



Ethiopian commodity exchange and contract farming arrangements:

Complementing institutions



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June 2010



VC4PD



Pictures: Wim Gorris, Herma Mulder and Francesco Cecchi

This series is a result of the Partnership Programme between the Netherlands' Ministry of Foreign Affairs Government and Wageningen UR.

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1 Preface

Since the establishment of the ECX, the ECX itself and the subject of specialty produce has been a much debated and sometimes politically sensitive issue. As the CEO of the ECX has put it: "specialty coffee has taken ECX by storm". The author would like to underline that the opinions expressed in this chapter are the author's own and do not reflect the views of the Ministry of Agriculture, Nature and Food Quality (LNV), the Royal Netherlands Embassy or DGIS. The goal of this paper is to inform and discuss from a research perspective to support (Dutch) policy-makers. It also would like to acknowledge the recent efforts made by the ECX to address the challenges that specialty markets pose.

2 Introduction : A new marketing system in Ethiopia

Ethiopia, once a commercial trading hub in antiquity linking markets of East and West, wishes to claim a place in the global market arena again¹. Therefore, the Ethiopian government launched a new marketing system, the Ethiopian Commodity Exchange (ECX), in 2008. The ECX is a marketplace where buyers and sellers come together to trade, and are assured of quality, delivery and payment. Several commodities, amongst which important export crops like coffee and sesame, are now sold through the ECX. Since 2009 it has been compulsory to sell all coffee through the ECX. For sesame, trade through the ECX will become mandatory from the 2010 season onwards.

2.1 Can the Ethiopian Commodity Exchange meet the requirements of all export markets?

The questions that we are trying to answer in this chapter is whether products sold through the Ethiopian Commodity Exchange can meet the demand of all end markets, which market requirements are currently not met, and the potential importance of these export markets for Ethiopian products.

To answer these questions, we examined² the first experiences of the ECX with the export of coffee and also explored the consequences for sesame trade through the ECX. These two commodities were chosen because of their importance for the Ethiopian economy. Coffee is the most important export crop of Ethiopia, while sesame ranks second. More than 95% of all sesame produced in Ethiopia is exported. Hence, the information on which market demands can be met and which markets cannot be served is essential for Ethiopian export.

We start with a closer look at various end markets and market trends. We then proceed to investigate the requirements of high value markets, and also describe some of the practical procedures that chain actors need to adhere to if they wish to sell or buy an organic or fair trade product. After a brief overview of how the Ethiopian Commodity Exchange functions, we focus on the extent to which the market requirements correspond to or clash with the procedures of the ECX. From there we highlight the opportunities and limitations of the ECX. Finally, we give a few recommendations for Ethiopian products to capture higher value markets

¹ Ethiopia commodity Exchange. Making markets work for all.
<http://www.ecx.com.et/downloads/Brochuer/ECX%20Brochure%20English%205.12.09.pdf>

² This is a result of the sub-programme 'Value Chains for Pro-poor Development implemented under the Partnership Programme 'Globalisation and Sustainable Rural Development' of the Netherlands' Directorate-General for International Cooperation and Wageningen UR.

3 Closer look at international markets

What are the consumers and countries looking for? The answer to this question depends on many factors. Some examples are: purchasing power of the buyer, whether it is a small ingredient or a major product in daily consumption patterns, consumer's awareness on food safety issues, etc. While our research focussed on mainly on sesame and coffee, the results described below are also valid for other Ethiopian export products.

3.1 Which markets buy Ethiopian sesame seed?

Ethiopia is the sixth world producer in sesame seed. The main export markets for Ethiopian sesame seed in 2008 were China, Israel, Turkey, and other countries in the Middle East. The price paid for Ethiopian sesame seed is below world average because Ethiopia exports to countries that pay rather low prices (Wijnands et al., 2009). The demand for sesame seed is growing. The Chinese market demand, presently Ethiopia's main export market for sesame seed, is also increasing rapidly (Wijnands et al., 2009).

Ethiopian sesame is predominantly sold to low value export markets, rather than high value markets in the United States, Europe or others. It is, for example, remarkable that no direct exports exist from Ethiopia to Japan, the second largest world importer. Sesame oil is an important component of Japanese cooking (Wijnands et al., 2009). The Japanese are very strict on quality, and especially on food safety. Late 2009 Japanese importers came to Ethiopia to verify whether Ethiopian sesame seed could meet their requirements. They intended to import 100,000 tons (for comparison: Ethiopian export of sesame seed in 2008 was nearly 131,000 tons). Unfortunately only a very small quantity of organic certified sesame met the Japanese demands of a traceable and pesticide free product.

In Europe and the USA there is limited sesame import from Ethiopia. In Europe, the largest markets for sesame are Greece (3% of world imports of sesame), Germany and the Netherlands (together 5% of world import). The USA imports account for 4% of the world sesame trade. While Ethiopia did export 9,000 tons to Greece in 2008 (equivalent to 8% of Ethiopian sesame export), the sales to other European countries and the USA together only represented 2% of all their exports (Wijnands et al., 2009). The reason behind this is probably the fact that sesame is mainly used for bakery applications in these countries. They request assurance of high food safety standards that Ethiopia currently cannot provide.

3.2 Growing global niche markets but insufficient production

While Ethiopian sesame is currently mainly sold on low value markets, there are several high value niche markets that could be of interest to Ethiopian farmers who are willing to invest to receive a premium price. We will look into such niche markets below.

Worldwide the concept of quality products among consumers is growing. Taste is important but there is also growing interest in the conditions in which products were made. Hence, product quality increasingly began to include criteria related to environmental and socio-economic

sustainability. This request can be clearly identified by looking at market trends in Western countries.

Because consumers are increasingly aware of the social conditions under which a product has been produced, civil society organisations and companies are paying more and more attention to this concern. Fair trade nowadays has a significant presence and a high level of consumer recognition in Western countries. There are many organisations promoting fair trade. To illustrate the potential importance of this 'niche' market for an Ethiopian export product, we give an example of the coffee industry. The total coffee sales in 2008 of the three best known fair trade labels, FLO certified (Fairtrade Labelling Organizations), UTZ Certified and Rainforest Alliance almost equalled the total Ethiopian coffee production³. From Nestle to Dole, from Marks and Spencer to McDonald's, ever more big players in the food industry, trade or retailing are joining efforts to offer producers a fair deal for their work (Krier, 2008). Also, one of the biggest global buyers of coffee, Starbucks, is following this trend. They announced that they are increasing the Fair Trade purchases in 2009 to reach 18,000 tons (10% of their sales)⁴.

While the market of organic products may still be relatively small, global consumer spending on organic products increases with 15% per year (Biologica, 2008). Currently the shortage of supply of organic products is constraining the development of the organic market. This shortage of supply is also confirmed by Starbucks.

"Our purchases of organic coffee are limited due to the limited quantities available worldwide and the constraints of the organic certification systems for producers. Only a small percentage of coffee in the world is actually "certified organic" ⁵.

Starbucks mention that slightly more than 2% (4,000 ton) of their purchases in 2008 were certified organic coffee.

3.3 Sustainability as a major trend in mainstream Western markets

While a growing number of Western consumers is demanding fair trade and / or organic certified products, the majority of the consumers are still buying conventional products. Nevertheless, these consumers are also increasingly concerned about the ethical values adopted by commercial organizations and such concerns are influencing buying behaviour⁶. Most Western consumers wish to buy products that have been produced in an environmentally responsible way so as to protect the environment for future generations. They equally demand transparency in the supply chain and socially responsible behaviour by all companies involved in the production and sales.

The strength of such consumer demands has been shown in the past during public campaigns against, for example, Nike when it became known that they used child labour to produce sport articles, and also against the use of 'sweat shops' for cheap textile products. Public pressure forced many producers and retailers to change their sourcing policies. Retailers, and therefore also importers, now want to know who the actors are in the supply chain and how they operate. For example, Wal-Mart the biggest retailer in the world, requires all direct import, non-branded and private label suppliers to declare their factory's compliance with local laws and regulations in the

³ www.fairtrade.net, www.utzcertified.org, www.rainforest-alliance.org

⁴ Starbucks Shared Planet – Ethical Sourcing website (accessed 3 December 2009)

⁵ Starbucks Shared Planet – Ethical Sourcing website (accessed 3 December 2009)

⁶ This has been found in many studies. One that has already mentioned this trend in 2003 is Jones et al., (2004)



communities where they operate, as well as to demonstrate compliance with rigorous social and environmental standards⁷.

This action from Wal-Mart is not an isolated action. Sustainability is a key area in a forum that was created by Chief Executive Officers and senior management of around 650 retailers, manufacturers, service providers and other stakeholders across 70 countries⁸. These companies and retailers guarantee that all the products they sell, respect at least minimum norms of socially and environmentally friendly production. Sustainability and the strong chain relationships this requires, is part of the new strategy of retailers all over the world.

3.4 Requirements of high value markets

It could be of interest to Ethiopian farmers to consider producing for high value markets. Research has shown that farmers' margins are much higher if sesame is produced for a high end market (Wijnands et al., 2009). The top end market segment often pays a premium. On the other hand, their demand for a high value product can entail higher production costs. Experience from other countries has shown that the private sector is committed to co-invest in high value export chains to bring about a higher productivity and improved quality. Below we will look into the most important requirements of high value markets.

3.4.1 Food safety and hygiene

The assurance of high food safety standards is a requirement that has grown in importance over the past years in Western markets. After food scares such as the mad cow disease and pesticides that are occasionally found in food products, food safety and hygiene has become a key issue for customers.

To guarantee the customers that food marketed in the EU is safe, the EU has formulated the 'General Food Law'. This law, which came into effect in 2005, has put in place stringent guidelines requiring that all food manufactured and sold in the EU, should be safe and fully traceable "from farm to fork" and back again. In case a product has been identified as unsafe, food business operators or authorities need to quickly withdraw or recall products. Therefore, traceability is the cornerstone of the EU's food safety policy⁹. Food legislation in America and Japan is also moving in the direction of transparency of origin and traceability of the final product.

3.4.2 Fair trade certification

Above we already mentioned that there are several organizations that are promoting fair trade. Therefore, it is not possible to present one checklist of requirements for fair trade. In the box below we summarize the main points that are important when verifying whether the procedures of the Ethiopian Commodity Exchange would comply with the requirements of the major fair trade schemes.

⁷ <http://walmartstores.com/Sustainability/>

⁸ <http://www.ciesnet.com/2-wwedo/index.asp>

⁹ For more information, see General principles of food law - European Food Safety Authority - Procedures for food safety. Update 6 June 2008.

http://europa.eu/legislation_summaries/consumers/consumer_information/f80501_en.htm and EC Health & Consumer Protection Directorate-General. 2007. Factsheet Food Traceability. http://ec.europa.eu/food/food/foodlaw/traceability/factsheet_trace_2007_en.pdf



Box 1: major criteria for fair trade certification

- a fair producer price, guaranteeing a fair wage, covering the costs of sustainable production and living. This price needs to be at least as high as the Fair Trade minimum price and premium;
- part of the payments to be made in advance if so requested by the producer;
- long-term, stable relations with producers and producers' involvement in Fair Trade standard setting;
- transparency and traceability throughout the supply chain to guarantee appropriate consumer information;
- respect for the environment, protection of human rights and in particular women's and children's rights and respect for traditional production methods which promote economic and social development;
- capacity building and empowerment for producers, particularly small-scale and marginalized producers and workers in developing countries, their organisations as well as the respective communities, in order to ensure the sustainability of Fair Trade;
- support for production and market access for the producer organizations.

Source: Commission of the European Communities, 2009.

3.4.3 Organic certification

There are two major sets of regulations for organic production and certification: one for the USA and one for the EU. The first set of EU regulation on organic farming was developed in 1991. In 1999 additional rules for production, labelling and inspection of the main animal species were also developed. According to these regulations, only products that have been produced and processed following the EU regulation on organics can be marketed in the EU as organic¹⁰. In the United States, Congress passed the Organic Foods Production Act in 1990, requiring the United States Department of Agriculture to develop standards for the production and management of organic products, which were developed under the National Organic Program¹¹.

Box 2 summarizes the requirements for organic certification that need to be fulfilled for the Regulation of the Council of the EU as well as the National Organic Program of the United States.

¹⁰ EEC N. 2092/91 was the first set of EU regulation on organic farming. EC N. 1804/1999 included additional rules for production, labeling and inspection of the main animal species. For more information on these regulations see http://ec.europa.eu/agriculture/qual/organic/index_en.htm

¹¹ For more information, see <http://www.ams.usda.gov>

Box 2: major criteria for organic certification

- Fields where organic products have been grown are inspected as well as any machine, tools, spraying equipment used for farming activities, storage facilities, seeds and planting material.
- Organic products are not mingled with any non-organic or conversion products during harvest, transport, storage, processing.
- The use of synthetic products during storage is only allowed if treatment is absolutely necessary, products may only be used when the store is empty.
- Operators must ensure that products are transported, only in appropriate packaging, containers or vehicles closed in such a manner that substitution of the content cannot be achieved without manipulation or damage of the seal and provided with a label or an accompanying document. The document should be undeniable linked with the packaging, container or vehicle of the product. This document shall include information on the supplier and / or transporter.
- For each lot of product, for which an import- or transaction certificate has been issued: does the client have a representative and sealed sample kept present for half a year?
- Traceability system such that the product can be traced from the field throughout the whole value chain to the end buyer. Product flow from harvest to sold product must be consistent and traceable.

Sources: Council of the European Union, 2007; 2008a; 2008b; National Organic Program

¹².

3.4.4 Socially and environmentally responsible production

Producers, traders, exporters, importers and retailers that apply for fair trade or organic certification thus have to follow clear standards and regulations. There are no such generally accepted standards for 'sustainably produced products'. Often retailers, or groups of retailers, decide which minimum social and environmental requirements must be met for the products they sell. They set the rules to which their suppliers and producers must comply.

Despite the fact that the requirements may slightly differ between retailers, what is clear for all cases is that the importers need to know who the producers are and how the product has been produced. If they do not have this information, they cannot guarantee the consumer that the product has been produced in an environmentally and socially responsible way.

¹²See also the National Organic Program at <http://tinyurl.com/5qb8s8>

4 How does the Ethiopian Commodity Exchange work?

Now that we have an idea of the consumer demands and what is involved to meet these requirements, we will have a closer look at the procedures of the ECX. This is a necessary step in order to answer our question, whether products sold through the ECX can meet the demand of all end markets.

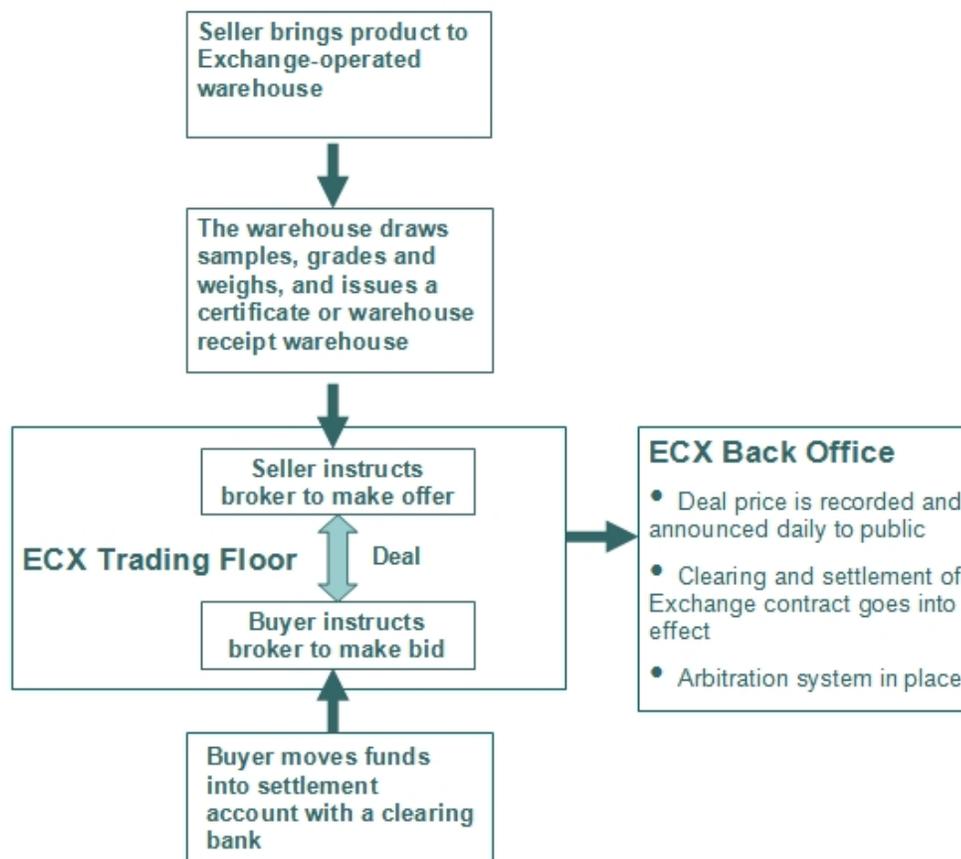
The Ethiopian Commodity Exchange works on the basis of membership. People who want to sell or buy, have to purchase a membership seat. Farmers or traders who wish to sell, deposit their commodity in an ECX warehouse¹³. Only standard lot sizes of 5 tons can be deposited. Most commodities in Ethiopia are produced by millions of smallholder farmers who each produce small quantities. For sesame, average yields vary from 300 to 600 kg per hectare. Hence, farmers need to group their produce if they wish to sell through the ECX. This can be done through a cooperative, union or by traders.

Once the product is deposited in the ECX warehouse, the ECX samples, grades, weighs and certifies the product according to ECX established standards. These standards include general requirements such as limited moisture content, limited impurities, no insects, and for sesame it also takes account of requirements like quality of the seeds and colour. Commodities in the ECX warehouse are commingled, based on similarity in the standard grades, colour and other grading factors. Products are stored in the ECX warehouse, and an Electronic Warehouse Receipt is issued to the depositor or his/her representative.

The trading takes place on a physical trading floor located in Addis Ababa, where buyers and sellers participate in an “open outcry” bidding. Market prices are constantly changing throughout trading hours. The ECX uses several ways to transmit these prices in real time to producers and consumers directly. Once a deal is made, the ECX credits the seller’s account and transfers title of the commodity to the buyer. The buyer then needs to collect its goods within 10 days from the warehouse where the product was deposited.

¹³ In October 2009 there were 14 ECX warehouses in Ethiopia

Figure 1: Functioning of the Ethiopian Commodity Exchange



Source: Gabre-Madhin, 2006

4.1 Can the Ethiopian Commodity Exchange meet all the consumer demands?

The question that we are exploring below is whether Ethiopian farmers, who choose to produce for high value markets, will meet all requirements when selling their product through the ECX. We will first start with the ECX's own opinion on the markets they can serve. This is followed by our comparison of the requirements of high value markets and the procedures currently followed by the ECX.

The introduction of the ECX caused a storm of controversy over the inclusion of coffee in 2009. Importers complained that the ECX did not acknowledge “specialty” or “gourmet” coffee, neither organic nor fair trade coffee. This despite the fact that the private sector had invested considerably in these products and certifications. Ethiopia, the birthplace of coffee, and the top African exporter risked losing an important part of its end market for coffee.

Following this commotion, the ECX prepared a discussion note (ECX, 2008) in which it analyzed whether they can serve the different niche markets. Their conclusion was that the Ethiopian Commodity Exchange has the flexibility to meet all market demands. They proposed to do so through the creation of new grade combinations (for example for coffees originating from specific geographical areas) and through the incorporation of environmental and social certifications into

the ECX standard contract specifications (for example for organic and fair trade certified products).

Experience of the past two years that the ECX has been operational, has shown that trade through the ECX meets the demands for a good and constant quality product. However, contrary to the ECX's conclusion, there are certain market demands that the ECX currently cannot meet.

Firstly, the ECX currently does not have a traceability system in place. It therefore does not meet the demands of the organic and fair trade market, nor of the EU, USA or Japanese food markets. At present a product can be traced back to an ECX warehouse, not to the farmer. It is technically feasible to introduce a full traceability system. However, because many smallholder farmers produce small quantities for sale through the ECX, this will be a major and costly operation. Also, to gain the confidence of the importers, an additional measure will be necessary. A procedure that guarantees that the product has indeed been grown by the producer whose name is on the bag and that no commingling took place at farmer's level, will be necessary¹⁴.

Secondly, for organic certification all actors, inputs and activities (input supply, production, treatment, transport, storage, sales) in the supply chain need to adhere to organic procedures. This implies – next to full traceability - separate transport to and from the ECX warehouse, separate storage space in ECX warehouses, 'organic' treatment against post harvest losses during storage, separate administration so that the organic products can be followed from the very first inputs to the sales of the final product. To ensure that no prohibited inputs have been used, and no commingling with conventional sesame has taken place at any point in time, all steps and actors in the supply chain have to be inspected and certified. Technically speaking this is feasible. But the fulfilment of all the requirements for organic certification will require important investments by the ECX. Especially if organic production is spread throughout the country.

Thirdly, the ECX cannot ensure that a product has been produced in a socially responsible and environmentally friendly way. Since the ECX does not have a traceability system, it is not possible to identify the origin of the product back to the grower. Hence, it is not possible for the buyer to know for example how the product has been grown and treated, or what the labour conditions have been during the whole process. This is crucial for organic and fair trade markets but also for an increasing number of 'mainstream' markets in the USA, EU, and Japan.

The last requirements that cannot be met by the ECX are related to fair trade. Next to traceability, socially responsible production methods and the payment of minimum prices, fair trade markets also ask for longer-term relationships between buyers and sellers, ask for contracts to be agreed upon by both parties before the start of the growing season, and ask buyers to provide pre-financing at the start of the growing season, etc. The ECX cannot comply with these conditions because it is a spot market system and trading is anonymous.

¹⁴ With sesame produced in areas near borders with neighbouring countries this is a major issue. Farmers in other countries are using pesticides that are forbidden in Ethiopia. If prices are high in Ethiopia, sesame from farmers in neighbouring countries is sold to Ethiopian farmers. This crop produced by foreign farmers can easily be sold through the ECX together with the produce of Ethiopian farmers.

4.2 Ethiopian Commodity Exchange: opportunities but also limitations

In an interview¹⁵ held with the Chief Executive Officer of the ECX at the end of 2009, she mentioned that they have realized that the very flexible system of the ECX does not meet some of the very important needs of the “specialty coffee” market. This chapter highlights that the ECX currently does not meet some of the needs of the high value export market neither.

Ethiopia has made a strategic policy decision to establish the ECX as the exclusive trading system for several Ethiopian commodities. When looking at the market for sesame, we conclude that sesame seed traded through the ECX meets the demands of the world’s biggest importer, China. However, it does not meet the demand for traceable, safe, pesticide free, socially and environmentally responsibly grown products. This is the reason why the second largest importer, Japan, currently does not buy sesame seeds from Ethiopia.

The ECX has contributed to transparent market prices, quality grades that are standardized and contracts that are enforced. This is an important achievement for producers as well as exporters and importers. Yet one of the implications of the ECX is that buyers and sellers now no longer meet in person to do business. The consequence can be that there is little scope for producers and clients to work together on innovation, value adding and niche marketing.

There are a few cases in which trade does not have to take place through the Commodity Exchange. This presents opportunities that the ECX currently cannot offer. The Ethiopian law allows products to be exported directly by a producer to the international market. Producers who are large enough or producer unions that are sufficiently organized to attract contracts from foreign importers can sell outside the ECX. This exception accommodates the requirement of fair trade standards of direct contracts between producers and buyers and provides the possibility to meet the other requirements as well. Presently very few producers or unions qualify for this exemption.

¹⁵ Addis Fortune, 29 November 2009. Interview with Dr Eleni Gabre-Madhin. <http://www.addisfortune.com/Interview-Eleni%20Gabre-Madhin.htm>

5 Conclusions and recommendations

The Ethiopian Commodity Exchange cannot meet the demands of all end markets, especially the high value markets such as the second most important market, the Japanese. Neither does it respond to the requirements of the growing niche markets, nor the demand for sustainably and safely produced mainstream products by major Western retailers. It does meet the demands of the major importer, China, and other countries that pay rather low prices.

The major obstacles are the absence of a traceability system and that compliance to social and environmental standards cannot be guaranteed. While it is technically feasible to adjust ECX procedures, this will require considerable investments.

The Ethiopian government may have made the conscious choice of focusing on low-value markets, because these need relatively few investments. In this case, having all produce traded through the ECX is a rational choice.

However, Ethiopia's coffee and sesame sectors have the potential to serve higher-end markets, as the quality produced is generally high in Ethiopia. Ethiopia also has several specialty coffee and sesame types. If Ethiopia chooses to exploit these, the ECX is probably not the most favoured marketing instrument. Although the Ethiopian government has exempted producers wanting to sell to international customers from the obligation of selling through the ECX, additional measures need to be taken to fully profit from the high value markets.

A system for tracking and tracing would be one of those measures. Because such measures are costly, it is recommended that an analysis of the costs and benefits of the investments is made. The recent WRR report (2010) has advised Dutch Development Cooperation to focus more on economic infrastructure and services. The investments that need to be made if Ethiopia is to access the high value (niche) markets is an example of economic infrastructure the WRR report mentions.

In addition, an analysis of alternative trade relations to meet the demands of markets currently not served by the ECX should also be made. Building strong chain relationships (for example through contract farming) is part of the strategy of high value markets. Experiences in other countries have shown that strong relations between value chain actors are an incentive for the private sector to invest in smallholder agriculture. This is also in line with the policy note published jointly by the Dutch Ministry of Foreign Affairs as well as the Ministry of Agriculture, Food Quality and Fisheries that mentions new forms of sustainable value chain development and the role that can be played by the private sector to bring about such change¹⁶.

¹⁶ See track 2: Public service provision and institutions, and track 3: sustainable value chain development. In: Ministry of Foreign Affairs of the Netherlands. 2008. Agriculture, rural economic development and food security.

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