

**Background Note for Participating Experts:
Experts Workshop on Shade-Grown Coffee**
Commission for Environmental Cooperation
Oaxaca, Mexico
29-30 March 2000

Background and Objectives:

The purpose of this workshop is to explore practical ways of supporting sustainable production and consumption of Mexican shade-grown coffee.

In recent years, efforts to support the production of shade-grown coffee have intensified. Two assumptions guide such efforts: shade-grown coffee can yield greater benefits to biodiversity conservation relative to sun-grown or industrial-type coffee production. Second, shade-grown coffee represents an expanding market opportunity within the growing specialty coffee market category.

Although the question of how to marry these two areas—the sustainable use of biodiversity and the practical measures that support green markets—has been widely discussed under the rubric of “win-win” trade-environment links, the question remains complex in practice.

As our knowledge about green markets continues to evolve, several elements are clear, and form the guiding assumption of the March 2000 CEC workshop.

First, measures to promote shade-grown coffee have been concentrated in different areas along the coffee production path. This workshop assembles a small group of experts representing the relevant stages throughout the shade-grown coffee product chain. It is hoped that by bringing actors together, bottlenecks, information gaps, missed opportunities, and possibilities for cooperative action can be better addressed and that this broader approach can yield better results compared to piecemeal efforts.

Second, progress made in the area of shade-grown coffee may bear important lessons for efforts in support of the sustainable use of biodiversity. Indeed, the CEC’s work on shade-grown coffee is founded on the assumption that lessons learned with this commodity can be

replicated, to some extent, in other areas in the agricultural sector.

Finally, by way of introduction, it is worth reiterating that the lessons learnt here, in addressing shade-grown coffee, are of considerable interest to a broader policy debate currently underway. For example, the advanced (unedited and unofficial) text of the Eighth Session of the Commission for Sustainable Development (CSD), to be held 24 April 50–5 May 2000, makes the following observations of relevance to this workshop:

“The Commission has repeatedly emphasized that consumer preference for environmentally preferable products (EPPs) offer new trading opportunities for developing countries. Several developing countries have indeed expanded exports of EPPs (as well as Fair Trade products)...

An important issue is how to make certification more affordable for small producers. Eg. through mechanisms such as “umbrella certification” of certain products (i.e. certification of entire geographical areas or groups of producers rather than individual enterprises) or the development of regional or national certification bodies. Another issue that has been raised in earlier deliberations in the Commission is how trade incentives (including through improved market access) could be provided for the production of EPPs, in particular inherently environmentally preferable products originating in developing countries.”

As noted above, among the key issues that have been identified in past efforts to promote green goods and services is the role of certification. This is an important focus of this workshop. The current state of labeling and certification for shade-grown coffee in North America will be examined in detail during the workshop.

Given the reference, in the draft CSD text above, to “umbrella” certification, a key question for the workshop is to what degree different certification agencies see a need for cooperative actions?

And, if cooperative action is pursued, what is the role of public policy in supporting such efforts?

Session One: Merging Biodiversity Conservation with Market-Based Solutions

This Session will set out in broad terms the underlying assumptions of how shade-grown coffee can support biodiversity conservation efforts.

Relative versus Absolute Benefits to the Environment:

A growing body of literature suggests that shade-grown coffee can provide better support to biodiversity conservation, relative to non-shade grown coffee. It is important at the outset to note that biodiversity conservation benefits must be seen as relative as opposed to absolute: there are environmental and biodiversity costs associated with shade-grown coffee, however, various studies suggest that those costs are lower, relative to sun-grown or industrial type coffee production. For example, past studies have demonstrated that shade coffee producing areas support strong bird, insect, and other fauna. For example, studies have shown that shade grown coffee farms could support as much as 74 percent of bat populations of adjacent rain forests.

Studies have also shown that the clearing of forests for industrial coffee production leads to a significant decline in biodiversity. For example, research in Mexico suggests that there is between 94 and 97 percent fewer bird species supported by technical or industrial-type coffee plantations, compared to shade-grown coffee farms.

In general, arguments linking shade-grown coffee with comparatively greater biodiversity benefits are well supported. Less clear is whether markets exist or can be supported to deliver biodiversity benefits.

Coffee Markets:

Each year global expenditures on coffee amount to between US\$10 to \$15 billion. Within the global coffee market, the specialty coffee market segment has increased dramatically in the past decade—some estimates suggesting that this

market segment will double 1995 levels of US\$1.5 billion in annual sales, before the end of 2000.

Estimates of the shade-grown coffee market within the specialty coffee market category are, however, far from clear. This reflects a practical problem of how shade-grown coffee is defined within international coffee markets. Some estimates suggest that shade-grown coffee represents roughly 1-2 percent of the specialty coffee market, with total sales estimated at US\$30 to \$60 million per year. However, this figure depends on how shade-grown coffee is classified. Furthermore, uncertainty about the actual definition of shade grown coffee has a practical impact on obtaining clear data on total sales, trends and projections, all of which creates problems for anyone within the product chain trying to decide if they wish to shift to shade grown coffee. It also complicates the issue of whether increasing exposure in this sector business sense for buyers and financiers.

This lack of a clear and precise definition of shade grown coffee is an important obstacle to any efforts to encourage market-based solutions for shade-grown coffee. If the potential market for shade-grown coffee is to be realized, then an unambiguous definition is essential, especially for consumers interested in differentiating between shade-grown and other types of coffee.

In contrast to the shade-coffee situation the organic coffee segment of the specialty coffee market is much more clearly delineated. Estimates suggest the organic coffee market has expanded rapidly in the past decade, and currently represents between 5 to 7 percent of the specialty market. Estimates also suggest that it is the fastest growing segment of this market, with some forecasters looking at a 10 percent per annum growth rate in this decade.

The question of product differentiation therefore represents an important focus of this workshop. Perhaps the most strongly established tools to support market-based solutions for environmental protection are labeling and certification schemes. Labels and certification systems work on the assumptions that consumers are both concerned about biodiversity conservation, and if provided with an opportunity to support products that can yield relatively greater benefits for the environment,

are willing to purchase labeled products at a premium.

Work by the CEC in 1999 shows that the *potential* market demand for shade-grown coffee in North America is strong. The CEC study, which consisted of a North American telephone survey of consumers coupled with a point of sales analysis, came up with two particular findings, among others:

- One in five consumers in Canada, Mexico and the United States are “very interested” in purchasing shade-grown coffee from Mexico;
- Consumers expressed a willingness to pay a modest price premium for shade grown coffee: 42 percent of consumers in Canada, 36 percent of consumers in Mexico, and 22 percent of consumers in the United States expressed a willingness to pay an additional US\$1 per pound for Mexican shade grown coffee.

The point of sales survey also suggests that shade-grown coffee represents approximately five percent of total sales in the gourmet coffee market. This level is significantly higher than the current 1-2 percent that shade-grown coffee represents of the gourmet market segment, and may reflect either the effectiveness of focused advertising and information campaign, or inaccurate data.

It can therefore be established that the existing and, more importantly, potential demand for shade grown coffee indeed exists.

If consumers are going to translate environmental “concern” into actual purchasing habits, then they must have confidence that products they purchase are different from other products in the same category. Product differentiation is therefore crucial to tapping the potential demand of consumers.

The coffee market is not lacking in market-based labeling schemes to differentiate products. Work by the CEC has identified approximately 17 labeling and certification schemes within North America for coffee. However, the number of schemes may be causing fragmentation of the narrow market niche for shade-grown coffee, and confusion and distrust among consumers about competing labeling claims, resulting in an unintended reverse effect on the consumer side.

In this context, participants may wish to consider the following questions:

- Are competing environmental and biodiversity claims by different schemes impeding consumer potential for shade grown coffee?
- What efforts are needed to categorize and quantify shade-grown coffee markets?
- Are there areas for potential cooperation between different labeling schemes, through efforts like mutual recognition or equivalency of product criteria?
- Assuming progress is made in closing the gap between potential and actual consumer demand, what are the consequences of increased production for shade grown coffee for environmental quality and biodiversity protection? Are more efforts needed on the production side, to examine the scale effects of expanded production of shade grown coffee?

Session Two: Perspectives from Retailers/Roasters in Marketing Shade-Grown Coffee

Any initiative to promote the sustainable production of coffee must address the issues of importance to the producers. In the chain of production, they are the ones who must make the key decision of what means of production they will employ.

Producers face a number of factors when making the decision to convert to full-sun, technified production, or continue with more “traditional”, shade-grown coffee methods. In the final analysis, a farmer is not in the business of conserving habitat for migratory birds, preserving sensitive ecosystems, or avoiding the use of harmful chemicals as a primary goal. Farmers support families and labor to make a sustainable living. Based on rational decision making, farmers will adopt production methods that yield the highest rates of return on investment.

To convince coffee farmers—and in particular small coffee farmers, whose economic hardships are generally the most severe—of the economic benefits of maintaining, switching or expanding to shade grown coffee production, several key questions need to be answered:

- Are the production criteria for shade-grown coffee practical, achievable and affordable?
- Is there a comparable return on investment for shade-grown coffee, compared to other types of production?
- How do farmers address the question of lower production yields because of slower growing periods?
- Is the potential price premium consumers say they are willing to pay high enough to cover the lower returns of investment?
- Do small scale, shade-grown coffee producers face different types of problems from other small-scale farmers in securing access to credit and technical capacity?
- What types of organizational or public policy assistance is needed to support small-scale farmers in meeting shade-grown coffee production criteria?
- Could agricultural subsidies be changed so as to discourage environmentally damaging practices, and encourage environmentally benign/beneficial ones?
- Are there other financial mechanisms that would aid in supporting shade coffee?

It is worth noting that for many small producers in Mexico, farm production methods already meet, or can easily comply with shade coffee production criteria (for example, those of the CEC-sponsored Biophysical Criteria developed with the Smithsonian Migratory Bird Center (1999)). These criteria were developed specifically to be implemented by Mexican small producers. The criteria focuses on establishing guidelines to ensure that habitat for migratory bird species is conserved, while allowing farmers to grow coffee. The stakeholders involved in the creation of the criteria were from both the scientific community and the coffee sector. The Smithsonian criteria built upon the discussions that occurred at the First Sustainable Coffee Congress that took place in September 1996 in Washington, DC. Production criteria developed then reflected the assumption that they would eventually become part of a larger effort within Mexico to begin official certification of Shade-grown coffee. The production of certified “shade-coffee” was seen as being a means to encourage sustainable development in Mexico, while at the same time furthering the conservation of the existing ecosystems. The Smithsonian criteria do not include any standards relating to the social or economic

conditions of the producers. The issue of a price premium for certified shade-grown coffee was addressed as a way to improve the condition of the small producer, as well as a tool to encourage the conversion of coffee farms to full shade operation. What the premium would be, or how producers would gain access to it was not addressed at the workshop.

In looking at the issue of meeting production criteria, it is also important to note that Mexican coffee producers already hold a comparative advantage in shade grown coffee. For example, because most small-scale farmers in Mexico grow crops under a canopy of shade trees as a less costly alternative to expensive agrochemical inputs (and as part of an Integrated Pest Management approach) they comply already with the criteria. In cases where actual practices do not conform with production criteria, the changes necessary to achieve compliance with different coffee labeling and certification schemes—including most organic systems—are usually minimal.

Although production criteria are achievable, small-scale farmers face well-documented impediments. One way of addressing them is through farming cooperatives or companies to improve economies of scale. Once enough producers ally themselves, they can improve their ability to negotiate with distributors or “middlemen” in the product chain, reduce information gaps or failures, and improve their marketing and bargaining position. Cooperatives are commonly viewed as being one way of lowering the monopoly powers of coyotes, reducing rents more generally throughout the product chain, and allowing farmers to benefit from actual price premiums paid by consumers.

Another benefit of cooperative organizations for producers is the ability to invest in processing facilities. Unless organized into cooperatives, most small scale farmers sell coffee as cherry or parchment, and have little opportunity to add value. Cooperatives provide opportunities for training, capital, and investment in equipment for the processing of the coffee into a higher-value state.

In looking at the potential for cooperative organization, it is worth examining if organizations arranged in response to the gourmet coffee market face different types of

challenges and opportunities from other agricultural cooperatives.

One of the most serious issues confronting producers is financing. Access to credit for individual small farmers is virtually non-existent. Even for cooperatives, financial associations are reluctant to provide capital without stringent limits on what path must be taken. Loans from banks are generally tied to a specific “technified package” that includes conversion to full-sun production, hybridized seeds, and heavy use of agrochemicals. The banks do not believe that organic production methods will produce sufficient returns to be profitable, and so simply refuse credit to farmers seeking to expand or replant their fields based on the organic model.

The perspectives of retailers and roasters obviously varies, reflecting different interests, corporate practices, the size of companies involved, distribution and marketing reach, and primary outlets. Large-scale roasters —Nestlé, Proctor & Gamble and Phillip Morris—control over 60 percent of the market. These companies provide coffee primarily to mass retailers such as supermarkets. An important consideration for them revolves around price, quality and consistency of supply. Generally for large buyers, the main point of competition is not product specialization—although this obviously is a consideration—but cost.

The potential for small producers and cooperatives to supply coffee to large scale buyers and tap into the mass coffee market appears to be very constrained. The main reason concerns the quantity of supply required by this sector, which is beyond the capabilities of most small producer cooperatives. Also, due to the intense competition based on price in world coffee markets, large roasters are generally closed to coffee brands that have a premium pricing system.

There is currently a trend towards consolidation within the coffee industry. As the market for specialty coffee grows (sales are expanding by 20-25 percent per year) the big roasters (the three mentioned previously, P&G, Phillip Morris, and Nestlé) are moving into this growing market by acquiring small specialty roasters (e.g. P&G and Millstone). This trend may change the specialty market completely if the larger companies decide to use their huge capacity to increase the demand

for “specialty” green beans and flood the market with the product. This could drive up the price for these coffees considerably, unless the production capacity is sufficient to keep pace with demand. If this is the case, then prices for specialty coffees could fall, further hurting the small producer.

At the opposite end of the spectrum, there are micro-roasters, who roast the beans on a per-pot basis. These operations average 500 bags per year of coffee, and offer a good target market for small producers. The number of micro-roasters has grown dramatically over the last twenty years, and they now account for 5 percent of the volume of coffee roasted in the United States.

In between large and small volume roasters are mid-sized roasters like Starbucks or Second Cup. The concerns of this group focus less on price, and more on quality and reliability. The average consumer of specialty coffee is educated, and has a mid-to-high level of disposable income. To these consumers, the taste and status associated with their choice of beverage is generally of higher concern than the price.

These roasters require access to a high-quality product, and reliable, timely delivery. As they create their own blends, they also want access to green beans from a number of different sources, and the coffee must be of a consistently high quality. Often these smaller operations (micro-roasters included) tend to establish strong ties with the producers and cooperatives with whom they do business. This may go to the point where the roaster will conduct site visits to the producing country. This involvement in the product from start to finish can be capitalized on as setting it apart from the competitors’ products.

In the past there has been a less than favorable connotation attached to coffee from small producers, especially Mexican coffee. International coffee markets have in the past rated Mexican coffee as being below first-tier coffees in terms of taste. However, in recent years coffee markets have recognized that while there may be inconsistencies with Mexican coffee overall, Mexico is capable of producing high quality coffees on a consistent basis.

In addition, small producers were viewed by international coffee markets as unreliable in terms of delivery. However, this perception is changing, as more roasters enter into contracts

with small producers. The other concern roasters have regarding the purchase of specialty coffee is one of false claims of origin. Small and micro-roasters depend on the ability to create their own blends from coffee of specific origins. To them it is imperative that they have an accurate and stringent tracking system to be able to verify that the coffee they purchase is “as advertised”. These concerns will drive the need for independent verification of the chain-of-custody and point of origin.

Retailers:

The concerns of coffee retailers are much the same as those of the roasters. In fact, many of the retailers have their own roasting operations, and micro-roasters house their roasting and retail operations on the same premises.

Specialty coffee retailers are generally focused on the procurement of high-quality coffee. Like the roasters, they require that the quality of the product be consistent, and that the delivery schedule be reliable and timely. Large retailers (such as supermarkets) purchase large quantities, and usually order their coffee on a chain-wide contract. Due to the respective volumes of coffee that each of these sectors deals in, the smaller retailers have been generally more receptive to carrying “sustainable” coffees. Smaller retailers tend to have a more personal relationship with their customers and therefore feel more comfortable anticipating demand. Obviously, if customers do not purchase enough quantity of the product, then retailers are unlikely to order it again, and may try to sell surplus coffees on secondary markets. The situation with a large retailer, such as a supermarket, is such that they must sign a long-term contract in order to be able to secure sufficient volume for all stores. If sales are poor, the retailer is still committed to purchasing a product that it cannot sell. For this reason large retailers tend to wait until there is an established demand for a product before supplying it (e.g., organic, shade, Fair Trade coffee).

Even smaller retailers are concerned with the perceived lack of demand for sustainable coffee. They are concerned that the price premium will drive up costs to the point where they will be unable to sell the coffee as it will be too expensive. In this instance they foresee that the costs of certification will limit the marketing of sustainable coffee to tiny niche markets.

Session Three: Consumers Perspectives on Shade-Grown Coffee

Despite the concern among consumers about environmental effects of coffee production, it is nevertheless true that products that attempt to carve out an ecological niche have to market and compete with other products, known as “like” products in commercial trade terms, in the same category.

According to the market study commissioned by the CEC, any campaign to promote Mexican shade-grown coffee will have to address several key points:

1. Among the coffee industry there is a common belief that Mexican coffee, especially from small producers, is of an inconsistent and inferior quality when compared to plantation coffee from other producing areas.
2. The shade-grown concept is not generally recognized by the coffee consumer. Most coffee drinkers are unaware of the social, economic, and environmental impacts of coffee production. This lack of “issue awareness” will hamper efforts to promote the product as being “sustainable”.
3. The lack of issue awareness could account for the finding of the CEC market study. When promoted as “Canopy grown, and environmentally protective” the percentage of consumers willing to pay a price premium declined versus a marketing campaign focused on taste and relative health benefits (“Slow-grown, no heavy chemical use).
4. The issue of a price premium is also contentious. The CEC results indicated that US consumers were more sensitive to price increases than those in Canada or Mexico (although interest in purchasing the product also declined in those areas as the premium was increased). This is especially significant in light of the size of the US coffee market, the largest in the world.
5. Marketing would have to overcome consumer apathy at the cash as well. Although there is a trend in consumer behavior to *say* that they will purchase the more expensive, but environmentally-friendly product, at the cash register they tend to opt for the less-expensive option.

6. Marketers must be careful not to put too much emphasis on the negative consequences associated with the consumption of coffee. In so doing, a consumer backlash may develop against the particular brand or product being advertised. The CEC study found that:

“..many consumers feel that coffee is bad for them, but enjoy indulging in it nevertheless. The last thing they want to hear is that the coffee they drink destroys forests and that the people picking the beans are exploited or living in poverty. While all this might be true, conveying these negative factors in a marketing campaign will likely have a negative response.”

A market intelligence report on coffee by Find/SVP, cited in *Sustainable Coffee at the Crossroads* (Consumer’s Choice Council 1999), characterizes the typical specialty coffee drinkers as “24 to 40 year olds who are college-educated and who earn over US\$35,000 a year.”

The potential for growth in consumer interest in purchasing shade-grown coffee depends on many of the same conditions as does the market for “green goods and services” in general; product awareness, quality, and access. As mentioned earlier, consumers are often not aware of the issues that a given product is meant to address. By providing consumers with the necessary information, in the form of pamphlets, posters, radio spots, and newspaper ads, they can be made aware of why the product is environmentally preferable, and will choose to purchase it (in theory at least).

Another concern of consumers is that “green” products are not as effective or as high quality as the conventional products that they are meant to replace. In the case of shade-coffee consumer concerns focus around the issue of taste. Expert cupping tests have found that Mexican shade-grown coffee can compete with other “gourmet” coffees, but that there are still quality control issues which must be addressed. Consumer taste preferences are also more subjective and personal than the expert criteria. Any marketing campaign must emphasize the taste benefits of shade-grown coffee.

The last hurdle in encouraging consumers to purchase Mexican shade-grown coffee is the

accessibility of the product. Consumers will not buy the coffee if it is not easy for them to do so. While some consumers will make the extra effort to order the product specially from roasters who carry it, the general coffee-drinking public will not. Mexican shade must be available in specialty coffeehouses on a regular basis so that consumers will become familiar with it and have a chance to order it regularly. If the coffee is not easily available to consumers, the market will not grow.

Session Four: Tools to Identify and Market Shade-Grown Coffee

There are three distinct systems employed in the certification of coffee production processes. They are:

1. Organic Certification
2. Shade-Grown (and “Bird-friendly”) Certification
3. Fair Trade Certification

Numerous other systems, developed by industry and NGO’s, exist that may contain some elements of the three categories noted above

The issue of certification, and labeling of coffee in general, is one that sparks much debate within the industry. Among the different certification agencies there is a general consensus that third-party verification is necessary to assure that any product being marketed based on the type of production methods used actually reflects the production criteria identified in the labeling or certification system. (Certification of the origin of a coffee shipment was pushed into the limelight by the Kona Coffee scandal, in which lower grade coffee was passed off as a higher grade (and consequently higher-priced) coffee.)

Organic Criteria:

The organic certification system has existed for the longest time of the three, has carved out a well defined and expanding market niche, and is supported by clearly defined criteria. Organic certifiers have a strict set of criteria that must be followed, and guidelines are clear and usually based on quantitative targets. While the public may equate organic production with the absence of various synthetic agro-chemicals (fertilizers, pesticides, herbicides, fungicides), it is more than

that. Organic agriculture is a system that is intended to preserve the health and fertility of the soil through composting, terracing, vermiculture, and other “traditional” farming practices.

Some organic systems (e.g., QAI, and OCIA) include social criteria and some shade guidelines in their programs in addition to the basic standards. This integration of the shade criteria into the organic verification standards and procedure make sense in the case of most Mexican small producer operations as they already employ “passive organic” techniques. They grow coffee under a canopy of shade trees to preserve soil fertility and as part of their IPM strategy, and therefore do not employ agrochemicals, which are also prohibitively expensive.

Shade-Grown Criteria:

Shade criteria for the production of coffee have been developed by a number of different agencies. The systems for shade certification, unlike those for organic production, are not all the same, reflecting the lack of maturity of the “shade” concept. The Smithsonian Migratory Bird Center developed biophysical criteria that could contribute to the conservation of biodiversity as well as the broader goal of environmental protection in Mexico. These criteria were developed at a workshop sponsored by the CEC in February 1999, in Veracruz, Mexico.

The SMBC criteria address the amount of shade, the structural, faunal, and vegetative diversity, soil and water conservation, and the use of agrochemicals. The criteria include recommendations as to what steps should be implemented to achieve conformity, and a “Plus” Status for producers seeking to go beyond the basic standards. The Plus standards involve such measures as the elimination of synthetic/inorganic fertilizer, and increased structural and vegetative diversity in the shade tree canopy.

The Eco-Ok program of the Rainforest Alliance (managed by the Conservation Agriculture Network) requires the inclusion of shade trees in the *cafetal*, as well as social standards relating to worker pay, and working/living conditions. The requirements for certification are not as stringent as those of other systems, which has been cited by both supporters and critics alike.

Fair Trade Criteria:

The Fair Trade certification system for coffee production is unlike the Organic or Shade schemes in that there are no set environmental standards. Instead, the Fair Trade system is focused on improving the socio-economic situation of the small producer. There are four basic criteria that must be met for Fair Trade coffee production:

1. Purchase directly from small farmers organized into democratically-run cooperatives.
2. Guarantee a floor price when world market prices are low (presently the floor price is set at US\$1.26/lb of washed Arabica).
3. Offer farmers advance pre-financing (credit) to help cover harvest costs.
4. Develop long-term trading relationships between importers and farmer co-ops.

The Fair Trade program is specifically intended to apply to small coffee producers, defined as those who cultivate between 3-5 hectares of coffee, harvest between 1,000-3,000 lbs of green coffee per year, and rely principally on family labor, hiring workers only during the harvest season if necessary.

More information on the comparability of different labeling schemes will be found in a paper and data-base available to participants at the workshop.

Session Five: Transparency and Comparability of Labeling and Certification Schemes

Among the issues that have been under discussion for some time, are concerns about comparability of different coffee labeling and certification schemes. Different options warrant greater examination in this regard, including informal cooperation among schemes, more formal approaches such Mutual Recognition of schemes, or the pursuit of harmonization and an umbrella labeling concept. Although the creation of an umbrella or super seal is well beyond the scope of this workshop, a discussion of the opportunities for Mutual Recognition and Equivalency between labeling programs is not. Mutual recognition of certifications between programs would be a valuable step towards the wider expansion of labeling programs in the

industry as it would open up a larger market to certified operations.

Mutual recognition of certification standards is an ongoing debate in the coffee industry. The term “mutual recognition” refers to an agreement between two (or more) different organizations to accept and officially recognize each other’s work. In the context of coffee labeling, mutual recognition refers to the recognition by one certifier of the work of another certifier.

Mutual recognition does not however imply that the standards set by the parties are the same. Within the certification forum mutual recognition may be approached in two different ways, *Harmonization* and *Equivalency*. These are defined in the CEC paper “Environmental and Other Labeling of Coffee: The Role of Mutual Recognition in Supporting Cooperative Action”:

“Harmonization requires the adoption of one set of criteria that defines sustainable coffee and which provides the basis for its certification. Given the incongruent (and even competing) sets of issues brought to the table by various stakeholders, it will likely be very difficult to agree on any such common standard. Nonetheless, providing consumers with one, consistent designation may be the only approach that guarantees acceptance.”

“Equivalency implies that certifying bodies would continue to use their own criteria, but would respect the common, agreed upon goal (e.g., producing and marketing shade/sustainable coffee for a reasonable price while maintaining ecological integrity). Efforts would therefore be made to find and respect common ground that does exist between criteria and concerns. Stakeholders would essentially choose to travel by different roads to the same destination. This could allow for variances in farming practices, as long as a general, mutually-respected, effort is being made to produce coffee that addressed environmental and social concerns. Subsequently, consumers could be presented with one label representing ‘good’ coffee.”

In a document prepared for the CEC in support of the upcoming Oaxaca workshop, *TerraChoice Environmental Services* outlines a framework for enhanced cooperation and mutual recognition in four steps:

1. Cooperation and interchange of information, including policy objectives;
2. Mutual confidence is established;
3. Mutual recognition of testing and verification is established; and
4. Analysis of environmental criteria leading to mutual recognition.

To date this framework has been implemented by several members of the Global Ecolabeling Network (GEN), including manufacturers of photocopier equipment.

Mutual recognition agreements (MRAs) and its potentially supporting role in relation to shade grown coffee will be an important focus of this discussion. As mentioned previously, the TerraChoice report on MRAs will be sent to participants under separate cover.

Session Six: Identifying Financing Opportunities for Shade-Grown Coffee

The purpose of this session is to explore ways in which the private sector can become more engaged in efforts to market shade grown coffee.

Since UNCED, there has been a recognition that the public sector cannot meet all domestic and international environmental problems, and that the private sector has a pivotal role in environmental and biodiversity protection.

This observation applies to all aspects of environmental management, including the role of the private sector in financing environmental protection. It has long been noted that well functioning financial and capital markets are necessary for well functioning environmental protection and biodiversity conservation schemes.

This is not to suggest that markets in general and the private sector in particular bear all responsibility for the environment. However, market-based solutions such as the labeling of shade-grown coffee require the financing and capital investment primarily from external sources, such as commercial credit, venture capital and joint ventures, different types of debt financing like bond issues, or the launching of common or preferred stocks.

In looking at plans to expand the production and marketing of shade-grown coffee, several points are worth repeating. First, the international market for coffee in general is significant, estimated at US\$10-15 billion per annum. Specialty coffee represents approximately five percent of total coffee sales, and portions within that market are growing at rates of 10-15 percent or more per year.

Equally important, studies suggest that in principle, the demand for shade coffee among consumers is substantial. Accepting the usual caveats that expression of theoretical interest for a given product significantly overstates actual consumer responses, the CEC analysis of point of sales suggests that shade-grown coffee can expand its present market niche within the gourmet coffee market segment, anywhere up to *five percent of total sales*. This in itself represents a 100 to 200 percent increase from current sales.

Given these factors, several questions are worth exploring:

- Do private investors or commercial lenders have enough information about the potential market expansion of shade-grown coffee?
- Do investments in shade-grown coffee pose more of a commercial risk to lenders or investors than sun-grown coffee? For example, does the rate of return on investment for shade-grown coffee differ from other coffees because of slower rates of growth or different harvesting methods?
- If return on investment rates differ from commercial coffees, is there a role for public financing in closing the gap?
- Given the important role of small farmers in shade-grown coffee production, do they face access to credit problems in the area of shade grown coffee that differs from more systematic problems of small-scale farmers?

This latter area—the challenges facing small-scale farmers—is especially important. It is well-known that small-scale farmers, whether they are producing “green” or non-green commodities, face many challenges related to access to credit. These include: internally generated cash revenues are extremely limited, because of limited scale factors; they are often precluded from capital markets due to their size; relative transaction costs are high; risks to commercial lenders in exposure to small scale farmers is

usually deemed to be too high. This perceived risk is often attributed to the absence of collateral that the small producer can put up to guarantee their loan.

There are various responses to these and other problems, including strengthening the bargaining position of small farmers through cooperatives; and expanded efforts in micro-financing, both of which have been examined elsewhere.

Among the challenges of particular interest to the participants of the upcoming Oaxaca workshop is identifying the role of public policy in supporting access to financing for small-scale farmers producing shade-grown coffee. Among the options that have been identified generally include:

- Supporting dedicated financial institutions designed to channel funds through small credit programs managed by commercial banks;
- Providing security for loans;
- Creating subsidy and other public policies, including concessions or grants for example;
- Creating positive environmental subsidies and diminishing reverse subsidies;
- Addressing information obstacles faced by small-scale farmers, through access to internet and other information technologies;
- Creating Trust Funds, such as those used by the World Bank, which are frequently established as revolving funds and earmarked for biodiversity-related projects.

Session Seven: The Role of Public Policy in Supporting Shade-Grown Coffee Markets

A general assumption of market-based instruments is that different tools like labeling are designed to harness the power of markets in order to yield environmental improvements. While interest in market-based instruments is often seen as a retreat of government policies, in practice such instruments benefit from complementary policies by governments in several areas.

Two are worth noting:

- Green procurement
- Public Financing

Green Procurement:

Although recent studies suggest that consumer purchasing of labeled products and services has leveled off in the last five years, new opportunities are opening up in the area of green procurement. Research tends to show that the potential for increased procurement of green goods and services by federal, sub-federal and municipalities in North America exists, and a recent study by the CEC—*Supporting Green Markets*, 1999—identifies key procurement agencies in North America.

Although differences exist within North America, three issues are worth noting:

- Public procurement at the federal, sub-federal, and municipal levels represents enormous buying power in its own right. For example, the US federal government alone spends US\$200 billion per year on the procurement of goods and services, and continues to develop and initiate mandatory procurement policies in support of green goods and services;
- Government agencies that have green procurement policies are more likely to purchase products that have recognizable environmental labels, and which can compete on price with non-labeled products within the same category. It may be worth exploring the procurement possibilities that could exist by a cooperative label for shade-grown coffee;
- Green Procurement initiatives exist in the private sector as well. Examples of companies in the United States that employ environmentally-preferable purchasing programs in dealings with suppliers include General Motors, Hewlett Packard, Ford Motor Company, Bank of America and many other large companies that have applied green procurement policies in dealings with suppliers.

In Canada, the federal government alone spends an estimated CAD\$11.6 billion on products and services, and has taken a lead role in promoting green procurement. A recent study has also shown that eight provinces and territories in Canada have also developed, or are developing, policies relating to environmental procurement. Some provinces, such as Ontario and Alberta, have mandatory policies for the use of Ecologo

(the seal used by the Canadian Environmental Choice Program) products if they are available.

At the municipal level, many towns, cities and public entities (e.g., universities, schools, hospitals) also have policies to promote green procurement policies.

Similar trends can be identified in the United States. On an annual basis, the US federal government spends approximately US\$200 billion per annum on goods and services. All US federal agencies are instructed to purchase environmentally preferable goods and services. “Environmentally preferable” is defined under the relevant US Executive Order as “products or services that have a lesser or reduced effect on human health and the environment when compared with competing products or services that serve the same purpose. This comparison may consider raw materials acquisition, production, manufacturing, packaging, distribution, reuse, operation, maintenance, or disposal of the product service.”

Several initiatives fall under the implementation of the Executive Order, and the pilot phase of the Comprehensive Procurement Guideline program, administered by the Environmental Protection Agency, has concentrated on 39 products in the following categories: construction, landscaping, park and recreation, transportation, non-paper office products and paper products. (For more information on different schemes in the US, please see CEC, *Supporting Green Markets*, 1999).

In addition to federal initiatives, considerable activity is underway at the state and local levels regarding green procurement.

Environmental Financing:

There is now a well-established body of literature identifying ways in which government policy can be used to reduce the financial burden domestic industries face in meeting pollution abatement regulations. Among the tools that have been used in this regard are various “green subsidies,” including grants, soft loans, temporary tax incentives such as tax credits, accelerated depreciation provisions, the creation of tax deductible funds, or the use of tax-free bonds for investors. Many of these approaches developed to reduce costs of pollution abatement

can be used to support efforts, especially among producers, in the area of shade-grown coffee.

Although financial support schemes are less developed in the area of biodiversity protection than pollution, considerable work has also concentrated in recent years on the design and implementation of various incentive measures for biodiversity conservation and sustainable use.

For example, one of the most-cited examples of “win-win” trade and environment linkages refers to the environmental benefits of removing many subsidies, especially in the agricultural sector. Subsidies in agricultural production have come under particular scrutiny. Various studies have estimated the environmental costs of under-priced agro-chemical inputs in the agricultural sector, and the ensuing environmental benefits of removing such distortions.

What is clear from the trade-environment debate is that removing subsidies, or securing land tenure or other reforms, is in and of itself not sufficient to secure environmental benefits. A “one size fits all” for public policy reforms does not work, nor can one policy initiative solve all problems. A recent OECD publication, *Handbook of Incentive Measures for Biodiversity* (OECD, 1999), notes that a combination of measures by governments is necessary to adequately address all the issues.

This combination includes:

- Economic Incentives:
 - Fees, charges and environmental taxes;
 - Market creation and assignment of well-defined property rights;
 - Reform or removal of adverse or negative subsidies.

- Regulations and Funds:
 - Standards, regulations and access restrictions;
 - Environmental funds and public financing;

- Framework Incentives:
 - Information provision, scientific and technological capacity building;
 - Economic valuation;
 - Institution building and stakeholder involvement.