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**COFFEE CO-OPERATIVES SHAPING NEW TRADE RELATIONS:
The Case of Fair Trade Markets in Honduras**

A Research Paper presented by

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PREFACE

This research paper was almost finished by the time when the strongest hurricane in the last century passed through Honduras, devastating the country: 7,000 people died, 1.4 millions lost their homes and 80% of the infrastructure is gone.

Mitch also affected the agricultural sector, particularly the crops of staple foods (beans, maize and rice) and the banana plantations. The coffee sector located in the mountainous regions was less affected. However, there are estimations that suggest that around 25% of the 1998/99 harvest is lost. Moreover, many co-operatives, including one that was part of my fieldwork for the research, have lost their entire infrastructure.

Now, the coffee sector is the only crop that can help Honduras to overcome this terrible situation. Now, more than ever, coffee co-operatives in Honduras need an effective fair-trade for its production.

CHAPTER I: INTRODUCTION

1.1 The problem

In Latin America and Africa millions of small producers are engaged in coffee production. Historically the coffee market has been influenced by the global tendencies of capital accumulation and the dynamic of the economic agents involved in coffee trade. As a result nowadays, in the context of a liberalised market the structure of coffee production is heavily monopolised through the control of Transnational Corporations (TNC's) over key links in the trading and roasting of coffee. Moreover, TNCs have incremented during the last decade their stock operations in the stock exchanges of coffee, New York and London, influencing the trends in prices.

Since the breakdown of the International Coffee Organisation, in 1989, markets have experienced a great instability. Alternative trade organisations (ATO's) around the world, based in Europe and the United States, have promoted alternative way of market relations between small coffee producers in the third world and consumers in developed countries. This alternative trade recognises the necessity of a fair trade of quality coffee, instead of aid, for small producers in developing countries. Therefore, ATO's such as the Max Havelaar (MH) Foundation in The Netherlands have promoted new relations among co-operatives of coffee producers and importers and roasters in consuming countries.

During the last years, as coffee instability has increased Honduran co-operatives registered in MH have faced a more competitive environment and most of them have been facing problems related with their competitiveness as enterprises. These problems are related with the low level of expertise of co-operatives in mechanisms of price fixation. In addition, some co-operatives have higher operational costs than their competitors, middlemen and exporters. Moreover, the entrance of co-operative organisations in the exporting markets supposes the uprising of new conflicts at the national level as middlemen and exporters are displaced from segments of the market. This fact imposes additional pressure to the tight relations between organised producers, middlemen and exporters.

This research seeks to contribute to the analysis of the new links developed in the coffee market among coffee co-operatives, importers and roasters, with the contribution of Max Havelaar Foundation. Therefore it analysis the coffee chain, the economic agents involved and the fundamentals of the market transactions prevailing in normal and alternative markets of coffee. Furthermore, it critically examines the characteristics of the Honduran coffee co-operative movement, considering the socio-economic context in which it has developed and the institutional framework where it operates. Finally it assess the level of competitiveness of co-operatives operating in and out the new alternative markets and attempts to determine certain correlation of the competitiveness with the management skills and the size of the co-operatives.

The findings expect to stimulate a deeper debate among coffee co-operatives, producer's associations, ATO's, importers and roasters about the conditions required to develop stable long-term commercial relations.

1.2 Research Hypothesis

Honduran coffee co-operatives do not have an adequate participation in the process of policy making for the coffee sector in Honduras. Historically the institutions that implement the set of policies for the sector have been controlled by national roasters and exporters. In addition co-operatives faces the challenge in their communities to displace strong middlemen that control not only the coffee trade but also other services exerting a high influence over coffee growers. This situation reduces the capabilities of coffee co-operatives to actively participate as economic agents in the coffee markets at the national and international level.

As the MH initiative of fair trade offers new relations with traders and roaster in Europe, the issue is whether or not Honduran coffee producers participating in co-operatives that have entered in the alternative coffee market have effectively gained a higher share of the international market prices if compared with other co-operative and non co-operative coffee producers.

Coffee co-operatives participating in MH/FLO have not benefited to same extent their members. Then it is argued that a higher degree of management skills and the size of the co-operatives can contribute to enhance the competitiveness of co-operatives. Management skills include the development of administrative infrastructure, accounting systems, improvement of personnel expertise and the knowledge of the international market mechanisms. Moreover, it implies the development of fluent commercial relations with importers. In relation to the size it is recognised that a co-operatives requires a minimum level of operations to develop economies of scales in the provision of exporting services to their members and compete with middlemen and exporters.

1.3 Methodology

As part of these research it has been included a chapter comprising a case study of coffee co-operatives in Honduras as an outcome of a survey, undertaken during three weeks, sponsored by Max Havelaar Foundation. The sample includes 12 co-operatives that represent 25% of the Honduran coffee co-operatives registered. In the selection of co-operatives, a criterion of the relative weight of each coffee producer Province was taken in account. Furthermore, there were included co-operatives exporting and non-exporting to international markets to generate a comparison among them.

The survey covered the visit of coffee co-operatives and interview to one member of the board of directors and one member of the administration (in most of the cases the Manager), in each co-operative, covering aspects related to the volume and characteristics of coffee commercialisation, the management system, the processing

facilities and financial situation of coffee co-operatives and the relations and degree of participation of co-operative leaders and managers in the national coffee organisations and institutions.

During the visit to Honduras there were also interviewed members of one regional and one national producers associations of coffee co-operatives, La Paz (Provincial) Producers Association (APAS) and the Honduran Coffee Co-operatives Central (CCCH) respectively.

1.4 Data for the study

The data used for this research paper includes primary and secondary data.

By primary data it is meant interviews to coffee co-operative leaders and managers in Honduras. In addition, interviews in the Netherlands with the Supervisor of Max Havelaar Foundation for Central America, the Co-ordinator of Fair Trade Labelling Organisations (FLO) and one coffee trader operating in the alternative market initiative.

In relation two secondary data, books, articles, bulletins, brochures and statistical information collected from the Honduran Coffee Institute, the Honduran Coffee Co-operatives Central, Max Havelaar Foundation, Fair Trade Labelling Organisation, the International Coffee Organisation and the ISS Library among others were used.

1.5 Limitations of the study

The management skills and the size of a co-operative consider variables related with the functioning of co-operatives as economic enterprises. However the understanding of the reality and problems of co-operatives while they enter in the international market requires the understanding of the social relations that take places in the communities and the formal and informal links between coffee members and the different bodies that encompasses the social organisation of a co-operative. The study of these issues would require a more extensive survey including a rapid rural appraisal (RRA) in coffee communities.

1.6 Organisation of the research paper

The rest of this research is organised as follows: the second chapter considers the evolution of the world coffee market as a food system, which has been affected by global tendencies of capital accumulation. The third chapter provides an explanation of the alternative trade initiative of Max Havelaar Foundation and the challenges related with the structural constrains of the coffee market and the capacities of small coffee producers co-operatives to take advantage of it. The fourth chapter, covers the analysis of the historic role of the state in the co-operative movement in Honduras, the social and institutional framework in which co-operatives are functioning and the key elements for the understanding of the performance of coffee co-operatives. The fifth chapter is devoted to the study case of Honduran coffee co-operatives. In this chapter is analysed to

what extent members of MH coffee co-operatives have improve their level of competitiveness as economic enterprises. Moreover, it is determined the correlation of the competitiveness with their management skills and the size of the co-operatives. After that it will be presented the major findings as a result of the analysis of Honduran co-operatives. Finally, chapter six presents the of this research paper.

CHAPTER II: WORLD COFFEE MARKET

This chapter will analyse the process of historical evolution of the world coffee market considered as a food system, which has been affected by global tendencies of capital accumulation. The theoretical framework of food systems allows understanding the process and mechanisms by which economic agents and the state have excerpted different degrees of control and influence over the coffee market.

Coffee is the largest market of an agricultural product in developing countries. In Latin America coffee contributed 23.9% to agricultural export earning in the period 1980-84 (IDB, 1986:147 quoted by Kay, 1995:16). Nowadays, seventy five percent of the world's production is not consumed nationally but exported to the world as green beans, involving more than twenty five million producers all over the world in seventy (70) countries (Fair-trade Canada, 1998). Brazil and Colombia have had historically a major role among producing countries, with a share of 40 % to 50% of the world supply and; the United States the European Community and Japan have been the major importers.

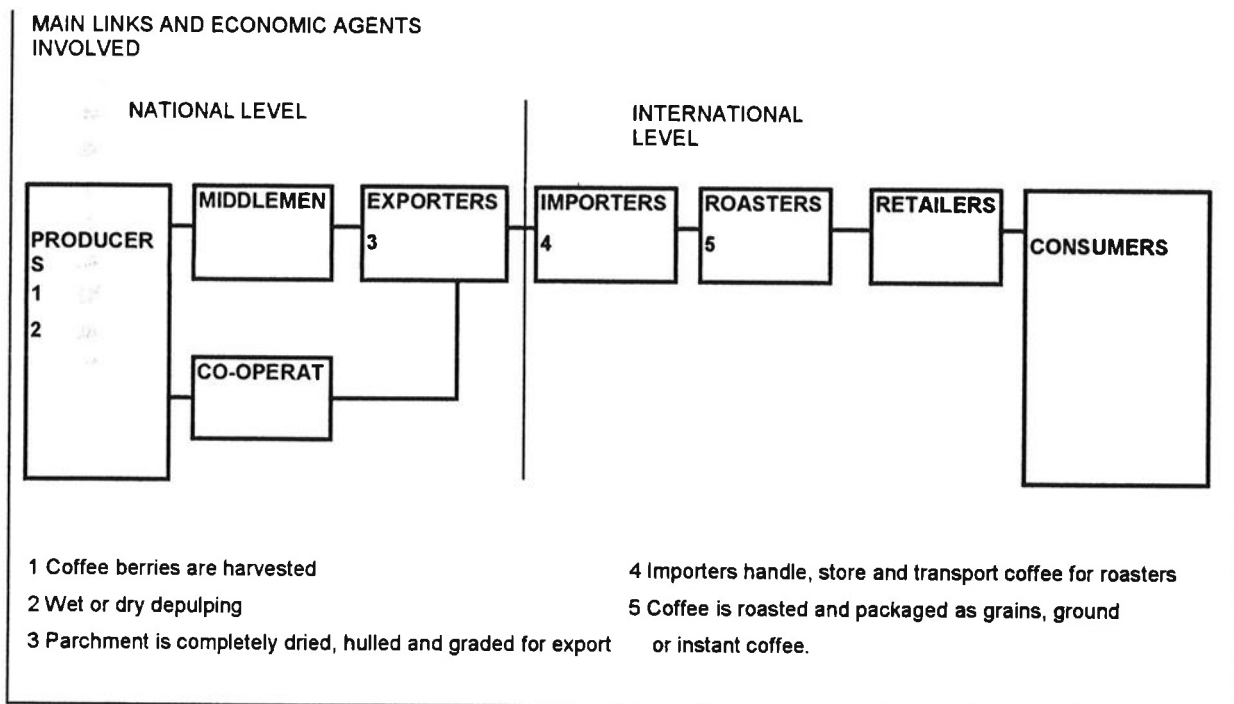
The coffee market is analysed as a food system. Methodologically, Fine (1996:32) addresses three key elements for the understanding of food systems. First, the comprehension of *structures* of a food system and a clear explanation of each of the links along the food chain, the activities that belong to them and the permanent process of reproduction and transformation over time. Not only those links that are related with production and processing but also those related with trading and retailing, as the enterprises involved have become increasingly oligopolised, influencing conditions of supply and demand and having a privileged access to finance. Markets of agricultural products, such as coffee, comprise a sequence of distinctive activities, nonetheless, structurally bounded into a unified whole where economic agents interact. (Fine, 1996: 31). Each food chain is distinguishable from each other in that the ways in which production, distribution, marketing, consumption, etc. are integrated differ from one commodity (group) to another; and the significance of each of these factors is dependent upon the relationship to the food chain as a whole (Fine, 1996: 35). In addition, national and international economic policies and the trends in world trade determine the institutional framework, including laws and regulations of national and supranational institutions, in which economic agents operate. The food chain, the articulation and relations among the economic agents and the state; and the institutional framework along the food chain; as a whole, constitute the *structures* of a food system (Gago, 1997:29 my translation).

Second, recognising the presence of inherent *tendencies* linked to the imperatives of capital accumulation and profitability and, third, to analyse, in a historic perspective, the *interactions* of *structures* and *tendencies*. Thus, the conflicts that arise among economic agents, as a consequence of *interactions* and the resolution mechanisms implemented through the market or the state, at the national and international level can be discussed. Therefore, there is an implicit dialectic relation of *structure*, *tendency* and *interactions* for each different food system (Fine, 1996:34). Every food system shows certain dominant *mode of ordering* of the economic agents by which it is meant, a certain path of position in

(and control of) the links of the food chain, influenced by the *tendencias* of capital accumulation. Even if a *mode of ordering* may be predominant at a certain period, different and multiple parallel *modes of ordering* of economic agents may coexist. This analytical framework is relevant to the analysis of the modalities, dynamic and degree of accumulation of the different economic agents that interact in the coffee food system.

In the case of the coffee chain, as described in Chart 1, the sequenced links can be simplified for the purpose of the analysis as follows: at the national level, coffee berries are harvested, following a wet or dry depulping method to obtain coffee parchment (1st processing). The parchment is transported to “beneficios” (export firms), dry or wet, to be completely dried¹, hulled and graded (2nd processing) for export as coffee green beans. At the international level, green coffee is shipped to importing countries. Importers handle, store and transport coffee to industrialists. Coffee is then roasted and packaged as grains, ground or instant coffee, passing to retailing and final consumers.

Chart 1: Simplified structure of the Coffee Food System



Economic agents, from the production to the final consumption, including producers, co-operatives, middlemen, exporters, importers, roasters, retailers and consumers, assume transactions within the coffee chain. These economic agents control one or more of the links and set up vertical and horizontal relations along the chain, that are determined by their access to production factors, especially capital (the most dynamic of them). These relations require to be studied to understand how the coffee system is reproduced, shifted and transformed over time

¹ Coffee is dried to a standard level of humidity of 12-13% (ICO, 1998)

It is supposed that coffee chain should be arranged according to certain rationality, limited by the prevailing technological and organisational constraints. However, the modalities of articulation among the predominant economic agents in the coffee chain, in a certain moment, have not been the outcome of a technological or an organisational determinism, but of the prevailing *tendencies* of capital accumulation and the relative power position of the different agents, including the government. Therefore, *tendencies*, in a certain moment, do not reflect the most efficient option in a market (CEPAL, 1995:77).

In the following sections, it will be analysed the *interactions* between the prevailing global *tendencies* of capital accumulation and the *structures* of the coffee food system in three distinctive periods: From free market to the emergence of the International Coffee Organisation (ICO) agreement 1830-1962, ICO-agreements 1963-1989, and market liberalisation from 1989 up to now. In each of these sections it can be distinguished a prevailing *mode of ordering* of the economic agents.

2.1 The expansion of the coffee market: From “free market” to ICO agreements, 1830-1963

The prevailing *tendencies* of the regime of capital accumulation during the last century and the first two decades of this century are related to the entering of emerging countries in post-colonial schemes of exports of raw materials to developed countries. An international free trade of foods expanded to an unprecedented scale, while the main processing activities were concentrated in the consuming countries². Thus, there was a rapid expansion of world coffee production, especially in Latin America, headed by Brazil. In 1830, 90,000 metric tons were traded, half coming from Brazil, by 1870, it grew up to 450,000 metric tons and it reached 1,600,000 metric tons in 1920. The main consumer markets, meanwhile, were England, Germany and the United States (Roseberry, 1995:3).

During the First World War, the Great Depression on the 1930s and the Second World War, there was a severe decline in demand due to the lost of purchasing power in importing countries. The Brazilian government that controlled between 75 and 90 % of the world production and exports of green coffee co-ordinated policies at the national level to limit production, parchment processing and exporting activities. Moreover, the monopolistic control over the market enabled the manipulation of prices and the control over supply for instances, destroying exportable coffee.

By the early 1930s, when the period of international free trade was coming to an end, Colombia gained a world market share of over 10% and gradually other Latin American countries started to produce exportable coffee, marking the start of Brazilian lost of its monopolistic position (Brand, 1991: 66). Therefore, Brazil as major producer and the United States, as leading consumer³, developed with minor success different attempts to form Cartels of Latin American producers seeking to stabilise prices by settling supply quotas

² Settling high tariff and non-tariff barriers in industrialized countries to processed goods coming from the Third World reinforces this characteristic.

³ By 1963 the United States consumed over 50% of the world's coffee and other nations, such as Canada and (to a lesser degree) Mexico and Japan, imported their coffee through the United States (Bates, 1997: 140)

according to demand levels in consuming countries. During the late 1940s prices started rising driven by a sharp rise of the world demand, as a consequence of both, the end of World War II and a great drought in Brazil, motivating other Latin American countries, and new African countries, to go into serious plans of coffee expansion. As new plantations started to produce, prices moved down by the late 1950s and early 1960s. Long term response to prices by producers' supply would mark the historic behaviour of coffee markets⁴.

In 1962, Brazil and Colombia, with the support of the United States relaunched the proposal to establish an International Coffee Agreement (ICA) that could be able to constrain coffee shipments. As a result of overproduction, producing countries had accumulated stocks of 72 million bags (higher than the world annual demand) and prices had dropped to US \$ 0.66/kg. Moreover, in the context of the cold war, the United States was willing to support the implementation of ICA, as it was crucial to assure Latin American alignment and to secure a success of its development assistance programme, Alliance for Progress⁵.

During this period there was initially a great expansion of world coffee production in the context of international free trade. Then, from 1930s up to 1960s there was a crisis in the mode of accumulation that led to the establishment of the ICA as an international regulative framework for coffee trade marking the definitive end of free trade. During this period the prevailing *mode of ordering* of economic agents in the coffee food system was characterised by a strong control of Brazilian government over the production, national commercialisation and exports of coffee, negotiating on behalf of producers with traders. In consuming countries trading, roasting and retailing were in hands of small-specialised firms who provided coffee to a spread network of retailers.

2.2 ICO Agreement 1963-1989

The aims of the 1963 ICA, referred in the text of the agreement, reflected both producers and consumers' interests that were summarised in four objectives: price stabilisation, higher export terms, security of supply to consumers and long-term market stabilisation (Brand, 1991:67,68). The voting rules of the International Coffee Organisation (ICO) were defined to assure domination of Brazil and Colombia that at that moment were producing 41.6 and 13.9 percent of the world coffee production, respectively. With 498 out of 1,000 votes they controlled decisions of ICO Council, that required a two-thirds majority, and leded key committees created (Bates 1997:138). Later on, a bicameral structure was introduced, giving equal participation to producing and consumer countries in ICO Assembly and committees. In the new voting system a proposal, to secure passage, required two-thirds of the consumer's countries votes and two-thirds of producing countries' votes. The United States, controlling 40% of the consumers' votes, held veto power increasing enormously its influential position and capacity to overcome any decision that may cause

⁴ After a rise in prices produces usually plant more coffee. However, it takes five or six years for coffee trees to reach full bearing. The long-term lag in supply thus averages seven years and price elasticity rises to levels above 0.40. Besides, short term supply respond to world prices by changing intensity of labor and other inputs in production is almost completely inelastic (Brand, 1991:25)

⁵ The losses in income in producing countries, resulting from fall in the coffee price, could undermine the impact of the Alliance for Progress (Bates 1997: 146).

unfavourable changes in the prices or quantities of coffee agreed upon ICA (Bates 1997:143).

The agreement mechanism, signed by producing and consumer countries, was based in the definition of a certain volume of green coffee that could generate an equilibrium in supply and demand considering a target price indicator⁶. Each exporting member country was allotted a quota equivalent to its maximum annual exports during a reference period, considering its historical share in world production. ICO Council would set each year quotas in line with trends of coffee world supply. These quotas would be effective while prices fluctuate in a settled price's range. If prices would exceed the range quotas were to be suspended and markets liberalised. If prices would fall below the range quotas they will be adjusted to reduce supply. Importing countries committed to request certificates of origin collected from all imports, from member and non-member countries, as far as some cases of "tourist coffee"⁷ were discovered during the first years of ICA implementation.

ICA was meant to stabilise prices regulating the supply of coffee production. Especially, Brazil and Colombia exerted a strong oligopolistic control as major producers, in a general context of increasing intervention of national governments over the economy, within the model of industrial substitution development. In the coffee sector, governments controlled national market boards jointly with coffee producers' organisations (like FNC in Colombia). In addition, they regulated prices defining "minimum prices," creating special contingency funds, determining taxation policies and negotiating with large traders in importing countries. ICA created a set of political rules for the coffee system that went beyond the principles of market forces.

During this period, considering the low price elasticity of world coffee demand, the basic structural situation in the world markets was characterised by a relatively slow rise both in demand and in supply⁸. Therefore, ICA provided an adequate framework to assure regular incomes for coffee producers. Moreover, the real level of world market prices of coffee remained far more stable than prices of other agricultural products like cotton, tea and oils (Brand, 1991:30)

In relation to importers and roasters, large transnational corporations (TNCs) that displaced small traders during the 1950s and 1960s like General Foods, Nestle, Rotfus and Procter and Gamble signed bulk contracts with Colombian and Brazilian producers boards, determining fixed amounts of coffee to be traded with specific discounts in price of coffee. The great industrialists of coffee in the United States were more than partners; they became lobbyists and advisors in the US Congress to assure enforcement by the US government of ICO agreements. Dominant producers created incentives for the large roasters to secure the co-operation of the consuming nations in efforts to regulate the

⁶ The indicator price was the arithmetic mean of the New York exdoc prices of mild Arabicas, Unwashed Arabicas and Robustas.

⁷ The so-called "Tourist coffee" was a complex mechanism by which coffee exported, out of quota, to non-member countries was re-exported to importing member countries damaging ICA.

⁸ Coffee consumption worldwide has risen by 1.3% p.a. in the past 15 years (Brand, 1991:30)

international trade of coffee, contradictory with “all American” values of capitalism and competitive free markets. (Bates, 1997: 153).

In terms of the new *tendencies* of capital accumulation related with what Friedmann calls “the second food regime”⁹, since the 1960s TNC’s increased their control over the coffee world market modifying the forward linkages within the food chain, setting up new vertical relations, expanding and integrating their oligopolistic control over roasting, wholesaling and retailing. At the same time a process of horizontal integration in each link took place, enlarging market share and reducing competence. By the late 1980s eight large transnational companies controlled around 51% of the world coffee trading and roasting¹⁰. (Pelupessy, 1993: 43). Besides, TNCs have increased stock market operations in the coffee stock exchanges, mainly New York and London, influencing enormously market tendencies¹¹.

By the 1980s ICA mechanism failed to continue absorbing the long-term cyclical coffee overproduction, reducing the interest and power enforcement of the system and driving it to a collapse in 1989. Three main issues contributed to this situation: first, small coffee producers’ countries, with relative cost advantages¹² and/or with sets of policies to protect producers from the effect of fluctuations in world market's prices¹³ started to gain additional shares in the world coffee production and went far beyond the quotas fixed in ICA. As a consequence, during the negotiation of 1976 and 1983 ICAs deepen political difficulties were encountered to find a consensus on prices, quotas and monitor procedures. Small exporting countries were reluctant to accept no increments in their quota exports¹⁴, while the financial burden of growing stocks became unmanageable and sells out of quota increased¹⁵. In addition the distribution of quotas according to coffee varieties was not longer supporting the demand tendencies¹⁶. Second, the increasing sales of coffee out of quota to non-producer developing countries and Eastern Europe countries made prices fall dramatically in markets out of ICA. The greater the price difference

⁹ The second food regime (1945-1973) is characterized by Friedmann as: the intensification toward highly processed standardized food together with standardization of food production (Friedmann, 1987:252) This process has been achieved through the rise of TNCs.

¹⁰ The list includes Rothfos, ED&F. Man, Volkart, Cargill, Aron, Rayner, Bozzo and Sueden.

¹¹ Stock market operations include physical and paper contracts. Buying or selling contracts in a certain moment can highly influence price fluctuations. Especially if it is considered that stock exchange prices are used as international reference prices for settling coffee contracts around the world.

¹² A group of Latin American and African countries that have relatively low labor and input costs (Brand, 1991:71)

¹³ Specially countries whose balance on current account heavily depends on coffee exports established policies, including: exchange rate measures, subsidized credit programs, inputs subsidies, extension services and the distribution of high-yield plants (Brand, 1991:25)

¹⁴ 1976 and 1983 new ICAs secured the same quota for Brazil in detriment of other producing countries. By the 1970s Brazil had lost the original share in world coffee production held in the 1960s while other producing countries, especially the small ones, had increased their production. Moreover, in 1975 Brazil lost an important share of world coffee production as a consequence of a sharp frost that caused severe damages. In the following years prices rose reaching, in April 1977, US\$ 3.38 per pound in the New York stock exchange, the highest level since the late 1940s (Brand, 1991:36).

¹⁵ While quotas were in effect, the producing countries accumulated stocks at a rate of about 10 million bags p.a. and also increased their non-quota exports by an average of 1.0 million bags p.a. (Brand, 1991:33).

¹⁶ There are two basic varieties of coffees: Arabica and Robusta. Arabica coffees have a higher quality and softer taste, and are harvested mainly in Latin America. Robustas have less quality and are mainly produced in Africa and Asia. (Pelupessy, 1993:20)

became between member and non-member markets, the less willing the importing members' countries were to accept the producing countries market-splitting operation (Brand, 1991:81). Third, quotas for high quality coffee were proportionally lower than the demand, causing supply bottlenecks and incrementing artificially their prices¹⁷, generating dissatisfaction in importers. Importers and roasters have targeted high price segments as a part of a market strategy to increase their profits. This requires the use in blends of high quality coffee, especially mild Arabicas. The demand over mild Arabica coffee, produced by Colombia and other producing countries has been growing. In fact, from the harvest 1983/84 to the harvest 1989/90 the share of Colombian mild arabica and other milds in the imports of ICA members increased from 40.7% up to 49.8%. However, the trend to high quality consumption should not be understood, as is commonly assumed, as a proactive attitude of consumers, but as a passive reaction to market strategies defined by importers and roasters¹⁸.

In 1989 ICO Council again revoked the agreement, as great differences among producers became irreconcilable. Moreover, the producers refused to continue notifying ICO of their stocks and flooded the market with accumulated stocks that sunk prices in July/August 1989. The breakdown of ICA system marks the end of the ICO regulation in the coffee food system.

In short, during the ICO-agreement period there was a gradual change in the *structures* of the coffee food system and the *mode of ordering* of economic agents influenced by the structural limitations of ICA and major changes in the *tendencies* of capital accumulation. With the debt crises in the 1980s and pressure of international financial organisations (IFOs) there was a global shifting, particularly in developing countries, toward markets' liberalisation, reduction of state interventionism over productive activities and great control of transnational corporations over agricultural production and markets. The changes in the coffee food system can be summarised as first, in the supply side, a gradual and consistent reduction of Brazilian and Colombian hegemonic position in the market and their capability to reinforce the validity and application of ICA. Moreover, the withdrawal of the governments of producing countries in their active role regulating and co-ordinating national coffee policies and in the negotiation of supplies with state-trading nations¹⁹, diminishing their bargaining power²⁰. Second, in the demand side, there was a process of concentration in the trading, roasting and retailing links of the coffee chain where a reduced group of transnational firms has extended their vertical and

¹⁷ In the autumn of 1988 the German Coffee Association expressed its concern about the ICA having the effect of restricting consumption: "The importing member countries can but feel particularly bitter about being denied access to quality coffees after small quotas have been exhausted, while the countries in the parallel market are able to import the coffee of their choice without difficulty" (Brand, 1991:86)

¹⁸ There is a tendency to exaggerate the causal significance of consumption over production, on the basis of limited and cursory analysis. This is because of the notion that varied and shifting tastes can have a major influence upon production rather than consumption being seen as a passive response to the latter's dictates (Fine, 1996:39).

¹⁹ The Instituto do Café in Brazil (IBC) fixed the total quantity to be exported each year, setting a minimum export price and buying surpluses that were not exported or sold on the free internal market. IBC had its own coffee export companies to trade with state-trading nations (Brand, 1991:48).

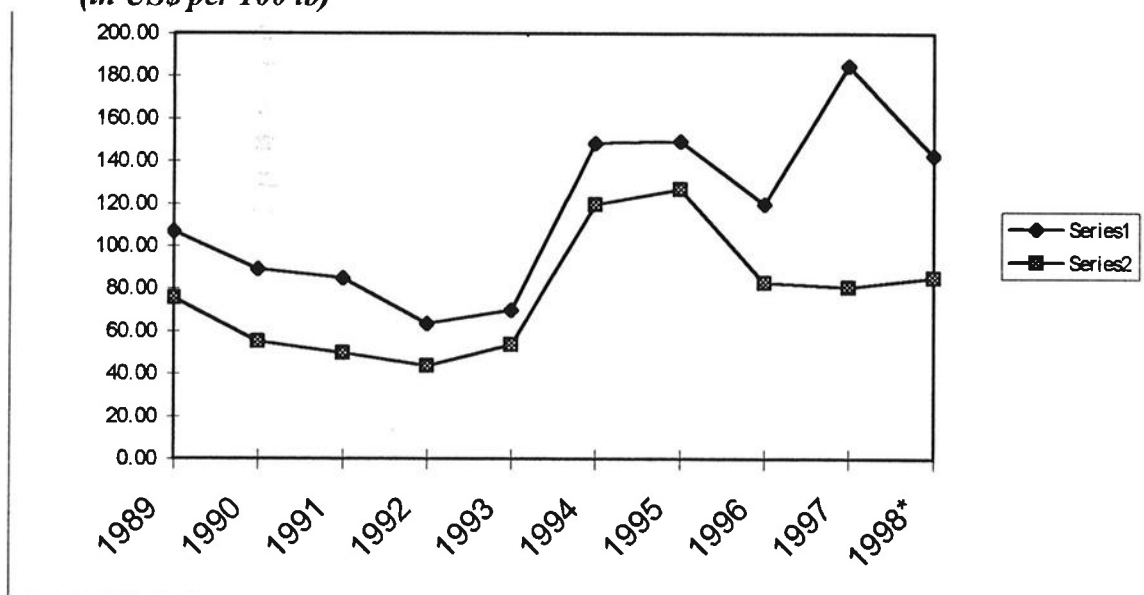
²⁰ An exception for this trend is the position of the FNC in Colombia, that still plays an important role in the co-ordination of policies tax levy and minimum price among others

horizontal links. Nowadays, seven firms import 45% of the green coffee import trade and five of them concentrate 49% of the roasted and instant coffee production (Brandt, 1991:30).

2.3 A liberalised market: 1989 until the present

In 1989, with the end of ICO agreement, prices started falling dramatically until 1993, threatening the survival of especially small coffee producers (See Chart 2) as there was a massive transfer of stocks held by producing countries to consumers²¹. Consequently, foreign exports' earnings of coffee producing countries as well as fiscal income of their governments fell to unprecedented low levels (Somo, 1994: 6). Besides, in all producing countries trends of state withdrawal from the coffee sector deepen. Marketing bodies such as marketing boards in Africa and coffee institutes in Brazil and Mexico have been replaced by private exporters. Investments in extension services, road infrastructure and port facilities have been dramatically cut. As a consequence coffee producers reduced the labour and inputs used in production. In many countries producers even cut coffee trees and replaces them by new crops²². World coffee production and quality drop progressively to levels bellow the global consumption, coffee stocks started to be absorbed by the market coming down to relatively low levels by 1993.

Chart 2: Average annual indicator prices on the New York Market (in US\$ per 100 lb)



Series 1: Other milds Arabicas Series 2: Robustas
 Source: International Coffee Organisation, September 1998
 * Prices from January to August

²¹ Producers stocks fell about 30% from over 60 million bags in 1988/89 season to about an estimated 40 million bag during 1993/94, according to the Landell Mills Commodity bulletin (Somo, 1994: 5)

²² In Brazil is estimated that 25% of all coffee trees were cut while in Colombia the FNC introduced programs to pay incentive to producers willing to uproot their less productive estates (Somo, 1994: 6)

In 1994 prices recovered up to levels of US\$ 148.53 in average, in the case of other mild arabica coffees, experiencing since then, volatile upward and downward variations. Within an inelastic coffee demand, prices of coffee paid by consumers remain relatively stable while sharp upward and downward trends are taking place in the international market of green coffee. Thus, transnational firms have increased capital accumulation and profitability in the trading and roasting operations. Changes in prices appear to be highly disconnected with supply, demand and stocks level as overall economic recession and inflation has attracted speculative capital to invade the coffee business, making the market extremely unpredictable and nervous (Somo, 1994:8)

This chapter has examined in a historical perspective the evolution of the world coffee market considered as a food system. The influence of the changes in the global tendencies of capital accumulation and the own dynamic of the economic agents (mode of ordering) and the state has shaped the structures of the coffee food system over time.

In the following chapter it will be analysed how in the last decade, simultaneously with the expansion of TNCs and the liberalisation of the coffee market, appeared what can be considered as a new mode of ordering of economic agents that try to address the severely undermined interests of small coffee producers.

CHAPTER III THE ALTERNATIVE TRADE INITIATIVE

The alternative trade initiative launched in 1988 by Max Havelaar Foundation, at a time when ICO agreements were coming to an end, emerges as an option of trading coffee for small coffee producers in Latin America and Africa. The system will, theoretically, lead to a higher share of final consumers' price by coffee growers, strengthening their position in the market. However, this new mode of ordering of economic agents that stands parallel to the mainstream in the coffee food system faces enormous challenges related with the structural constraints of the coffee market and the capacities of small coffee producers co-operatives to take advantage of the opportunities that provide to them.

3.1 The uprising of the coffee alternative trade initiative

During the last 25 years NGOs and consumer associations working in the Third World have been promoting the development of alternative trade relations between small producers in the Third World and consumers in developed countries, especially Europe and the United States, advocating a "fair trade" instead of aid. According to Max Havelaar Foundation (MH) "prices of raw materials, on which many countries in the South rely, drop systematically compared to the goods these countries have to import from the industrialised world and, at the international level, something should be done about regulations to keep the prices of raw materials at an acceptable level" (Max Havelaar website: 1998). In sum, NGOs were requesting a correction on the exchange terms for developing countries that have been enormously undermined in the past decades.

Organisations participating in alternative trade have a wide range of concerns. Some go beyond fair trade, encouraging organic production to secure the environmental systems in tropic regions, where coffee is harvested, encouraging organic production certification by specialised organisations²³, and/or appealing to egalitarian democratic ideals such as: political participation, access to communal health and educational services, child welfare, defence of indigenous cultural identity, justice, etc. (CAFEMAM Website: 1998)

In the mid-1980s, Max Havelaar Foundation (MH), a NGO based in The Netherlands sponsored by the Dutch government, initiated talks with importers and roasters to settle an alternative commercialisation system of green coffee that could allow a higher participation of organised coffee producers in the final price paid by consumers in developed countries. "The price should cover production costs and profits with which a decent life could be lived" (Max Havelaar site: 1998).

²³ SKAAL/ECO in the Netherlands, Naturland in Germany, VSBLO in Switzerland, OCIA International in the US and Canada, Byodinamic Institute for Rural Studies of Brazil and AMAE in Mexico among others.

MH established a quality mark to be promoted among the European consumers. Purchasing coffee will imply helping small coffee producers to obtain a higher share of the price paid and, therefore, improve their social conditions. The system should include basic principles to be followed:

- * To be an effective system, with a regular access of consumers, the products should become part of the regular trade, being available in every supermarket.
- * A model not based on charity but on equality and respect where the interests of producers coincide with long-term interests of consumers, traders and roasters.
- * Special attention to the image of quality and reliability and
- * Secure the accomplishment of the fair trade conditions established.

By 1986, MH started talks and consultation with importers and roasters in The Netherlands to get the “know how” and design a trade mechanism to incorporate actively organisations of small coffee producers, i.e. co-operatives, in the international coffee market. Since 1988 when Max Havelaar quality mark was officially launched in the Netherlands and presented to Price Claus, other organisations in European countries and the United States have entered in relations with small coffee producers. These organisations have united efforts and created a single register of producers’ organisations participating in alternative markets, co-ordinated by MH and denominated Fair Trade Labelling Organisations (FLO). Through MH/FLO International Register, the co-ordination of activities among alternative trade organisations (ATO’s) has been achieved, minimising the monitoring costs of the system. For example, Equal Exchange in the United Kingdom adopted the European Fair Trade pricing Formula in 1991, and has developed relations with Oxfam American, operating in El Salvador, Nicaragua, Peru, Guatemala, Tanzania, Costa Rica, Colombia and Mexico. They argue that commercial relationship should be complemented with market information, product feedback, financial support and other relevant services available according to members and observers capability (Equal Exchange, Website: 1998).

Nowadays, the fair trade system includes more than 15 ATO’s that share information and complement their monitor activities. The system operates by licensing companies who sell Fair Trade coffee and allowing them to carry special consumers’ labels such as Max Havelaar or TRANSFAIR²⁴. It is presumed that coffee purchased with this labels guarantees that it was bought directly from farmer co-operatives, that co-operatives were paid a guaranteed minimum price receiving long-term commitments from the buyers of their production and that farmers were provided with credit at reasonable rates. Moreover, that independent agency rigorously monitors the implementation of the criteria (FairTradeMark Canada: 1998).

3.2 How does MH/FLO system works?

As it was stated above MH/FLO established an International Register of producers’ co-operatives, importers and roasters willing to participate in the initiative to co-ordinate the

²⁴ Transfair is a trademark developed by a German ATO that now is jointly working in FLO Register.

operations in the system. Co-operatives, to be registered, have to fulfil the social requirements of the initiative being organisations of small coffee growers²⁵, politically independent and democratically elected. In addition, the organisations should have sufficient administrative abilities to guarantee the export of their products and to act as a reliable trading partner (Max Havelaar, 1998). Initially, co-operatives are temporally registered with the commitment to submit yearly reports about their participation in the market, financial situation and the destiny for the social premium received²⁶. The registration becomes definitive after two years when MH ensures those requirements are accomplished satisfactory. In the case of importers and roasters participating, they are small enterprises operating in Europe that are willing to fulfil the requirements of prices and conditions of the initiative.

As requested by importers, the system operates within the rules and regulations of the international coffee market, using the New York and London stock exchanges reference price indicators in the fixation of each coffee lot²⁷. Thus, importers cover from risk of abrupt changes in world market prices through hatching operations in future markets in the stock exchange. Co-operatives propose volumes, varieties, prices differentials²⁸, qualities and shipment schedules of coffee to the importers registered in MH/FLO. After mutual agreement, importers commit to purchase coffee according to MH/FLO conditions and contracts are signed. MH/FLO conditions include, paying "net cash"²⁹ a minimum price of US \$ 126.00 per 100 pounds of green coffee for arabica coffees and US\$ 106.00/100 pounds in the case of robusta coffees. When prices in the world market³⁰ overpass the minimum price, a surcharge of US \$ 5.00 is paid to co-operatives above the prevailing market price with the commitment to be invested in social projects in the producing communities. In addition, importers commit to grant credits³¹ to co-operatives for their seasonal operations up to 60% of the value of the contract, valued according to the minimum price settled. Co-operatives monitor prices in the stock exchange and send orders to importers by the time they decide to fix prices of coffee lots. Then, coffee lots are shipped to importers according to the previous schedule arranged.

Roasters registered in FLO request specific volumes, qualities and types of coffee to the importers to produce different blends which are commercialised with their own brands, adding the Max Havelaar quality mark. Retailers pay a license fee of Df 0.09 (US\$ 0.05) per 250 grams of roasted coffee to MH. It is necessary to emphasise that MH does not purchase, process or sell coffee, it only receives payments of license rights, from roasters,

²⁵ A small coffee grower is defined as the one that produces less than 24 bags of 100 lb. green coffee (30 qq parchment) and does not depend structurally of hired labor (Max Havelaar, 1998).

²⁶ The affiliation agreement signed by co-operatives commit them to invest the surcharge obtained (US\$ 5.00) in social projects in their communities.

²⁷ A coffee lot is equal to 250 bags of 69 kg. or 375 bags of 46 kg., a total of 17250 kgs. of green coffee.

²⁸ Price differentials are minus or plus values paid according to the historical quality reputation of coffees in relation to its origin. For instances Colombian coffees have the highest plus differentials in the international market.

²⁹ Net cash against a complete set of documents. Those stipulated in the contract and others commonly required in coffee trade.

³⁰ The New York stock exchange price indicator for arabica coffees and the London stock exchange price indicator in the case of robusta coffees.

³¹ All credit instruments are accepted if the amounts are available in reasonable terms for co-operatives under separate conditions in a credit contract (Max Havelaar, 1998)

to manage the quality mark and monitor producers and manufactures that are making use of it. Finally, roasters sell MH coffee to consumers through retailers and institutional clients.

3.3 Is MH/FLO system a new *mode of ordering* of economic agents?

After knowing the way that the fair trade system operates, a question arise: Which are the implications of the MH/FLO alternative trade initiative in terms of the *mode of ordering* of economic agents along the coffee chain?

MH/FLO strategy has affected the coffee chain in both the demand side, through the development of a new product in the market and in the supply side, empowering producers to participate in the markets. From the demand side, Max Havelaar quality mark coffee represents a great opportunity for relatively small importers and roasters in Europe. It is a market niche where they can have additional revenues in the context of a market highly influenced by large traders/importers. From the supply side, MH/FLO allows coffee co-operatives, which before were selling coffee to middlemen and exporters, to move forward along the links of coffee chain as they are incorporated as economic agents in the international market. Co-operatives assume the control and profits over a whole range of activities that traditionally were in the hands of middlemen and exporters such as: coffee parchment drying, storing, transport, hulling, grading and export of green coffee. Consequently co-operatives' members are supposed to obtain a higher share of the final consumer price; having gained access to new sources of information of market tendencies, improving their bargaining position and increasing their capability to take accurate decisions in relation to coffee marketing. Moreover, they access credits at lower interest rates spreading the risk of their financial operations.

3.4 Relevant features of MH/FLO fair trade system

3.4.1 Market Share

Yet, it has been showed the way by which the MH/FLO system has changed the mode of ordering of the economic agents in the coffee food system. However, the expansion of MH brand market share faces structural constraint considering the oligopolistic position of economic agents that control the trading and roasting of coffee as it was explained in the last chapter.

According to MH/FLO, nowadays, 250 co-operatives in 17 developing countries³² are part of the Register and 13,103 tons of roasted coffee was commercialised with Transfair and Max Havelaar brands in 11 countries in Europe³³, Japan and Canada in 1997. For this purpose, MH has developed a market strategy targeting "ethical consumers" who are willing to pay, in some cases, higher prices for each bag of roasted coffee. The share of MH brand varies from country to country depending on the years of introduction of the

³² Tanzania, Zaire, Uganda, Cameroon, Mexico, Guatemala, El Salvador, Honduras, Nicaragua, Costa Rica, Dominican Republic, Haiti, Venezuela, Colombia, Bolivia, Peru and Brazil.

³³ The Netherlands, Belgium, Switzerland, Denmark, France, Germany, Austria, Italy, Luxembourg, Great Britain and Sweden.

seal and the relative awareness of consumers of the aims of the initiative, among others reasons. However, after an initial rapid expansion, in the first years, market share seems to be reaching the edge. For example, according to surveys overtaken by the Marketing Division of MH/FLO, 84 % of Dutch citizens recognise MH brand. Only 13-14% buys it occasionally and in 1997 the brand shared 2.65% of roasted coffee market in The Netherlands after 10 years of introduction. In Switzerland the market share of the initiative reaches 3.19% while in the European countries participating it is 0.87%, in average³⁴. Small roasters and MH/FLO have limitations to finance strong promotion campaigns of the brand in the media and they have a relatively weak relation with retailers (especially supermarkets). All this constrains enormously the possibilities for expanding the market if it is compared with the opportunities that large traders and roasters, which they compete, have in term of access to funds and experience in the business. For this reason, MH wants to strengthen their relations with buyers in the retail level, establishing close relations with the hierarchy of retail commerce to improve the opportunities for certified products, promoting their rotation and reducing margins.

3.4.2 Price paid to coffee producers under MH/FLO system

Despite, the relative small share in the consumer market of MH/FLO coffee brands, in order to assess the fair trade initiative, one question has to be answered: Do coffee growers obtain higher margins when they participate in the alternative system of trade?

Chart 3 shows the average prices received by arabica producers, during 1997, considering the average monthly spot price of the New York stock exchange for normal markets and the average prices received by co-operatives participating in MH/FLO as registered in the system (1 Green Coffee FOB Price). In addition there has been considered estimations of costs for Costa Rican producers calculated by MH/FLO. These costs includes the second processing margins (2), encompassing operations from farm gate to the port including costs of transport, bags, standardised drying, hulling, grading, costs in port, communication, financing and administration for export of green coffee. Then, first processing and farm costs (4), which includes depulping, maintenance and harvesting costs. Considering this cost estimations it has been calculated Gross ex-farm price (3) and the net margin for coffee growers' (5).

³⁴ Information obtained through interview with Max Havelaar Staff members in 1998 and different reports facilitated by them.

Chart 3: Prices of Normal and Max Havelaar 100% Arabica Coffee in 1997
(in US\$/per 100 lb. of coffee)

	ITEM	NORMAL MARKET	MH/FLO MARKET	DIFFEREN CE
		Value US\$	Value US\$	Value US\$
1	GREEN COFFEE FOB PRICE	184	189	+5
	Minus			
2	2nd PROCESSING MARGINS	43	37	-6
3	GROSS EX-FARM PRICE	141	152	+11
	Minus			
4	1st PROCESSING AND FARM COSTS	75	75	0
5	NET MARGIN FOR COFFEE GROWER	66	77	+11

Source: MH/FLO Register, 1998 and own calculations (For details see Annex 1)

According to our own estimations, coffee growers organised in co-operatives participating in the MH/FLO market obtain in average US\$ 77.00 per bag of green coffee (5 NET MARGIN FOR COFFEE GROWER), US\$ 11.00 more than producers in normal markets. In detail, co-operatives that receive the US\$ 5.00 surcharge, obtain in average US\$ 4.00 more per green coffee bag (US\$ 1.00 is lost due to fluctuations in the market) and US\$ 6.00, that correspond to the profits gained by exporters in the normal market, now are saved and transferred to producers as co-operatives assume the 2nd processing activities.

3.4.3 Long term agreements and handling of stocks.

The principles of MH/FLO alternative trade initiative states that co-operatives would be granted with long-term agreements with their partners, importers and roasters. Nevertheless, even if the co-operatives have the guaranty to receive prices according to MH/FLO conditions; volumes, schedules and price differentials conditions in the contracts are usually signed in a yearly base and some co-operatives have expressed their concern about the late settling of schedules and signing of contracts. When schedules shipments are settled, usually conflicts arise. The ideal shipment time for producers frequently does not correspond with the demands of importers. If the importers request for more separate shipments co-operatives have to store coffee, increasing their storing and financial costs and loosing competitiveness in the market. However, importers argue that yearly contracts and agreements are beneficial not only for them but also for co-operatives, as they are not tied to a single importer. From the point of view of the importers, the development of a trusty and long term relations is based on the previous success of both sides to accomplish with requisites of quality, shipment schedules and credit facilities.

3.4.4 The competitiveness of coffee co-operatives

In Central America, and particularly in Honduras, some co-operatives have higher operational costs in exporting services and comparative less experience than other economic agents (middlemen and exporters) undermining their possibility to compete in the local market. Paradoxically, these problems are more evident when the international prices overpass the minimum price settled in MH/FLO initiative. In the following paragraphs it will be explained in detail how international price fluctuations, higher service costs and a lack of knowledge of the international coffee market are interrelated affecting the co-operatives competitiveness.

Co-operatives participating in MH/FLO initiative are the so called "marketing" co-operatives that taking advantages of economies of scale organise their service in the form of joint selling combined with a parallel operation for granting credit to their members on the security of the coffee which they have provided (Chayanov, 1991). For co-operatives, coffee delivered by members remains member's property, throughout the whole time when it is handled by the co-operative. Co-operative marketing means precisely the joint marketing of coffee by its members, not to trade in the sense of buying for the purpose of subsequent resale because it might expose co-operatives to the risk of losses (Chayanov, 1991:127). Thus, even if there is a minimum price guaranteed in MH/FLO conditions, when international prices overpass this level, co-operatives' members assume the risks over the final price they will receive as the co-operative operate as a commissionist.

3.4.4.1 Higher prices in the international market

Soon after ICA agreements breakdown, in 1989, international prices drop and remained low and stable up to 1993. During this period prices for arabica "other milds" coffees, produced in Central America, were less than US\$ 95.00/100 lb.³⁵ However, coffee co-operatives participating in MH/FLO received higher prices as they could achieve the benefits of the minimum price settled (US\$ 126.00³⁶) under the alternative market. In this circumstances they had a clear advantage over local middlemen and exporters as the guaranteed higher prices to their members and remained out of speculative market operations. During 1994 prices raised dramatically from US\$ 77.21 in January up to US\$ 220.10 by September (more than \$US 142.00). Paradoxically when the international prices overpassed the "minimum price", co-operatives were suddenly exposed, at the national level, to a higher competition of middlemen and exporters. Co-operatives had higher costs due to, in many cases; inadequate infrastructure available and irregular access to credits, if compared with middlemen and exporters. Further, at the international level, in a context of great instability in prices (See chart 4), co-operatives with relatively little knowledge of and access to market information and the major variables that affect it have faced difficulties and uncertainties to participate in international markets and decide the proper moment for price fixation because of the complexity of price fixation mechanisms.

³⁵ Contract "C" New York stock exchange FOB price for other mild arabicas coffee.

³⁶ Minimum FOB Price for Central American countries under MH/FLO initiative

**Chart 4: ICO Average annual indicator prices of the New York Market
1979 ICA AGREEMENT BASIS**

HIGHER AND LOWER MONTHLY PRICES FOR OTHER MILD ARABICAS

YEAR	OTHER MILD ARABICAS			
	AVERAGE	HIGH	LOW	DIFFERENCE
1989	106.96	149.5	67.76	81.74
1990	89.15	94.92	75.83	19.09
1991	84.97	93.72	75.11	18.61
1992	63.64	77.46	52.42	25.04
1993	69.91	80	56.88	23.12
1994	148.53	220.1	77.21	142.89
1995	149.30	178.22	103.99	74.23
1996	119.89	128.56	109.38	19.18
1997	185.02	264.5	131.83	132.67
1998*	142.81	175.87	113.86	62.01

Source: International Coffee Organization, and own calculations
September 1998

* Prices from January to August

3.4.4.2 Higher operational costs

At the national level, as normal and “alternative” prices get closer, middlemen and exporters with more experience and probably lower costs of transport, banking and processing offered more competitive prices. Co-operatives face, then, problems related with infrastructure availability and management criteria, which turn into relatively higher transport, storing, processing and banking costs reducing their possibilities to compete.

3.4.4.3 Lack of knowledge of the international coffee market

As prices overpassed MH/FLO minimum price co-operatives started to operate within the framework of market operations with stock exchange price reference. In addition, the great instability in coffee markets challenged co-operatives to take fast decisions, regarding price fixation, to remain competitive. Price fixation entails a very complex procedure, importers have for instances three or more generations of expertise in the business. This situation has brought up the limitations of management skills of coffee co-operatives and the importance of communications infrastructure to keep updated with market trends.

Inadequate price fixation can affect coffee co-operatives participating in international markets. For instances, an *anticipated fixation* while prices show an upward trend in the market and co-operative members have not completely delivered the physical coffee may lead members to divert coffee to middlemen and exporters who offer higher prices. As a consequence, co-operatives running short of stocks are forced to abandon their role as

pure commissionist and they have to buy coffee from members and non-member producers, to accomplish the contracts with importers, even at higher prices. Some co-operatives fail to ship all the coffee lots agreed with importers under contracts. Even if official data is shrouded, on this matter, importers, roasters and MH/FLO Register have recognised this critical issue and the possible damage it could cause to the credibility of the alternative system. Importers affirms that during the last 4 years (1995-1998) co-operatives have failed to send thousands of coffee bags resulting in lost of important amount of money as they have been forced to buy coffee in the international market at higher prices to cover deliveries to roasters³⁷.

On the contrary, in a *late fixation*, while world market prices show a downward trend, co-operatives who do not have a periodical access to market information and that have a sporadic contact with importers when dealing with orders of price fixation, may end fixing at very low prices. Consequently, members receive lower ex-farm prices damaging the credibility of the co-operative business. Moreover, in some cases members face indebtedness with the co-operative as cash advances received per bag overpass the final price, reducing co-operatives liquidity and its capability to compete in the coffee business.

MH/FLO monitor system and importers have been urging co-operatives to take concrete steps to improve this conflictive situation. Two measures have been proposed by MH/FLO in the last Regional Assembly of Latin America held in Costa Rica on July 1998. First, the development of an assistance network to monitor more closely co-operatives and give assistance in the market activity and second, the creation of a financing fund for new and old co-operatives participating in the system to access fluently to credits that importers are not willing to facilitate.

In sum, MH/FLO initiative has been able to modify the *mode of ordering* of economic agents in the coffee chain, connecting small coffee growers co-operatives with relatively small traders and roasters. Even if there is a predominance of an oligopolistic structure in the world market, MH/FLO has positively affected the share of profits among economic agents. Although, problems related with the business expertise and competitiveness of co-operatives are putting in risk the entire system and urgent measures require to be assumed by all partners.

However, until now there is not a detailed and precise knowledge of the situation, the level of farm-gate prices that members of each co-operative are obtaining and the specific causality of major variables such as the level of management skills and the size of producers organisations. Considering a survey developed in Honduras a study case of the dilemmas of coffee co-operatives in alternative markets are analysed in Chapter IV.

Considering the fluctuating environment of the market and the capabilities of the producers' organisations, it has become increasingly important to understand first, to what extent do members of coffee co-operatives have benefited from the opportunities of MH/FLO alternative trade initiative, if compared with other non MH/FLO coffee co-

³⁷ Explain the importers covering system.

operatives operating in Honduras and single producers. Moreover, to determine how the relative success of MH/FLO coffee co-operatives is correlated with their management skills and size. For Honduran coffee co-operatives that started participating during the harvests 1994/95 and 1995/96 in MH/FLO initiative, the situation seems even more difficult as they entered when a strong market competition was prevailing and they could not enjoy the previous period of low risks and higher relative prices (1989-1993).

For a better understanding of the environment in which Honduran coffee co-operatives under MH/FLO register operate, the next chapter will provide: a brief background of the Honduran economy, a summary of the Honduran Coffee sector stressing its macroeconomic relevance, the institutional framework and the characteristics of coffee producers and co-operatives.

CHAPTER IV: THE HONDURAN COFFEE SECTOR

Considering the importance of the comprehension of the historical context in which co-operatives have developed, in this chapter it will be analysed the socio-political context of the Honduran coffee co-operatives participating in MH/FLO system. Co-operatives can not be defined as a homogenous category as they differ in terms of the forces behind their creation, their level of autonomy and their internal social and economical organisation. Further, among other reasons, the historic role of the state in the co-operative movement, the social and institutional framework in which co-operatives are functioning and the contribution to the overall economy of the productive activity in which they are embedded represent key elements for the understanding of the performance of coffee co-operatives.

4.1 Introduction

The development of coffee production in Honduras is inextricably interwoven with its economic and social history. The country has experienced two strategies of development: *the economic enclave model (1880s-1950s)*, characterised by the predominant influence of the foreign capital in mining and banana production; and *the diversified agrarian model (1950s-1990s)*, when a gradual process of diversification in exportable agricultural products took place.

4.1.1 1880s - 1950s the economic enclave model:

In 1876, the creation of the Rosario Mining Company, marked the beginning of the economic enclave era in Honduras as the raising national oligarchy, in formation, strategically allied with foreign capital investors to assure a relative political and economic stability after decades of deep uncertainty, since the independence from Spain in 1821. By 1900s, the process of international capital accumulation in Honduras was accelerated, in the northern coast, with the settlement of enclave economies of US banana companies. They were granted with great concessions, liberalised from paying taxes for all inputs required for production as well as for exports. Through the first half of the twentieth century the mining and banana companies assumed an important role in the political and economical life in Honduras, diversifying their operations in industry and service sectors, including packing and plastic's industries, palm oil production and processing and banking services among others. In addition, the labour migration to enclave regions accelerated a historic and chronic scarcity of labour in other regions. The extractive pattern of the enclave economy deepened the rooted underdevelopment of vast regions of the country that had remained practically isolated and disconnected from the capitalist development and the external markets, due to the lack of an appropriate infrastructure system inherited from the Colonial period. Therefore, rural communities, located in the mountainous regions, continued with an agricultural production based on food crops for self- sufficiency with sporadic trade relations. In addition the absence of a strong local oligarchy, that could encouraged the agricultural production for local and external markets and the relative scarcity of labour

due to the existence of a significant population of small peasants owning their land, and not forced to become proletarianised labour, emphasised this pattern (Baumeister, 1990).

4.1.2 1950 - 1990s - The diversified agrarian model.

Honduras did not remain isolated from the process of “agriculture modernisation” that became a mainstream in the world during the 1950’s and that commonly is denominated as “the green revolution”. The international financial institutions promoted a significant restructuring of the institutional apparatus of the state to provide an appropriate framework for the development of modern capitalist agricultural production linked to export markets. For the first time, there was a possibility to undertake a serious program of diversification of the national agricultural production in an attempt to incorporate other regions to a capitalist development. However, production diversification for export markets was promoted and implemented, especially in valley areas by large farmers. Sugar cane, cattle and cotton were the main crops introduced. Infrastructure investments took place improving the network of roads and credit lines were available to finance production activities. Meanwhile, small-scale cattle ranching and coffee production were the two main sectors that expanded in mountainous regions controlled by small producers. During the last 40 years coffee production spread as a way to link peasant economies with commoditized markets becoming nowadays the most important agricultural product for the Honduran economy.

4.2 Honduras: a late comer in the world coffee market

Honduras, is a late comer in world coffee production, starting to produce significant amounts of coffee since the 1960s. Nevertheless, it has gradually become a major agricultural export income for the national economy. The expansion of the coffee sector was encouraged by the relative improvement of the infrastructure system that before the 1950’s was practically non-existence and that pushed vast communities in the Western areas to trade with their neighbours countries, Guatemala and El Salvador.

In the 1950’s Honduran coffee production shared less than 1% of the world production, raising by 1990 up to 2.02%. Coffee production in terms of volume, areas cultivated, productivity and number of producers increased. However, coffee production with low technology remains and an expansion rather than a significant growth in productivity explain most of the production growth. (Chart 5)

Chart 5: Expansion of coffee production in Honduras. Main features

Description	1974	1989/1990	Percentage of increment.
Coffee area cultivated (hectares)	81,060	171,920	112
Total production (green 60 k.bag)	706,253	2,042,783	189
Productivity per hectare	8,71	11,88	36
Share of Central American production	9.2%*	17.0%	84
Number of producers	40,000	66,524	66,3

* Data of year 1969-71

Source: Baumeister, 1990 and own calculations.

Moreover, the extraordinary incomes during the coffee boom in 1975/76³⁸, stimulated producers to invest in new areas and to introduce to some extent chemical inputs (fertilisers and pesticides). In addition, during the 1980's the governmental Honduran Coffee Institute (IHCAFE) invested in the development of infrastructure, mainly roads, in the coffee production areas and introduced a credit and assistance program, targeted to small and medium producers³⁹, to renew coffee plantations.

4.3 The macroeconomics contribution of the coffee sector

Coffee production has gained an important role at the macroeconomic level and in the overall performance of the Honduran economy that can be summarised as follows:

Hard currency generation. Since 1995 coffee became the first source of hard currency income for Honduras generating US\$ 349.3 millions representing 32% of total exports displacing banana production (Banco Central de Honduras, 1995: 55). In addition, coffee generates an even higher net currency entrance due to the low import dependence coefficient of its production if compared with other main agricultural sectors.

The tributary contribution. During the 1960s and 1970s coffee was a major source of export taxes income for the government, sharing around 60-70% of total export taxes (Euraque, 1996:19). During the early 1990s taxes were cut due to the drastic fall of the international prices. However by 1995 as international prices recovered, coffee exports shared 42% of export taxes income of Honduran government (Banco Central de Honduras, 1995: 66).

Economic activity. The coffee production, commercialisation and exporting activities are spread in 14 of 18 provinces in the country, including remote rural communities. Moreover,

³⁸ Dramatic reductions in world supply and increment in prices as a result of a sensitive reduction in the supply caused by the Brazilian frost.

³⁹ Coffee producers with less than 3.5 hectares representing a 76% of the whole producers (IHCAFE 1988)

small producers that have a low-income level and a higher spending coefficient, contribute to the growth in consumption and accelerate the development of other economical sectors.

Employment. Coffee activities employs around one quarter of the labour force in the agriculture sector (IHCAFE, 1988).

4.4 Characterisation of the Honduran coffee sector.

In Honduras, coffee production is widely spread, 85.8% of the agricultural units produces food crops combined with coffee and cattle production. Coffee accounts for 39% of the total land available for agriculture and is largely developed in small plots with a low productivity per hectare⁴⁰. In 1988, 41.7% of coffee producers had less than 2 hectares of coffee in farms with an average size of 10.5 hectares and producing only 6.2% of the national production. Then, 54% of the production was concentrated in 33,872 small and middle coffee growers planting between 2 and 10 hectares of coffee, which is considered the most dynamic group of coffee producers in terms of their expansion in production (Baumeister, 1996). (See Chart 6)

Chart 6: Distribution according to size of the number of coffee farms and production in Honduras

1988	NUMBER OF COFFEE FARMS		PRODUCTION 46 kgs. green coffee bags			
Range in coffee ha.	Farms	%	Acumul. %	Volume (thousands)	%	Acumul %
0.0 - 1.0	13,189	19.9	19.9	24.4	1.3	1.3
1.1 - 2.0	14,515	21.8	41.7	94.6	4.9	6.2
2.0 - 5.0	22,933	34.5	76.2	485.8	25.1	31.3
5.0 - 10	10,939	16.4	92.6	576.9	29.8	61.1
10.0 - 20	3,791	5.7	98.3	445.3	23.0	84.1
20 +	1,157	1.7	100.0	306.6	15.9	100.0
TOTAL	66,524			1,933.6	100.0	

Source: Baumeister, 1996

Honduras produces "other milds" arabica coffee which grows between 800 to 1,300 meters of altitude. Coffee is harvested yearly from October to March⁴¹. In the case of small and medium producers, coffee cherries are depulped using the so-called "wet method" (small machinery with a constant flow of water). The parchment (silver coffee) and mucous-

⁴⁰ In average 2.8 hectares per unit (IHCAFE, 1988)

⁴¹ The period may vary according to the height where coffee plantations are located.

covered beans are then placed in fermentation tanks for twelve to eighteen hours, which dissolves the mucous. Then, silver coffee is dried and stored or directly shipped to the processing-exporting firms. Coffee producers sell silver coffee, according to their individual drying facilities; wet, semi-dried or completely dried⁴² to middlemen. Middlemen operating in municipalities partially or fully complete the drying process. Then, exporting firms standardise the humidity level of silver coffee, remove the parchment cover (hulling), grading and packing green coffee for export mainly to large transnational corporations. Eight percent of the national production is transferred to national roasters to be processed for the local market.

Coffee is produced in remote mountainous areas with inadequate roads and communication infrastructure. Moreover, in many cases coffee plots are far away from the villages and sometimes with no road at all. In this context, middlemen, in co-ordination with exporting firms, establish strong patronage-client relations with coffee producers, specially small and middle, that go far beyond coffee commercialisation and provision of finance resources. Middlemen control transport channels, food grain commercialisation and inputs provision. Under this conditions producers have a relative weak bargaining position and a narrowed access to the market. Thus, in Honduras, from the local based producers to the national and international consumers, coffee structure is mainly controlled by a reduced group of economic agents and characterised by a pyramidal structure, meaning that as one goes forward from the production to the commercialisation less agents intervene. By 1989, 66.5 thousand farms were located in 14 of the 18 provinces, 19.3 thousand middlemen were operating in the municipalities and provincial capitals and 42 exporting companies were located mostly in San Pedro Sula city, 6 of them controlling more than 43% of the operations (Baumeister 1990:38).

4.5 Organisation of coffee producers and co-operatives formation

In 1967, the Honduran Coffee Producers Association (AHPROCAFE) was founded. Rather than an authentic organisation of coffee producers, AHPROCAFE was created as part of a top-down manoeuvre of the governmental "Coffee Office" to legitimate a set of policies for the coffee sector and to have a loyal "coffee producers" representation in ICO Council and other regional forums. Moreover, the Honduran government, as in many other Latin American countries, intervened in the agricultural sector encouraging the organisation of marketing co-operatives providing credit and initial capital diminishing the strict autonomy of the peasants as producers and sellers. The co-operative system was attractive to the State because it avoids a head-on clash with the peasantry (Worsley, 1971: 32). Therefore, from 1968 to 1971 the Coffee Office and AHPROCAFE jointly promoted the creation of coffee co-operatives, strengthening the already existing to develop a project of a second level exporting firm denominated "Honduran Coffee Co-operatives Federation" (FEHCOCAL). In 1971, FEHCOCAL started its exporting activities. Being a highly induce project, the lack of an adequate social and administrative structure, inexperience in coffee exportation business, corruption and speculation in a context of an unstable international market⁴³ ended in a

⁴² In average a size of 2.8 hectares per unit and a productivity of 582 kgs. per hectare, the lowest in Central America (IHCAFE 1988).

⁴³ FEHCOCAL operation coincided with the 1975/76 international coffee boom.

bankruptcy. This situation harmed the economic stability of the whole co-operative system, as many of the co-operatives suddenly could not receive the payments from the coffee exported. Besides, this experience severely damaged the possibility to promote and expand the co-operative movement in the long term.

Only by the mid-1980s, AHPROCAFE leaders made a revision on its internal regulations introducing grassroots and middle structures to articulate the organisation. Local and provincial boards were created seeking to decentralise activities increasing the participation of coffee producers. Simultaneously, coffee co-operatives were affiliated with the same voting rights of local boards. Moreover, by 1988 coffee co-operatives leaders gained seats in AHPROCAFE's national board of directors reactivating the commercialisation and exporting project. On year later, AHPROCAFE and coffee co-operatives developed an exporting branch: DICOMCAFE. The irruption of DICOMCAFE in the coffee sector allowed single coffee producers and co-operatives to export directly without the participation of middlemen and exporting firms moving forward in the control over links of the coffee chain. With the slogan "each producer an exporter", after three years of operation DICOMCAFE became the third national exporting firm, building a main exporting facility in San Pedro Sula City and four middle processing centres. DICOMCAFE went even far away from reshaping the national commercialisation chain; it also constituted new links at the international level with European coffee importers through the Max Havelaar Fair trade organisation, based in The Netherlands.

In 1992 DICOMCAFE faced scarcity of liquidity and an increasing financial burden, as AHPROCAFE members did not used the whole installed capacity of the regional processing centres, showing the weakness of the organisational structure of AHPROCAFE. In addition co-operatives and single producers, instead of investing in the firm, received dividends as part of political decisions of AHPROCAFE. After a severe internal crisis, DICOMCAFE shifted their activities moving from purchasing operations to a processing-export service arrangement with coffee co-operatives to export to normal and fair trade markets. DICOMCAFE sold the regional processing centres to co-operatives and private companies and modernised the final processing equipment in San Pedro Sula. Moreover, co-operatives invested resources in DICOMCAFE, as shareholders, improving the financial situation of the company and its capacity to provide the exporting service. Consequently, the co-operatives individually assumed the risk and control over their financial operations that before were carried out by DICOMCAFE.

4.6 The coffee co-operative sector

Co-operatives are social organisations that introduce **economies of scale**, specialising in joint non-direct agriculture activities⁴⁴ such as: input provision and output trade in a backward/forward integration and risk sharing. While some authors refers to this kind of co-operatives as "service co-operatives" (Deininger, 1993), others call them "marketing co-operatives" (Chayanov, 1991, Worsley, 1971, Alcantara, 1974) and nowadays they are also identified as agricultural enterprises in a contract farming system Wilson, 1996). The fact is that co-operatives can develop a contract farming modality according to a "dual" character,

⁴⁴Ruben refers at this concept as economies of scope.

both as economic enterprise and as a social organisation where efficiency and participation require equal attention (Ruben 1997:75). According to Wilson (1996:470 cited by White, 1997:102) contract farming is a particular way of linking commercial agro-production and agro-industry in which primary production is not concentrated in large capitalist (or socialist!) production units but remains in the hands of "small holders", linked institutionally through contracts to larger "nucleus" enterprise which handles one or more of the upstream and downstream activities such as input supply, output processing and market.

Marketing has been the leading function of Latin American agricultural co-operatives. States promoted the creation of marketing co-operatives considering an intervention in the agricultural sector to obtain the capital needed by the State to the modernisation not only of agriculture but also of the whole society via the development of industry. At the same time, ideological influence could be more easily exerted via the network of communication and control represented by the co-operatives under State control or influence (Carroll, 1971:203). Therefore, co-operatives have been always threatened by the possibility to be controlled by the state and the development of autonomous co-operative movement has been blocked directly and indirectly by state institutions.

In the case of Honduran coffee co-operatives, during the late 1960s and the 1970s co-operatives represented an opportunity for governments to reduce friction in the countryside and exert a certain degree of control over coffee growers. Gradually during the 1980s new co-operatives were created improving their political influence in local and national boards of the Honduran Coffee Producers Association (AHPROCAFE) and the coffee exporting division created, DICOMCAFE. As DICOMCAFE transformed in a service firm, co-operatives have been improving their control over the activities relate with the coffee chain and assuming a new role in the relations with MH/FLO initiative.

However, the strong patronage-client relations in rural communities where coffee is produced constitute a great challenge for co-operative organisations. Co-operatives more than a successful business related with coffee marketing requires developing a social network in the communities that can replace the paternalist role of middlemen. Middlemen are powerful economic and social agents in the communities, in a context of high levels of illiteracy and poverty. They usually own transport facilities and control the markets of inputs and food grains providing usury credits. Middlemen are also in many cases local political leaders of the traditional parties. Therefore, the introduction of marketing co-operatives, when middlemen are already well socially entrenched and supported by national exporters, can also be extremely difficult. Many co-operatives have faced failures due to the impossibility of properly replace the services that middlemen provide to small coffee growers embedded in social network relations. For a small producer already engaged in relation with middlemen it may be extremely difficult to overcome the firm ties with middlemen and incorporates in co-operatives. Some produces may be highly indebted and may depend on middlemen not only in the commercialisation of their crops, but also as providers of cash advances and transport of goods and even of ill children to the nearest health centre. Even if the co-operative may seem a clear option to obtain higher prices for their production it may not cover the whole range of services provided by middlemen. For instance, the majority of the Honduran coffee co-operatives do not have their own transport

facilities reducing the possibility to provide an adequate service to producers and displace middlemen. Furthermore, some co-operative members after several years participating in a co-operative still do not sell all their coffee to their co-operative keeping relations with middlemen in the communities (Survey of co-operatives in Honduras, 1998) Then, coffee co-operatives in many cases face not only the challenge of being competitive agents in the coffee business but also to operate in the complex social network of the communities replacing the services provided by middlemen.

In the last decade, the Honduran coffee co-operatives have attempted to enhance the position of the producers through the participation in international markets under the MH/FLO initiative. This process has faced the opposition of middlemen and exporters that have lost a portion of their markets and, at same time, the internal opposition of some groups of coffee producers as part of a complex process of reorganisation of the sector. In November 1997, 25 co-operatives that were exporting, through DICOMCAFE, to traditional and alternative markets created the Honduran Coffee Co-operatives Central (CCCH), a second level co-operative organisation. The CCCH co-operatives includes more than 3,000 producers that represents around 4% of the total farmers in Honduras and as a whole exported during the harvest 1996/1997 67,500 bags of 46 kilograms of green coffee that represents 2% of the national production. (Interview with the President of CCCH, 1998)

4.7 The institutional framework

The Honduran Coffee Institute (IHCAFE) is the national institution in charge of the co-ordination of policy implementation for the coffee sector. It was created in 1972, during the populist military government of Oswaldo Lopez Arellano⁴⁵, substituting the previous "Coffee Office". As in other producing countries, IHCAFE policies were part of an increasing prominent role-played by the State in the economy. Its activities includes the supervision of exporting operations, assignment of internal market quotas, periodical information of market prices and provision of technical assistance and training services. However, the export and roasting activities remain under control of private firms. The funds to finance the budget of IHCAFE come from an export tax denominated Export Certificate. From every 46 kgs. bag of green coffee exported the government charges L. 10.00 (US\$ 0.75) and transfers L.7.00 (US\$ 0.52) to IHCAFE. During last season 1997/98 2.8 million bags were exported and around US\$ 1.5 millions were transferred to finance IHCAFE budget⁴⁶ (La Prensa, February 3, 1998).

Delegates of the government⁴⁷, AHPROCAFE, the roasters association and the exporters association integrate the IHCAFE board of directors. In the process of policy formulation and implementation that takes place in IHCAFE, the divergent interests of the government, national roasters, exporters and producers are reproduced at the moment of defining policies for the sector. Even if the Honduran coffee growers finance entirely the budget of IHCAFE,

⁴⁵ Oswaldo Lopez Arellano was President of Honduras from 1971-74, coming to power as a result of a pacific coup d'etat, developing a populist government co-opting popular organizations and expanding the sphere of the state to productive activities.

⁴⁶ The rest of the Export Certificate tax is transferred as follows: L.1.00 (US\$ 0.08) per coffee bag exported is transferred to AHPROCAFE and L.2.00 (US\$ 0.15) to coffee producing municipalities to finance local infrastructure in coffee producing areas.

⁴⁷ Representatives of the Finance, Treasury and Natural Resources Ministries.

historically AHPROCAFE delegates have showed a weak negotiation position as their leaders have been influenced and manipulated by strong interest of roasters, exporters and the government. Nevertheless during the second half of the 1980s, as AHPROCAFE was restructured and co-operatives leaders were incorporated, the organisation started campaigning for the privatisation of IHCAFE as the state withdrawal from the economy in other productive sectors, as part of the liberalisation policies introduced during the 1980s. AHPROCAFE leaders argued that IHCAFE has not played its role adequately, denouncing bureaucratic practices and corruption. Therefore, they proposed a transferring of its activities to Ministries of the national government and a rapid liquidation of its assets⁴⁸.

One of the central issues related with the national coffee policy is the imposition by law of a compulsory fixed price of the internal consumption (IC) coffee. Exporters, under supervision of IHCAFE, transfer 8% of the coffee produced in Honduras to national roasters and pays a lower price to producers. Since 1976, when prices of green coffee in the international market rose above US\$ 300 per 46 kgs bag of green coffee the Honduran government decided to establish a lower price for coffee for internal consumption (IC) of L. 130.00 (US\$ 65.00) transferring the reduction to producers and creating a system of quotas for the national roasters. An oligopoly of roasters (2 firms control more that 90% of the market) has enjoyed for more than 20 years a captive market. The great lobby of the roasting companies has allowed the system to continue. Roasters finance exporters to have the initial capital to begin the seasonal cycle of exports. In addition the government manipulates the issue and gives a great importance to coffee price arguing that is a crucial product of the basic food entitlement of Hondurans. Nowadays, even if coffee prices in the international market drop producers still receives far lower prices for IC coffee, while there has been a process of devaluation and prices have not been adjusted. In 1995, after great pressures of coffee producers the IC price was incremented to L 500.00 (US\$ 53.00) and then in 1997 it was again incremented up to L. 700.00 (US\$ 53.00)⁴⁹ It estimated that roasters had profits of L.96 million (US\$ 10.13 millions) with net margins of 42% over costs during 1995 (Lara Hurst, 1995). As low quality of coffee is not suitable for export, the Honduran population consumes a very bad quality of coffee. Moreover, as the prices of roasted coffee are higher in neighbour countries, Honduran roasted coffee has been smuggled to neighbour countries where is better paid.

However, there is a lot of misinformation to the public about who pays the indirect subsidy of IC coffee. An article in a national newspaper this year affirms: " Thanks to an state subsidy the coffee was during many years the only product which price did not increased in the middle of a great inflation that Honduran suffered during the last governments" (La Prensa, February 3, 1998, my translation)

⁴⁸ The proposals of coffee producers have varied over time since the mid-1980s. However the have basically asked that the supervision of exports, statistics and the international representation should be transferred to the Minister of Economy while the technical assistance and extension services should be undertaken by the Minister of Agriculture.

⁴⁹ Due to the process of devaluation in Honduras, even if the prices of IC coffee were incremented they represent the same value in Lempiras (Honduran currency). In 1995 US\$ 1 = L. 9.47 and by 1997 US\$ 1.= L.13.00 (Banco Central de Honduras, 1998)

Other important issues of the national coffee policy that affect producers, especially the small ones organised in co-operatives are:

* The restrictions to small coffee co-operatives to obtain export license. In 1993 the commercialisation regulations of IHCAFE required a minimum export of 500 bags of coffee for each co-operative and request to own equipment to process coffee for export (hulling and grading of coffee). Therefore, co-operatives of small producers that have been exporting using the export service of DICOMCAFE have not been allowed to export with their own names. This situation complicates the process of credit provision by national banks and traders to co-operatives as the export documents are officially granted to DICOMCAFE.

* The inadequate location of the majority of export firms in San Pedro Sula city in the north of Honduras, close to the export port, but very far away from the main producing regions. As coffee is transported in many cases as wet parchment and there are not suitable transport facilities, coffee parchment suffers damages during the transport that affects the quality of Honduran coffee. In the international market Honduran coffee has been punished in an estimated US\$ minus 4.00 differential from the New York stock exchange reference price.

* High taxes paid by Honduran coffee producers. Honduras has one of the highest tax tariffs for coffee export in Central America. During the 1997/98 harvest producers paid around US\$ 15.70 per bag exported⁵⁰ (Survey of Honduras Co-operatives, 1998). As a result thousands of bags, especially in the west region, are smuggled to El Salvador and Guatemala as higher prices are offered to producers by exporting companies. Therefore, AHPROCAFE has been requesting a reduction of taxes to increase the producers incomes and reduce the smuggling of coffee to neighbours countries that, at the end, reduces the fiscal incomes of the State.

In 1994, the government decided to create the National Coffee Fund (NCF) with delegates from AHPROCAFE and national Ministers, but with a clear majority of the government. NCF obtains their funds through complex systems of prices differentials related with the quality of coffee for export and for local consumption. IHCAFE supervises the transfer of around L. 70.00 (US\$ 5.60) per bag of green coffee exported to the NCF. Finally, this indirect tax is deducted for the final price paid to coffee producers. The NCF has collected more that L. 1,000 million (US\$ 77 million) during the last 4 years. Through the NCF it has been constructed roads and bridges, rural electrification projects and a programme of fellowships for sons/daughters of coffee producers has been financed. However, the NCF projects are not only directed to coffee producing regions and co-operative members have denounced a political use of the funds (Survey of co-operatives in Honduras, 1998)

⁵⁰ Taxes include the IHCAFE certificate, the IC consumption subsidy, the transfers to the National Coffee Fund and the national income tax (Survey of co-operatives in Honduras, 1998)

During 1998, there has been an intensive debate in the media and the institutions related with the national coffee policy as a project of reforms to laws related with coffee production are being discussed in the Honduran National Congress. The Honduran Coffee Co-operatives Central (CCCH) created in 1997 has assumed a leading position in the discussion and their leaders have requested a representation on IHCAFE and the NCF board of directors. The proposal of CCCH includes: the liberalisation of the IC coffee price, that implies the abolition not only of the indirect subsidy to IC coffee but also of the transfers to the NCF; and the creation of the National Coffee Council as an institution with representation of the different agents related with coffee production that will define the main policies for the sector.

In this chapter it has been analysed the context in which Honduran coffee co-operatives participating in MH/FLO initiative have been developing their activities. The coffee sector has an outstanding place in the economy of Honduras. Coffee co-operatives have been gradually improving their level of autonomy and their capabilities to assume new links in the coffee food chain. However, the historic conditions of dependence of coffee producers in the communities and the relatively weak participation of the co-operative movement in the institutions that co-ordinate the national coffee policies limits enormously the capabilities of the co-operatives to improve their position in the market playing adequately their role as exporting enterprises.

CHAPTER V: ALTERNATIVE TRADE INITIATIVE IN HONDURAS

Study case of Honduran coffee co-operatives

Considering the case of Honduras, this chapter will analyse to what extent members of coffee co-operatives have benefited from the opportunities of MH/FLO initiative as co-operatives improve their level of competitiveness in export operations. In addition it will be determine the level of correlation of the competitiveness of MH/FLO co-operatives with the their management skills and the size of the co-operatives. In doing so, information collected during a survey of Honduran coffee co-operatives will be examined.

5.1 Introduction

As it was explained in Chapter III, during 1994 prices raised dramatically in the coffee international market. Co-operatives were suddenly exposed to a competitive environment where prices remained most of the time above the MH/FLO "minimum price" without showing a clear tendency. For Honduran coffee co-operatives, that started participating during 1994/1995 harvest in MH/FLO initiative, the situation was even more difficult as they entered in the coffee market when a strong competition was prevailing and they could not enjoy the previous period of low risk and higher relative prices (1989-1993). Honduran co-operatives, that have little knowledge of and access to market information and the major variables that affect it, have faced difficulties and uncertainties to decide the proper moment for price fixation. In addition, some of them have higher costs due to inadequate financing, processing, transport and storing capacity. Therefore, Honduran co-operatives have showed different levels of competitiveness in the export business and, consequently, they have benefited their members to a different extent through the payment of coffee ex-farm prices.

Co-operative members benefit not only from the level of ex-farm prices obtained every season, but also they receive additional services from the co-operatives. In the communities co-operatives are part of the social network and they are seen not only as a marketing enterprises but also as a social organisation that can represent the interest of the population, providing information of markets, facilitating social services and providing other complementary services related with the production of other food crops that are planted simultaneously by coffee producers. However, as coffee is a cash crop that provides an additional income to the households, the level of prices obtained by members of coffee co-operatives is as a key variable to assess the benefits that a co-operative can offer to its members.

Considering the problems that some co-operatives have been facing in their operations in export markets, it becomes increasingly important to determine: first, to what extent do members of each coffee co-operative in Honduras have benefited from the opportunities of MH/FLO alternative trade initiative, if compared with other non MH/FLO coffee co-operatives operating in Honduras. These benefits will be measured considering the ex-farm price received by co-operative members and it will establish a certain level of

competitiveness of the co-operative. Second it will be determined how the level of competitiveness of MH/FLO coffee co-operatives is correlated with their management skills and the size of the co-operatives.

In Honduras 17 co-operatives are registered officially in MH/FLO system out of a total of 48 co-operatives registered. For the analysis, relevant statistical sources⁵¹ and a survey undertaken in Honduras are used. The survey consisted in interviews to the manager and one member of the Board of Directors (BD) in 12 co-operatives selected according to the regional weight of coffee production regions⁵². Seven co-operatives registered in MH/FLO and five out of the Register are considered. The interviews covered issues such as: the services provided by the co-operatives, the number of members, the administration and processing infrastructure, accounting system, the commercialisation procedures, the level of knowledge of international market and the procedures of decision making within the organisation, among others.

From the co-operative to the export port

Most of the co-operatives' producers depulpe coffee in their own plots using small machinery. Then, co-operatives receives wet parchment that is dried, stored and then transported to DICOMCAFE who provides the export service to co-operatives participating in normal and MH/FLO markets. The export service includes the services related with the second processing of coffee that comprises uniform drying of coffee parchment, hulling, grading packaging, transport to port, port storing and handling. DICOMCAFE charges co-operatives with the costs of the export service and the taxes paid to the government for the coffee export. Taxes vary according to coffee FOB prices. For instance, in the last harvest the charge for co-operatives per 100 lb. bag of green coffee included US\$ 7.29 of 2nd processing services and in average, US\$ 15.71 of tax charges for a total amount around US\$ 23.00. (See chart 7). DICOMCAFE service allows co-operatives to have economies of scale in this decisive link of the coffee chain as their share the fixed costs of the firms, reducing their operational costs.

Chart 7: Estimated exports service charges of DICOMCAFE for Honduran co-operatives in the harvest 1997/98 (per 100 lb. of green coffee)

Items	Value in US\$
Farmgate - port costs	7.29
Taxes	
Ihcafe Certificate	0.81
National consumption subsidy	5.59
National Coffee Fund	5.59
Income tax	3.72
Total	23.00

US\$ 1 = L. 12.35 Source: Survey of co-operatives in Honduras, 1998.

⁵¹ Sources include IHCAFE, ICO and MH/FLO Register.

⁵² The sample includes 12 co-operatives from the main producing provinces: La Paz (3), Intibuca (2), Copán (1), Santa Bárbara (1), Comayagua (1), Francisco Morazan (1), Olancho (1) and El Paraiso (2).

DICOMCAFE operates with a coffee export license granted by IHCAFE. Through DICOMCAFE MH/FLO International Register has co-ordinated relations with the co-operatives, sending information related with the system. Further, DICOMCAFE provides periodical information of price tendencies in the international market for co-operatives. However, this is not a fluent and periodical mechanism of information and co-operatives can only access to it through telephone⁵³ or by direct visit to DICOMCAFE in San Pedro Sula⁵⁴.

5.2 The competitiveness of MH/FLO Honduran coffee co-operatives

The purpose of this section is to assess the level of competitiveness of co-operatives in terms of the economic benefits provided to their members. The level of ex-farm prices decisively reflects the benefits obtained by coffee growers from their organisations and it has been selected to measure the competitiveness of co-operatives. The next Chart details the ex-farm prices paid to members of Honduran coffee co-operatives included in the sample, during the last two harvests (1996/97 and 1997/98).

Chart 8: Ex-farm prices for coffee growers affiliated to Honduran coffee co-operatives (In US\$ per 100 lb. of green coffee)

CO-OPERATIVES	1996/97	1997/98
MH/FLO Co-operatives		
COMISAJUL	165.00	140.90
COARENE	115.36	109.16
COCASJOL	95.28	98.47
CARMOL	140.50	94.04
COCAOL	101.86	96.72
CARRUCHIL	NA	93.49
CABRIPEL	97.35	83.10
Non MH/FLO Co-operatives		
MAYA	96.63	80.49
COSAL	101.21	99.78
COMICAOL	95.56	97.00
COPROCATEL	NA	84.70
CARSBIL	67.07	89.28

N.A: Non available because of inadequate accounting registers.

Source: Survey of co-operatives in Honduras, 1998.

It is possible to see that in the harvest 1996/97 MH/FLO co-operatives ex-farm prices went from US\$ 95.28 to 165.00, with the exception of Cabripel members that received US\$ 97.35. The case of Cabripel can be explained because even if it was registered in MH/FLO, during the last two harvests it sold coffee through middlemen and not through the initiative. Meanwhile, the five non MH/FLO co-operatives sold all their coffee to

⁵³ As it will see later on, only 2 out of 7 co-operatives have telephone in the office.

⁵⁴ San Pedro Sula city is situated 50 kilometers far to the export port, Puerto Cortes, but 150 up to 450 kilometers far from producing regions in Honduras.

middlemen and/or exporters and their members received an ex-farm price that went from US\$ 67.07 to US\$ 101.21, around US\$ 30 to 50 less than in the alternative market.

The harvest 1997/98 showed the same path, while MH/FLO co-operatives ex-farm prices went from US\$ 93.49 to 140.90, excluding Cabripel; non MH/FLO co-operatives paid to their members an ex-farm price that went from US\$ 80.49 up to US\$ 99.80, again around US\$ 20 to 30 less than in the alternative market. In short, the range of ex-farm prices for the seven co-operatives operating under MH/FLO initiative was higher than the range in the five non-MH/FLO co-operatives in both harvests, as they exported coffee to normal and alternative markets.

5.3 Explaining the different levels of competitiveness of MH/FLO Honduran coffee co-operatives

Even if co-operatives registered in MH/FLO initiative paid in most of the cases, higher prices to their members, there was a wide gap between the co-operatives participating. The ex-farm price paid to co-operative members is a compound price resulting from the share of the different levels of prices obtained through exports to normal and alternative markets and, in some cases, sales to local middlemen and exporters. As co-operatives increment their exports to normal and alternative markets and properly fix prices, over time, they could offer better compound ex-farm prices to their members.

MH/FLO co-operatives usually begin operations in the system with a first contract agreement of one or two coffee lots under MH/FLO conditions. As the relation with the importers improves year by year, co-operatives tend to increase the volumes of coffee exported to normal and alternative markets gaining knowledge and expertise to adequately follow the market tendencies and fix prices, offering better ex-farm prices to their members. Consequently, the assessment of the competitiveness of MH/FLO co-operatives considers not only the data of the ex-farm price received by co-operative members but also the commercialisation channels used by co-operatives during the last two harvests 1996/97 and 1997/98 in which all co-operatives included in the sample were registered in MH/FLO⁵⁵. Furthermore, the level of competitiveness is contrasted with an evaluation of their management skills and size to determine whether there is a correlation among these variables and if a critical level of managerial skill and size can be defined for co-operatives that want to properly take the advantages of exporting through the initiative.

Firstly, it will define what it is meant by management skills and size and what is their importance in terms of the level of competitiveness of a co-operative. Then, it will be explained in detail the variables considered, determining analytical categories to assess management skills and the size of the co-operatives.

⁵⁵ Comisajul was the first co-operative registered in MH/FLO (94/95). the next harvest (95/96) Coarene, Carmol and Capribel joined the initiative and in the harvest (96/97) Cocasjol and Cocaol were included.

5.3.1 Management skills

Co-operatives have to compete with commercial capital not only in the struggle for markets abroad but they also have to compete at the local level for the attention of their own members by offering them better conditions, perfecting the technical and organisational standards of the co-operative apparatus as an enterprise (Chayanov, 1991:118)⁵⁶. The co-operative movement has been, sometimes, reluctant to the development of managerial skill arguing that such skill is only needed in a system based on improper motives such as private profit-making and competition. However the experience shows that Direction, professional management and supervision should be addressed (ILO, 1988: 5).

Enlarging the management structure

Marketing co-operatives that hope to replace existing commercial apparatus (displacing economic agents) have to ascertain what function is performed by each component of this apparatus to decide what kind of co-operative organ will undertake the task of performing this function (Chayanov, 1991:116). The co-operative management structure has to develop the same degree of labour specialisation, administrative infrastructure and level of training of the personnel of those economic agents to be replaced. In the case of coffee co-operatives, they require dealing with external financial operations, current exchange and taxes calculations. Moreover, they need to develop specific cost system and recruit and/or enhance the administrative expertise of their personnel.

Access to market information

When co-operatives enter into coffee international markets, they compete with economic agents who are in an oligopolical position to control prices and possess knowledge and economic experience gained over many years and who also dispose large amounts of capital and even larger credit facilities. In these circumstances, access to market information becomes a determinant factor. Co-operatives' leaders require following the current state of the markets, the trends and the possible development of factors which determine the formation of prices for been capable of finding the price level which they are seeking. (Chayanov, 1991:129,135). In this matter the market knowledge of managers and BD members, the information sources available, the communications infrastructure and the regular contacts with importers and MH/FLO are relevant.

Process of decision making

The nature of co-operative organisations entails a collegial form of management through the General Assembly, the Board of Directors (BD) and the Manager. However, a co-operative is not only a self-sufficient democratically structured organisation. It is also an economic enterprise operating in the conditions of the capitalist world. The advantage of

⁵⁶ Literature related with co-operative functioning and administration was consulted to conceptualize management and size in a context of a co-operative organization. Chayanov is quoted because even if his ideas were written more than 70 years ago they are still relevant, very clear and forceful.

the collegiality from the point of view of the co-operative's internal structure often becomes a major limitation from the point of view of the business requirements of organising an enterprise (Chayanov, 1991: 139)

The trade off between collegiality and rapid effective decision making can be overcome only when there is a clear definition of the boundary between directing and managing. Directing includes defining overall objectives, establishing and co-ordinating policies and systems of control to evaluate effectively the performance of the different areas of the co-operative. Managing includes actions to carry out objective and policies, decide short-term commitment of resources of the organisation and reporting periodically to the BD (ILO, 1988: 25, 26, 240,241).

In sum, it seems to be decisive for coffee co-operatives, that expect to assume control over forward linkages in the coffee chain participating in international markets, the expansion of their management structure providing the administrative infrastructure and human resources required for marketing operations. Moreover, they need to have a fluent access to market information and the main factors that affect it. Finally, a clear definition of functions among the assembly, the BD and the manager is required to take accurate and fast decisions.

5.3.2 Size of the co-operatives

In addition to the management abilities, co-operatives requires a certain size and volume of operations to utilise economies of scale. Like large firms, co-operatives can have cost advantages in the acquisition of market information, the modernisation of infrastructure, the costs of mortgage instruments for credit and credit worthiness of a borrower (Deininger, 1993: 22). For coffee commercialisation, economies of scale are particularly important in terms of processing infrastructure, wholesale, transport and financing. Therefore, marketing co-operatives require a minimum volume of operations of jointly coffee processing and marketing for external markets to remain competitive. This issue is more relevant if it is considered that to be registered in MH/FLO, co-operatives members participating should have a maximum production of 30 bags of 46kgs of coffee. However, there has not been considered properly the necessity of a minimum desirable level of production per member to allow co-operatives to be competitive in their operations.

In the case of Honduran co-operatives, decisive economies of scale are obtained in the joint second processing activities carried by DICOMCAFE. While local parchment drying, storing and transport to DICOMCAFE is accomplished by each co-operative, reducing but not leaving out of consideration the issue of a minimum size for co-operatives to remain competitive.

5.3.3 Analytical categories to assess management skills and size of the co-operatives

Considering the main variables related with the management skills and the size for a marketing co-operative enterprise, the following analytical categories were constructed,

as a result of the physical observations and the information gathered through the interviews in each of the 7 Honduran co-operatives participating in MH/FLO included in the sample:

Management skills

1 *Management infrastructure including office facilities and office equipment.*

a) Office facilities refer to the construction quality, the organisation and availability of space in the office. Three grades are considered:

* Adequate: when there is a good construction quality and sufficient space and offices for each Department of the co-operative (accounting, manager and BD meeting room).

* Basic: when there is a good construction quality but not enough space available for an adequate operation.

* Inadequate: when neither construction quality nor space is available.

These cases include the use of storehouses or communal rooms as offices.

b) Office equipment refers to the provision of computers, typewriters, desks and archives. Three grades are considered:

* Adequate: When co-operatives have at least one computer, a typewriter and enough desks and archives according to the personnel employed and the volume of files used.

* Basic: When co-operatives do not have computer but have at least a typewriter and enough desks and archives.

* Inadequate: When there is practically no office equipment available.

2 *Accounting and data systems.* Including updates level and commercialisation cost system. Co-operatives have computerised or manual accounting system. Moreover, the information is updated daily, monthly or annually. Some co-operatives have a clear procedure and forms available for cost estimation while other receive the information processed by DICOMCAFE and in some cases there is not a clear system used.

3 *Personnel annual salaries expenditures in US\$.* It refers to personnel in the administrative structure including Managers, accountants and Secretaries. In some cases personnel is hired part-time.

4 *Level of education and qualification of administrative personnel and members of BD.* In this analysis category is considered the level and type of formal education received.

5 *Degree of knowledge and access to market information.* Including market knowledge, sources, communication infrastructure and contacts with importers and MH/FLO.

In relation to communication infrastructure three grades are considered:

- * Adequate: when co-operatives have access to telephone, fax and e-mail in the office.
- * Basic: when co-operatives have access to telephone and fax through the Communications Office operating in the town where the co-operative office is situated.
- * Inadequate: when co-operatives have access to telephone and fax located in a distant community (20- 40 kms) and in the cases when there is not communication infrastructure available at all.

The process of decision making and definition of BD and Administration responsibilities was measured but it was rejected as an analysis category because it was not significant to determine management skill variations among the co-operatives. In general, in all the co-operatives interviewed there is a great disparity in the opinions of the managers and the BD members in relation to what activities are performed by each of the components of the internal structure of the co-operative including the General Assembly, the Board of Commercialisation, the BD and the Manager. From co-operative to co-operative the tasks assigned to each body of the co-operative structure change significantly showing a very low level of consensus over which activities should be carried out by each structure of the co-operative.

Size of the co-operatives

- 1 ***The volume of production commercialised by the co-operative.*** It includes all the coffee commercialised by members, but does not represent the total production of them. Co-operative members have a foot in each commercialisation network as they still sell coffee to middlemen and exporters due to the strong patronage-client relations in the communities.
- 2 ***The total assets owned by each co-operative in US\$***
- 3 ***The processing and store capacity.*** The majority of the co-operatives in the sample have drying yards as part of their infrastructure. However, concrete drying yards are relatively cheap and do not denote a great investment in infrastructure. Therefore, it is only considered the drying equipment representing the processing capacity and the store capacity is estimated by the number of bags of parchment coffee that can be stored in the warehouses that the co-operatives own.

Variables such as the transport capacity, the number of services provided by the co-operative, the number of permanent and temporal personnel employed and the number of members of the co-operatives that were initially considered as analytical categories, were latter rejected because they resulted not significant to reflect the size variations of the co-operatives.

5.3.4 The correlation of the competitiveness of co-operatives and their management skills and size.

Considering information of the harvest 1996/97 and 1997/98, in this section three levels of competitiveness of the co-operatives included in the sample are developed. The levels go from 1 to 3, in a decreasing order, and they are correlated with the analytical categories of management skills and size.

5.3.4.1 Level 1

Chart 9: Honduran Coffee co-operatives participating in MH/FLO
(Coffee commercialised in 100 lb. bags of green coffee)

Competitiveness: Level 1

Co-operativ	Channels of commercialization 1996/97						1996/97 Ex farm price	Channels of commercialization 1997/98						1997/98 Ex-farm price
	National		Export markets		Total bags commers.	National		Export markets		Total bags commers.				
	M %	E %	Normal %	Altern %		M %		E %	Normal %		Altern %			
COMISAJUL	---	---	36	64	4125	165.00	---	---	16	84	7125	140.90		
COARENE	---	---	56	44	2541	115.36	---	---	78	22	4958	109.16		
COCASJOL	---	---	91	9	4263	95.28	---	35	57	8	10340	98.47		

M = Local middlemen E = Local exporters

Source: Survey of co-operatives in Honduras, 1998

According to Chart 9, co-operatives in Level 1 have the best performance in terms of ex-farm (EF) price paid to their members. During the harvest 1996/97 they exported all their coffee to normal and alternative markets. Comisajul sales have a higher share of alternative market, followed by Coarene and then Cocasjol. During the following harvest (1997/98) all of them incremented the volumes of coffee commercialised. In relation to the share of alternative market, Comisajul incremented it from 64% to 84%, while Coarene reduce it from 44% to 22% and Cocasjol remained in 8-9% selling coffee to national exporters. The experience gained by co-operatives in the export business partially explains why Comisajul, that started 4 years ago in MH/FLO Register, has the highest EF price followed by Coarene that entered the following year and Cocasjol that has only two years of experience. Summarising as co-operatives have more experience and expand the volumes of coffee traded through MH/FLO, members have received a higher EF price.

Chart 10: Level 1: Summary of management skills and size analysis categories

Co-operatives	COMISAJUL	COARENE	COCASJOL	RANGE
MANAGEMENT SKILLS				
Office facilities	Adequate/own	Adequate/own	1 Basic/own	2 Adequate/own 1 Basic/own
Office equipment	Adequate	Adequate	Adequate	All adequate
Accounting system	Computerised and daily updated	Computerised and daily updated	Manual monthly Updated	2 Computerised and daily updated 1 Manual monthly updated
Cost estimation	Systematised	Systematised	Systematised	All systematised
Personnel Annual salaries in US \$	9,940	8,329	4,478	4,478 – 9,940
Education level and qualification of managers	Higher education	Higher education	High school	2 Higher education 1 High school
Educational level and qualification of BD Presidents	Higher education	Primary school	Primary school	1 Higher education 2 Primary school
Knowledge of the international market and access to price information	Basic knowledge of the international market. SE updated price information through IHCAFE and DICOMCAFE	Basic knowledge of the international market. SE updated price information through IHCAFE and DICOMCAFE	Basic knowledge of the international market. SE updated price information through IHCAFE and DICOMCAFE	Basic knowledge of the international market. SE updated price information through IHCAFE and DICOMCAFE
Communications infrastructure	Basic	Basic	Adequate	1 Adequate 2 Basic
Relations with traders	Direct relations	Direct relations	No relations	2 Direct relations 1 No relations
SIZE				
Production Commercialised in 100 lb. bags	7,125	4,958	10,340	4,958 – 10,340
Total Assets in \$ US thousands	121.5	218.8	184.8	121.5 – 184.8
Processing capacity	No equipment	Drying capacity of 90 qq per day	Drying capacity of 470 qq per day	2 with dryers 90 – 470 qq per day
Store Capacity in bags	1,500	2,500	3,000	1,500 - 3,000

Source: Survey of co-operatives in Honduras, 1998

This group of co-operatives has an acceptable management structure to respond to the new activities assumed as an export/marketing business. According to Chart 10, all co-operatives have adequate office facilities and office equipment, with the exception on Comisajul that has basic facilities but is now in the process of expansion of its offices. In addition, Comisajul and Coarene have computerised and daily updated accounting system. In the case of Cocasjol, even if it still has a manual accounting system, it has plans to computerise its accounting system with the recent acquisition of computer

equipment. Moreover, this group has the highest expenditure in personnel annual salaries in the administrative department that goes from US\$ 4,478 to 9,940. In relation to human resources, 2 of the co-operatives managers have higher education degree and Comisajul is the only co-operative in the sample whose President has University level education (Economist). This group of co-operatives has the highest degree of access to market information. All of them have at least a basic communication infrastructure allowing them to access periodically to market prices in the New York stock exchange by IHCAFE daily service⁵⁷ and through regular communication with DICOMCAFE. Moreover, all of them have a clear understanding of the MH/FLO system and a basic knowledge of the factors that affect and the tendencies of international market prices. Further, Comisajul and Coarene are the only co-operatives in the sample that have a direct and fluent contact with importers in Europe. This might be related with the fact that some leaders of both co-operatives were part of the BD of AHPROCAFE and DICOMCAFE, which allowed them to develop close relations with European importers.

In relation to the capacity of the size of co-operatives, Level 1 co-operatives commercialised the highest volumes of coffee, among 4958 bags (13 lots) and 10,340 bags (27 lots) in the last harvest. They are the only co-operatives that have more that US\$ 100 thousand in assets. Two of them, Coarene and Cocasjol, have owned parchment drying equipment and Comisajul in negotiating the purchase of a processing equipment that includes facilities for second processing. This group of co-operatives has the highest store capacity of all the MH/FLO co-operatives in the sample (among 1,500 and 3,000 bags). In addition Level 1 co-operatives have relations with national banks and traders to finance their operations. Therefore, it indicates that the size of co-operatives in Level 1 contributes to their competitiveness in the coffee market.

In short, the evidence allows to affirm that the leading position of Level 1 co-operatives in alternative markets can be explained by their adequate management infrastructure, their competent accounting system and the higher degree of access to market information. Moreover, the evidence also suggests that the size of the co-operatives decisively contribute to their performance in alternative markets.

5.3.4.2 Level 2

Chart 11: Honduran Coffee co-operatives participating in MH/FLO
(Coffee commercialised in 100 lb. bags of green coffee)

Competitiveness: Level 2

Co-operativ	Channels of commercialization 1996/97						1996/97	Channels of commercialization 1997/98						1997/98
	National		Export markets		Total bags commers.	Ex-farm price		National		Export markets		Total bags commers.	Ex-farm price	
	M %	E %	Normal %	Altern %				M %	E %	Normal %	Altern %			
CARMOL	---	---	---	100	1406	140.50	29	---	71	---	2100	94.04		
COCAOL	86	---	---	14	2900	101.86	68	---	---	32	2350	96.72		

M = Local middlemen E = Local exporters

Source: Survey of co-operatives in Honduras, 1998

⁵⁷ Ihcafe has a permanent telephone line service that provides New York stock exchange prices for other mild arabicas.

Co-operatives Carmol and Cocaol are considered in this second level. Chart 11 shows that during the harvest's 1995/96 and 1996/97 Carmol exported all its coffee through MH/FLO. In the first harvest considered it paid an EF price of US\$ 140.50 to its members, relatively high if compared with co-operatives in Level 1. However, in the following harvest it lost access to alternative markets, selling 71% to normal markets and 29% to local middlemen. As a consequence it reduced considerably the ex-farm price to US\$ 94.04. In the case of Cocaol after two years in alternative markets, it has incremented its participation in MH/FLO markets from 14% in harvest 1996/97 up to 32% in harvest 1997/98. However it seems that Cocaol did not achieve a great advantage from the coffee traded in alternative markets considering that the EF price was only US\$ 2.00 higher than Carmol. These co-operatives seems to be in an intermediate level, while Carmol has lost access to alternative market and reduced drastically the EF prices paid to its members, on the contrary Cocaol has incremented its participation in alternative markets slightly improving the EF price for its members.

Chart: 12

Summary of management skills and size analysis categories Level 2

Co-operatives	CARMOL	COCAOL	RANGE
MANAGEMENT			
Office facilities	Basic/partially rented	Basic/ rented	Basic/rented
Office equipment	Basic	Adequate	1 Adequate 1 Inadequate
Accounting system	Manual monthly updated	Manual monthly updated	2 Manual monthly updated
Cost estimation	Through DICOMCAFE	Inadequate	1 through DICOMCAFE 1 inadequate
Ranges of personnel Annual salaries in US \$	3,358	3,134	3,134 – 3358
Communications infrastructure	Inadequate	Adequate	1 Adequate 1 Inadequate
Education level and qualification of managers	High School	High School	2 High school
Educational level and qualification of BD Presidents	Primary school	Higher education	1 Higher education 1 Primary school
Knowledge of the international market and access to price information	Little knowledge of the international market. Sporadic SE price information through IHCAFE and local prices by middlemen	Little knowledge of the international market. Sporadic SE price information through IHCAFE and local prices by middlemen	Little knowledge of the international market. Sporadic SE price information through IHCAFE and local prices by middlemen
Relations with traders	No relations	No relations	No relations
SIZE			
Production commercial in 100 lb. Bags	2,100	2,000	2,000 - 2,100
Total assets in \$US thousands	100.7	NA	
Processing capacity	No	Rented drying equipment	1 has rented drying equipment
Store Capacity in bags	100	500	100 - 500

Source: Survey of co-operatives in Honduras, 1998

Both co-operatives do not have a respectable management infrastructure. As it can be seen in Chart 12, Carmol and Cocaol have basic office facilities and equipment, but rented. Cocaol has a very old computer (286 model). Moreover, even if members interviewed affirmed that there is an accounting system monthly updated, Carmol does not have a satisfactory procedure of commercialisation cost calculations and the settlements for members are prepared and sent by DICOMCAFE. In the case of Cocaol, it is in the middle of a drastic restructuring of the accounting system because after one year of problems with the accountant they decided to laid off him and rejected the balance sheets prepared by him. In addition, both co-operatives have expended less in the annual salaries of the administrative personnel, around US\$ 3,000, if compared with Level 1 co-operatives.

This group of co-operatives has a low degree of access to market information. Even if their leaders have affirmed that they have a little knowledge about MH/FLO as organisation, they do not have a proper knowledge of MH/FLO system. Moreover, neither Carmol nor Cocaol have ever been in contact with importers. In the case of Cocaol, it is partially explained because it has an inadequate communications infrastructure as they can only access to telephone and fax through APAS a regional NGO that supports them but that is located 15 kms. away from their offices. However, Cocaol has an adequate communication system as they have telephone and fax in the office that allow them to contact periodically DICOMCAFE and IHCAFE information services.

In relation to the size of the co-operatives, Carmol and Cocaol commercialised around 2,000 bags of coffee, less than 50% of what Coarene commercialised (the smallest co-operative in Level 1 in terms of volume commercialised). Carmol does not have processing equipment, it uses drying yards for parchment processing and the storing capacity seems to be insufficient, having a warehouse for only 100 bags of coffee parchment. Cocaol has an old processing equipment that has not been renovated because it is rented to IHCAFE and it has sufficient storing capacity (500 bags of coffee parchment).

In sum, in this level it appears to be two different paths:

- 1) In the case of Carmol, in the harvest 1997/98 it lost the access to alternative markets. Before it had relatively good years, selling all its coffee to alternative markets receiving relatively high EF prices. This situation can be partially explained because they have been facing financial problems due to accumulate loses. Carmol members have not capitalised the co-operative and they have received overpayments because of the inadequate accounting and cost estimation system. Moreover, as they do not have access to the market they heavily depend upon DICOMCAFE as their solely source of information, accessed sporadically due to constrains in their communication infrastructure.
- 2) Cocaol, after two years of participation in MH/FLO, has been increasing its participation in alternative markets. It seems to be in a process of restructuring with the entrance of a new President, a journalist that owns a local radio station, and the revision of the accounting system. Even if nowadays they do not have a good knowledge of the market system, they have the communication infrastructure to access daily to the information of international market prices.

Finally, even if both co-operatives have a smaller size if compared with Level 1 they appear to be in a stage where economies of scale can be reached and where size is not a significant limitation to remain competitive in the market.

5.3.4.3 Level 3

Chart 13: Honduran Coffee co-operatives participating in MH/FLO
(Coffee commercialised in 100 lb. bags of green coffee)

Competitiveness: Level 3

Co-operat	Channels of commercialization 1996/97					1996/97 Channels of commercialization 1997/98					1997/98	
	National		Export markets		Total bags	Ex-farm	National		Export markets		Total bags	Ex-farm
	M %	E %	Normal %	Altern %	commers.	price	M %	E %	Normal %	Altern %	commers.	price
CARRUCHIL	---	---	---	100	938	NA	---	67	33	---	1145	93.49
CABRIPEL	100	---	---	---	200	97.35	100	---	---	---	200	83.10

M = Local middlemen E = Local exporters

Source: Survey of co-operatives in Honduras, 1998

This level of competitiveness includes co-operatives Carruchil and Cabripel. After three years of participation in MH/FLO markets this group of co-operatives has paid very low EF prices to their members. According to Chart 13, Carruchil sold all its coffee to alternative markets in the harvest 1996/97 but the following year it lost the access completely, exporting 33% to normal markets and selling 67% to local export firms. In the case of Cabripel, it has only exported 200 bags in a partially lot during the harvest 1995/96 and in the two following harvests considered in the analysis, it sold all its coffee to local middlemen.

Chart 14: Summary of management skills and size analytical categories

Level 3

Co-operatives	CARRUCHIL	CABRIPEL	RANGE
Office quality	Inadequate	Inadequate	All inadequate
Office equipment	Inadequate	Inadequate	All inadequate
Accounting system	Manual (recently began)	Manual annual updated	1 Manual monthly updated 1 Manual annual updated
Cost estimation	through DICOMCAFE	No system at all	1 through DICOMCAFE 1 No system at all
Ranges of personnel Annual salaries in US \$	895	537	537 - 895
Communication infrastructure	Inadequate	Inadequate	All inadequate
Education level and qualification of managers	Higher education	Primary school	1 Higher education 1 Primary school
Educational level and qualification of BD Presidents	Primary school	Incomplete Primary school	1 Primary school 1 Incomplete Primary school
Knowledge of the international market and access to price information	No knowledge of international market. Sporadic SE price information through IHCAFE an local prices by middlemen	No knowledge of international market. Sporadic SE price information through IHCAFE an local prices by middlemen	No knowledge of international market. Sporadic SE price information through IHCAFE an local prices by middlemen
Relations with traders	No relations	No relations	No relations
SIZE			
Production Commercialised in 100 lb. bags	1145	200	200 - 1,145
Total assets in \$ US thousands	88.7	NA	
Processing capacity	No equipment	No drying equipment	No drying equipment
Store Capacity in bags	300	960	300 - 960

Source: Survey of co-operatives in Honduras, 1998

Carruchil and Cabripel have practically no management infrastructure. According to Chart 14, both co-operatives have inadequate office quality. Carruchil operates during the harvest season in a storehouse and Cabripel uses a communal room. They do not have office equipment such as computers, typewriters, desks and archives. In Carruchil they have recently hired a part-time accountant that is beginning to update the accounting system and also a part-time/seasonal manager. The manager has higher education level and used to be part of the staff of a local NGO that supports the co-operative (APAS). In the case of Cabripel the BD just have a notebook where they register sells and expenditures and they hire an accountant to prepare annual balance sheets. In addition, both co-operatives expended very little resources in administrative personnel during the last year, US\$ 537 in Cabripel and US\$ 895 in Carruchil. Also, the Presidents of the BD of Carruchil and Cabripel have very low levels of education, primary school for the former and incomplete primary school for the latter. Both co-operatives do not have access to the international market. They have never contacted importers directly, they

have inadequate communication infrastructure and in the past they only obtained price information from middlemen. However, Carruchil is now receiving more information as the part-time manager recently hired has some degree of knowledge of the international market. In addition, Carruchil has access to the service of daily information of IHCAFE through telephone and fax facilities in APAS.

In relation to their size, Carruchil and Cabripel do not have processing equipment and only Carruchil has drying yards for coffee parchment processing. Carruchil commercialised 1145 bags of coffee (4 times less than Coarene, the smallest co-operative in Level 1) and Cabripel just commercialised 200 bags (less than 1 lot of coffee). In addition, the coffee commercialised per member in these co-operatives is less than 10 bags of green coffee. This implies that the majority of their members are micro producers. For these co-operatives the size of their operations seems to be a real constrain to participate in export markets.

In sum, the low level of EF prices paid to members of Co-operatives in Level 3 and their gradual loss of participation in MH/FLO market can be explained by a very low degree of management skills. The absence of administrative infrastructure, the lack of an accounting system and administrative personnel together with a low level of education, lack of knowledge and relations with international markets explains the failures in the attempt to move forward in the coffee chain of production. In addition, the size of these co-operatives seems to contribute decisively to reinforce this path.

5.4 Reflections on the findings

- 1 In all the co-operatives considered in the sample there is a strong correlation between the level of competitiveness and the management skills developed by the co-operatives. Co-operatives who have been improving their administrative infrastructure, accounting system and incorporate personnel with a higher level of education are better playing its role as economic enterprises. Even if some co-operatives have improve their knowledge of the market and their relations with MH/FLO and traders in Europe, all of them require to improve their degree of knowledge and access to the coffee international market.
- 2 In relation to the size of the co-operatives it seems to be a critical level required to adequately provide the services of drying, storing and transport of coffee parchment. Therefore, MH/FLO initiative has not only to define a ceiling in relation to the volume of coffee produced by co-operative members but also a floor required to allow economies of scale.
- 3 As it was explained in Chapter III, the MH/FLO initiative pays a surcharge of US\$ 5.00 per each bag of green coffee sold to be invested in social projects. However, even the co-operatives with adequate accounting system have not registered this surcharge separately in the accounting records. Therefore, it is impossible to measure the impact of these extra funds.

- 4 One critical issue to be addressed by MH/FLO initiative is to spread the understanding of the advantages that the system can provide. Most of the co-operative leaders interviewed have little knowledge of the system, and it can be supposed that this situation is even worse among co-operative members. This is a difficult task considering that 11 out of 12 Presidents of the co-operatives' BDs in the sample have only primary school and that illiteracy is a critical problem in coffee producing regions.
- 5 The absence of consensus on the tasks to be performed by the different bodies of the organisational structure of the co-operatives has appeared when analysing the decision making process. There are some reasons that can provide clues to this situation: the lack of an adequate communication infrastructure together with the lack of possibilities of sharing experiences (such as regional and national workshops or even informal meetings). Most of the co-operatives operate in isolation even if they are located in the same region. One exception is the co-operatives working with APAS in La Paz province. It can be expected that Honduran Coffee Co-operatives Central (CCCH) that started operating last year could provide room to overcome this limitation of the co-operative movement.

CHAPTER VI: CONCLUSIONS

This paper has examined the structures of the coffee food system that includes the coffee chain, the agents that intervene and the institutional framework with emphasis in the Honduran case. The use of the methodological approach of the food system provides an overall understanding of the influence of the tendencies of capital accumulation over the world coffee markets.

The coffee market has followed three main trends that encompasses different modes of ordering of the economic agents: from free international trade (1830-1963) to a regulate market, controlled by producing countries under ICO agreements (1963-1989), and again to a free trade (1989 until the present) highly controlled by transnational corporations in the key links of the coffee chain.

Honduras as a late comer in the coffee market started exporting coffee in the 1960s in a context of a highly regulated market controlled by Brazilian and Colombian lobbyists within ICO Council. The Honduran coffee co-operatives were born in this period as part of a top-down strategy of the national government to co-ordinate and control the emerging social peasant movement.

By the time the coffee market was liberalised in 1989, Max Havelaar Foundation launched a proposal for an alternative market system for co-operatives of small coffee producers seeking for a fair trade of coffee. This new mode of ordering of economic agents in the coffee chain changed the degree of margins and capital accumulation of the different agents as small coffee growers could achieve a higher ex-farm price. Small importers and roasters developed a market niche targeted to ethical consumers who were willing to pay a higher price for "fair trade" coffee. MH/FLO alternative market has a small participation in coffee markets, in average less than 1% in all the European countries where the initiative participates. The expansion of the initiative is constrained by the oligopolistic control over trading and roasting by a group of transnational firms. However, the systems offer higher prices for coffee growers.

In Honduras coffee is the main source of hard currency income and export taxes, generating more than 25% of the agricultural employment. Even though coffee co-operatives have been gradually improving their level of autonomy and organisation, creating a second level association, i.e. CCCH, they are not properly represented in the national coffee institutions, limiting their possibilities to influence the coffee policies. In addition, the development of marketing co-operatives in the communities is constrained by the strong patronage-client relations that links small coffee growers with middlemen backed up by the national exporters.

For Honduran coffee co-operatives participating in MH/FLO markets the system has given them the opportunity to obtain higher ex-farm prices as compared with co-operatives operating through traditional markets that sell their coffee locally to middlemen and exporters. However, MH/FLO co-operatives in Honduras have not benefited to the same extent from the system as they have little knowledge of an access to market information and

the major variables that affect it. In addition, some of them have higher operational costs due to inadequate financing, processing, transport and storing capacity.

Marketing co-operatives, which move from national to international markets, require a significant degree of management skills including management infrastructure, accurate accounting systems, trained administrative personnel and a good knowledge of the market operations and tendencies. Moreover, they require such a size that allows them to benefit from economies of scale. Those co-operatives that have been able to export but have low levels of management skills have been facing serious problems to survive.

MH/FLO and importers informally agree that something has to be done. Furthermore, those co-operatives have to improve their management structure and become more competitive keeping in track with the alternative trade initiative. So far, experiences of alternative market have showed that more than simply provide an access to markets for small coffee producers the long term competitiveness of co-operatives requires improve their managerial abilities and a minimum size.

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ANNEX 1

PRICE SHARE OF NORMAL AND MAX HAVELAAR 100%
ARABICA COFFEE IN 1997 (in US \$/lb)

ITEMS	NORMAL MARKET		MH/FLO MARKET		
	US \$	%	US \$	%	
CONSUMER PRICE	4.50	100.0	4.23	100.0	
DISTRIBUTION ROASTING & TRADING MARGINS	Value added tax (6%)	0.25	5.6	0.24	5.7
	Max Havelaar license	0.00	0.0	0.08	2.0
	Distribution margins	0.54	12.0	0.80	19.0
	Roasting and trading margins	1.52	33.8	0.85	20.1
	Roasting losses	0.35	7.8	0.36	8.5
Total margins	2.66	59.1	2.34	55.2	
GREEN COFFEE FOB PRICE	1.84	40.9	1.89	44.6	
2nd PROCESSING MARGINS	Export taxes (6% FOB Price)	0.11	2.5	0.11	2.7
	Fob Costs	0.26	5.8	0.26	6.1
	Exporter margin	0.06	1.3	0.00	0.0
	Total margins	0.43	9.6	0.37	8.8
GROSS EX FARM PRICE	1.41	31.3	1.51	35.8	
1st PROCESSING AND FARM COSTS	0.75	16.7	0.75	17.7	
NET MARGIN FOR COFFEE GROWER	0.66	14.7	0.76	18.0	

Estimations:

- * The normal market price is of Dow Egberts brand, 100% arabica roasted coffee, Df. 4.84/ 250 grs.
- * The MH market price is of Cafe Forestal brand, 100% arabica roasted coffee, Df. 4.55/ 250 grs.
- * Value added, distribution costs and license fee from estimations of MH/FLO
- * Roasting losses are 19% of Green Coffee FOB price.
- * The green coffee FOB price for normal markets is the average for other mild arabicas.
- * The green coffee FOB price for MH market is the average paid by importers under the System for arabica coffees.
- * 2nd processing margins refers to FOB costs including 2nd processing, transport, bags Costs in port, communication, financing and administration. Estimated by MH/FLO for Costa Rican coffee.
- * 1st processing and farms costs such as: maintenance, harvest, inputs and transport Estimated by MH/FLO for Costa Rican coffee.
- * The exchange rate used is Dfl. 1.95 = US\$ 1.00