



**Summary report of the 6th Consultative
Forum on Coffee Sector Finance**

Background

1. The 6th Consultative Forum on Coffee Sector Finance took place during the week of the 117th Session of the International Coffee Council in London, United Kingdom on Wednesday 21 September 2016. The theme of the Forum was ‘Global Challenges and Co-Responsibility in the coffee sector’. Its main question was: “Does the current market structure create value for all?” It was chaired by Mr Juan Esteban Orduz, President and CEO of the Colombian Coffee Federation Inc. The Forum brought together experts from the public and private sectors to discuss challenges facing the coffee sector with a special focus on the profitability of coffee farming. The Forum was co-sponsored by the Colombian Coffee Federation and consisted of 5 panels with over 20 speakers from across the coffee sector.
2. The presentations and background documents for the Forum can be found on the ICO’s website at http://www.ico.org/forum6-e.asp?section=Meetings_and_Events.

SUMMARY REPORT OF THE 6TH CONSULTATIVE FORUM ON COFFEE SECTOR FINANCE

Welcome and opening remarks

1. The Executive Director, Mr Robério Oliveira Silva, welcomed participants to the 6th Forum. The Forum was an innovative feature established under the 2007 International Coffee Agreement in order to facilitate consultation on matters relating to the coffee sector. He also emphasised his intent to continue exploring new approaches to distribute the value arising from the coffee sector fairly and evenly, and expressed his thanks to the Chairman, moderators and panellists for giving their contributions to the event.

2. The Chairman expanded on the title of the Forum and the need to ensure that the coffee production chain works well at each stage in terms of economic sustainability in order to secure future supply. It is in the interest of all to be jointly responsible for the various costs and benefits along the supply chain. The starting point for this Forum was the threat posed to the industry as a whole by challenges such as price volatility, decreased farm yields and profitability, climate change, food safety, and social and environmental concerns. Are farmers bearing the brunt of the costs to address these issues, and what can be done to distribute value and responsibility evenly across the coffee value chain?

Assessing the economic sustainability of coffee growing

3. The Secretariat introduced a new ICO economic study called 'Assessing the economic sustainability of coffee growing', which was intended to serve as a background document for the forum. This study showed that from 2000 to 2015 international coffee prices had been below their ten year average level. This study specifically looked at costs and revenues in Brazil, Colombia, Costa Rica and El Salvador. Over ten years, it was shown that many producers were operating at a level which failed to cover their variable costs of production. This led to a lack of investment: coffee producers were unable to maintain their coffee fields, and this had an effect on the livelihoods of smallholders. The question of what can be done to address this situation was posed to the Forum as a starting point for discussions.

Panel 1: Tackling challenges in coffee growing countries

Although there are global challenges which affect the entire industry, each country also has its own specific concerns and priorities. What are the most important issues currently facing the coffee sector in specific countries, and what are the lessons learnt which can be transferred to other regions?

4. This panel was moderated by Mr Piotr Krawczyk from the Department of International Cooperation, Ministry of Economic Development (Poland). He welcomed participants to the

panel, and introduced the panellists. He stated his ambition to provide participants with fresh insights and discover new links between the economic, social and environmental problems affecting the coffee industry, and requested panellists to focus on the human aspect.

Mr Carlos Melles, Federal Deputy, Government of Brazil

5. Increasing productivity could lead to higher risks being borne by producers without a reciprocal commitment from the demand side. Increasing productivity requires higher input costs. Coffee has to be profitable and is a high-risk activity. Producers face many risks, but banks do not provide finance to them. Producers were only better off when the ICO, IBC and the Brazilian Coffee Federation were regulating the market. In the free market, the producer has become poorer, so this is a very serious moment for reflection.

Mr Carlos Brando, Independent coffee expert

6. Brazil is a very efficient coffee producer, and its market share has increased to 33% of the world total. However there are still challenges: firstly, adaptation to climate change; Brazil has lost between 22 and 24 million bags of coffee in the last three years due to drought. The second challenge is the mechanisation of harvesting and other activities in mountainous areas where labour can account for up to 60% of production costs. Third, extension services to reach smallholder growers need to be improved, as smallholders account for 80% of all growers and produce 35% of the crop. Fourth, greater funding for research is required, with a strong focus on climate change mitigation. Finally, marketing and value addition has to be increased. These are not new challenges, and some of them already have success stories behind them. For example Brazil is already the largest source of sustainable coffee in the world.

Mr José Hugo Hernández, Executive Director, Salvadorian Coffee Council

7. El Salvador was the worst hit in the region by the recent coffee leaf rust outbreak. Measures had to be taken to ensure that productivity will improve, working with the private sector and public policy. The coffee forest, i.e. coffee grown under shade, is crucial to environmental sustainability. Within the coffee pact, signed between the public and private sectors, El Salvador is seeking better adaptation and resilience to climate change. It is also very important for the future of young people, who are leaving the countryside. This is a significant challenge, particularly in countries which are very dependent on coffee production. Education, information and raising awareness must be increased.

Mr Le Tien Hung, General Director, Simexco Dalak Ltd

8. There are several challenges currently facing the Vietnamese coffee sector. First, there is the problem of climate change, which is already affecting coffee growing areas. Deforestation is a big problem, as it reduces water availability for irrigation. Coffee trees in

Vietnam are becoming less productive as they get older, and many areas have trees over 20 years old, and the replanting rate is low because of high interest rates on loans. Farms are generally small, around 1.5 to 2 hectares, which makes it harder to apply new technologies. Coffee is also facing competition from other crops such as pepper and avocado which are more profitable. Vietnamese coffee farmers are also getting older, and young people do not want to be farmers. Finally, the premium for certified coffees is too small, and does not attract farmers. It is therefore expected that Vietnamese coffee production will decrease over the next five years, which is very concerning.

Mr Fred Kawuma, Secretary General, InterAfrican Coffee Organisation (IACO)

9. There are 25 coffee producing countries in Africa, but many producers are facing significant challenges, such as low productivity, poor access to finance, ageing farmers and a lack of effective extension services. Some of the coffee trees in Africa are over 60 years old, which gives very low yields. Political challenges can also affect output, when countries experience periods of conflict or epidemiological problems. Producing countries need to get young people involved in agriculture, and increase the access to new technologies for farmers. This requires national coffee policies in producing countries, which have already been effective in Tanzania, Uganda and Côte d'Ivoire.

10. In the panel discussion, participants discussed how to develop an enabling environment for producers. This would require an efficient financial system to provide financing to acquire inputs and equipment, the logistics are often not good enough. National policies are important to support farmers, who need to move from subsistence farming to agribusiness. Connecting producers with the market through initiatives such as micro-auctions, has produced results. Public/private partnerships are crucial, as neither sector can address these issues alone. The best stimulus to increase production is always price.

Panel 2: Socio-economic indicators

The socio-economic conditions of coffee growers are of paramount importance to ensuring a sustainable coffee sector, yet we have surprisingly little data on their trends and dynamics. What programmes and initiatives are currently addressing this, and which areas are in most need of attention?

11. This panel was moderated by Mrs Nancy Cheruiyot, Interim Managing Trustee of the Commodities Fund, Kenya. She started by stating that coffee demand is growing, but producers do not receive attention. There is not enough data on the socio-economic status of producers.

Mr René León, President, Regional Cooperative Programme for the Technological Development and Modernization of Coffee Production (PROMECAFÉ)

12. In Central America, approximately 15 to 20% of foreign currency comes from coffee. There are some 330,000 growers in the region; assuming 5 people per family gives nearly 2 million people involved in coffee, and 12 million jobs directly linked to the coffee industry. Most producers are smallholders, on 1 to 3 hectares. The sector is currently going through a difficult period, with complicated problems such as climate change, higher temperatures, and diseases like coffee leaf rust. The situation is not currently economically sustainable, and the producer is asking how a cup of coffee can cost US\$3-4 while the farmer is earning just a few cents. Coffee farming families have high illiteracy rates, non-balanced food diet and this leads to social problems such as illegal drug trafficking and migration. There is a need to be responsible not only for the benefit but also for the risk.

Mr Sjoerd Panhuysen, Knowledge Officer, Hivos International

13. We must talk about the living wage associated with coffee production, as parents do not want their children to become coffee farmers. Certification has not brought the benefits expected 10 to 15 years ago and sustainability of production remains to be addressed. Most importantly, reliable data is necessary. There is not enough information on the number of coffee farmers in the world or how many hectares of coffee there are. These are important figures that are required in order to talk about profitability of the coffee sector.

Mr Pablo Ramírez, International Consultant

14. Mr Ramírez opened the debate stating that sustainability has always had three pillars: social, environmental and economic. However, economic sustainability seems to be losing attention. This asymmetry is creating a farmer livelihood risk. Priorities should be focused on the economic pillar of sustainability, because this will drive change, with the others following. The farmer should not be responsible for driving this; the responsibility needs to be shared. Some options include reducing price volatility, paying a living wage and increasing the demand for sustainable coffee.

15. The moderator asked the panel how one could encourage young people to be coffee farmers. They are only going to be interested if it is profitable. There are also technological solutions which can be exploited in order to make rural activities such as coffee farming more appealing to young people. 95% of coffee farmers in one project said they did not want their children to be farmers, so this is a serious problem. However, there is hope, with groups such as this Forum looking at this issue.

16. From the discussions, the panel concluded that farmers are getting poorer and there is a need to come together initiating studies and discussing alternative ways to ensure profitability. To have a happy coffee drinker we must guarantee a happy producer.

Panel 3: Co-responsibility for climate change

Climate change is a challenge for the entire coffee value chain, and we need to take a comprehensive, collaborative approach. How can we ensure that responsibility for adapting to and mitigating climate change is shared by all actors?

17. This panel was moderated by Mr Primus Kimaryo, Director General of the Tanzania Coffee Board. Coffee is produced in the south and consumed in the north. Coffee demand is increasing, but output could decrease because of climate change. How can this issue be addressed?

Mr Alejandro Keller, President a.i., National Coffee Association of Guatemala (Anacafé)

18. Climate change has to be treated holistically, it is not just a national issue. It is necessary to prioritise and define what is really important. We must analyse the social dynamic that climate change has on the sector, for example increases in migration and the effect on food security. There will of course be a cost to adaptation measures; new plant varieties, investment in plantations, etc. in order to optimise production.

Mrs Annette Pensel, Interim Executive Director, Global Coffee Platform

19. The challenges faced by coffee farmers are very complex; US\$350 million has already been invested in sustainability, but this is not enough. There are many fragmented initiatives currently being implemented, but it is difficult to scale up. So how can farmers be supported more effectively? This is what the Global Coffee Platform is aiming to address, using the Sustainable Development Goals as guiding principles. The Global Coffee Platform is made up of roasters, exporters, producers, cooperatives and civil society organizations. The Platform wants to be a vehicle of change.

Mr Brian Lainoff, Lead Partnerships Coordinator, The Crop Trust

20. Climate change is going to put massive pressure on the ability to grow the food, or in this case the coffee, that is needed to satisfy consumption. The impact will be most severe in coffee producing countries. The development of crop varieties that can cope with heat, drought and other extremes may well be the single most important step that can be taken to adapt to climate change. It is not the only step but it is a step. It takes time to adapt, so measures should be taken as soon as possible to assist in coping with this.

Mr Aitor Ezcurra, Chief of Corporates Division, Inter-American Investment Corporation

21. There has been a lot of pressure internally and externally on developmental financial institutions regarding climate change. In terms of coffee, much of the climate change business for the Inter-American Development Bank (IDB) is going to be on efficient transportation and on agribusiness. For example, IDB recently provided to medium-size and small-size coffee farmers in Nicaragua long term financing for replanting related to the problem of coffee leaf rust. It involved partial replanting. A risk sharing facility has been developed and implemented. It brings together many of the players of the supply chain, international traders and coffee companies. With so many parties involved, many different views had to be balanced. One lesson is that putting together this kind of financing is difficult in view of complex issues. However these challenges are not insurmountable.

22. The main conclusion from the discussion is the need to bring all stakeholders together to align strategies, agendas, priorities and funds for projects on climate adaptation and mitigation strategies and other priorities of the sector.

Panel 4: International Prices

It is increasingly argued that the New York 'C' contract does not reflect the fundamental movements in supply and demand that affect most coffee growers and that price volatility comes in big part from financial speculation. In your experience, is this true? Are there other price discovery mechanisms that should be explored?

23. This panel was moderated by Mr Ronald Peters, Executive Director of the Coffee Institute of Costa Rica (ICAFÉ). He opened the debate by stating that coffee producers are the most vulnerable in the coffee sector and in many cases not economically valued by the market. What does the 'C' Contract do to guarantee price discovery? Sustainability is a fashionable word but the industry does not acknowledge the financial risk borne by the producers.

Mr Nicolas Tamari, CEO, Sucafina

24. In general the futures market is a valid tool for price discovery, although this is more for mainstream coffee than for gourmet coffee. Over the long term, the New York market does ultimately reflect the reality of supply and demand, especially for natural Arabica coffee, even if the contract is a washed Arabica contract. However, in the short- and the medium-term, there are price dislocations compared to fundamentals that are due to speculation or climatic events. In particular, the increasing amount of money in the hands of hedge funds are causing exaggeration to the upside and the downside. This encourages technical analysis rather than fundamental analysis of the market. However, further down the road, the producer will need to have an incentive to keep producing quality coffee.

Mr Rodrigo Correa da Costa, Director Commodities, SG Americas Securities, LLC

25. Despite differences in terms of quality, origins and timing, the New York futures market does reflect what happens in the fundamentals. This includes stocks in consuming countries, producing countries and transit, as well as the consumption and production numbers. In terms of volatility, this is what provokes interest from financial entities to be in the market and take price risks that the industry, roasters and producers are not willing to take. So they are a fundamental part of the market.

Mr Edgar Cordero, Senior Advisor on Global Strategy, Colombian Coffee Growers Federation, Inc.

26. The 'C' contract is a financial instrument; it is only part of the coffee market. The coffee market is 25 million producers and hundreds of millions of consumers, as well as roasters, stores, steamship companies and everyone else in the middle. Price movements depend on the perception of supply and demand, and can always change. There is no such thing as equilibrium, it is always in flux. This is basically old-time Marxist theory of income and distribution – how do we get money to go from one end of the chain to the other?

Mr Ric Rhinehart, CEO, Speciality Coffee Association of America (SCAA)

27. The futures market for commodities initially had three basic purposes: to facilitate price discovery, to provide a vehicle for risk management, and to act as a buyer or seller to complete the transaction. In coffee, the futures market has failed in two out of three of those purposes. In 2011, no coffee was being tendered to the exchange and it would have been almost impossible to buy a fresh lot of coffee from the exchange. Some argue that it had also failed as a price discovery mechanism. In terms of its success as a risk management mechanism, it is a tool that benefits people who have money that they need to protect. The underlying contract of the New York 'C' is washed Arabica coffee from a small selection of tenderable origins. But the reality is that the market is no longer tracking that commodity, it is tracking Natural Arabicas, and to a lesser degree Robustas and the strength of the US dollar. It is essentially a derivatives market. Farmers want to manage their downside risk, and the futures market is not an effective tool for them. This is not so much a price problem, but more of a distribution problem, which is the topic that should really be addressed.

28. The main conclusion following the discussions in this panel is that the "C" contract reflects only the availability of Brazilian supply. It was also suggested that the pricing mechanism should take into account the cost of production in exporting countries. However, the futures market continues to be a good price discovery mechanism. And the "C" Contract is not dysfunctional. Adding Brazilian Naturals into the "C" Contract to make it tenderable does not make any difference. The main question is how to manage the risk.

Panel 5: Financial mechanisms for coffee producers

There are significant opportunities available to facilitate the provision of finance to smallholder coffee producers, yet access to finance remains an issue for many farmers. What is needed to make these innovative financial solutions happen?

29. This panel was moderated by Mr Alfredo Moisés, CEO of Café Monte Grande.

Mr Benjamin Schmerler, Senior Director, Root Capital

30. Capital alone is not sufficient to get finance moving, there is a need to offer financial management training in rural areas to get suppliers into the pipeline. Small businesses that need capital of between US\$50,000 and US\$3 million are not currently adequately catered for. Over time, these businesses can graduate to more commercial capital solutions. There are barriers in creating innovative ways to finance small producers, but there are also other solutions that need to be considered.

Mr Cory Bush, Senior Trader, Falcon Coffees

31. There are four points which are key to building collaborative supply chains, including access to smallholder finance. First, radical transparency is necessary from the farm gate to the consumer, which can help to solve the distribution challenges which have been mentioned in previous panels. Second, risk management instruments need to be localised to be appropriate for the scale and the context in which they are deployed: there is a difference between producers in East Africa and in Brazil. Third, co-investment in the supply chain development is necessary between roasters, social lenders and multilateral institutions. Fourth, the correct type of finance should be available to the right participants at the right time.

Mr Craig Courtney, Senior Independent Consultant, Initiative on Smallholder Finance

32. There are many different types of risk – market, price, foreign exchange – that are being faced by all parties in the coffee supply chain. These risks also exist in other supply chains, but coffee seems to be experiencing more difficulty. According to some reports, lending in this sector has decreased while other sectors have increased. So there is a mismatch between the risk and the solutions. Some of the solutions lie in blended finance, aligning the aspirations of the various capital providers to create solutions with greater partner coordination and risk sharing.

Mr Mauricio Ribeiro do Valle, Superintendent of Finance and Human Resources, Cooxupé

33. Investment in the production of coffee is high, but high interest rates in Brazil are a major problem, unlike in the developed world. A cooperative can act as an intermediary between the producer and the large financial institutions, organising its members and negotiating with the financial system. A cooperative can also help a producer access the futures market to mitigate price volatility by absorbing the marginal risk. As such, the cooperative can organise producers in order to reach external markets which would otherwise be unavailable.

34. Panellists also discussed ways of specifically targeting smallholder producers of coffee, some of whom face very poor living conditions, and how to reduce uncertainty in the longer term. It was emphasised that it is important to consider what the finance is being used for, as it needs to be a productive investment. Furthermore, the absorption capacity for capital needs to be sufficient even if the supply of capital is there. The use of blended capital, mixing finance from public and private sector institutions, has been shown to work in individual cases but can be difficult to scale. Finally, there is a foreign exchange risk for producers, since coffee is quoted in dollars, which adds further uncertainty to both producers and lenders.

Closing Remarks

35. The Chairman thanked all the panellists and contributors for a fruitful discussion on the theme of the Forum. Some of the conclusions will be used in drafting the Strategic Review. The Executive Director concluded by thanking the Chairman, Mr Orduz, for his dedication to advocate the challenges faced by the coffee sector in producing countries and the need to address them in a cooperative way.

36. The next forum will take place in September 2017.