



Kilimanjaro and Oromia Coffee Value Chain Case Studies: Producer Benefits from Fair Trade and Free Market Channels

Christopher Coles

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dialogue

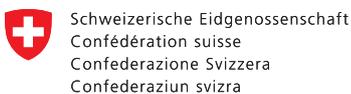
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Kilimanjaro and Oromia
Coffee Value Chain Case
Studies: Producer Benefits
from Fair Trade and Free
Market Channels

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Cover photo

Left: Coffee on the tree. *Right:* Parchment coffee packaged and ready for transportation. (Photos by Christopher Coles)

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List of Acronyms

The following list explains commonly used abbreviations. Others are defined in the text when used.

AKSCG	Association of Kilimanjaro Speciality Coffee Growers (Kilicafé)
CBD	Coffee berry disease
CPU	Central processing unit
CQI	Coffee Quality Institute
DST	Direct Specialty Trade (ECX)
ECX	Ethiopia Commodity Exchange
EU	European Union
FLO	Fairtrade Licensing Organisations
G32	Vyama 32 vya Kahawa; group of 32 primary cooperatives
GoE	Government of Ethiopia
GoT	Government of Tanzania
KCB	Kilimanjaro Cooperative Bank
Kg	Kilogramme(s)
KNCU	Kilimanjaro Native Coffee Union
ICO	International Coffee Organisation
Lb	Pound(s)
MT	Metric tonne(s)
NGO	Non-governmental organisation
OCFCU	Oromia Coffee Farmers Cooperative Union
QCC	Quality Control Centre
SCAA	Specialty Coffee Association of America
TaCRI	Tanzanian Coffee Research Institute
TCB	Tanzania Coffee Board
US¢	US cent(s)
US\$	US dollar(s)

Glossary of Terms

An explanation of value chain terminology commonly used in this paper.

Actor	A participant in a value chain; may be primary (owns products) or secondary (supports primary functions with services such as labour or processing but does not own products)
Downstream	Activities, actors and nodes occurring after the current stage in the chain; an analogy of river flow, substituting products for water. Activities, actors and nodes in the opposite (backward) direction are referred to as 'upstream'.
Function	Primary or secondary (service) activities in the value chain
Gross margin	A measure of profitability, the gross profit expressed as a percentage of revenue
Gross profit	The remainder when direct (variable) costs are subtracted from revenue
Horizontal coordination	A form of upgrading; strengthening linkages within nodes, for example group formation
Node	A functional grouping of actors performing similar activities, for example, production, processing, wholesale and retail nodes.
Upgrading	The process of gaining a better position in the value chain, also applied to the improvement of products, processes, coordination and functional distribution.
Vertical coordination	A form of upgrading; strengthening linkages between nodes, for example contracting.

1 Introduction

Much has been written about the impacts of Fair Trade upon its intended main beneficiaries, the participating producers (see for example, Ruben et al., 2008). Much of this evidence is derived from cases in Latin America; in sub-Saharan Africa the system is relatively young and undocumented. We take two case studies from Eastern Africa to help us examine the micro- meso- and macro-level determinants of producer benefits and make comparisons with ‘free market’ channels for similar products.

Importantly, a) this is a qualitative study, and b) it does not claim to be representative of the entire Fair Trade movement, nor even of the respective study areas. Our objective is to identify factors that affect how intended Fair Trade benefits can be attenuated by political and social institutions at different levels in their translation into the everyday realities for coffee farmers.

We frame our study in the wider context of global evidence for Fair Trade impact at producer level and discuss strategies for maximising the returns of participation, while minimising the disbenefits of non-participation. Most studies report that guaranteed price minima lead to improved and, importantly, more stable incomes. Enhanced stability, where producers are buffered against global market volatility by the Fair Trade system, reduces vulnerability, which may be further reduced through diversification of income sources – commonly, a maximum of around thirty per cent of total output is sold to Fair Trade channels (e.g. Aranda and Morales, 2002).

However, relatively little is known about the role of institutions in this process in the value chain context. Kaplinsky and Morris (2001) defined a value chain as: ‘the full range of activities that are required to bring a product or service from conception, through the different phases of production (involving a combination of physical transformation and the input of various producer services), delivery to final consumers, and final disposal after use’. The value chain concept is a powerful tool for measuring the distribution of benefits among supply chain participants and in recent years international development organisations have increasingly employed value chain analysis and development approaches to frame policies and projects in market development in rural areas in developing countries.

The paper begins with descriptions of each study area and our methodologies. We then present background information on the global coffee market. Part 2 introduces the objectives, methods and study sites. Part 3 presents the results and part 4 summarises their implications for development policy and practice.

1.1 The global coffee market

Coffee is the second most traded commodity, and prior to the global financial crisis Northern countries had been consuming ever increasing volumes year on year. There is

a glut of low grade commodity coffee while high quality coffee is in short supply (Daviron and Ponte, 2005). This situation creates a distinct price differential between bulk low-grade 'grinder' coffee and speciality, or 'gourmet', products supplied to higher value markets. At the higher value end of the market consumers' increasing consideration of social and environmental issues in making purchasing decisions has led to a proliferation of new certifications and distinctions such as 'bird coffee', 'shade coffee', forest coffee, Fair Trade coffee, organic coffee and even 'woman coffee' as well as combinations of these.

Lower value markets are an oligopsony of large, multinational firms who buy beans low and sell roasted coffee high (e.g. Ponte, 2002). Higher value 'speciality' markets are more diversified and competitive but larger players, such as Starbucks and Ecom Agroindustrial Supply Corporation Ltd. are seeking to gain greater control of price and supply.

Speciality coffee is defined as coffee from a known geographic origin that has a value premium above commercial grade coffee due to its high cup quality and particular attributes that it possesses. According to a key industry informant, this market requires around 7.2m bags (0.43m MT) of coffee annually, representing approximately 1 per cent of total washed mild Arabica production. At 30-60 per cent above the prevailing market value this market segment has a value of at least US\$ 2bn (assuming a relatively low FOB price of US\$1.50/lb). The Specialty Coffee Association of America (SCAA) estimated that the consumer market in 2007 was worth US\$13.6bn in the USA alone. As firms such as Starbucks (currently the biggest Fair Trade coffee buyer), Costa, Caffè Nero and McDonald's attempt to position themselves as leading brands in terms of responsiveness to the new consumer consciousness this 'niche' market is growing as it becomes increasingly 'mainstream'.

Volume and price drive the commodity market, whereas quality and traceability with a high degree of geographic specificity are the entry criteria for the speciality market. The requirement for traceability is driven by:

- Consumer interest in farm, community or geographical area-specific products
- Opportunities to positively influence quality through market ties
- A commitment to reinvestment in farm communities, particularly in pro-poor social infrastructure (e.g. education, water supply, empowerment and so on)
- Socially and environmentally conscious companies seeking sustainable supply chains
- Increasing concern for food safety and tightening inspection and testing regimens.

Around 80 per cent of smallholder coffee farmers are not linked to Fair Trade certified markets and those that are sell around 20-30 per cent of their production to this market

on average (Ruben et al., 2008). The implications of this are twofold; first, there is a large latent potential to increase the volume of smallholder-produced Fair Trade-certified coffee, and second, if smallholders cannot meet demand for certified product buyers will look to accredited plantations.

Production tends to rise and fall cyclically (figure 1) but industry stakeholders and recent statistics point to a broader overall trend of decreasing production of speciality coffee. This is associated with a number of factors including erratic rainfall patterns in production areas, conversion of farmland to other uses, producers' perception of coffee growing as relatively unprofitable compared with alternative activities and diversification into other livelihood strategies.

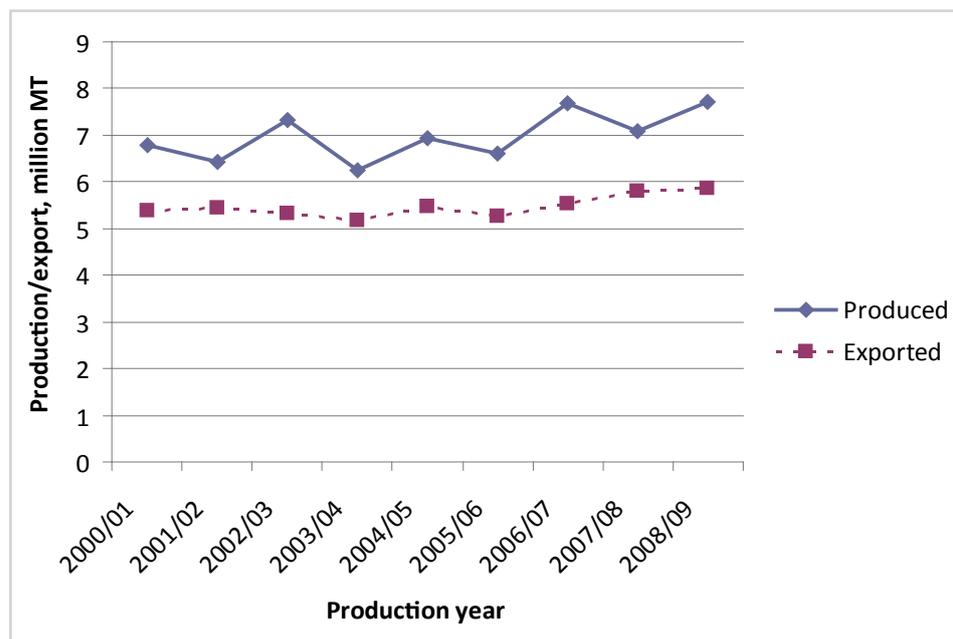


Figure 1: World coffee production and export from production years 2000/01 to 2008/09.

(Source: International Coffee Organisation data)

UK Fair Trade coffee sales values have increased tenfold from £15m in 2000 to over £150m in 2010, fuelled by the heavy investment in brand and market development by processors and retailers. There was a trebling of global green Fair Trade coffee volumes from 30,000MT in 2005 to nearly 100,000 MT in 2010.¹

¹ Information supplied by FLO.

2 Methods

2.1 Objectives

These case studies form part of a wider research project on the political economy of coffee. The objectives of this research project were (a) to examine the effects of coffee price changes on the livelihoods of producers in the case study areas; (b) to explore

coffee value chains and the stakeholders involved at various levels in the chain; (c) to identify household responses and coping strategies for dealing with price changes and changing marketing arrangements (e.g. speciality markets, Fair Trade arrangements); and (d) to assess, as far as possible, the impacts of changing production patterns and marketing channels on income, livelihoods and the environment.

This present study focuses on the value chain for coffee in Ethiopia and Tanzania with the objective of assessing the direct and indirect benefits for smallholder producers participating in these Fair Trade marketing chains. The observations we make refer to the small sample of groups we visited, but the institutional and policy factors we identify are applicable to the respective countries and their relationships with global markets.

2.2 Research methodology

Ethiopia and Tanzania are two of the three case studies that were selected for the research project on the political economy of coffee. Ethiopia is the centre of origin for Arabica coffee (*Coffea arabica*). Its main production is concentrated in the south-western, southern and eastern highlands of the country. Coffee production, consumption and trade have a long history in Ethiopia. It is believed that coffee originated in Kaffa province, and in the 14th century was brought to Yemen, where the Dutch then found the drink and took coffee seedlings to Indonesia in the 17th century, where first plantations were established. It is estimated that today around 15 million people in Ethiopia depend directly or indirectly on the coffee economy. Coffee accounts for 69% of all agricultural export (Tadesse Woldemariam Gole, 2002). Ethiopia is insofar different from the other African producers as it has a historically established tradition of coffee consumption within the country. In Tanzania, as in Kenya, Arabica coffee was introduced as a commercial crop around 1900 by the then colonial administration. Although for the national economy less important than in Ethiopia, coffee constituted the largest export crop, representing about 5% of total export earnings, 24% of traditional cash crops and generating export earnings averaging US\$100 million p.a. over the past 30 years (Bafes, 2003, TCB / TaCRI, 2010). In both Ethiopia and Tanzania, coffee production is important for the livelihoods of producers in specific highland areas, that offer considerable comparative advantages for coffee production.

The selection of cooperatives in the two case study sites was consciously non-random and non-stratified. We wanted to work with groups that represented a range of levels of functionality so that we could examine the reasons behind these differences. In this sense, finding associations with significant challenges was at least as important as visiting those that were highly functional.

Our research was qualitative; all of our findings are from interviews and discussions with key stakeholders whose identities we have withheld in order to preserve confidentiality. This is particularly important for these cases, where much of the information offered was politically and commercially sensitive.

2.2.1 Tanzania case study

Fieldwork took place in November 2009. We held interviews and focus group discussions with executive and non-executive members of three primary cooperative societies, one belonging to each of the Kilimanjaro region’s secondary organisations – KNCU (Marangu East cooperative), AKSCG (Kishisha Farmers’ Business Group) and the G32 (Vyama 32 vya Kahawa; Mruwia cooperative) and other value chain actors and stakeholders in Moshi town (figure 2). Detailed information on the socio-economic background of the study area appears in Mhando and Mbeyale (2010).

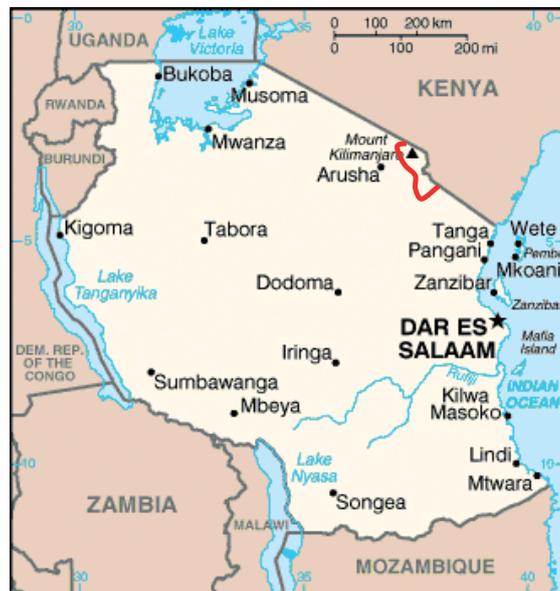


Figure 2: Map of Tanzania showing the location of Kilimanjaro Region and Moshi town. (Source: CIA World Factbook)

2.2.2 Ethiopia case study

Fieldwork took place in August 2009. We interviewed members and office holders of coffee farmers’ primary cooperatives, in addition to non-member farmers and coffee traders in Haro, Gengi-Ilbu and Chidero-Suse kebeles (the smallest administrative division) in Jimma Zone, in addition to other actors in Jimma and Addis Ababa (figure

3). Our sample of cooperatives was selected to represent a spectrum of functionality, from non-Fair Trade registered (Chidero-Suse), Fair Trade-registered but not regularly purchasing coffee (Gengi-Ilbu) to Fair Trade-registered and regularly supplying the cooperative union (Haro). Each of the groups in our sample had considerable levels of historical debt as the result of buyers defaulting on payments for consignments of coffee.

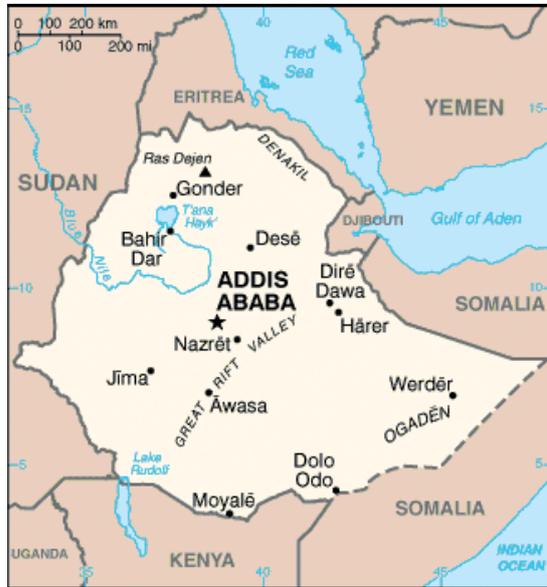


Figure 3: Map of Ethiopia showing the location of Jimma (Jima). (Source: CIA World Factbook)

3 Results

3.1 Producers' institutions

The three umbrella or 'apex' producers' institutions, KNCU, G32 and AKSCG, are Fair Trade-registered. In each case, certification is held centrally, not by individual cooperatives.

KNCU was the original Tanzanian coffee union, registered in 1932, abolished in 1976 and reinstated in 1982. In 1984, it was registered as a limited company to protect it from the asset stripping that it experienced during the period between abolition and reformation.

More recently, the formation of competing clusters of smallholders groups has seen it halve its original size of 120,000 farmers in ninety-seven groups to 60,000 in sixty-seven groups in 2009, each smallholder with an average of 0.5ha of land.

By the time of its reinstatement, the KNCU had been stripped of much of its capital and assets, forcing it to rely on commercial bank loans at interest rates of up to twenty-five per cent APR to pay members for their coffee. Consequently initial payments (of the three-payment system still currently in operation) to farmers were very small and often delayed. As a response the farmers themselves formed the Kilimanjaro Cooperative Bank (KCB) in 1999, which pioneered the warehouse receipt system. However, KNCU has subsequently had ongoing difficulties with securing KCB finance and currently relies on commercial loans. In 1994, over US\$500,000 were owed to producers in the form of missing contributions to KCB formation and currently the union's debt is estimated to be in excess of US\$600,000.

In response to these difficulties, thirty-two primary cooperatives within KNCU that were able to fulfil the KCB's lending criteria chose to market their coffee within their own network known as the 'G32'. This organisation functions in a similar manner to a cooperative union, with the central committee providing coordination and marketing services to individual groups.

AKSCG (brand name Kilicafé) was launched in 2001 with ten founder groups including many of the strongest KNCU farmers. Its formation was facilitated by Technoserve using a Farmer Business Group (FBG) model.

All cooperatives in the Ethiopian case belong to the Oromia Coffee Farmers' Cooperative Union (OCFCU), which was founded in 1999 and currently has 143 member cooperatives comprising around 133,000 farmers. It markets coffee on behalf of members and returns profit dividends, along with Fair Trade premium payments, to them pro rata.

3.2 Value chain functioning

All coffee produced and marketed by organisations in the Tanzanian case was washed (mild) Arabica. Ripe red cherries are pulped on-farm by hand or in central processing units (CPUs) to make parchment coffee. This is then bulked and transported to a curing plant for secondary processing, where the parchment is removed and the resulting green coffee is sorted, graded and polished. Curing plants are operated by private processing companies and the Tanganyika Coffee Curing Company (TCCO). Coffee producers are permitted, at the discretion of the Tanzania Coffee Board (TCB), to export their coffee directly to buyers. However, all the KNCU and G32 groups choose to put their output through the TCB auction, which is the mandatory trading forum for all coffee that is not licensed for direct export.

In Ethiopia, the cooperatives produce both dry-processed (hard) and washed Arabica. Primary cooperatives linked to OCFCU operate their own CPUs and sell washed parchment coffee to the union, which then performs all secondary processing, marketing and export functions.

Dry-processed coffee is dried on-farm and dehulled at a private facility in the production area, either by producers or collectors, and traded through the Ethiopian Commodity Exchange (ECX) auction. The free market route for (the majority of) washed coffee that does not enter union-mediated Fair Trade channels comprises local collectors working (illegally) for suppliers, who arranged pulping at a privately-owned CPU and forward the parchment coffee to auction, often via their own agents. Curing is performed after sale to exporters via auction at the ECX. In both countries, coffee graded below export standard is sold on the domestic market.

In early 2010, the ECX introduced the Direct Speciality Trading (DST) system, a decentralised auction of the highest quality coffee direct to importers. In this case exporters provide services to producers but do not take ownership of the coffee.

In both cases, producers are entirely free to sell their coffee outside cooperatives to licensed private traders. This choice may depend upon their immediate need for cash, access to markets and the relative prices on offer.

3.3 Quality and price relationship

In both cases there are disconnects between coffee quality and the price it fetches, which de-incentivise investment in quality by producers. In Kilimanjaro, the low production volume is a major quality constraint because it creates the need to aggregate consignments of coffee at the secondary processing stage, thereby eliminating traceability to individual growers, who cannot be rewarded according to the quality of their production.

The large number of compulsory buying posts in some villages creates extreme competition among private traders, who tend to accept coffee regardless of its quality in order to maximise volumes purchased. In other villages, the ‘veto’ is used by authorities to ban private collectors altogether, eliminating competition and granting the local cooperative a monopsony. Lastly, pricing instruments that reward quality are rather blunt; coffee from up to twenty societies is bulked and auctioned together and, therefore, the premium KNCU pays to societies whose output fetches the highest auction price cannot discriminate among individual producers.

In Jimma zone, cooperatives’ debt levels mean that they struggle to raise working capital in time for the annual harvest. This delay in entering the market means that private buyers operate without competition and buy as much coffee as possible at prices as low as half the price offered before cooperatives eventually enter the market. Time sensitivity of processing high quality cherries compels farmers to accept any price. Similarly to the Kilimanjaro case, indiscriminate purchase by private buyers to maximise their market share also contributes to the price-quality disconnect.

3.4 Policy and legal frameworks

Almost all coffee industry matters in Tanzania are controlled by the Tanzania Coffee Board (TCB) in Moshi, the directorate of which is politically appointed. The most salient features of its Tanzania Coffee Industry Regulations, 2003 (emanating from the Coffee Industry Act of 2001) are as follows:

- All growers, central pulpers, warehouse keepers, processors, exporters and liquorers are required to register with, and obtain a licence from, the TCB, which is at liberty to refuse applications as it sees fit.
- No one company (defined as a person or organisation operating under the same management or control) except a cooperative is permitted to hold an operating licence for more than one of the functions of buying, curing or exporting coffee.
- Buying of coffee in the production area anywhere outside an official ‘buying post’ is prohibited.
- All coffee that is not approved for a direct export licence must pass through the central auction. The TCB retains full control over which coffee may or may not be directly exported.

These rules were a bid to reduce market power of integrated exporters. Larger firms have responded by registering separate subsidiaries under different names, adding to transaction costs. High, inflexible fees for multiple licenses are not affordable by smaller businesses and, therefore, this policy has had the opposite of its intended effect – small firms are priced out of the market while seventy per cent of auctioned coffee by volume and value is purchased by the top five integrated subsidiaries of multinational buyers. In addition, the additional costs are passed back to the farmers in the prices they receive.

Another unintended anti-poor effect of this legislation is the inability of private buyers to emulate the contingent contracting system employed by cooperatives, which allows them to pass back to producers some of the proceeds of premium price onward sales. In Kilimanjaro region, the private sector is at least as efficient as unions at transmitting value to growers but it can legitimately only offer single payments due to licensing and trading legislation. In theory, cooperative unions are an assemblage of individual producers. However, in practice there is an administrative cadre running central services on a salaried basis.

At twenty-three per cent of its export earnings (table 1) the Ethiopian Government is eager to ensure that the country's coffee remains competitive. The Ministry of Agriculture and Rural Development's Coffee Quality Control and Marketing Proclamation 602 of August 2008:

- Stipulates the Government quality inspection regime and a moisture level standard of not more than twelve per cent.
- Defines domestic consumption coffee as that not fit for export and prohibits the sale of export grade coffee in domestic markets.
- Specifies how, where, when and by whom trading, transportation and storage of coffee in its various forms may take place. This includes the prohibition of intermediaries other than 'suppliers' who buy from producers and deliver to the ECX; in other words, it bans collectors and suppliers' agents. It also determines that coffee should not be held for more than six months by suppliers and must be exported before the beginning of following season.
- Forbids the export of coffee by anyone except the farmer unless it has been purchased at the ECX, but allows provision for cooperative unions to export directly and follow their own quality control procedures.
- Requires coffee to be exported unmixed and with its place of origin recorded.

In the post-Derg era of liberalisation the Government-imposed, politically orientated Producer Cooperatives were transformed into farmer owned market oriented businesses according to the provisions of the Cooperative Societies Proclamation 147/1998 and its amendment 402/2004. These set out the objectives, guiding principles, legal and financial obligations, constitutional requirements and rights for societies, perhaps the most significant and salient of which to this case is the stipulation that that no more than 30 per cent of profits shall be utilised to run the cooperative and its services, the remaining 70 per cent being returned to members as dividends. In our study, one cooperative made no profit through failure to purchase coffee and another spent a significant proportion of its profits servicing its debts. It is only better functioning groups that can aspire to meet this target.

In terms of commercial governance, quality standards are set by chain leaders – roasted coffee retailers in importing countries – and regulatory bodies such as inspection and

certification institutions (for example, the Fairtrade Foundation) and passed down each strand of the chain. However, among the now illegal collectors in the free market channel are some who are accused of disregarding standards in order to maximise the volume they supply. This adds to the price-quality disconnect exhibited by the ‘conventional’ local coffee market.

3.5 Corruption, collusion and illegality

Historically, collusion among buyers in Tanzania was a major problem. Although the legal framework officially prohibits the purchase of own coffee, companies would conspire to retain ownership of so-called ‘captive coffee’ through the auction process. This problem has been alleviated to some extent but 70 per cent of auctioned coffee is still bought by five companies, indicating that the market is not fully competitive. Government policy contributes to this situation; the requirement for companies to register as separate entities to perform each function in the chain is easily overcome by multinational subsidiaries, albeit that these costs are met ultimately by producers in the form of lower prices, but stifles competition from smaller, domestic firms, which are required to pay the same fees in order to enter the market.

The TCB maintains strict control over the grading process and has the power to withhold permission to export based upon its own quality assessment. That KNCU has only recently been able to sell coffee outside the TCB auction, and that it is highly improbable that the coffee it produces has always been of lower than export quality, suggests that the Board’s decision making process is, at the very least, somewhat arbitrary.

In addition, AKSCG was temporarily suspended by the FLO for marketing irregularities, with coffee sourced from non-Fair Trade audited sources being sold under the centrally-held Fair Trade licence. This kind of practice risks damaging the Fair Trade brand, and that of Kilimanjaro coffee, with potentially negative consequences for producers’ incomes.

In Ethiopia, interviewees working in the free market channel reported a chain of corruption that included the inclusion by suppliers of higher quality bags in lower quality consignments to upgrade classification in collusion with farmers, drivers and samplers; officially all 150 sacks in a standard consignment are sampled but in practice this is not the case. In addition, they described the transfer of bags between areas of the warehouse demarcated for the storage of coffee of different quality grades, said to be performed in collusion with some exporters. There is also written evidence that some lots sold at the ECX experience weight losses that are far more substantial than the relatively small mass reduction attributable to further drying; in these cases ECX refunds buyers accordingly.

In addition to the ongoing conflict between the GoE and exporters there are strong suggestions of the existence of corruption, illegality and inefficiency within the free market exportable coffee chain. For example, interviewees reported knowledge of contra-band consignments leaving Ethiopia by road to neighbouring countries.

3.6 Financial benefits of Fair Trade and free market channels

Profitability analysis for one sample groups of farmers supplying Fair Trade and free market channels (tables 2 and 3) and value capture (figure 4) reveals that:

- Despite often very healthy gross margins for producers, net incomes from coffee farming (which represent around seventy-five per cent of total household earnings) for groups we sampled are low because low yields and small landholdings limit production volume. Some smallholders deliver only a few kilogrammes of parchment coffee per season.
- The major reason for the lowest profit margins reported in Tanzanian sample groups was the high incidence of coffee berry disease, necessitating the use of expensive fungicides even where farms are relatively large and gross revenue (production) is relatively high.
- Prices paid to farmers on the free market are generally lower than those paid by farmers' organisations. Although private collectors compete on price with farmers' organisation in coffee purchase (first payment by groups) they are not able to make additional payments in instalments after selling the coffee on (contingent contract).
- Small producers' share of retail prices varied from 1-7 per cent in each case. The UK market, from which indicative prices were taken, is relatively high and, therefore, this estimate of relative gain is close to the minimum value.
- Retail prices are given for indicative purposes only and do not imply 'super' profits for importers, packers, roasters, distributors and retailers. The costs of doing business in end markets such as the UK are high and include marketing and market research, promotion, logistics and customer support.
- In Tanzania, the G32 group and KNCU practices of auctioning the coffee raises the price at FOB level but, despite additional deductions by AKSCG for CPU loan repayments, the latter is more efficient at transmitting money to individual farmers. However, none of the farmer-based institutions deliver a greater share of value to producers than the free market. Indeed, at the global average 2008 retail price for roasted coffee (which may be a better representation of the value of the poorer quality coffee in channel I) of US\$ 11.78 per kilogramme² the producer gains eleven per cent of value from the private channel, compared with around twelve per cent for higher priced certified coffees if using this same average benchmark.

² International Coffee Organisation (ICO) data.

- Inefficiencies in the value chain are paid for by the farmers. In each of the strands, transaction costs, including capital costs, management overheads and taxation, limit the unit prices that producers receive for their coffee.
- In Ethiopia, all producers supply both red and dry cherries and, therefore, each sell to at least two channels. Importantly, they all trade at least some of their production on the free market. The cooperatives in the study area have yet to supply the DST auction.

The greatest degree of variation in economic gains among individual growers is explained by:

- Value added – actors who process coffee attain higher margins, prices and proportions of value captured. For example, farmers who sell hulled green coffee can obtain more of the market value than those selling only dried cherries.
- Volumes handled – although they may not achieve the highest gross margins the very large number of units handled increases the potential profit and losses of actors who perform bulking functions.
- Access to, and use of, factors of production – the wide variation in income at production level is due partly to variations in productivity but mostly to area of landholdings. Although producers have very healthy margins their absolute income is severely restricted by the generally very small area they cultivate. In addition, producers who employ manual labour have lower margins and gross profits than those who utilise only household labour. Similarly, access to processing facilities is a major determinant of a) transport and processing costs, and b) value added. Access to capital drives prices and determines profits – producers with limited capital are forced to sell at low prices whereas intermediaries and cooperatives with quantitative constraints are restricted in the volume of coffee they can purchase and the prices they are able to offer.
- Cost efficiency – in addition to differential use of labour at the production node, greater processing, transport and storage efficiencies reduce costs and increase profit
- Inter-group differences in sales arrangements – even within any one strand the groups of actors interviewed differ in their buying and selling arrangements depending upon factors such as their proximity to collection and processing stations, their productivity, their access to capital and their skills in production, processing or marketing.

	Producer Farm gate	Supplier/ processor Auction	Exporter FOB	Retailer Retail
Tanzania				
<i>Open market</i>				
Price	1.27	2.60	3.00	17.44
% FOB	42	44/87*		
% Retail	8/15*			
<i>AKSCG</i>				
Price	1.43		3.40	19.91
% FOB	42		58	
% Retail	7		10	
<i>G32/KNCU</i>				
Price	1.47	2.73	4.00	19.91
% FOB	37			
% Retail	7			
Ethiopia				
<i>Open market</i>				
Price (red cherries)	0.18	2.23	3.78	34.00
Price (dry cherries)	0.60			
Price (dry green coffee)	1.22	1.41	2.67	34.00
% FOB (washed)	5	57	41	
% FOB (unwashed)	23–46	7–30	47	
% Retail (washed)	0.5	2	5	
% Retail (unwashed)	2–4	8	4	
<i>Coop union</i>				
Price (red cherries)	0.26	2.00	4.40	34.00
% FOB	6	40	54	
% Retail	1	5	7	

*Processors and collectors/medium-scale producers

Figure 4: Average prices (US\$) and value shares at four nodes in open market and Fair Trade value chain strands in Tanzania and Ethiopia.

Table 1: The relative contribution of coffee to Ethiopia's export trade, years 1999/2000 to 2009/10.

	1999/2000	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10 (proj)
Exports FOB	486	463	452	483	600	818	1001	1189	1466	1447	1736
Coffee	262	182	163	165	223	335	354	424	525	376	395
Non-coffee	224	281	289	318	377	483	647	765	941	1071	1341
Coffee % of total	53.9	39.3	36.1	34.2	37.2	41.0	35.4	35.7	35.8	26.0	22.8

Table 2: Prices, margins, revenues and profits obtained by farmers in sample groups from sales of parchment and green coffee to buyers in each of the three value chain strands in Tanzania. Gross margins are gross profit expressed as a percentage of sales revenue. In this case they are calculated from the most common cost and production scenarios in each of the groups sampled.

		Price	Margin	Revenue	Profit
Mruwia, G32 group**	Green coffee to buyer via G32	1.35-1.46	61	173.4	106.3
Kishisha FBG, AKSCG group (high occurrence of CBD)	Green coffee to buyer via AKSCG	1.43	-1	1142.0	-16.4
	Parchment coffee to private collector	1.13	-28	901.6	-256.8
Kishisha FBG, AKSCG group (low occurrence of CBD)	Green coffee to buyer via AKSCG	1.43	29	1142.0	369.8
	Parchment coffee to private collector	1.15	9	901.6	85.06

*Minima = conventional, maxima = certified organic or Fairtrade.

**Private collectors rarely visit Mruwia.

(Source: survey data)

- Inter-group differences in sales arrangements – even within any one strand the groups of actors interviewed differ in their buying and selling arrangements depending upon factors such as their proximity to collection and processing stations, their productivity, their access to capital and their skills in production, processing or marketing.
- Ability to access direct export channels, either through institutional membership or satisfying minimum output volume as a single producer.

In Ethiopia, intermediaries avoid negative margins associated with price fluctuations on the legal market by selling coffee illegally when the market prices falls to unprofitable levels. The incomes of producers in our sample are restricted because they sell only red cherries and not dry processed coffee to the cooperative, which is only traded in the free market chain. However, these growers obtain better prices than those selling to the free market, where prices only increase when cooperatives enter.

For any one individual farmer, selling to a functional cooperative at a stable price for the entire season would result in a higher income than selling to private traders at extremely low prices early in the season and then at a price slightly higher than that of the cooperative toward the end. Moreover, when cooperatives buy coffee, prices from private buyers rise for all producers.

Table 3: Prices, margins, revenues and profits obtained by farmers in sales transactions of dry and washed coffee based upon the modal landholding size of each sample group in Ethiopia. Revenue and profit are expressed in US\$.

Group	Transaction	US\$/kg	Gross margin	Mean gross revenue/season, US\$	Mean net profit/season, US\$
Haro cooperative	Dry cherries to supplier	0.61	42%	512.4	213.4
	Dry cherries to collector	0.59	39%	494.1	195.1
	Red cherries to cooperative	0.22	58%*	466.7	449.6*
	Red cherries to collector	0.24	43%	505.6	217.0
Gengi-Ilbu cooperative**	Dry cherries to collector	0.56	67%	229.4	154.7
	Dry green coffee to supplier***	1.22	67%	247.0	165.6
	Red cherries to cooperative	0.30	58%	222.2	128.2
	Red cherries to collector	0.22	44%	166.7	72.7
Chidero-Suse cooperative	Dry cherries to collector	0.63	71%	273.0	194.5
	Red cherries to pulper	0.26	59%	155.6	91.3
	Red cherries to collector	0.19	42%	111.1	46.8
Chidero-Suse non-cooperative	Dry cherries to collector	0.63	91%	426.5	387.7
	Red cherries to pulper	0.19	72%	111.1	79.8
	Red cherries to collector	0.17	69%	100.0	68.7

*Calculated including the profit dividend

**Note that modal landholding area for this group is 50% of that of the others

***1kg dried cherries = 0.5kg green coffee

(Source: survey data)

3.7 Non-financial benefits of Fair Trade and free market channels

Fair Trade premium payments translate into non-financial benefits. However, these payments are contingent upon the volume of Fair Trade certified coffee supplied to buyers via unions – only cooperatives that are functional and can supply coffee on a regular basis can gain from these payments; this requires them to be well capitalised and well managed. Of the cooperatives we visited in Oromia, for example, which were all heavily indebted, one had bought no coffee for several seasons and, therefore, could return no Fair Trade premia, one had not purchased coffee in 2008/09 but had received some payments in the past, and one had generated enough money to fund a kebele water infrastructure project.

In addition, many of the producers we spoke with complained that they were not aware of how Fair Trade payments were calculated, how they were disbursed and what the decision making process at community level entailed. Cooperatives and cooperative unions keep written records of payment schedules and, therefore, the perceived lack of transparency may simply be a communication failure.

In Ethiopia, all cooperatives are entitled to assistance from the Federal Agency of Cooperatives. This includes information on the market price of coffee and assistance with calculating break even points, group establishment and registration, auditing, assistance with credit acquisition, problem identification, technical and marketing support, and training in accounting, quality improvement and management skills. In addition, it facilitates networking with NGOs and researchers.

The OCFCU collaborates with the cooperatives agency to offer member groups facilitation of credit with commercial banks and coverage of minimum interest payments on long-term loans, training in organisational development, and recruitment and salaries for professional managers.

The legal frameworks of both countries make it illegal for export companies to trade directly with producers. In addition, companies are reluctant to make material investments in producers because capital is tied up for long periods, there is a very high risk of default by producers, pre-financing may lead to oversupply and advanced payments or inputs would incur interest. However, companies such as Starbucks Ltd. are providing technical support to coffee producers on a non-contract basis with the aim of increasing quality and productivity so that ultimately its requirements can be met and the price it pays is driven down by supply side increases (information from key industry informant).

As with the Fair Trade system, this kind of support is unavailable to producers who are not members of organised groups, either because they do not exist or because they are excluded by entry requirements. With the inability to build longer-term relationships with private buyers, these producers do not have access to any non-financial benefits such as the capacity building support of Fair Trade networks or embedded services as part of commercial transactions.

4 Conclusions and Discussion

In both cases, many producers linked to Fair Trade markets enjoyed (to a varying degree) many of the benefits reported in the wider literature, namely higher prices through guarantees and increased local competition, enhanced access to affordable finance for production, a reliable market for outputs, access to technical support and business development services, exposure to international markets and new business practices, and capitalisation of community development initiatives through the Fair Trade premium.

Although the particular challenges facing the limited sample of cooperatives in our study are not necessarily transferrable, many of the factors we identified as affecting the extent to which producers benefit from their participation in Fair Trade are more widely applicable.

4.1 The role of producers' institutions in determining benefits

A major result of this research is confirmation that the mere existence of a purchasing cooperative can bring benefits to all local farmers through increased competition leading to higher prices from private buyers (in addition to the premia members can gain from sales to certified markets). However, the level of functionality, particularly raising sufficient capital to purchase coffee in a timely manner, of such institutions is very important in that it governs the extent to which they can deliver these benefits, and functionality depends upon strong leadership and good management.

In addition, we have shown how institutions can further limit benefits through structural and operational inefficiencies, which raise costs that are passed on to producers. Indebtedness prevents efficient mobilisation of finance and limits profitability, while practices such as auctioning coffee earmarked for direct export raises transaction costs

The decline, in comparison with Parrish, Luzadis and Bentley's (2005) study, in the performance of AKSCG relative to KNCU in returning value at the farmer level may have been due to management and coordination issues in AKSCG, which was temporarily suspended from the FLO as the result of anomalies in the marketing process. The importance of the quality of management and leadership in determining the extent to which producers benefit from their participation in Fair Trade markets cannot be overstated – it is generally the case that the use of groups in value chain upgrading interventions is more effective when they are functional and have effective leadership (Simmons, Patrick and Winters, 2003).

In cases where there are no producer groups or producers cannot fulfil group entry requirements – for example, female producers who supply labour but do not own land – non-members are excluded from both financial and non-financial benefits of linkage to Fair Trade channels.

4.2 Limitations on outputs

Low output limits benefits to farmers in several ways – firstly, even at relatively high unit prices their income is limited by the volume sold. Secondly, small quantities from individual farmers must be bulked to achieve economies of scale, incurring costs and removing individual traceability (and with it the ability to incentivise high quality production by differential pricing on an individual basis). In addition, low volumes limit machinery utilisation rates, resulting in higher unit processing costs in order to cover fixed overheads.

The limited proportion of output that can be sold into premium markets in many cases is an additional limit on producer income. In addition, it has the side effect of limiting the degree to which producers are aware of the Fair Trade system. However, the recent growth of the market is increasing the potential benefits to producers.

Deepening Fair Trade markets may increase the proportion sold into them, but the fundamental issues of small landholdings in Ethiopia and fragmentation and diversification in Tanzania are far more intractable. In the Tanzanian case, the move away from coffee into alternative livelihoods may only be a problem for the producers who remain and for the internationally strong Kilimanjaro brand.

4.3 Implications for Fair Trade

The Fair Trade system has created well documented benefits for producers in Latin America (e.g. Ruben, 2008). However, these success stories have yet to be repeated to the same extent in Africa. Producers in our study had little information or understanding of the Fair Trade system. This was partly a function of the limited extent to which some of the groups in our cases engaged with the Fair Trade market at the time of the study, and partly due to inadequate channels of communications between central management and farmers.

Both countries have experienced periods of centralised socialist government and farmers were forcefully organised into cooperatives. Often, these cooperatives were also misused for political aims. The willingness to organise and trust cooperatives at present is limited, due partly to historical experience. Current weakness in management and alleged corruption in some cooperatives is set against other groups that perform very well. Reversing many farmers' attitudes toward cooperatives will depend upon all of them demonstrably delivering transparent to their members.

In contrast to the situation in Oromia, the open market channel in Kilimanjaro compared favourably to the institutional channels in its efficiency in transferring money to farmers. This was because high transaction costs of institutional marketing practices neutralised the benefits of higher prices. In addition, an upward trend in world prices for high quality coffee reduced the differential between the New York Stock Exchange-linked auction prices and Fair Trade minimum prices in Tanzania. In a world where supply of all coffees in the 2009-10 growing season fell below demand by 6-8 million

60kg bags (International Coffee Organisation data), and demand for speciality coffee continues to rise, this situation is set to continue. Given that the central principle of the Fair Trade system is in maintaining minimum fair pricing standards, this poses a challenge to the Fair Trade movement.

Both cases raised the need for producer organisations to become more transparent and accountable in the manner in which processes work. For example, decisions surrounding the use of Fair Trade premia, and in which payments are calculated and managed on the farmers' behalf.

4.4 Implications for public policy

The governments of both countries could potentially play a role in increasing and widening benefits from both Fair Trade and non-Fair Trade coffee sales. In Tanzania, the TCB's role in the export process could be made less arbitrary and licensing regulations could be relaxed to lower entry barriers for smaller export companies and, in addition, to reduce transaction costs to existing buyers that are passed on to farmers, and to allow producers who are excluded from groups to access some of the benefits of longer-term relationships with buyers.

In both auction systems, barriers to entry for individual producers are high and exclusive; marketing requirements and legislation prohibiting exporters from buying direct from producers has the regressive side-effect of limiting small-scale producers who are not members of cooperatives from the benefits of longer-term trading relationships. Although the ECX-DST spot market, for example, has the capacity to generate high prices on any one day, it has very limited 'outreach' selling only small volumes for those who can meet its entry requirements. Without institutional links to markets or the capacity to export directly themselves, individual smallholders are at the mercy of the two open market systems, with their associated intermediaries, bureaucracy and (in the case of Ethiopia) reported irregularities and corruption.

In both cases there are examples of over-regulation that has outcomes in direct opposition to the stated objectives – a strong example is the manner in which Tanzania's blanket application of its licensing system reduces competition by creating the same entry barriers for small, local firms as multinational subsidiary companies.

In summary, any form of longer-term marketing relationship delivers benefits to producers regardless of the model. However, with regard to Fair Trade specifically, advocates should be careful to avoid implying 'poverty eradication' outcomes – although there are clear financial and non-financial benefits of linkage to certified product markets the main constraint remains landholding size; marginal price increases for the coffee crop are insufficient to lift a five-member household farming 0.25ha out of poverty. The challenge for Fair Trade, particularly during a period when open market coffee prices remain high, is to improve communications, transparency and democratic processes at the producer level so that benefits continue not only to flow, but also to be understood shared equitably by all participants.

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As part of a transversal research project exploring coffee value chains in Tanzania, Ethiopia and Kenya, this study traced Fair Trade and open market coffee value chains in Kiliman-jaro Region, Tanzania and in Jimma Region, Ethiopia. It compares the governance frameworks and benefit distribution among actors in both chains and makes recommendations for policy changes in order to maximise returns for smallholder farmers.

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