markets, the high number of transactions across futures markets, gives them a unique ability to “reveal” the going price for coffee at a specified time and, as such, provide a key reference point for physical markets. Futures markets, besides being used for purely speculative purposes, are used by coffee traders and others in the coffee supply chain to manage risk in physical markets.

Physical markets for coffee revolve around contracts intended for actual delivery. Although delivery in physical contracts may also be for a future date (forward contracts), they are *not* traded on futures markets but rather used as a basis for establishing the terms of trade between buyers and sellers along the coffee supply chain. Unlike futures markets, physical markets determine the *actual* prices paid for coffee delivered and, as a result, are responsible for the distribution of actual revenue in the coffee supply chain. Although prices across physical markets often use prices on futures markets as a reference point for establishing prices, other factors such as geographic location, quality and other terms of delivery can lead to positive or negative differentials with respect to such prices. Physical markets for specialty coffee are notable for the independence they exhibit with respect to futures market prices—a feature which is deemed to reflect the “individuality” or “inherent value” of the coffee traded on such markets.

### 3.1 Market Drivers

Market authority across the coffee supply chain is generally determined by the degree of rent capture along the supply chain. In the case of both conventional and specialty physical markets, roasters have the greatest opportunity for rent

capture and thus also exhibit the greatest degree of market authority.<sup>14</sup> The natural authority of roasters along the supply chain is further enhanced by high levels of concentration in the roaster segment of the supply chain. These features have led some commentators to classify the coffee supply chain as being “roaster driven.”<sup>15</sup>

The largest roasters (namely those with the largest market authority) tend to rely heavily upon traders for their supply of coffee rather than dealing directly with producers or producer groups. Smaller roasters and particularly those serving the specialty coffee sector, exhibit a greater tendency to deal directly with producers and their organizations in securing their supplies. In any event, producers, unless acting under the umbrella of a national producer organization,<sup>16</sup> tend to enter into trading relations with significantly less bargaining power than the traders and/or roasters. Although the existence of disparities in bargaining power need not imply unfair trading conditions, it does establish the potential for setting conditions that favour players downstream on the supply chain over producers. But bargaining strength also allows for the possibility of setting baseline rules which intentionally protect weaker stakeholders along the supply chain as well.<sup>17</sup>

Finally, regardless of the specific market authority of any given player, the overall global market, particularly as depicted through futures market trading, establishes clear and transparent boundaries on the actions and deals that anybody can expect to negotiate over the course of any set of physical transactions. The quantity of transactions in futures markets combined with the diversity of participants more or less eliminates the potential for price manipulation on behalf of individual segments of the supply chain.<sup>18</sup> In this sense, futures markets provide an equalizing influence on disparities in market power otherwise present in the physical market for coffee.

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14 The market authority of roasters is evidenced by a variety of features including; 1. the adoption of supplier-managed inventories; 2. outsourcing of supply management; and 3. the establishment of minimum standards and quantities from origins. See Stefano Ponte, *Standards and Sustainability in the Coffee Sector: A Global Value Chain Approach* (IISD, 2004).

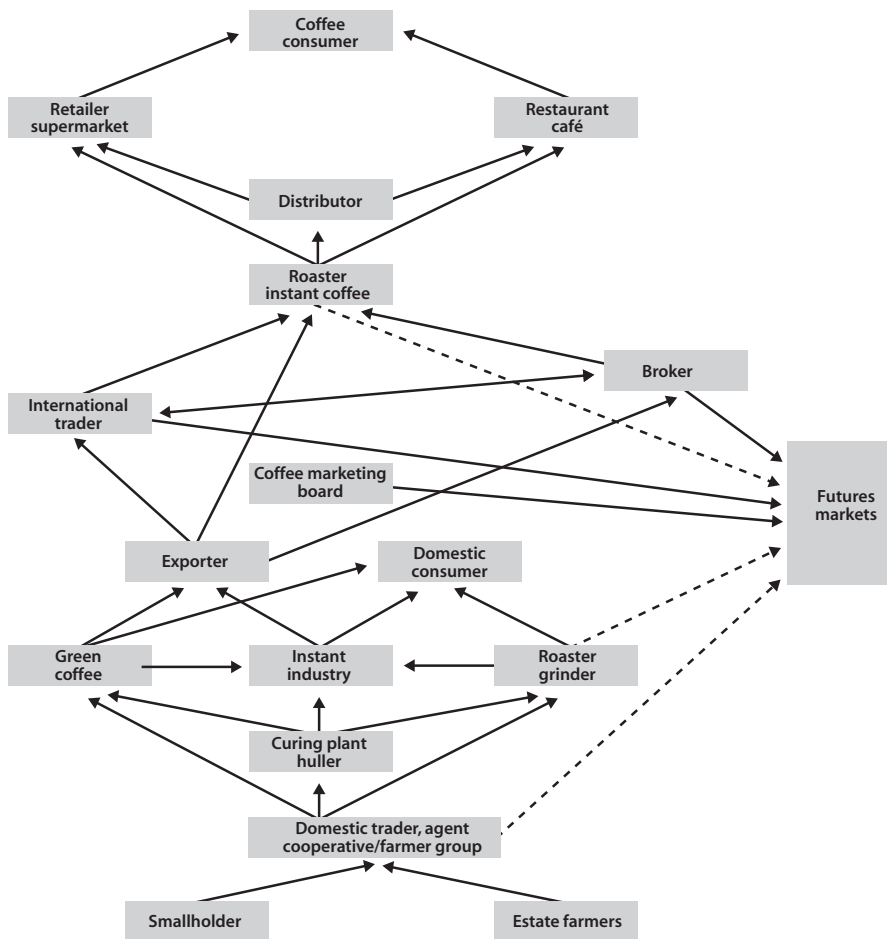
15 *Ibid.*

16 For example, under the Federacion Nacional de Cafeteros (Colombia) or ANACAFE (Guatemala).

17 For example, Starbucks uses its buying power to set rules on producer payment with its intermediaries as part of the implementation of its CAFÉ Practices.

18 Futures markets trade volumes up to eight times the size of physical markets. Only very large transactions such as those by pension funds and/or national agencies typically have any significant impact on price performance in futures markets.

Figure 1. General Structure of the Coffee Market Chain



Sources: Adapted from Talbot (1997), Ponte (2001), Ponciano *et al.* (1995).

## 4. The Role of Trading Practices in Building Economic Sustainability for Producers

While most of the challenges facing coffee producers are dependent upon, or revolve around, trading relationships, it is not self-evident that *trading practices per se*, can be expected to resolve all, or even most, of the main challenges facing coffee producers. For example, there is little that trading practices can do in the immediate or short term to influence the overall supply and demand characteristics of the market (and concordant world market prices for coffee); nor is there much that trading practices can do to compensate for shortcomings in national policy or infrastructure which limit opportunities for diversification among coffee producers.

At the same time however, trading practices, are the foundation upon which the basic commercial viability of any given coffee producer ultimately rests. Similarly, trading practices define the principal point of contact that producers have with the rest of the world, making them particularly influential in determining producer strategies for overall economic sustainability. As such, one can expect trading practices to play a role of some importance in determining the economic viability of coffee producers. Indeed the growth in concentration along coffee supply chains and the integration of supply chain practices, suggests a role of growing importance for trading practices as tools for improving producer capacity to deal with changing market conditions.

While all trading practices along a single supply chain are inter-related and therefore can have some degree of influence on those at the beginning of the chain (namely producers), it is nevertheless clear that some trading practices can be expected to have more direct impacts on producers than others. For simplicity, this analysis will limit itself to a consideration of:

1. trading practices between producers and any independent buyers (e.g., all buyers other than democratically-organized co-ops);

Producers, particularly small producers, suffer the greatest challenges from the perspective of economic sustainability and have the weakest bargaining power. Direct trading practices between producers and independent third parties represent clear opportunities for ensuring an equitable distribution of benefits and resources generated by the rest of the supply chain. Trading practices between producer co-ops and producers may also have important impacts upon producer well-being, however they are excluded from the analysis since co-ops technically represent producer interests.

2. trading practices between producer co-ops and any traders, roasters and/or retailers;

Producer co-ops, to the extent that they are democratically operated, formally represent producer interests. Trading practices that help cooperatives provide their respective producer services more effectively, operate as a proxy for producer economic sustainability. Trading practices between cooperatives and any other direct buyers (e.g., processors, traders and/or roasters) can be said to have direct impacts on producers.

3. other trading practices established by market drivers in the supply chain (e.g., roasters/consumers) with other players in the market.

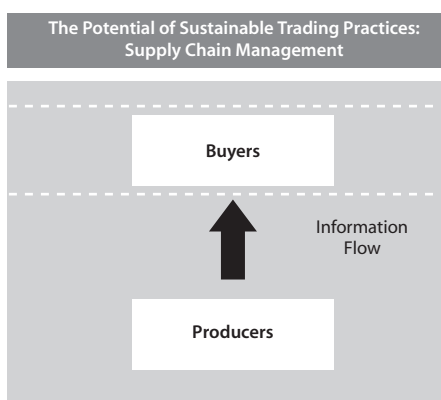
Although direct trading practices with producers and producer cooperatives are likely to have the greatest impacts on producers, the existence of clear market authority by certain players along the supply chain suggests that trading practices with others along the supply chain may result in substantive impacts on producers and thus are included within the analysis.

## 5. Conceptual Relationship between Trading Practices and the Producer Context

Below is a short list of the ways in which trading practices and trading relationships more generally can directly influence the commercial situation of producers:

### 5.1 Enhanced Voice in Supply Chain Management Decisions

Whole supply chains are increasingly being subject to directives, management systems and other requirements established by players downstream on the supply chain. Supply chain management systems often have direct economic impacts on producers but typically provide little opportunity for producer input in their development. To the extent that the only opportunity for producers to communicate with the proponents of such systems (or learn about them) comes through their direct relationships with the market, trading relationships, by allowing producers to communicate their needs and interests, have a role to play in diminishing the negative impacts and maximizing the positive impacts of supply chain management.

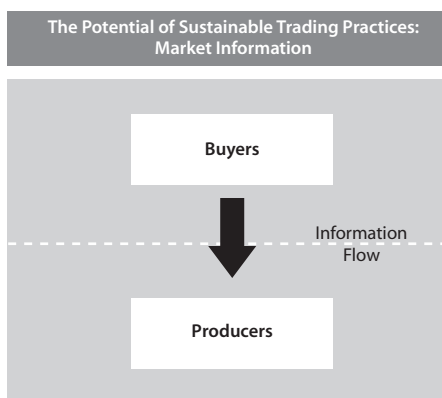


### 5.2 Enhanced Access to Market Information

Producers need market information in order to respond appropriately and proactively to market demands. To the extent that producers are able to deal directly with market players who themselves have intimate knowledge of, and relationships with, international markets, the trading relationship can operate as an important source of market information for producers. Although trading

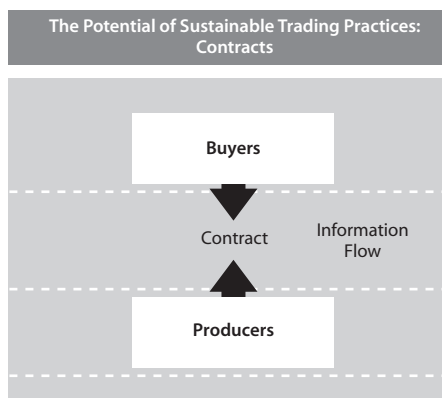


relationships necessarily contain some market information through the demands communicated through the exchange process itself, there is an opportunity for enhancing producer knowledge significantly through proactive efforts towards information provision through trading relationships.



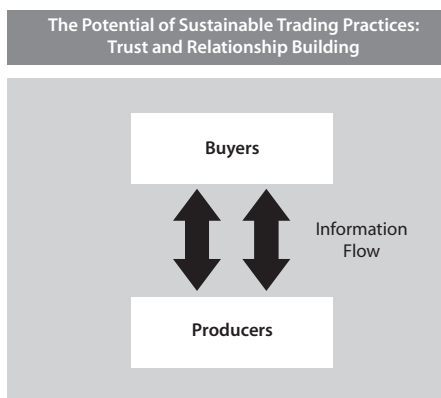
### 5.3 Enhanced Predictability and Transparency for Producers through Contracts

The contract, as a specific legal document for fixing economic and collateral commitments in commercial relationships, is an obvious focal point for the development of transparency and stability in sustainable trading relationships. Contracts can contribute to sustainability merely through the transparency and evidentiary roles they play in trading relationships. More proactively “sustainable” contracts may also be possible through the elaboration of specific criterion related to producer economic stability and predictability.



## 5.4 Enhanced Producer Autonomy through Relationships of Trust and Cooperation

Supply chain and trading relations are principally *economic* relationships whereby the respective partners seek opportunities to maximize profits. Where two trading partners exhibit substantial disparity in the market power and capital, opportunities for one party to take advantage of another for their own institutional benefit are amplified. To the extent that rent seeking by players downstream on the coffee supply chain is in direct competition with rent seeking by producers, there is a need to seek alternative means for securing a “sustainable” distribution of rents. Developing relationships of trust that extend *beyond* the normal relations of indifference, competition and profit maximization can form a foundation for enhanced producer autonomy, market “voice” and overall economic sustainability.



## 6. The Potential of Specialized Trading Arrangements: Examples from the Field

The above overview, provides a basis examining the role of specific practices in promoting producer sustainability in actual practice. Below we consider the strengths and weaknesses of a number of arrangements which have been identified by coffee stakeholders as potential instruments for promoting sustainable trade through trading practices and related arrangements in the coffee sector.<sup>19</sup>

### 6.1 Contracts

The contract is arguably the most fundamental instrument available for enhancing the economic viability of producers. The formation of written contracts requires the formal elaboration of the terms of trade which can help minimize the potential for misunderstandings while maximizing transparency and predictability in the economic relations between producers and their trading partners.<sup>20</sup> Contracts hold special value beyond the reduced transaction costs they can bring to commercial relations through their parallel operation as a legal “record” of the rights and obligations of the respective parties to the contract. For producers who have limited capital, the existence of a contract for purchase, can operate as a source of collateral for leveraging financing.

To the extent that contracts are legal documents and include language that is difficult for producers to understand, traders and other counterparts to the agreement need to make special arrangements for allowing producers to seek appropriate counsel in the formulation and interpretation of any given contractual arrangement. The use of standard form contracts, such as the GCA Green Coffee Contract and the ECF Coffee Contract, establishes basic parameters which enhance predictability and reduce transaction costs for the sector as a whole. Although existing standard form contracts are generic in character, they do allow for the specification of additional terms of reference through further schedules. The enhanced transparency presented by such contracts is deemed to be favourable not only to the industry as a whole, but to producers in particular, who might otherwise face contracts drawn unilaterally on an individual basis and thus suffer greater exposure to strategic contracting by buyers. Nevertheless, producers have expressed concerns about the rigidity of the

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19 The list of potential options draws from previous research conducted by IISD and UNCTAD under the auspices of the Sustainable Commodity Initiative and a series of targeted interviews with 15 traders/producers carried out specifically for this paper between the period of January and March 2006.

20 Note that standards-based sustainability systems are increasingly requiring the use of written contracts throughout the supply chain as part of their overall “sustainability package.” See, for example, Café Practices, the Common Code for the Coffee Community and Utz Certified.

mechanisms for determining weight and quality under the ECF contract which suggests a potential and/or need for introducing greater flexibility for responding to producer constraints in such contracts.<sup>21</sup> Notwithstanding the reservations by some producers about the final form of such standard contracts, there appears to be a general consensus among stakeholders that such contracts offer the best “formal” basis for building sustainable contracting practices. Annex 1 provides a list of the “basic elements” for ensuring transparency within the context of promoting social and environmental sustainability through contractual form. Below we consider some specific contractual formats that have been used to promote economic sustainability for producers.

### 6.1.1 Delivery, Quality and Passing of Title

A number of technical features of contracts are effectively tools for distributing risk among the contracting parties. The manner in which risks are distributed by contracts can play an important role in determining producer risk exposure and therefore overall producer economic sustainability. Some examples of how producer risk can be reduced through contractual form include:

### 6.1.2 Passing of Title

The risk associated with product loss, storage or mould formation rest upon the player who retains title to the product (Art. 19(e) of the ECC specifies that title does not pass until full payment for the product is made, which is to say until the product has been delivered, accepted and paid for). Practically speaking, these requirements normally mean that title (and therefore risk) on the product, do not pass until the buyer has physically received it. By having contracts pass title from producers to buyers sooner in the delivery process, producer risk of loss can be reduced. The workability of transferring title at the early stages of delivery depends fundamentally upon the ability of those taking title to be able to protect their interests (e.g., have knowledge and control over the product). However, in cases where neither the producer nor the trader have direct control over the product, traders may have better opportunities to insure against loss than producers. Early transfer of title can provide a relatively low-cost opportunity for enhancing producer sustainability.

### 6.1.3 Quality and Weight Claims

Since the weight and quality of coffee changes during shipment, the time at which weight and quality of the shipped product are fixed under the contract

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21 For example, under the current ECF Contract, quality determinations are made at the port of entry and are deemed final. The absence of non-onerous (e.g., arbitration) opportunities for making counterclaims and/or the possibility of “proportional” adjustments (rather than outright rejections) based on quality, exaggerate the burden placed upon producers. Producers are reported as having left ECF contract negotiations over such matters in the past.

will determine the distribution of quality and size-related risk among the buyer and seller. The European Contract for Coffee specifies two different mechanisms for determining quality and weight: 1. “weight upon shipment” (where the buyer accepts risk associated with quality and size changes once shipped), Art. 3, ECC; and 2. “delivered/landed weights” (where the seller assumes risk until final delivery and weighing at the point of delivery), Art. 4, ECC. All other things being equal, from a producer perspective, “weight upon shipment” agreements would appear to be preferable than “delivered/landed weights” as they reduce overall producer risk while simultaneously providing for a .5 per cent discrepancy between shipped weight and landed weight.

#### 6.1.4 Delivery Times

In the natural course of business, buyers will specify delivery according to their own specific needs and timetables, leaving producers and others along the chain to manage their supply accordingly. In the case of under-capitalized producers with minimal ability to physically store beans or manage the quality and/or market risks associated with storage, timely delivery following harvest can help significantly in reducing producer risk exposure. Some companies (see Box 1) have helped ease the pressures related to delayed delivery of harvested coffee by adjusting their own import schedules to meet the harvest schedules of their suppliers.

##### **Box 1: Cooperative Coffees: Producer-adjusted Delivery Schedules and Financing the Transition to Certification**

Cooperative Coffees (CC) is a green coffee importing cooperative, comprised of 17 community-based coffee roasters in the U.S. and Canada, “committed to supporting equitable and sustainable trade to the benefit of farmers and their exporting cooperatives, families and communities.” All CC coffee is certified organic and Fair Trade. Notwithstanding the promised benefits to producers associated with participation in such certification systems, CC has sought additional means for ensuring producer financial security. Below we outline two creative ways in which CC has managed to implement its commitment to producer sustainability.

###### *Producer-adjusted Delivery Schedules*

At the request of producers, CC accompanied several producer suppliers in an effort to identify ways in which the supply and delivery of coffee could be simplified and made more efficient for producers. The staff from CC visited the producers and began jointly studying their problems. Additionally, CC explained to the producers their business issues and limitations. On the basis of this team effort, both parties understood the main problems that they faced and how it could potentially affect them in the future.

Some of the issues discussed were, limited storage capacity, logistical difficulties, limited sources of funding and tight cash flow. A number of challenges to producer economic sustainability were traced back to difficulties associated with the storage and financing harvested coffee—coffee which had to wait for delivery to buyers based on buyer-determined delivery schedules. Through a joint effort between CC and its suppliers, a mechanism for synchronizing coffee delivery with actual production and harvesting schedules was developed, thereby reducing the financial and risk burden assumed by producers. In Chiapas, for example, the harvest schedule is from mid-December to March, but coffee would normally be shipped throughout the better part of the year. As a result of the synchronization process, CC buyers take all coffee by no later than May. In so doing, CC solved a logistic, security and financial problem, but at the same time has guaranteed a reliable supply of their coffee. The success of the effort was dependent upon the ability of both parties to recognize their respective needs and limitations.

#### *Financing the Transition to Certification*

Certification under any sustainability standard, requires investments of resources and time. In the case of organic certification, the transition period is typically on the order of three years. Under normal circumstances, producer must complete the three-year transition period before they can secure any premiums associated with organic production. In the case of Fair Trade certification, producers must undergo an initial certification audit which can cost on the order of \$5,000. In recognition of the additional financial strain the transition period can place on producers, CC encourages its members to pay “transitional premiums” while farmers are in the process of implementing organic production. Some CC members have also adopted the practice of paying an additional premium on certified coffees in an effort to enable producer organizations to expand the number of organic certified farmer suppliers. An additional approach adopted by some CC members involves loans to producers to cover up front investments toward certification on a no interest basis for repayment on their first shipments of certified coffee.

### **6.1.5 Long-term and Outright Price Contracts<sup>22</sup>**

One of the principal challenges facing coffee producers is uncertainty in international coffee markets. Long-term and outright price contracts which secure a price or price range for purchasing a fixed amount of coffee over a fixed period of time (or for delivery at a fixed time), can help producers manage the risk they face through market volatility. Different forms of long-term and outright price contracts include:

- multi-season contracts specifying minimum quantities for purchase/sale at fixed prices;

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<sup>22</sup> Example: Starbucks frequently uses outright price contracts in its trade with preferred producers.

- single season contracts specifying minimum quantities for purchase/sale at fixed prices; and
- multi-season contracts specifying minimum quantities for purchase/sale reference to real-time market prices (e.g., floating price long-term contracts).

While long-term contracts make eminent sense, there is a strong moral hazard problem associated with completion when prices rise above those specified under the terms of the contract. Dealing with the enforcement problem is arguably the single greatest obstacle to the full-fledged implementation of long-term and outright price contracts. In order to improve the potential use of such contracts several steps can be taken:

- traders offering long-term contracts can take a certain portion of the crop as security against delivery;
- prices can be allowed to vary with market prices but within a specified range; and
- in cases where contracts are signed with cooperatives rather than directly with producers, specified producers can be referenced directly into the contract to ensure the contract is linked to specific production *and/or* special incentives for delivery to the cooperative for contract fulfillment can be provided by the cooperative.

The fact that producers face strong incentives to exit long-term contracts over time is a reflection of the importance producers place on being able to respond “freely” to changes in market conditions over time—particularly with respect to price formation. Given this underlying producer interest, floating price long-term contracts may offer the greatest potential for enhancing producer sustainability. Although floating price long-term contracts do not secure financial revenue for producers *per se*, they do provide greater security with respect to market access.

All forms of long-term contracts face additional, and significant, challenges in light of the role they can have in creating complacency and dependency among either of the parties to the transaction. On the one hand, buyers, with a long-term contract in hand, may take delivery from the contracted producers for granted, and reduce producer investments to help ensure delivery. On the other hand, long-term contracts may reduce the need (and therefore ability) of producers to market their products through alternative resources thereby increasing their dependency upon a few buyers—leading to the unintended result of actually *increasing* the long-term risk facing producers. Ultimately, long-term contracts are unlikely to be a primary solution to producer sustainability although they can operate as part of an overall portfolio for managing producer/buyer risk.

### 6.1.6 Minimum Price Arrangements

The clearest example of a minimum price arrangement is provided by the Fairtrade Labelling Organizations International (FLO) certification system. FLO criteria specify that traders pay at least the minimum price specified by FLO criteria for the specific type of coffee and region.<sup>23</sup> The FLO fixed pricing structure serves three important purposes: 1. administrative efficiency; 2. predictability in pricing; and 3. coverage of variable costs of production for producers. Moreover, the fact that markets for FLO certified coffee have been growing at 25–50 per cent per annum over the past decade indicates a growing interest among consumers, roasters and others along the supply chain to ensure that prices cover production costs at the producer level. Nevertheless, worldwide market penetration of FLO certified coffee remains at less than two per cent and is indicative of a general unwillingness (at present at least) of mainstream consumers and/or roasters to pay more for the FLO “price guarantee.” Indeed, the inability of fair trade coffee to reach mainstream levels may, to a large degree, be traced to systemic inconsistencies between the fair trade model and basic market forces.<sup>24</sup>

Within the context of “certified” or “verified” coffees, based on the adoption of recognized sustainable practices, different variations on the fixed-price model include:

- variable “minimum” prices based on geographic region and quality;

Although the task of identifying applicable minimum prices on a global or continental basis may be a Herculean task, it may be possible to identify minimum prices based on local production and marketing

23 The minimum prices for FLO certified coffees are:

Coffee Type	Regular		Certified Organic	
	Central America Mexico, Africa, Asia	South America the Caribbean	Central America Mexico, Africa, Asia	South America the Caribbean
Arabica washed	126	124	141	139
Arabica not washed	120	120	135	135
Robusta washed	110	110	125	125
Robusta not washed	106	106	121	121

24 In order for a system of fixed pricing to work over the long term, the price must be fixed at a rate that matches the producer and consumer functions. A summary overview of the growth of fair trade suggests that growth has primarily been restricted to quality based markets—markets within which consumers are willing and able to pay higher price for coffee. In more mainstream coffee markets wherein the consumer function is specified by lower prices with less emphasis on quality, the appropriate rate of minimum price—based solely on the producer and consumer functions—will be different from that of higher quality coffees produced for the specialty market. As such, there is little reason to expect that a single fixed price (e.g., the current fair trade model) either *is*, or even *should be*, expandable to the market as a whole. However, it also suggests that there may be potential in a *flexible* fixed-price model.



costs, as well as quality levels, which are more suited to actual market conditions. *Advantages:* such a model is more flexible than global fixed pricing and has the potential to integrate quality differences. *Disadvantages:* assembling minimum prices across geographic regions and types would be highly costly and subject to political and economic interests.

- no minimum price, but fixed minimum social-environmental premium;

Under this variation, the base price paid for the coffee remains voluntary, but a minimum social/environmental premium is fixed for coffees complying with specific practices. *Advantage:* it is simple to establish and allows the market to determine the base price for coffee, more efficient pricing system. *Disadvantage:* in the absence of proper controls, base prices may be used to compensate for the “additional” costs associated with the fixed premium.

- no minimum price or premium, voluntary “recommended” minimum social-environmental premium or price.

Certification systems can provide a forum for establishing and recommending price bands for their products without actually imposing the implementation of such bands in any particular case. Additional benefits or restrictions could apply to members who did not meet the recommended price bands thereby providing market-based incentives for compliance. *Advantages:* Allows the market to continue to establish prices but increases the attention given to non-physical criteria in the pricing formula. *Disadvantages:* Could be complicated to manage. Management of such a system would have to show a clear responsiveness to actual market conditions to actually work.

While the above discussion describes different ways in which pricing might be systematically integrated within one or another existing certification system (or similar supply chain initiative), it is also possible to apply the same principles to bilateral trading relationships in the form of minimum price or price-band contracts.

At the most elementary level, buyers are already involved in this when they offer long-term and/or outright contracts to suppliers. However, the risk of non-delivery associated with eventual increases in prices can present an untenable situation for traders. One way around this could be through the establishment of contracts where the buyer arranges to buy a fixed volume of coffee at a minimum price of X (such as in the case of outright contracts) with the option of paying a higher price if/when world prices rise above a certain level.<sup>25</sup> We found no

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<sup>25</sup> Of course, any arrangements of this sort need to recognize the fact that the buyer bears an additional risk in this case. In order to accommodate the cost of this risk, it is conceivable that minimum price contracts might be established that are indexed to world prices at a discount (that is which provide prices that are equal to, or lower than, world prices above the

specific examples of buyers offering this kind of purchasing system and therefore have no direct evidence of its viability. It is worth noting, however, that related examples of tied selling/hedging arrangements do exist (see Shared Hedging below) and were considered by many of those consulted as a particularly promising arena for promoting producer sustainability.

### 6.1.7 Price to be Fixed Contracts – Sellers’ Call<sup>26</sup>

Price to be fixed contracts are contracts that specify a delivery date but leave the price to be fixed (using the futures market as the reference point) by one of the parties to the contract. When two traders enter into such contracts, they typically cover any risk associated with the actual price fix date with a matching hedge, which reduces the actual risk associated with an uncertain date for fixing the price. For producers who do not have ready access to hedging instruments, the autonomy of being able to choose when to fix the price associated with a particular delivery can provide a soft alternative to straight hedging at little additional cost to traders. It is worth noting, however, that the increased autonomy associated with PTBF sellers’ call contracts by no means eliminates producer exposure created by longer term market trends. Both traders and producers have noted the inherent riskiness in PTBF sellers’ contracts due to a general lack of sufficient knowledge and awareness among producers of the full magnitude of the risks associated with such contracts and the general tendencies in the market as a whole. As such, sound education on market behaviour and overall risk exposure can be regarded as something of a prerequisite for the effective use of PTBF sellers’ call contracts.

## 6.2 Financing<sup>27</sup>

One of the basic principles underlying the implementation of sustainable trading relationships is the explicit recognition that the commercial act of sale and purchase of coffee beans have widespread and deep impacts on the overall livelihood of not only producers but whole producer communities. An example of the “multiplier effect” of transactions involving physical coffee can be

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minimum). Discounting is, effectively, the price that producers pay for having a fixed minimum price (similar to purchasing options on the market). To the extent that indexed prices are discounted against world market prices, such contracts would be threatened with non-compliance under high world market prices and therefore need to consider the establishment of security and/or incentives systems as in the case of long-term contracts.

26 Example: Many traders already use PTBF sellers’ call contracts for at least some of their business. Roasters, probably due to their lack of facility in using hedging instruments themselves, tend to establish buyers’ call contracts. Green Mountain Coffee Roasters is an example of a roaster that has used PTBF sellers’ call contracts in its contractual dealings with producer groups as a tool for promoting producer autonomy.

27 Many traders provide some degree of financing to preferred suppliers.

found in the availability of opportunities for financing which are generated on the basis of the physical transactions in coffee.

Ultimately, banks and other financial service providers rely on evidence of the economic sustainability of their clients. Traders and other buyers purchasing coffee directly from producers have an opportunity to help producers put their best business foot forward and as such this should be considered as part of an overall sustainable trading package. The use of contracts for the physical transactions can help secure financing. Alternatively, where adequate relationships of trust have been established, traders may be able to provide security or other “comfort” to would-be financial service providers.

Traders, as a result of their financial capacity and knowledge of producer clients they deal with directly, also have an immediate role to play in providing financing directly to their producer suppliers. By building on their extended relationships with producers, and by leveraging existing and future contracts as collateral, traders have the potential to offer financing at interest rates far below those of more traditional financing institutions. While many traders are active in the area of financing it is, nevertheless, widely acknowledged that existing financing from traders is insufficient to cover demand due primarily to a lack of capital and expertise. Considerable opportunity rests in leveraging trader relationships with producers to increase access to financing through the development of cooperative arrangements with the traditional financing sector.

Services aimed at improving overall financial management, and, in particular, risk management, can play a key role in securing better access to financing and success with financing obtained. Traders can thus play an indirect role in improving access to finance by helping producers improve their own financial and risk management strategies. Improved producer financial planning and risk management, as we observe in Section 6 below, can also play a critical role in building sustainable relationships with buyers.

### 6.3 Cooperative Business Arrangements

One of the fundamental challenges facing producers rests with the lack of power, presence and overall representation in international markets. Traders can position themselves as “collaborators” with producers in a joint effort to generate the greatest revenues (and profits) possible for both parties. While it is clear that the development of such relationships may entail a complete re-visioning of the relationship between producers and traders, the fact that both producers and exporters fulfill activities on the production side of the supply chain make such a joint positioning feasible in specific cases. In other cases, a sustainable trading relationship may be based on reducing the number of actors along the supply chain. Below is a short list of different ways in which explicit “business cooperation” between traders and producers can improve the sustainability of producers.

### 6.3.1 Direct and Long-term Trading Relationships<sup>28</sup>

Direct trading relationships with roasters and/or retailers can help producers in two different ways. On the one hand, the reduction of middlemen along the supply chain allows for reduced transaction costs and greater overall revenues for distribution among producers. On the other hand, direct trading relationships can improve the information flow to producers regarding market demands.

Long-term trading relationships provide a basis for developing predictability and trust in trading more generally. Many traders seek long-term trading relationships as a matter of good business sense. Proactive efforts to maintain long-term relations, however, may be appropriate in cases where a particular producer or producer group is suffering a particularly difficult period due to temporary difficulties.

### 6.3.2 Market Analysis Reporting

Major traders must engage in market analysis and reporting in order to conduct their businesses properly. The sharing of in-house market analysis with producers can be an invaluable tool for producers in managing their own risk and strategic planning. To the extent that such information involves proprietary interests, confidentiality contracts may be necessary to render the release of detailed financial analysis viable for traders. Advances in technology combined with real time reporting of composite world market prices by NYBOT, LIFFE and the ICO, have all helped in giving producers a more transparent bargaining position for the sale of their products. An acute absence of information on market trends on specialty and other differentiated markets (such as “sustainable markets”) still persists and represents an area of particular need as a tool for helping producers plan strategically or to extract maximum value from products as they deliver them to market.

### 6.3.3 Preferential Sourcing Arrangements<sup>29</sup>

Some markets, such as specialty markets, have inherent benefits linked with them (such as higher and more stable revenues). Regardless of any specific benefits associated with one or another market, being able to build on established relationships can reduce transaction costs and uncertainty. Some companies have established formal relationships or “preferential sourcing policies” that give primacy, *ceteris paribus*, to select producers. This can add stability to both

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28 Nestlé has a number of programs where it sources coffee directly from producers. Nestlé uses the direct contact with producers to help provide extension services to producers so they can more readily meet Nestlé’s quality requirements.

29 Starbucks grants preferred supplier status to those of its suppliers who meet a minimum score basis under its Café Practices program.

sides of the trading relationship—which can be particularly important for producer economic stability. While it is not necessary, one way of solidifying such relationships is to express commitments for preferential dealings in the form of separate contracts outlining the terms of the preferential relationship. Examples of this “far end of the spectrum” of preferential trading relationships include:

- floating price long-term contracts: Agreements to purchase/sell a specified volume of coffee over several seasons with prices referenced to current market conditions; and
- exclusivity contracts: Agreements to sell exclusively to a single buyer.

As preferential sourcing relationships become more formalized, they have the potential to instil complacency among trading partners while reducing the ability of such player to respond to market changes over time and must, therefore, be treated with caution. Both producers and traders interviewed underlined the potential danger of complacency and of having limited ability to take advantage of new buyers as two main disadvantages of preferential sourcing relationships. The actual effect of preferential sourcing arrangements to contribute to continual improvement and entrepreneurial creativity will depend upon a balance between security, continual information exchange and the provision of ongoing incentives to improving production and trading practices.

### 6.3.4 Cooperative Marketing Arrangements<sup>30</sup>

Perhaps the most obvious type of cooperative arrangement that producers and traders can undertake is cooperation towards shared marketing efforts. By combining producer and trader efforts, more substantive resources and existing networks can be tapped to develop new markets for distinctive coffee qualities. This could entail matching financial contributions towards a joint marketing strategy or the delegation of specific marketing activities between producers and traders depending on their respective expertise (for example, with traders generating information flow among their contact base and producers generating data and information on the coffee quality).

As a matter of fact, most of the certification bodies currently provide both tools and resources for marketing coffees produced in compliance with their practices. The resources provided by these initiatives in generating market recognition have been demonstrated to play a significant role in increasing demand and the overall potential for price premiums. To the extent that such activities effectively help producers secure higher revenues, these investments should be

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30 Traders will commonly “market” any coffee they have available to them. Specific efforts to help individual producers or producer groups market their “origin specific” coffee are a growing opportunity for traders and producers to cooperate.

considered as one element of a more generalized strategy for improving the sustainability of trading relationships along the supply chain.

**Box 2: Internalizing the Costs of Sustainable Development through Market Recognition<sup>31</sup>**

Currently there are a number of standards-based sustainability systems operative in the coffee sector. Most of these systems specify social and environmental criteria for production (and trading) which in turn allow producers to sell their products under a label or other designation. By providing verifiable and credible systems for linking “sustainable” production practices with physical products (e.g., actual coffee beans), these systems can help the market place an economic value on product qualities that don’t necessarily affect the physical characteristics of the product. The ability to link market prices with actual production practices marks a major advancement in the implementation of the “principle of cost internalization,” itself a core principle of sustainable development. Evidence of the effectiveness of this approach is demonstrated by the existence of premiums for most standards-based coffees ranging between US\$.03 and US\$.30 per pound. While these trends indicate that the market is becoming better at pricing the costs of sustainable production, there is scarce knowledge or information on whether or not, or when, premiums received actually cover the costs of sustainable production. This is an area in need of significant research.

*Average Premiums Received for Some of the Leading Certification Systems*

Fair Trade	Organic	Rainforest	Utz Certified
\$1.26–C, \$.05	\$.10–\$.30	\$.10–\$.20	\$.03–\$.10

### 6.3.5 Shared Hedging Operations

While roasters and traders depend fundamentally upon futures markets and corresponding hedging operations for managing their risk profile across market volatility, producers, arguably those who are *most* in need of stability, typically do not have access to such tools. Among the many obstacles producers face in using traditional risk management tools are:

- a limited understanding of futures markets and risk management;
- insufficient capital to make initial hedges (due to large volume requirements for futures contracts);

<sup>31</sup> Sources: Consumers International, *From Bean to Cup* (2006), CIMS, *Comparative Analysis of Major Players in the Global Sustainable Agriculture Industry* (2002), CIMS, *Prices and Premiums for Certified Coffees* (2005).

- insufficient capital to maintain hedges in the face of margin calls; and
- inadequate local infrastructure for servicing hedging instruments.

Traders, on the other hand, not only have access to capital but also have considerable experience in working hedging instruments. While initial hedges are fairly straightforward to manage, changes in market conditions will typically result in margin calls which often cannot be met by under-capitalized producers or producer organizations. To the extent that sufficient trust exists between the producers and traders, traders can provide hedging services in the name of producers. Such agreements, however, will normally require the provision of one or another form of security for placing hedges. The fact that traders have personal and regular business relations with one or another group of producers can often put them in a position of being able to offer hedging services at a lower cost than traditional banking channels. While there are some examples of such practice (see Box 3 below), they are rare since traders typically rely on their own liquidity to protect their own assets, with the result that the needed liquidity for making producer hedges is difficult to deliver. One approach for overcoming the challenges of meeting margin calls associated with hedging and other risk management tools, is to link private delivery hedging services with public funds for covering margin calls when they arise.

**Box 3: Private Sector Hedging Support – Sourcing + Service GmbH (S+S)<sup>32</sup>**

Sourcing and Service GmbH (S+S) is a trading company which, in addition to facilitating direct relationships between producers and markets, has taken a proactive approach in enabling producer access to hedging services by servicing hedges placed on behalf of producers.

In a volatile market the servicing hedges entails significant risks, not because such activity is speculative in its own right, but as a result of requirements to cover margin calls with cash when prices fluctuate a specified amount with respect to the hedged price. Even the most prudent hedger can be forced to abandon hedges due to unexpected margin calls simply because he/she does not have the cash to support an otherwise sound position. The result can be disastrous and makes it particularly difficult for farmers without significant liquidity to take advantage of hedging opportunities as part of a larger strategy for sound risk management. S+S enables farmers, who would not otherwise be able to take hedge positions, to do so, by covering their margin calls until price fixation.

<sup>32</sup> Sourcing and Service GmbH is a Swiss-based trading company that helps producers hedge by sharing its own hedging capacity with producers.

At time of writing, S+S has the capacity to keep 10 lots hedged on behalf of the producers any given moment. Once this limit is reached, S+S must wait for the price fixations of the buyers to free up capacity for new hedges. S+S tries to maximize the number of hedges that they can do in a period of a year by rolling hedging capital into new hedges as soon as possible after being released from a previous hedge.

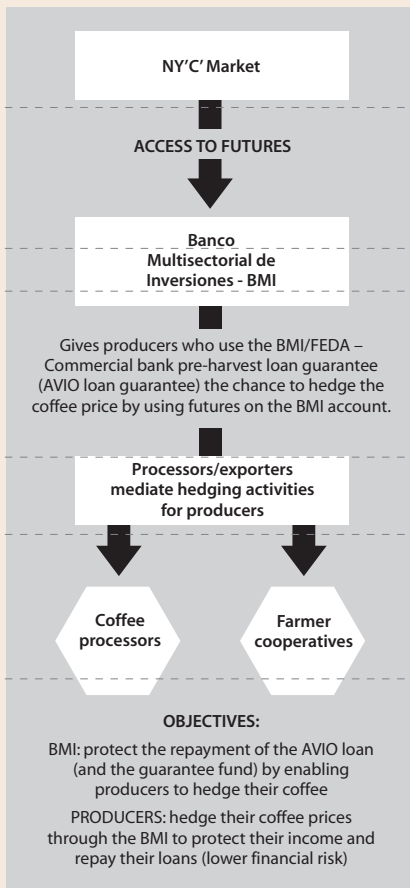
While S+S feels that its hedging services are helping farmers manage their risk in a meaningful way, they do not have the capacity to meet actual demand. According to S+S, considerable benefits could be provided to farmers if such hedging services could be provided on a wider basis.

#### **Box 4: Hybrid Public-Private Hedging Support: The BMI Public/Private Hedging Fund<sup>33</sup>**

In 2003, the El Salvadorian government, in collaboration with the Banco Multisectorial de Inversiones (BMI), established a hedge aimed at providing coffee producers access to risk management instruments. The main operative components of the fund consist of direct services for managing hedging activities of clients as well as the provision of automatic credit to cover margin calls related to risk management activities. One of the main purposes of establishing the fund was to reduce the pressures on government-sponsored credit guarantees under its PROGARA program. As such, the BMI funds are limited to producers who have been recipients of such guarantees—which nevertheless represents the majority of coffee produced in El Salvador. In an effort to reduce transaction costs and consolidate the delivery of services, the BMI fund is offered exclusively through exporters and processors who are then responsible for offering the services to producers directly. Through bilateral contracts signed between processors/exporters and producers, and between processors/exporters and BMI, the BMI fund is able to offer hedging services directly to producers. In its pilot stage, the BMI fund was able to secure higher than average prices for participants in the program. By the second year of operation, nine out of a potential 40 processors/exporters, with 60 per cent of national production, were participating in the fund. Some farmers spontaneously pooled their coffee during the second pilot year to achieve the minimum lot sizes for the users (the processors/exporters) to hedge.

33 Adapted from Pauline Tiffen, Guido Fernandez (Commodity Risk Management). *Report on the BMI-FEDA Hedging Fund El Salvador* (World Bank, 2005).





The fund is now in the process of being consolidated and expanded on a national basis. Despite the success of the fund thus far, social habits towards speculation and a general lack of understanding of the potential benefits of participation at the producer level remain significant obstacles to optimal levels of use. Although the BMI/Processor/Exporter hedging services are subsidized by the government, processors and exporters play an important role in training and disseminating information on the services.

### 6.3.6 Price-sharing Arrangements<sup>34</sup>

Probably the most involved form of proactive cooperation involves actual sharing of profits received from sales. In order to enable credible profit sharing, a certain amount of openness with respect to the accounting operations of the respective partners is necessary. The obvious benefit for producers is the implicit guarantee that the trader will do everything they can to maximize the returns not only for themselves but for the producers as well, through their everyday trading activity. As producers move towards positions of direct interaction with/dependence upon the market, however, they are simultaneously

<sup>34</sup> Example: Qualicafe X, a Brazilian Specialty Coffee Trader, has a system for sharing profits generated from successful sales on international markets.

faced with greater exposure to risk and volatility. One trader operating on a shared profit basis noted that the need for stability and pre-payment, was of such importance to most producers that they were willing to sacrifice price premiums in order to have closer control and predictability over cash flow.

As an alternative to price-sharing, buyers and producers may be able to create a better planning basis as well increased trust through “price transparency.” Starbucks, through its Café Practices, has begun implementing price transparency as one of the basic elements of its supply chain—at least as between producers and traders. Under the Café Practices program, traders are obliged to provide accounts to Starbucks and to pay producers set amounts determined by Starbucks.

### **Box 5: Undesirable Trading Practices**

In the same way that some trading practices may have a particular potential for enhancing the economic sustainability of producers others may be particularly vulnerable to reducing producer sustainability. While the identification of decidedly “disadvantageous” trading practices for producers is less than straightforward, the following examples of “undesirable trading practices” were raised over the course of stakeholder interviews:

#### **1. Coyote Practices**

Coyotes are traders who operate at origin as middlemen between producers and processors/exporters. Coyotes typically offer producers the “service” of immediate payment for immediate or future coffee delivery—but at highly discounted prices and high interest rates. Although the size of price discounts varies depending on market conditions and producer knowledge of the market, it is not uncommon for Coyotes to charge between five and 10 per cent interest per month (60–120 per cent per annum) on cash advances. It is difficult to justify discounts of such proportions except on the basis of limited knowledge and opportunity on the part of producers. Without suggesting that the services rendered by Coyotes are without foundation, there are typically less expensive ways of fulfilling the functions that Coyotes provide (such as through cooperative or trader pre-financing). Therefore, the existence of Coyote practices are an indication of the need and potential for alternative trading systems to improve the economic situation of producers.

#### **2. Reverse Auction System**

One practice highlighted by traders in the sector as one with decidedly negative consequences for producers is the holding of “reverse auctions” by roasters. Under the reverse auction process, a roaster puts up an offer to purchase a specified quantity of coffee of a certain quality and then allows traders and producers to bid the lowest price for which they are willing to sell the specified amount of coffee. The

potentially sinister character of the reverse auction system lies in its potential to use producer “desperation” as a tool for reducing producer prices below world market prices. Even where traders bid against each other to supply on a reverse auction basis, the overall effect is to place exaggerated pressure on competing traders which, one assumes, is likely to be passed on to producers through corresponding dealings.

### 3. Misinformation

Several commentators highlighted “false claims” with respect to quality and practices associated with coffee production, sale and marketing as a pervasive and recurrent source of distrust and, ultimately, sub-optimal trading practices. Claims made by third party NGOs on behalf of coffee producers as well as claims made by traders regarding “expected market trends” were both identified as significant sources of such misinformation.

### 4. Poor Planning

A lack of knowledge among producers of their cost structure, financial risk and ability/willingness to deliver under changing market conditions, was identified as a persistent form of “undesirable trading practice.” Commitments made on partial information or incomplete planning strategies, frequently lead to disappointment and relationship breakdown which effectively operate as obstacles to generating longer-term relationships of trust that form the foundation of sustainable trading practices.

## 7. Sustainable Trading Relationships: The Foundation of Sustainable Trading Practices

Any attempt to use bilateral trading relationships to promote the economic sustainability of one of the parties (i.e., producers) in a free market context is highly vulnerable to disappointment. The natural operation of the market is built on the premise that economic activity *automatically* delivers goods and services through bilateral transactions under conditions that are acceptable to both parties. Where rules stipulating benefits for one party or another are “imposed” from one source or another, the normal response of the market will be to make compensatory adjustments which may counterbalance any expected benefits for either one of the parties.

The market’s unquenchable desire to find equilibrium has, repeatedly demonstrated a capacity to nullify the efforts at altering “natural” market outcomes. Notwithstanding this critical cautionary note, it is also true that markets are not perfect, and in some specific cases the provision of targeted incentives, tools and instruments can effectively nudge the market towards a new equilibrium position which more appropriately meets sustainability objectives over the long term. Clarification on the ways in which different practices may impact producers (as discussed above) provides an essential starting point both for establishing more predictable relations between buyers and sellers and for identifying appropriate points of entry for technical assistance and policy intervention.

However mere “knowledge” of potential opportunities is clearly insufficient as a basis for generating more sustainable practices. Indeed, our brief overview of a range of potential instruments for promoting producer sustainability, demonstrates that the actual ability of such instruments to promote producer sustainability depends upon a number of different variables, the absence of which can produce *unsustainable* results. The single most important condition for ensuring that any given trading practice, instrument or contractual arrangement *actually* produces sustainable outcomes for producers (and others along the supply chain) is the establishment of trust between the trading parties. Indeed, the absence of sustainability in the coffee sector can largely be attributed to an over-reliance on impersonal and highly competitive conditions—conditions that have given rise to a deeply seated suspicion among different actors along the supply chain. Without an appropriate basis of trust, trading relationships are subject to intense pressure and highly vulnerable to inefficiency and failure. As such, one of the principal targets in developing sustainable trading systems, or promoting sustainable trading practices, should be the development of *relationships of trust*. Our interview process confirmed the need for trust as the basic building block for sustainable trade while also highlighting several conditions for building relationships of trust.

## 7.1 Building Relationships of Trust

As a general rule, all parties must recognize the need for profit on all sides without letting the profit mission squeeze out cooperative action. Although this goes without saying, the history of trading coffee *as a commodity*, in large volumes through a wide range of intermediaries, has provided a basis for the establishment of highly impersonal trading relationships based solely or primarily on financial drivers. The development of trust requires the development of shared experience and understanding which implies a general need for the development of more personal relationships along the supply chain. Starting from this basis, there are a number of specific areas where producers, traders, roasters, governments and NGOs can jointly work towards building the trust needed to support “sustainable” trading practices:

### 7.1.1 Communication

Open communication channels help avoid the development of “positions” based on rumours and misinformation. Regular contact is the basic ingredient for building personal relationships. To the extent that direct trading relationships help promote direct contact, they can promote the development of trust and, ultimately, sustainable trade. Both buyers and sellers can benefit from the development of strategic communication plans—not simply as marketing tools (where opportunities for trust-building are overshadowed by pecuniary self interest)—but as information exchange tools and opportunities for building mutual respect.

### 7.1.2 Flexibility

The coffee sector is marked by market and weather volatility. Underdeveloped infrastructures and capital savings in producer communities exaggerate the impacts of market volatility often leaving producers in situations which were either unforeseeable or, at least, unpreventable given the real options before them. To the extent that buyers have access to a more stable capital basis and an ability to absorb market shocks, the integration of flexibility into trading relationships or even “producer-based” schedules for delivery can help avoid disappointment between the parties and undesirable stresses on trust. Naturally, producers too should demonstrate flexibility how and whenever physically possible.

### 7.1.3 Producer Knowledge of Market Situation and Conditions

False expectations are arguably the most persistent source of disappointment and relationship stress. While expectations can be adjusted through regular communication between buyers and sellers, ultimately, tools for gathering information unilaterally will play an important role in generating a real basis

for joint action and cooperation where competing interests are at play.<sup>35</sup> A number of types of information gaps were identified as bearing directly on the sustainability of trading relationships:

a. Information on market trends;

Objective, third party information on market trends can help avoid perceptions of manipulation by either party while simultaneously providing both parties to the bargain with a more stable basis for planning obligations.

b. Information on producer cost structure;

Producers can, with little difficulty, generate systematic information on their cost structure but often do not do so for lack of tools, training and guidance. Information on cost-structure should form the foundation of price negotiations with buyers. Knowledge on cost-structure also empowers producers to avoid deception in their trading relationships by providing a reality check for hopes and expectations.

c. Information on producer risk profile;

Although knowledge of producer risk profile may require more in-depth training (and therefore be less accessible to the smallest producers), knowledge about risk and clear identification of the risks in any given situation are key elements in determining an “acceptable agreement.” Information on risk profile is also the basis for managing risk.

d. Information on instruments for managing risk;

The single largest cause of defaults in contracts and corresponding trading relationships is market volatility. In principle, where risk is managed, the potential for default is also minimized. As such, risk management offers an important tool for eliminating tensions and building trust in relationships.

e. Information on pricing structure along the supply chain.

Following the observation that a lack of trust is typically built upon misconceptions and false information and/or on actual practices where one party takes advantage of another, transparency on pricing along the supply chain can provide a blunt instrument for establishing trust. When the respective parties know what they are getting, they can monitor their respective progress over time and effectively verify the “fairness” of any given arrangement.

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35 Note that producers of Fair Trade have often noted that the largest benefit they receive from participation in the Fair Trade system (more so than price itself) is improved access to information and marketing channels. See, for example, Oxford Policy Management, *Fair Trade: Overview, Impact, Challenges* (U.K.: Department for International Development, 2001).

## 7.2 Recommendations for Action

With the Rio Earth Summit, the international community formally recognized the primacy of “meeting the needs of the poor” in the global effort to ensure long-term social and economic sustainability. Small producers servicing the global coffee supply chain suffer from systemic poverty, lack of savings and lack of access to credit and related risk management tools and therefore merit special attention in the implementation of sustainable development as mandated under the Johannesburg Declaration.

While the growth in the number of voluntary sustainability initiatives aimed at improving producer sustainability attests to a general recognition of this need, the majority of small coffee producers still find themselves vulnerable to and constrained by poverty. As such, there continues to be a need to seek systemic tools that can help producers balance social and environmental sustainability with their economic sustainability. Trading practices are not only the farmer’s gateway to international supply chains and trade, but also play a pivotal role in determining the terms of trade facing producers. This context provides the rationale for our overview of the potential use of specialized trading practices as tools for proactively promoting producer (economic) sustainability.

Our overview demonstrates that there is very little in the way of trading practices that can definitively be characterized as beneficial or contrary to producer interests. Lower returns are often compensated by more immediate payment or greater predictability in the price received. The value of one practice over another for any given producer will depend on the specific needs of that producer at the time.

Nevertheless, it remains the case that any actions that can serve to improve the overall situation (e.g., predictability *and* revenue generation or revenue generation *and* flexibility) would appear to be undeniably preferable to the status quo. We have seen that actions that improve the quality and nature of the trading relationship provide, itself hold particular potential in setting the stage for reaping better returns from any given set of trading practices. Alterations in the nature of the trading relationships have the potential to empower producers across the board by improving efficiency and communication while still allowing the market to allocate costs according to the diverse needs and situations which inevitably define any given producer/buyer context. Systemic intervention aimed at promoting sustainable trading practices should therefore principally focus on improving the sustainability of the trading relationships, principally, by enabling the development of improved trust and predictability between the parties. With this in mind it is possible to identify a few priority areas for specific intervention towards the development and implementation of sustainable trading practices:

**Recommendation 1: Improve producer information on markets and costs through the development and implementation of concrete information generation and dissemination tools**

A great deal of hardship and disappointment are the result of inadequate planning and strategic development. The absence of information on individual producer performance and market performance operates as a key obstacle to more efficient planning and relationship building. Producers need to perform cost accounting on a systemic basis as a basic element of sound business planning and long-term sustainability. There is a massive need for tools and training toward this end specifically. Incentives towards the performance of cost accounting may be a desirable feature to include within standards as a means to ensuring proactive movement towards sound business models. Buyers and other third parties can play a proactive role in compiling and transmitting information on markets, particularly value-added markets. Systematizing such information in the form of regular market reports (and prepared by a consortium or independent third party) is desirable to avoid potential conflicts of interest while retaining the reliability and predictability of the data provided.

### **Recommendation 2: Improve transparency in trading relationships through the implementation of buyer reporting requirements**

One of the main obstacles to building trust between buyers and sellers relates to a lack of information on what are the real costs and revenues between parties. Reporting of the costs and returns of producers and traders through aggregate or anonymous reporting could help both sides understand the challenges facing either side without threatening actual competitiveness. Existing standards systems could take advantage of their respective infrastructures in the implementation of such systems by establishing requirements on reporting which are in turn available to all members of the system. While some systems have begun integrating transparency requirements within their systems, access to, and the detail of information available remains extremely limited at present and therefore represents an area of considerable opportunity.<sup>36</sup>

### **Recommendation 3: Build flexibility explicitly into trading arrangements**

Relationships between buyers and sellers can be strengthened in many cases by developing more responsive conditions for delivery and price setting. Identification of core bottlenecks and meeting existing contracts provides an indication of the weakest link in the relationship. In some cases, allowing producers to adjust or set the terms with respect to core areas of difficulty and plan accordingly can preempt future disappointment caused by failure to comply. The practice of adjusting the timing of contract delivery to meet producer harvest conditions and timing, is one example of how built-in flexibility can improve the strength of the relationship between buyer and seller.

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<sup>36</sup> For example, Utz Certified and CCCC reporting requirements are one dimensional and therefore limited in breadth; Starbucks' reporting requirements do not provide information to producers; RA transparency requirements remain optional.



**Recommendation 4: Implement targeted instruments for improving producer capacity to manage risk**

There is substantial opportunity for improving buyer-seller trading relationships through improved risk management for producers. An inability to manage risk effectively is the principal cause of contract defaults. A number of different options are available for promoting improved risk management among producers. The effective use of such tools requires, first and foremost, extensive producer training. A number of activities have been undertaken by the World Bank, Root Capital, Twin Trading and Green Development Foundation, but there is a need for wider investment. Buyers and third parties can facilitate access to risk management instruments by managing the use of such tools and/or providing loans for margin calls as needed. Local banks can also play an important role in facilitating the management of risk. In order to promote the development of risk management facilities designed for producers, third party or public involvement will be necessary in most cases. To the extent that this is the case, there is a need to promote discussions with such parties towards the establishment of facilities.

**Recommendation 5: Provide contractual training for producers**

Inadequate use and application of contractual form and terms was identified frequently as a source of relationship breakdown. Inadequate understanding of the rights and obligations among producers is often a source of unnecessary defaults on contracts. On the other hand, producers who are equipped with strong contracting capacity, are likely to be able to secure more strategic and beneficial contractual terms by participating more proactively in contract formation. An explicit program of training on the meaning and effective negotiation of contracts should be promoted by public authorities and/or other third parties.<sup>37</sup>

**Recommendation 6: Invite shared partnerships and collaborative endeavours**

A lack of personal contact throughout the trading relationship was identified as a further contributor to the absence of trust between buyers and sellers. The pursuit of mutual undertakings between buyers and sellers that extend beyond the regular “price and delivery” obligations can help to stimulate the development of more meaningful relationships. Any of the “Cooperative Business Arrangements” identified in Section 6 above could serve to build understanding and trust—though it is clear that the effective use of such measures also requires an initial degree of trust. Third parties in the form of public authorities and NGOs can play a pivotal role in stimulating the establishment of such relationships through the injection of funding to carry parties past the initial threshold of uncertainty.

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<sup>37</sup> The International Trade Centre’s *Coffee – An Exporter’s Guide* provides a useful basis for developing farmer training tools. See footnote 9 above.

**Recommendation 7: Improve access to financing and pre-financing**

Explicit efforts should be made to enable producers to avoid dependency on Coyotes and the rents they charge for the provision of immediate payment. Improvements in access to financing and pre-financing are the most direct means to achieving this end. Producer information improvements through cost-accounting and market information (Recommendation 1) along with more coherent risk management strategies (Recommendation 4), besides having the potential to improve the quality of the trading relationship between buyers and sellers, also have the potential to improve the overall bankability of producers thereby improving access to credit more generally. There is also anecdotal evidence that the participation in standards initiatives has a positive impact on producer bankability. In order to leverage this impact with local banks and other financial institutions research on the impact of adopting sustainability standards on risk profile should be conducted.

**Recommendation 8: Avoid the use of reverse auctions**

Reverse auctions, although not pervasive in the coffee sector, were cited by several commentators as one of the clearest examples of an “undesirable” trading practice. Insufficient revenue generation remains one of the principal challenges facing small producer sustainability across the coffee-growing world. Growing differentiation in the coffee market holds the promise of attaining greater returns on their production by increasing the importance of quality-based, rather than price-based competition. The practice of holding reverse auctions however, promotes price-based competition and does so in a setting that minimizes the importance of personal relations—both features which ultimately detract from the ability of producers to secure sustainable livelihoods. The fact that reverse auctions typically rely on a buyer’s particular market authority to drive such a process makes it all the more threatening to proactive efforts of building sustainability into coffee supply chains. The practice of using reverse auctions effectively forces coffee sellers to bear the burden of reduced costs thereby reinforcing some of the key sources of unsustainable trading relations in the coffee sector and should therefore be avoided.

Table 1: Sustainable Trading Relationships within Existing Standards Systems

Trading Criteria	Starbucks	Utz Certified	Common Code	Rainforest Alliance	Fair Trade
Written contract requirement	Yes	No	Yes	No	Yes
Minimum price or premium stipulation	Yes – no minimum but price for producer specified	No	No	No	Yes – price minimum and social premium set by FLO
Reporting requirements for traders	Mandatory information on prices paid to producers to Starbucks only	Mandatory generic data on premiums available on a regional basis	Mandatory information on volume and value of purchasing	No	Prices paid reported to FLO
Financing requirements	No	No	No	No	Yes – buyers obliged to provide prefinance if requested by producers
Fees to traders	No	\$.01 per lb	Annual membership fees	No	No
Fees to producers	Must cover verification costs	Must cover verification costs	Annual membership fee based on volume— verification costs covered by buyers through membership fees	Must cover verification costs as well as annual licence fee of \$5–7 per hectare	Must cover verification costs
Fees to others	No	No	No	No	\$.10 per lb to licensees (company responsible for applying the FLO label)

## Annex 1: Basic Elements of Sustainable Contracts

A written contract provides a basis for building transparency, clarity and predictability in the trading relationship—key elements to building sustainable trading relationships and the foundation of sustainable trading practices. The ability of the contract to perform this basic function depends to a large degree on its ability to include relevant information. Below we provide a summary overview of key elements to include in any given contract in order to serve as a basis for building sustainable trading relationships.

Table 2: Basic Elements of a Sustainable Contract<sup>38</sup>

Core Contractual Elements	Detail
Information identifying the parties to the contract	<p>Accurate information on the quality and location of each party to the contract helps prevent fraud and allows for easier follow-up with respect to questions on the contract. If a party isn't adequately identified in a contract, it may be unenforceable at law.</p> <ul style="list-style-type: none"> <li>• Name and purpose of the company</li> <li>• Address and contact information of the company</li> <li>• The registration number of the company</li> <li>• The juridical form of the company</li> </ul>
Purpose of the contract	<p>The purpose of a contract is essential both as device for clearly communicating the interests of the parties in concluding the contract, as well as providing a basis for interpreting the other elements of the contract in the case of dispute. Specification of the purpose of the contract promotes predictability. In addition to noting the purpose of purchase and sale, a contract can include specific objectives related to the establishment of a "fair trading relationship" and/or "sustainable production/trading practices."</p>
Nature of the obligations of the parties	<p>The contract should specify the kinds of rights/obligations at issue. For example, are the rights/obligations:</p> <ul style="list-style-type: none"> <li>• for a fixed term or for an open period;</li> <li>• is it for a specific delivery of goods or an ongoing delivery of goods;</li> <li>• what quantities of goods are to be traded; and</li> <li>• duration of the contract?</li> </ul>

<sup>38</sup> Adapted from AFNOR, "Commerce Equitable, Les Trois Principes des Commerce Equitable," 2nd draft 2006-04-F.

Table 2 (continued)

Core Contractual Elements	Detail
Payment schedule and obligations	<p>A contract may not be enforceable without specification of the price or a means for establishing the price. This portion of the contract can specify any fixed or shared pricing arrangements parties may have between them. At the very least, both parties have a direct interest in specifying:</p> <ul style="list-style-type: none"> <li>• the price or means for determining the price unambiguously;</li> <li>• the dates of billing;</li> <li>• the dates for payment;</li> <li>• means for adjusting prices and payment for alternations in quality and/or delivery time;</li> <li>• the means of payment;</li> <li>• the consequences of late payment; and</li> <li>• the currency of payment.</li> </ul>
Physical quality of the product	<p>Quality is a key element in determining value and therefore must be specified with equal clarity as that of payment amounts and schedules. Specifications can include:</p> <ul style="list-style-type: none"> <li>• type or species of product;</li> <li>• location of production;</li> <li>• quality grade of product; and</li> <li>• any other features related to the physical characteristics of the product.</li> </ul>
Special terms of production and performance criteria	<p>Contracts specifically aimed at promoting sustainable production and trade should include reference to the kinds of practices each of the parties are expected to maintain. Social, environmental and economic “performance” requirements may be appropriate in any given case. Specification of a requirement for compliance with a third party standard or certification will effectively incorporate the terms of the standard within the contract.</p>
Means of managing and verifying compliance with the contract	<p>Clarity can be enhanced by specifying terms for ensuring compliance with the contract. For example, one company may require another to open its books to demonstrate payments to workers or producers, etc. This section should list the key contact persons for managing the contractual relations as well.</p>
Language of the contract	<p>The language in which the contract should be specified as a means for specifying the “legally” applicable version of the contract.</p>
Terms for resolving disputes	<p>The contract should specify what law applies to the contract and what the dispute resolution process is (arbitration or adjudication).</p>
Any other special arrangements	<p>Any other cooperation of expectations between the parties should be listed explicitly to maximize predictability and transparency. Things eligible for inclusion here include any:</p> <ul style="list-style-type: none"> <li>• financing arrangements;</li> <li>• marketing arrangements;</li> <li>• hedging arrangements;</li> <li>• preferential purchasing arrangements;</li> <li>• technical assistance arrangements; and</li> <li>• commitments to information provision.</li> </ul>

## Annex 2: Price Fixation in Futures Markets

The ICO classifies coffees for export by type. The principal types are: Mild Arabica (Colombian Milds and Other Milds), Hard Arabica (Brazilian Naturals) and Robusta (Several Origins), the price declining from first to last in this listing (Table 3).

Table 3: Coffee Types Commercialized in the International Market

General	Type	Principal Producing Countries
Mild Arabica	Colombian Milds Other Milds	Colombia, Kenya and Tanzania Guatemala, Mexico and India
Hard Arabica	Brazilian Naturals	Brazil and Ethiopia
Robusta	Several Origins	Vietnam, Brazil, Ivory Coast Indonesia and Uganda

Source: Ponte, S. (2001).

International traders are typically concerned with characteristics such as uniformity and consistency of green coffee. It is also essential to be aware of the species, the type of processing (wet or dry) and the coffee's region of origin. Traders also rely on the official classification (*official grade standard*) which may vary with origin, but generally refers to the size of the beans, their density, format and number of defects found in a sample. Some roasters insist on pre-sampling with the aim of testing the intrinsic value of coffees, a characteristic that is not evaluated according to official classification procedures. This practice is principally reserved for those coffees with greater value, such as the Arabicas.

The differences in value for Arabica and Robusta coffees, following the norms of the "C" contract (New York) and Robusta 406 (London), depend primarily on the number of imperfections found, the origin and port of destination. These criteria are summarized in Box 2.

**Box 6: Price Differentials in the Coffee Market***Differentials for the "C" Contract in Arabica Coffees*

- a) imperfections: differential of 10 points for each imperfection below the basis. No deliveries will be permitted for coffee containing more than 15 full imperfections, or 23 imperfections; except in case of Colombian coffee, no delivery containing more than 10 full imperfections below the basis shall be permitted.
- b) differences in value between various grades and growths (in points)

<b>Basis: Mexico, El Salvador, Guatemala, Costa Rica, Nicaragua, Kenya, New Guinea, Tanzania, Uganda and Panama</b>	<b>Basis (pts)</b>	<b>Basis + Peru and Honduras</b>
Colombia	+200	+200
Honduras	-100	
Venezuela	-100	-100
Burundi, India, Rwanda	-300	
Peru	-100	
Dominican Republic, Ecuador	-400	-400
India		-100
Burundi and Rwanda		-300

- c) Differentials in value between delivery ports (points)  
 Basis: New York District Ports  
 Minus 125 points: New Orleans, Miami, Antwerp, Hamburg/Bremen, Houston (after 2005)

*Differentials for the Robusta Coffee Futures Contract – no. 406*

- a) Main origins of coffee (tenderable): Angola, Brazilian Conillon, Cameroon, Central African Republic, Ecuador, Ghana, Guinea, India, Indonesia, Ivory Coast, Liberia, Malagasy Republic, Nigeria, Philippines, Republic of Zaire, Sierra Leone, Tanzania, Thailand, Togo, Trinidad, Uganda, Vietnam.
- b) Grades tenderable:  
 Type 1: up to 150 defects per 500 g at basis.  
 Type 2: from 151 to 250 defects per 500 g at a discount of US\$15 per tonne.  
 Type 3: from 251 to 350 defects per 500 g at a discount of US\$30 per tonne.  
 Type 4: from 351 to 450 defects per 500 g at a discount of US\$45 per tonne.  
 Coffee containing more than 25 per cent passing through screen 14 round and less than 10 per cent passing through screen 12 round shall be tenderable at a discount of US\$60 per tonne.







The past decade has given rise to a growing number of voluntary standards for sustainable agriculture production. The coffee sector has proven to be one of the most vibrant and dynamic commodity sectors for standards development during this period, with standards being designed to serve distinct specialty and mainstream markets. For the most part, sustainability standards in the coffee sector have focused on specifying criteria for “sustainable production”—and yet, it is widely recognized that many of the greatest challenges facing the sustainability of the sector as a whole, and smaller producers in particular, are related to the sustainability of the trading relationships between producers and buyers in international markets. This paper, one of the first of its kind, takes a detailed look at the issues and range of options available for the integration of “sustainable trading practices” within existing coffee supply chains.