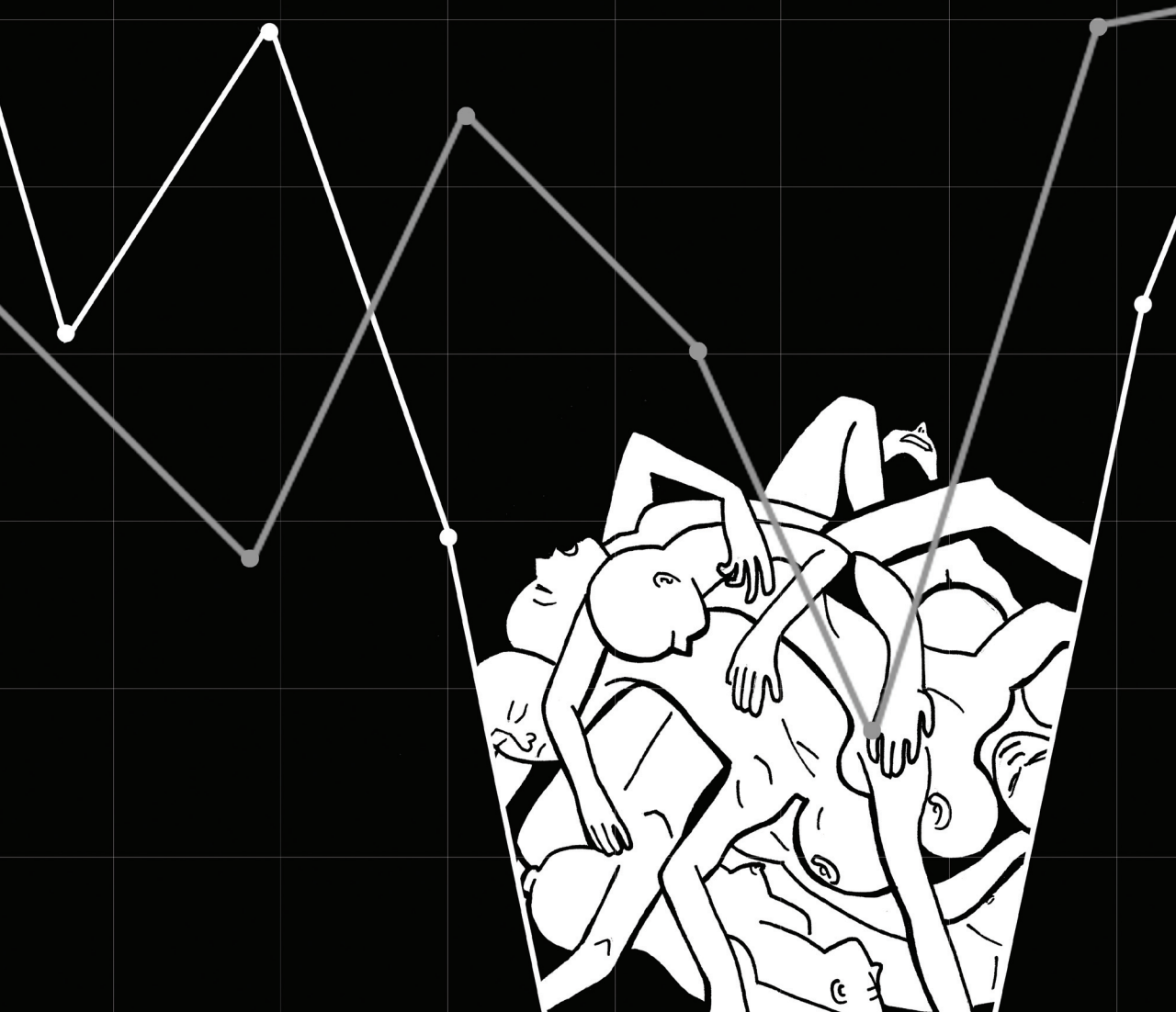


THE REAL PRICE OF COFFEE

Fair Trade in the Rwandan Crisis and as an
Economic Mechanism for Global Peace

by Marcos Rego-Monteiro



ABSTRACT

COMMODITY PRICE INEFFICIENCIES, CAUSED BY ASYMMETRIES OF POWER, SIZE, AND ACCESS TO information between free market participants, have led to devastating social consequences, domestically and abroad. One example is the 1994 Rwandan genocide. These problems stem in significant measure from conditions in industrialized societies. Taking coffee as a principal example, this paper proposes that the policies of fair trade have made important progress in addressing these problems, and can make significant further strides towards solving them.

GLOBALIZATION HAS BEEN defined economically in much the same way as free trade, as “the increasing efficiency of markets to reduce barriers to trade in capital and goods through reduced tariffs and increased foreign investment.”¹ In this process of trading goods and capital, business organizations can be started and expanded along with infrastructure to create growth in incomes. Nevertheless, many small producers in developing nations receive compensation insufficient to meet their costs of daily living. Much suffering and many social problems result. The Rwandan genocide of 1994 is one example. Fair trade is a practice that involves businesspeople in industrialized countries entering into contracts directly with producers in developing countries. The contract provides a floor price for goods and includes a social premium. While the floor price ensures that producers’ costs are met, the social premium provides extra income for community reinvestment. By attempting to correct some of the free market’s problems, fair trade seeks to lay the economic foundations for peace and prosperity.

Standard measures of worldwide economic activity like the Gross World Product (GWP) show overall growth consistently from 1950 to 2000. However, prevailing methods of calculating economic activity, like the GWP or the Gross Domestic Product (GDP), fail to include a number of fundamental variables, and provide only partial measures of economic well-being.² Standard measures undervalue and misrepresent factors and costs affecting social inequality, with devastating consequences in the world. For example, 2.5 billion people now affected by the global economy live on less than \$2 per day, barely surviving and unable to thrive.³ Standard measures do not account for the growing income disparity between the economic elite and the rest of the world’s population. Specifically, this appears in excessive CEO pay.⁴ The world’s poor have been disadvantaged and marginalized in various ways, including being driven off their land because they were paid inadequate prices for their goods, such as coffee.⁵ Since these real world costs are socially harmful and excluded without being valued, they are called “negative externalities.”⁶

Nevertheless, standard measures can provide important information. For instance, they show that per capita GDP of industrialized nations is growing significantly faster than that of many developing nations. This is consistent with studies of several indices by London School of Economics Professor Robert H. Wade.⁷ Recent reports, such as those by the World Bank Chief Economist Francois Bourguignon⁸ and the U.N. Assistant Secretary-General for Economic Development Jomo

Sundaram⁹ reflect the same patterns of inequalities within nations and between them.

Because of the externalization of costs and asymmetries of power and resources between market participants, the way commodities are priced has deviated from the theoretical assumptions of market behavior as discussed by Adam Smith. For example, free and efficient markets require symmetrical buyer and seller participants who do not influence the price of goods. Another free market principle says that sellers must be responsible for the entire cost of their product, and this must be reflected in the price.¹⁰ When pricing is efficient, bargaining allows producers to meet their costs. In actual practice, however, and in the case of commodities like coffee in particular, powerful participants manipulate the market to pay a price lower than small producers’ costs. Most global problems are linked to these market asymmetries and inefficiencies. Many familiar problems include corporate crime,¹¹ environmental degradation, the 1994 Rwandan genocide, the Chiapas,

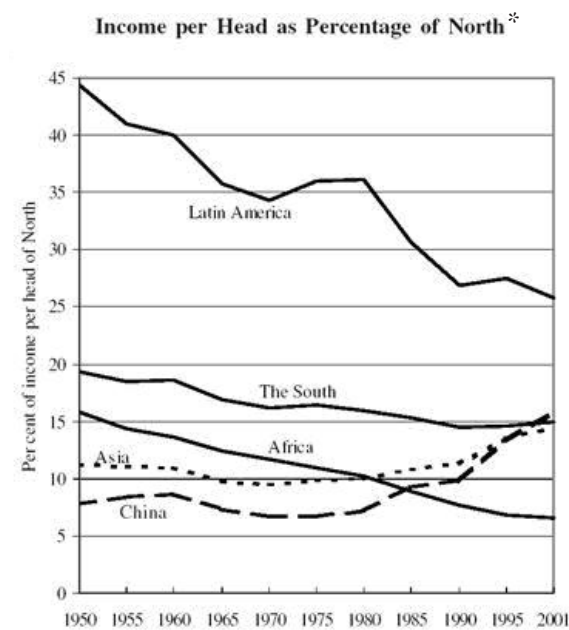


Figure 1

*North is defined as North America, Australia, Japan, and Western Europe. South includes the countries of Latin America, Asia, and Africa.

Mexico uprising of the same year,¹² the Darfur conflict and genocide,¹³ drugs,¹⁴ domestic and international immigration pressures,¹⁵ and urban slums.¹⁶ This paper proposes that the policies of fair trade have made important progress in addressing the source of these problems, and can make significant further strides towards solving them.

The problematic inefficiencies of insufficient prices and asymmetric resources in the world economy, and for producers in developing nations in particular, stem in significant measure from conditions in the industrialized societies. The United States, for example, has demonstrated a trend towards the greatest disparities since the 1980s, returning to levels typical before the Great Depression and World War II, and often attributed to developing nations. These patterns reflect policy trends continued by the Reagan Administration (which was supported by neoliberal economic theories)¹⁷ and increased contributions to conservative institutions by wealthy individuals.¹⁸

With wealthy individuals and groups supporting policies of deregulation in both taxes and financial markets, an emphasis on orthodox corporate accounting developed.

A decline in corporate social responsibility followed, while CEO salaries and perks increased.¹⁹ Reagan's policies resulted in a tax program that benefited the wealthy and burdened the lower income brackets.²⁰ Although this was pursued with such notions as the "trickle-down effect," in which benefits for the wealthy were also to result in benefits for the non-wealthy, these have proven untrue. Deregulation in the United States since 1980 correlates with disproportional social problems, including significantly greater levels of violence, rape, imprisonment,²¹ and family cohesion troubles²² than other industrialized nations. The Reagan Administration's general deregulation of the markets accelerated corporate consolidation, leading to numerous instances of corporate crime²³ and inefficiencies in the marketplace.

Although the American Revolution of 1776 was in part against restrictions on small colonial tea sellers²⁴ and original American legislation of corporate charters intended corporations to be socially beneficial,²⁵ corporations have over time used their growing financial power to influence government policy. The landmark 1919 decision of the Michigan Supreme Court in *Dodge v. Ford Motor Co.*

articulated a mission other than the public interest, stating "A business corporation is organized and carried on primarily for the profit of the stockholders."²⁶

Internationally, the ethic of social responsibility can be traced back over two millennia through Enlightenment democratic theory, modern education's origins in the Christian Church, and the efforts of Thomas Aquinas.²⁷ The corporation developed shortly after European colonialism and the Protestant Reformation,²⁸ as did the supply chain of colonial commodities.²⁹ An early historical benchmark can be seen in the British Regulating Act of 1773 in response to corporate plundering by the British East India Company in India.³⁰ With the industrial revolution, foundations were laid for new types of corporations as the concentration of wealth and power began achieving new levels. Market inefficiencies appeared as these early asymmetries led to harsh working conditions. Striking laborers were treated harshly as they sought reforms.³¹

European and U.S. corporations influence the international commodity markets. In the coffee industry, excessive CEO pay, power and resource

asymmetries, and inefficient pricing reflect these general patterns.³² Profit maximization for shareholder return is the overruling objective, and social obligations are minimized or disregarded.

The commodity markets consist generally of two broad categories of products being bought and sold: agricultural products like sugar, coffee, and cotton, and raw materials like copper and petroleum.³³ Coffee is often second only to petroleum in annual value of volume traded.³⁴ Coffee's 2006 global production reached 125 million 60kg bags, with a consumption of close to 120.4 million bags.³⁵ These large amounts of coffee reflect the toil of many small independent farmers; approximately 25 million farmers participate in growing coffee worldwide.³⁶ Ninety percent of the world's coffee grows in developing nations, and only 15% grows on plantations larger than 50 hectares. Over two-thirds of coffee grows on small plots of 10 hectares.³⁷

In the prevailing market supply chains, small farmers often sell their coffee to private brokers. Brokers in turn sell to a processing plant, which then sells to a local exporter. Any of these previous

stages can be owned by the government. The exporters sell to the international markets and traders. The traders then sell to a roasting company, which subsequently sells to retailers. Smaller retailers and roasters may work through a trader intermediary. The larger corporations, however, usually have their own representatives directly at the market. Of the retail price of coffee, corporations usually receive some 35%, with 55% going to other agents, and only 10% to the farmer producer.³⁸ Among corporations buying on the commodity markets, a small number of large companies dominate. Unroasted coffee traders Neumann and Volcafe together control almost 30% of the market, and the top eight companies control about 56%. The remaining participants control less than 3% each. Among coffee roasters, large corporations control the market to an even greater extent. For example, in 1998, five corporations—Kraft, then a subsidiary of Philip Morris (now Altria), Nestle, Sara Lee, Proctor & Gamble, and Tchibo—controlled 70% of the market.³⁹

Besides the problem of too many powerful corporate middlemen, another aspect of the market's inefficiencies originates on the producer side. A large

percentage of coffee, 60% in 2004, comes from farms in just four countries: Brazil, Vietnam, Colombia, and Indonesia.⁴⁰ These nations influence prices because of their size in the business. Smaller nations are negatively affected by their lesser resources in information and organization.

International Commodity Agreements were created to minimize price inefficiencies. They were first attempted in 1906, with mixed success. After World War II, the U.N. facilitated meetings seeking to minimize price volatility. International Commodity Agreements were negotiated and attempted for many different products, and often involved the use of an International Commodity Organization, which bought stocks and managed supply to prevent large price swings.⁴¹ This was the case for coffee in the International Coffee Agreement (ICA).

During the early 1980s, new arrangements for quotas and buffer stocks of coffee succeeded in maintaining a price window between \$1.20 and \$1.40 per pound for several years. The United States' economic policies and anti-regulatory stance were held in check because of anti-communist and geopolitical concerns about the economic stability of

commodity producing nations. With continuing strong corporate urging and changes in the former Soviet Union, however, the highly influential U.S. changed course and withdrew from the ICA, which led to the Agreement's collapse in 1989.⁴² Other Agreements met a similar fate. The International Tin Agreement, for example, collapsed in 1985 due to various complexities in managing the price.⁴³

For coffee, the unregulated price collapsed to below \$.80 per pound, including lows of close to \$.40, and continued at those levels for many years.⁴⁴ While the market price itself fell below the farmers' costs, the farmers received only a small fraction of it. Unable to meet their needs and obligations with proceeds below their costs, the farmer producers were faced with desperate circumstances and choices. In Ethiopia, for example, a coffee farmer residing in the Kafa area stated,

Five to seven years ago, I was producing seven sacks of red cherry (unprocessed coffee) and this was enough to buy clothes, medicines, services, and to solve so many problems. But now even if I sell four times as much, it is impossible to cover all my expenses. I had to sell my oxen to repay the loan I previously took

out to buy fertilizers and improved seed for my corn, or face prison.⁴⁵

Rwanda provides a powerful study of the negative societal impacts of free market inefficiencies. The genocide of 1994 resulted from a series of events significantly exacerbated by the collapse of the ICA. In 1993, the price of coffee had plunged after the collapse of the Agreement in 1989, and from its window of \$1.20 per pound, sold at well below \$0.80 per pound, with a low of about \$0.40 in mid-1992.⁴⁶ Farmers had to sell their coffee to Rwandex,⁴⁷ the government controlled exporter, in a monopsony situation.⁴⁸ Many farmers pulled out their coffee trees to grow other crops because of the low prices.⁴⁹ The price collapse devastated Rwanda's major source of income, and led to famines.⁵⁰ In light of difficulties in paying international obligations, in September, 1990, the International Monetary Fund stipulated structural adjustment policies such as currency devaluation and social service cuts, which led to a number of difficult conditions like inflation.

Factional tensions became increasingly strained.⁵¹ Apparently motivated by these circumstances, in October, 1990, a group

made up largely of Tutsi refugees, the Rwandan Patriotic Front (RPF), began incursions from Uganda seeking to overcome prohibitions on their return. Anti-Tutsi attacks began, with Tutsi fleeing and making retaliatory strikes. Ten



Figure 2

thousand Tutsi victims were counted at that time, and hundreds of thousands of refugees fled to neighboring countries. Thousands of pro-democracy protesters marched in January, 1992 in the capital of Kigali, and extremist members of Habyarimana's Hutu government advocated a large-scale violent response. Racist death-squads like the Interahamwe were established. Widespread inter-ethnic

violence began in Burundi in October, 1993, leading to large numbers of Hutu refugees entering Rwanda. On April 6, 1994, Habyarimana, along with Burundi's new leader, died in a crash, a presumed assassination by extremists. Shortly afterwards, the infamous mass murder of Tutsis commenced.⁵²

The twenty years prior to the genocide were marked by relative peace and economic stability. The causes of the genocide trace back to the collapse of coffee prices, a result of the abrupt removal of international regulatory agreements due in part to anti-regulatory policies and corporate influence in the U.S.

Fair trade offers a direct means of addressing problems caused by free market inefficiencies and asymmetries. Fair trade had its beginnings in several efforts involving religious communities, activists, and academics, which started during and after World War II, including Oxfam in 1942⁵³ and Ten Thousand Villages a few years later.⁵⁴ In 1973, a Dutch organization imported coffee under socially responsible conditions, and fifteen years later, a priest in Mexico had an innovative idea. A label to identify the standards used in trading responsibly with developing nation

farmers was created.⁵⁵ The mark was called "Max Havelaar." In 1997, the large number of certification organizations that had been formed throughout Europe and North America came together and created the international FairTrade Labelling Organization (FLO).⁵⁶



Figure 3

In fair trade, the import buyers in an industrialized nation recognize the needs of the producer. Fair trade certifiers first require producers to organize in a communally-owned cooperative. Such arrangements enable them to share resources to gain necessary market information, send representatives to learn about production factors, diversify their crops, and access future contracts sources. Second, the international non-profit and non-governmental organization (NGO) FLO studies regions to determine a minimum floor price which will allow producers to meet their costs, and conducts

regular inspections. A small amount, the social premium, is added to this to provide additional funding for investment. The FLO requires importers to provide certain services, such as advancing credit to producers. With these conditions met, the producer cooperative and importer are both qualified to make a contract at the floor price plus the social premium.

Regardless of market price fluctuations, therefore, the producer is guaranteed a living wage. With the extra capital of the social premium, the producers can also better prepare for changing market conditions.⁵⁷ Fair trade additionally requires International Labor Organization labor law standards, as well as environmental standards.

Fair trade works. By 2001 in Rwanda, for example, co-ops had formed, and fair trade arrangements were established

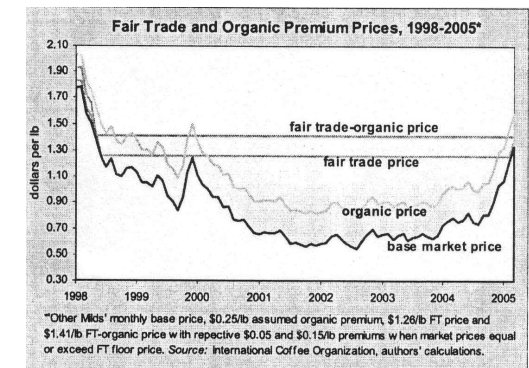


Figure 4

with industrialized nation importers and NGO certifiers. The benefits have been steadily accumulating. For instance, the Kizi Village Cooperative has constructed school facilities and hired teachers. An Internet cafe has also been opened. Farmers can now utilize this service to gain market information. Similar success has met fair trade farmers in Chiapas, Mexico.

The UK's Adam Smith Institute (ASI), a free trade NGO, offers typical arguments against fair trade. It argues in one report that there is no evidence beyond anecdotal stories for the advantages of fair trade. ASI claims that some farmers benefit at the expense of others, framing its argument in terms of broad statistical differences between countries. It contrasts Mexico, which has a large number of fair trade certified farmer cooperatives, with Ethiopia, which has few. Mexico, ASI argues, gets favorable treatment because of its wealthier coffee farmers. Moreover, ASI asserts, a major defect exists in fair trade because only small amounts of a farmer's products, currently 20%, receive the fair trade price. As such, the remaining 80% of farmers' products must be sold at the market price. Finally, ASI suggests that fair trade price floors encourage farmers

to produce inferior goods. The conclusion of this group of arguments seeks to characterize the fair trade approach as a political ideology seeking to dominate market processes and undermine the free market system through "the attempted control and management of production and trade."⁵⁸

In fact, fair trade practitioners seek to solve problems within the current free market practice. ASI neglects the origin of fair trade, which is a response to the inefficient nature of the market because of the asymmetric resources of participants. Moreover, ASI's claim that fair trade favors wealthier nations is unfounded, and appears to be based largely on fair trade's historical origins in Latin America and early focus there.⁵⁹

Furthermore, the claim that Mexico consists of "relatively wealthy" farmers is based on unsubstantiated data, without specific references to clarify income disparities. Mexico is a relatively industrialized country with a high degree of income inequality. Small Mexican farmers have been devastated by inefficient free market commodity price swings, and have experienced significant struggles.⁶⁰

The claim that fair trade is defective

because only 20% of farmers' production sells for the fair trade price reflects ASI's basic failure to analyze fair trade in the context of history and existing market inefficiencies. The 20% is a reflection of fair trade's nascent character in a global commodity market that has been subject to inefficiencies for decades. Progress takes time; this is not a defect. Fair trade entities continue to engage in efforts to build market share for their products. In East Africa, for example, U.S. AID and corporate participants like Starbucks are reported to be establishing higher price arrangements likely to reflect considerations of the standards set by fair trade.⁶¹ As for the argument that fixed floor prices encourage low quality products, fair trade has a rigorous inspection regime that ensures superior goods.

Typical criticisms of fair trade are based on ideology and ad hominem attacks rather than facts. Moreover, they often fail to address the differences between free trade theory and practice or the serious problems in the prevailing practice. For example, arguments against fair trade have stated that the practice represents the artificial inflation of the price of a good. In fact, the oligopolistic character of

world markets already deviates from Adam Smith's original assumptions for free market theory and keeps prices artificially low.

From the market inefficiencies leading to Rwanda's 1994 genocide to the full range of crises of Darfur, immigration, climate change, and poverty, we see that the consequences of economic beliefs which disregard and are hostile to social responsibility are devastating. Fair trade seeks to restore the necessary conditions for free trade as originally defined by Adam Smith: efficient markets of symmetrical participants able to receive rational prices for their products. Designed to internalize costs, fair trade addresses many of the problems that small farmers face. Such a socially responsible practice can also help to reform the conditions that have resulted from deviations from fair and efficient markets in our own industrialized societies. We can learn from fair trade's efforts to help Rwanda, others, and ourselves. As they say, "Amahoro, Rwanda!" We should appreciate the necessary conditions and simple practical steps to create a just, environmentally, and economically sustainable future for everyone.



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- Fig. 1 Income per Head as a Percentage of the North from Bob Sutcliffe, “World Inequality and Globalization,” *Oxford Review of Economic Policy* 20:1 (2004).
- Fig. 2 “Fair Trade and Organic Premium Prices” from Muriel Calo and Timothy A. Wise, “Revaluing Peasant Coffee Production: Organic and Fair trade Markets in Mexico,” *Global Development and Environment Institute* (October 2005).
- Fig. 3 Fair trade labels from <http://www.maxhavelaar.be/international>.
- Fig. 4 Map of Rwanda from the CIA World Factbook, <https://www.cia.gov/library/publications/the-world-factbook/geos/rw.html>.