# Economic and Social Development in Latin America:

# The Role of Coffee

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## 1. Introduction

At the dawning of the twentieth century, the coffee sector played a seminal role for the economic and social modernization of Latin America. It was the main dynamic factor for the economies of many countries and a pivotal element of social transformation. It was, perhaps, the principal force behind the introduction of free labor in many Latin American countries. Today, at the beginning of a new century, the coffee sector continues to play an important role in the social and economic environment of the region. The challenge for the sector is to find a dynamic role in this new context.

Today I would like to reflect on a few points connecting this important economic sector with the economic and social development in Latin America. I will begin by briefly reviewing the historical role of coffee in Latin America in three different periods: from its inception in the nineteenth century to the economic crisis of the 1930s; the import substitution development strategy; and within the new economic context of the last two decades. Then I would like to discuss some current aspects of the coffee sector in Latin America and its perspectives.

## 2. The Historical Role of Coffee: Economic and Social Transformations

The beginning of coffee production in Latin America coincides with the region's first experience of economic liberalism, characterized by open economies, flexible exchange rates and an attempt at strengthening domestic markets. During this period, which extends roughly from the second half of the nineteenth century up to the world economic crisis of the 1930s, the coffee sector played an important role in many countries such as Brazil, Colombia, Costa Rica, and a bit later and to a lesser degree in other countries in South and Central America. To be sure, the coffee sector grew during that period to become a catalyst for the economic and social modernization in those countries.

On the economic side, coffee was one of the most important export items, generating hard currency and having a major impact on the gross domestic product. The coffee sector was one of the pillars of the economy. For example, around 1925, coffee represented around seventy percent of Brazil's total exports and around eighty percent of Colombia's total exports.

As Werner Baer states in his book "The Brazilian Economy", coffee had many secondary effects on the economy such as employment of free immigrant labor, foreign investment in infrastructure, capital accumulation of coffee growers, and the derived growth of industry.[1] Additionally, the demand for free labor led many coffee producers in Brazil to join the campaign for the abolition of slavery. Similarly, Roberto Junguito and Diego Pizano in their book "Producción de Café en Colombia" remind us that the economic relevance of coffee was not limited to its impact on growth via increased exports.[2] They suggest that coffee has had a clear link with the development of other sectors and with the overall development process of Colombia. Among other impacts they stress the links between coffee production with employment and the social situation given the activity's high demand for labor, its relation with public finances, its impact on industrial, regional, and institutional development and its role in national politics.

It is clear that coffee is on the base of the economic and social development in many areas of our region. At its peak, the coffee sector generated thousands of jobs and allowed for

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Baer, Werner, 1983. *The Brazilian Economy, Growth and Development*, second edition, Praeger.

some social mobility of people involved in the activity. Jobs, wages, freedom, migration, and social mobility were the elements of the coffee economy in such countries as Brazil, Colombia, El Salvador, and Guatemala.

Coffee production also stimulated the insertion of Latin American economies in the world trade. In this period, given its high level of dependence on external markets, the price of coffee was the principal factor in guaranteeing equilibrium in the balance of payments and, as a consequence, guaranteeing macroeconomic stability and economic growth. Income generated by coffee production and exports created domestic demand in the industrial sector in many countries, allowing for the diversification of their economies.

In other words, domestically, social development was highly dependent on the jobs created and sustained by the production and export of coffee. There is no doubt that coffee was a dynamic factor in many countries of Latin America in the early twentieth century.

## 3. The Import Substitution Development Strategy: Coffee Income creates demand

Many Latin American countries responded to the global crisis of the 1930s by creating strong, entrepreneurial states and adopting a closed-economy development strategy. The main characteristic of this development model is known as "industrialization via import substitution." In that scenario, the State was the main conductor of the economic development process and the principal investor in the economy through State enterprises and infrastructure projects. Moreover, sectors and products thought to be strategically important for the country's economic development enjoyed large subsidies and strong protection against foreign competition. Income

[2] Junguito, Roberto and Diego Pizano, 1991. *Producción de Café en Colombia*, Fondo Cultural Cefetero.

generated by coffee exports had an important role in creating demand for the domestic manufacturing sector, and, according to some analysts, export tax revenues helped the government to support the industrial development in many countries of the region.

This growth strategy, however, resulted in inefficient and non-competitive economies insulated from world markets. Despite all these problems, between 1950 and 1980, the "import substitution" strategy resulted in economic growth rates in Latin America above international averages. The "import substitution model" was unsustainable and triggered a general economic crisis in the 1980s with growing budget and trade deficits, accelerating inflation rates, and recession.

During the import substitution era, coffee remained an important source of export revenues although at a relatively lower level. For example, in the case of Brazil, which I am most familiar with, the share of coffee in total exports declined from seventy percent at the end of the 1920s to around forty percent in the 1960s, to less than ten percent in the 1980s and around five percent in the 1990s. In other producing countries in Latin America, coffee's share of total exports, although lower than at the beginning of the century, remains substantially high, close to one quarter of total exports in Costa Rica, above fifty percent in El Salvador, and even higher in Guatemala.

## 4. Recent Economic Changes in Latin America: Markets and Democracy

More recently, Latin America experienced another radical change as a response to the crisis resulting from the end of the "import substitution strategy" and also as a response to the changes in the international economic environment, namely economic globalization. Economic globalization has brought both challenges and opportunities to the region. Globalization means the strengthening of market mechanisms. Globalization means more competitiveness and risks. And in order to be successful in global markets, Latin American countries must increase their overall productivity. To do so, the region needs to increase investments in improving labor skills and incorporating new technologies. Globalization is here to stay and countries must adapt to it. As Manuel Castells wrote recently, "in the last two decades of the twentieth century, a new economy has emerged around the world. It is certainly capitalist. Indeed, for the first time in history, the whole planet is either capitalist or highly dependent on capitalist economic processes. But it is a new brand of capitalism, characterized by three fundamental features. Productivity and competitiveness are, by and large, a function of knowledge generation and information processing; firms and territories are organized in networks of production, management and distribution; the core economic activities are global – that is, they have the capacity to work as a unit in real time, or chosen time, on a planetary scale. Not everything is global. In fact, most employment is local or regional."[3]

Another component of the recent economic transformations in Latin America has been the liberalization of trade and capital accounts. On one hand, the region seeks to open new markets for its products and, on the other, it also experiences more competition from foreign producers in local and international markets.

Similar to the changes of the 1930s, the recent transformations have also included major changes in the role of the State in the economy. This time, however, reform of the State was aimed at achieving fiscal equilibrium and increasing the efficiency of the public sector. A major component of reforming the State was a comprehensive privatization program of State-owned

[3] Castells, Manuel (2000), "The Global, networked economy," in Hutton, Will and Anthony Giddens (eds.), *Global*

enterprises accumulated in the previous decades. The privatization program was designed to increase the overall efficiency levels of the economy, where the State remains the primary supplier of public goods but exercises a smaller role in productive activities.

In summary, it is a new economy, one that is more efficient and more competitive but with more risks as well. A question we need to ask is how is Latin America now and how coffee production fits in the overall economic, political and social situation of the region.

**5. How is Latin America now?**

There is no doubt that Latin America has advanced dramatically in the last century, especially in the last forty years. Unfortunately, the fast economic growth registered in the 1960s and 70s decreased substantially in the 1980s and 90s. The real GDP average annual growth rate declined from above five percent in the 1970s to a meager 1.1 percent in the 1980s, and remained below three percent in the 1990s.

Despite important gains, there is much yet to be accomplished in the region. At the beginning of the twenty first century, Latin America is still experiencing serious economic and social problems. The most urgent question to be addressed in the region relates to economic growth. Following a decade of lost opportunities, Latin America experienced positive economic growth in the 1990s, although at rates below the region's historical averages. It is clear that, given the size of the population and current income levels, Latin America needs to grow at least twice as fast as the rates observed in the recent past if it is to reduce the high levels of open unemployment and underemployment in the region. Furthermore, income distribution in Latin America remains the most unequal in the world, and poverty levels continue very high, with an

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*Capitalism,* The New Press.

estimated 200 million people living in poverty at the end of the 1990s. As Lustig and Deutsch stated in a 1998 study, "approximately 150 million people in Latin America and the Caribbean, or one out of every three individuals, are currently living on incomes that are less than US$2 a day."[4] Thus, Latin America has two major challenges ahead of itself: accelerate economic growth and, in doing so, promote and improve access to economic opportunities to the large share of the population living in poverty. Economic growth should also be sustainable, taking into consideration the environment and the preservation of biodiversity to future generations.

As Ignacy Sachs points out, "one among many ways of defining development: economic growth subordinated to the double ethical imperative of synchronized solidarity with the present generation (social) and the diachronic solidarity with the future generation (environmental)."[5]

**6. Coffee production within Latin America's new economic structure**

How does the coffee sector fit within the new economic structure of Latin America? This is not an easy question to answer. However, I would like to reflect on some aspects of the current situation of the sector. First of all, one of the most important problems, if not the most important one, faced by the sector throughout its history remains present today, namely the variability of international prices. More recently, this issue has become even more complicated as new producers enter the market, increasing supply and reducing the market power of all producers. In the absence of fast growth in demand, producers will continue to face lower prices, and unless production costs decline or governmental subsidies increase, lower profitability and difficult times are likely to remain on the horizon.

[4] Lustig, Nora and Ruthanne Deutsch , 1998. *The Inter-American Development Bank and Poverty Reduction, An Overview*; Inter American Development Bank.

These problems must be addressed within the current economic structure in the region, namely economies increasingly open to foreign competition and investments, more market oriented resulting in less governmental interventions in the market place and attempting to achieve fiscal equilibrium. In summary, the code word is competitiveness.

On the governmental support side, many governments in the region are currently pursuing fiscal equilibrium, which reduces the availability of public resources for price support programs. Furthermore, under democratic regimes, new demands from different social groups must be attended to, further reducing the availability of resources and, under transparency laws, budgetary items must be supported by larger segments of society represented by elected officials. Price support programs are less likely to continue in the future under the new public sector structure in many countries in Latin America, where governments have become more a provider of public goods and less an investor and direct supporter of private sector activities.

The market structure of the coffee sector globally is another factor contributing to lower rates of profitability and large differences between prices paid to coffee producers and prices paid by final consumers. Similar to a pyramid, the global coffee market structure has many producers at the base facing high levels of competition and much lower numbers of intermediate agents, exporters, processors and importers who face less competition, and thus, more market power. Theoretically, an agreement between producers with established production and export quotas could be used as a tool to increase market power at the base level. However, economic theory tells us that these types of agreements are very difficult to implement and enforce, especially when their successes result in higher prices, creating incentives to members to

[5] Sachs, Ignacy, 2000, "The Preeminence of the Social: Bridging the Gap between the Ethical Discourse and the harsh Practices of the Market-led Growth," International Meeting on Ethics and Development, Inter-American Development Bank, Washington D.C., December 7 and 8, 2000.

increase future production.  Given these constraints, one should ask what could be done to stabilize prices and to assure the long-run feasibility of coffee production in Latin America?

One alternative to be exploited is to reconcile the social and environment goals.  To generate jobs and to contribute to the protection of the ecosystem.

A good example of the concept of development targeted in social and environmental gains is the association of coffee production with protection of the current biodiversity.  On the social side, coffee represents the main source of income for millions of small farmers; on the future generation side, sustainable coffee production protects the environment, thus contributing to biodiversity conservation.  The question is: How can we reconcile these two goals?  In other words, how can we generate and increase income to producers and, at the same time, protect the environment?

An important task in order to improve profitability is to invest in research and technology aimed at increasing productivity and quality of coffee production.  However, productivity increases - while important in reducing production costs - could also accentuate the problem of higher production and result in downward pressures on prices.  To avoid this problem, it is fundamental to increase demand for the sector.  Besides the efforts to increase consumption of coffee as a beverage, it is highly desirable to increase investments in research for alternative uses of coffee.  For example, it has been argued that caffeine may have useful medical applications.  The role of governments and multilateral institutions, directly and indirectly, is likely to be helpful in this area.

The adoption of a cooperative model of production following the general structure of the Colombia experience could both decrease production costs as inputs are bought on a large scale and reduce the number of intermediate agents, thereby increasing the share of final consumer expenditures received by producers.[6] Additionally, alternatives could be explored in smoothing income across time. For example, analogous to Ando and Modigliani's "Life Cycle Hypothesis of Savings," a fund could be created to save in good years and invest in assets to be sold to complement member incomes in bad years.[7] Given the sophistication of financial markets in the world, income saved in good years could be invested to generate gains to offset losses in bad years.

In this context, the Inter-American Development Bank will continue to lend support to governments in the region as they consolidate their economies on the basis on increased efficiencies and competitiveness. Furthermore, the Bank has attached high priority to reducing poverty and decreasing economic and social inequality in the region. Therefore, programs and policies that have a positive impact on small coffee producers, promote employment, and raise income levels of the poor are well within the scope of the Bank's priorities. The Bank has also voiced its support for environmentally friendly projects, and it is open to projects that focus on sustainable development.

The Bank's history in Latin America also allows it to work across countries, coordinating policies and efforts for collaborative work, designing and implementing agreements that are beneficial to all members. The Bank has also accumulated experience and human capital in many areas of expertise that could make a positive contribution to the coffee sector in Latin America.

In summary, coffee production has been and will continue to be for a long time an important economic sector in Latin America. The history of this sector is intimately linked with

[6] It is important to note that production costs in Colombia are higher than in many other countries due to locational factors and high transportation costs. However, in the absence of a cooperative model, total production costs could have been even higher.

the region's economic and social development. Despite current problems, the sector can and should consolidate its position as a major player in the region. The Inter-American Development Bank, as in the past, continues to support programs and projects that advance the pursuit of economic and social development in the region.

[7] Ando, A.K. and F. Modigliani, 1963, "The 'Life-Cycle' Hypothesis of Saving: Aggregate Implications and Tests", American Economic Review, 53, 55-84.