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Adding Value: Certified Coffee Trade in North America

Giovanucci, Daniele and Byers, Alice and Liu, Pascal

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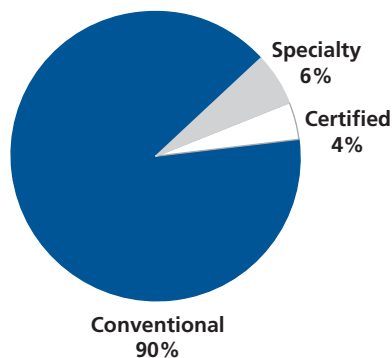
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CHAPTER 3: CERTIFIED COFFEE⁸²

Coffee is one of the most important commodities on the world market. It is produced and exported by nearly 60 nations, ranks as one of the top cash crops in developing countries, and is critical to the economies of several of them⁸³. According to the International Coffee Organization (ICO), world exports of green coffee amounted to 5.3 million metric tonnes in 2006, valued at approximately US\$10.85 billion. The value of exports is expected to exceed US\$12 billion in 2007 – a considerable rebound from the low of US\$5.5 billion that producing countries received in 2002 but still only about 17 percent of the US\$70 billion estimated global retail sales⁸⁴.

Nevertheless, in some nations, producers received only US\$0.30 per pound of coffee when export prices are over three times higher. In one African nation, producers earn even less with an average of only US\$0.09 per pound of robusta⁸⁵. For many, coffee is the only cash crop yet it can be a difficult way to earn a living. Low prices are only part of the challenge. World conventional coffee markets are highly competitive and typically cyclical with recurring patterns of oversupply that make prices volatile and producer incomes very insecure.

Figure 11. World exports of certified coffees in relation to specialty and conventional coffees in 2006



Source: D. Giovannucci estimates based on various data sources

Social and environmental certification has created a fast-growing niche market that offers an advantage to growers that can produce quality certified products. Certified coffees are commonly defined as those that include the three pillars of sustainability (economic, environmental and social) and are certified by independent third parties. This category has emerged from almost negligible quantities in the late 1990s to become a significant portion of today's coffee exports. In 2006, certified coffees amounted to approximately 4 percent of global green coffee exports or more than 220 000 metric tonnes (Figure 11)⁸⁶.

⁸²Please cite as: Giovannucci, D., Liu, P. and Byers, A., 2008 Adding Value: Certified Coffee Trade in North America. In Pascal Liu (Ed.) Value-adding Standards in the North American Food Market - Trade Opportunities in Certified Products for Developing Countries. FAO. Rome

⁸³World Bank (Lewin, B., Giovannucci, D. and Varangis, P., 2004)

⁸⁴ICO (2007)

⁸⁵ICO (2007)

⁸⁶Giovannucci, D (2008)

While the market penetration of certified coffee is still relatively modest, coffee is nevertheless the leading agricultural sector in terms of both the number and frequent use of such certifications. These certification initiatives are more responsive to public needs and have become important vehicles for managing or regulating sustainability in coffee⁸⁷.

When coffee prices plummeted in the late 1990s and early 2000s, hundreds of thousands of farmers were forced out of business. Oxfam⁸⁸ and the Lewin *et al.* World Bank report (2004) note resulting hunger, dislocation, and even a number of deaths attributable to this collapse. Prices for certified coffee declined considerably less than those of conventional coffee during the crisis, providing some growers with a lifeline⁸⁹.

1. OVERVIEW OF THE NORTH AMERICAN COFFEE MARKET

Nearly all coffee sold in North America is imported from developing country producers and exporters⁹⁰. The North American coffee market accounts for over one quarter of global coffee imports in value (27 percent in 2005) and the United States is the world's largest single buyer of coffee. Its consumers are increasingly attentive to quality and origin, and have demonstrated a growing interest in the social, economic, and environmental aspects of coffee production. The expansion in the number of gourmet coffeehouses in the United States illustrates this rapid evolution. From approximately 450 in 1991 there are now nearly 24 000 in operation⁹¹. The unique development of such differentiated demand in the United States and Canada, especially over the last decade, has had a significant impact on the coffee industry and its producers. In recent years, the value of differentiation has increasingly concentrated in the intangible and downstream parts of the value chain as some retailers sell coffees at many multiples of their purchase price⁹². The demand for certified and higher quality gourmet coffees allows producers to capture a greater percentage of the final retail value for their crops in the form of price premiums⁹³.

Volume, value and prices

Approximately 1.42 million metric tonnes of conventional green coffee was imported into North America in 2006, with 1.28 million metric tonnes entering the United States⁹⁴ and 139 000 metric tonnes into Canada⁹⁵. The FOB value in 2006 is estimated to exceed US\$3.6 billion⁹⁶. The tariff levels are favourable to coffee imports: green and roasted coffees enters the United States and Canada duty free and for most other processed coffee products the tariff is either zero or very low. When measured by value, Colombia accounts for the largest share whereas Brazil supplies the largest quantity. Green arabica coffee accounted for about 53 percent of the total. The United States also exported significant quantities of coffee (68 percent of which was roasted) that in 2006 were valued at US\$451 million. Canada is the largest market for US exports and it also re-exports a modest amount of coffee.

⁸⁷ Reynolds, L., Murray, D. and Heller, A. (2007)

⁸⁸ Oxfam (2003)

⁸⁹ Varangis, P., Siegel, P., Giovannucci, D. and Lewin, B. (2003)

⁹⁰ With the exception of production from Hawaii and Puerto Rico

⁹¹ Sources: SCAA, Mintel, NCA elaborated in Giovannucci, D. (2008)

⁹² Ponte, S. and Daviron, B. (2005)

⁹³ World Bank (Lewin, B., Giovannucci, D. and Varangis, P., 2004)

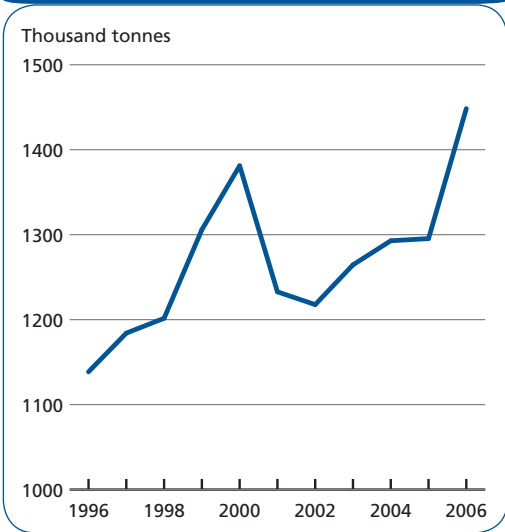
⁹⁴ USDA FAS (2007)

⁹⁵ Canadian Coffee Association (2007)

⁹⁶ USDA FAS (2007)

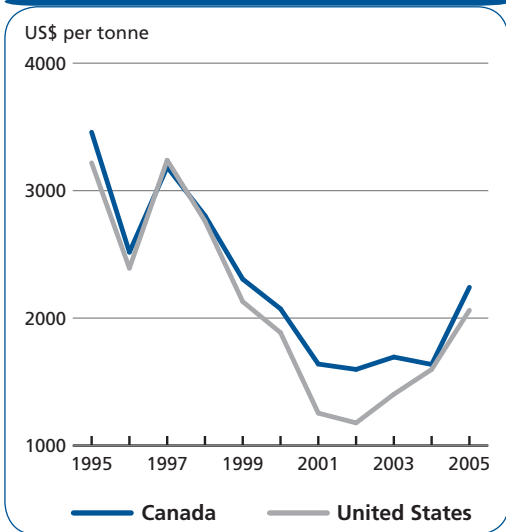
North American consumption has shown little overall growth in recent years. The quantity of green coffee imported into North America grew markedly in the 1990s and reached a peak in the year 2000. The volume declined in 2001 and 2002 and then showed only marginal average growth of approximately 1 percent per annum (Figure 12) until 2005. Disaggregating the different market segments uncovers that the sales of conventional coffees actually declined while growth has occurred in the differentiated or specialty coffees. Real prices for all coffees fell from the mid-1990s, reaching record-low levels in the early 2000s. This fall was reflected by declining unit values of imports in Canada and the United States as shown in Figure 13. The severe price declines appear to have had little or no impact on global consumption trends. The fall in prices however caused considerable hardship for all coffee producers. Import prices have partly recovered since 2002, but they are still below the nominal price levels of the early 1990s.

Figure 12. Imports of green coffee into North America



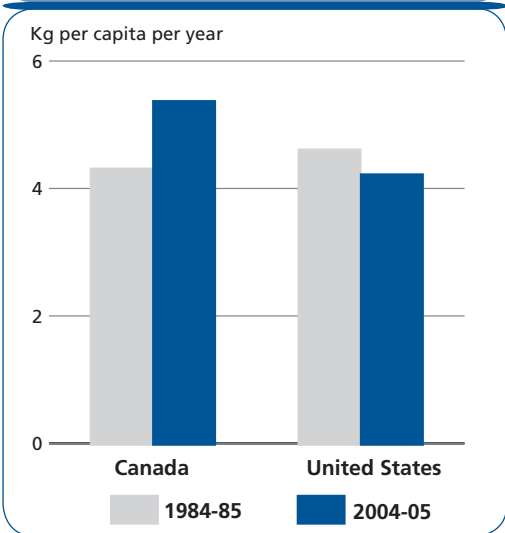
Source: FAOSTAT (ICCO for 2006)

Figure 13. Unit value of United States and Canada green coffee imports



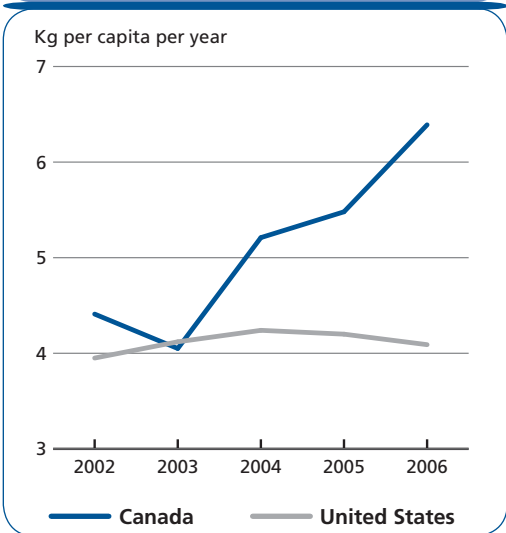
Source: FAOSTAT

Figure 14. Change in coffee consumption across two decades, United States and Canada



Source: International Coffee Organization (ICO) 2007

Figure 15. Recent changes in coffee consumption in Canada and the United States



Source: International Coffee Organization (ICO) 2007

In the United States, per capita consumption has been almost stagnant over the past five years, and is even below its level of the mid-1980s despite population growth. Conversely, it has expanded in Canada (Figures 14 and 15). Individual consumption in Canada reached 6.39 kg per capita in 2006 and is among the highest in the world, well above that of the European Union (4.95 kg), the United States (4.09 kg) and Japan (3.38). Higher consumption rates are only found in Scandinavian countries and some smaller European states (Benelux, Estonia and Switzerland).

2. CERTIFIED COFFEE

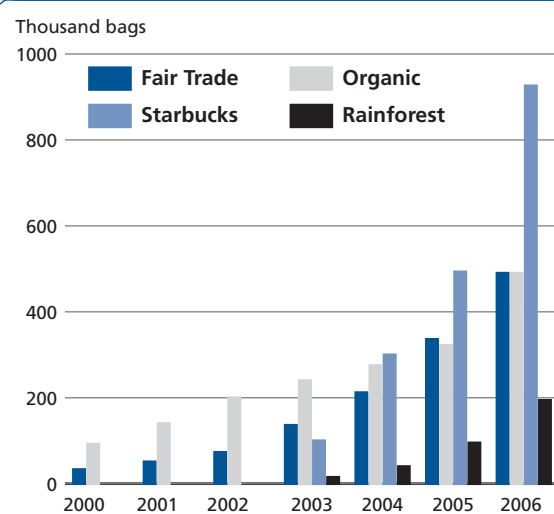
Calculating estimates of the quantities of certified coffees marketed in North America is made difficult by the fact that only a portion of the coffees that are certified under a sustainability programme are actually sold under a certified seal. Several factors contribute to this dynamic:

- a) A portion of a farm's output may not meet quality requirements of a buyer seeking certified coffees and must therefore be sold as conventional.
- b) Some coffees are purchased for their sustainability attributes and, for various reasons may be blended or marketed without the identity of a certification.
- c) A buyer may want to purchase only a portion of the coffee as certified and the rest as conventional, even though the entire farm may be certified.
- d) In some cases, buyers are not seeking a certification but will give preference to certified coffees even though they do not use the certification and may or may not pay a premium.

Unless otherwise specified, the figures provided in this section relate to the quantities actually purchased as certified. Total certified production volumes may be substantially higher.

Estimates for 2006 indicate that the imports of certified coffees rose to approximately 110 000 metric tonnes, accounting for nearly 8 percent of the market. These certified coffees include organic, Fairtrade, Rainforest Alliance, Bird Friendly, Utz Certified and Starbucks C.A.F.E. Practices and account for overlapping certifications (Table 11). This is a very substantial growth from the approximately 60 000 metric tonnes of certified coffee that were imported into North America in 2005, then accounting for approximately 5 percent of the green coffee imports. The export value (FOB) for these coffees was estimated at approximately US\$330 million in 2006⁹⁷.

Figure 16. Estimated growth of US certified coffee imports



Sources: Giovannucci from own data and CIMS, TransFair, Rainforest Alliance, Starbucks

⁹⁷ Calculation by Root Capital and Giovannucci based on conservative estimates of average FOB prices

Many large North American retailers such as Starbucks, Dunkin Donuts and McDonalds, now offer organic and/or fair-trade coffee. Other coffees certified as sustainable are increasingly becoming popular as well (Figure 16). RA is now one of the fastest growing coffee certification schemes in North America, due in part to its partnership with industry giants like Kraft Foods. Utz Certified and Bird-Friendly (Smithsonian Migratory Bird Center) have smaller positions.

Table 11. Estimated imports of certified green coffee into North America

| Type | Quantity (MT) |
|--------------------------------|----------------|
| Organic | 30 700 |
| Fair-trade | 32 100 |
| Rainforest Alliance | 11 600 |
| Utz certified | 1 800 |
| Bird friendly | 200 |
| C.A.F.E. Practices (Starbucks) | 58 000 |
| Total (*) | 110 000 |

(*) Due to multiple certification, the total is less than the sum of the rows

2.1 Organic coffee

Market situation

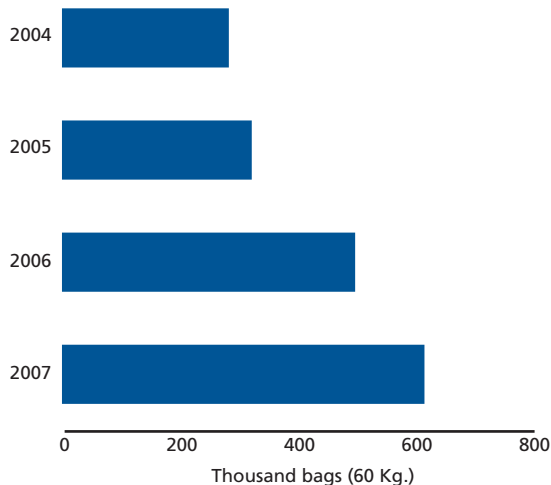
Based on a survey of importers and industry sources, Giovannucci estimates that world sales of certified organic coffee exceeded 67 000 metric tonnes in 2006, nearly half of which (30 700 metric tonnes) were consumed in North America. This is considerably more than the approximately 52 000 metric tonnes of organic coffee consumed worldwide in 2005⁹⁸, when

Table 12. Estimated imports of certified organic coffee (metric tonnes)

| Year | 2003 | 2005 | 2006 |
|---------------|------------------|--------|--------|
| World | 42 000 | 52 000 | 67 000 |
| North America | 16 500 (2004) | 19 000 | 30 700 |

Source: Giovannucci and Coffee Guide for 2005 and 2006; World Bank (2005) for 2003. Giovannucci and CIMS for 2004.

Figure 17. US imports of organic coffee (past and industry projections)



Source: Giovannucci and Villalobos, 2007. The State of Organic Coffee: 2007 US Update, CIMS: San José, Costa Rica

19 000 metric tonnes (37 percent) were consumed in North America (Table 12 and Figure 17). The share of North America in world organic coffee consumption has increased substantially.

This estimate indicates that organic coffee represents approximately 2 percent of the total North American coffee market in volume. The share in value is slightly higher since organic coffee usually fetches higher prices than conventional coffee.

Market trends

Estimates for the growth rate of the organic coffee market differ across sources. Data collected by AC Nielsen⁹⁹ show that organic coffee sales in the United States increased by 54 percent during the period November 2004 - November 2005, while total coffee sales grew by only 8.5 percent in that period (covers only certain segments of the market). Data from the *Organic Trade Association's 2006*

⁹⁸ The Coffee Guide (2007)

⁹⁹ AC Nielsen quoted in Supermarket News, 19 December 2005 issue, United States

Manufacturer Survey point to a slightly slower growth for organic coffee of 40 percent over the period December 2004 - December 2005. Both surveys polled limited sources. As regards North American organic coffee imports, Giovannucci and Villalobos found in research conducted for CIMS covering US importers that the average growth rate between 2004 and 2005 was 23.5 percent¹⁰⁰. Their more recent 2007 survey indicates that the average growth in 2006 was approximately 56 percent compared to 2005 imports of green organic coffee¹⁰¹. They estimate that growth will slow considerably in 2007.

Suppliers

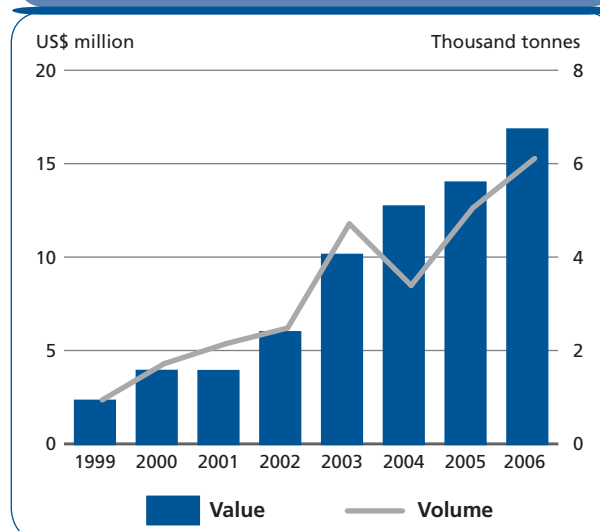
Certified organic coffee is exported from more than 30 countries (Table 13). Most of the global supply comes from Latin America where the largest exporter in 2006 was Peru (26 400 metric tonnes), followed by Central America, Brazil, Mexico and Colombia. Ethiopia is Africa's largest exporter followed by Uganda. In Asia, Papua New Guinea and Timor-Leste are the leading exporters followed by Indonesia and India.

Most organic coffee found in North America comes from Latin America, in particular from Peru, Mexico, Brazil, Bolivia, Colombia, Costa Rica, Guatemala and Nicaragua. Peru's exports to the United States have been rising steadily since 1999 and reached 6 100 metric tonnes in 2006 (Figure 18). Coffee accounts for over half of Peru's organic export earnings to the United States. There is strong interest in organic coffee from a wider range of countries¹⁰².

Prices

Price premiums vary considerably due to several factors. In many cases, organic premiums are part of larger premiums based on quality, regional designation, reputation of the producer or additional certifications like fair-trade or bird friendly¹⁰³. In recent decades tight relationship between supply and demand meant that nearly any certified organic coffee would receive a premium. In a study carried out

Figure 18. Peru's exports of organic coffee to the United States (volume & value)



Source: J. Fernandez, PromPeru 2007

Table 13. Organic coffee suppliers

| | |
|---------------------------------|--|
| Latin America and the Caribbean | Bolivia, Brazil, Colombia, Costa Rica, Cuba, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Peru, Trinidad and Tobago, Venezuela |
| Africa | Burundi, Cameroon, Ethiopia, Ghana, Kenya, Madagascar, Malawi, Rwanda, Togo, United Rep. Tanzania, Uganda, Zambia |
| Asia | China, Timor-Leste, India, Indonesia, Lao PDR, Nepal, Philippines, Sri Lanka, Thailand, Viet Nam |

* Some are occasional exporters

¹⁰⁰ Giovannucci, D. and Villalobos, A. (2006)

¹⁰¹ Survey of US-based importers estimated to cover well over 90 percent of the North American market.

¹⁰² ITC (2002)

¹⁰³ Giovannucci, D. and Villalobos, A. (2006)

in Northern Nicaragua during the 2000-2001 harvest, Bacon¹⁰⁴ found that the average price reported at the farm gate for organic coffee was US\$0.63 per pound, while that of conventional coffee was US\$0.41 per pound, i.e. a premium of 54 percent. While the actual amount paid has remained somewhat constant, the relative percentage is clearly greater during periods of low prices. Today the organic premium is much more correlated with quality. High-quality producers tend to receive a larger premium.

In the first half of the 2000s, the premiums for organic coffee showed a declining trend as new supply from many origins became available. However, the decline reversed in 2005 as demand firmed up in several channels, particularly among larger retailers. According to Giovannucci and Villalobos, price premiums averaged around US\$0.28 per pound (US\$0.62 per kg) in 2005 and many companies reported premiums between US\$0.15 and US\$0.80. For 2006, Giovannucci and Villalobos, cite that premiums paid by importers averaged US\$0.24 per pound with a tighter range of US\$0.10 to 0.60 per pound. This represents a general average premium of just over 20 percent. Some Latin American exporters reported premiums between 30 and 40 percent for 2005 and 2006¹⁰⁵.

A premium paid by the buyer is not necessarily received by the producer. As certified coffees move further into mainstream distribution channels they become part of increasingly complex supply chains and, quite often, face less transparent transactions. It is difficult to determine how the premiums are distributed along the supply chain and how much reaches the farmer or cooperative. There is considerable variation in distribution and a number of North American importers are not aware of how the premiums they pay are distributed in the country of origin.

Importers that are aware of what price reaches their suppliers claim in a recent study that approximately 80 to 90 percent of the premium reaches the farmer or cooperative¹⁰⁶. However, this is probably not representative of all certified coffees since it is likely that importers with a greater interest in knowing what their farmers receive may also stimulate higher payment levels to them.

2.2 Fair-trade coffee

Market situation

Coffee is by far the most important fair-trade product and sales of fair-trade certified coffee have grown considerably in the last decade. FLO indicates that sales of certified fair-trade coffee worldwide reached 52 077 metric tonnes in 2006, up from 33 994 metric tonnes in 2005 (+53 percent). Nearly half of this volume was sold in North America.

According to TransFair USA¹⁰⁷, 29 380 metric tonnes of fair-trade coffee were imported into the United States in 2006, up from 20 220 metric tonnes in 2005 (+45 percent). The fair-trade coffee market in the United States has grown dramatically in recent years (Figure 19), although preliminary estimates for 2007 indicate a marked deceleration due in part to some over-purchasing in 2006. Canada imported and sold an estimated 2 770 metric tonnes of green fair-trade coffee in 2006 growing by approximately 60 percent over 2005.

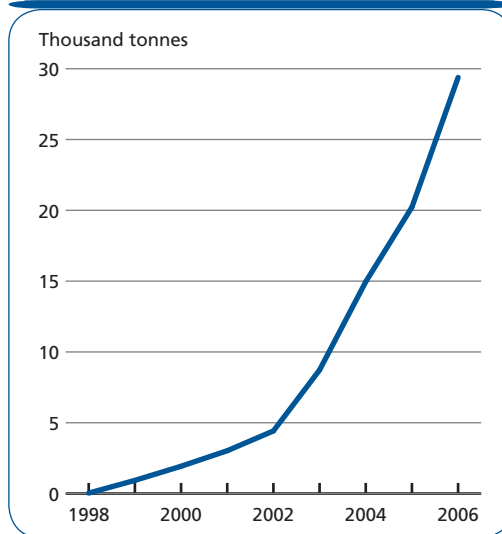
¹⁰⁴ Bacon, C. (2005)

¹⁰⁵ Daabon and Apex Brasil

¹⁰⁶ Giovannucci, D. and Villalobos, A. (2007)

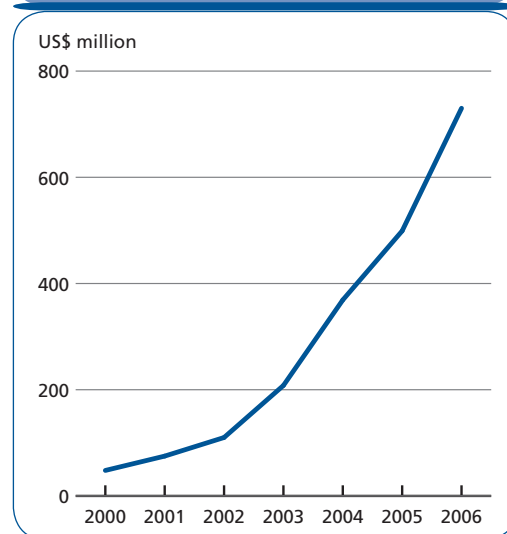
¹⁰⁷ TransFair USA (2007) Fairtrade Almanac 1998-2006

Figure 19. Imports of FLO-certified coffee into the United States



Source: TransFair USA (2007)

Figure 20. Estimated retail sales value of fair-trade certified coffee in the United States



Source: TransFair USA (2007)

Fair-trade certified coffee imports account for some 2 percent of the total US green coffee imports. TransFair USA estimates that the retail sales of fair-trade coffee in the United States reached US\$730 million in 2006 (Figure 20), up from US\$499 million in the previous year (+46 percent). It calculates that fair-trade coffee represents over 3 percent of the US retail market value. The number of firms (roasters and importers) licensed by TransFair in the United States has risen steadily since 1999 to 463 firms in 2006 (Table 14).

Table 14. Number of firms licensed by TransFair USA

| No of licensees | Roasters | Importers | Total |
|-----------------|----------|-----------|-------|
| 2000 | 62 | 13 | 75 |
| 2006 | 395 | 68 | 463 |

Source: TransFair USA (2007)

There is considerable overlap of the organic and fair-trade coffee sectors. In 2006, approximately 78 percent of the fair-trade coffee sold in the United States was also certified organic while in Canada and the world this reached near 50 percent on average. This reflects a tendency toward double and even triple certifications; a trend with challenging implications for producers (see Section 3). The premium for fair-trade coffee that is also certified as organic rose in 2007 by US\$0.05 per pound to US\$0.20. The increase reflects the higher costs of organic production and compliance and also serves as an incentive for greater environmental sustainability.

Suppliers

Fair-trade coffee was produced and exported by 26 countries in 2006 (Table 15). The five largest fair-trade suppliers to the North American market were Peru, Mexico, Nicaragua, Indonesia and Ethiopia, together accounting for two-thirds of US imports. Other important suppliers include Guatemala, Colombia and Brazil¹⁰⁸.

¹⁰⁸ Transfair USA (2006)

Table 15. Countries supplying FLO-certified fair-trade coffee to the United States in 2006

| Country | Exports to the USA (MT) |
|----------------------|-------------------------|
| Peru | 7 349 |
| Mexico | 3 581 |
| Nicaragua | 3 299 |
| Indonesia | 2 821 |
| Ethiopia | 2 584 |
| Brazil | 1 998 |
| Guatemala | 1 788 |
| Colombia | 1 520 |
| Papua New Guinea | < 1 000 |
| Costa Rica | <1 000 |
| Dominican Republic | < 1 000 |
| Haiti | < 1 000 |
| Honduras | < 1 000 |
| Timor-Leste | < 1 000 |
| El Salvador | < 1 000 |
| Rwanda | < 1 000 |
| United Rep. Tanzania | < 1 000 |

Source: TransFair USA 2007

Prices

The FLO system guarantees a Fairtrade Minimum or floor price that is based on the estimated cost of sustainable production. The minimum price ranges from US\$1.01 to US\$1.21 per pound depending on the type of coffee and the country of origin (Table 16). When market prices rise above the minimum, i.e. US\$1.21 for many washed arabicas, a small additional premium is paid¹⁰⁹. For many years that additional premium was US\$0.05 per pound but in June 2007 it was raised to US\$0.10 per pound. The premium is intended for use by cooperatives for social and economic investments at the community and cooperative level. When the coffee is also certified organic, an extra premium of US\$0.20 per pound applies.

This system proved very beneficial during the recent price crisis. Although the fall in conventional coffee prices caused considerable hardship for small coffee growers across the developing world, the price obtained by fair-trade growers was often above the

Table 16. FLO Minimum prices for coffee as of 2007 (US cents per pound FOB)

| Type of coffee | Central America, Africa, Asia | South America & Caribbean |
|--------------------|-------------------------------|---------------------------|
| Washed Arabica | 121 | 119 |
| Non-washed Arabica | 115 | 115 |
| Washed Robusta | 105 | 105 |
| Non-washed Robusta | 101 | 101 |

Source: FLO 2007

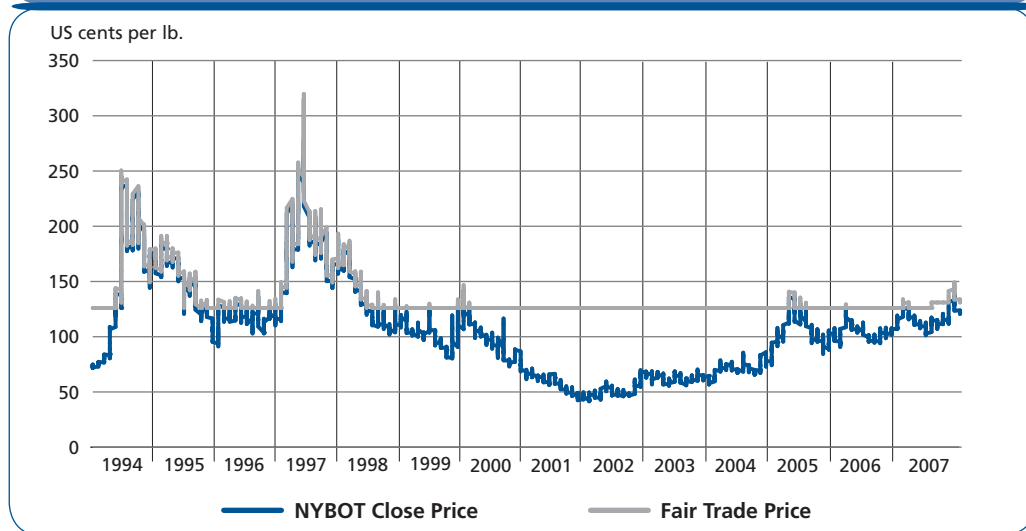
Table 17 Countries and farmers supplying fair-trade coffee globally in 2006 (FLO-certified)

| Country | Farmers participating |
|--------------------------|-----------------------|
| 1. Bolivia | 3 666 |
| 2. Brazil | 7 500 |
| 3. Cameroon | 1 037 |
| 4. Colombia | 19 502 |
| 5. Congo, D.R. | 87 |
| 6. Costa Rica | 14 555 |
| 7. Côte d'Ivoire | 3 937 |
| 8. Dominican Rep. | 5 745 |
| 9. Timor-Leste | 17 576 |
| 10. Ecuador | 1 249 |
| 11. El Salvador | 1 257 |
| 12. Ethiopia | 40 325 |
| 13. Guatemala | 8 898 |
| 14. Haiti | 28 968 |
| 15. Honduras | 2 054 |
| 16. India | 2 343 |
| 17. Indonesia | 2 346 |
| 18. Kenya | 8 811 |
| 19. Laos | 517 |
| 20. Mexico | 24 988 |
| 21. Nicaragua | 7 174 |
| 22. Papua New Guinea | 4 756 |
| 23. Peru | 33 991 |
| 24. Rwanda | 10 916 |
| 25. United Rep. Tanzania | 3 321 |
| 26. Thailand | 192 |
| 27. Uganda | 2 950 |
| 28. Venezuela | 677 |
| 29. Zambia | 289 |
| TOTAL | 259 627 |

Source: FLO International and TransFair USA 2007

¹⁰⁹ For arabica coffees (representing the majority of fair-trade certification) the market price is determined by the price of the second position 'C' futures contract at the InterContinental Exchange (ICE).

Figure 21. Fair-trade price advantage in difficult years



international market price (Figure 21). In October 2001, when the market price fell to a record low of US\$0.45 per pound, the price of fair-trade coffee was 180 percent higher. Recently, as market prices have stayed above the US\$1.00 range, the relative premiums for fair-trade coffee have been more modest. As such there are questions about the extent to which producers want to continue with the certification when the price differential is small. For many that do continue there are likely to be two reasons: i) having a longer-term vision of the cyclical nature of commodity pricing, and ii) recognizing the other benefits of fair-trade (i.e. organizational strengthening, more stable relationship with buyers and community investment).

Over a quarter of a million farmer families directly benefited from the sales of fair-trade coffee in 2006 (Table 17). Most belonged to 241 organizations of coffee producers that were certified by FLO in 2006. FLO estimates that the fair-trade system earned farmers an extra income of some €41 million (US\$57.4 million) that year. This sum represents an average of more than US\$200 per farmer above what they would have earned selling on the conventional market. TransFair USA estimates that the quantities sold in the United States alone generated an additional income of US\$17 million for 106 farmer cooperatives in 23 countries.

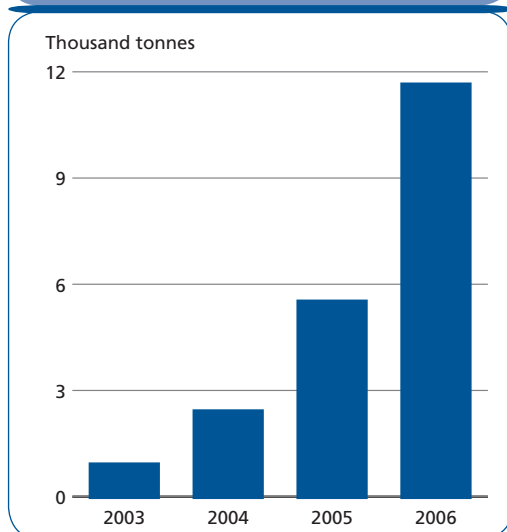
2.3 Rainforest Alliance coffee

RA emerged in the mid-1990s as a certifier of environmentally friendly coffees (originally called Eco-OK) that were then collectively called shade-grown. From early efforts in Central America, it has expanded to other parts of Latin America and more recently to Africa and Asia. In terms of coffee volume sold, it is currently the fastest growing. As of October 2007, RA had certified 16 838 farms and over 200 000 hectares of coffee.

According to RA, 11 631 metric tonnes of their certified coffee were imported into North America in 2006, up from approximately 5 500 metric tonnes in 2005. This represents slightly less than 1 percent of the total imports of green coffee into North America. Since 2003, North American imports of RA-certified coffee have grown by more than 100 percent annually (Figure 22).

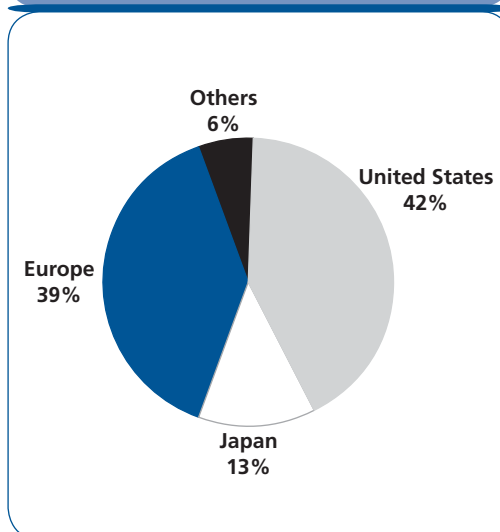
The international market for these coffees has also expanded considerably in recent years with more than 100 percent average annual growth in the last three years. In 2006, North America represented roughly 42 percent of all RA coffee sales (Figure 23) though this share is dropping. Sales are expanding rapidly in Europe and are also on the rise in several other markets including Japan, Australia and Brazil, though at a slower pace.

Figure 22. Imports of RA-certified coffee into North America



Source: Rainforest Alliance

Figure 23. Markets for Rainforest Alliance coffees (2006)



Source: Elaborated from Rainforest Alliance data

As with the organic and fair-trade certification schemes, RA has recently been adopted by some larger roasters and retailers such as Kraft Foods, Tchibo and Lavazza in Europe and Wal-Mart and Kraft in the United States. As with other certifications, their partnerships with major industry players are growing. For example, all of the nearly 1 200 McDonald's restaurants in the United Kingdom and Ireland now exclusively sell Kenco (Kraft Foods) coffee from RA-certified farms.

Brazil is the single largest supplier of certified RA coffees. Nearly all of the RA coffees before 2006 came from Latin America. Today Ethiopia, United Republic of Tanzania and Indonesia also participate (Table 18). Several new origins are in the process of certification.

Table 18. Exporters of Rainforest Alliance coffees (2007)

| Country | No of farms |
|--------------------------|-------------|
| 1. Brazil | 34 |
| 2. Colombia | 2 104 |
| 3. Costa Rica | 2 023 |
| 4. El Salvador | 210 |
| 5. Ethiopia | 6 294 |
| 6. Guatemala | 88 |
| 7. Honduras | 309 |
| 8. Indonesia | 539 |
| 9. Mexico | 1 149 |
| 10. Nicaragua | 17 |
| 11. Panama | 4 |
| 12. Peru | 4 065 |
| 13. United Rep. Tanzania | 2 |

Source: Compiled from RA data

The price premiums for certified RA coffee range from US\$0.04 to US\$0.20 per pound with the average at US\$0.08 to US\$0.12. As with many other certification schemes, these premiums depend largely on the quality of the product and the relationship between the buyer and the producer.

2.4 Bird Friendly coffee

Bird Friendly® (BF) was one of the early environmentally-oriented certification schemes for coffee and helped to establish the standards now used by others. It emerged as a response to the dramatic decline in North American migratory bird species when this decline was strongly correlated to the reduction of the avian winter habitat areas of Latin America. The reduction of these forests often coincided with their conversion to agricultural land, including the conversion of naturally shade-grown coffee to more intensive methods that eliminated much of the tree cover. Studies in the 1990s demonstrated that shade coffee farms could both provide valuable habitat for avian biodiversity as well as remain profitable. To encourage such farmers, the Smithsonian Migratory Bird Center (SMBC) elaborated its BF certification. The BF programme focuses on natural biodiversity and a prerequisite

for its seal is organic certification, which, among other guidelines, prohibits the use of any synthetic fertilizers, pesticides, herbicides or fungicides.

While relatively small in terms of coffee sold, it supplies a significant North America niche. Over 3 600 metric tonnes of BF coffees were sold in 2006, all to Japan, Canada and the United States. Yet, according to the SMBC, less than 200 metric tonnes were sold with the BF label. The bulk of BF-certified coffee is grown in Mesoamerica, from southern Mexico through Central America (Table 19).

Table 19. Number of bird-friendly certified farms by country of origin (2006)

| Country | No of certified farms |
|-----------|-----------------------|
| Mexico | 11 |
| Peru | 10 |
| Salvador | 6 |
| Guatemala | 4 |
| Bolivia | 1 |
| Venezuela | 1 |

Source: Smithsonian Migratory Bird Center

Price premiums for BF coffee have ranged from US\$0.05 and US\$0.28 per pound with the average typically being between US\$0.05 and US\$0.10; that is in addition to the price premium for the organic certification. As with other certifications, the premiums vary according to the buyer and the quality of the coffee.

2.5 Utz Certified

The Utz Certified label currently has a relatively modest presence in North America, but is growing. This programme was founded in Guatemala as Utz Kapeh in 1997 by Dutch coffee roaster, Ahold Coffee Company and later became an independent globally-oriented foundation. It helped to develop a code of Good Agricultural & Business Practices that is now the Coffee Code of GlobalGAP (formerly EurepGAP). It also uses basic social criteria from the International Labour Organization Conventions. Producers and participating firms must meet the Chain of Custody requirements that ensure traceability.

Utz Certified coffee is exported from 18 producing countries and sold in 19. Utz is one of the few schemes that certify significant quantities of robusta coffee. Europe is, by far, its major market region. Global sales of Utz certified coffee reached 36 000 metric tonnes in 2006, representing 25 percent growth over the prior year. North American sales accounted for less than 5 percent or 1 800 metric tonnes¹¹⁰.

Products that use the Utz Certified logo may benefit from a suggested price premium but there is no mandate for this. In practice, producers have been receiving premiums that average US\$0.03 to US\$0.05 with a reported range of between US\$0.01 and US\$0.12 over the last three years¹¹¹.

2.6 Private company standards for quality and sustainable coffee production

The standards and verification programmes set by companies are seldom included in sustainability discussions because of three reasons: i) they are under the private control of a company or group of firms that can at any time alter, dilute, or simply not fully use the standard or code as they see fit; ii) they may be designed more for corporate needs than for producer sustainability, for example, having questionably effective standards or not using independent third-party certification; and iii) they may not meet the economic needs of producers (one of the pillars of sustainability) by not providing adequate remuneration for sustainable production practices.

¹¹⁰Source Utz Certified

¹¹¹ Giovannucci personal communication with Utz Certified and field investigations to Central America, Mexico, Colombia in 2005-06.

Nevertheless, this report briefly considers two company certification schemes because of their large potential impacts due to the size of their purchasing and the perception that, for the most part, the above arguments may not apply to them. It should be noted that at the time of writing this report no independent study has been carried out on the costs and benefits of these schemes.

Starbucks is one of the world's leading coffee brands and one of the top retail food chains operating more than 14 000 outlets worldwide in 2007. Several years ago it developed its own private sourcing standard called Coffee and Farmer Equity Practices or C.A.F.E. Practices that incorporates a set of basic social and environmental standards with its private quality requirements.

In 2006, Starbucks purchased more than 145 000 metric tonnes of coffee and paid an FOB average price of US\$1.42 per pound (non-exporting growers may reportedly obtain 15-35 percent less depending on how many middlemen stand between them and the exporter). Nearly 77 000 metric tonnes were independently certified according to C.A.F.E. Practices¹¹² and approximately 56 000 metric tonnes were estimated to be sold in the United States. Global projections for 2007 indicate that the total will exceed 100 000 metric tonnes¹¹³ Starbucks also purchased significant but smaller amounts of organic, fair-trade and other eco-friendly coffees.

Nespresso is one of Nestlé's fastest-growing subsidiaries providing espresso and brewing equipment on a membership basis to clients around the world. North America is one of its most important markets. Although it is not a certification scheme, it may be useful to mention Nespresso's AAA Sustainable Quality Program® due to the impacts it may have on coffee growers in the future. This programme was co-developed with RA, whose members also verify compliance with the standard. It features social and environmental practices and purchases coffees in Costa Rica, Colombia, Guatemala, Mexico, Brazil and Kenya. It was publicly introduced in 2005 and is still relatively new. In 2006 nearly 6 000 metric tonnes, or approximately one-third of Nespresso's purchasing, met its AAA standard¹¹⁴. According to Nespresso, producers typically receive well above the market price for a combination of quality and sustainability though Nespresso makes no distinction in terms of a premium for meeting the AAA standard.

3. COSTS AND BENEFITS TO DEVELOPING COUNTRY SUPPLIERS

3.1 The value of transparent price premiums

Many buyers believe that it makes good business sense to request that some higher standard of quality is met as part of sustainable practices. Indeed, the trend toward higher quality in certified coffees may well improve their desirability in the marketplace¹¹⁵. However, when buyers fail to distinguish the value they place on sustainable practices, they dilute its importance. Paying a high price for a certified coffee may simply mean that a buyer is purchasing a higher-quality coffee with preferred flavour characteristics. As such, when

¹¹² Starbucks corporate records

¹¹³ Estimate calculated from total global certification based on relative percentage of total store revenue earned in the United States.

¹¹⁴ Personal communication November 2007 D. Giovannucci with Nespresso's Karsten Ranitzsch and GoodBrand & Company's Dean Sanders.

¹¹⁵ Bacon (2005); CIMS (2003)

there is no correlation between the price and the recognition of a producer's sustainable practices, it becomes more difficult for a producer to justify the costs of sustainability. For sustainability to advance, producers need to have a clear signal from the market about sustainability and there is no signal clearer than a price premium.

The transparency of pricing — where buyer and seller clearly understand what is being paid for — facilitates transactions and improves market functions. In practice it may be difficult to achieve a rigid or exact distinction such that, for example, 37 cents is for the quality and 22 cents is for the certification. Nevertheless, some distinction is necessary. While the lack of transparency may create a temporary negotiation advantage for the buyer, this is a false economy since it is also more likely to reduce the number of interested participants or the number of certified products available. Furthermore, without clarity and transparency in these transactions, it becomes difficult for any buyer or firm to claim they are supporting sustainability. Without a clear correlation between price and sustainability practices, the buyer may simply be paying for any other characteristic such as rarity or taste.

Besides knowing what the premium is for, it is also important to know who receives it. Growers that are large enough to export directly tend to receive much, if not all, of the negotiated premium for certified coffees. However, most growers operate through middlemen or cooperatives that play a vital role in marketing their coffee. In some cases these can capture a substantial portion of the premium paid for certified products. Few buyers are willing to disclose the distribution of premiums along the value chains. Yet, if producers fail to receive a fair portion of the premium they may also fail to achieve sustainability. In accordance with fair labour practices, companies are increasingly insisting on transparency that assures them that their value chain is performing sustainably. Some, like Starbucks, want to know what the farmers who provide their coffees are actually paid. Recent examples illustrate the dangers faced by firms that are unaware of (or uninterested in) the pay or the conditions of their value chain¹¹⁶. Value chains can be both transparent and competitive as demonstrated by one of the fastest-growing certified coffee import firms in North America¹¹⁷. Transparency and sustainability are intertwined.

3.2 Assessing the costs and benefits of different certification schemes

Increasingly, producers have their coffee certified to two or three different standards. Roasters and major retailers in North America as well as Europe have shown an increasing trend toward multiple certifications for a single product¹¹⁸. Today, the majority of both organic and fair-trade coffees in the market carry at least one other certification. The implications of meeting multiple standards can be substantial for any producer. In addition to learning the individual requirements of the different standards, they may necessitate following somewhat different practices and also keeping separate sets of records. In some cases additional financial resources are required in order to invest in meeting the standards. The benefits they receive may be both tangible and intangible and can vary significantly between standards.

Several of the certification programmes, encourage and even require farmers to meet basic good management methods such as keeping records, adopting lower-cost integrated pest management, or resource and water conservation strategies. Though the evidence is only anecdotal, some certifiers note that this appears to provide some efficiency benefits at the farm level that can supplement an actual premium.

¹¹⁶ US government resolution of child slavery in the cacao industry, Wal-Mart and JCPenney garment industry "sweatshop" scandals, Nike Inc.'s stock value decline resulting from consumer awareness of pay and working conditions in their contracted footwear factories. See also: Klein, N. (2000); Utting, P. (2005)

¹¹⁷ Firm is ranked in Inc. Magazine's "Inc. 5000", that lists the fastest growing companies in America. See <http://sustainableharvest.com/mba>

¹¹⁸ Busch, L. and Loconto, A. (2007); Giovannucci, D. and Koekoek, F.J. (2003); Busch, L. and Bain, C. (2004)

A recently launched effort under the auspices of 20 institutions¹¹⁹ has developed a useful method for measuring, at the farm level, the costs and benefits of any sustainability initiatives. This work carried out by the Committee on Sustainability Assessment (COSA) is now being piloted in Africa and Latin America. For producers, it provides relevant information on the expected financial and time investments so they can both select and manage any sustainable practices they choose in a more cost-effective manner. Traders and the rest of the industry benefit since sustainable management can help to achieve stability and consistency in farm output. For policy-makers, COSA methods offer clear and objective information on how different sustainable practices actually impact producers and their communities. Even the sustainability initiatives or standards bodies themselves benefit since they need to understand the impacts of their methods at the farm level¹²⁰.

4. MARKET PROSPECTS

In recent years, there has been strong growth in the demand for certified coffee. Some certification labels are gaining credibility, generating substantial revenues for producers, and rapidly entering the mainstream¹²¹. While the conventional coffee market shows little or no growth in North America, the market for certified coffees has been growing at double digit rates since the turn-of-the-century. Of course, the volumes are still smaller for certified coffees so large growth rates are slightly less significant. Nevertheless, an average for the three-year period 2004-2006 shows consistently higher growth for certified coffees than for either conventional or specialty and gourmet coffees (Table 20).

North America's growth pattern resembles tendencies in other developed markets including much of Europe and Japan. Giovannucci and Koekoek (2003) note that growth for certified coffees has historically occurred in either small-scale or alternative trade channels whose intrinsic reach would limit the expansion of certified products. Increasing consumer demand in recent years has stimulated most mainstream retailers to devote more space to sustainable products.

Today, highly visible retail food service chains (i.e. Starbucks and McDonald's) and mainstream supermarkets (i.e. Wal-Mart, Kroger, Safeway and Loblaws) are the twin drivers for the fast-growing consumption of certified sustainable products. These firms seek to both differentiate their offerings and meet emerging demand while improving their positioning as socially responsible corporations. These market channels have provided considerable opportunities for certified producers and yet could pose severe challenges as well.

Table 20. Growth rate of distinct coffee industry segments

| | Global % | USA % |
|---------------------|----------|-------|
| Conventional | 1-2 | 0-1 |
| Gourmet (specialty) | 5-10 | 10-15 |
| Organic | 13-17 | 38 |
| Fair-trade | 46 | 41 |
| Rainforest Alliance | 106 | 120 |
| Utz certified | 31 | + |

Source: Giovannucci calculations based on USDA, SCAA, FLO, TransFair USA, Giovannucci, CIMS, Utz Certified, Rainforest Alliance

When large firms manage considerable proportions of the volume, even minor changes in their purchasing choices can have a significant impact on what is still a relatively small segment of the market. Certified markets are still relatively thin in terms of the number

¹¹⁹ The Sustainable Coffee Partnership at: www.iisd.org/markets/policy/scp.asp

¹²⁰ www.iisd.org/standards/cosa.asp

¹²¹ World Bank (2004). And also in Giovannucci, D. and Ponte, S. (2005)

of buyers and therefore can be volatile. This does not match well with the much longer timeframe of producers who typically have to work for one to three years to complete a certification process.

Industry projections for the North American market suggest continued but more modest growth in 2007 and 2008. Double-certified coffees such as organic + fair-trade are likely to continue their strong growth since they are widely accepted by consumers and broadly distributed. About three-fourths of fair-trade coffee in the United States and half in Canada and the rest of the world is also certified organic with this trend likely to continue or even increase. Similarly, a large proportion of organic coffee commonly also carries another certification with fair-trade being the most common. Imports of organic coffee into North America are forecast to reach about 35 000 metric tonnes in 2007¹²². The Coffee Guide forecasts global imports to range between 60 000 metric tonnes and 66 000 metric tonnes in 2007¹²³ while Giovannucci estimates over 70 000 metric tonnes. The growth of single-certified fair-trade coffee sales is also expected to slow somewhat from its pace in recent years. Sales of RA-certified coffee are projected to grow, though less quickly than in the past, with 2007 global estimates exceeding 2006 numbers by just over 50 percent and overall volume exceeding 40 000 metric tonnes. Utz Certified coffee, which has a relatively modest presence in North America, is expected to grow well in 2007 though on a small base as global sales reach approximately 50 000 metric tonnes.

Quality continues to be a key factor for growth in the North American market for certified organic, BF and fair-trade coffees. With the advent of much larger buyers, several certification schemes have attracted much larger producers as well. The less demanding standards can provide large volumes at lower costs for buyers, and are facilitating the creation of more mainstream commercial partnerships between producers, traders and large buyers. There are also company codes (not certification schemes) that intend to provide the most basic social and environmental standards to the industry, though none have yet been visible in North America¹²⁴.

There are concerns for the consumer perception of different sustainability labels on products. Some of the concerns focus on the possible difficulty of making distinctions between them though currently few are advertised and no problem has yet emerged. Other concerns center around the potential advertising of a label when the product may contain only small quantities of sustainably-grown coffee. The organic label is the only one that is regulated in North America (this is pending in Canada) and requires a very high percentage (>95 percent) of certified organic product before the term can be used on the label.

Many growers are adapting their production methods in order to take advantage of these emerging market segments¹²⁵. More than 20 million families rely on coffee for their livelihood and between one and two million farms participate in the different certified programmes. Many are small-scale family farms that produce over 70 percent of the world's coffee¹²⁶.

Differentiated and value-based products offer a way for producer countries to participate in the highly competitive international coffee market. According to a World Bank report by

¹²² Projections from Giovannucci.

¹²³ World Market for Organic Coffee, *The Coffee Guide*, 03.02.11

¹²⁴ The Common Code for the Coffee Community (4C) is the most visible such code. It encourages basic good agricultural and management methods and includes minimum social and environmental standards.

¹²⁵ Bacon, C. (2005)

¹²⁶ Oxfam (2001)

Lewin, Giovannucci and Varangis, a competitive market position based on processes that are more difficult to duplicate, such as certified coffees, is potentially a more viable long-term strategy for coffee producers:

Differentiation can present a feasible competitive platform, especially for countries lacking the necessary factors to be competitive as bulk raw material producers. Such process-oriented strategies lend themselves well to many of the poorer producing countries and present a rare opportunity for rural smallholders to participate in global markets while also safeguarding their natural resources¹²⁷.

Nevertheless, it is important to note that this segment of the market is also becoming increasingly competitive as it grows. Being certified is important for many growers but it is not enough. Success depends on also having good quality, consistency and effective marketing relationships.

¹²⁷ World Bank (Lewin, B., Giovannucci, D. and Varangis, P., 2004. p.13)