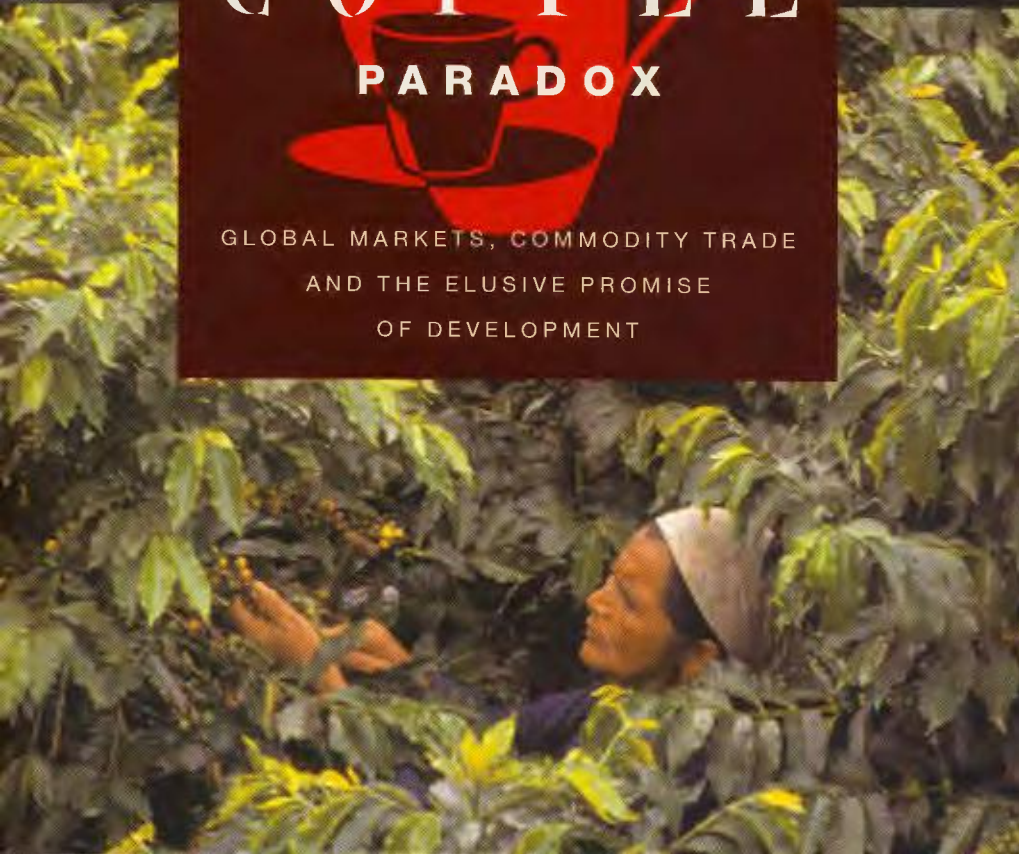


BENOIT DAVIRON
STEFANO PONTE



THE
COFFEE
PARADOX

GLOBAL MARKETS, COMMODITY TRADE
AND THE ELUSIVE PROMISE
OF DEVELOPMENT



About this book

Can developing countries trade their way out of poverty? International trade has grown dramatically in the last two decades in the global economy, and trade is an important source of revenue in developing countries. Yet, many low-income countries have been producing and exporting tropical commodities for a long time. They are still poor. This book is a major analytical contribution to understanding commodity production and trade, as well as putting forward policy-relevant suggestions for 'solving' the commodity problem.

Through the study of the global value chain for coffee, the authors recast the 'development problem' for countries relying on commodity exports in entirely new ways. They do so by analysing the so-called coffee paradox – the coexistence of a 'coffee boom' in consuming countries and of a 'coffee crisis' in producing countries. New consumption patterns have emerged with the growing importance of specialty, fair trade and other 'sustainable' coffees. In consuming countries, coffee has become a fashionable drink and coffee bar chains have expanded rapidly. At the same time, international coffee prices have fallen dramatically and producers receive the lowest prices in decades.

This book shows that the coffee paradox exists because what farmers sell and what consumers buy are becoming increasingly 'different' coffees. It is not material quality that contemporary coffee consumers pay for, but mostly symbolic quality and in-person services. As long as coffee farmers and their organizations do not control at least parts of this 'immaterial' production, they will keep receiving low prices. *The Coffee Paradox* seeks ways out from this situation by addressing some key questions: What kinds of quality attributes are combined in a coffee cup or coffee package? Who is producing these attributes? How can part of these attributes be produced by developing country farmers? To what extent are specialty and sustainable coffees achieving these objectives?

About the authors


Benoit Daviron is a French economist at the Centre de coopération internationale en recherche agronomique pour le développement (CIRAD), in Montpellier. He has published widely on issues of food policy, trade in foodstuffs, as well as tropical commodity chains, international agreements and agriculture in developing countries. He has been a Visiting Scholar at the University of California, Berkeley.

Stefano Ponte is Senior Researcher at the Danish Institute for International Studies, Copenhagen. He is co-author (with Peter Gibbon) of *Trading Down: Africa, Value Chains and the Global Economy* (Temple University Press, 2005) and author of *Farmers and Markets in Tanzania: How Policy Reforms Affect Rural Livelihoods in Africa* (James Currey, 2002). He has published extensively on commodity trade (especially coffee) and development, global value chains, the political economy of standards, agro-food markets, and rural livelihoods in developing countries.

The Coffee Paradox

Global markets, commodity trade and
the elusive promise of development

Benoit Daviron **and** Stefano Ponte

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Abbreviations

AAFN	alternative agro-food network
ABA	American Birding Association
ACE	Alliance of Coffee Excellence
ACP	Africa–Caribbean–Pacific (countries)
ACPC	Association of Coffee Producer Countries
AOC	Appellation d’Origine Contrôlée
ATO	alternative trade organization
CAFE	Coffee and Farmer Equity Practices Programme
CAP	Common Agricultural Policy
CBK	Coffee Board of Kenya
CDR	Centre for Development Research (Copenhagen)
CEPCO	Coordinadora Estatal de Productores de Café (Oaxaca, Mexico)
CFC	Common Fund for Commodities
cif	cost, insurance, freight (as being included in the price)
CIRAD	Centre de Coopération Internationale en Recherche Agronomique pour le Développement
CMB	Coffee Marketing Board
CQI	Coffee Quality Institute
CQP	Coffee Quality Improvement Programme
CSCE	(New York) Coffee, Sugar and Cocoa Market
CTA	Coffee and Tea Authority (Ethiopia)
DFID	Department for International Development (UK)
DOC	Denominazione di Origine Controllata
ECEA	Ethiopian Coffee Exporters Association
EPZ	export-processing zone
EU	European Union
EUREP–GAP	European Retailer Group Good Agricultural Practices
FAO	Food and Agriculture Organization
Fedecafé	Federación Nacional de Cafeteros de Colombia
FLO	Fair Trade Labelling Organizations International

fob	free on board (cost exclusive of freight and insurance)
GATT	General Agreement on Tariffs and Trade
GCC	global commodity chain
GDP	gross domestic product
GLAF	Globalization and Economic Restructuring in Africa
GVC	global value chain
HACCP	Hazard Analysis and Critical Control Point
IBC	Instituto Brasileiro do Café
ICA	international coffee agreement
ICO	International Coffee Organization
IFAD	International Fund for Agricultural Development
IFOAM	International Federation of Organic Agriculture Movements
IGO	indication of geographical origin
IIED	International Institute for Environment and Development
IISD	International Institute for Sustainable Development
IMF	International Monetary Fund
INAO	Institut National des Appellations d'Origine
IRSG	International Rubber Study Group
ISEAL	International Social and Environmental Accreditation and Labelling
ITC	International Trade Centre
ITL	Italian lira
KPCU	Kenya Planters Cooperative Union
LDC	least-developed country
LIFFE	London International Financial Futures and Options Exchange
MNC	multinational corporation
NGO	non-governmental organization
NIC	newly industrialized country
NOP	National Organic Program (US)
NYBOT	New York Board of Trade
OCA	Organic Coffee Association
OECD	Organization for Economic Cooperation and Development
OFPA	Organic Foods Production Act (US)
OTA	Organic Trade Association
PDO	Protected Designation of Origin
PGI	Protected Geographical Indication
PSP	preferred supplier program
SAI	Sustainable Agriculture Initiative
SCI	Sustainable Coffee Initiative
SCAA	Specialty Coffee Association of America

SCCF	Sustainable Coffee Cooperation Forum
SMBC	Smithsonian Migratory Bird Center
SMI	supplier-managed inventory (system)
SMR	Standard Malaysian Rubber
STABEX	Stabilization of Export Earnings
TCB	Tanzania Coffee Board
TRIPs	trade-related intellectual property rights
UCDA	Uganda Coffee Development Authority
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
US	United States
USAID	United States Agency for International Development
USDA	United States Department of Agriculture
WHO	World Health Organization
WTO	World Trade Organization

To Zeno William

Preface

Every day, about 2.25 billion cups of coffee are consumed in the world (Dicum and Luttinger 1999: ix). Yet the act and symbolic associations of coffee drinking are not the same as they were twenty years ago. New consumption patterns have emerged with the growing importance of specialty, fair trade, organic and even ‘bird-friendly’ coffees. Coffee bar and café chains have spread dramatically, although the relative coffee content of the final consumption ‘experience’ in these outlets is extremely low. Café chains sell an ambience and a social positioning more than just ‘good’ coffee. The coffee market has gone through a ‘latte revolution’, where consumers can choose from (and pay dearly for) hundreds of combinations of coffee variety, origin, brewing and grinding methods, flavouring, packaging, ‘social content’, and ambience. Retail coffee prices continue to rise in the specialty market, and even in the mainstream market they have not decreased nearly as much as international coffee prices have. Roasters capture increasing profit margins. At the same time, coffee farmers receive prices below the cost of production.

The global value chain for coffee¹ is currently characterized by a ‘coffee paradox’: a ‘coffee boom’ in consuming countries and a ‘coffee crisis’ in producing countries. A paradox within this paradox is that the international coffee market is awash in coffee of ‘low quality’, while there is a dire shortage of ‘high quality’ coffee – and it is the latter that is generating sales growth. How can we explain such divergent dynamics?

Some analysts have depicted the current market situation in terms of the law of demand and supply: there is simply too much coffee in the global market. They argue that chronic oversupply – facilitated by the breakdown of the International Coffee Agreement in 1989 – arose from increased production in Brazil and Vietnam. Other analysts have

explained the coffee crisis in terms of market power. They argue that the growing gap between the price of the raw material (the coffee bean) and the final product is the result of oligopolistic rents captured by an increasingly concentrated roasting industry.

In this book, we propose an explanatory framework that considers market power not simply on the basis of controlling market share, but also in relation to the ability to define the 'identity' of a coffee – in other words the ability to set the language and the reference values that determine production norms and quality standards. We argue that the coffee boom in consuming countries and the coffee crisis in producing countries can coexist because the coffee sold on the international market and the coffee sold as a final product to the consumer are becoming increasingly 'different'. This happens because it is not the *material quality* 'content' that roasters, retailers and cafés are selling, but mainly *symbolic* and *in-person service quality* attributes. As long as coffee farmers and their organizations do not control at least parts of this 'immaterial' production, they will be confined to the 'commodity problem' – even though coffee may be moving away from 'commodity status' in consuming countries.

Rather than conceptualizing coffee in different markets as beans 'more or less roasted', we propose to treat coffee as the sum of attributes produced in different geographical locations and by different actors along the value chain. Thus 'market power' is a question not only of market share but also of capturing the most valuable attributes while undermining the value of the attributes that need to be purchased.

A new consensus is emerging in both the North and the South among donor communities, policy makers, academics, and even some civil society groups – developing countries should 'trade their way out of poverty'. If tariff barriers were removed, market access would improve. If we stopped subsidizing developed country farmers, poor farmers in the South would benefit. If technical assistance was provided, non-tariff barriers such as food safety standards would be overcome. If only trade rules were fair, poverty in the world would be reduced. If producers in the South were included in global value chains, they would learn from their buyers and upgrade. There is a grain of truth in each of these statements, and some problematic aspects. For decades (and sometimes centuries) low-income countries have been producing and exporting tropical commodities, such as

coffee, that encountered small tariff and non-tariff barriers, little or no competition from farmers in the North, and have been part of global value chains. They are still poor.

International trade has indeed grown dramatically in the last two decades in the global economy, and trade is an important source of revenue in developing countries. These countries are estimated to generate more than thirty times more revenue *per capita* from exports than they receive in aid – and aid flows are decreasing (Oxfam 2002a: 47; OECD/DAC database). Yet most low-income countries still depend heavily on exports of primary commodities – which have lagged behind the growth of global income. As a result, low-income countries account for only 3 per cent of income generated through exports in the global economy (UNCTAD 2002).

Coffee is produced in more than 50 developing countries and involves several million small farmers. Historically, coffee exports have been linked to several development ‘success stories’: Brazil at the end of the nineteenth century, Colombia and Costa Rica in the 1920s, Kenya and Côte d’Ivoire in the 1960s and early 1970s. Some of these stories have been time-bound, others have provided the basis upon which further growth and diversification occurred. In many other stories, the promise of development has been elusive. Furthermore, there has been no equivalent success story in recent decades.² In the governance of the global value chain for coffee, producing countries used to play an important role. Since the late 1980s, this has not been the case. Governance is firmly in the hands of actors based in the consuming countries of the North, especially roasters.

The key issue is not that these producing countries are not trading, but rather that they are not gaining much from trade. In other words, these countries are stuck in a commodity problem that has made development an elusive target. They produce similar agricultural products and labour-intensive manufactures that are flooding global markets and depressing prices. The classical questions that have been asked in relation to solving the commodity problem are: Can the gains from commodity exports be increased? Otherwise, how can low-income countries break away from relying on exports of primary commodities?

These pertinent questions have been at the centre of commodity trade analyses for at least half a century. In this book, we seek a shift in

emphasis. We argue that the promise of development is an elusive one partly because global value chains are increasingly driven by large actors based in the North, and partly because low-income countries are stuck in producing and exporting goods that are valued only for their material quality attributes. Symbolic and in-person service quality attributes which provide higher value-added gains are generated in consuming countries in the North – or by Northern actors. We explain this discrepancy in value through a combination of historical political economy, global value chain analysis, and convention theory.

Throughout the book, we use the terms ‘commodity’ and ‘primary commodity’ interchangeably. Most authors dealing with the relation between commodity exports and development do not actually provide a definition of ‘commodity’, nor do they explain the identity of a commodity as compared to other goods, and particularly to industrial goods. Rather, they use the proxy distinction between agriculture and manufacturing, or primary and secondary sectors, instead. Others, while acknowledging that markets for labour-intensive manufactures behave like the ones for agricultural products, and that high-value fresh produce value chains are substantially different from, for example, the cocoa value chain, still have a process-based definition of commodity. In our approach, commodities are goods with a world market where most participants and transactors use the same standards to discover the same quality attributes, and for the most part only measurable attributes. At the extreme, these are goods where transactions are organized around a single global quality standard. In much of the literature, standards are determined by technology and the constraints and opportunities it generates. The history of agricultural markets suggests the opposite: standards are created to allow the existence of market transactions; they also impose their constraint on downstream transformation processes.

This kind of approach has implications in terms of what we do not cover in this book. Many of the contributions on the commodity problem and/or the coffee crisis have placed emphasis on the impact of low international prices on the livelihoods of producers in the South. That decreasing commodity prices have had a severe impact on farmers and their communities is without dispute, and has been accepted by the mainstream agro-food industry as well. Therefore, it is not our intention to focus on producer livelihoods, although we do not intend

to undermine the significance of this topic. Our main aim in this book is to use the case study of coffee to recast the development problem for countries relying on commodity exports. What is the value given by the consumer to different attributes that are combined in a coffee cup or a coffee package? Who is producing these attributes? How can part of these attributes be produced in developing countries? Can developing countries capture the value of in-person service activities at all? To what extent are specialty and sustainable coffees helping achieve these objectives? In other words, what are the upgrading opportunities for developing countries and for small producers within these?

In Chapter 1, we provide a historical background to current debates on the role of commodity trade in promoting and sustaining economic growth and development in the South. First, we lay out a brief history of changes in models of commodity production and trade, starting in the fifteenth century when the long era of slave plantations began. Within this discussion, we pay particular attention to the role played by standards in creating ‘commodity markets’. Second, we review the academic and policy debates on commodity trade and development. Once we have highlighted the limitations of these debates, we introduce the global value chain (GVC) framework, which is the main analytical tool used in this book. Finally, we develop a typology of quality based on material, symbolic and in-person service attributes that helps in unpacking issues of governance and the distribution of value-added increments along global value chains.

In Chapter 2, we start analysing the coffee industry. First, we provide a brief overview of how coffee flows from producer to consumer – including its material transformations. Second, we analyse historical trends in production and exports. Third, we examine various systems of coffee labour mobilization and organization of production. Fourth, we analyse a succession of different forms of market organization, including their constitutive elements such as contracts, grades and standards. Finally, we examine changes in retail and consumption patterns, focusing in particular on the *latte* revolution that has taken place in the last 25 years with the emergence of the specialty coffee industry.

In Chapter 3, we examine issues of regulation and governance in coffee value chains. In the first two sections, we analyse these issues in relation to the global value chain for coffee, following two broad

periods: (1) the period before 1989, when producing countries had influence in its regulation and governance – first through the dominance of Brazil, and later through international regulation in the form of international coffee agreements (ICAs); and (2) the period following the demise of ICAs, when private sector actors based in consuming countries (especially roasters) have become the ‘drivers’ of the global value chain; ICAs still exist but, as we will see, have no regulatory ‘bite’. In this context, particular attention is paid to the corporate strategies of key actors, especially large roasters. In the third section of this chapter, we provide in-depth case studies of regulatory changes in coffee value chains originating in four East African countries (Ethiopia, Kenya, Tanzania and Uganda). These countries have liberalized their domestic markets to different extents and with different trajectories, leading to different local outcomes of global transformation. In the final section of this chapter, we look at international coffee prices in a historical perspective. We show that the historical cycle of coffee booms and busts has become much less pronounced since the 1970s – and thus that the current coffee crisis is quite different from those in the 1930s and the 1960s. We also show that changes in the ownership of coffee stocks (and their different degrees of availability) have much to say about the current crisis, which is characterized for the first time in history by low international prices *and* low levels of stocks.

In Chapter 4, we apply the analytical framework provided in Chapter 1 to coffee quality. We follow coffee quality from farm to cup, not only in its material attributes, but also in its symbolic and in-person service attributes. As in Chapter 3, the focus in terms of producing countries is on East Africa. In consuming countries, we cover both mainstream and specialty markets. Because types and patterns of consumption vary from country to country, more detailed information is provided in relation to the US and Italy.

In Chapter 5, we examine the new frontier of coffee quality: sustainability. Sustainability certifications, codes of conduct, and sourcing guidelines are multiplying and becoming mainstream. They are extending the content of symbolic quality attributes beyond brand, ambience of consumption and packaging design (among others) by embedding environmental and socio-economic preoccupations in the description of coffee. They are also re-framing governance, away from state-controlled processes and towards more hybrid public/private

dynamics, if not outright private ones. First, we evaluate the impact on supposed beneficiaries of four groups of coffee certifications: organic, fair trade, shade-grown and Utz Kapeh. Then we analyse private and public/private initiatives in the realm of sustainability, such as the Starbucks Coffee and Farmer Equity Practices (CAFE) Programme and the Common Code for the Coffee Community.

Chapter 6 is structured in two main parts. In the first part, we provide empirical evidence of value distribution along the global value chain for coffee and specific value chains (various combinations of Uganda and Tanzania coffees on the one side, and mainstream retail, bar consumption, and sustainability coffees in the US and Italy on the other). This analysis provides a stark picture of inequalities along coffee value chains. However, singling out what attributes are valued at what points of value chains also helps to identify possible solutions to the commodity problem. We examine the more theoretical underpinnings of these solutions in the second part of this chapter. Four aspects are covered in some depth: (1) the role of quality conventions in changing the governance of value chains; (2) whether the purported transparency of alternative commodity networks helps producers; (3) territoriality as a vehicle for linking responsibility with specific places; and (4) the potential and real roles of consumers and retailers in stimulating social change.

We lay out the more practical and policy-oriented aspects of solving the commodity problem in Chapter 7. We first examine what regulation can and cannot do for producers given the changes in governance of value chains that have taken place in the last 25 years. We also critique business- and donor-oriented solutions to the coffee crisis that have been proposed thus far. Second, we provide an eclectic menu of possible solutions, with specific focus on unorthodox approaches that have received less attention in policy circles so far: (1) how to improve sustainability initiatives so that they really benefit producers; (2) how to facilitate producers' control of symbolic quality attributes through indication of geographic origin (IGO) systems; and (3) how to 'make hedonism work for the South'. While these approaches, at first sight, seem to relate mostly to niche markets, we will show that they have broad implications for the future of mainstream markets as well.

Benoit Daviron's contribution to this book is the product of two decades of research and study dedicated to coffee and other tropical

commodities. Most of this time has been spent as a researcher at the Centre de Coopération International en Recherche Agronomique pour le Développement (CIRAD), Montpellier. Some of the ideas and arguments presented in this book have been discussed with several CIRAD colleagues, more specifically with Tancrede Voituriez and Bruno Losch, and with François Lerin from the Institut Agronomique Méditerranéen. He would like to thank them for their support and friendship. Benoit started some of the background work for this book during a one-year stay as a visiting scholar at the University of California, Berkeley. He is grateful to Alain de Janvry for his kindness and hospitality. He would also like to thank Vinod Aggarwal, Peter Evans and Andrew Janos for the stimulating seminars they offered during this time.

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