SMALL-SCALE FARMERS IN DEVELOPING COUNTRIES FACING GLOBALIZING MARKETS: IMPORTANCE OF LABELLING FAIR-TRADE COFFEE

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Abstract

During the last years the price of green coffee beans has fallen dramatically. The local producers in developing countries are the hardest hit. Especially the small-scale farmers and farm-workers are prone to remain in poverty. Up to now, they remain restricted from any benefits of globalization and trade liberalization. The supply chain of coffee is dominated by a few multinationals. The farmers have very limited bargaining power, and are price-takers. Moreover, their lack of access to inputs, markets and information limit their possibilities to diversify out of production of traditional crops as coffee. Fair-trade organization attempt to contribute to the livelihood of farmers by guaranteeing them a fair price for coffee beans. Although, fair-trade labelled coffee is still a niche market, the consumption is steadily growing. In particular more and more supermarkets sell fair-trade and/or organically-grown coffees. This article presents a description of the fair-trade coffee market. It is argued that fair-trade labels present a new market channel for small-scale farmers. We furthermore discuss how multinationals do not favour this active market intervention. The large coffee roasters argue that active support distorts the market even more.

Keywords: fair-trade, coffee, globalization, labels, institutional innovation
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1. Introduction

The fight against rural poverty over the world is daunting and it is tempting to agree with Al-Sultan, who has written in IFAD (2001) that poverty is a tragic aspect of human society that was in the past accepted with a sense of fatality. Yet it is hard to ignore the tragic fate of the 1.2 billion people worldwide that are living in (dollar)poverty (IFAD, 2001).

This article aims to investigate the possible role of agriculture with regard to poverty alleviation and development. It focuses more specifically on the problem of numerous smallholder farming families engaged in traditional crops such as coffee who currently fail to get access to well and fair functioning market services and as a result remain caught in poverty.

Economists have tried to identify universally effective policies to promote and sustain development, but in reality the developing countries differ to such an extent that it is not clear that a single best strategy exists (Adelman, 2001). Yet, rural poverty remains pervasive. The result is that numerous ideas about rural development and ways to alleviate poverty exist, while the role of smallholder agriculture has also been exhaustively studied (Delgado, 1999).

The role of agriculture balances between the provision of food and the production of products marketed locally or internationally. The production of food and cash products competes for the use of factor inputs, including labour, land and capital. The importance of the agricultural sector in a developing economy goes beyond food production for self-subsistence. On a macro-economic level, agriculture should be considered as an income-generating sector. Thus, a change in the scope of the potential contribution of agriculture and increased access to input and output markets is central to strategies for the development of this sector. To this end, the farms will have to commercialise and integrate even more into the economy.

Recent thinking on development and strategies to better exploit the comparative advantages in the agricultural sector are highly influenced by the trends towards globalisation and liberalisation (Maxwell & Heber-Percy, 2001). Yet, globalisation withholds new constraints and challenges for the farmers, whereby the degree to which the small-scale farmer can get access to the new markets is central.

Beside natural shocks such as drought and price risks related to poor roads and communication infrastructure, also the lack of economic coordination and opportunism pose serious risks to those involved in the rural economy. Economic players face serious coordination risks when investing in the supply chain, they can go bankrupt if other players refuse to make complementary investments. The risk of opportunism involves unethical self-interest seeking, such as selective or distorted information disclosure and occurs especially if there are weak institutions protecting contractors. There are numerous examples of traders taking advantage of the lack of price information to cheat farmers and of farmers who break the contract with the trader when they can get a higher price from another one. Those risks are not easily overcome through the market mechanism (Vannoppen, 2003). The supply chain of traditional crops as coffee and tea is to a high degree controlled by a limited number of multinationals, which will determine the price paid to the farmers. Yet small scale farmers have a more difficult access to this information.

Supporters of fair-trade organizations advocate that free trade pricing is unfair to producers in developing countries due to asymmetric information and differences in bargaining power. A fair-trade label can provide the producers with access to a better market (Leclair, 2002). Fair-trade has its origin in the 1950s, when trade was promoted to support war-hit regions. Trade of fairly priced products from developing countries increased since the UNCTAD conference of 1968 with the initiation of a "Trade not Aid" philosophy. This was a motivation for NGOs as SOS Wereldhandel (the Netherlands) and OXFAM (UK) to develop a fair-trade campaign (Solagral, 2002).

This article discusses the importance of fair-trade labels in the coffee market. The international coffee trade is since 1997 in a deep crisis. The green bean price on the auction in 2002 was down to a third of what it was in 1997 (the underlying reasons are described in more detail in the next section). The drop in prices is hardly hitting coffee producers in many developing countries. Especially the small-scale producers and workers on large plantations are prone to remain in poverty. They are price-takers, and therefore strongly dependent on what is paid by multinationals controlling the supply chain. The first fair-trade label for coffee was launched in 1988. Since, fair-trade coffee is available in over 19 countries worldwide (Rice & McLean, 1999).

Yet, not all stakeholders in the supply chain of coffee are convinced of the potential of fair-trade labels to alleviate poverty. Some argue that a free market system is the only way to restore the balance in the market. This article discusses the tension between a free market system and the promoted market access and focuses on the significance of labels for coffee. We argue that fair-trade labels mainly provide a solution mitigating the information asymmetry between the farmer and the consumer. The organisations issuing the labels present a new market access to the farmers, by proposing new institutional arrangements, and contracts between the producers and the coffee traders.

The article proceeds as follows. The next section gives an overview of the problems of small-scale coffee producers in the international market. The section thereafter discusses the importance of fair-trade labels to mitigate market failures. Following that, the significance of institutional innovation in a liberalized market is discussed. Finally, we present conclusions.

2. Problem Statement

It is a well-known fact that small-scale coffee farmers in developing countries have recently been faced with serious problems on the international market. While the consumption of coffee has increased steadily at an annual rate of about 1.5%, the prices on the world market have been on a decline. With its yearly fluctuation, the real price in 2003 decreased to nearly a quarter of what it was in 1960. This is mainly caused by a great oversupply of coffee beans on the international market by its largest producers i.e. Brazil, Colombia and Vietnam (Chalmin, 2003). More specifically, Technoserve (2003) clearly distincts three main factors driving the constant decline of prices for green beans on the world market. The first factor is the innovation of coffee production in Brazil with a move of the production to less frost-prone areas, along with an increased use of irrigation and mechanical harvesting. The government supported the production by providing price forecasting and risk management. Furthermore, productivity, coordination and market responsiveness have improved throughout the supply chain. Second factor is the entry of Vietnam on the coffee market. Its production at low labour cost has increased dramatically in particular in the last decade following the advice of the IMF. The Vietnamese government has been promoting the production of coffee by provision of yield improvement and market information. A third factor is the increasing production and use of Robusta. This is mainly as a result of innovations in the use of Robusta in blends as new ways were found to reduce its acid taste. Robusta is increasingly used in popular flavoured coffees and is increasingly sold in price sensitive countries.

The coffee supply chain is a complicated web whereby the producer, mainly small-scale producers or large farms employing many wage workers, is a long way down the chain from the end-consumer (see Figure 1). This means that the end-consumers and producers seldom meet. Another factor is the high degree of transformation involved. Coffee is merely sold in blends. Both issues pose a particular problem in terms of information asymmetry between producers and consumers. A coffee drinker does often not know from which kind of coffee beans his drink is made from. The information on where the beans exactly come from and how they were produced is merely anecdotal. The producer supplies a raw product with little room of manoeuvre to respond to market demands. The producer does not respond to a direct demand of the consumer, also because it takes 3 years before new trees start to produce fruit. Furthermore, coffee cherries have to be picked yearly for maintaining the trees healthy, regardless of the market price (Technoserve, 2003).

As shown in Figure 1, many traders (including the domestic traders, exporters, international traders, brokers, retailers and restaurant holders) are involved in the supply chain. Each of them will charge a trade margin. Worldwide the coffee supply chain is controlled by four multinationals that dominate the transformation and marketing of coffees, namely Kraft (13%), Nestle (13%), Sara Lee (10%) and Procter & Gamble (4%). In sum the four companies control over 40% all coffee bought (Koffiecoalitie). It can be argued that market liberalization leaves the farmers even more powerless down the supply chain, as they can not anymore rely on the guaranteed sales to the marketing boards. While the disappearance of the marketing boards, and further globalization of the coffee market should provide for new incentives, the distribution of generated income between producing and consuming countries has become even more unequal, unstable and informal (Ponte, 2002). The development of labels could therefore provide new opportunities for the farmers and even promote new institutional arrangements ((a) amongst the farmers to increase the collective action, and (b) within the supply chain).

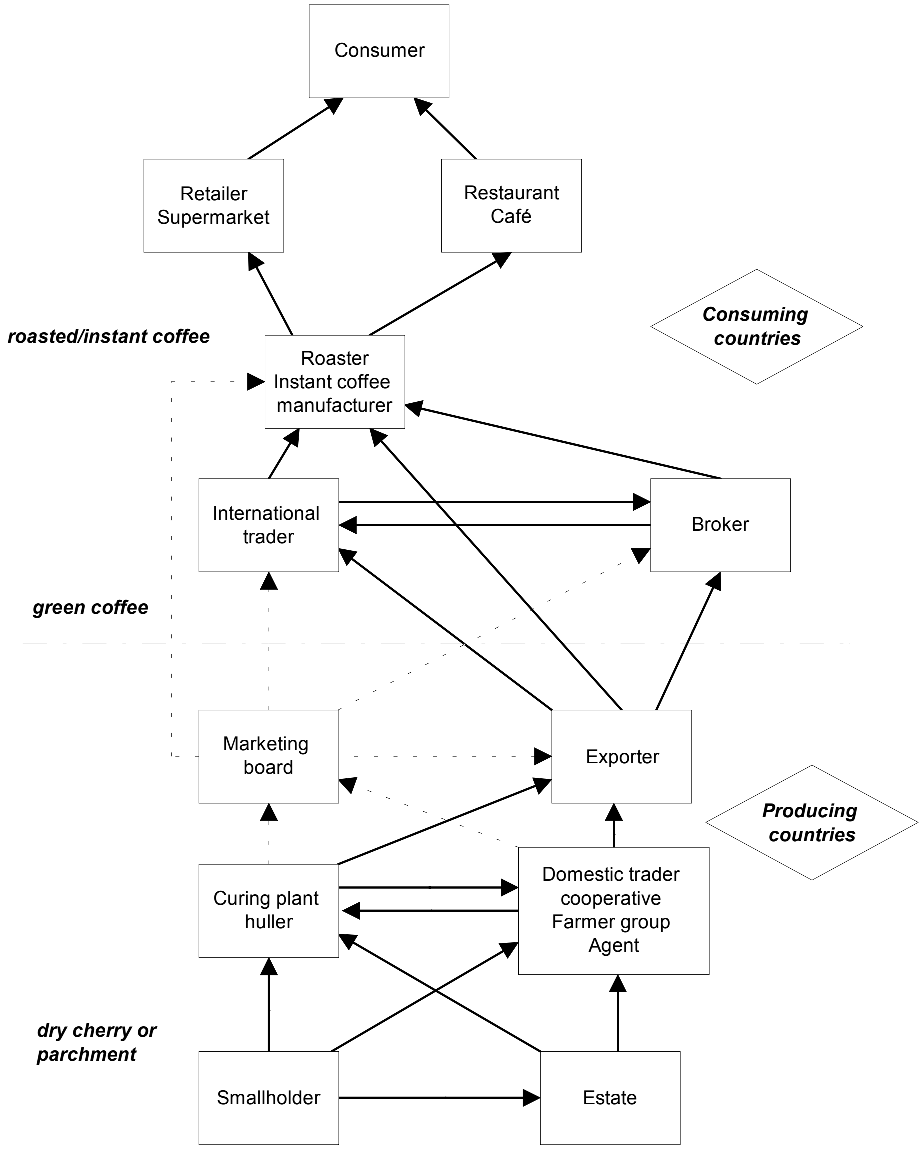

Figure 1. Supply chain of coffee; the dotted arrows links are disappearing with market liberalization (Source: Ponte, 2002)

Although the consumption of fair-trade coffee is increasing, it remains a small market segment. Giovannucci and Koekoek (2003) estimate that the consumers in eleven major European coffee markets combined use more than 15.4 million kilograms of certified fair-trade and 11.2 million kilograms of certified organic coffees in 2001. Of these, 5.3 million kilograms were double certified as both fair-trade and organic. Sustainable coffees (grouping fair-trade, organic and eco-friendly coffees) represent on average less than 2% of the consumption in developed markets. There is a large distribution noticeable between these 11 major European coffee markets, with the share of sustainable coffees in consumption ranging from 0.3% up to 3.4%.

As the origin of the coffee is not often mentioned, the low price received by the producer is not a major concern for the Western consumer. Browne et al. (2002) describe a degree of ethicalness, identifying this small group of ethical consumers (2%) as those consumers who will go out of their way to buy on a cause related basis. Semi-ethical or armchair-ethical-consumers (20-30%) will buy a fair-trade product if it is available in the supermarket at a modest price premium; and would-be-ethical (70-80%) consumers are said to choose fair-trade if there is no price premium and no special effort required. Fair-trade does not only assist specific - disadvantaged - groups of producers but also increases the awareness of Western consumers for the low levels of living in developing countries (Leclear, 2002). These ethical consumers are driven by their concerns for poverty, worker exploitation and environmental impacts in developing countries (Browne et al., 2000). The marginal benefits consumers perceive from consuming a fair-trade product is then not only its utility value but also the 'warm glow' of supporting small-scale agriculture (Leclair, 2002). The next section discusses the construction and content of labels to mitigate market failures.

3. Labels to Mitigate Market Failures

The problem statement clearly illustrates the information asymmetries between producers and consumers, as producers have information of which consumers are not aware (Golan et al., 2000; Bougherara & Grolleau, 2002). Consumers have not a precise idea on where the coffee beans come from, and even less on what price was paid to producers in developing countries. Due to the lack of information, consumers can not make an optimal choice, and might buy a product that does not match their preferences. As a result, resources are less efficiently used than in a perfect market (Golan et al., 2000).

To maximize profits a firm can decide to add information to the product. Likewise a government can decide to communicate certain product attributes to consumers, either to correct for missing or imperfect information or to decrease externalities. In both cases, a label placed on the product can help consumers to differentiate the preferred product from similar products. The label provides missing market information on the production process or attributes certifying that the product complies to a set of criteria (Bougherara & Grolleau, 2002). These criteria can be minimum requirements for social, economic and environmental development. A consumer of labelled products is prepared to pay a premium for the extra attributes of these products. Labelling then increases economic efficiency by helping consumers to target expenditures towards products they most want (Golan et al., 2000). For consumers concerned with producers' poverty situation and livelihood a fair-trade label can ascertain them that a fair price was paid for the coffee cherries.

For voluntary labels, developed by an individual or group of firms, it is imperative that the benefits from increased sales of a labelled product outweigh the costs. Issued by the government, mandatory labels will have a social goal, trying to alter people's economic behaviour. Yet both try to target the consumers' behaviour by attracting attention to certain product attributes. Product attributes can be classified into three groups, namely search attributes are giving information on quality the consumer perceives before purchase, by inspecting the product. Consumers attach experience attributes to the product after purchase, while credence attributes are not accurately evaluated. They are better known by the producers than by the consumers, as is the case for environmental or ethical attributes.

Fair-trade labels will increase both search attributes and credence attributes. A third-party assessment is commonly put in place to add to the credibility. The label would form a proxy, while the consumer does not need to search a more direct contact with the producer (Golan et al., 2000; Bougherara & Grolleau, 2002). Fair-trade labels provide an assurance that the product bought is ethically produced and traded. Fair-trade labels have a clear orientation towards people-centred concerns, while for example organic labels have mainly an environmental and animal friendly focus, and are therefore merely bought by consumers concerned for health problems (Browne et al., 2000). It is the commitment of fair-trade organisations that the premium paid by the consumers goes to a better price for the farmer (Browne et al., 2000). Organisations within Fairtrade Labelling Organizations International (FLO) are not actively part of the market as buyer or seller of coffee. The FLO was founded in 1997 as an umbrella organisation for 17 national initiatives. Simultaneously a single fair-trade label was created and an agreement was made on the standards for fair-trade. Generic fair-trade standards are issued for small farmers' organisation and for hired labour on plantations with the aim to ensure that (1) fair-trade benefits reach the small farmers and/or workers; (2) the small farmers' organisations and/or the workers has/have potential for development; and (3) fair-trade instruments can take effect and lead to a development which cannot be achieved otherwise (www.flo.org).

The FLO and national initiatives certify the compliance to the standards throughout the supply chain (Figure 2). The standards for organisations of small-scale producers include rules for (1) social development (e.g. fair trade makes a difference in development; and the organisation should be democratic, participative and transparent); (2) economic development (e.g. the fair-trade premium is to be administered in a way which is transparent for beneficiaries, and members should gradually take on more responsibility over the whole export process); (3) environmental development (e.g. producers are expected to protect the natural environment; to make environment protection a part of farm management; and to implement a Integrated Crop Management system which includes a minimal use of fertilizers and pesticides); and (4) standards on labour conditions. The latter include that following ILO conventions forced labour must not occur, while children may only work if their education is not jeopardised. Workers and employers have the right to establish and to join organisations. Conditions of employment and of working environment should follow ILO standards. Similar codes of practices are issued for hired labour, with a stronger emphasis on social development of the workers (more details are found in FLO, 2001a, 2001b, 2002).

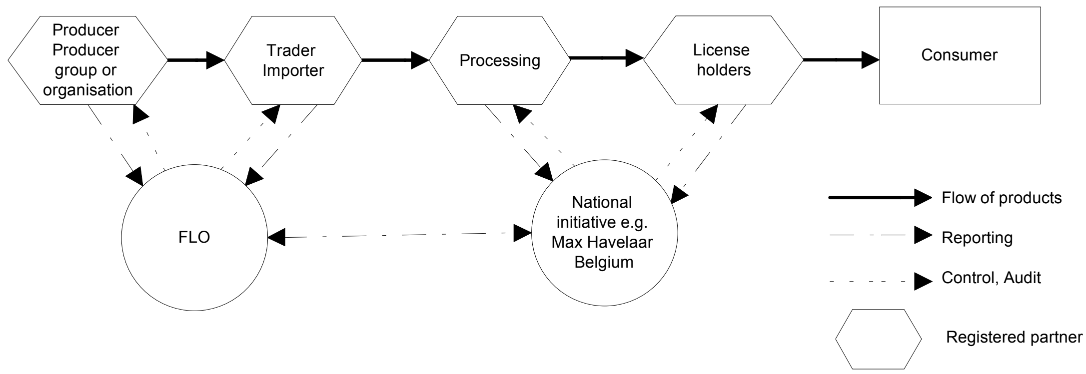

Figure 2. Flow products, reports and control
Source: Max Havelaar (2002)

Also traders, importers and processing industry have to comply to a number of fair-trade standards mainly on the contracts made throughout the chain. Important hereby is that the certified producer organisations are paid a price that covers the production costs: “When by legal regulation, all coffee has to be passed through the auction, importer and exporter will agree upon a reasonable margin for the exporter to cover his costs. Over the New York “C” and London “LCE” established prices, there shall be a fixed premium of 5US$-cents per pound. For certified organic or biological coffee […] an additional premium of 15US$-cents per pound green coffee will be due, on top of the FLO-International price as determinded under point 3.5. To protect the producers, minimum prices have been defined which overrule FLO-International prices as defined under 3.5 when these are lower than the relevant minimum price. The minimum price vary according to the type and origin of the coffee.” (FLO, 2002).

The farmers are not charged any certifying costs, while the FLO and national initiatives as Max Havelaar are financed through the contribution of the licence holders who market the coffee. The control procedures are issued by the FLO, and include three-monthly administrative controls, reports to auditors and visits of local consultants trained by the FLO. The controls are performed throughout the supply chain in collaboration between the national initiatives and the FLO (Max Havelaar, 2002).

About three-quarter million farm-households can beneficiate from premiums for sustainable coffees (Giovannucci & Koekoek, 2003). Studies investigating on the contribution of fair label premiums to the small farmer’s livelihood include Robins and Roberts (1997); Bowfield et al. (1998) and Pretty (1998) cited by Browne et al. (2000). Yet fair-trade coffee is still a niche market. Leclair (2002) concludes that the alternative trade of traditional crops is not important enough to make a difference in supply and demand on the world market. The next section lists arguments pro and contra for active market intervention, and discusses the significance of new institutional arrangements needed to get involved in this conducive market environment.

4. Institutional Innovation in the Labelling Initiatives

4.1 Trade Liberalisation and Institutional Innovation

The Washington Consensus, driven by the Washington based organisations as IMF and World Bank, was all about market liberalisation with a decreasing state intervention. It inspired the WTO negotiations to focus on continued decreasing subsidies and state protection in agricultural markets. The increased international flow of goods was seen as *the* way to increase incomes of farmers world-wide. Potentially, poor countries could benefit from WTO trade rules, e.g. greater predictability, a negotiation forum and a system to tackle trade conflicts based on agreed rules instead of economic or political power (Solignac Lecomte, 2000). Yet, in practice, the WTO trade rules have up to now brought little to the developing countries. Market liberalisation presents many risks, especially for developing countries. The richer countries tend to trade more amongst themselves, while developing countries have a significant smaller trading capacity. Furthermore, industrialized countries continue to subsidize agricultural exports and by doing so depress world market prices for agriculture produce. At the same time, developing countries are denied the right to protect their home markets (Vannoppen, 2003).

Trade liberalisation brings about both opportunities and risks to the poor. The impact of trade liberalization on poverty is subject to great debate among development economists. It is difficult to assess or even predict the impact of freer globalized markets. According to Solignac Lecomte (2000) the potential benefits for the poor include (a) increased availability of, and low prices for imported inputs and consumption goods; (b) greater demand and higher relative prices for goods locally produced by the poor, and for labour from poor households, including traditional exportable goods (e.g. cash crops) and non traditional ones (e.g. labour intensive manufactures); and (c) higher productivity through enhanced technology. Potential costs on the other hand include (a) increased competition with, and potential displacement of, local production of importables, e.g. through depressed prices of locally produced goods; (b) higher prices for imported inputs; and (c) indirect effects, such as tariff cuts eroding the fiscal base, thus resulting in cuts in public social spending.

Solignac Lecomte (2000) further mentions that not opening the markets seldom does the poor any good. Inward-oriented economies have not proven to successfully reduce poverty. Trade creates wealth because it allows individuals, groups or regions to make the most of the access to and the use of inputs (North, 1990). However, low access to production assets, low involvement in international trade and lack of safety nets for eventual costs are found to limit the access of the poor to the benefits of liberalizing markets. Trade reforms can therefore be "made poor-friendly through (a) adequate coordination and sequencing of trade reforms with other economic and social reforms (market regulation, access to entrepreneurs to credit …); (b) general complementary policies to upgrade the capacity of the economy to respond positively to change (education, infrastructure,…); and (c) poverty-focused complementary policies (social safety nets,…)" (Solignac Lecomte, 2000).

In support of a substantial body of literature, Solignac Lecomte (2000) advocates that *ceteris paribus* trade openness has a positive impact on poverty alleviation. However, the catch lies in the *ceteris paribus* which doesn't match with reality. It is therefore proposed that trade liberalisation should be part of a "comprehensive growth strategy". Mauritius for example followed a policy of liberalizing the markets, but added to it some form of selective protectionism. Also the initial conditions of a country's economy will affect the impact of trade liberalisation. In countries with highly unequal income distribution, the rich will benefit relatively more from increased trade than the poor or in other words, it is more easy for the rich to turn the opportunities of trade liberalisation into an advantage.

Agriculture remains an important economic sector in developing countries. In the WCA, small farm systems are regarded principally as an efficient structure to organise labour (Kydd & Dorward, 2001), while the World Development Report 2000/2001 (World Bank, 2000) places emphasis on trade and the role that revenues from increased market participation can play in triggering development, economic growth and poverty reduction (World Bank, 2000). The WCA recognises that globalisation and more open trade arrangements provide new opportunities for production and sales. However, it tends to underestimate the new constraints and problems for the farmer that arise. They therefore promote the production and sales of non-traditional products. Yet small scale farmers have many difficulties in accessing these new markets. They are often forced to keep on producing coffee or tea. Yet it is problematic that they can barely be protected against the fluctuations and decreasing world market prices.

Accessing the new markets, requires both a conducive production and marketing environment. With regard to the former, the farmer needs to acquire enough knowledge and assets to produce the new goods. A change in the production system incurs new risks of fluctuating prices and yields. Yet, the risk-coping capacity of firms in developing countries is low, especially in agriculture. This uncertainty is often a block towards commercialisation (Cook & Chaddad, 2000). Furthermore, international markets impose increased quality requirements and food safety measures. A Belgian supermarket is not easily tempted to sell steaks imported from Zambia or Tanzania. Recently the many food scandal have given rise to very strict laws and regulations on food quality and exact traceability up to the animal. Farmers in developing countries often do not have the knowledge nor the assets necessary to upgrade production to match these requirements. Moreover, many of the constraints are due to a lack of infrastructure, e.g. bad roads, no or unreliable supply of electricity which excludes the use of cold-chains. Also, to sell on any new market farmers face important transaction costs. Transaction costs are implicit costs that arise when trading, and include search and information costs, negotiation costs and monitoring and enforcement costs. The lack of access to information is the result of a self-reinforcing cycle of problems comprising low population densities and poor communication infrastructure which characterises rural areas. These in turn bring about important market failures, resulting in low economic development and ultimately insufficient prospects in improving the infrastructure (Dorward *et al.,* 2002).

4.2. A Fair Market

For the poorest farmers to access the globalizing markets institutional innovation is needed to overcome the constraints mentioned above, i.e. access to a fair market, access to production assets, and safety nets to increase risk-coping capacity. The access to a fair market is more than the physical possibility of selling the product. It is also about finding the traders and create a trust relationship while negotiating prices. The businesses of poor farmers are often too small or to remote from communication services to access to correct market information. Farmers sell on a spot market, whereas private traders can hedge on private commodity markets. The latter reduces price risks significantly, especially for a commodity such as coffee, for which the market is dominated by a limited number of strong brands to which the customers are loyal (Tollens, 2003). Fair trade initiatives can therefore be seen as a trigger for farmers to associate in new networks, in order to collectively market the coffee. As a group they are stronger in negotiating price and contract conditions with traders.

This brings us back to the case study of fair trade labelling in coffee. When a small farmer in a developing country trades coffee on a spot market, this coffee will with high probability not be sorted, not graded into quality classes, nor cleaned for very low quality cherries. The cherries might be poorly handled and packaged, and as a result the farmer will be paid the price of the lowest quality. Traders then bear the costs for post-harvest handling and transport, but also high transaction costs. Traders are uncertain of the quality of the coffee, and try to negotiate lower prices (the effect of moral hazard falls on one contracting party who will attach a risk premium to the price (see Williamson, 1971)). Fair trade aims to overcome this and to provide the farmer a honest price.

Although it is often argued that fair trade pricing is against the principles of free trade, it should bring to some farmers the market access that is crucial for commercialisation the business. As mentioned above, fair trade is about “guaranteeing that the weakest link in the marketing chain, usually the farmer or the plantation worker, receives an equitable or decent share of the value of the end product, under all circumstances” (Tollens, 2003). Two major objections from economists are that a fair price, or a price that guarantees a decent living standard, is difficult to define, and (2) that no-one can desire to be paid a decent living standard for producing what he wants (Tollens, 2003). The market pricing is then considered to guide production, and control for oversupply (which is the case on the coffee market). As Tollens (2003) further argues, fair trade can be economically justified if it targets the poorest farmers, as part of a poverty alleviation policy, and the traded volume represents a relatively small segment of total trade to not distort regular market channels.

From its principal, fair trade is targeting the poor, and is part of a poverty alleviation policy. Fair trade projects are in itself often experiments, to assess the potentials of collective marketing actions. The projects are based on institutional innovation, with new institutional arrangement horizontally in the supply chain as farmers form associations to collectively market coffee, and vertically in the chain as the collective of farmers is engaging in new trade arrangements with private traders. A coffee farmer can join neighbouring farmers in an association. They can collectively grade and sort the coffee, and provide the trader with properly packaged cherries of different qualities. If the trader is part of the fair trade initiative, he is by contract obliged to pay the farmers a "fair" price. The trade-experiment can even go further, and can provide a market access to those farmers who want to add extra attributes to their product; for example, the production of organic coffee, the identification of special characteristics of the production area, or a traditional way of drying cherries in the sun.

4.3. Institutional Building

The institutional reforms supported by the 'Washington Consensus on Agriculture' (WCA)[1] are inspired by those in Liberal Market Economies (LME)[2]. Kydd (2002a; 2002b) reasons that farmers in poor countries need more appropriate institutions which are more likely to be comparable to institutions in Coordinated Market Economies (CME). In contrast to LME, the institutions in CME are more supportive to horizontal or networked strategic interaction, across and within supply chains, or in other words, deliberative institutions. The ideal institutions for smallholder farmers can therefore be described as "deliberative, working horizontally inside a sector and vertically along the supply chain, based on a consensus of what may constitute a just outcome". These would then be superior institutions which are "judged in terms of a reduction of transaction costs, improved coordination, stronger strategic commitment to investing in needed specific assets and allocative efficiency" (Kydd, 2002a; 2002b).

The new markets have higher requirements regarding quality, product differentiation and punctual delivery. This requires additional capital and process supervision, leading to higher risks and increased transaction costs. Institutional innovation of the CME type would imply a larger cooperation between the individual small-scale farmers whether formally belonging to a cooperative or loosely member of a joint initiative. The FLO in many cases prefers to deal with coffee producers organisations. Coffee is typically a product sold in bulk. The advantages of grouping the produce of the individual farmers are multiple, including a better bargaining position towards the traders and a better access to production and market information. The transaction costs are shared among a larger number of farmers. Individually too small, the bulking of the sales would not only decrease the transaction costs involved in the information gathering and contract negotiation, but also increase the trustworthiness as partners. This is because as a group, the farmers can better assure a timely delivery. Social control among the group members could increase the reliability of compliance to the codes of practises. This would be crucial for the success and sustainability of fair-and/or organic-labelling initiatives. Thus as a group the farmers have a better access to the information such as the codes of practices and how these should be implemented; they are better able to timely deliver the required amounts of coffee; the social control increases the trust for the certifying organisations and the bargaining power is increased. The collective action and the better access to information lowering the transaction costs will stimulate farmers to invest time, knowledge and assets in the production.

The cooperative movement in coffee production is not new to many developing countries. Yet we argue that increased attention should be paid to the institutional arrangements involved. We argue that fair trade projects are experiments. This is especially true when farmers of a certain area are not yet associated. The associations in itself need to be based on clearly defined rules and agreements and therefore require a good institutional setting. Organisational support and institutional development

[1] The WCA refers to the common set of analysis and prescriptions in publications of the World Bank, IFPRI and IFAD.

[2] In Liberal Market Economies, activities are coordinated through hierarchies (firms) and competitive market arrangement. Coordinated Market Economies differ because they "make more use of non market relations to coordinate endeavours and to construct core competencies", see Kydd (2002a, 2002b) and Hall & Soskice (2001) for more detailed description of both models. According to the analysis reported in Hall & Soskice (2001) the Liberal Market Economies are found in English speaking countries and Coordinated Market Economies in the rest.

assistance can help farmers to develop these institutions. Herein development cooperation and other organisations should have an important role to play. Trust is key to the success of the collective action. There is evidence that successful alternative market channels such as the labels for products of the Parma region in Italy or the Label Rouge for poultry in France took time to develop. In the initial stage, these quality products were sold on the local markets. It was only after a large local success and increased demand, that the projects were expanded.

The above examples indicate the importance of supplying to a local market. This is also true for coffee. NGOs tend to increasingly recognise the potentials of local and regional markets for traditional cash crops in a strategy for food security. It calls for active aid to help farmers trade, and to increase their capacity to respond to changes. Fair trade initiatives are not enough, but as mentioned before they can be an experiment. The fair trade organization provides market contacts, while the government could support the collective action and production innovation through extension on new production techniques, marketing, collective action and business management, or through an improved access to technology (e.g. production, innovation, diversification, and postharvest handling) and production assets.

New contracts and government structures need to be developed not only between the farmers, but also vertically within the supply chain up to the consumers. As mentioned above, the credence attributes are of great importance for fair-trade labelling. This is because the consumers will pay a premium as they believe and trust that the producers will be better off. It should be recognized that marketing initiatives for sustainable coffee, in which fair-trade coffee can be included, allows consumers to contribute to the realisation of "non-trade" concerns such as the fight against poverty, improving workers' conditions and the promotion of ecological sustainability. Over the past years, developing countries and NGOs have been lobbying at the WTO for a so-called "Development box". In it would be "preferential and differential treatment" measures, giving room for support to the local and regional efforts for rural development and food security (Vannoppen, 2003). Yet, up to now, no consensus on the Development box has been reached.

Labels for sustainable coffee provide the consumer a guarantee that the coffee is produced in a labour and eco-friendly way. Supermarkets are susceptible to criticism or exposure by media, consumer unions or lobby groups. They are therefore increasingly interested in promoting ethical trade through "socially responsible or sound sourcing". Browne et al. (2002) and Belgian examples point to the interest of supermarkets to establish private regulations for ethical trade by launching own-brand products that are labelled to be ethical and that are competitively priced. The government regulation on fair-trade is in many countries rather limited. Fair-trade coffee, even with double certification of also being grown organically, is increasingly available in supermarkets. This is also the result of consistent availability and improved quality, enabling a much larger distribution (Giovannucci & Koekoek, 2003).

However, multinationals dominating the coffee market often argue that a free market can restore the price at a fair level (cf. Tollens, 2003 and see above). The low prices should then motivate some farmers to withdraw from producing coffee, with a decreasing impact on the supply on the world market. They might not participate in selling fair trade coffee, but it can not be denied that fair trade triggered ethical initiatives of multinational producers. And they recently have taken many initiatives to profile themselves as ethical companies.

5. Conclusion

The above discussion clearly indicated the need for new contracts and new government structures for small-scale farmers to mitigate the costs and information asymmetries arising from the globalizing market of traditional products such as coffee. The farmers are far down the supply chain that is dominated by a limited number of transnational companies. The many traders in the chain furthermore cream off the amount paid to the farmers. The consumers have furthermore little feeling with the origin of the coffee. They are often unaware of the life cycle of the coffee, and therefore have limited concerns on the price that is paid to the farmers. This motivated development organisations to develop fair-trade labels, and to increase the consumers' awareness. While the consumption of fair-trade coffee is rising, it still remains a limited segment of ethical consumers. Large coffee roaster companies are reluctant to develop or join a fair-trade label, as they consider it not be a solution to the crisis on the coffee market. Yet whether fair trade labelling can provide an incentive towards the production of more quality and less quantity, is still under debate.

Fair trade should be part of a development policy of a country. It should target the poorest farmers or farm workers and be limited to selected groups of farmers. The availability of skills, labour and time, and the prevailing land tenure (social capital) can restrict some farmers from participating in fair-trading. Moreover, providing an incentive for the farmers to continue producing coffee, can restrain them from thinking about economic alternatives. It may therefore prolong the economic dependence on developing countries, while the fair-trade is an initiative of Western-based organisations. On the other hand, it should be argued that the crisis on the coffee market is more quantity related, as low-quality coffee cherries are massively produced. A fair-trade labelling initiative then presents a solution in the way the quality of the coffee is rewarded, and takes away the incentive of massive production. We agree that in the long run, many farmers will have to diversify out of coffee, to another agriculture product or to the non-agricultural sector. Yet reality shows that in the short run, the farmers face many constraints and many risks so that removing the coffee trees would not be realistic.

The case of fair-trade coffee shows that the problems for traditional crops are complex. Further research should focus on the impact that fair-trade coffee has on the international market. The increased attention for institutional innovation in the development debate is welcomed. Yet recommendations seldom go beyond general statements on how to reform the markets and to build or change institutions and infrastructure (Kydd & Dorward, 2001). More studies are needed to estimate the possible effects of new institutional arrangements amongst the farmers, especially on how new governance structures can be initiated that are successfully providing a conducive production and market environment for the farmers.

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