Why What's in Your Mug Matters:

Catholic Relief Services perspectives on the role of coffee in the lives of Latin American farmers

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For several years, Catholic Relief Services (CRS) has encouraged individuals, parishes, and schools to brew coffee from our Fair Trade network. Certainly the blends offered by our partners fully committed to Fair Trade are delicious, but why else is CRS promoting Fair Trade? This paper, drawn from the work of agro-enterprise staff in the CRS Latin America and Caribbean Regional Office, helps explain in depth why and how CRS accompanies coffee farmers working to build financial stability for their families and communities. Through this overview of the coffee production process and the ways that CRS is working directly with farming communities, you will see why the coffee in your mug matters to thousands of families in the region. If you are also interested in how Fair Trade in general relates to the principles of Catholic Social Teaching across other product sectors in different parts of the world, please turn to our CRS Fair Trade Handbook, available at www.crsfairtrade.org/resources.

In this document you'll learn that coffee farming represents the leading economic strategy for tens of thousands of smallholder farmers in Central America and Mexico. For many, however, coffee income is precarious. Prices are notoriously volatile. Yields are falling. Quality is failing to keep pace with the rising standards of the marketplace. Access to premium markets is limited. And production costs are on the rise, further squeezing the already narrow margins of smallholder farmers and compromising the mainstay of their fragile livelihoods.

Against this backdrop, the explosive growth of high-value coffee markets in the United States and Europe over the past decade represents an important market opportunity—even in uncertain financial times--for smallholder farmers in Central America and Mexico to increase coffee income. Their ability to seize this opportunity, however, is constrained by poor production practices, limited capacity for post-harvest activities, weak farmer organizations and lack of access to essential services.

CHALLENGES FARMERS FACE

Although smallholder farmers in Mexico and Central America own the land they work, many have been excluded from high-value specialty markets because they have been unable to overcome significant challenges in their coffee chains related to production, post-harvest processing and marketing. There are more than one dozen links in the chain that connects the farms on which coffee is grown and the markets in which it is sold overseas. At each link, smallholder farmers and farmer organizations must manage complex processes with technical precision to preserve coffee quality and value—all in a context of fierce competition and limited access to resources. As the saying goes, these chains are only as strong as their weakest links. If smallholder farmers or their cooperatives fall short in any one of them, their coffee can lose quality and value. Furthermore, smallholder farmers are structurally disadvantaged by the dynamics of the global coffee trade, which rewards the efficiency and economies of scale that are hard for smallholder farmers to achieve. These factors exclude many smallholder coffee farmers from high-value market opportunities.

Low Productivity

Smallholder farmers in Mexico and Central America are registering chronically low yields. CRS partner organizations suggest that yields of 15 *quintales* (QQ)[1] of processed, export-ready coffee per hectare (ha)[2] are necessary for smallholder farms

[1] A *quintal* is a 100-lb. bag of coffee and the prevailing unit of commercial exchange in the coffee trade in Mexico and Central America.
[2] 1 hectare = 2.47 acres.

to be commercially viable; cooperatives have reported to CRS production levels as low as 4 QQ/ha.

Some of the reasons behind such low productivity are beyond the control of smallholder farmers, including changing weather and climate patterns. Improved farming practices, however, can address many of the other leading causes of low yields, including: depleted soils, soil erosion, inadequate input levels, aging coffee trees, low-quality seed, poor pest and disease management, suboptimal coffee densities and poor overall farm management.

Limited Post-Harvest Capacity

Smallholder farmers and farmer organizations lack essential post-harvest processing infrastructure, the know-how to use it properly and the capacity to effectively coordinate complex post-harvest processes.

- *Limited post-harvest infrastructure and capacity.* Smallholder farmers lack access to the small-scale physical infrastructure they need to add value to their coffee through: (1.) more effective quality control and (2.) transformation of the primary material into a processed product for export. Despite the relatively low cost of the technology required for on-farm wet milling and pre-drying, it is still cost-prohibitive for many farmers who sell coffee in its unprocessed cherry form immediately after it is harvested and forfeit the value added through processing to the next actor on the chain. Even when smallholder farmers and farmer organizations have post-harvest infrastructure in place, they often lack the expertise to use it effectively.

- *Weak coordination*. After coffee is processed on the farms where it is grown, it must be aggregated and transported to the next actor in the coffee chain—processes that require coordination of multiple actors. The failure of farmer organizations to effectively coordinate these processes can lead to loss of coffee quality and value.

Lack of Market Access

Most smallholder farmers in Mexico and Central America do not have direct or reliable access to high-value coffee markets even though they have the potential to produce large volumes of specialty-grade coffee. Among the leading reasons for the continued exclusion of millions of smallholder farmers from high-value market opportunities are the following:

- *Limited economies of scale.* Smallholder coffee farmers work on plots that are, by definition, very small. They are not able to produce the minimum volumes necessary to engage directly in high-value coffee markets or exert much leverage in negotiations with coffee buyers or other service providers. In many parts of the region, farms are getting smaller over time due to subdivision through inheritance, making them even less commercially viable.

- *Limited market intelligence.* Few smallholder farmers enjoy access to the timely, reliable information on coffee prices and other market trends they need to earn market prices for their coffee or take advantage of other business opportunities in the marketplace.

- *Limited commercial contacts.* Most smallholder farmers are insulated from direct contact with coffee buyers by at least two layers of intermediaries, limiting access to market intelligence and reducing opportunities to negotiate directly for more favorable terms of trade. When smallholder farmers do have direct contact, they often lack the experience and knowledge to engage confidently.

- *Barriers to entry in sustainable coffee markets.* The growth of markets for sustainable coffees—Fair Trade, organic, shade-grown, etc.—has created valuable opportunities for a limited number of smallholder farmers. For most, however, barriers to entry remain high, including fierce competition for limited markets, stringent certification standards and high costs—Fair Trade certification requires a one-time 500-euro application fee and annual fees ranging from 1400-3400 euros.

As a consequence, most smallholder farmers in the region face significant price volatility in local coffee markets. Prices on wholesale markets in the region are based on commodity trading on the New York "C" market, and do not reflect quality-based differentials or bear any relation to the costs of production at origin, which are high and rising, particularly for organic coffees. When market prices were at historic lows between 1998 and 2003, it was not uncommon for farmers to sell specialty-grade coffee for less than the cost of production for several years running. This period reduced reinvestment and led to considerable degradation of smallholder coffee systems. Smallholder farmers now find themselves in a dilemma: they are unwilling or unable to take the risk associated with investment in high-value coffee production, yet deeper engagement in high-value markets is precisely what they need to reverse the current downward cycle.

Cross-Cutting Challenges

The limited capacity of smallholder farmer organizations and lack of access to critical services contribute to each of the challenges presented above. An intersection of concerns also arise:

Weak Farmer Organizations

Smallholder farmers cannot survive in competitive international markets without strong organizations. Unfortunately, many smallholder farmer cooperatives are chronically weak and lack the management capacity and technical expertise necessary required to bring large volumes of high-quality coffee to market consistently. Many farmer organizations are unable to effectively perform even the most basic functions of farmer organizations—achieving economies of scale for purchasing inputs, negotiating sales and improving access to services for members.

Limited Access to Services

Smallholder farmers and farmer cooperatives frequently lack access to the following services:

- *Technical assistance.* To perform effectively in each of the areas identified above—production, post-harvest and market engagement—smallholder farmers and farmer cooperatives need access to technical assistance from a wide range of sources, including but not limited to: agricultural extension workers, coffee processors, coffee cuppers and quality control experts, management consultants, financial management experts, market researchers, coffee buyers and marketers. While many farmers and farmer organizations may have access to assistance around one or more of these skill sets, few have access to support in all of them. Given the fragility of the coffee chain and the fact that any single misstep along the way can compromise coffee quality and value, cooperatives need integrated support in all these areas simultaneously to engage successfully and sustainable in high-value markets.

- *Credit.* Smallholder farmers and farmer organizations lack access to the credit they need for effective engagement in high-value. At the farm level, smallholder farmers need credit for working capital and re-investment in production and post-harvest processing systems. At the organizational level, cooperatives need to be able to offer pre-harvest financing to their members and deliver a sufficient pre-payment upon delivery of coffee to ensure member loyalty.

  Farmers who do not have easy access to credit on commercial terms are often forced to sell their coffee via forward contract to meet acute financial needs between harvests. Under forward contracts, cash-strapped farmers pledge coffee from future harvests to local buyers at a pre-determined price in exchange for cash. The immediate impact is that farmers forfeit the difference between the price paid under the forward contract and the market value of the coffee at harvest—which can be considerable—and reduce total income by reducing the amount of coffee available for sale at harvest time. The longer-term risk is entering a cycle of debt to buyers and local lenders from which escape is difficult without access to improved market opportunities.

  Cooperatives that do not have access to credit cannot compete with better-capitalized competitors for access to their members' coffee. Their inability to accurately forecast the volume of their members' coffee they will be able to bring to market makes it impossible for them to reliably negotiate contracts with buyers.

DEMANDS OF THE MARKETPLACE

Coffee quality is a complex variable that is affected by a chain of production and post-harvest activities for which farmers and their representative organizations share responsibility. Some of the factors accounting for coffee quality are beyond their control: altitude, rainfall levels and patterns of rainfall, severe weather events, etc. But farmers have control over many of the variables that most directly impact coffee quality. In production, these include shade management, fertilization, improved harvest practices and overall farm management. During the post-harvest period, on-farm wet milling and drying are vital to preserve and enhance coffee quality. And when coffee leaves the farm, smallholder farmer organizations play an essential role in preserving coffee quality and value through effective provision of collection, transport, payment, and marketing services.

Specialty Export Markets

The U.S. market for specialty coffees increased from $7.7 billion in 2000 to $13.6 billion in 2007—a rise of 77 percent.[3] While migration to higher-value coffee has not necessarily translated into rising prices for smallholder farmers, it has created valuable opportunities for smallholder farmers to secure price premiums based on quality. This is especially true in a small number of high-value niches of the specialty industry.

High-Value Niches

Within the broader specialty coffee segment, there are fast-growing high-value niches that command additional price premiums: "social" coffees that are produced by smallholders (Fair Trade), "environmental" coffees that are grown according to principles of sustainable agroecology (organic, shade-grown/sustainable) and "boutique" coffees that meet the most stringent quality standards. The markets for these coffees have experienced sustained growth over the past decade, with projections for strong growth into the future, especially for "double-certified" or

[3] TransFair USA (2008). "Almanac: 2007."

"triple-certified" coffees that combine multiple certifications across or within these categories.

- *"Social Coffee"—Fair Trade*
  Fair Trade creates price premiums for smallholder coffee—the only market-based system that enforces a price floor. The Fair Trade Labelling Organizations, International (FLO), establishes pricing standards for Fair Trade Certified coffee and, in coordination with its network of 20 "Labelling Initiatives" in countries where Fair Trade Certified products are sold, provides third-party verification of compliance with the terms of Fair Trade Certification. These standards represent minimum prices that buyers must pay to smallholder cooperatives in order to qualify for Fair Trade Certification. In Mexico and Central America, FLO's minimum price for washed Arabica coffee is $1.25 per pound if it is conventionally grown and $1.45 per pound for certified organic coffee. In addition, buyers pay a $0.10 per pound social premium to the smallholder cooperative that the coop reinvests in productive infrastructure or community development initiatives, including: schools, health clinics, water wells, roads and other projects that foster community development.

  The Fair Trade minimums apply regardless of what is happening on the New York "C" market. In times of market collapse, Fair Trade insulates farmers from price risk and provides income stability from one year to the next. When the market price of coffee rises above $1.25/$1.45 per pound, Fair Trade buyers must pay the market price plus the social premium so there is always a financial benefit to participation in FT markets.

  The market for Fair Trade coffee in the United States has sustained significant growth in terms of both volume and value in the past decade. In 2000, 4 million pounds of Fair Trade Certified coffee were sold in the United States with a market value of $48 million; by 2007, those figures had grown to 66 million pounds and $837 million, respectively.[4] In addition to these figures, a small number of progressive coffee companies in the United States sell non-certified coffee under the Fair Trade concept. We estimate the value of the market for non-certified Fair Trade coffee to be worth as much as an additional $10-20 million.

  CRS has been working since 1995 to promote the consumption of certified and non-certified Fair Trade products among U.S. Catholics as a way to promote equitable trade and global solidarity. In 2003, CRS launched a Fair Trade Coffee Project designed to link U.S. consumers directly with smallholder coffee-farmer cooperatives, including those served by CRS overseas. Since in 2005, the CRS Fair Trade Program has made a series of small grants through our Fair Trade Fund to producers to help them more effectively engage in U.S. Fair Trade markets.

- *"Environmental Coffee"*
  Eco-labels that make claims about the environmental conditions under which coffee was grown have proliferated in recent years and increased their share of the specialty coffee market.

  - *Organic.* Organic coffee is grown on farms that have been inspected and certified by accredited third-party agencies to verify compliance with standards established in consuming countries. Organic standards are generally designed to reduce the level of toxic synthetic inputs in the farming process and

[4] TransFair USA (2008). "Almanac: 2007."

promote ecologically responsible management of the production and post-harvest processes. In the United States, the volume of organic coffee imported in 2006 has been estimated at 65 million pounds, with 2007 imports projected to grow to 80 million pounds.[5] Recent research in Mexico and Central America indicates that certified organic coffee delivers higher price premiums to smallholder farmers than any competing certification scheme.[6] The high price premium for organic coffee has been the subject of debate in recent years, however, among smallholder farmers and their advocates who argue that it is still not sufficient to cover the additional production costs associated with organic farming.

- *Shade-Grown/Sustainable Coffee.* Despite the lack of uniform standards for sustainability, coffee sales in the shade-grown/sustainable category have grown significantly over the past decade. The leading coffee label in this category is Rainforest Alliance Certified coffee.

  Rainforest Alliance Certification is among the most ecologically stringent in its requirements for ecosystem conservation and forest protection, including stipulations on the density (more than 70 trees per hectare), diversity (at least 12 species) and structure (at least two strata) of shade trees.[7] The rigor of Rainforest Alliance standards has not been an obstacle to growth in the volume and market value of Rainforest Alliance Certified coffee, however: it has increased from 7 million pounds in 2003 to 91 million pounds in 2007.[8] Although prices for Rainforest Alliance Certified coffee are reached through negotiation between buyer and seller and not guaranteed as under the Fair Trade approach, Rainforest Alliance estimates that the average price premium that Rainforest Alliance-certified coffees earn is 10 cents per pound.[9]

  The Smithsonian Migratory Bird Center's certification for "Bird-Friendly" coffee is the only other third-party inspection and certification for shade-grown coffee, but its popularity among smallholder farmers is limited by its unusually high costs and the uncertainty of its benefits in the marketplace.

- *"Boutique Coffee"*
  Farmers who produce coffees of surpassing quality can earn significant premiums in the very small boutique market niche, where buyers place extraordinary value on coffee quality and exclusivity. These coffees are generally judged and sold in micro-lots through formal auctions, such as the Coffee Quality Institute's "Q Auction" system and the Cup of Excellence events held annually in eight Latin American countries. These channels have generated extraordinary prices for truly unique micro-lots: the winning coffee in Nicaragua's 2007 Cup of Excellence sold for more than $47 per pound.

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[5] Giovannucci, D. and A. Villalobos (2007). "The State of Organic Coffee: 2007 U.S. Update," San José, Costa Rica: Sustainable Markets Intelligence Center (CIMS).
[6] Méndez, V.E., C. Bacon, S. Petchers, D. Herrador, C. Carranza, L. Trujillo, C. Guadarrama-Zugasti, A. Cordón and A. Mendoza (2005). "Sustainable Coffee from the Bottom Up: Impacts of Certification Initiatives on Small-Scale Farmer and Estate Worker Households and Communities in Central America and Mexico," Boston: Oxfam America (unpublished).
[7] Sustainable Agriculture Network (2002). "Generic Standards for Coffee Farm Evaluation."
[8] Rainforest Alliance, "Rainforest Alliance Reaches New Milestone As Area of Certified Farmland Exceeds One Million Acres," 15 April 2008 press release.
[9] Personal communication with Rainforest Alliance President Tensie Whelan.

The growing demand of the boutique coffee niche is also increasingly met by individual companies that have positioned themselves in the specialty market as purveyors of fine and exclusive coffees. Their intrepid coffee buyers scour coffee producing regions around the world to find the most extraordinary coffees and build lasting relationships with the farmers who produce them.

One of the sources of value for these coffees is their exclusivity—since they are sold in micro-lots or through direct trading relationships with coffee companies, they are truly one-of-a-kind coffees that command a corresponding premium in the marketplace.

The total volume of coffee sold through these channels is extremely limited and the coffee tends overwhelmingly to come from larger and better capitalized estates rather than smallholder coops that struggle with some of the quality issues identified above.

Bringing Coffee to the Marketplace

Most of the energies of coffee cooperatives and the development organizations such as CRS that support them have been focused in recent years on increased engagement with specialty and sustainable export markets. There are, also, significant opportunities for profitable engagement with national coffee markets throughout Mexico and Central America, where domestic markets for specialty and even sustainable coffees have grown in recent years. Mexico has its own Fair Trade certifying agency for the national market and market feasibility studies conducted recently in Central America by FLO's producer liaison office in Central America, suggest that conditions exist in El Salvador, Guatemala and Nicaragua for Fair Trade coffee as well.[10]

Building Stronger Farmer Organizations

Smallholder farmer organization have a critical role to play in providing technical support and coordination in connection with the processes described above. The role of farmer organizations varies from one case to the next based on local realities and member needs, but generally the farmer's role in the coffee value chain decreases and the cooperative's responsibility increases as coffee moves away from the farm toward the market.

While there are important technical assistance functions that the cooperative can play at the farm level, its real added value lies in the coordination, aggregation and marketing functions. The cooperative is the critical link between smallholder farmers and multiple markets: it aggregates members to achieve economies of scale in purchasing inputs; it secures technical assistance and financial services on behalf of its members that they could not secure on their own; it aggregates supply to achieve commercially viable volumes; and it represents farmers in the marketplace with coffee buyers. If cooperatives are not effectively managed, even the best coffee will not get to market, or will get to market without earning a fair price.

In order to help smallholder farmers more effectively address these issues, CRS has launched CAFE Livelihoods (Coffee Assistance For Enhanced Livelihoods), a three-year, four-country initiative that will bolster the livelihoods of 7,100 smallholder coffee farmers in more than 30 farmer organizations in El Salvador, Guatemala, Mexico and Nicaragua by increasing the value of their coffee and deepening their engagement in

[10] Personal communication with FLO Central America Liaison Kieran Durnien.

high-value coffee markets. CRS will partner with coffee-industry allies on an integrated and market-based approach to the entire coffee chain that will provide technical assistance in the areas of coffee production, post-harvest processing and market engagement, while strengthening the management capacity and competitiveness of participating farmer organizations.

Key project outcomes include:

- Adoption of improved production practices, including organic and shade farming;
- Increased coffee productivity and yields;
- Expanded access to small-scale infrastructure to capture added value;
- Improved coffee quality;
- Improved general and financial management of smallholder cooperatives;
- Expanded access to commercial credit for farmer organizations; and
- Diversification of market channels;
- Increased income from coffee sales.

CAFE Livelihoods will also enhance the capacity of smallholder farmers and farmer organizations for autonomous learning and innovation through ongoing technical assistance and learning events at the local, national and regional levels. In addition to the direct benefits generated for 7,100 smallholder farmers in four countries, the project will benefit an estimated 35,500 family members indirectly through higher and more stable household incomes.

Bookmark www.crsfairtrade.org and check back periodically for updates on the progress we are making with our partners. In the meantime, you as a consumer make a simple but powerful choice every day as to what coffee to brew and enjoy. When you choose Fair Trade and other sustainable coffees, you are joining CRS in our efforts to make every farmer matter.