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Who Shall We Blame Today: The International Politics of Coffee

The Current Situation

Over the past year, as the stories of deprivation, farm abandonment, and even death among desperate coffee producers affect everyone in the coffee industry, there is an increasing need to understand what is happening. This need is paticularly pointed in light of emerging information of the likelihood of ongoing overproduction in the next 2-4 years and the likely continued depression of prices. The consequences are quite serious and so it is surprising that some pundits have chosen to lay the blame on some convenient scapegoats.

When looking for an answer to coffee's dismal prices most fingers first point toward Vietnam whose dramatic 1400% production increases in a decade (1990-2000) appear to have surprised the industry. While Vietnam's meteoric rise to the position of #2 producer with 14.7 million bags in the 2000/2001 year makes it the most visible contributor to overproduction, it is by no means the only one. Brazil, for example, has added more to the global supply over the last five years than Vietnam.

Consider the current position in Brazil. It produced a bumper 98/99 crop of about 38 million bags from about 3.4 billion trees. Recent estimates suggest there are approximately 4.4 billion trees now in production with about 1.5 billion more still developing. Of these 6 billion trees many new ones went into northern frost-free zones and the highly productive areas of the Cerrado.

This capacity has strong implications for future supply but will pointing fingers resolve anything? Historians would note that this boom-bust cycle has plagued the industry for more than a century. Indeed, it's not just coffee that suffers this cycle, it is almost an *a priori* definition of commodities.

It may be little consolation but these historic lows are not confined to the coffee market. During the last three years, many commodities have reached 20- and, in some cases, 30-year lows. Many of the agreements supporting the price of commodities such as cocoa and rubber are defunct, just like the International Coffee Agreement. But even an agreement would probably offer only limited improvements since the coffee industry is undergoing some fundamental changes in the nature of the business. It is important to recognize the extent and consequences of this paradigm shift:

- Tree plantings now practically ensure structural long-term overproduction

- The ability and willingness to substitute coffees in most industrial blends
- Increased concentration, esp. among roasters and traders, reduces market options
- Market concentration, inadequate information, and speculation will fuel continued high volatility in the absence of any international agreement
- Lower green beans prices no longer necessarily correlate to lower roaster and retail prices that would usually stimulate increased consumption

To understand some of the production side changes, it is important to understand an important precursor: the liberalized market.

The Battle Between Coffee Boards and Development Agencies

Recently, several news sources have run opinions and articles that lay the responsibility for the current coffee crisis on the shoulders of The World Bank[1] and even the International Monetary Fund. It is certainly true that both institutions and several others have exerted pressured to liberalize the commodities industries beginning in the 1980s, with a series of actions, including structural adjustment programs, that stimulated and accelerated the pace of market-oriented reforms. These reforms usually focused on getting the government out of direct involvement in the production and marketing of products and allowing free market forces to improve efficiency and productivity.

Before the 1990s about two-thirds of the coffee producing countries counted on government controlled coffee boards that participated in extension services, quotas, price controls, coffee taxation or subsidies, marketing, and even credit. There was ample evidence of rampant inefficiency and sometimes even corruption. For diverse products such as cloves and vanilla to rubber and palm oil, dominant producing countries have fallen by the wayside and were replaced by others regardless, and sometimes because of, government controlled commodity boards. Most would agree that government commodity boards did more harm than good; liberalization, at least in theory, was a sound idea. But getting the government out of commodities markets, has not usually translated into an efficient and equitable private sector management of these markets. In most countries today coffee is in the hands of the private sector and few, if any, useful public services such as extension and credit are carried out.

It could be coincidental but in recent years many commodities have experienced 20 to 30 year lows and coffee price volatility has quadrupled. These could arguably be the vagaries of the markets and not the result of liberalization but they nevertheless impact the poorest segments of society most of all. In many developing countries, the inability or failure to diversify has left commodity production as the primary source of income for millions of poor families. In most cases, the safety nets afforded by previous government intervention (including boards), no matter their inefficiency, have not been appropriately considered or planned for in the rush to liberalize. Knowledgeable World Bank insiders, ranging from former chief economist Joseph Stiglitz to senior economist and agribusiness

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[1] *Dow Jones International News* (May 5, 2001); the *San Francisco Chronicle* (May 20, 2001) *Tea and Coffee Trade Journal* vol 173/No. 10 October 20th, 2001; San Jose, Costa Rica AFP article November 20

specialist Steven Jaffee, have admitted that in the rush to liberalize during the 1980s and early 1990s, there was inadequate attention paid to what would happen next.

Noted academics in international financial and donor agencies, many who unfortunately have little if any business or commodity market experience, typically expected private enterprise and market institutions to quickly and equitably bring balance to the marketplace. Instead, the resulting policy and institutional vacuum often wreaked havoc in the markets, a lesson that taught many economists and policymakers, the value of cautiously sequenced reforms and viable institutions (understood as the formal and informal "rules of the game"). Despite increased exports many producers, who are often among the poorest, are left in a position of greater exposure to risk. For coffee, that risk translates to approximately 20 million families around the world.

In the1980s, while many donors continued to finance growth in commodities, the World Bank had already noted that their low demand-price elasticity meant that any significant production increase would quickly reduce prices and generally restricted its financing of coffee, cocoa and tea expansion. However, world coffee production still increased considerably with investments from many other sources that, like the French Development Agency's loans to diversify Vietnam's production to Arabica, continue to this day[2].

Vietnam, The World Bank, and coffee

Contrary to a number of press reports claiming that the World Bank has financed massive coffee expansion in Vietnam, its own internal documents show that its involvement in Vietnamese coffee production has actually been minimal. The World Bank does have a considerable loan portfolio there but none of its investments have been designed to directly promote coffee production[3]. One clear indicator is that Vietnamese coffee expansion actually began well before 1994 when the World Bank resumed relations there.

Research indicates that only two World Bank projects in rural Vietnam could be linked to coffee production. The first is the 1996 Rural Finance Project that helped Vietnamese banks provide credit for farmers and rural entrepreneurs. When it began to disburse in1998/99, a small percentage of this – $16 million – was borrowed by coffee farmers primarily for maintenance and irrigation. The other, an Agricultural Diversification Project, was designed to promote crop diversification away from single commodities. But reportedly no resources from this project have gone to support coffee expansion. While $16 million is a considerable sum of money in a poor rural economy, such an amount would finance very little, less than 5%, of Vietnam's coffee expansion.

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[2] For example, a recent Reuters article (Oct. 17, 2001) notes that: "Vietnam has decided to extend until late 2004 an arabica coffee cultivation project funded by the French Development Agency and ease terms in soft loans for growers and processors to speed up the programme."

[3] World Bank economist Don Mitchell has being quoted saying that "Vietnam has become a successful producer" and this has been linked to coffee even though it has enjoyed high growth rates for many agricultural products and he maintains never to have indicated or implied that the World Bank either pushed or funded coffee expansion.

Interestingly, the World Bank's coffee related projects around the world indicate some interesting trends:

- Promoting risk management techniques in various countries by facilitating the knowledge of and access to market mechanisms (i.e. futures and insurance) for cooperatives and individual producers
- In Chiapas, Mexico, El Salvador, and Uganda there are small projects designed to foster the maintenance of biodiversity friendly, small-scale production of certified shade-grown coffee
- Solar-powered coffee dryers to preserve rural environments and earn small farmers extra income in Nicaragua
- Mexico marginal areas support to smallholder productivity and organics
- Côte d'Ivoire support toward improved marketing of cocoa and coffee

What's Next: Some Solutions

My nine-year-old niece has noted that the commodities price chart in my office bears a striking resemblance to a roller coaster. Anyone producing coffee as a commodity should recognize that it will undoubtedly be a difficult ride yet commodities like coffee remain an important source of export earnings for many developing countries and an important source of income for the poor.

How best to manage the negative consequences of fewer market options and volatile coffee markets remain key issues particularly for producing countries. They will have to develop a long-term strategy since the recent introduction of support systems and payments to farmers in Colombia, Mexico and other countries, although these may be politically necessary, are nevertheless very difficult to sustain in the long run and artificially distort market signals to producers who may continue high levels of production despite the market's message that there's already too much.

Paradigm shifts in production and consumption patterns indicate that the present low price cycle could be considerably longer than normal so governments will probably be unable to continue to mitigate the crisis while waiting for an upturn. In the case of most producing countries it would be worthwhile to analyze the cost structure and competitive advantages of the sector in order to better target any farmer or organizational support, improved technology, and access to markets.

The volatility of commodities and the fast changing nature of demand will require more attention to the role of small producers (who provide most of the world's coffee) and the mechanisms and policies to help mitigate their considerable risk. New risk management tools are proving useful and can be more quickly made available even to small farmer cooperatives. It is not surprising that many coffee buyers have resisted stabilizing prices at higher levels since the current low prices add to their profitability. Yet, there is a role for them unless they wish to eventually participate in a global market dominated by a cartel of only a very few producing countries. De Beers and OPEC prove that it can certainly happen. A proposal being discussed at the International Coffee Organization

(ICO) to eliminate the lowest quality triage from world trade could be a win-win solution since it would pull approximately 5 million bags out of circulation and improve coffee quality and therefore potentially raise consumption.

Pioneering firms like Starbucks, Green Mountain, and Thanksgiving Coffees are providing long-term incentives for improved quality and consistency by offering multi-year performance-based contracts at a minimum price wherein both sides can earn a decent profit. These and other firms are applying norms like the Conservation Coffee Principles[4] in their coffee buying to reward producers that strive toward social and environmental sustainability. Buyers and roasters that are truly committed to sustainable coffee practices could employ such a low-cost, win-win solution with minimal effort.

The changing nature of competitiveness will also require that producers who are not inclined to battle for the title of lowest-cost raw material supplier must develop differentiated products and processes as well as capture more of the value added during each stage of processing, packaging, and marketing. A recent study of historical experiences in Latin America reveal that "the most important element is not what is produced, but how it is produced," according to Guillermo Perry, the World Bank's chief economist for the region.

As coffee scholars such as Diego Pizano and others have recently pointed out: there is increasing concentration at the retail, roaster, and brokerage levels with considerable domination by a handful of large players. Enterprises and even countries will have to consider new alliances that could be a vital tool for many producing countries to capture more value. Internally, countries can capture the value of processing, logistics, and retailing and improve competitiveness by improving the effectiveness of marketing chains and better understanding the functioning of the market differentials and the margin levels existing at each stage between the producer and the final consumer. Development agencies and NGOs can play a vital role, particularly in linking growers to emerging high-value niche markets such as fair trade and environmentally benign production such as organic or shade-grown coffees that already post retail sales of approximately $500 million.

Finally, there is no silver bullet to solve this dilemma and it bears repeating that this crisis is not just a business problem; it is killing people. Rather than dissipating too much energy in assigning blame we, the people of the coffee industry, can use our creativity, our relationships, and our commitment to create some useful solutions for the new paradigms in the coffee world.

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[4] Conservation Principles For Coffee Production Conservation International: Consumer's Choice Council, Rainforest Alliance, Smithsonian Migratory Bird Center, Summit Foundation. At www.consumerscouncil.org