dec 1994

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Stichting Onderzoek Multinationale Ondernemingen
Centre for Research on Multinational Corporations

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Beyond a Fair Price

An analysis of the Gabriela Cocoa
Initiative price policy

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1 December, 1994
Amsterdam, Netherlands
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Contents

1. Basic statistics

The 1980s was a disasterous decade for commodities as a whole: the commodities terms of trade plummeted 35% from 1978-88. The price of manufactures rose no less than 44% from 1985-88 during the same period.[1] This catastrophic state of affairs was the result of two main factors. First, prices were forced down by a situation of oversupply, prompted by high prices in the late 70s and the desperate need for foreign exchange to ease debt reduction. Second, world demand had reached saturation point as technological improvements and decreasing industrial output took their toll.[2] Fluctuations in the dollar's value did not ease the strain, as prices of manufactures rose accordingly while those for commodities only fell further because of abundant supplies.

Amidst these disasterous circumstances, cocoa demand was on the increase: it was steadily and rapidly growing in comparison to other commodities due to a widening product range and increased marketing.[3] Despite this apparent boon, massive increases in production, thanks in part to the introduction of two new and efficient producers (Malaysia and Indonesia), meant that total cocoa availability far outstripped demand. Although cocoa production and consumption growth rates maintained a similar average between the 1980/9 and 1990/1 seasons, the build-up of enormous stocks meant that demand could never meet the ever-growing net world crop. During the same 10 year period, stocks grew 110% from 642 to 1,346 million tons! Moreover, between 1985-92, cocoa demand rose 3% per year, while supply rose faster and more sporadically, some years reaching 10%.[4]

According to the 1991 UNCTAD Prospects for the world cocoa market, the message for producers is "startingly grim": producers need to dramatically reduce areas under cultivation, and even vigorous stimulation of demand will not remove the need for a substantial reduction in supplies.[5] Although prices are predicted to rise, the continuing decline in real terms despite production deficits in 1991/2 may mean that the underlying real price has declined as well. In that case, any future price projections must be made according to this lower reference point.[6] The 1992-4 seasons have all produced shortages, with the 1994 season amounting to 110,000 tons. In july, it was reported that Cote d'Ivoire's harvest was being threatened by a long lasting drought. As the largest cocoa producer, Cote d'Ivoire may inadvertantly end up imitating the role of Brazil in the coffee world. Predicted shortages for the 1994-5 cocoa season is 209,000 tons; this will be the fourth consecutive shortage, following seven years of overproduction. Despite large existing stocks, prices rose 30% within the first half of 1994.[7]

2. Types of cocoa and products

2.1 Description of the crop

Originating in Latin America, Theobroma cacao, literally translated as "spice of the gods", was used as a drink and as a measure of wealth in the Aztec and Maya cultures. Today, several varieties exist which are divided into three broad groups: Criollos, Forastero and Trinitario, from which one derives "fine and flavor" and bulk cocoa. Chocolate manufacturers blend the better quality fine and flavor beans with a majority of bulk cocoa to produce the desired taste.[8]

Criollos is a tree lacking vigor and susceptible to disease and therefore accounts for only 1-2 % of total world production. However, Criollos produces fine cocoa which used to demand a premium on the world market. Unfortunately, the massive surplus in recent years has rendered this premium obsolete and there is thus no incentive to produce these better quality beans. Forastero, mainly found in West Africa and Brazil, accounts for 80% of world production and is classified as bulk cocoa. Finally, Trinitario is a cross between the two former groups, which produces a hearty, prolific tree prefered in Cameroon and Ecuador. Because they are hybrids between the bulk and the fine producing trees, Trinitarios produce varying qualities of cocoa.[9]

Other quality aspects depend more on the climate or local pre-processing techniques of fermentation and drying, than on the type of tree. Brazillian cocoa, for example, is generally sour and its fat content is such that it produces butter which is too soft.[10] Because these drawbacks are thought to originate from the climate and soil, they are in most cases insurmountable. However, some Brazillian cocoa is accused of having a "hammy" or smoky flavor, which results from the use of fire during the drying process. Moreover, one or two bad beans in a batch can contaminate the whole batch in processing.[11] On the contrary, cocoa from Ghana, and West Africa in general, is highly prized because of its superior flavor which is thought to result from the sun-drying method. Fermentation and drying eliminate the bitter taste, give the brown color and develop the flavor of the cocoa bean and are thus extremely important. It is generally thought that the traditional methods, such as those used in West Africa, produce superior results. In Latin America, it is often the case that beans are sold immediately, and fermentation and drying are done elsewhere with modern equipment which the farmers themselves could never afford.[12]

The tree itself can take up to 4-5 years after planting to begin to produce fruit, and its peak yield will be reached between the 10th and 15th year, lasting for five years; the tree itself may produce fruit for up to 50 years. The figures for more recent, higher-yielding varieties differ in that trees begin producing fruit earlier, reach peak yields earlier and remain at this level far longer, perhaps up to the 25th year. However, because hybrids are relatively new, most having been planted in the 1980s, yields beyond the 25th year are unknown. All trees exhibit blossom, unripe and ripe fruit simultaneously and each fruit will take between five and five and a half months to ripen. For this reason, there are usually two harvests: one main harvest during the summer months and another, smaller one during the winter.[13]

The major cocoa producers are as follows, in thousand tonnes:[14]

country	1992/3 estimate	1994/5 forecast
Cote d'Ivoire	697	840
Ghana	312.1	240
Brazil	295	300
Indonesia	245	280
Malaysia	225	220
Nigeria	135	140
Cameroon	90	100
Ecuador	70	80
Dominican Republic	51	50
Colombia	50	50
Mexico	50	48
Papua New Guinea	38.8	38
Total World Production	2357.8	2486
Total World Exports	1693.7	

2.2 Products

Before grinding, the cocoa beans must be washed, shelled, sorted and roasted to further develop the flavor. As the cocoa bean consists of 55% cocoa butter, grinding turns the beans into a liquid mass. Part of this goes directly into chocolate manufacture; the bulk is then pressed ("Dutching") to separate the butter, which is also used to make chocolate. The remaining solids are broken into hard cakes and ground up into cocoa powder. In contrast to other tropical commodities, a large share, approximately 30%, of world cocoa grindings take place in the producing countries themselves. Most of this is attributable to the more industrialized countries, such as Brazil, who ranked number one in terms of world grindings during the period 1985-88 (236.7 thousand tons). However, the developed countries presently lead, with the USA, Germany and the Netherlands each grinding approximately 12% world total.[15]

2.2.1 World market

The demarcation line between cocoa processors and chocolate manufacturers is not always clear, as some companies have integrated both within their activities. This is more and more the case as both sides of industry becomes increasingly dominated by transnational corporations (TNCs), many of whom wish to increase control over all aspects of the cocoa market by incorporating all activities under one roof.

In the processing industry, the most important TNCs are (1988 figures, thousand tons):

TNC	tons of beans/year	% net world grindings (2,135)	% net world crop
Cargill(USA)	320	14	13
Grace Cocoa(USA)	280	13	11.5
Cacao Barry(France)	230	10.7	9.4
Schröder(Germany)	160	7.5	6.5
ED&F Man(UK)	150	7	6

Likewise, chocolate manufacture is heavily concentrated in a few consuming countries and further dominated by a handful of TNCs (1988 figures, thousand tons):

	tons of beans/year	% net world crop	sales 1989
Nestle (Switz)	225-250	9-10	$4.6 (billion)
Jacobs Suchard (Switz)	230-250	9.5-10	$2.1
Mars(USA)	200-220	8-9	$4.4
Hershey (USA)	125-145	5-6	$1.8
Cadbury Schwepes (UK)	85,000-95,000	3.5-3.9	$1.8

Some of these TNCs have branched out into the processing industry, either for their own use or for resale to other manufacturers. Nestle processes a considerable amount of cocoa beans for its own use: approximately 200,000 tons. Jacobs Suchard also owns a major cocoa processor, Van Houten. With or without processing activities, the money TNCs save on the low cost of beans can be used for product development, production modernisation and marketing. In particular, the highly competitive image content of chocolate products makes the chocolate industry very expensive to break into.[16]

2.2.2 Dutch market

Although the two most important world markets for cocoa are in London and New York, Amsterdam is the world's largest cocoa port, through which an estimated 20% of the total world crop passes annually. Amsterdam's well established reputation in trading and its good harbor and storage facilities maintain the city's important position in world cocoa trade. Moreover, the long history in the cocoa industry provides the Netherlands with a historical advantage over its competitors. Certainly the fact that the process of pressing cocoa liquid to separate the butter from the cake was invented in Holland in 1828 gave the Netherlands an advantage which it has managed to maintain ever since. It is the world's largest exporter of cocoa butter and powder: although it provides only 11% of world grindings, only 22%

of this is used domestically. Presently, the USA is the single most important destination for powder, although the EU as a whole is the largest customer for powder and butter. Demand in Holland itself has risen thanks to reduced VAT, extra advertizing and improved product image. However, approximately half of domestic chocolate consumed is imported, as covered chocolates has the largest market share.[17]

The large cocoa processing industry in holland has, over the last decade, become dominated by foreign owned TNCs. The four largest, designated by 1988 market share, are as follows:[18]

Cacao de Zaan- 34%
Gerkens Cacao- 28%
Berisford Cacao- 14%
Bensdorp- 12%
Others- 12% (Dutch Cacao, Jan Shoenmaker, Callebaut)

A study done in 1989 revealed that during the 60s many Dutch processors thought that industry would be moved to cocoa bean producing countries. Therefore, they sought out large company participation in order to develop market power. A few of the buy outs run as follows:[19]

1. Bensdorp bought Blooker, was sold to Unilever and then to Cacao Barry.
2. Droste bought Ringers and together with Venz went over to Douwe Egberts/Sara Lee.
3. Gerkens, Korff and Stuurman Cacao are all part of Cargill- these make up the General Cacao Groep
4. Van Houten is via Grace Cocoa, Peter Paul into the hands of Jacobs Suchard
5. British company Continental Foods owns Van Dungen, Frank Rademaker, and Driessen.
6. British Rowntree owns Nuts, and were themselves bought by Nestle.

The chocolate manufacturing market in the Netherlands is likewise dominated by a small number of large multinationals. Two of the largest European takeovers were: Rowntree by Nestle (1988) and Jacobs Suchard by Philip Morris (1990). Within the European chocolate sector, the five largest companies hold 70% market share:[20]

1. Nestle
2. Philip Morris (Jacobs Suchard): Cote D'Or, Toblerone, Milka, etc.
3. Cadbury
4. Mars
5. Ferrero

However, the chocolate market differs from the processing sector in several ways. First, final products are divided into several categories, each with differing corporate market strength. The trend is to produce one or two products in one large factory for the entire European market.[21] Moreover, many products which use some chocolate are manufactured via food producers and not confection producers (eg, cookies with a chocolate layer).

The most important categories are:[22]

1. solid chocolate bars: Verkade, Jacobs Suchard-Cote d'Or (Philip Morris)
2. candybars: Mars, Nestle, Jacobs Suchard-Cote d'Or (Philip Morris)
3. chocolates and bonbons-: Baronie De Heer, Droste, Ferrero, Van Dungen, others
4. sandwich items: Venz/De Ruijter (Centrale Suiker Mij.) wessanen

Second, while the Netherlands is the world's largest exporting of cocoa butter and powder, making up 11% of world grindings, only 22% of that total is used domestically. This means that the manufacturing industry is much less important than processing. Although consumption is rising, due to reduced VAT, improved product image and increased advertising, 50% of domestic consumption is made up of imported bonbons.[23]

3. World market and cocoa producers

3.1 Description of cycles and recent changes

The increasing concentration of ownership in the cocoa and chocolate industry has proven to be one of the most important structural changes on the demand side of the world cocoa market during the last decade. In fact, over the last 20 years the number of dealers, brokers and agents has decreased from 192 to 88. In the same period, there have been 200 takeovers within the chocolate manufacturing industry.[24] Understandably, this consolidation has had adverse affects on competition and stockholding activities. Fewer trade houses, processors and manufacturers has meant severely weakened competition, putting a great deal of control into the hands of the few. Moreover, diminished availability of finance for stockholding, more efficient stock management, higher interest rates, improved supply availability and the emergence of the ICCO buffer-stock have all led to new stock holding policies whereby only a lower price would justify holding a high level of cocoa stocks.[25] As well as distorting control of the world market, these factors negatively affect the accuracy of market predictions.

Structural changes on the supply side have revolved around the historical cycles of overproduction. While the eighteenth and nineteenth centuries saw steady rises in European cocoa consumption, it was the Spanish and Portuguese colonies, especially Brazil, which enjoyed the benefits of increasing demand. However, this favorable scenario could not continue forever. Ultimately, the financial difficulties of the interwar period caused demand and price to plunge. The consequent collapse of the Latin American producers left room for newcomers. Actually, already by 1924 Ghana was producing more than a third of world output. Even during the period 1970-4, Ghana and Nigeria together produced 43% of world total output.[26] However, by this time the oil crisis had already taken its toll. While Nigeria transfered its energies to the oil sector, Ghana was not so fortunate in its resource diversity. Ghana's prominent position and overwhelming dependency on cocoa eventually forced it to bear the brunt of adjustment pressures while the world cocoa market experienced a period of overproduction as demand declined. Just as Ghana had been ready to fill the void in the 20s, francophone Africa was ready to replace anglophone Africa as major producer. In 1980-84, Cameroon and Cote d'Ivoire took the lead, the latter alone producing 30% of world output.

Today, history seems to be repeating itself: Malaysia "seized its chance" in 1988 when Cote d'Ivoire withheld supplies in efforts to raise cocoa prices.[27]

Experts call this pattern of oversupply and price declines the "modified cobweb cycle": cyclical price fluctuations lead to cycles of new plantings, leading further to overproduction and increased price instability. According to this model, the last 60 years can be explained as follows: the low prices of the 1960s led to declining production and shortages in the 70s. Undersupply meant higher prices and more plantings to meet the increased need and take advantage of higher prices. This, of course, led to oversupply and a disasterous collapse in price.[28] Many commodities follow this set up, especially those with a substantial lapse time between planting and peak yield.

However, some experts believe this cycle is about broken to be due to an anomaly during the 1980s: despite continually falling prices, the World Bank and the Asian Development Bank financially supported Indonesian and Malaysian cocoa plantation efforts under the guise of diversification. Moreover, subsidized high prices and increasing need for foreign exchange in Cote d'Ivoire also led to substantial investments in new trees. Taking into account the time lapse between planting and peak yields, huge increases in production were expected beginning and lasting throughout the 90s. Fortunately, this potential disaster has not yet materialized because of lax maintenance and fewer inputs due to extremely low prices. The predicted continuation of low prices throughout the 90s provides little incentive to invest in new trees. In this way, as the present crop outlives its peak period well below potential, there will not be a wave of new supply to follow.[29]

3.2 Attempts to stabilize world market: ICCO and UNCTAD

Whether or not this anomaly leads to actual change in the world cocoa market is questionable. The plantings during the 80s were more the result of increasing debt and misguided IMF/World Bank adjustment programs than actual coherent planning.[30] Thus, enduring stabilization will require vast changes in developing economies based on sensible measures such as diversification and value-added industry. However, over the last 20 years there have been attempts to reduce the turbulent fluctuations of the world cocoa market based on the mutual interest of producers and consumers of achieving a more reliable market situation. This kind of cooperation is better known as an international commodity agreement (ICA).

3.2.1 ICCO and the International Cocoa Agreement

Although the cocoa cycle of overproduction and falling prices was approaching the end of its second revolution by the late 60s, several attempts to establish an ICA for cocoa had failed. While many other commodities enjoyed commodity agreements during the 20s and 30s, adjustment pressures for cocoa were regulated via traders' cartels and manufacturers' organizations, both of which failed to control the market. When the cocoa community finally managed to discuss a cocoa ICA in 1963 under the auspices of the UN, negotiations broke down over the pricing mechanism. Only a break in the rising price trend of the late 60s would force producers and consumers to compromise.[31]

The 1972 UNCTAD brokered Cocoa Agreement created the International Cocoa Organization (ICCO) in London and established a buffer stock in attempt to control the historic price fluctuations. Unfortunately, price volatility proved to be uncontrollable: the established price range of 23-32 c/lb. was useless as prices doubled over the next year: from 25.6 to 61.6 c/lb. from early 1972 to may 1973. By 1974, prices peaked at 116.8 c/lb., almost 5 times the 1972 price. Obviously, the ability to deal with such volatility was extremely limited and the buffer stock was rendered obsolete. Subsequent agreements, in 1975 and 1980, did not fare any better. Though prices slumped in the mid 70s, they peaked again in 1977 at 250 cents/lb. as production fell to its lowest levels in 10 years. Following failed negotiations and the temporary dissolution of the ICCO and the ICA, the 1980 agreement lacked the participation of the USA and Cote d'Ivoire, the main consumer and producer nations. Furthermore, though successive years of surpluses meant that 1981/2 stocks were at their highest 14 levels in 14 years, buffer stock purchases were completely insufficient to maintain the floor price.[32] This scenario was replayed in 1987, when within one year after the fourth agreement was reached, the buffer stock had reached its maximum of 250,000 tons due to the massive surpluses of the 1986/7 season. While the surpluses continued to grow, the buffer stock was rendered obselete and price was indefensible.[33]

The early 1990s have been occupied by several attempts at negotiations. Because members continually failed to reach agreement, the 1986 agreement was extended until September 1993 without the market intervention activities, as the buffer stock was at full capacity. A new ICCO aggreement begun in february 1994 is weak because USA and Indonesia did not take part. The ICA has given up attempting to directly alter prices, and have now decided to try production management- voluntarily limiting production in combination with a stimulation in consumption.[34] For these purposes, production and consumption commissions have been established. Unfortunately, the concept behind and range of action of the production commission is vague, and yet to be decided. The actual plan of action is unknown for both. Both commissions are required to supply the directorate with estimates of projected annual demand and supply: if these do not correspond, the production countries are supposed to take measures. What these will be are still a mystery. Also, the ICCO authorized the sale of buffer stocks in 1990. Since the 1994 agreement, they intend to pick up the pace of sales and be rid of the stocks within 4.5 years (by 1999).[35]

3.2.2 UNCTAD Integrated Programme

Concurrent to the ongoing cocoa negotiations which began in 1963, a comprehensive commodity program was the cornerstone of the newly established UNCTAD's "trade not aid" agenda. Since the mid-50s, commodity exporters had experienced consistent oversupply, a decline in real prices and substantial export barriers to western markets. Not surprisingly, the initial idea was shelved during UNCTAD II(1968) and III(1972) sessions due to western opposition. However, the effort was given new life by the sudden growth in third world leverage in international affairs stemming from the OPEC instigated oil crisis. As part of the New International Economic Order (NIEO), the UN held a special session on "Problems of Raw Materials and Development" in 1974, during which the Integrated Programme for commodities was proposed.

Although the proposal was adopted at UNCTAD IV(1976), the producers' dominant position quickly expired/dematerlialized and lengthy negotiations between the major producing and consuming nations ended in a compromise agreement in 1980(V). The developing countries had been seeking to establish a Common Fund which would provide a $6 billion pool for financing commodity price stabilization measures. In a nutshell, the West's objection to this idea was basically a refusal to allow huge sums of their "donated" money to fall under the control of the developing world. This would, in effect, encourage the empowerment of the third world based on western financing! The industrialized countries not were prepared to shoot themselves in the foot, as they saw it, and by the time the agreement was signed the proposal was worthless: the Fund was scaled down to a mere $500 million and made dependent on the establishment of new International Commodity Agreements, most of which had collapsed by the late 80s. Moreover, the agreement was not ratified until July 1989, because of the refusal of the USA and USSR to participate. The USSR finally ratified in 1987, at which point the required 90 ratifications and 2/3 capital were accounted for. However, the price stabilization mechanism, or first window, has been weakened to the point of being powerless. For the time being, the second window, established for development purposes, will be the most active arm of the Common Fund, which is housed in Amsterdam.[36]

4. Fair Trade

4.1 Introduction

The idea of alternative trading evolved from charities who wanted to do more than collect money for disaster relief. For example, Oxfam was established during WWII in order to aid famine victims in the third world. After the war was over, however, they wanted to be more than a bandage organization: they wanted to try to change the underlying causes of poverty.[37] Although anti-colonialism was gaining support, and more and more colonies were gaining independence, the North-South divide was already painfully obvious. The colonial legacy of cash crop export was well established and provided the only basis of income for many former colonies.

Following decades of development failure, and the increasing turbulence of the world commodity markets, the those involved in third world affairs fell into two camps. Some felt that a complete divorce between the two spheres was necessary in order to allow the developing countries to build themselves up without interference from the industrialized countries. Developing countries should stop growing cash crops and try for food self sufficiency. However, this kind of solution was never viable. The realities of the world economy would never forgive a nation who refused to participate: any nation who refused to pay back loans or to play by the North's rules would suffer isolation in the world trade and financial markets.

Others felt that cash crops were not inherently bad; it was the social relations governing their trade which were unacceptable. The essence of alternative trade is to tell the consumer the "truth" about the product they are buying: under what human circumstances was this product made? If North-South trade must continue, the North should take it upon themselves to help the South by helping them to diversify and increase their control over their trade. In this way, the South improves its trading position, and thus its citizens' lives, and doesn't have to leave the world trading scene altogether.[38]

4.2 Dutch FT initiatives

The first initiative of this sort followed a similar route as Oxfam. Founded in 1959 by a group of youths in Kerkrade, NL, S.O.S. initially stood for "support underdeveloped areas".[39] However, it was established as a normal development organization whose main aim was collecting and transporting funds to needy countries. In fact, its first campaign was milk powder for Sicily. The inspiration to introduce fair trade to Holland came from the first UNCTAD Conference in 1964, the slogan of which was "Trade not Aid". With this in mind, they began importing items from the third world: the first wooden statues came from Haiti in 1967. Although SOS did not consciously plan on the trade initiative becoming the foundation of its organization, the concept behind SOS changed from an aid organization to a trade organization as the random contact with Haiti led spontaneously to other producers eager to participate. Accordingly, it changed its name to SOS Wereldhandel, SOS now standing for "foundation for development".[40] The real breakthrough came in 1973, when SOS began its successful 1000 x 1000 campaing for coffee farmers in Guatemala. The idea was to convince 1000 people to invest F. 1000 interest free for three years. Although they experienced difficulties in the beginning, from 1988 their turnover grew 300%, as did the size of the staff. By 1991, SOS had 5000 investors; by 1992 the total invested reached F. 3,64., 000. Moreover, within a short period, coffee made up more than 50% of SOS' total turnover: of the 1993 turnover of F. 29.4 million: 53% coffee, out of 2,500 products. In 1994, SOS Wereldhandel changed its name to the Fair Trade Organization (FTO).[41]

Something else happened in 1988, however, which made the success of coffee possible. While it was obvious that there was a market for fair trade coffee, its potential was not being reached due to marketing and retailing limitations. Moreover, small farmers' in Mexico were eager to expand the market in order to sell more of their coffee at preferential market prices: is it possible to reach more consumers?[42] They made clear the importance of putting the means of development into the hands of the farmers. Donations may provide some necessities on an irregular basis, but fair trade would put the onus for development on the producers and give them a consistent source of funds to achieve goals they decide upon themselves. The opportunity to close the gap between these producers and consumers who understand the existing inequalities and want to do something about it, led to the creation of Max Havelaar in 1988.[43] Nico Rozen's idea was to incorporate the knowledge, networks and resources of mainstream business (normal distributors and commercial companies) in order to reach a bigger scale of operations.[44] The main problem with this idea was a potential clash of interests: consumers can trust a fair trade organization, but how can they trust a regular company? Obviously, they must be regulated by an independent body. Thus was born the concept of a certified seal organization called Max Havelaar. The Max Havelaar model is a way of creating a market and offering it to the companies on the condition they work within Max Havelaar established and controlled fair trade criteria. In this way a common goal could be reached: to sell the largest volume possible at a price fair to consumers and producers.[45]

Max Havelaar attempts to broaden the scope of Alternative Trade via a number of principles:

1. Fair trade should become "normal" trade, with goods available in every supermarket, etc.

2. Fair Trade works to benefit all sectors of trade because of the converging interests of all parties involved.

3. Success depends greatly on fighting against existing prejudices: poor quality of product, unreliable trading partners, exploitativeness of commercial roasters and traders. In this way, public image is important.[46]

Ideally, Max Havelaar accepts that producers should control as much of the production chain as possible. But while producers could not take care of particular parts of the production process themselves, importing, roasting and distributing would be handled by the existing experts. Thus, the role of Max Havelaar is to:

1. promote sales and consumption
2. inform and mobilize consumers under a guarantee of fair trading conditions
3. identify and maintain contact with producer groups who are prepared for inclusion in the International Coffee Producers' Register and to help them in the development process as much as possible.
4. verify and control roasters as part of the Max Havelaar guarantee[47]

The market share of Max Havelaar coffee is 2.3%, and since the start f. 27.5 million "extra" has gone to producers. Moreover, by 1992 all Dutch coffee roasters participated, except for the largest Douwe Egberts.[48]

4.3 Gabriela origins

Although Max Havelaar was just getting its feet off the ground, already in 1988 cocoa farmers were expressing interest in a similar initiative for their product to the organization Solidaridad, who began searching for interested parties.[49] Again, in May 1989 a large international conference was held in Bahia, Brazil, which was attended by farming and trade union representatives, both of whom called for the development of alternative trade links and the stimulation of small farmer cooperatives.[50] Finally, in January 1990 a meeting was called by Dick de Graaf (FNV-Voedingsbond) and Dirk de Jager (TIE) in order to consolidate interest in such an initiative. Representatives were invited from several organizations of diverse origins who all had expressed interest in researching the potential for cocoa initiative based on human and environmental standards: Max Havelaar, Konsumenten Kontakt, Honger Hoeft Niet (now Inzet), SNV-Vorming, TIE, SOMO, Dutch Cocoa and Chocolate Company BV, and Voedingsbond FNV. Although a solid group was established, it was not until a second meeting took place in July that the ball began to roll. This time, NIO-Vereniging and Vereniging Milieudefensie were invited as well and research tasks were assigned. However, serious obstacles were already in sight:

1. the complexity of the product: production and processing of cocoa are much more complicated than that for coffee. While coffee is 100% final product, cocoa has many final products which must be separate. Thus, a market segment is more difficult. So, a simple mechanical copy of the Max Havelaar coffee model was not possible.

2. environmental problems in production, transport, storage: is incomparable, greater than for coffee. Nearly impossible to separate bio-cocoa from regular when fumigated before transport. Moreover, as cocoa is only a part of chocolate, a 100% bio product is extremely difficult.[51]

By November that year, Max Havelaar had agreed to represent the initiative in external relations, while HIVOS assumed employer and administrative office duties for the study group. By 1992, it was clear that there was a market for fair trade chocolate and producers associations willing and able to deliver sufficient quality chocolate. Both FTO and Max Havelaar cited the large amount of know-how in chocolate production situated in Holland as a definite advantage in the development of the initiative. By 13 october, 1993, the first bar of Max Havelaar chocolate was ready for sampling.[52]

4.4 Fair Trade partners

4.4.1 manufacturers

Against a background of transnational domination, the Gabriela project experienced much opposition to the initiative from commercial interests. Indeed, the fear of involvment in fair trade is a daunting, but not insurmountable, obstacle. The example of coffee provides insight into the difficulties of wooing mainstream business. As Douwe Egberts controls 76% of the Dutch market, the smaller roasters were being pushed out of the mainstream markets. Thus, fair trade coffee was not only seen as a niche market, it was a way they could regain market share. For some companies, it was really a matter of survival, and this new business opportunity could save them from bankruptcy. Although this was not the case for chocolate, the sucess of Max Havelaar coffee meant that they could begin duscussing the project with stronger companies right from the start who were looking at it only as a market opportunity. Instead of a defensive move, it was a step forward.[53]

Whether for survival or growth, one thing is certain: these companies participate for profit alone. Nevertheless, because of the risks involved, potential profit margins may not be enough to win over small companies. First, fair trade as a "left-wing" operation goes against the capitalist foundations of mainstream business. Second, for a company with a well estabalished brand name, an introduction of a poor quality fair trade chocolate may ruin their reputation.[54] Third, the reliability of partners is crucial to good business, thus small farmers must be able to deliver on time. Because of their lack of experience with small producers, most commercial businesses are not convinced of the quality or reliability of fair trade suppliers.

> They don't know why small farmers would be reliable partners, they only know that they are small, they don't know what a fax machine is, they don't know what international transport is.... So, how can they work with them?[55]

Fortunately, Max Havelaar was able to provide some guarantees to their commercial partners. When they began with coffee there was already a good quality fair trade coffee on the market. With chocolate, there was not much of a basis, and what did exist was not liked in the commercial sector, so it could not be used as an example. The only answer was to include processors of the highest quality. In order to gain their support, they had to back up the first shipment with a quality guaranatee and risk coverage. Without this financial backing, "no one would have bought anything." Finally, Max Havelaar convinced Dutch Cocoa to provide their cocoa butter and Callebaut (Philip Morris) to make their liquid chocolate. The participation of Callebaut, the world's leading liquid chocolate producer, provided an important advantage. Because of that company's good name, "all other doors were open."

As soon as an interested party discovers that Callebaut guarantees the quality of the liquid chocolate, "they're in." The participating manufacturers are Baronie-De Heer BV, H. Neuteboom BV, Automatic Holland, and the Fair Trade Organization.[56]

4.4.2 Traders

Like manufacturers, traders see fair trade as a business opportunity, but with another aim. A roaster or chocolate producer is interested in margin; traders are interested in reliable sources, as the backbone of a trading organization is reliable sources. If traders know they can regularly sell a certain quantity of a good quality, and the quality is consistent, they are in a much stronger position. Otherwise they have to waste time finding new sources every year with differing quality. Therefore, for traders to get in touch with new, reliable suppliers was the main business opportunity.

Furthermore, there is a higher level of sympathy for small farmers because traders are more directly familiar with their circumstances. They are used to buying from exporters in origin countries, and they visit these places two or three times a year and have knowledge of the primary production process. In contrast, very few of the chocolate companies have visited cocoa producers: they are at the end of the production chain, and never bother to bypass the existing intermediary steps.

Nevertheless, initially it was important to the traders to know that they were backed up by Max Havelaar. Otherwise, like the manufacturers, they would not have bought the first containers. Moreover, they know Max Havelaar emphasizes quality and maintains good standards: if someone delivers bad quality they are disciplined or kicked out of the project. This acted as an unwritten guarantee of quality. Still, Max Havelaar had to provide financial guarantees for the first containers, as they had to be bought before there was even a processor who was willing to buy in the Netherlands.[57]

4.4.3 Retailers

The retailers viewed fair trade in the same way as the manufacturers: they saw that it was gaining market share, so it became interesting for them to introduce fair trade coffee on their shelves.[58] However, chocolate is as of yet not as widespread as coffee. Although they have made big profits on coffee, retailers first want to see if chocolate will be successful before they agree to provide it to their customers. Unfortunately, the general attitude experienced by Max Havelaar is that they've already done their bit for the third world and do not need to do anymore. This is in contradiction to Switzerland, where the market share for Max Havelaar coffee is 5% thanks to strong support from retailers (compared to 2.5% in Holland). Max Havelaar Nederland feels that such a market share for coffee will take more time: although consumers are very positive, the organization of the retail does not yet permit such growth. Thus, although chocolate is found in about 70% of the supermarkets, stimulating the market is "more difficult than [they] hoped it would be."[59]

5. Gabriela price policy

Created in the face of plummeting commodity prices, one of fair trade's goals is to improve the international trade structures with respect to the small farmer. One way of achieving this goal is embodied in the fair price: a price which will allow the farmer to take development into his or her own hands. Thus, Gabriela's potential to change could be exemplified by such a figure and the way in which it was determined.

5.1 Potential difficulties

5.1.1 Price set up: unique to cocoa

Although the general approach to cocoa is much the same as for coffee, there are particularities to cocoa that provide advantages as well as disadvantages to an initiative such as Gabriela. For example, coffee is a monoculture crop, meaning farmers set aside a certain amount of land only to grow that particular cash crop. However, because cocoa must be grown in shade it is always dispersed with other crops, often other cash crops such as oil palm. Consequently, cocoa is usually provides only a part of a farmer's income, although it may be an important part.[60] Another difference with coffee is the amount of the particular commodity in the final product. While coffee makes up 100% of the final product, a relatively small amount of cocoa goes into chocolate, which means that a higher price paid to the farmer will have less of an impact on the final price to the consumer than in the case of coffee.[61] Moreover, because Gabriela only buys a small, predetermined amount of an individual cooperative's total harvest, the welfare impact is limited. Based on this fact, suggestions have been made to emphasize the relationship between the coop and the processor rather than with Max Havelaar itself.[62]

5.1.2 Recent developments

More recent developments in the cocoa sector have taken their toll on producers and therefore effect any attempts to calculate production costs. First, historically low prices have led to neglect in maintenance, and thus lower variable costs. Diminishing income means that farmers can no longer afford to pay laborers or buy inputs such as fertilizers and pesticides and consequently, standards have deteriorated. In some cases, trees have been left to decay or been uprooted. On the other hand, the massive planting initiatives in countries such as Indonesia, Malaysia and Cote d'Ivoire have meant higher than usual fixed costs. Therefore, any estimtates of production costs must take these fluctuations in fixed and variable costs into account. Certainly, the cyclical pattern of overproduction as described above implies farmers' reactions such as these to variations in demand and price. Fixed and variable costs are never static and changes according to supply and demand patterns depend further on the ownership structure of the land, either small holder or plantation. As prices decline, plantations replace chemicals with cheaper labor. Inversly, higher prices mean increased chemical usage in search of higher yields. Higher prices for small holders, on the other hand, do not bring about substantial benefits due to structural barriers in the buying framework of many producing countries. Thus, these kinds of cost variations need to be balanced according to recent and probable future trends.[63]

5.1.3 General

Another crucial aspect of price set up revolves around the question of price differentials. Obviously, actual producers costs will vary widely, not only between countries but also between areas. Gabriela could instutute differentials in order to compensate for these variations. In order to understand the need for differentials, one must understand the fine points of price formation and the elements affecting it, which is too much to ask of most consumers. In order to reach the maximum market share, a single price is the best way to get a message accross to the widest public possible. The same applies for industry, who find it easier to work with a monoprice. Still, this single price means that some farmers are receiving more or less benefits from the Gabriela initiative. Those who are located far from a port are particularly disadvantaged, as they must cover the cost of transport themselves.[64]

5.2 Gabriela price formulation

According to the 1992 Haalbaarheidsonderzoek, Gabriela is searching for a price which is acceptable to the producer and the consumer alike. In other words, the price must 1. cover production costs, 2. provide an extra margin for development, and 3. be competitive enough to realize the prospective market shares for final products. Exposed as the outcome of government bargaining with little thought for the position of the producer, the ICCO price policy is rejected as an indicator for a fair trade price. Van de Kasteele believes the ICCO price bears "no relationship to a good price for the farmer".[65] Bearing this in mind, two methods are chosen which provide the basis of price formulation: the cost price of production and historical pricing policy.

The first method makes use of atleast two studies: an ICCO working paper by Ruf and de Milly, "Producer Prices in Seven Countries..."; and a World Bank report from 1985, Cocoa Production. Considering that the ICCO price indicators were discarded for power political reasons, both studies are of somewhat dubious origins. Van de kasteele admits that the fragmentary information provided by these two reports does not lend itself to a clear cost-price structure. Nevertheless, a minimum price is discernable, ranging between 60 to 75 cents per kilo, or $600 - 750/ton.[66]

Providing a more stable analytical basis, the second method uses "literature and research contacts" which indicate that 1988/9 was the critical point at which prices were no longer remunerative for farmers. For Latin America, this was $1500/ton and for Africa, 300 CFA/kilo. Judging from this information, it seems the price range should fall somewhere in the middle of the high 1984/5 of $2,100 and the minimally remunerative 1988/9 prices of 1450.[67]

From this information, a minimum price of $1595/ton ($1450 plus 10% social development premium) is reached. Because of the low level of organization in most of the cooperatives, it is understood that this minimum will not cover the costs of much needed investment in infrasctructure, and thus additional financing must be sought elsewhere.[68] In fact, this price was changed in 1994 in agreement with TransFair International.

5.3 Analysis of methods used

Based on the information used in the Haalbaarheidsonderzoek, the Gabriela price seems very generous: according to chart on page 16, it covers even the more expensive producers' costs plus an additional development allowance. However, a closer look at the literature, both that used and other available sources, offers better insight into the complexity of formulating a fair price.

5.3.1 Literature used

First, the sketchiness of the literature is conceded to by Ms. Van de Kasteele.
The ICCO working paper by Ruf and de Milly is based on seven countries, only three of which are potential sources of cocoa for Gabriela: Ghana, Cameroon and Brazil. Indeed, the study itself warns,

> ...because of the lack of uniformity, the comparison as a whole and, in particular, the figures drawn there from, must be treated with great circumspection.[69]

Furthermore, they warn that the production costs stated in the report "should ... be regarded only as a guide." Finally, the report comes to the conclusion that the "present [c. 1989/90] or short-term production costs may vary by as much as double".[70]

Worse yet, the World Bank report Cocoa Production, consists only of estimates for labor inputs and is based on 1982 figures for Malaysia (not a potential Gabriela source) and 1940 figures for Ghana which were "recently substantiated".[71]

Another element of confusion arises from the claim that the minimally remunerative price for Latin America and Africa were the same. According to the ICCO working paper, in the year 1989, 300 CFA equaled one dollar; this was also the year in which the cut off price was calculated. In this case, the cut off price for West Africa would be $1/kg, or $1000/ ton- $500 less than the Latin America minimum. Moreover, according to the haalbaarheidsonderzoek, this figure was derived from research done in Cameroon alone. Further, the figure was not calculated according to actual cost structure, but is based on past experience of remunerative prices.

5.3.2 Other suggestions

Notwithstanding these contradictions, the difficulty involved in calculating a precise figure for such a vague concept must be taken into account. The scarcity of reliable and timely information renders precision impossible. Nevertheless, the uncertainty could be reduced if the Gabriela price could withstand comparison to other suggestions for a fair price for cocoa. Unfortunately, this is not the case. A few examples suffice to show that the Gabriela price appears inexplicably low.

1. OS3, the Swiss organization which already produces chocolate bars for the European market, pays $2200/ton to its producers in El Ceibo, Bolivia.[72]

2. The German organization TransFair, which was established in 1993 to set up criteria for a European Fair Trade mark, refused Max Havelaar's price and offered a (slightly) higher version: $1500/ton + 15% social development allowance (ie, $1725/ton).[73]

3. The European Fair Trade Association (EFTA), established to facilitate cooperation and information exchange among existing organizations, indicated a prefered price of $1900/ton for future European-wide operation of the cocoa initiative.[74]

4. At the UNCTAD Cocoa Conference in July 1992, producing countries suggested a price ranging between $2207 and $3195; while consuming countries offered a more sober figure of $1186 to $1779 per ton.[75] Certainly even these figures were politically formulated. But the difference between all these prices and the Gabriela price is disturbing:

OS3 +$605
TransFair +$130
EFTA +$305
UNCTAD producing low +$612
UNCTAD consuming high +$184

Moreover, although Gabriela decided against using the ICCO price ranges as a worthy indicators, they do shed some light on the present Gabriela price. Because the Haalbaarheidsonderzoek made clear that ICCO prices were in no way related to an actual "fair" price, the author's assumption was that it was too low. Surprisingly, this is not the case: from 1980-86, the price range was set at $3,100-200/ton; and in 1987 this was lowered to $2668-1875/ton.[76] The <u>lowest</u> of these is still $280 above the Gabriela price.

The balancing act of raising the price just enough to keep market acceptance and push up the volume of sales is TransFair's focal point. However, this argument is not so simple. On the one hand, a price acceptable to consumers may translate into demand for higher volumes of cocoa, thus more cooperatives and more farmers involved in the project. On the other hand, this cannot be guaranteed, and may merely result in a "good conscience at a cheap price". This kind of outcome would provide no substantial deviation from the present realities of North-South trade relations.

Taking this into consideration, TransFair's suggested floor price would not be lower than $1893, based on an average of 10 years (1980/1- 1990/1) ICCO annual daily prices. Even the ICCO average used in the onderzoek, ranging between the 1984/5 peak and the point at which Gabriela suggests cocoa was no longer a remunerative crop (1988/9), was $1783, $188 above the Gabriela price.[77]

5.3.3 Role of Max Havelaar

This brings the discussion back to the uncertainties about goals and roles. What is Gabriela saying about itself by setting its minimum price at such a low level? Was this determined in any way by perceived consumer attitude or was it just poorly calculated? In the Eindrapport fase 1, the estimated achievable market shares depended on a final price not more than 20% higher than the usual consumer price. However, because the impact of a high producer price on the final price was limited, it would be possible to focus more on the farmer than on the consumer when formulating the price policy. In other words, the price paid to the farmer could play a more decisive role than the price the consumer is willing to pay.[78]

Was the Gabriela price sufficiently researched? Table 1 compares several estimates of producers' prices:

Table 1
Producers Price Information[79]

Country	C. d'I	Ghana	Nig.	Camer.	Malaysia	Indo.	Brazil
Ruf/dMilly	1,160	950	800	1500	950-1550	410-910	1550
Chalmin*	1102	-	-	-	1000	-	-
UNCTAD#	825-990	-	-	-	960-1210	600-?	1,100-1300
UNCTAD							
1986	1155	819	1188	1213	1674	-	1350
1988	1343	773	1673	1410	-	1278	-

Per continent:	WAfrica	SE Asia	LA	World
	800	900	1225	950

individual case studies
* if 300CFA=$1

Of these, only Ghana, Cameroon and Brazil are potential producers for the Gabriela project. However, it is generally understood that the Latin American producers who make up the bulk of Gabriela's cocoa are more expensive than Brazil, as shown in Table 2.

Table 2[80]

Fixed and variable costs of cocoa bean production, 1986/7, based on percentages of world average (=100)

Country	variable	fixed	total costs
Cameroon	80	100	180
Cote d'Ivoire	90	85	175
Ghana	55	81	136
Nigeria	85	110	195
Brazil	135	115	250
Colombia	155	125	280
Dominican Republic	125	127	252
Ecuador	130	147	277
Indonesia	72	82	154
Malaysia	85	82	167

In fact, Latin American producers are the most expensive in the world. However, it is immediately apparent that the actual figures within and between countries vary in the extreme. Still, without paying attention to the exact numbers, it is easy to see that the differences in production costs per country are large.

One very important point which should be mentioned is the matter of real and nominal prices. Most of the prices listed above are nominal; that is, listed according to the value of the currency (in most cases the US dollar) during the year in which it was figured. Real prices would be the value listed according to today's worth. Currency fluctuations already have a large impact on world commodity trade. Futures and spot prices are usually set in dollars: as the value of the producer's currency wavers against the fluctuating dollar, the amount he or she earns wavers accordingly. But the changing value of the dollar makes the comparison of figures from different years extremely misleading: $1000/ton in 1990 is not the same as $1000/ton today. It is not clear whether or not Ms. van de Kasteele made allowance for these variations. Indeed, most price studies fail to reveal the dates of their sources. The figures used above are nominal prices.

5.4 Price

With the various weaknesses of the price formulation exposed, uncertainty about the validity of the fair cocoa price must be resolved. First and foremost, why does the analytical basis of the Haalbaarheidsonderzoek seem so inadequate?

5.4.1 Problems with price formulation

The basic answer to this question is the fact that a truly fair price is indeterminable. The vast differences in price per country found in table X should be seen as proof of this impossible task. These sources of the inconsistencies may be blamed on the inclusion or exclusion of FOB (Free on Board), taxes, technical inputs or fixed costs, among others. In other words, there is no analytical basis for price determination used by all researchers. For example, some studies have completely left out fixed costs (planting, infrastructure) and only count the variable costs (harvesting, labor, etc.).[81] Unfortunately, as mentioned above, this kind of background information is usually not provided.

The situation in the field is equally if not more unorganized. A farmer does not keep track of his or her fixed and variable costs. A farmer producing under the existing conditions only knows she or he is subject to the whims of a middleman who will not include his daily labor costs, etc., in the price he pays. It is only when a farmer becomes involved in the fair trade process and is getting a higher price that interest is stimulating in keeping track of production costs.[82]

Under these circumstances, the Ms. Van de Kasteele privately admitted: it is impossible to figure a real price. One can only make an estimate based on fairly reliable sources. Price generalities must be accepted, and a certain figure is, according to producers and traders, approximately the price which will still be remunerable: a "safe" price. Because price is only ever going to be relative, the fair trade argument needs to move away from price. In reality, the first years of the cocoa initiative were spent establishing contacts, while price was of little importance. Establishing good contacts, like any other trading organization, is the main concern; price is of secondary importance. Moreover, fair trade is not price alone, and other aspects need to become important.[83]

While no study would ever produce a completely reliable figure, a fair price must still live up to certain standards acceptable to the public. The Gabriela partners recognized that price does not conform to "scientific" norms. This is why they decided to do the price policy study internally, based on pragmatism: a theoretical university study would have taken a year and still come to the same conclusion. Still, the analysis had to be defensible on all sides. Van de Kasteele explained in an interview that big-name studies were used which would be easily recognized and trusted by certain sectors of the academic and consumer communities: ICCO, UNCTAD and World Bank.[84]

Furthermore, because fair trade is like a seal of approval, esecially in the Max Havelaar case, it must have objective criteria. This means a formula is needed which can be used in every situation. However, as seen above, the realities of cocoa production do not conform to formulas, and in particular cases the fair price might be the wrong price. The price paid in Africa may not be enough in Latin America, where producers are more expensive.[85] But the public, who does not grasp the intricacies of primary production, finds a single price easy to understand.

5.4.2 Compromises

This issue of clear, objective criteria also explains the discrepancy between the Gabriela price and other fair cocoa price suggestions. All fair trade initiatives need to be publicly acceptable in their price policy, but the differencse lie in timing and perspective. For example, OS3, who provided a price much higher than the rest. One reason for this difference is because they began their cocoa project when prices were still high. In other words, they estimated a price based on very different criteria. In actual fact, this has worked against them. Most agree that the OS3 price is too high: they began high and could not lower their price when the world market price plummeted. They could not redefine what was "fair" based on the world market.[86] Now, they have to justify their position to other initiatives.

But the issue goes one step further. Some fair trade organizations judge the situation from a Western, paternalistic perspective, while others view it more from the producers' perspective. Without original information to back up any particular perspective, due to OS3's failure to respond to inquiries, it is possible to draw some conclusions based on OS3's practice. As fair trade is supposed to improve farmers' ability to defend themselves on the world market, dependency on fair trade is a hot issue among alternative trade organizations (ATOs). However, OS3 began and still works with one cooperative alone, El Ceibo in Bolivia. Moreover, OS3 buys 100% of El Ceibo's output. Hans Bolscher of Max Havelaar commented:

> Those contacts were so protected that they were so used to extremely high prices, there was no relation with reality anymore.[87]

The long relationship with El Ceibo meant that it became one of their parameters for a fair price.[88] Bolscher admits that the price discussion is always the idea of "the more you pay the more you help" versus the reality of the consumer market. As M. Barrat-Brown says in his book, Fair Trade:

> The aim is to pay as much as possible, not as little as possible, to the producer, yet at the same time offer goods on the market at competative prices or at prices acceptable to consumers ....[89]

When the Gabriela partners were deciding on their price policy, this difference in perspective played an important role, as well. Van de Kasteele privately concedes that the Gabriela price policy was an agreement between all the parties involved, a compromise between various interests and concerns. More recently, a compromise was made on the European level which brought different groups' alliances to light. Max Havelaar and TransFair International, who both serve basically the same function in different countries, decided to consolidate their fair trade criteria in order to increase transparancy in the European market. This collaboration included a rise in the fair price paid to cocoa cooperatives. While EFTA is not under obligation to follow the new criteria, they did have influence over the compromise between the two organizations. EFTA is the founding member of TransFair. Moreover, OS3 is a member of EFTA. Because EFTA members specialize in a product and sell to each other, all the EFTA members used to buy their chocolate from OS3 and pay their high price. This is also why TransFair was defending the view of the ATOs.[90]

Now both have changed their prices, and it is a big change for both sides. For the ATOs, "now they think it's fair to pay less. For the producers that's quite [hard to swallow]."[91] Although the Gabriela price was considered in trade and production as high but still acceptable, they understood the difficult position of the ATOs. Bolscher admits he is not happy with it. He feels that the Gabriela price was "more than enough":

> If I discuss with cocoa farmers they all say its absolutely a good price, there's no need for more. We don't want to pay them a luxury price, which makes them lean back. If you look at the cocoa partners that were involved with alternative trade, they have been leaning back.

This way they will never achieve what fair trade set out to do.[92] Yet, he believes the new price, $1725, is not excessive and is a workable price.

Still, this new price configuration does not reflect the idea that the farmers deserve more. Max Havelaar feels that farmers should have more, but not so much that it cuts off markets: if fair trade chocolate is too expensive, the market is too small to be sustainable. While this is true, it does beg the question: to whom is fair trade reponsible? What is missing in much of this price discussion is the farmer. While it is true that price is not the most important aspect of fair trade, it must be seen in the proper perspective. If the world market price is low, the income from fair trade allows the small farmers to survive. However, those consumers with a conscience do not want to go broke buying fair trade goods. Obviously, there is a delicate balance between the consumer and the producer when discussing price: the farmer should be paid fairly, but the consumer also wants to buy fairly.

Indeed, the marketing research for the Gabriela initiative predicted that a 10% price rise above the existing $1595 would eliminate a quarter to a half of potential buyers.[93] Although it was generally agreed that this figure was exagerated, the concept is clear and definite differences in opinion can be seen. FTO is generally willing to spend more money on the farmer, via its development assistence, or raise the price of its chocolate in order to include fair trade sugar. This may be viewed as "paternalistic" by other parties who feel that the producer should not be pampered, or unwise to raise the price further above the market average. On the other hand, Max Havelaar works solidly within the mainstream business world and depends on its participation for the success of its efforts. Thus, Max Havelaar must confront the consumer issue head on. The market is the mainstay of its commercial participants, for whom the consumer is king.

However, limiting the public's knowledge of fair trade to price is not only misleading, but also dangerous. The focus on price is due to the fact that it is easy to communicate, and it provides an explanation why fair trade products are more expensive. But when world market prices rise, this argument is false.[94] A good example is the recent upswing in coffee prices. While the Max Havelaar price followed the world market as it rose, there was an established ceiling price above which they would not pay. Because fair trade is opposed to following the whims of the world market, ATOs try to maintain a range which is always remunerative. But how do they explain why their price is lower than the world price, but their coffee is still more expensive?

The public must understand all the benefits of fair trade, not just price. They must understand the underlying realities of cocoa trade, that the fluctuations are the problem and Max Havelaar refuses to follow them on principle, as this would undermine the initiative. But more importantly, price is only a limited part of the advantages of fair trade. If fair trade has nothing more to offer, then price is the most important aspect. Fortunately this is not the case. When the impossibility of reaching a fair price is evident, the focus should shift to other aspects of the initiative.[95]

Both FTO and Max Havelaar admit that the ultimate aim of their initiative is to alter international trading structures: all trade should one day be "fair". But, It is now clear that a fair price is an unreachable ideal. How, then, can fair trade expect to change the trading structures? How do they change the lives of small farmers for the better? How do they improve the farmers' ability to hold their own on the world market? In the face of these daunting goals, fair trade is indeed instigating change on the grassroots level. This kind of development is achieved through:

* trying to increase market presence
* stimulating cooperative development
* creating links between farmers and the international trade structures
* providing development opportunities to farmers
* impacting the trading system

6. Market share

Despite the somewhat faulty publicity focus, Max Havelaar's market share is on the increase. Their ability to find a place in the extremely competitive chocolate world should be applauded: increasing domination by TNCs makes it more and more difficult for small players to find a place in the market. The commercial companies who do choose to get involved with fair trade products do not do it out of the goodness of their hearts. Rather, they see it as a way of breaking into the market by providing a specialized product. It is not a zero-sum game for them, but a profit-making venture.

This financially inspired motivation should remind us of the capitalist foundations behind this kind of participation, the very aim of which is to increase profit. And, as mentioned earlier, these companies have indeed succeeded in this venture. Still, to what extent can they expect this to continue, keeping in mind the size of the niche fair trade can expect to fill? In other words, what size share of the market can Max havelaar hope to gain? There are several market researchers who believe that one third of the Dutch population is willing to buy fair trade products. However, more pessimistic research puts that figure at 14-17%, which may be equally as misleading. Moreover, people may be excited about the idea, but when it comes to deads they are less enthusiastic.[96] FTO believes that 14% may be reached if other companies get involved in order to provide a larger variety of fair trade products to the consumer. FTO, however, recognizes its limitations:

> I don't have any doubt on our size: we are very very small.... It's very reasonable to think that we will always be small. And that's also because of another reason: we as an organization are also responsible for helping producers in the third world by fair trade assistance, and so on. You cannot ask that from a regular firm, they just want to import and sell. And a lot of our attention goes to the other side, of helping producers without importing and selling. So we have the aim to enlarge our market share but we are pragmatic: it is not possible to have more than 2 or 2 1/2 %.[97]

FTO feels this is enough to be an example to mainstream business.

Max Havelaar, on the other hand, is slightly more ambitious. Although they agree that 15-20% of the consumers may be reached by the motivation to do something charitable, the vast majority "just doesn't care: they want good chocolate at a nice price, and forget about the rest." Along with lack of concern for development matters, marketing is another obstacle. Chocolate is a heavily marketed product, and people usually only buy it on an impulse. Therefore the chocolate has to reach them at the right moment, with the right taste. For these reasons, the market is much smaller than the potential: they predict a market share of not more than 5-6% for chocolate. This compares with a higher expectations for coffee, because coffee is a loyalty product: if you've bought it once, chances are you'll stick to that brand. Moreover, even though price is more of a concern for the consumer when buying coffee than when buying chocolate, coffee is bought regularly. Within 10 years, there may be potential for 5-10% market share for coffee. But the initial goal is 5%, which they feel is more or less realistic although they admit the participation of Douwe Egberts is a crucial issue.[98] Moreover, FTO admits there is much confusion about the Max Havelaar seal: most people think it's a brand, so they look for a package with the Max Havelaar name, which doesn't exist. This communication problem is compounded by the widely held idea that Max Havelaar imports poorer quality products than other commercial firms. For example, coffee:

> People really think that our coffee is coming from the third world, whereas all coffee comes from the third world! It's a pity because its very well known , but people don't know what it actually is. And that's a real problem.[99]

7. Cooperatives

Individual small farmers are not party to fair trade contracts. Rather, they must be part of a collective because, by working together, they have more power in the long run.[100] The financial stability of the cooperative involved also plays an important role. Alternative Trade is a risky venture: a cooperative must be stable enough to provide the structure necessary for consistently carrying out tasks they may be unfamiliar with: collection, storage, delivery and perhaps processing. Moreover, coops must have money upfront in order to loosen themselves from the middlemen. The time lapse between these credit payments and the actual product coming onto the market maybe years! This is especially so for investments in planting or processing equipment.[101]

7.1 Organization

Therefore, the farmers involved learn about cooperation. In comparison to coffee, cocoa farmers lack the knowledge of how to set up, organize and run a cooperative. Especially in Africa, where Marketing Boards have controlled the sale of cocoa until recently, the farmers have no experience with anything beyond the fermenting and drying process. Some farmers in South America sell their beans unfermented, and are thus further behind. Not only is the formal structure an issue- how to deal with representatives- but the finalcial organization is also a problem. Dividing the money between the cooperative board and the farmers so that the cooperative functions properly is something which needs to be learned. The farmers must earn enough to maintain interest in being part of the cooperative, but the board must have enough money to carry out its duties.[102]

7.3 Relationship

Because of Max Havelaar's limited market share and consequent small volume, there are in fact cooperatives who are waiting for a chance to sell under the Max Havelaar conditions. But the balance between a too long and a too short relationship is a difficult one. First, buying from a producer for only one or two years does not give them the opportunity to build up their cooperative. Likewise, a permanent relationship is out of the question. Fair trade organizations should not create "islands of dependency" whereby cooperatives become too dependent on fair trade. This is a complaint of Max Havelaar, who claims that some ATO's have suppliers who are 100% dependent on them: when the ATO backs out, the farmers are at square one again. Therefore Max Havelaar limits itself to importing +/- 25% volume of any cooperative's output. Thus, it is the kind of relationship, not the length, which is important.[108]

7.4 Pre-financing

Pre-financing may be even more important than price, without which farmers cannot loosen themselves from the grip of the middleman. In cases where the fair price does not fully cover the costs of production, although it is still more than the world market price, pre-financing provides a bigger incentive to take part in fair trade. Product development, quality control, market experience and establishing a long-term relationship are important too.[109]

8. Links

Because Max Havelaar is buying a relatively small amount of any cooperative's produce, the income benefits are minimal, thereby focusing the development benefits on education and direct links with traders and processors. One of the most important effects of the Max Havelaar scheme is the mutualy beneficial link made with traders. A good example is the story of Mama Toktok in Sierra Leone. As the marketing board system crumbled, traders were waiting in the wings to assume the middlemen positions between the farmers and the port. One mama Toktok paid the farmers f. 47 perbag, and received f. 110 per bag at the port: a margin of more than 200%! Worse yet, she often paid in rice instead of money, exploiting the farmer's need for food during the inbetween harvest period. Now, Max Havelaar pays the coops f. 172, f. 98 of which goes to the farmer, leaving f. 74 for operational costs (storage, delivery, etc.), and f. 20 for social development.[110]

In this relationship, Max Havelaar has played the intermediary in place of Mama Toktok. they call themselves the linking pin, between the farmer and the trader, or better yet "the marketing organization for the small farmers, coops. We do their marketing job."[111] It is very difficult for a small village to sell It is very difficult for a small village to sell directly to an international trader. So Max Havelaar takes samples from these farmers to the traders and convince them to try it. If they buy one good container, they will increase the volume. Consequently, they establish relations with a trader or a roaster; perhaps Max Havelaar has to "smooth over" the connection in the beginning, but as they see it is working they back off.

> When they sell under the Max Havelaar conditions, they get a bit more money, they get access to credit, they get access to development organizations if they need one. If they want advice on changing to biological production, they can get it through us. That's how we try to assist them. We give advice, we bring together.[112]

The spin off market resulting from these kinds of contacts provides the single most important motivating factor for many cooperatives. Especially for cocoa, where possibilities are limited, the spin off market is much more important than the Max Havelaar market. If a cooperative sells two containers to Max Havelaar, they might simultaneously sell 20 containers under market conditions but without the middleman. They needed the two containers to learn about and get in touch with the system. In the long run this may be more important than those two containers to Max Havelaar. Max havelaar believes that "the spin off in cocoa is extremely important. Without that the development impact would not be as big as it is now." Again, sierra Leone provided an example. Last year they sold one container under Max Havelaar conditions. This year, for several reasons, they could not participate. but they could sell 500 tons, or 40 containers under market conditions at £750/ton, giving them a total of a million dollars. they could do this because they had been put in touch with a trader who knew Max Havelaar would back the organization and help with prefinancing. In Ghana, where the marketing board is on the way out, establishing trade relations with the world market is their main objective. That is worth more than the 200-300 tons they might sell under Max Havelaar conditions: it may mean 5,000 tons they can sell in the future. This is their main reason for getting involved in the Max Havelaar scheme.[113]

9. Development efforts

In order to make use of these independent links with traders, the farmers must learn several steps of the trading process which they are unfamiliar with. For example, they have never shipped cocoa to an exporting harbor; they have never been responsible for quality control, inspection regulations and fumigation at the harbor. They do not know about contracts, international banking, price setting, credit arrangements or insurance. If they are to loosen themselves from the middlemen, they must learn to do all of these things. Max Havelaar put on a training workshop in the Netherlands to enable the farmers to take on these kinds of responsibilities. Usually, however, this is the job of development organizations and traders. Max Havelaar works with several development NGOs, many of whom are Dutch. They also hook the farmers up with traders who aid them in the learning process. If a trader is interested in settin gup a long term relationsip, it is in his best interest to assist the farmers.[114] Max Havelaar also holds local courses on contracts, although they are difficult to organize. The farmers also learn by experience, as was stated earlier in terms of quality: if the first delivery is not up to standards, the processor or trader explains why the quality is bad and how to improve it.[115]

In contrast, the FTO set up a sister organization in 1991 to provide fair trade assistence. They help with product development, improve organizational structure and marketing, and and invest in cooperative needs. For example, if a cooperative cannot provide its own transportation to the harbor, FTO may co-finance a truck. A concrete example was the San Juan La Laguna coop in Guatamala which received 75% financing for coffee processing equipment, while the farmers invested the rest. They believe weak producers need help adjusting their product to the high demands of the western consumer. Assistence works to eliminate this tension between the market and the producers. Another example is a book circulating in South America which teaches farmers to cultivate coffee organically.[116]

10. Impact on trading system

Another important aspect of fair trade is its impact on the trading system. This takes many forms, from traders taking over Max Havelaar's responsibilities to mainstream business questioning their own practices. For our purposes, the effects can be divided per group: Manufacturers, traders, political groups and international organizations.

10.1 Manufacturers

Mainstream businesses are effected in two ways. First, the financial stability of the fair trade organization responsible for an initiative plays an important role. For example, FTO's increasing turnover translates into more and more mainstream business interests.

> We try to establish good relations with ... firms to try to influence them, that they want to do something more for these weak producers. Because we are becoming a stronger organization, we can ask more because we are now more interesting for trade organizations... people are really eager to work for us, so now we are asking them things in the field of the third world.[117]

Within the chocolate sphere, FTO was able to convince the main manufacturer, Baronie, to begin using fair trade sugar cane instead of dutch sugar beets. This was possible because FTO is Baronie's biggest customer. "So you can see if you are growing larger, you can establish good relations."[118]

Secondly, a successful organization may be seen as a threat to mainstream business. FTO believes that this is how communication starts.[119] Some may see fair trade as interfering with traditional business, threatening because they cannot play the business game according to their own rules: there is someone else coming with new rules and it makes them feel uncomfortable.[120] However, more and more companies are beginning to see it as an opportunity. Even if this begins in purely profit terms, it sometimes leads to interesting outcomes. For example, the major competitor in the coffee sector, Neuteboom, was a small roaster who, because of his size, was not unable to enter mainstream business. However, Neuteboom has grown because of the Max Havelaar initiative: by taking a risk in the fair trade sector he doubled his turnover. Moreover, within Neuteboom attitudes began changing: the employees began to argue about the difference between the normal and the fair trade coffee they were producing. They asked, "how can we make this normal coffee, because it's not fair?" Now Neuteboom is paying more for his normal coffee than he formerly did because the staff asked him to do so.[121]

As fair trade organizations begin to gain recognition by the public, the larger companies have to defend themselves. If Max Havelaar exists in order to counter injustices in the mainstream business world, the established brands may have to justify their own activities according to these new standards. Furthermore, as more companies recognize fair trade as a trend, they also see the potential for profit within this new niche market. For instance, Esprit, Body Shop and others have begun the Social Venture Network: this gives them the opportunity to view the production process, the environmental impact, the human impact, and a fair price.[122] A similar effort has been instituted in the United States, the Business for Social Responsibility, whose members include well known brands such as Lotus, Reebok, the Gap, Espirit and Body Shop, among others.[123] In this way, they are justifying themselves to the public and making a profit. Still, the lip-service quotient of this sort of activity needs to be kept in mind.

There is a tenuous balance in this relationship, however. Although ATOs dream of changing world trade practices, they also fear they will have to pay a price for success.

> If alternative trade becomes 'big business'... ATOs would lose the very thing that differentiates them from other importers: the ability to work directly with small producers and their commitment to people before profits."[124]

Also, fair trade will lose its integrity if other profit-businesses begin to market social consciousness, as with environmental concerns. For this reason, European ATOs are developing a fair trade seal, which means products meet strict criteria.[125]

Furthermore, it must be remembered that while fair trade maintains a small market share, the large companies will take notice but withstand the annoyance. As soon as ATOs gather a more substantial market share, the conglomerates will surely use hard measures to win back their disloyal customers.[126] If Max Havelaar can indeed gain 5-10% of the coffee or chocolate markets, they are certain there will be counteractions from the major players.[127] A good example of this sort of activity is the somewhat recent attack on the Body Shop, which temporarily damaged that company's share value.

For the time being, FTO atleast is happy with its 2% aim: at this rate it is present enough to be noticed and perhaps followed. Because they do not receive subsidies from the government and must work like a regular firm, they believe their success should send a message to commercial firms: you can be profitable <u>and</u> fair.[128]

10.2 Traders

The skepticism with which the initial cocoa initiative was met by industry was matched by traders: they did not think that small farmers were capable of middlemen activities. But now that they see the project in action, they have also discovered new ways of working.[129] In fact, there is not a commodity trader in the Netherlands who does not know about Max Havelaar. Sometimes the traders are so convinced that they begin to assume Max Havelaar's duties in the field. For instance, a trader is now negotiating with a cocoa producer in Africa: he wanted to buy from them, asked Max Havelaar what was necessary, and even provided prefinancing from his own funds! "They are in fact taking over the linking pin role that Max Havelaar has." While Max Havelaar links up the producer with the trader, eventually the trader learns how to play and assumes the role inbetween the producer and the chocolate manufacturer. In the coffee sector as well, its the trader who tries to push new origins onto the coffee roasters by suggesting the purchase of one container to try it in the roaster's melange. "Traders play a very positive role..... So its very important role."[130]

10.3 Political level

Quite apart from this micro level activity, fair trade organizations are also trying to make an impact on the macro level. Although buying from farmers may be the primary goal of Max Havelaar, for example, some of the founders felt that the political change was the highest goal: influencing the general trade terms.[131] FTO recognizes the importance of the area, too. Within the European Fair Trade Association (EFTA), of which they are a member, they have hired a lobbyist who works in Brussels at the European Parliament. Because ATOs come up against unfair trading practices, such as the Multi Fiber Agreement which discriminates against third world clothing imports, they feel it is important to focus on the overarching policies. Indeed, the Dutch development minister has recognized the benefits of fair trade. Moreover, the Dutch house of parliament and the European parliament as well as 250 municipalities in the Netherlands are using FTO coffee.[132]

10.4 International organization

Fair trade is being noticed on the international level as well. Hans Bolscher of Max Havelaar said, "When I joined two years ago, I was astonished to see how seriously we are taken by big international bodies. They really ask us our opinion on matters. Several times we have been quoted in the cocoa or coffee negotiations at international levels." For example, the Max Havelaar system has been discussed during ICCO negotiations. Even World Bank or international commodity organizations' guidelines make reference to the Max Havelaar system.[133]

Still, Bolscher warns that the impact should not be overestimated. Max Havelaar deals with 10,000 tons of coffee in Europe, in a total market of +/- 2 million tons. Moreover, worldwide fair trade amounts to some $50 million worth of exchanges per year, while the sales of coffee alone by the three giant companies exceeds $50 billion! Fair trade pales in comparison to the trading giants.[134] Although Max havelaar may be getting more respect for its point of view, it does not change business' attitude towards the free market system. But it does change their attitude towards the producers, even if slightly, from one of disregard to one of respect.[135]

11. Suggestions for future research for SOMO

Now that the price policy question has been resolved, there are a number of other areas which deserve research consideration:

11.1 Fair Trade sustainability

Can the Max Havelaar farmers really survive when compared to other more efficient producers who are winning over large shares of the real world market? Direct links with the world market certainly work to improve the farmers' ability to defend themselves in the international trading arena and ensures them a better standard of living. However, judging from the 1993

ICCO Trends and Prospects report, decreased supplies and increased efficiency are the two most important areas of improvement for cocoa farmers. Moreover, as cited in the introduction, the 1991 UNCTAD Prospects's message for producers is to "dramatically" reduce areas under cultivation.[136] With this in mind, does Max Havelaar really have any impact on the overarching realities of cocoa production? Furthermore, is Max Havelaar stimulating the wrong kind of production by not focusing on efficiency?

Max Havelaar suggests that their definition of efficiency differs from the world market notion in that they include not only productivity but also social economical and environmental aspects. In the short term it may be better to use pesticides, etc., to achieve increased output. But if long term aspects are included, they believe the small farmer cooperative is one of the most sustainable and efficient production methods in existence.

11.2 Fair Trade trend

In his book, Fair Trade, M. Barratt-Brown suggests that fair trade will be the next marketing wave. Moreover, US ATOs also predict that social concerns will be the next consumer agenda, following in the footsteps of environmental concerns. This will push many businesses toward fairer trading practices.[137] Ton Tukker of FTO admits that, at the moment, there is a "back to the basics" trend which is being promoted by the larger retailers. This trend is also providing a consumer basis for fair trade products. But how long will it last? Hans Bolscher of Max Havelaar admits that fair trade is a trend, but not as strong as the environmental/health trend because there is less self interest involved. Yet he believes fair trade has a stable market. Is there any substance to the idea of a fair trade marketing wave? At what point will mainstream business partners lose interest, thereby causing the failure of fair trade?

11.3 Comparison FTO and Max Havelaar

The two organizations have the same goals, but different means. For both, the aim is development. Max Havelaar is a certified seal, with no special provisions for development, and who work within the principles of mainstream business. FTO is a development organizations, with an entire section devoted to development assistence, but who work like a business. Which approach achieves more results?

FTO is the only development organization with its own brands of coffee. By working like a regular business, they hope to be an example for others. Furthermore, they try to influence those they work with concerning fair trade practices. Max Havelaar does not ask its business partners to step outside of the capitalist strategies. They claim that FTO was not successful until they changed to more commercial marketing techniques. Is FTO too idealistic? Is Max Havelaar too realistic?

11.4 Processing vs. manufacturing industry

In mid-1994, the Netherlands Cocoa and Cocoa Products Association (NCCV) published its last annual report. This was the product of unresolvable differences between the processing and manufacturing industries, of which there were mainly three.

First, the CAO conflict with labor unions. The more labor intensive processing industry had more interest in demanding better terms than the capital intensive chocolate industry.[138] Second, as ICCO buffer stocks are sold, warehousing is losing business to other ports, such as Hamburg.[139] As of 1990, the ICCO began allowing the sale of its 230,000 tons of buffer stock, 140,000 of which are housed in Amsterdam. Dutch warehousing companies earn f. 12 million annual turnover from these stocks. Losses of this magnitude mean they will have to cut staff and reduce storage space in the future. Moreover, because potential customers are aware of the extra room coming free, they may demand tariff reductions, resulting in even more financial losses.[140]

However, the third, and most serious, difference is the EU 5% directive, which if passed will allow chocolate manufacturers to use up to 5% cocoa butter substitutes. This could be the final blow to the Dutch processing industry, as substantial amounts of its production could be replaced by other fats provided by TNCs such as Unilever. This issue has indeed pitted the once united cocoa and chocolate industries against each other in an often emotional battle.

11.5 5% ruling

On top of all the difficulties the Gabriela initiative has overcome with its commercial partners, there exists a much more ominous problem which threatens to drastically alter the world chocolate market, fair or otherwise: the EU 5% directive. At present manufacturers in the Netherlands are not allowed to call chocolate made with any substitutes "chocolate": often it is called "cacaofantasie". But they are allowed to export this product to the UK, Ireland and Denmark, where manufacturers are allowed to use substitutes *and* export to other EU members. This stems from their later entry, 1973, into the EC. Most EC-9 members feel this is unfair competition, and want to change the standard.[141]

This directive is not only divisive for the cocoa and chocolate industries, as mentioned above, but it is disasterous for cocoa farmers the world over. If the EU allows 5% substitutes, the US will surely follow suit: this means that atleast 10% of world cocoa production, 200,000 tons, will be relegated to oversupply. Furthermore, the 5% line will act as an insurance against cocoa price increases: as soon as the price rises, they will use cheaper fats. The advocates of 5% have claimed that the substitutes will be other tropical oils, esecially oilpalm from poor countries like Mali and Burkina Faso. But the truth is that two of the largest producers of cocoabutter substitutes, Unilever and Karlshams (Sweden Nordica Group) dominate the substitutes market with 60-70% of world supplies. Moreover, Unilever and Fuji have developed an enzyme production process to produce oils. This means that these transnationals are no longer dependent on the variable supplies from tropical countries.[142]

And there are still other issues involved. Max Havelaar believes that there is a potential conflict within the European Commission: when the official proposal comes to the Commission they will probably support it, but Jaques De Lors will not. This will look bad for De Lors' future political career, so he prefers not to have it in the Commission at all and many are trying to avoid this hot political issue. Moreover, three of the four potential future members allow 5%: Finland, Norway and Sweden; Austria is discussing it. This means that a delay may make the decision easier.

The US recently voted against the 5% regulation, and here, too, the role of TNCs is very important. Max Havelaar believes this is a Mars strategy to gain advantage in the US market. Hershey, the leader in the American chocolate market, strongly opposed the regulation while Mars was in favor. Mars, who is one of the largest manufacturers in Europe, wanted to begin with 5% in its European markets in order to gain expertise in the field. Mars could then transport this knowledge to the US- knowledge which Hershey would not have. Even more disturbing is the fact that once the US has approved 5%, and chances are likely they will, the figure is no longer fast and may rapidly increase.[143]

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