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Coffee: Institutions and Development

Why has Coffee Control Succeeded in the Past?
Can it Succeed in the Future?

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Coffee Market Institutions

- National (marketing boards, producers' &/or exporters' associations) or international (ICO, ACPC)
- National organizations can either transmit government policy *down* to producers (marketing boards) or producer interests *up* to government (producer associations)
- Rosemary Thorp has rightly emphasized the importance of the Colombian Federación Nacional de Cafeteros. One of the strengths of the Federación is that it combined both these functions.
- This is difficult to replicate in other countries.

Comments on Bates & Thorp

- If I have a criticism of Bates and Thorp, it is that they look backwards, not forwards.
- The Federación was able to look after Colombian coffee farmers because coffee was a rich crop.
- The Federación deal was that government would tax coffee but the Federación spend part of the tax revenue.
- Coffee is now a poor crop, with little revenue.
- Does the Federación still have a role? Might Colombia now be better served by the private sector?

The International Coffee Agreement

- I agree with Bates (*Open Economy Politics*, 1997) that the coffee agreement raised the coffee price.
- I believe that if coffee control had remained effective, prices would have been higher in the early ‘90s (and now) than was (is) the case.
- I suggest that the Federación will only have a useful future if coffee control can be restored.

Commodity Agreements as Cartels

- I see International Commodity Agreements as *internationally-sanctioned cartels*.
- This characterization applied to the coffee, sugar and tin agreements, but not to cocoa or rubber.
- In an internationally-sanctioned cartel, producer governments act to restrict supplies (ie as a cartel) but under international law and subject to the consent of consumer country governments.

Benefits to Producers

- Restriction of supplies will raise prices.
- Producers clearly benefit from a cartel in periods of excess capacity ...
- … but, over time, the benefits tend to be eroded by efficiency losses and through rent-seeking.
- Producers can form a cartel by themselves (OPEC), but this is not always effective (CIPEC) …
- … delegates to this conference will make their own judgments on the effectiveness of the ACPC.

Free Riding

- Free riding is the major cartel enforcement problem.
- Producers who are small &/or high cost &/or rapidly expanding have an incentive to stay out.
- Free riders enjoy the benefits of the high cartel prices without paying the cost of a reduced level of exports.
- In a free market, producers cannot control free riding
- … but consumers can, by agreeing only to import from cartel members.

Bates's View

- If producers cannot unilaterally enforce an effective cartel, are not consumers (in particular, the USA) better off with a low price free-for-all?
- Bates argued US membership reflected perceived political benefits: "In response to the question, Why should consumer nations join an agreement that, like the , would raise producer prices? we can thus answer: for security reasons. The United States was willing to trade economic costs for political benefits."

  (Bates, 1997, p.125)

What's in it for Consumers?

- This assumes that consumers are offered the choice between a cartel and the free market.
- The effective choice may be between a partially effective unilateral cartel and a fully effective cartel supported by consumers.
- By supporting the cartel, consumers can prevent free riding, but can impose a lower price. *Pace* Bates, they can benefit directly.
- The core producers also gain because they have a higher share of exports. The free riders lose.

Numerical Example

Two low cost producers and one high cost, free riding producer.

Numbers are computed as the Nash solution to a cooperative cartel game.

		Low Cost Producers (2)		High Cost Producer (1)		Cons-umer
	Price	Out-put	Profit	Out-put	Profit	Value
Fully effective cartel	56	17	778	10	366	958
Partially effective cartel	46	18	630	19	485	1485
Commodity agreement	40	23	692	14	276	1803

International Coffee Control 1962-89

- I claim that coffee control conforms to this model …
- There are two components to this claim -

1 Consumer governments enforced export quotas by requiring official ICO certificates of origin for all coffee imports.

2 Producer governments (led by Brazil and Colombia) threatened unilateral cartel action if no agreement could be reached with consumers.

- Coffee control required both these elements.

The Threat of Unilateral Action

- Brazil and Colombia coordinated Latin American retention in the 1950s, resulting in the 1st Agreement.
- After the 1972 lapse of controls, Brazil coordinated moves towards a unilateral producer cartel, starting from a 1974 meeting in Caracas.
- When no agreement was reached with consumers on price triggers, the Bogota Group (led by Brazil and Colombia) set up a fund to support the coffee price. This eventually led to the 3rd Agreement.

Why Did Coffee Control Break Down?

- In my view, because the producer threat of unilateral cartel action became less credible.
  - Rent-seeking - farmers were no longer always the major beneficiaries of high prices.
  - Tension between arabica and robusta producers.
  - Expansion of production in new producing countries.
  - Brazilian ambivalence towards control (Brazil is now the second largest coffee consuming country).

The Current Market Situation

- The coffee price is currently very low.
- This is due to four factors

a excess of production over consumption

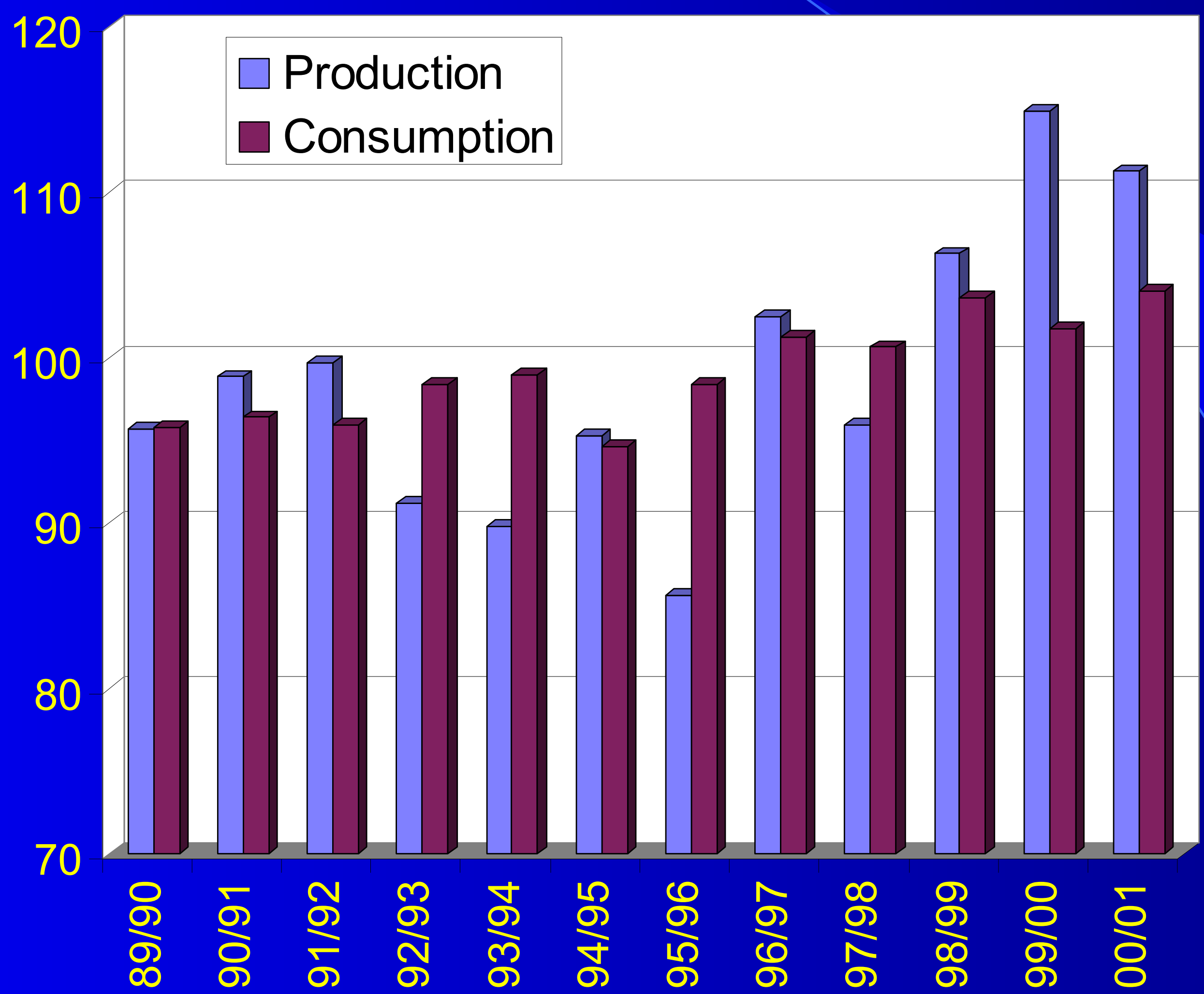
b accumulation of stocks in consuming countries

c exchange rate depreciation in many producing countries (Brazil, Indonesia, Uganda, Vietnam …)

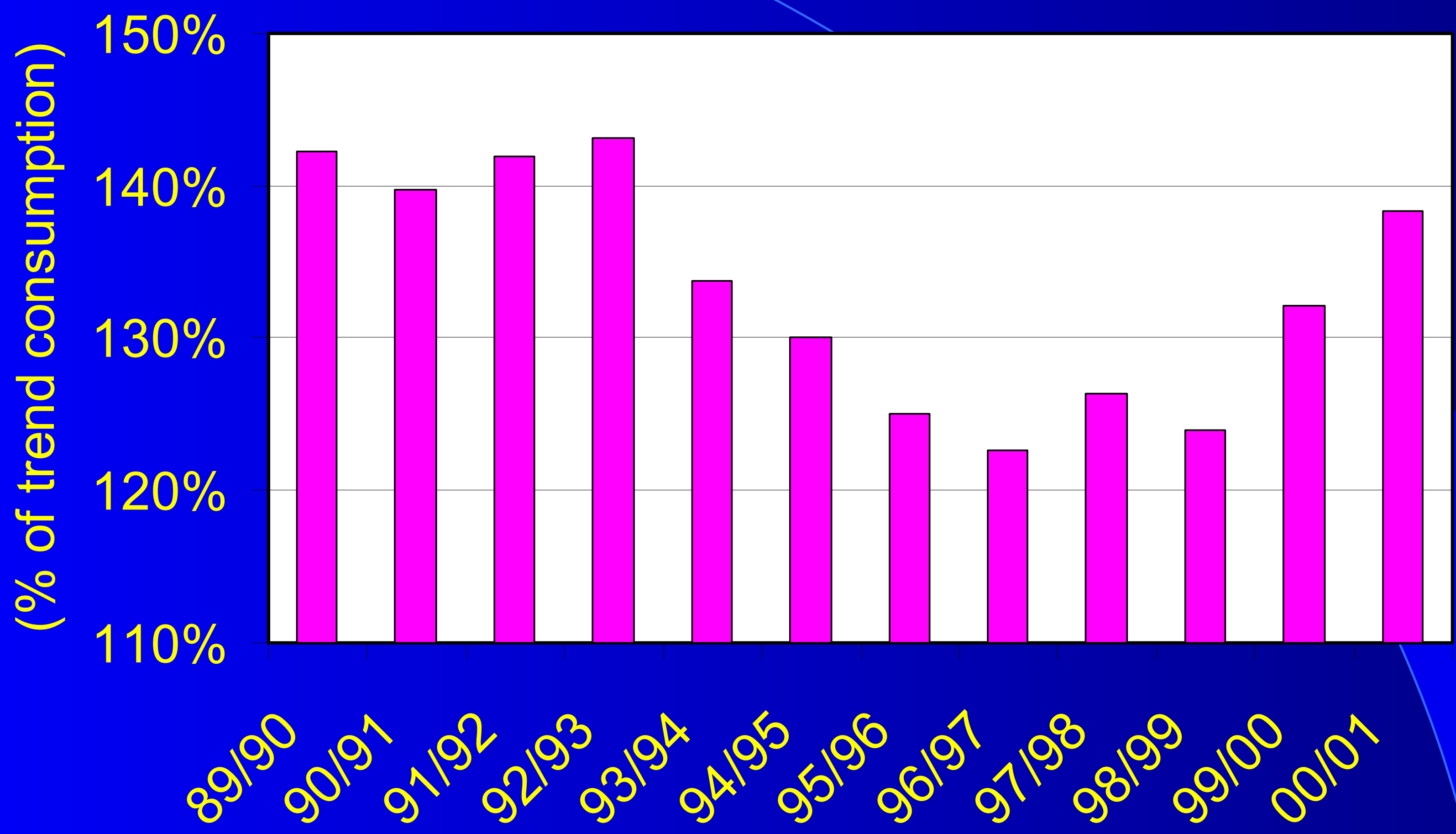
d steady productivity advance in coffee production and marketing.

- A control scheme could address *a* and *b*, not *c* or *d*.

Production & Consumption 1989 - 2000



Coffee Availability - 1989-90 to 2000-01



Availability = $(Q_{t-1}+Q_t+E_tQ_{t+1})/3 + SC_{t-1} + SQ_{t-1}/2$ where Q is production and SC and SQ are end crop year producer and consumer stocks.

Coffee Retention

- In my opinion, retention is unlikely to be effective …
  - Export quotas are not enforced by importing countries; no agreement to enforce quotas is likely.
  - The fundamental imbalance is between production and consumption. If this imbalance is not addressed, retention will require producing countries to carry very high levels of stock.
  - Retained stocks will still be available to the market if the price rises sufficiently. Knowledge of this will tend to keep prices down.

Coffee Diversion

- Diversion of coffee to alternative uses has the potential to be more effective.
- By diverting low quality coffee, quality may be raised.
  - Diversion is more likely to obtain consumer support, and also consumer cooperation in implementation.
  - Diverted stock is no longer available for normal consumption - so the price impact will be greater.
- But if production continues to exceed consumption, a continuing diversion policy will be required.
- Diversion would have been more effective in the early ‘90s when the problem was one of excess stocks.

Other Solutions

- The current problem is one of excess productive capacity - too large an area under cultivation.
  - Farmers might be encouraged to grub up coffee trees and produce alternative crops.
  - Alternatively, farmers might be encouraged to replant early. This would take land out of production for 3-4 years, and may also raise quality.
- Both policies require an incentive scheme.
- These policies should be seen as complementing, not substituting, a diversion scheme.

Conclusions

- Coffee control worked through cooperation between producers and consumers - this was in the direct economic interests of both parties.
- The threat of unilateral action was important in generating cooperation; control broke down when this threat ceased to be credible.
- An effective control scheme to deal with the current market imbalance will also benefit from cooperation.
- Coffee diversion has the potential to be more effective than retention; but neither policy addresses the fundamental production-consumption imbalance. This requires incentives to reduce the area under cultivation - at least temporarily.