

Ensuring a German coffee tax exemption benefits producers

Final report

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Executive Summary

In April 2018, the German Federal Ministry of Economic Cooperation and Development (BMZ) publicly called for exempting coffee companies (e.g. roasters) from specific taxes if their coffee has been sustainably produced and fairly traded. The aim of the exemption is to improve the social, environmental, and economic conditions in coffee producing countries and to contribute to the Sustainable Development Goals. Disadvantaged coffee producers, particularly smallholders, largely face low and variable productivity as well as receive low and unstable prices. Their share of the coffee retail price is generally estimated to be lower than 10%.¹ In many cases, the producers' income from coffee is insufficient to afford a decent standard of living and reinvest in their farms while adapting to climate change and protecting natural resources.

The German government charges a special tax on roasted coffee (2,19 EUR/kg) and soluble coffee (4,78 EUR/kg) that generates revenues of over one billion EUR per year (value added tax is charged on top). As a result, up to 45% of the coffee retail price in Germany is captured by the government. To put this in perspective, the potential value from a coffee tax exemption (2,13 USD/kg green coffee) is above the International Coffee Organization's (ICO) 5-year average price for Robusta (2,04 USD/kg) and comprises 70% of ICO's 5-year average price for Arabica (3,05 USD/kg) (considering that most coffee producers receive between 60% - 90% of the FOB price)². The potential value would also be sufficient to cover the payment of a fair price, such as:

- a living wage for coffee plantation workers in Kenya³
- compensation for all externalities of climate smart coffee in Mexico, calculated at 3,90 USD/kg⁴
- high-value service packages to coffee smallholders (estimated at 70 USD per producer per year)⁵

Although the tax exemption would channel financial incentives through the supply chains of German roasters to producers and could have potential impact, it is important to note that there are limitations to this policy instrument's supply chain approach. The coffee sector's experience in sustainable production and fair trade has been mainly through the supply chain. Despite having delivered some benefits to both farmers and commercial partners, the approach has largely resulted in 'islands of success'. A high-performing and resilient coffee sector requires a holistic and coordinated approach that addresses systemic issues – such as price volatility and lack of services – addressing the root causes of poor performance. As such, a *beyond the supply chain* solution is out of scope of this proposed mechanism that links the coffee tax exemption to sustainability impact.

This report has been prepared by Aidenvironment, an expert in sustainable agriculture system design and evaluation, who was asked by GIZ to contribute input for the implementation of the German coffee tax exemption initiative.

¹ Samper, L., Giovannucci, D. and Marques Vieira, L. (2017). The powerful role of intangibles in the coffee value chain. Economic research paper No.39. WIPO.

² Panhuysen, S. and Pierrot, J. (2018). Coffee Barometer 2018

³ Aidenvironment, on-going work for Rainforest Alliance

⁴ TruePrice and Solidaridad (2017), The true price for climate smart coffee: quantifying the potential impact of climate-smart agriculture for Mexican coffee

⁵ IDH (2017), Driving innovations in smallholder engagement: Insights in Service Delivery and Finance. The 70 USD per farmer is an average taken from multiple service delivery models in various sectors, including coffee.

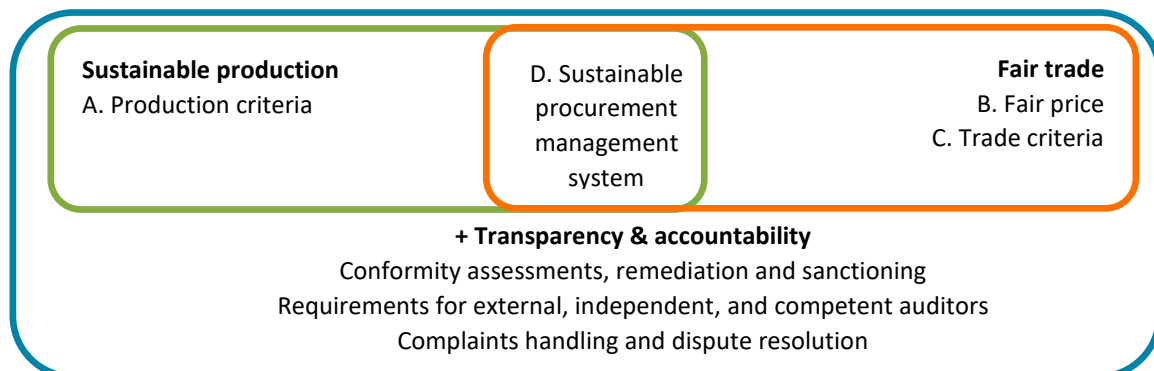
Key insights to inform the design of a potential tax exemption mechanism

Based on the assessment of individual approaches to sustainable production and fair trade, six key insights have been gained that cut across approaches and can inform the design and management of a potential tax exemption, which are:

1. Disadvantaged coffee producers need significant technical and financial support to meet sustainable production criteria. They should be supported in reaching the desired performance levels through investments and payment of fair prices.
2. More fairness in trading practices and prices, supported by value transfer safeguards, need to be introduced for coffee to be sustainably produced. These measures should be introduced in tandem with investments in direct producer support.
3. Increased responsibility and risk sharing by downstream companies (e.g. roasters, retailers) is needed to robustly promote sustainable production and fair trade for disadvantaged coffee producers. A 'sustainable procurement management system' operated by roasters has the potential to manage the implementation and assurance of requirements for sustainable production and fair trade efficiently and credibly, from both a coffee company and German administration perspective.
4. Transparency and accountability are essential features to assess and demonstrate externally the effectiveness of any approach to stakeholders. Features like conformity assessment (i.e. assurance), performance monitoring, and public reporting allow stakeholders to monitor and voice support or concern regarding what companies have done and how they have done it to earn the tax exemption. However, these features substantially increase the implementation and assurance costs of a supply chain mechanism. It is important to strike a balance between credibility and efficiency to avoid that a significant amount of the exempted tax is used for controlling rather than providing benefits to producers.
5. There is no silver bullet to achieve sustainable production and fair trade. Any tax exemption mechanism should include several components and allow for various implementation models.
6. Although the German government pursues a tax exemption for roasters to improve conditions in coffee producing countries, the barriers to sustainable production and fair trade at scale are systemic and beyond the supply chain alone to resolve. Complementary, pre-competitive approaches promoting public and private investment can make wider and more sustained impact.

Proposed mechanism to link the financial incentive of the tax exemption to sustainability impact

Based on our assessment, we propose a framework of four core components that together comprise the mechanism to link the financial incentives from the tax exemption to sustainability impact. The components are the following: transparency and accountability + production criteria + fair price + trade criteria. In addition, a sustainable procurement management system can be added. The framework is shown in the figure below:



For each component of the framework, we describe the main elements, benefits, and implications as well as the open topics that remain to be addressed. The specific criteria of each component will have to be defined, which is out of scope of this proposal.

Transparency and accountability

One of the four components that cuts across the framework is transparency and accountability. This component comprises the following elements:

- ✓ Conformity assessments, remediation, and sanctioning
- ✓ Requirements for external, independent, and competent auditors
- ✓ Complaints handling and dispute resolution

Transparency and accountability safeguard the integrity of the implementation and assurance of the tax exemption's requirements and provide credibility towards stakeholders. As the transparency and accountability component underpins all other components, the scope of conformity assessment, complaints handling and dispute resolution covers the production criteria, fair price, trade criteria, and the sustainable procurement management system.

Open topics to be addressed: development of conformity assessment requirements and remediation and sanctioning rules at production and trade levels. Definition of benchmarking rules to determine if the conformity assessment, remediation, and sanctioning rules of existing voluntary sustainability standards meet the transparency and accountability requirements. Development of the mechanisms to handle complaints and resolve disputes.

A. Production criteria

The production criteria component comprises the following elements:

- ✓ Practice-based core criteria (farm & washing station), including traceability requirements

This component alone leads to improved social and environmental impact, but limited livelihood impact. It has a high level of credibility yet at a high cost. To mitigate potentially low livelihood impact, the Fair Price component (B) is proposed. To reduce assurance costs, the Management System component (D) is proposed.

Open topics to be addressed: type of producers eligible, definition of production criteria and avoiding a race to the bottom, step-wise improvement, and the development of benchmarking rules

B. Fair price

The fair price component can include different forms of prices and premiums. These include:

- ✓ Cash premiums (flexible or fixed)
- ✓ Floor prices and/or floating prices

Fair price represents a critical component of sustainably produced and fairly traded coffee. This component alone leads to higher incomes that can potentially have a positive livelihood impact. Moreover, the costs to implement and verify payments are relatively low. However, it is difficult to reach unorganized smallholders and the social and environmental impact remains unclear.

The fair price component alone carries the risk of buyer dependency and market distortion. To mitigate incentives for unsustainable production from a high price signal, the Production criteria component (A) is included. To mitigate risks of buyer dependency and market distortion, the Trade criteria component (C) is proposed.

Open topics to be addressed: choice of instrument (price and/or premium), choice of price-setting benchmark, price-setting, degree of price differentiation, conditioned use of fair price, payment timing

C. Trade criteria

This component contains three main elements, which are:

- ✓ Minimum fair trading practices (e.g. payments and contract terms)
- ✓ Long-term buying commitments (e.g. 3-year time horizon)
- ✓ Administrative traceability (e.g. mass balance)

The Trade criteria component provides the ability to balance power differences between roasters and producers as well as to facilitate investment in sustainable production. This component alone has a high level of credibility, yet at a high cost. To reduce assurance costs, the Management System component (D) is proposed.

Open topics to be addressed: type of supply chain actor to whom trade criteria are applicable to, clear benchmarking rules and the nature of consumer communication

D. Sustainable procurement management system

The sustainable procurement management system is a component that we recommend adding to the set of four components (production criteria + fair price + trade criteria + transparency and accountability). This component includes the following elements: policies, plans, risk management, risk-based conformity assessments, traceability (see also C), complaints handling, and public reporting.

The sustainable procurement management system leads to greater efficiency, reduced assurance costs, and broader benefits e.g. transparency and risk sharing. This component places the responsibility of showing farm performance on the exempted company, which reduces the costs of audits upstream (i.e. frequency and intensity of audits on producers and traders). However, by placing such responsibility on the exempted company, the sustainable procurement management system does add costs to SMEs that may reduce their competitiveness and could present credibility risks if its requirements are not well-defined (i.e. companies find loopholes and take shortcuts).

Open topics to be addressed: Development of system requirements and benchmarking rules

A concluding note

The above proposal that links the financial incentive of a potential tax exemption to sustainability impact was made recognizing the limitations of such a policy instrument in channeling benefits through the supply chain at scale. For this reason, we recommend that alternative solutions be considered such as using the tax revenue for broad investments in the production base rather than expecting exempted companies to fully improve conditions. For instance, the German government could finance, directly or indirectly through a multi-stakeholder-managed fund, the producer organization, service delivery, and value chain development components of sustainable production and fair trade (see section 1.2.). This type of investment is part of the holistic and coordinated approach that would help transform the coffee sector to a high level of performance and resiliency.

We suggest a few main steps to assess the proposed tax exemption mechanism:

- *Research:* Further research on the mechanism's components such as fair price, trade criteria and the sustainable procurement management system
- *Consultation:* Deeper consultation on the proposed mechanism to validate and strengthen it as well as to grow the buy-in of stakeholders for implementation
- *Promotion:* Wider promotion to key stakeholders in government, industry, and civil society to build a critical mass of support in advance of a decision by the German government

Introduction

The German government charges a tax of 2,19 EUR per kilogram (kg) of roasted coffee. For soluble coffee the tax amounts to 4,78 EUR per kg. The tax generates revenues of over one billion EUR per year. As a result, depending on the type and brand of coffee, more than 45% of the coffee retail price can be captured by the state. In addition, value-added tax is charged on the coffee (7% for roasted ground coffee and beans, 19% on prepared coffee).

In contrast, coffee farmers in producing countries obtain a share of the coffee retail price estimated to be lower than 10%⁶. The share depends on the country where farmers produce, the type of coffee they produce and the specific supply chain they are selling to. Often coffee farmers' income from coffee is not sufficient to afford a decent standard of living. As a result, many neglect their farms and look for alternative livelihood opportunities which further deteriorates the economic viability of those coffee farms.

In April 2018, the German Federal Ministry of Economic Cooperation and Development (BMZ) publicly called for exempting companies (e.g. roasters) from the coffee tax if their coffee has been sustainably produced and fairly traded. The overarching aim of the exemption is to improve the social, environmental, and economic conditions in coffee producing countries and to contribute to the Sustainable Development Goals. With this high-level goal, the exemption of the coffee tax could be legally justified. In this context, it is critical to be able to plausibly explain that the underlying objectives are achieved through the exemption of the coffee tax. Furthermore, the preconditions for the tax exemption for sustainably produced and fairly traded coffee need to be clearly defined. The criteria of sustainable and fair trade coffee need to differ significantly from today's common practice in coffee production and trade. A state authority would have to be named to control the tax exemption process and ensure that its objectives are being fulfilled.

To address this concern, GIZ is facilitating a stakeholder process to discuss different options for the coffee tax exemption. GIZ has asked Aidenvironment to provide expert input into this stakeholder process through the following report. The analysis, results and recommendations in this report represent the opinion of the authors and are not necessarily representative of the position of GIZ or BMZ.

The report starts by outlining the key issues that need to be addressed to increase sustainability in the coffee sector and improve the livelihoods of the most disadvantaged producers. The next chapter assesses existing sustainability initiatives in the coffee sector on their effectiveness and potential relevance for the tax exemption mechanism. Chapter three proposes a mechanism which links the financial incentive of the tax exemption to sustainability impact. It concludes by proposing the next steps to further develop the mechanism and reiterating the need for complementary investments.

⁶ Samper, L., Giovannucci, D. and Marques Vieira, L. (2017). The powerful role of intangibles in the coffee value chain. Economic research paper No.39. WIPO.

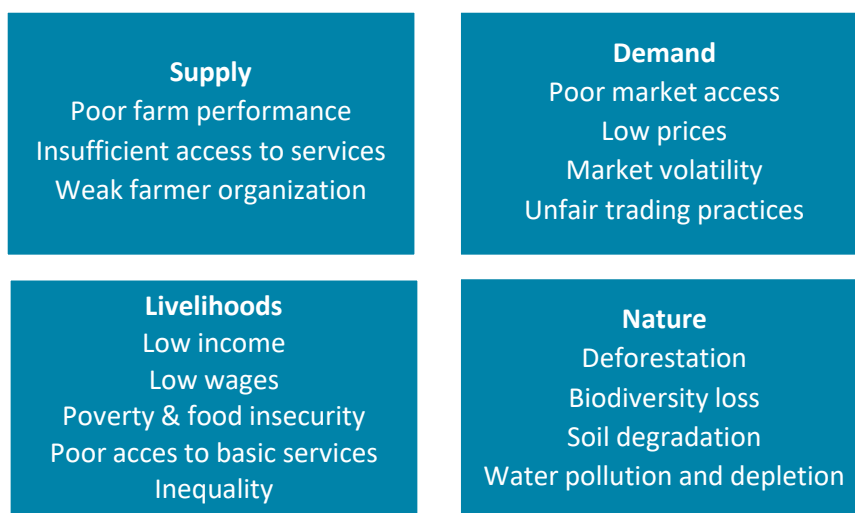
1. Key issues and components for sustainably produced and fairly traded coffee

1.1 General description of the key issues and root causes

The objective of the German coffee tax exemption is to improve the social, environmental, and economic conditions in coffee producing countries and to contribute to the Sustainable Development Goals. The focus is on the most disadvantaged producers typically smallholders who are often poorly organized and have low-performing farms (i.e. yield, quality).

The key sustainability issues related to this segment of producers can be found in four, often interrelated, themes that are generally accepted by the global coffee sector: Supply, Demand, Livelihoods and Nature.

Figure 1: Prominent sustainability issues in the global coffee sector



Supply

Smallholder farms are characterized by low and variable productivity. This is partly caused by poor agricultural practices and ageing trees, further enhanced by pests and disease outbreaks and adverse weather events. The prevalence and intensity of pests and disease, if not adequately managed, can severely affect yield, quality, and ultimately, farm profitability. The issue of pests and disease is made worse by climate change. Unpredictable climate – warmer temperatures, droughts, and heavy rains – exacerbates the prevalence and intensity of pests and disease in the coffee sector such as the leaf rust and coffee berry borer. If producers do not have sufficient resources, knowledge, and access to services, they are unable to adequately manage such pests and disease.

Insufficient service delivery impedes producers from accessing the training, inputs, and finance needed for sustainable coffee production. Training is a constant need for producers to continuously improve their farming. Coffee farms need inputs – varieties, seedlings, and fertilizers – to perform better. Too few improved varieties that yield more and better coffee and combat pests and extreme weather are produced, distributed, and planted by producers. Too few seedlings are available to producers to renovate their ageing farms. Fertilizer can be unaffordable and/or inefficiently applied

impeding the improvement of soil fertility for a more productive coffee farm. Producers have limited access to finance to invest in their farms since many cannot offer the collateral that traditional financiers require for loans. Most service delivery models by public and private actors are poorly organized and inefficient reducing their effectiveness and benefits for coffee producers.

Unorganized, remote producers cannot access services and markets. Low levels of producer aggregation hinder the ability of producers to access services and markets collectively. Smallholder producers are dispersed in rural areas. Basic infrastructure can be lacking, impeding them as commercial actors to access services and markets.

Supply-side issues pose a problem to meeting the increasing market demand. In 2016/17, global coffee production was nearly 9.5 million MT.⁷ By 2050, it is estimated that some 19 million MT will be needed if consumption grows 2% annually. Leading producers like Brazil, Colombia, Vietnam, and Indonesia and other producing countries in Latin America, Asia, and Africa will have to address key supply issues – climate change, service delivery, and producer organization – to double coffee production.

Demand

Low and unstable prices make conventional coffee unprofitable and do not reward sustainable coffee production. As a soft commodity, coffee is traded in a market that is highly volatile. In addition to the erratic variation in prices, the long-term trend is that prices are depressed. Over the past 40 years, real prices have declined by 66% adjusting for inflation.⁸ Moreover, only 10% of an annual USD 200 billion industry is retained in producing countries with smallholders in East Africa, for example, earning only 61% of the export price (conversely, 80% in Costa Rica).⁹

Despite the depressed and volatile market, the costs of production have steadily increased over time making coffee production less profitable.¹⁰ Even for those coffee producers that can earn profit, it is largely unfeasible to renovate farms and recover the costs of applying sustainable production practices.¹¹ In addition, most market segments expect producers to deliver quality coffee. Green coffee derived from good practices on-farm and in primary processing is the foundation for the value added in roasting, blending, and marketing. The market, however, offers seemingly inadequate rewards to meet its demands.

Unfair trading practices constrain supply chain relationships perpetuating low, unstable prices and investment in sustainable production. Many mainstream buyers (e.g. roasters, retailers) do not know the producer at the beginning of their supply chain. This lack of transparency encourages market behaviour at each stage of the supply chain that is unsupportive to sustainable coffee production. Unfair trading practices can include unclear or unfair contract terms (e.g. short-term deals), retroactive contract changes (e.g. demanding rebates), unfair transfer of commercial risks (e.g. long delays in payments), unfair termination of a commercial relationship (e.g. without reasonable period of notice).

There can be incentives, unfortunately, to engage in unfair trading practices. Buyers are typically in a stronger position in the market compared to suppliers. Smallholders are the most disadvantaged, particularly when they cannot access national and international markets. International market trading (i.e. coffee futures) can have adverse effects on disadvantaged coffee producers when it is overly

⁷ World Coffee Research (2017). Annual report 2017. Creating the future of coffee. WCR.

⁸ Sachs, J. (2016). The impacts of climate change on coffee: trouble brewing.

⁹ Samper, L., Giovannucci, D. and Marques Vieira, L. (2017). The powerful role of intangibles in the coffee value chain. Economic research paper No.39. WIPO.

¹⁰ ICO (2016). Assessing the economic sustainability of coffee growing. International Coffee Council 117th session 19-23 September 2016 London, United Kingdom. ICO.

¹¹ TruePrice and Solidaridad (2017), The true price for climate smart coffee: quantifying the potential impact of climate-smart agriculture for Mexican coffee

speculative. Unfair trading practices may not be a deliberate choice as market and government structures (i.e. the rules of the game) and dynamics (i.e. competitiveness) as well as contextual factors (e.g. poor producer organization) may compel such behaviour by supply chain actors.

Unconducive public policy and regulation can lead to unlevel playing fields, inefficient markets, and act as a disincentive for the market and producers to invest in sustainable coffee production.

Regarding coffee producing countries, national governing bodies may not set or enforce quality and sustainability standards or insufficiently manage traceability systems, if present. When active in price-setting, the process and result of price-setting may be insufficient or further expose producers to market volatility, low prices, and low share of the value. In some cases, taxation by national governing bodies is disproportionate to their re-investment in the sector (e.g. research and extension). A lack of transparency and accountability within national governing bodies generally creates mistrust among national and international stakeholders. The role of policy and regulation is further discussed as the sixth component of section 1.2.

Sectoral governing bodies often act in silos without a conducive national agricultural development policy and rural development framework to guide them and ensure coherence and effectiveness. This can misplace national coffee production goals vis-à-vis other agricultural and rural opportunities. Competition among producing countries on production goals can, at the international-level, contribute to market distortions and unintended sustainability consequences among their own countries' producers.

Livelihoods

Poverty and hunger are severe issues in many coffee-producing areas. Coffee production is not economically sustainable for many producers and those producers who can make a profit struggle to cover the costs of farm establishment and renovation.¹² In addition to the low productivity, other factors contributing to this situation include small farm sizes, high input prices and poor market access. A lack of profits puts pressure on the finances of coffee-producing households. The average coffee farmer in Tanzania, Uganda and Kenya earns less than the PPP adjusted poverty lines.¹³ In other countries, such as India, Indonesia and Vietnam, farmers are relatively well off, often making at least a living income. Producers living in poverty cannot secure food that is nutritious and affordable, particularly within a growing season. Food insecurity is equally experienced by producers of specialty and organic coffee.¹⁴ Producers unable to meet their basic needs are unable to pay for or access health and education services, if available. This dire situation forces members of many households - often young men, the next generation of coffee producers - to migrate to urban areas in search of opportunity that is more attractive than coffee.

Poverty exacerbates gender inequality in many coffee-producing areas. The target of further cost savings can be women and children, typically a source of informal and uncompensated labor. In cases of migration, women face additional burden as they must perform all tasks needed for coffee production. In some countries, women may not be permitted to own land and/or able to be formally recognized as coffee producers.

Seasonal workers are paid low wages and face informal and unsafe working conditions. Given the supply and demand issues, smallholder producers look for cost savings. Labor is the most significant

¹² ICO (2016). Assessing the economic sustainability of coffee growing. International Coffee Council 117th session 19-23 September 2016 London, United Kingdom. ICO.

¹³ TruePrice (2017), Assessing Coffee Farmer Household Income, commissioned by Fairtrade International

¹⁴ Caswell, M., V.E. Méndez & C.M. Bacon (2012) Food security and smallholder coffee production: current issues and future directions. ARLG Policy Brief # 1. University of Vermont: Burlington, VT

variable of production costs in areas with low levels of mechanization. In many producing countries, seasonal workers, often migrants, have to operate in the informal labor market unable to exercise their rights. They are under pressure to work without contracts, for low wages and in unsafe conditions such as no use of personal protective equipment, carrying of heavy or hazardous materials, no first aid available, or no water available. Such issues are more prominent in countries with unresponsive national policies and enforcement of labour regulation.

Nature

Deforestation, degradation, and climate change put pressure on sustainable coffee production and the resilience of producers to face future environmental change. Forests are cut down to establish new coffee farms.¹⁵ In the absence of responsive environmental regulation and enforcement, short-term strategies like the conversion of undeveloped land and full sun, intensive production thrive as a way to meet yield and quality goals. These developments can result in soil erosion and degradation, and biodiversity and habitat loss in coffee-producing areas.

Coffee milling drains precious water supply and can damage water quality downstream. Many coffee-producing areas have limited surface water reserves (e.g. streams or lakes) or become increasingly water-scarce due to climate change. Wet processing coffee cherries can require 1200 liters of water to produce 7 kilograms of green coffee for export.¹⁶ Inefficient milling – due to outdated technology – can put further pressure on a scarce resource. Moreover, the waste water from milling is released untreated into local water sources. The pulp removed from coffee cherries becomes a toxin during the milling process and, if not properly treated, contaminates the water that communities downstream depend on. Most specialty (Arabica) coffee is derived from the wet milling method.

1.2 Components of sustainably produced coffee and fairly traded coffee

In this section, we present a description of the key components of sustainable production and fair trade in the coffee sector that can address the issues facing coffee producers and supply chain actors.

Framing the components of sustainable coffee production and fair trade

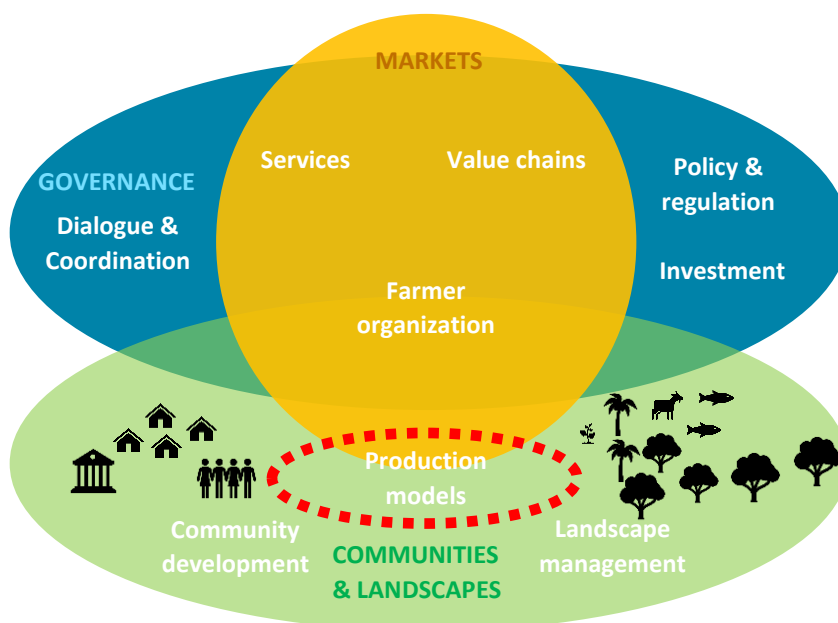
The coffee sector has arguably the most experience with sustainable production and fair trade initiatives. Most of the approaches have been supply chain-driven. Despite delivering some benefits for both farmers and commercial partners, they have largely resulted in ‘islands of success’. Increasingly, supply chain actors, government, donors, and civil society realize that, to improve sustainability and have an impact at scale, systemic issues - like price volatility and lack of services - need to be resolved in the enabling environment to allow value chains to act efficiently, effectively, and fairly in the landscapes and communities where they operate. A high-performing and resilient coffee sector requires a holistic and coordinated approach that addresses – locally and globally – the root causes of poor performance.

Figure 2 presents a model comprising three core spaces of intervention – markets, governance, and communities / landscapes– to improve sustainable production and fair trade and, ultimately, the livelihoods of the most disadvantaged producers.

¹⁵ Baker, Peter (2014) Global Coffee Production and Land Use Change. Obtained at: https://www.researchgate.net/publication/273445289_Global_Coffee_Production_and_Land_Use_Change

¹⁶ <https://coffeelands.crs.org/2012/08/293-coffee-and-water-resources-at-origin/>

Figure 2: A focus on markets, governance and communities & landscapes



Source: Aidenvironment (2018)

By markets, landscapes and governance, we refer to:

- *Markets*: the performance of markets comprising the production systems, organization of producers, and dynamics between the actors along the value chain and service delivery
- *Governance*: the institutions and processes at administrative and sector levels. Its components are multi-stakeholder dialogue, sector coordination, policies and regulation, and sector investments
- *Communities & landscapes*: the dynamics between production systems, ecosystem services and communities

The next section provides more detail regarding these three spheres to ensure sustainable coffee production and fair trade. The spheres are presented according to nine components.

Markets

1. Production models

The basis of improving the livelihoods of disadvantaged farmers is the promotion of viable farming systems in terms of profitability and resiliency. The challenge is that closing the income gap is achieved by intensification and renovation. A complementary strategy is to increase quality and value addition in cases where the market rewards it. Crop diversification could promote more stable incomes (often considered to be as important for smallholders as higher incomes). The different roles men and women play in farming and post-harvesting activities should be considered when selecting the crop mix. Promoting crop diversification will also imply that farmers need support to make these alternative crops more profitable and access new markets. A viable farm requires a viable farm size. Where absent, investment strategies and agricultural policy will be needed to promote viable farming systems.

2. Producer organization

Key for wide-scale promotion of sustainable production and fair trade is to organize producers around service delivery and market access. Farmers could be organized in different ways, including through service provider networks, outgrower schemes, supply chain networks, cooperatives, or sector-wide organisation. Whatever organizational form is promoted, key success factors are professional

management, viable business models and accountable governance structures. Having strongly organized farmers is also a prerequisite to engage in value addition.

3. Services

Producers, particularly smallholders, need to have resources, inputs and knowledge to renovate their farms, apply good agricultural practices, and improve soil fertility for long-term farm profitability. This requires cost-efficient, economically viable and scalable service delivery models. In many producing countries, there is still a need to establish or strengthen models whether supply chain-driven, through producer organizations, the public sector, or specialized service providers. Innovative service delivery models can be designed that treat farmers as customers. Service providers know their customers and offer them a value proposition, for example, access to progressively complex and discounted services as producers show improvement on-farm. Services need to be tailored to a farmer's need and either offered in a bundled way or, at least, be designed to complement other critical services. To promote farmer resilience, service providers like buyers need to look at the whole farming system and the needs of households (instead of a single focus on coffee).¹⁷

4. Value chains

The trading relationships between value chain actors, from smallholder producers to end-users, have a dominant influence on both sustainable production and fair trade. Sustainable production requires supportive market incentives for good performance and disincentives for poor performance. For example, companies can adopt policies and standards to ensure the coffee they procure is produced according to good social and environmental practices in producing countries. This approach allows companies to ensure they 'do no harm'. These policies and standards can also contain alternative market incentives such as fair trading practices and fair prices. Fair trading practices can include long-term purchase commitments, clear contracts, respect of contract, absence of retroactive contract changes (e.g. price rebates) and unjustified quality claims, quick invoice payments, pre-finance and price insurance (see Appendix I for complete list).

Fair prices include mechanisms such as minimum prices, premiums and cost-plus pricing models. Fair and stable prices reflect the cost of (sustainable) production and reduce a producer's exposure to market volatility. In combination with purchase commitments, it provides farmers with a predictability that incentivizes investing in their farm. Pre-finance assists cash-strapped producers to obtain the inputs needed for production and it helps producer-based organizations procure coffee from their members during the harvest. Smallholder incomes could also be enhanced by making them benefit from downstream activities. This is possible either by supporting farmer groups to engage in value-added activities (e.g. processing, exporting) or by giving them a share in downstream activities.

Many of these incentives require shorter and more transparent supply chains. Traceability is one form that transparency can take, allowing companies to know their suppliers and the source of their coffee (e.g. place of origin). Such traceability allows for more efficient value transfer and avoids margin escalation i.e. that each supply chain actor adds on a margin as a transaction cost while de-coupled from value addition). It can also allow companies to know the farm and community conditions where their coffee is produced. This could be a basis to make additional investments in their supply base (e.g. service delivery or community development). Companies can then define key performance indicators based on the topics they consider important in order to monitor activities and progress on certain outcomes.

¹⁷ IDH (2017), Driving innovations in smallholder engagement: Insights in Service Delivery and Finance

Many of these approaches will not work in a highly competitive cost-driven market environment. In such a race to the bottom, there is simply too little value to distribute. Therefore, more emphasis is needed on value creation. This could be achieved by giving more attention to quality, product differentiation and other innovations which increase the value of end-products.

Governance

5. Sector dialogue and coordination

Multi-stakeholder, sector dialogue and coordination is also a key component to promoting sustainable production and fair trade. Dialogue among all stakeholders in the coffee sector can cover all relevant sustainability issues and components. Sector dialogue should lead to a shared vision of viable coffee farming systems, effective service delivery and responsible sourcing models as well as a sound strategy to guide the fulfilment of such a vision. Effective coordination also requires sector-wide monitoring of progress towards the fulfilment of the vision and to inform evidence-based learning. Sector dialogue and coordination also promotes alignment among key stakeholders on the strategic investments to make. This form of multi-stakeholder governance is valuable in producing countries – in cases where effective public governance is limited – and is often part of the major sustainability initiatives found in the coffee sector. Increasingly, multi-stakeholder governance takes the form of platforms. Such a function can also be implemented through national commodity boards. These should also be based upon multi-stakeholder governance and could be placed both within or at arm's length of the government.

6. Policy and regulation

The role of public policy regarding the coffee sector in producing and consuming countries is to ensure a level playing field for all coffee producers and supply chain actors. A set of coherent public policies accompanied by effective regulation creates such a level playing field. The aim is to prevent unsustainable production and trading practices and reward improved social, environmental, and fair trading practices.

The importance of a sound regulatory and policy environment cannot be understated when promoting sustainable production and fair trade. For instance, governments have a pivotal role to play in protecting labor rights and meeting environmental objectives. They also have a large toolbox to influence markets both directly and indirectly. It ranges from lighter mechanisms such as product quality standards, product traceability systems and price transparency to heavier market interventions such as price fixing, price stabilization and supply management. Supply management can entail a combination of land use planning, production or export quota, buffer stock management, price incentives, the promotion of crop diversification, dissemination of market intelligence as well as promoting non-farm income opportunities. Supply management is preferably done based upon international coordination to avoid that countries undermine each other's strategies to increase farmer incomes. If the ambition is to influence international markets, rather than react to them, then public policy should be based upon sound macro-economic modelling of supply and demand dynamics with its management done in a transparent way. Governments in producing countries could also decide to subsidize farmer households rather than farm output. Alternatively, governments can support demand, for example by promoting domestic consumption or through market promotion abroad.

Moreover, national governments have leading jurisdiction over landscape management and community development. A healthy crop specific sector requires a healthy agricultural sector. Hence, it is important to integrate crop-specific policies in the wider agricultural and rural development policies, including regulation related to land tenure and employment creation. This will facilitate crop diversification and a general transformation toward higher performing farming systems.

7. Investment

The promotion of a high performing coffee sector comes with a cost, particularly if such policies are complemented with investments in research, subsidized service provision or price stabilization mechanisms. Hence, governments should pursue adopting mechanisms (e.g. taxes or fees) which generate the revenues to reinvest in the sector strategically. In all these governance aspects, transparency and accountability are key principles to be respected.

Communities and landscapes

8. Community development

Many practices on the farm depend on the norms, values and practices within the communities in which they are located. Community development is a complementary sustainability approach to address poor labor conditions, food insecurity, and unequal gender relations. Community development can comprise of women's empowerment (e.g. alternative income generation, participation in local governance), youth development and child labor monitoring programmes. The lack of access to basic services and infrastructure can also threaten the effectiveness of the farm-related sustainability approaches. Hence, community development relevant to coffee farming also comprises investments in basic services such as water, sanitation, healthcare and education as well as infrastructure like roads and electricity.

9. Landscape management

Viable farms require healthy landscapes. Landscape interventions can be important complementary strategies to create the enabling environment for farm performance. Landscape management approaches are particularly relevant when competing interests exist between landscape users and when the performance of a coffee farmer is affected by other landscape users. This approach is also a means to combine farmer income enhancement with other objectives such as forest protection, watershed management and biodiversity conservation. As coffee farmers are often not the only driver of deforestation, landscape approaches facilitate working with other landscape users as well. Landscape management can unlock new sources of finance at national and international levels (e.g. Payment for Environmental Services (PES) and the Reducing Emissions from Deforestation and Degradation (REDD+) to reward for implementing sustainability approaches).

Each of the above nine components serve a function that is part of a holistic transformation approach to the coffee sector. The interventions related to these components will differ per context and for their design the whole range of local, national and international market and policy dynamics should be taken into consideration. Different stakeholders will have different, complementary roles to play.

2. Assessment of sustainability approaches and existing initiatives

Coffee has several decades of history in sustainability initiatives. This chapter’s focus is on the approaches and corresponding initiatives that: 1) address one or more of the components presented in the previous chapter; and 2) and are applicable to importers and roasters who could be exempted from the coffee tax. In our classification, we distinguish between approaches and initiatives as well as those that promote sustainable production and those that promote fair trading. By sustainability approach, we refer to a generic approach that serves a specific function to meet a social, environmental, and/or economic objectives. An initiative comprises one or more sustainability approaches by a company or multiple stakeholders to meet a sustainability objective in the supply base.

2.1 Typology of approaches in the coffee sector

We identified the main types of approaches based on their function and classified them according to their form. The table below outlines the main features of the various forms that sustainability approaches take.

The approaches related to sustainable production are voluntary production standards, supplier code of conducts, geographical criteria, responsible sourcing, producer support, community development and landscape management as well as pre-competitive funds. The fair trading approaches include direct trade, long-term purchase commitments, fair trading practices as well as fair prices and premiums. The approaches to sustainable production and fair trading are underpinned by various levels of transparency and accountability.

Sustainable production

Approach	Features
<i>Criteria-based sourcing</i>	
Voluntary production standards by NGOs (i.e. voluntary sustainability standards (VSS)) and/or industry	<ul style="list-style-type: none"> Standards (practice-, or performance-based) + premium Traceability (individual, group, or wet mill) Assurance (individual, group, or wet mill) Capacity building Monitoring & evaluation Public reporting of performance Communication and labelling
Supplier Code of Conducts	<ul style="list-style-type: none"> Internal standard of good practice Assurance (e.g. 2nd party)
Geographical criteria	Similar to production standards yet applicable to defined jurisdictional area (e.g. community, district or province)
<i>Sustainable procurement management systems</i>	
Responsible sourcing programs	<ul style="list-style-type: none"> Policies Action plans and targets Standards and codes (internal or external) Monitoring Additional features: <ul style="list-style-type: none"> Management system (e.g. risk) Evaluation and public reporting of performance

	<ul style="list-style-type: none"> • Premium
<i>Investments</i>	
Producer support programmes	<ul style="list-style-type: none"> • Capacity building • Inputs (e.g. fertilizer, pesticides, seedlings) • Credit • Coffee-related infrastructure (e.g. warehouses)
Community development & landscape management programs	<p><i>Community-focused</i></p> <ul style="list-style-type: none"> • Infrastructure (e.g. roads, electricity) • Basic services (e.g. healthcare, education) • Women’s empowerment (e.g. income, leadership) • Youth development <p><i>Landscape-focused</i></p> <ul style="list-style-type: none"> • Land use planning • Natural resource management
Pre-competitive funds	<ul style="list-style-type: none"> • Capacity building • Inputs (e.g. fertilizer, pesticides, seedlings) • Credit • Coffee-related infrastructure (e.g. warehouses)

Fair trade

Approach	Features
<i>Fair trading relationships</i>	
Direct trade, long-term purchase commitments, & fair trading practices	<ul style="list-style-type: none"> • Direct, stable commercial relationships • Trade criteria • Fair prices
<i>Fair pricing</i>	
Premiums	<ul style="list-style-type: none"> • Fixed premium • Flexible premium • In-kind premiums
Prices	<ul style="list-style-type: none"> • Floor price • Fixed price • Floating price

2.2 Assessment of existing initiatives in the coffee sector

This section contains our assessment of sustainability initiatives in the coffee sector that are most relevant from a German tax exemption point of view. We identify their strengths and weaknesses and explore how they could be addressed through the coffee tax exemption.

Approach	Main initiatives
Sustainable production	
Criteria-based sourcing	Voluntary sustainability standards (RA/UTZ, Fairtrade, 4C, Organic, SAI Platform, Enveritas, Certifica Minas Café), Corporate Supplier Code of Conducts and area-based verification
Responsible sourcing programs	Starbucks C.A.F.E. Practices, Nescafe Plan, Nespresso AAA, Lavazza, Tchibo, Jacobs Douwe Egberts, Illy, Lidl Fair Globe, Aldi Nord, Rewe Pro Planet

Investments	Coffee & Climate, Neumann Foundation, International Coffee Partners, Coalition for Coffee Communities, Coffee Farmer Resilience Fund
Fair trade	
Fair trading relationships Fair pricing	Fairtrade, Fair for Life, World Fair Trade Organization, GEPA, Counter Culture, Union, Moyee, Solino, Kaffee-Kooperative.de, Original Foods

In practice, companies combine different approaches and participate in several initiatives. Most initiatives address the *value chain* component (see section 1.2), as described below. Some approaches also support functions in the other components, for example, through company investments. Section 2.2.3 briefly touches upon other initiatives that combine approaches and that can potentially support one or more of the components of sustainable coffee production and fair trade from section 1.2.

For our assessment, we applied the following criteria:

Criteria	Description
Relevance	<ul style="list-style-type: none"> Target groups and key issues
Effectiveness	<ul style="list-style-type: none"> Depth, quality and sustainability of existing and potential impact
Scalability	<ul style="list-style-type: none"> Existing and potential reach of intended target groups (i.e. disadvantaged coffee farmers)
Credibility	<ul style="list-style-type: none"> Credible implementation Transparency (e.g. value transfer)
Efficiency	<ul style="list-style-type: none"> Additional effort and costs for company implementation (German companies, supply chain actors, producers) Effort and costs for German administration to manage the tax exemption
Level playing field	<ul style="list-style-type: none"> Non-discriminatory access for German companies

2.2.1 Sustainable production

Criteria-based sourcing

We identified three approaches within criteria-based sourcing: voluntary sustainability standards (VSS), geographic criteria, and supplier code of conducts. Voluntary production standards are a set of social, environmental, agricultural, and management practices that are recognized by multiple stakeholders to promote sustainable coffee production at the farm-level. Geographical criteria build upon voluntary production standards and apply sustainability requirements beyond the farm gate to a defined coffee producing area. Supplier code of conducts outline principles and commitments that roasters require from immediate suppliers (called Tier 1) and upstream suppliers to comply with related to basic labor, environmental, and management issues. They are largely based on national law in exporting countries and may not cover the farm level. VSS, geographic criteria, and supplier codes of conduct can address the *production model* and *producer organization* components of sustainable production (section 1.2).

Voluntary sustainability standards

VSS are the principal approach used by leading companies to implement sustainable production criteria at farm-level. The main VSS are Rainforest Alliance (merged with UTZ), Fairtrade, and 4C and Organic. Other standards exist that are applicable to the coffee sector such as Enveritas, SAI Platform's Farm Sustainability Assessment (FSA) or the government-run certification program Certifica Minas Café in Brazil.

Many of the insights given in this section are derived from various sources of literature in the footnote referenced.¹⁸

An overview of our assessment of VSS is included in the following table.

Criteria	Assessment
Relevance	Comprehensive coverage of farm-level issues
Effectiveness	Mixed impacts, limited on livelihoods
Scalability	Can reach large numbers but challenged to include most vulnerable ones
Credibility	From robust to medium assurance & accountability, but limitations
Efficiency	High assurance costs
Level playing field	All companies can participate

Relevance

The scope of VSS criteria is highly relevant for the issues facing coffee smallholders. They have been developed by extensive consultation processes, in which the participation of different types of coffee producers has been included, particularly when the ISEAL Alliance Standard-Setting Code of Good Practice was followed. Most VSS address issues related to Nature, Supply, Livelihoods but to a lesser extent Demand issues. For example, the Rainforest Alliance and UTZ are strong on conservation, biodiversity, good agricultural practices, and productivity and cover basic labor conditions such as occupational health and safety and wages. The Fairtrade standard has a similar scope but its strength lies in addressing Livelihoods issues such as labor, gender, and empowerment and Demand issues through fair trading practices and minimum prices.

Effectiveness

The effectiveness of voluntary standards is contested. For many years, VSS have been criticized for not measuring their impact in a credible way. By now, this has changed. There is a growing evidence base on the impacts of VSS (see ISEAL's [Standards Impacts website](#)). Most of the evidence shows mixed results of impact within certified production areas. There are clear contributions of VSS to positive impacts such as reduced operational costs, increased yield and product quality as well as improved social and environmental conditions. However, the impact is not always as high as expected. Moreover, there are limitations on what production-based standards can achieve in solving issues which have root causes at community, landscape, policy or market levels. For example, they have little influence on how value is distributed between value chain actors which can limit their impact on promoting decent livelihoods of producers and workers. Impact studies also show that the impact of VSS is highly influenced by contextual factors, as well as the quality of how standards are promoted (e.g. the quality of capacity building of smallholder producers).

Level-playing field, efficiency, and scalability

In the past 20 years, there has been significant increase in the number of certified coffee producers. VSS, as a market-based approach, are accessible to all coffee companies to support (i.e. non-discriminatory) and they have spurred a 'race to the top' where companies use them to differentiate

¹⁸ See for example: Kimberly Ann Elliott. 2018. "What Are We Getting from Voluntary Sustainability Standards for Coffee?" CGD Policy Paper. Washington, DC: Center for Global Development; Petrokofsky, G. & Jennings, S. 2011, The effectiveness of standards in driving adoption of sustainability practices: A State of Knowledge Review, Oxford University and 3Keel, commissioned by ISEAL Alliance; Carlson, A. and Palmer, C. A (2016). Qualitative meta-synthesis of the benefits of eco-labeling in developing countries. *Ecological Economics* 127 (2016); Oya, C, Schaefer, F, Skalidou, D, McCosker, C and Langer, L, 2017. Effects of certification schemes for agricultural production on socio-economic outcomes in low- and middle-income countries: A systematic review. *3ie Systematic Review* 34. London: International Initiative for Impact Evaluation (3ie).

themselves via sustainability in the marketplace. That said, VSS are known to mainly reach the larger, better organized and better performing producers.¹⁹ The business case for certifying the worst performing and most disadvantaged producers, often unorganized, is largely weak due to high transaction costs (i.e. sourcing, assurance) and the costs involved in meeting the rigorous VSS criteria. Additional to the costs of implementation, VSS are criticized for the cost of assurance as not enough innovation has occurred to improve inefficiencies. Thus, the potential scalability is too low to reach the most disadvantaged coffee producers and to reach them in a credible way without significant investment in organization and capacity building in the pre-certification stage. Furthermore, the fact that slightly more than one third of certified coffee produced is actually sold as certified calls into question the need to scale if existing producers reached by VSS are not receiving its full market benefits.

Credibility

VSS are a credible approach. For example, Rainforest Alliance, Fairtrade and Organic are strong on transparency and accountability as they are based on multi-stakeholder governance, require third-party assurance and some degree of product traceability, and undertake monitoring and evaluation of producer performance, which is publicly reported. Additionally, they define rules for companies to follow when communicating to businesses and consumers. There is, however, variation between VSS. For example, 4C and SAI Platform have less robust assurance models and no option for on-pack communication. For its part, Enveritas has developed an innovative assurance mechanism using satellite imagery that is the key feature of its system. Despite the fact that several VSS follow the highest standards in assurance (i.e. using ISO-accredited certification bodies), research shows that being certified is no guarantee that the required practices are respected by all producers throughout the year.

Geographical criteria

Geographical criteria refer to sustainability requirements applicable to a defined coffee producing area (e.g. country, province, district or village). As it focuses on sustainable production, it is a potential approach additional to the normal regulation of production and export (e.g. food safety, quality). The scope of geographical criteria can include production characteristics and enforcement of social and environmental regulation.

Our assessment of geographical criteria is presented in the following table.

Criteria	Assessment
Relevance	Scope can be adapted to local priorities potentially addressing root causes of farm unsustainability
Effectiveness	Defined performance levels expected to be low High investment required independent of performance levels defined
Scalability	Can reach large numbers but challenged to include most vulnerable ones, particularly when institutional environment is weak
Credibility	Unproven (national) assurance models and a possible traceability challenge
Efficiency	Causes costs to implement and monitor unproven models but some cost efficiencies in assurance are possible
Level playing field	May trigger a complete shift of sourcing areas and discriminate against companies' preferences and market positioning

Despite a few interesting features, this potential approach creates a lot of uncharted territory with the main risk being that it relies heavily on national enforcement.

¹⁹ See: <https://utz.org/wp-content/uploads/2016/03/Impact-report-2016.pdf>

Supplier Code of Conducts

Compared to the above multi-stakeholder-based VSS, our assessment of code of conducts shows clear differences.

Criteria	Assessment
Relevance	Varying coverage of issues – mainly legal, farm-level out of scope
Effectiveness	Unknown
Scalability	Reaches large numbers of farmers but indirectly
Credibility	Limited assurance & accountability, if required
Efficiency	Lower costs
Level playing field	All companies can define and apply

Relevance, effectiveness, and scalability

Market access strongly shapes supplier behavior. The fact that most coffee companies have Codes of Conduct is an enabling condition for sustainable production. The relevance of Codes of Conduct on the issues and components of sustainable production and fair trade is average. The scope is often limited to commitments to basic labor, environmental, and management requirements in line with national law and does not cover the farm level. The scope highly varies between companies.

The effectiveness of Supplier Codes of Conduct is largely unknown; Codes of Conduct mainly serve a compliance purpose and the results of any degree of assessment are not publicly reported. The sustainability of the coffee a major roaster sources is often reported in the annual report and/or a dedicated sustainability report yet mainly indicates outputs rather outcomes and rarely extends to the farm-level. Depending on the criteria of Codes of Conduct and their assessment, they could be potentially effective as large companies have the scale to promote improved production practices in their supply chains.

Credibility and efficiency

Supplier Codes of Conduct have costs and require some transparency and accountability. Their limited and variable scope attests to the preference for efficiency over credibility in defining criteria. External stakeholders are typically not involved in the process. Coffee companies, particularly multinationals, require some level of conformity assessment of their Codes of Conduct. It greatly varies though and is generally less robust being based on first and second-party assurance. Independent impact assessment, however, is not widely featured.

Altogether, the limited relevance, unknown effectiveness, and low credibility represents the large gap between policy and implementation.

Sustainable procurement management systems

According to our classification, we have identified one dominant form that sustainable procurement management systems take: responsible sourcing programs. By responsible sourcing programs, we refer to systems that include, in varying degrees, policies, targets, action plans, standards and codes, risk management, monitoring and reporting regarding sustainability of the green coffee purchased. Responsible sourcing programs differ from supplier codes of conduct and producer support programs in that they demonstrate that sustainability is integrated, in some degree, into the company's coffee business and part of a comprehensive management system. The systems can be either designed

internally by the company or by external organizations, for instance, based on VSS (e.g. Union for Ethical Bio-Trade).

Responsible sourcing programs have long featured as a sustainability approach used by companies. The main initiatives we included in our assessment (from roasters to retailer) are: Starbucks C.A.F.E. Practices, Nescafe Plan, Nespresso AAA, Lavazza, Tchibo, Jacobs Douwe Egberts, Illy, Lidl Fair Globe, Aldi Nord, and Rewe Pro Planet.

Responsible sourcing programs address the multiple components of sustainable production and fair trading (section 1.2), including production *model*, *producer organization*, *service delivery*, and *value chain development*.

Responsible sourcing programs

The table below outlines our assessment of company responsible sourcing programs.

Criteria	Assessment
Relevance	Varies. Mainly based upon companies' priorities but can refer to VSS criteria
Effectiveness	Potentially high where supplier relationships are stable; Difficult to know impact
Scalability	Tends to focus on 'low hanging fruit'
Credibility	Assurance is possible. Information on impact depends on robust M&E system
Efficiency	Requires costs to implement and monitor
Level playing field	Implementation and transaction costs may be too high for SMEs (i.e. non-specialty segment)

Relevance

The scope of company sourcing programs can be relevant for the issues facing coffee smallholders but they can vary considerably as multinational companies define them according to their priorities. Many leading multinational roasters have committed to sourcing certified coffee by VSS to meet some of their sustainability targets. For example, Nestle's Nescafe Plan uses 4C and the Sustainable Agriculture Network (SAN), Nespresso AAA is based on Rainforest Alliance much like the Lavazza's program, and Tchibo and Jacobs Douwe Egberts both source certified coffee from various VSS.

Sourcing programs tend to focus on Supply issues, such as quality and productivity, which have had a positive impact on producer's income. By focusing on a company's Supply priority, these programs typically do not reach beyond the already good performing producers i.e. the low-hanging fruit. Sourcing programs can also adapt to focus on issues that become increasingly pressing from the point of view of coffee stakeholders and consumers (e.g. hunger, child labor, deforestation). For example, Starbucks C.A.F.E. Practices emphasizes Supply and Nature issues and, on the Demand side, pays producers the fairtrade minimum price. This ability to adapt and focus on company priorities allows for potential investment in the root causes of unsustainable practices, which would contribute to more relevance and effectiveness.

Effectiveness

The effectiveness of responsible sourcing programs is difficult to assess. Companies tend to report limited information about their impact due to weak monitoring systems and concerns about competition. There is some evidence about improved quality and productivity leading to increased

income for producers. The potential impact though is high due to the significant resources, incentives, efficiencies, and general influence that (large) companies have over customers and suppliers. However, multinational companies operate in a highly competitive, cost-driven market environment where margins are slim and an opaque supply chain reduces the incentive to (adequately) invest in suppliers.

Scalability and level playing field

Since most responsible sourcing programs in the coffee sector are based on VSS, they are similarly limited in terms of scalability and efficiency. They tend to focus on high-performing producers (e.g. estates) and even implementation programs for high-performing smallholders can be costly, in part due to high transaction and investment costs. This can already be an obstacle for small and medium-sized roasters to invest in wide-scope responsible sourcing, particularly beyond niche markets, and could discriminate against their participation. In this case, there is little potential to include significant numbers of the most disadvantaged coffee producers. Some companies that define their own responsible sourcing programs can and have reached coffee producers at scale. Starbucks sources their entire supply according to C.A.F.E. Practices, which accounts for 25% of global supply but does not necessarily reach disadvantaged producers since the company defines a smallholder as owning up to 12 hectares, which is producer in a relatively good position.

Efficiency

Company sourcing programs are also costly due to inefficient service delivery models. The certification focus that aims to supply sustainable markets has ignored a general understanding about designing tailored and efficient models to effectively provide technical assistance, access to inputs, and access to finance. This has led to a duplication of efforts by service providers and at significant costs by companies with a return on investment that has been lower than expected.

From a German administration perspective, efficiency gains do exist. For example, the Starbucks case shows how sourcing programs can identify specific coffee volumes as sustainable, which facilitates the government's verification of such a responsible sourcing program as it relates to the tax exemption.

Credibility

The credibility of company sourcing programs is average. As most are based on VSS, their credibility is enhanced, particularly in terms of product traceability and assurance (both product and program). Transparency and accountability are limited as companies are accountable in terms of sustainability mainly to their customers, although they do engage external assessors like the major audit firms to substantiate their claims. That said, multinational companies mostly do not monitor and report robustly on the effectiveness of their programs in farming communities. Also, companies can communicate about sustainability to businesses and consumers above and beyond VSS communication rules since the scope of their sourcing programs is wider than VSS criteria.

The credibility of company sourcing programs not based on VSS is difficult to assess. For example, Illy's program addresses issues across Supply, Nature, and Demand themes, albeit averagely, but lacks substantive transparency and accountability. They apply third-party assurance but use a supply chain process standard that is less relevant and less recognized. In other words, sustainable production and fair trade criteria are not assessed. The public reporting of their work focuses merely on activities carried out rather than outcomes.

Investments

Within the investment approach, we identified three approaches: producer support programs, community development / landscape management programs, and pre-competitive funds. By producer support programs, we refer to the agricultural and financial services such as training, inputs, and credit

that coffee producers need to significantly improve their farm performance. This is a service-focused approach to deliver on-farm benefits typically within a roaster's own supply chain carried out by a trader e.g. exporter. Community development / landscape management programs, often inter-related, address some of the root causes of unsustainable coffee production. This is a service-focused approach to deliver off-farm benefits to areas where one or more companies source from. Pre-competitive funds are sources of finance from companies, often blended with public and/or institutional finance, to invest in service delivery (i.e. producer support, community development, landscape management) that contributes to on- and off-farm improvements in a region that benefits multiple supply chains. The investment approach differs from criteria-based sourcing in that it focuses on service delivery (on- or off-farm) rather than coffee sourcing. The investment approach also differs from, for instance, responsible sourcing in that it is service-focused and project-based rather than sourcing-focused and part of a comprehensive management system like responsible sourcing.

We identified the following, main initiatives: Coffee & Climate, Neumann Foundation, International Coffee Partners, Coalition for Coffee Communities, and the Coffee Farmer Resilience Fund. The investment approach can address multiple components of sustainable production (section 1.2), including the *production model, producer organization, services, community development, and landscape management*.

An overview of our assessment of the identified investment programs is found in the table.

Criteria	Assessment
Relevance	Can address root causes of farm unsustainability, often narrow focus
Effectiveness	Potentially impactful, but risk of temporary project lifespan
Scalability	Potential to reach 'high hanging fruit', scaling depends on partnerships
Credibility	Information on impact depends on robust M&E system
Efficiency	Unclear direct value for money, potential high costs
Level playing field	All companies can invest

Producer support programs

Producer support is a straightforward way for a company to invest in service delivery for sustainable production, either through their own supply chain or in collaboration with other stakeholders. Most roasters in Germany – large and small – focus on individual, sourcing-focused projects that support coffee producers, typically through a trader (e.g. exporter). However, some companies engage in service-focused projects. Our assessment centers on service-focused projects within producer support initiatives.

Relevance and effectiveness

There were three clear producer support programs in the coffee sector that we included in our review: International Coffee Partners, the Coffee & Climate initiative, and programs carried out by Neumann Foundation. These initiatives are (seemingly) done in collaboration but, in some cases, service-focused project tend to be implemented within a company's own supply chain in practice. The relevance of these initiatives to the set of issues faced by coffee producers is average. Initiatives that target a specific, pressing issue like Coffee & Climate can be relevant as it helps to focus and channel investment into hot spot areas. Single-focus initiatives though do not holistically address the issues limiting its overall effectiveness. For example, the International Coffee Partners program seems to be good at covering relevant Supply and Nature issues but has a weak emphasis on Livelihoods. Demand issues like fair trading practices and fair price are out of scope. To achieve impact though, these specific initiatives would need a commitment to beneficiaries beyond short-term projects and, to be truly collaborative,

extend activities beyond a company's own supply chain. Moreover, access to finance is not featured in these initiatives and the investment alone is insufficient to meet the significant needs. In this sense, we conclude that the effectiveness of the initiatives is poor to average.

Scalability

While the relevance and effectiveness might be limited, these producer support programs have the potential to be scaled. This approach is scalable partly due to its ability to reach low performing producers often for development objectives. Mainly, producer support programmes can be somewhat scalable since they focus on a single hotspot like climate change or access to fertilizer, especially in public/private partnership. Coffee & Climate could reach more producers as climate change increasingly affects vulnerable coffee producers globally. International Coffee Partners aims to reach 75,000 farming families in East Africa, Central America, and Brazil by leveraging government funding in combination with company investment. That said, investment has proven, in general, to be insufficient to adequately reach coffee producers with the required technical assistance.

Credibility

The credibility of the producer support programmes reviewed is difficult to assess. The initiatives do not communicate beyond their basic structure and scope of activities. Monitoring is limited to the activities carried out rather than outcomes or learning that can be shared among participants. There is some level of assurance in the case of International Coffee Partners but it is unclear its independence and robustness (e.g. third-party assurance).

Pre-competitive funds

Another approach for companies to invest in sustainable production is via pre-competitive funds that, in some cases, blend public and/or institutional finance. The example we identified was Root Capital's Coffee Farmer Resilience Fund.

Relevance, effectiveness, and scalability

Root Capital's Coffee Farmer Resilience Fund receives funding from US coffee companies that is matched by the public sector and foundations to invest in addressing coffee leaf rust across the production base in Latin America. As such, it aligns multiple actors around a common objective and catalyzes more investment to deliver services for the specific, pressing issue of climate change. Through such a cooperation, the sector is better positioned to respond to this critical issue and companies can contribute to a foundation of sustainable production in the region that benefits multiple supply chains. Despite its innovative features, modern pre-competitive funds are an unproven approach to reach critical mass of participants and producers and may be difficult to satisfy the interests of a company over the medium-term.

Community development and landscape management programs

Community development and more so landscape management programs are increasingly gaining attention in agricultural sectors. Our assessment focused on Coalition for Coffee Communities, an initiative on community development and landscape management led by a group of American roasters, which has secured a grant from the Inter-American Development Bank through the SAFE (Sustainable Agriculture, Food, and Environment) platform. Our assessment also included the wild coffee initiative by Original Foods, a German company that promotes wild coffee from biodiverse forests in Ethiopia.

Relevance

Community development and landscape management programs allow for investments to be made in some of the root causes of unsustainable production. These programs are also relevant since they can benefit disadvantaged coffee producers and are less tied to market-oriented production criteria. Coalition for Coffee Communities is relevant as it influences the enabling environment (i.e. policy, dialogue, and coordination) and channels private and public investments in off-farm service delivery

that benefits areas where multiple companies source from. For example, the initiative currently invests in food security programs in Nicaragua.

The initiative of Original Foods is also relevant to disadvantaged coffee producers and the issues they face. While investing in coffee-related infrastructure, the focus is on forest protection in tandem with coffee production, which address the Nature and Supply priorities. The initiative address producers' Demand issues by way of wild coffee being a highly niche market segment; the initiative is the world's first UNESCO coffee biosphere and the coffee is certified Fairtrade and Organic.

Effectiveness, scalability and credibility

Coalition for Coffee Communities is a new initiative and its potential effectiveness and scalability is unclear. Community development and landscape management can be credible at least in terms of internal accountability as the policy development and co-investment involves multiple stakeholders. They would also have to report publicly, including to affected communities. These models would have to be developed and tested. There is no substantive information publicly available on Coalition for Coffee Communities.

Original Foods has reached nearly 8.500 coffee producers with the initiative benefitting some 80.000 people. Due to the success, the company plans to extend the initiative to other coffee-producing areas such as Ecuador and Nepal.

Efficiency

Landscape programs typically are inefficient in the early stages due to the growing pains that are part of pioneering multi-stakeholder coordination. The approach taken by Coalition for Coffee Communities is unproven and it may be difficult to motivate many companies to invest at a landscape or community-scale.

Community development typically does not feature as a stand-alone initiative. This component is built into producer support programs as an add-on to the activities addressing Supply and Nature issues. For example, several roasters engage in promoting food security in coffee communities to ensure nutrition in between harvests. While this type of investment helps, community development addresses the symptoms more so than root causes of unsustainable practices and many companies are deterred from engaging by the sheer size of needs and the unknown return on investment for the coffee business.

2.2.2 Fair trade

To promote fairly traded coffee, there are two main approaches: fair trading relationships and fair pricing. There are several different yet complementary approaches within these components and initiatives typically combine a few or most of them according to their objectives.

Fair trading relationships

Fair trading relationships take different forms but generally comprise of a mix of direct trade, long-term purchase commitments, and/or fair trading practices. Direct trade is an approach mainly applied by SME roasters who procure high quality coffee for specialty markets and support producer organizations that directly supply them. Roasters can engage in long-term purchase commitments (e.g. 3 years or more) with the producer organizations that supply them where roasters commit to buy certain volumes over a specific time period. Long-term commitments are typically made by direct trade companies and in combination with other fair trading practices. In addition to long-term purchase commitments, fair trading practices refers to roasters respecting contract obligations including fair quality control, and addressing grievances as well as paying invoices quickly, and providing access to finance through pre-financing purchase contracts and taking out price insurance on behalf of producers (see Appendix I for

complete list). Fair trading criteria can be either designed internally by the company or by external organizations, for instance, based on VSS (e.g. Fairtrade, Fair for Life, World Fair Trade Organization).

Fair trading relationships can address the *value chain*, *production model*, and *producer organization* components of sustainable production and fair trading (section 1.2).

The relevant initiatives we assessed are: GEPA, Counter Culture, Union, Moyee, Solino, Original Foods, and Kaffee-Kooperative.de.

Direct trade, long-term purchase commitments, and fair trading practices

An overview of our assessment of fair trading relationships is found in the table.

Criteria	Assessment
Relevance	Mainly fair trade focus, production generally out of scope; balances power and facilitates investment
Effectiveness	Potentially high with stable suppliers
Scalability	Tends to focus on 'low hanging fruit' since done by SMEs
Credibility	Assurance as well as robust M&E is an issue (unless VSS are used)
Efficiency	High on transparency (and trust), low on verification
Level playing field	All companies can participate, yet untested in mainstream markets (i.e. by large companies)

Relevance

The direct trade initiatives reviewed have an average relevance in terms of addressing the issues in sustainable production and fair trade. In general, they are strong on fair trading practices and long-term commitments based on stable trading relationships that pay high prices and allow producer organizations to invest. They are relatively weak on addressing holistically sustainable production unless the initiative is based on VSS criteria. Many companies address a narrow set of issues such as quality, gender, and shade or organic production.

Long-term purchase commitments are highly relevant to producers since they provide a stable relationship that also supports value sharing and investment on-farm and off-farm. To illustrate, Union in the UK buys high-quality, traceable green coffee through long-term commitments and pays producers at least 50% more than the Fairtrade Minimum Price. In the US, Counter Culture is a pioneer in direct trade. Other SMEs extend long-term volume commitments of green coffee to supporting value creation at origin. For example, Moyee in The Netherlands has developed a 'FairChain' model whereby it creates joint ventures with partners in Ethiopia to carry out the roasting there while Moyee is responsible for the marketing in the consuming countries. In Germany, Solino operates similarly by roasting and packaging coffee in Ethiopia. According to their estimates, this in-country processing adds 60% more value to the export price and creates better jobs.²⁰

Fair trading practices are relevant for disadvantaged coffee producers although not directly addressing sustainable production. For instance, companies that pre-finance purchase contracts provide cash-strapped producer organizations with liquidity to buy inputs for their members and procure internally the coffee needed to fulfil the contract. More generally, fair trading practices along with long-term commitments create a better environment for producers to invest in the viability and sustainability of

²⁰ <http://www.solino-coffee.com/en/trade-not-aid/>

their farms (e.g. renovation, planting trees, longer term contracts for workers). In other words, the absence of fair trading practices undermines the willingness to invest.²¹

There are some standards that set various trade criteria such as Fairtrade, Fair for Life, World Fair Trade Organization, and BCorp. Several companies have decided to integrate Fair Trade principles into their mission and business management systems. For example, GEPA in Germany, engages in direct, long-term trading relationships to source its Fairtrade and Organic coffee. They pay a quality premium additional to the Fairtrade Minimum Price. Also, they engage in lobby and advocacy and impact investing that contributes to addressing more systemic issues.

Effectiveness and scalability

The application of fair trading practices through direct trading relationships can be potentially effective in improving conditions in coffee communities. From a livelihoods perspective, fair trading relationships between a specific roaster and producer can adjust the power imbalance present in global markets. The initiatives reviewed showed that fair trading relationships facilitate pre-finance, producer services and investment in community development and landscape management.

In separate research, we found that fair trading relationships depend on trust and collaboration, which is supported by producer organizations with some degree of professionalism. For instance, price-fixing of long-term purchase commitments does not typically occur until just before or during each coffee harvest and a lot of time can pass between when prices are fixed and when the coffee is delivered. This exposes both the producer and their buyer to price risk and potential default testing the strength of the relationship.

SMEs companies, like GEPA, have had considerable success (i.e. market share, producers reached, and relative impact) by adopting fair trading practices as part of their mission.²² However, the limited scope of sustainability issues addressed cannot lead to significant and sustained impact. Moreover, the impact of a single SME roaster may only have the potential to reach producers at a modest scale. Indeed, the scalability of fair trading practices is limited as it is largely determined by market dynamics (i.e. competition, speculation, long supply chains) and public policy (i.e. unlevel playing field).

Credibility and efficiency

The relative success that some coffee companies have had by embracing fair trading practices is partially by the fact that consumers find the approach to be highly credible. Consumers trust, for example direct trade programs due to the transparent relationships with their suppliers. Although direct trade can be transparent upstream, these initiatives share limited, substantive data publicly. Trivial reporting is due to the lack of robust monitoring and evaluation of the performance of their producer organizations. Moreover, direct trade companies, like other roasters, are less scrutinized due to their market position and mainly accountable to their customers who may not always require evidence to support the altruistic claims of direct trade.

The efficiency of fair trading initiatives is relative. These companies can be dynamic in their activities because they define their own direct trade criteria, source relatively small volumes, and earn higher margins by operating in speciality markets. High margins give them room to trial and error in their supply chain. However, direct trading relationships are time-consuming and add costs that other companies, even in the specialty segment may not internalize. In recent years, some direct trade platforms have emerged – e.g. Algrano and Bean Auction – that connect roasters with producers in an efficient way and provide market information and shipping services even though they do not engage in producer support programs.

²¹ Aidenvironment and IIED (2016), The Case for Fairness in Trade: How trading relationships enable producers to invest in sustainability and can benefit all actors in the supply chain, Commissioned by Fairtrade Foundation, Fairtrade Deutschland and Fairtrade International

²² https://www.gepa.de/fileadmin/user_upload/Info/Hintergrundinfo/Facts-and-Figures_E_06-18_web.pdf

Fair pricing

There are two main types of fair pricing; first, the payment of a fair price to the coffee producer (e.g. a margin above the cost of production) in relation to the market or de-coupled from the market and in relation to costs; second, the payment of a premium which is a (pre-agreed) amount above the conventional coffee price that rewards the producer for specific product characteristics (e.g. quality, sustainability).

The different forms of fair prices include floor prices, fixed prices, and floating prices. A floor price sets a limit on how low a price can be paid for coffee. If the market price is above the floor price, then the market price prevails. With fixed prices, prices are set. A floating price can be calculated as an average of a reference price over a set period of time. The reference price could, for example, be the spot price of a commodity on a leading exchange.

The different forms of premiums are fixed, flexible, and in-kind. A fixed premium is a fixed amount (per kg) paid above the conventional market price. For example, Fairtrade has set one premium for all origins at 20 cents per pound for conventional coffee. Flexible premiums are based on the principle of risk sharing where the premium amount depends on a predefined variable, e.g. market price. For example, the more the market price decreases, the higher the premium rises, until a minimum farm gate price level is reached. There are no systems which apply this model, although individual companies have used it in the past (e.g. Ritter Sport). An in-kind premium is delivering services to coffee producers (e.g. inputs, capacity building) that are worth a certain nominal value rather than paying cash. For a complete list and definitions of fair pricing, see Appendix I.

Fair pricing also addresses the *value chain*, *production model*, and *producer organization* components of sustainable production and fair trading (section 1.2).

Our assessment is also based on the initiatives reviewed in the above section on fair trading relationships, which are: GEPA, Counter Culture, Union, Moyee, Solino, Original Foods, and Kaffee-Kooperative.de.

Prices and premiums

The table below outlines our assessment of fair pricing.

Criteria	Assessment
Relevance	Fair trade focus only, balances power and facilitates investment
Effectiveness	Potentially strong on livelihoods and resilience. Further impact depends on producer capabilities.
Scalability	Requires traceable supply chains. Cannot reach unorganized smallholders
Credibility	Feasible verification of payment
Efficiency	Low implementation and verification costs but traceability costs needed
Level playing field	All companies can participate, yet untested in mainstream markets (i.e. by large companies)

Relevance, effectiveness, and scalability

Mainstream coffee markets are highly competitive and cost-driven. Structural, low and volatile prices are a driver of unsustainable production practices and impede producers to invest in their farms and earn a decent living. Within this context, some companies are willing and able to create more value,

enhance margins, and share it with their suppliers in producing countries. Most of them operate in the specialty markets whether Fairtrade, Organic, or based on quality such as single-origin coffees. Thus, a premium above the market price is paid to reward sustainability, quality, or investment in infrastructure. Indeed, some large roasters are keen to reward quality from their suppliers with or without sustainability characteristics. Although critical, a fair price is only one part of the set of problems and solutions for coffee producers.

As mentioned, SMEs can pay a fair price since they have a direct trading relationships as well as high levels of trust and transparency on who produces their coffee, what the conditions are in the farms and communities, and what the costs are across production, processing, and transport. The payment of fair prices and premiums can partly fill the value gap present in commodity markets.

In volatile market conditions, flexible premiums promise to be dynamic, further reducing the market and production risks faced by disadvantaged coffee producers. For instance, when prices are low, the premium will be higher and when prices are high, it will be lower. For large roasters, this approach could be effective if applied in their traceable supply chains with long-term purchase commitments. In this scenario, the payment of a flexible premium at scale would also avoid potential oversupply as only that companies' producers could benefit. No initiatives were identified in the coffee sector where a flexible premium is paid.

Credibility

There is little transparency, however, on how premiums are used along the supply chain and at the producer-level. They are largely paid to producer organizations without conditions as to how to invest it regarding the amount in (sustainable) production, member services, or infrastructure. In practice, premiums are typically used by producer organizations to mostly cover certification costs. They are largely insufficient to pay for sustainable production. Toward the market, premiums can easily escalate along the supply chain with each company adding more margin without a link to the sustainability value created for it. In the short- to medium-term, premiums can cover all the costs to be made at farm-level and the supply chain. In the long-term, the approach will not catalyse the significant investment needed in the enabling environment (e.g. community infrastructure) for sustainable production.

2.2.3 Other sustainability initiatives

Beyond the individual or company-driven initiatives, a few multi-stakeholder initiatives exist that operate in the governance space and try to tackle systemic bottlenecks in the enabling environment. These initiatives include:

- Global Coffee Platform (GCP): Born out of a merger between 4C and IDH's Sustainable Coffee Program, GCP aims to align the coffee sector in tackling the biggest issues on the supply side to be able to meet growing global demand. GCP organizes national platforms in Brazil, Colombia, Honduras, Tanzania, Uganda, Vietnam, Indonesia, and Kenya to focus on changes needed in the enabling environment to promote uptake of improved coffee production practices. The initiative develops tools, shares knowledge sector-wide, and launched the Sustainability Reporting Framework. It is open to all coffee producer types.
- Sustainable Coffee Challenge (SCC): The aim of this initiative is to promote profitable production through productivity gains while ensuring the conservation of coffee producing areas. SCC developed a framework of five key components and calls for company commitments as well as organizes collective action networks of practitioners. They also co-developed the Sustainability Reporting Framework. It is open to all coffee producer types globally.
- Global Arabica Plan: A proposal by Illy to form a multi-stakeholder Initiative to address climate change adaptation for the high-quality Arabica coffee variety. According to the proposal, a legal entity would be created and led by ICO, the Swiss coffee trade association, and UBS, a financial institution. The proposal includes three components:

1. public/private investment
2. technology transfer
3. sector coordination and learning

Another type of approach is that of institutionalized national sector governance systems. Examples include:

- ICAFE in Costa Rica: ICAFE is a state-sanctioned, non-governmental organization. Its mandate is to regulate and supervise the whole coffee sector. ICAFE has a comprehensive market management system including rules for price-setting, contract formulation, traceability as well as a price stabilization fund. It also invests in research, extension, market promotion and several sustainability programs.
- Federación Nacional de Cafeteros de Colombia (FNC): This public federation of coffee producers operates a guaranteed purchase system and offers various fair trading contracting models. FNC also invests in research, extension, national replanting schemes and market promotion.

2.3 Key insights on existing approaches and initiatives

The following table provides a summary of the strengths and weaknesses of the sustainability approaches reviewed.

Approaches	Strengths	Weaknesses
Production criteria (e.g. VSS)	<ul style="list-style-type: none"> • Comprehensive scope • Scalable • Relatively credible 	<ul style="list-style-type: none"> • Mixed impacts, weak on livelihood • Challenge to go beyond low hanging fruit • High assurance costs
Geographical criteria	<ul style="list-style-type: none"> • Can reach 'high hanging fruit' • Potential cost efficiencies in assurance 	<ul style="list-style-type: none"> • Relies too much on national enforcement • Can be discriminatory • Lots of uncharted territory
Trading criteria	<ul style="list-style-type: none"> • Balances power and facilitates investment 	<ul style="list-style-type: none"> • Tends to focus on 'low hanging fruit' • Assurance is a challenge
Fair price	<ul style="list-style-type: none"> • Potential livelihood effect • Low implementation and verification costs 	<ul style="list-style-type: none"> • Prices / premiums are too low • Cannot reach unorganized smallholders • Unclear social and environmental impact
Investment	<ul style="list-style-type: none"> • Can reach 'high hanging fruit' and address root causes 	<ul style="list-style-type: none"> • Unclear direct value for money, potential high costs
Sustainable procurement management system	<ul style="list-style-type: none"> • Potentially effective with stable suppliers • Potential cost efficiencies in assurance 	<ul style="list-style-type: none"> • Tends to focus on 'low hanging fruit' • Credibility can be an issue • Costs for SMEs

Based on the assessment of individual approaches to sustainable production and fair trade, key insights have been gained that cut across approaches and can inform the design and management of a potential tax exemption.

The six key insights are as follows:

- 1. Disadvantaged coffee producers need significant technical and financial support to meet sustainable production criteria.** The current approaches to sustainable production in the coffee sector do not sufficiently channel the benefits of initiatives to the most disadvantaged producers. Even when producers are organized, the level of investment is insufficient and inconsistent in order to implement the sustainable production practices that some buyers might require. Responsible sourcing programs can offer a premium but it is only paid after a certain performance level is reached, which requires producers - already at a disadvantage - to pay the cost upfront with few guarantees. This dynamic of the system makes approaches ineffective and not scalable as producers will not get there in a credible and efficient way.
 - The priority should be to support producers in reaching the desired performance levels, for example, through investments in producer support programs and off-farm interventions (i.e. landscape management) and paying them a fair price which allows them to invest and rewards their continuous improvement as they achieve higher performance levels.
- 2. More fairness in trading practices and prices needs to be introduced for coffee to be sustainably produced.** The current market system has clear imperfections. Beginning in the retail market, price pressure reduces margins throughout the value chain and promotes unfair pricing and trading practices. With this power dynamic, the tax exemption will plausibly result over time only in reduced consumer prices and not benefit producers. If a nominal tax-exempted value is transferred through the supply chain, the risk is that it will be diluted across companies as some actors will increase their margin and only a smaller proportion can potentially reach coffee producers.
 - Approaches should build in safeguards that ensure benefits actually reach producers. These measures include investments in direct producer support, fair trading practices and paying higher prices directly to producers.
- 3. Sustainable procurement systems have the potential to manage the implementation and assurance of sustainable production and fair trade efficiently and credibly both for companies and the German administration.** Current responsible sourcing programs differ greatly in their relevance and effectiveness as well as credibility and efficiency. Most large coffee companies – both frontrunners and laggards – operate some form of procurement or quality management systems to ensure the effectiveness of their business and show credibility to stakeholders (i.e. customers, regulators).
 - The integration of sustainability into companies' procurement or quality management systems would strengthen the efficiency, credibility, and effectiveness of implementing sustainable production and fair trade criteria while also allow for demonstrating its implementation and assurance to the German administration.
- 4. Transparency and accountability are essential features to assess and demonstrate the effectiveness of any approach to stakeholders but does not come cheap.** Companies define approaches (e.g. production criteria, community development) that are relevant to their – and their customers – sustainability objectives. They are skilled at communicating their results as they meet their objectives but stakeholders lack the means to accurately assess and comment on these company activities and outcomes. The fact that VSS and their production criteria are known to be a credible approach, despite their limitations, underscores the importance of transparency and accountability. However, the experience of past approaches shows that building credible mechanisms comes with a price. The costs for assurance and performance monitoring can be substantial. Introducing strict criteria to promote and safeguard credibility can significantly reduce

the potential value transfer of a tax exemption to producers. Furthermore, even robust third-party assurance does not ensure 100% compliance with defined production or trade criteria.

→ A credible approach to sustainable production and fair trade builds in transparency and accountability at multiple levels (e.g. assurance, performance monitoring, public reporting, complaints handling and dispute resolution). These features allow stakeholders to monitor and voice support or concern regarding what companies have done and how they have done it to earn the tax exemption. However, it is important to strike a balance between credibility and efficiency to avoid that a significant amount of the exempted tax is used for controlling rather than providing benefits to producers. Realistic expectations should be set and communicated regarding the potential impact.

5. **There is no silver bullet.** One-size-fits-all solutions have not achieved sustainable production and fair trade and will not in the near future. Selecting complimentary approaches from the available toolkit allows companies to choose what is suitable for their supply chain, innovate on solutions, and comprehensively address this complex issue.

→ The tax exemption mechanism should include several components of sustainable production and fair trade for a more holistic supply chain approach. In turn, the German government will define specific criteria but should allow for some flexibility, as it is practical to accommodate various implementation models by companies. This flexibility will also enable existing sustainability initiatives to position themselves to become eligible for the tax exemption.

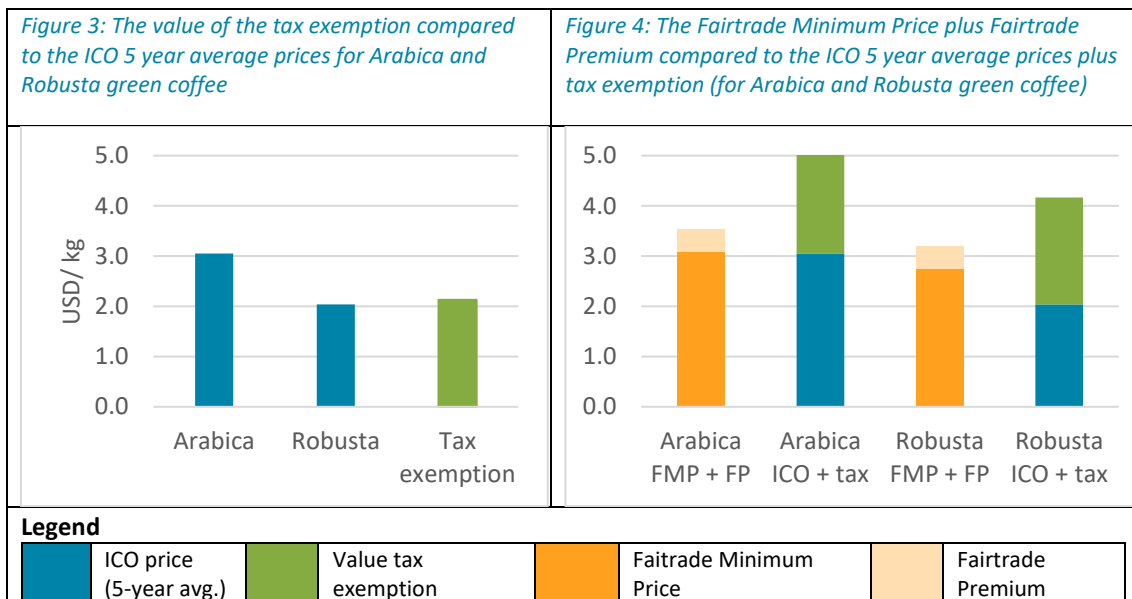
6. **The barriers to sustainable production and fair trade at scale are systemic and beyond the supply chain alone to resolve.** The coffee market is highly competitive and supply chains are fragmented. Even if a company's approach is relevant, effective, and scalable, the impact is only achieved within their own supply chain and at considerable cost. More systemic issues receive less attention and investment.

→ In addition to the tax exemption, pre-competitive approaches should be promoted to create a conducive policy environment, sector dialogue and coordination, and public and private investment that address common production and trade issues. This can achieve a wider and more sustained impact.

3. Mechanism to link the financial incentive of the tax exemption to sustainability impact

3.1 Potential financial impact and general limitations of the tax exemption

The value of the tax is above or close to farm gate prices. Its value translates to 2,13 USD/kg of green coffee.²³ This amount is just above the 5-year average ICO prices of Robusta (2,04 USD/kg) and well above the 5-year average ICO price of Arabica (3,05 USD/kg). Considering that most coffee producers receive between 60% - 90% of the FOB price, this means that the value of the coffee tax is above or close to the farm-gate price.²⁴



The value of the tax allows for paying a fair price. The above figure shows that the value of the tax exemption on top of the 5-year average price is considerably beyond the Fairtrade Minimum Price and Premium. The value of the tax exemption would also be sufficient to pay for:

- a living wage to plantation workers in Kenya²⁵
- all externalities of climate smart coffee in Mexico, calculated at 3,90 USD/kg²⁶
- high value service packages to smallholder farmers (estimated at 70 USD per farmer per year)²⁷

As the next figure shows, the total value of the tax exemption is almost three times larger than the current estimated investments in sustainability in the global coffee sector.²⁸

²³ Based upon a conversion rate from roasted coffee of 1,19 and a euro/USD exchange rate of 1,17

²⁴ Panhuysen, S. and Pierrot, J. (2018). Coffee Barometer 2018

²⁵ Aidenvironment, on-going work for Rainforest Alliance

²⁶ TruePrice and Solidaridad (2017), The true price for climate smart coffee: quantifying the potential impact of climate-smart agriculture for Mexican coffee

²⁷ IDH (2017), Driving innovations in smallholder engagement: Insights in Service Delivery and Finance. The 70 USD per farmer is an average taken from multiple service delivery models in various sectors, including coffee.

²⁸ Panhuysen, S. and Pierrot, J. (2018). Coffee Barometer 2018.

Figure 5: Potential for sustainability investment (in millions)



One could even say that the German consumers already pay the price of sustainability-produced and fairly traded coffee but largely to the German government. As a consequence, the German government has already captured the value needed to solve many issues in the German coffee supply base but uses it for other policy purposes. In other words, the tax exemption offers an important opportunity to create impact in coffee producing countries.

The amount of oversupply of coffee produced globally according to existing sustainability standards exceeds more than twofold German green coffee imports. In other words, the German tax exemption mechanism could potentially absorb a part of the surplus of certified coffee that is produced but not sold as certified. If the German market would do so, then many of the existing certified or verified producers would receive additional benefits from the German tax exemption in addition to the current situation. The ability of the German market to absorb it will depend on the match between the supply and demand in terms of origins, qualities, and the VSS preference of individual coffee companies. Assuming a relatively good match, there would be few incentives to include other producers other than the existing certified or verified ones, which means the tax exemption would not create benefits for the more disadvantaged producers who are not yet reached by VSS.

Using a tax mechanism to promote sustainable production and fair trade also poses some limitations.

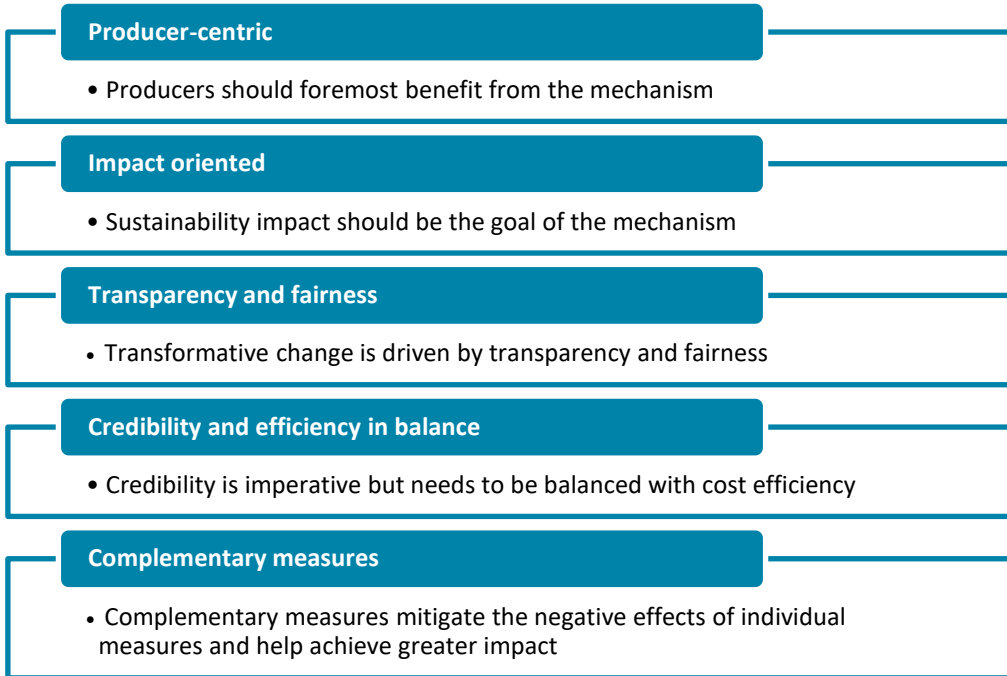
The mechanism is about exempting coffee volumes; the coffee that is being exempted should be sustainably produced and fairly traded coffee. This implies any incentive for producers to improve their sustainability will have to follow their coffee along the supply chain. This dynamic has two consequences:

- There is little room to invest the tax-exempted amount outside the supply chain directly to the target groups, independent from market access. This limits the opportunities to address more systemic, root causes in the enabling environment through this specific policy instrument. Complementary measures would be required.
- Producers will become highly dependent on their German buyers to receive these incentives. The imbalance in power relationships that results will require some safeguards to avoid misuse.

There is another important limitation of choosing a tax exemption mechanism for sustainability goals. The exemption can only be granted once the coffee is considered sustainable. The most disadvantaged smallholder producers lack the means to invest in sustainable production practices or to be organized within the management systems required for credible assurance. Therefore, they need more support and incentives to work towards the sustainability performance levels expected than the merely prospect of receiving a reward once they have reached them.

3.2 Guiding principles

We propose the following guiding principles of the mechanism:

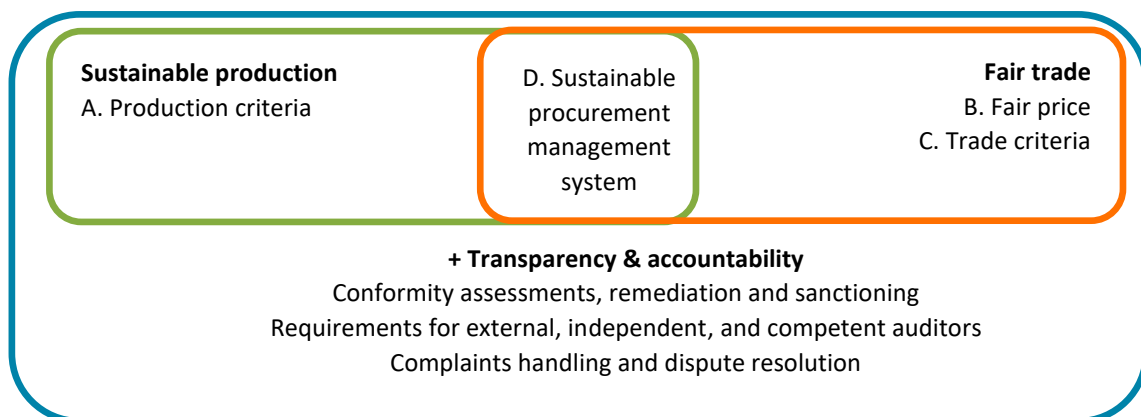


None of the current approaches alone achieves the desired impact. Therefore, we propose a combination of approaches presented in the next section.

3.3 Proposed options for the tax exemption mechanism

Based on our assessment of the key issues and sustainability approaches, we propose two options for the tax exemption mechanism that draw from five components for sustainably produced and fairly traded coffee represented in the figure below.

Figure 6: Five components of the proposed mechanism for sustainably produced and fairly traded coffee



The two options proposed for the tax exemption mechanism are:

Option 1

The mechanism would include the following components: transparency and accountability + production criteria + fair price + trade criteria.

Option 2

The mechanism would include the same components and add the sustainable procurement management system. Hence, option 2 would include: transparency and accountability + production criteria + fair price + trade criteria + sustainable procurement management system.

Hence, the framework proposed contains four core components - with an additional sustainable procurement management system - that together comprise the mechanism to link the financial incentives from the tax exemption to sustainability impact. For each component of the framework, we describe the main elements, benefits, and implications as well as further topics to address. The specific criteria of each component will have to be defined in detail by the German government in consultation with stakeholders, which is out of scope of this proposal.

Transparency and accountability

Transparency and accountability cut across the framework of components. This component provides credibility towards stakeholders as they can monitor and express their voice regarding what tax-exempted companies have done and how they have done it. The main elements are:

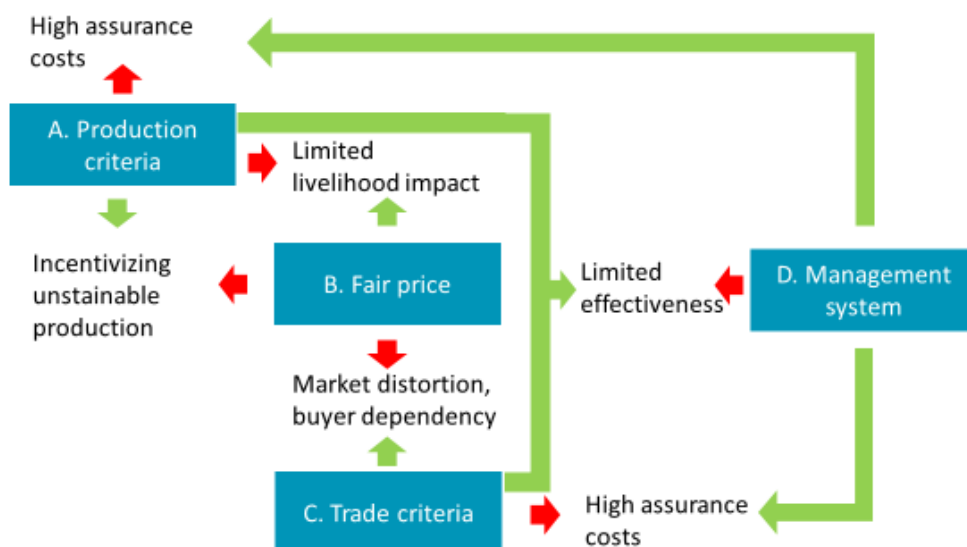
- *Conformity assessments*: The production and trade criteria as well as fair price components are to be assessed according to transparent rules for external conformity assessment. The producer and supply chain actors being assessed shall have recourse to the conformity decision taken; they can implement corrective actions in the case of non-conformity or be sanctioned e.g. suspended in case of failure to meet the criteria beyond the corrective action period. The sustainable procurement management system allows companies to combine external assessments with first-party and second-party assessments across the supply base linked to a proper risk management system.
- *Requirements for external, independent, and competent auditors*: External conformity assessment is carried out and reviewed by independent auditors and supervisors with the required technical competence and decision-making power.
- *Complaints handling and dispute resolution*: The entities involved in the implementation of the requirements set by the German government should have procedures in place allowing stakeholders to file a complaint and receive a response regarding any company behavior linked to the tax exemption. The implementing entities are for example, producer groups, exporters, importers, and roasters and the assurance entities are the external auditing bodies. For instance, exporters should be able to file a complaint with the German importer in case of not following the trade criteria. In addition, stakeholders should be allowed to file a complaint or escalate an unresolved dispute to the German government regarding any decision linked to the tax exemption. Complaints handling and dispute resolution are managed by the German authorities or delegated institutions with appropriate procedures for remediation and sanctioning. Complaints and disputes are managed in a transparent manner (i.e. public domain) while protecting any information subject to confidentiality.

Open topics to be addressed:

- *Development of conformity assessment requirements and benchmarking rules*: Requirements need to be developed for the conformity assessments (i.e. assurance) of the production and trade criteria, auditor requirements, and the mechanisms to handle complaints and resolve disputes. Also, clear rules must be defined to benchmark the conformity assessment requirements of existing VSS.

The benefits and implications of the set of components together are illustrated by the following figure.

Figure 7: The relationships between four components assuming transparency and accountability



A. Production criteria

The production criteria component comprises the following elements:

- ✓ Practice-based core criteria (farm & washing station), including traceability requirements

The production criteria define sustainable coffee production and shall be a set of core criteria to be met at the farm-level and washing station. The criteria are practice-based e.g. good practices rather than a focus on outcomes derived by applying such practices (e.g. % change in yield).

This component benefits from the existing experience of voluntary sustainability standards (e.g. certification systems) and company standards. Existing standards can be eligible after benchmarking according to this component's defined production criteria.

Expected implications:

- *Improved social and environmental impact, but limited livelihood impact:* impact studies show that existing standards show a positive, but mixed impact on social, environmental and economic issues. However, the impact on livelihoods or farm income is generally perceived to be low.
 - To mitigate potentially low livelihood impact, the Fair Price component (B) is proposed.
- *High level of credibility, at a high cost:* the assessment of producer criteria can be costly when robust credibility mechanisms are used.
 - To reduce assurance costs, the Management System component (D) is proposed.

Open topics to be addressed:

- *Type of producers eligible:* It needs to be concluded whether the mechanism is applicable to all types of producer (small to large-scale) or to a targeted producer type only. From their communication, it seems that BMZ targets smallholder producers, however, social, environmental and economic issues also exist among medium and large-scale producers (e.g. working conditions). The inclusion of all producers may risk that the larger, better performing producers will mostly benefit as they will be in a

better position to supply coffee that meets the requirements of the tax exemption. Targeting specific types of producers creates challenges in defining performance levels and can result in issues related to unfair competition. For the purpose of our proposal, we developed the mechanism based on the understanding that it would target the most disadvantaged producers, typically smallholders.

- *Definition of production criteria and avoiding a race to the bottom:* The coffee sector already has several comprehensive standards that have been developed according to rigorous multi-stakeholder consultation processes. One could argue that the sector does not need an additional standard. However, production criteria should be part of the mechanism to mitigate the risk of incentivizing unsustainable production practices by the other mechanisms. Therefore, the proposal is that the German government defines a limited, but impactful, set of core criteria for the production level covering important agricultural, environmental and social topics, including traceability. Defining the production criteria in this way could avoid a race to the bottom. The experience with the EU Renewable Energy Directive shows that the introduction of criteria against which other standards can be benchmarked tends to promote new standards that simply meet these criteria. These new standards can undermine the more rigorous (and impactful) standards. Hence, it is important that the German government sets the criteria on key topics sufficiently high to avoid this problem.
- *Need for step-wise improvement:* The most disadvantaged producers have constraints in meeting rigorous standards (they lack the means to make the required investments). One solution is to introduce step-wise approaches in which producers are allowed to improve their performance gradually over time while already benefiting from the system. In this case, an option is to develop incremental performance levels for the set of core criteria defined by the German government, including rules on the progress expected in reaching the performance levels. With multiple performance levels, rewards are given at each stage that a producer reaches. A similar option is that the mechanism incentivizes continuous improvement beyond certain performance levels. Our recommendation is to leave this last option out of scope as it is less feasible with practice-based standards compared to outcome-based standards.
- *Development of benchmarking rules:* Clear rules need to be developed for the benchmarking process of the production criteria of existing VSS.

B. Fair price

The fair price component can include different forms of prices and premiums. These include:

- ✓ Cash premiums (flexible or fixed)
- ✓ Floor prices and/or floating prices

The key message is that fair price represents a critical component of sustainability-produced and fairly traded coffee. In fact, a fair price enhances the livelihood impact and allows producers to make further investments in their farms. The forms of pricing that can be included in the mechanism need to be the subject of further research because of its potential important implications on production and trade.

Expected implications:

- *Higher incomes:* Fair prices are expected to result in higher incomes for producers with positive consequences for their livelihood. However, a fair price would give incentives for unsustainable production.
 - To mitigate these incentives, the Production Criteria component (A) is included.
- *Buyer dependency and market distortion:* Paying a fair price would create a dependency of the producer on the buyer who is paying the fair price. Also, a fair price would constitute a market distortion in the international commodity market. There is also the risk that any price differential at producer-level will escalate in the supply chain with each actor adding some additional margin resulting in higher consumer prices.

→ To mitigate these risks, the Trade criteria component (C) is proposed.

Open topics to be addressed:

- *Purpose of the fair price component:* Two choices exist: protect producers against the lowest prices or ensure they capture sufficient value from a sustainability point of view. Our recommendation is to focus on value capture for sustainability.
- *Nature of the component:* Cash premiums (flexible or fixed) and/or floor prices or floating prices.
- *Choice of benchmark against which prices or premiums are defined:* Many options exist including the benchmarks of the Cost of Sustainable Production²⁹, living income³⁰, living wage³¹, TruePrice methodology³² (that includes environmental and social externalities), market indices, percentage of tax amount.
- *Level at which prices or premiums are defined and actors to which prices are paid:* Options include German importer/roaster (to ensure a fair margin, but avoid price escalation), exporter, washing station, producer group, farm gate. If prices are not set at farm-gate than conditions need to be in place to ensure producers receive the benefits.
- *Degree of price differentiation:* It will need to be decided if prices and premiums should be the same or should differ according to origin or quality. If there are differentiated prices and premiums, then one option is to make the tax exemption variable per origin and/or quality based upon the corresponding price differentials. This will reduce the risks that the price differentials will create unfair competition (as some origins/qualities will become relatively more expensive than others).
- *Conditioned use of price differential:* One option to promote farm investment is to make it mandatory that part of the price differential is used for investment in the farm (e.g. to increase quality, productivity, and social and environmental sustainability).
- *Timing of payment:* There is a significant lead time between the moment that a farmer delivers its coffee and the German company is exempted from taxes. This can have implications for actors within the supply chain from a risk transfer perspective that need to be considered.

C. Trade criteria

This component contains three main elements, which are:

- ✓ Minimum fair trading practices (e.g. payments and contract terms)
- ✓ Long-term buying commitments (e.g. 3-year time horizon)
- ✓ Administrative traceability (e.g. Mass balance) (*see details in D*)

This component refers to the basic rules for the commercial relationships between the producer and the company exempted from the tax. Trade criteria introduces fairness and stability in the trading relations between producers and buyers that empowers producers and facilitates their investment in sustainable production. The administrative traceability facilitates the transfer of fair prices to producers and strengthens the claim that the tax-exempted coffee is sustainably produced.

Expected implications:

- *High level of credibility, at a high cost:* the assessment of the trade criteria can be costly.
→ To reduce assurance costs, the Management System component (D) is proposed.

Open topics to be addressed:

- *Type of supply chain actor applicable:*

²⁹ https://www.fairtradecertified.org/sites/default/files/filemanager/documents/Impact_Reports_Research/COF_RPT_COSP_V02_171106.pdf

³⁰ <https://www.living-income.com/>

³¹ <https://www.globallivingwage.org/>

³² See Vietnam example at: <https://trueprice.org/wp-content/uploads/2016/04/TP-Coffee.pdf>

- Producer until first buyer: Limitation to the scope of applicability would reduce the assurance scope and costs.
- Producer until German importer / roaster: This will increase the assurance scope and costs but it enforces the German company's role to create the trading conditions along the supply chain which are needed to have the desired impact at production level.
- Producer until retailer: This could be relevant as retailers determine, to a certain extent, what upstream actors can do (e.g. in terms of duration of contracts or payment terms).
- *Development of benchmarking rules*: Clear rules need to be developed for the benchmarking process of the Trade criteria of existing VSS.
- *Consumer communication*: Our recommendation is to not communicate on-pack to consumers (e.g. logo). This is due to logo fatigue and the recent trend of removing logos from packages. Companies and the German government could use other channels to communicate with German consumers (e.g. websites or media).

D. Sustainable procurement management system

The sustainable procurement management system is a component that can be added to the set of three components (production criteria + a fair price + trade criteria) that comprise the tax exemption mechanism. Existing management systems used by many coffee companies (e.g. quality or food safety) cover most of the overarching principles and elements that are relevant to a sustainable procurement management system. By integrating sustainability in procurement policies and practices, coffee companies can manage risks as well as opportunities for social, environmental and economic development. This component includes the following elements:

- ✓ Policies: Companies adopt formal commitments linked to sustainable sourcing
- ✓ Plans: Companies have plans with clear targets and milestones in support of their commitments
- ✓ Risk management: Companies have due diligence systems in place that consider sustainability principles for gathering information on suppliers and conditions in sourcing areas and determine risks for unsustainable practices
- ✓ Risk-based conformity assessments: Companies are responsible for ensuring conformity assessments are done. This could consist of a combination of 1st, 2nd, 3rd-party assessments. The intensity of conformity assessments are based upon risk parameters
- ✓ Traceability (see also C): Companies apply administrative traceability. They have a system in place to trace the volumes procured from a specific supplier (e.g. plantation or producer group). Traceability is managed by administrative means at regular intervals (e.g. monthly) such that the volume of coffee sold and claimed under the tax exemption never exceeds the volume procured. This system allows for traceability that is cost-efficient and effective in transferring benefits to producers. No physical traceability is required
- ✓ Complaints handling: Companies have procedures in place where stakeholders – both internal and external to the business – can file a complaint regarding the company's behavior linked to the tax exemption. Complaints are handled in a transparent manner (i.e. public domain) while protecting any information subject to confidentiality
- ✓ Public reporting: Companies collect data on volumes, producers reached and sustainability outcomes and report on it in an aligned way in the public domain

Expected implications:

- *Greater efficiency and reduced assurance cost*: the primary role of the sustainable procurement management system is to mitigate the high assurance costs that production and trade criteria entail. The aim is to maximize the efficiency of the mechanism's assurance by placing the responsibility of showing performance at the farm and washing station levels on the downstream company (e.g.

roaster), which reduces the intensity (and costs) of audits of producers and upstream buyers (e.g. marketing agents, exporters).

- *Additional benefits:* the sustainable procurement management system generates additional benefits, including:
 - increased integration of social and environmental sourcing in regular business practices
 - increased social and environmental responsibility downstream
 - increased transparency and wider risk sharing among supply chain partners.

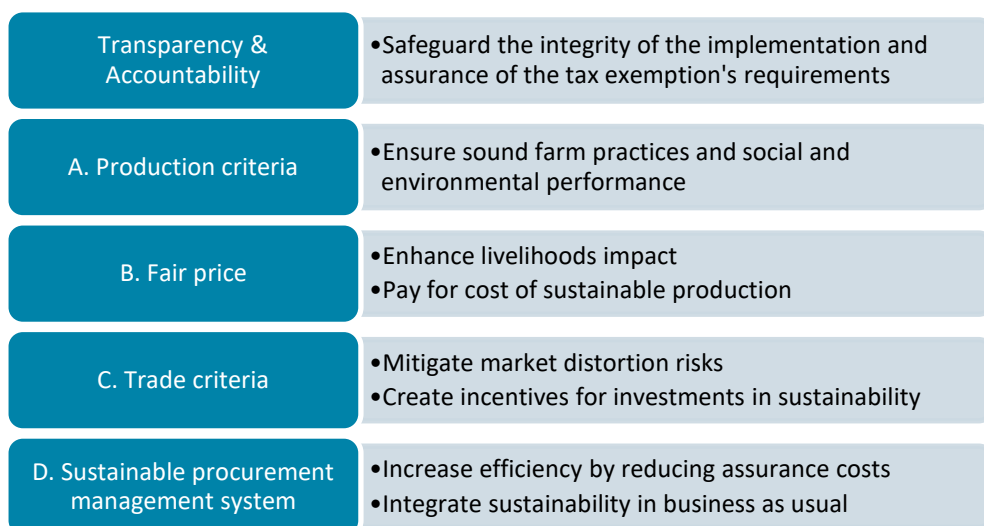
Some of the benefits will depend on the production criteria, fair price and trade criteria but the sustainable procurement management system enhances them.

Open topics to be addressed:

- *Definition of requirements:* The scope and depth of the requirements of this management system need to be determined.
- *Development of benchmarking rules:* Clear rules need to be developed for the benchmarking process of existing systems relevant to this sustainable procurement management system.

In summary, our proposal for the tax exemption mechanism and its benefits are as follows:

Figure 8: The components of the proposed mechanism and their intended impact



3.4 Next steps to assess the proposed tax exemption mechanism

In general, a few main steps are needed to assess the tax exemption mechanism proposed in this document.

Research

Further research is needed on some of the proposed mechanism’s components. For example, fair price is a critical component to include but can have several implications on production and trade. These potential implications need to be identified and assessed to deepen the argument’s basis before wider consultation and promotion of the mechanism. Other priority topics for further research are the nature and potential added value (or risks) of the trade criteria and the management system. It is expected that this research will also influence parallel assessments carried out by German legal and administrative experts involved in GIZ’s development process.

Consultation

The success of the tax exemption mechanism will depend on the degree of stakeholder consultation. While some initial stakeholder consultation has occurred, deeper consultation will be needed. Stakeholders can contribute their coffee expertise to validate and strengthen the components. In addition, consultation will grow the buy-in of stakeholders to bring others along and to implement the mechanism if and when approved by the German government.

Promotion

To build on stakeholder consultation, the mechanism will need to be promoted widely in advance of a decision by the German government. More industry stakeholders will need to be made aware of it and their buy-in secured. Moreover, the mechanism will be promoted to key stakeholders in government and civil society and possibly to the general public whose funds will finance the sustainability efforts. The promotion of the tax exemption mechanism will have its challenges and require continued effort to drive the initiative forward.

3.5 The need for complementary investments

One of the tax exemption's limitations is that there is little room to invest the tax-exempted amount outside the supply chain. However, some barriers to promote sustainable production and fair trade at scale are systemic and beyond the supply chain alone to resolve. These systemic issues can also undermine the effectiveness and sustainability of the tax exemption as a policy instrument. Recognizing that the tax exemption will not address systemic issues, the German government should consider addressing them through complementary investments. For instance, this could be done by investing in a better enabling environment. Section 1.2 proposes various components of such an enabling environment. For example, the German government could support initiatives which work on:

- Coordination and alignment, e.g. multi-stakeholder platforms for a shared vision and strategy, common tools, and sector-wide monitoring
- Public policy development, e.g. regulation on land tenure, labor rights, forests, coffee quality, and coffee prices
- Service provision, e.g. research in more resilient production models and scalable service delivery models for knowledge, inputs, technology and finance
- Landscape management, e.g. integrated landscape management programs to protect and restore forest, biodiversity and watersheds
- Community development, e.g. youth engagement programs, promotion of alternative livelihood options and investments in water, healthcare, and education and infrastructure like roads and electricity

Lastly, the German government could also consider reserving merely a proportion of the value of the coffee tax to invest in 'beyond the supply chain' initiatives.

Appendix I: Fair trading practices, prices and premiums

An indicative list of fair trading practices includes:

- Long-term purchase commitments
- Providing relevant essential information to the other party in contractual negotiations and ensuring that information is not misused
- Provision of written contracts and clarity of contract terms
- Honoring contracts
- Absence of retroactive contract changes (e.g. price rebates)
- No changes to a supply agreement unilaterally without reasonable notice of any such variation to the supplier
- No changes to supply chain procedure without reasonable notice or compensation
- Contractual sanctions are agreed in advance, are proportionate for both sides and are applied in order to compensate damages. If a party fails to meet its obligations, contractual sanctions are applied in a transparent way, in respect of the agreement and proportional to the damages.
- No misuse of unspecified, ambiguous or incomplete contract terms
- No abusive contract terms such as bonded contracts or exclusivity contracts (unless clearly beneficial to the other party) and non-competition clauses
- No excessive transfer of costs or risks to its counterpart such as demanding prices below costs
- No charging fees for services that are not demanded or are above value. No tying of third party goods and services for payment
- Absence of sudden unfair termination or disruption of a commercial relationship, used as a means to bully a contracting party
- No misuse of confidential information
- Compensation of forecasting errors
- No unjustified payment for quality claims
- No payments for wastage at the buyer level
- No obligation to contribute to marketing costs
- Quick payments of invoice
- Facilitation of pre-finance and price insurance
- Provision of a sourcing plan
- Provision of relevant market information to the producer on a regular basis

Sources:

- [UK Groceries Supply Code of Practice](#)
- [Fairtrade Trader Standard](#)
- B2B Platform (2011), Vertical relationships in the Food Supply Chain: Principles of Good Practice
- European Commission (2013), Green Paper, on unfair trading practices in the business-to-business food and non-food supply chain in Europe

Descriptions of fair prices and premiums:

There are various ways to promote the transfer of value and protect farmers against price volatility. This can be done through:

- Premiums
 - Floor prices
 - Fixed prices
 - Floating prices
-
- Cash Premium: a premium is the payment of a (pre-agreed) amount above the conventional price.

- *Fixed premium*: a fixed premium is paid above the conventional price. This premium is a fixed amount per kg. (e.g. Fairtrade have set one premium for all origins. It is 20 cents per pound for conventional coffee)
- *Flexible premium*: with flexible premiums the premium amount depends on a predefined variable, e.g. market price. It is based upon the principle of risk sharing. For example, the more the market price decreases, the higher the premium rises, until a minimum farm gate price level is reached. There are no systems which apply this model, although individual companies have used it in the past (e.g. Ritter Sport).
- In-kind Premium: instead of cash, farmers could receive in-kind services (e.g. inputs, capacity building) with a certain nominal value
- Floor prices: A floor price sets a limit on how low a price can be paid for coffee. If the market price is above the floor price, then the market price prevails. Floor prices can be defined against different benchmarks, for example:
 - Cost based pricing:
 - *Cost of production*: the market price which covers the minimum costs of production of an average farm (or any amount close to this benchmark)
 - *Cost of sustainable production*: the market price which covers the costs of sustainable production practices of an average farm
 - *Cost plus pricing*: this is based upon the costs of (sustainable) production plus a certain profit margin for an average farm
 - *Social and environmental cost accounting*: this is based upon monetizing the social and environmental externalities of coffee production and adding these to the cost of production (e.g. True Price)
 - Income based pricing (producer centric):
 - *Poverty lines / living income benchmarks*: based upon what an average household needs to earn to meet the poverty line or living income benchmark, while also being able to pay for the (sustainable) production costs.
 - Market driven:
 - *Futures prices*: floor prices can be set against the futures prices on a commodity exchange. By buying options it is possible to get insurance against price movements
 - *Perceived fairness*: prices are defined by what makes market sense allowing everybody in the supply chain to share in the value of their premium products (more suitable for niche markets)
- Fixed prices: They can be based on the same benchmarks as described above.
- Floating prices: A floating price can be calculated as an average of a reference price over a set period of time. The reference price could for example be the spot price of a commodity on a leading exchange.