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2nd World Coffee Conference– Session II

Coffee Polices in a Market Economy: A Perspective from the Common Fund for Commodities

by

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23-25 September 2005
Hotel Pestana, Salvador, Bahia, Brazil

Mr. Chairman,
Excellencies,
Distinguished Delegates,
Ladies and Gentlemen

May I begin by joining previous speakers in welcoming you all to this important international Conference and thanking the Government of Brazil for hosting it and for the kind hospitality extended to all delegates. Every time I come to Brazil I am overwhelmed with the warmth and generosity of its people and hospitality of its Government. This Conference could not have been hosted at a more opportune moment than now especially when the international community is concerned with global strategies for poverty reduction. We all know how critical incomes derived from production and trade of commodities are for a large proportion of rural populations in developing countries and for the revenues and foreign exchange earnings of the Governments of those countries.

Before I get to the main topic of my presentation today may I take few moments and briefly introduce to you my organisation, the Common Fund for Commodities.

Mr. Chairman,

As you all know, the Common Fund for Commodities is an Intergovernmental Financial Institution established within the framework of the United Nations with a specific mandate to support developing commodity dependent countries in their efforts to improve and diversify their commodity production and trade, thereby increasing their export earnings as well as sustain their real incomes. It is the only International Financial Institution in the world dealing exclusively with commodities. Currently 106 countries are Members of the Common Fund, including our host today – Brazil, plus the European Community (EC), the African Union (AU) and the Common Market for Eastern and Southern Africa (COMESA) as institutional Members. The main functions of the Common Fund, include:

1. To improve access to markets and reliability of supply for primary products and the processed products thereof;
2. To expand processing of primary products in developing countries with a view to promoting their industrialisation and increasing their export earnings through moving up the value addition chain including packing for the consumer markets;
3. To improve the competitiveness of commodities and enhance the cost effectiveness of commodity production;
4. To improve marketing, storage, financing, distribution and transport systems for commodity exports of developing countries, including an increase in their participation in these activities;
5. To improve market structures in the field of commodities of export interest to developing countries and to address market failures;
6. To broaden the range of exportable commodities and their respective chains;
7. To encourage the corporate social responsibility of multinational and national companies engaged in the commodity sectors;

The Common Fund supports projects that contribute to reducing the economic imbalance between developed and developing countries. These projects should assist in making commodity chains efficient and assist with diversifying commodity production and trade. We also seek to improve quality and productivity in a sustainable way. It is our aim to develop predictable conditions in the commodity trade.The Common Fund finances projects through grant finance, loan finance or a combination of both grant and loan finance. For further information on role and operations of the Common Fund, please refer to our publication "Common Fund for Commodities: Partner in Sustainable Development – Basic Facts", copies of which are available at the document table.

Mr. Chairman,

The reduction and, in the long term, the eradication of poverty is the cornerstone of the sustainable development programme which we are all working on, encapsulated by the UN-inspired Millennium Development Goals (MDGs). There is no simple solution to deal with poverty eradication but since poverty is more prevalent in commodity-dependent developing countries and especially in rural areas, where over 70 percent of the poor live, it is evident that eradication of poverty and a solution to commodity problems are closely intertwined. One cannot effectively address poverty without addressing the commodity *problematique*.

Indeed, commodities are still the backbone of the economies of the majority of developing countries. Out of the total 141 developing countries, 95 depend on commodities for at least 50 percent of their export earnings. Coffee is a classical example of such commodity-dependency representing, for example, 75% of the total exports of Burundi and 54% in Uganda, and about 22% in the case of Nicaragua, Guatemala and Honduras. About 20 to 25 million families produce and sell coffee for their livelihood

There is no doubt that coffee plays a central role in the economies of many developing countries and the Common Fund is cognisant of it and in fact it is the leading commodity benefiting from CFC funding. The Common Fund has so far supported 24 projects (15 regular and 9 Fast Track projects) in the coffee sector with a total cost of USD 68 million of which CFC has provided USD 37 million with USD 27 million as grant and USD 9.7 million as loan. The measures and actions supported by the Fund in the coffee sector cover areas such as production and productivity improvement, value addition, finding new markets, introducing new trading systems, improving access to finance through structured trade finance and piloting innovative credit schemes.

Mr Chairman,

It is a well known fact that coffee is the second most traded commodity after crude oil and all along its market has been subject to considerable intervention. At the international level, various supply control schemes have been attempted with the main objective of price stabilisation. We all know that success in that endeavour could not be realised as was evidenced by the collapse of the International Coffee Agreement in 1989 and the ineffectiveness of the Association of Coffee Producing Countries. At the domestic level, various policy measures and reforms have been undertaken by producer countries aimed mainly at helping producers survive periods of low prices. Policies in this regard constituted various levels of state intervention including selling of coffee through marketing boards. Under state controlled marketing system, commodity producers were guaranteed prices by the state and the provision of inputs, finance, quality control and extension services were the responsibility of the state. However, in due course, state intervention proved inefficient and bureaucratic and the role of the state in many countries have been rolled back ushering in a liberalised commodity sector consistent with the dictates of free market economy, leaving the state with a regulatory role only. It seems the crisis through which coffee is currently undergoing, manifested through price decline and volatility, is mainly due a lack of supply control mechanism which would ensure a proper balance between supply and demand in an international framework. In these circumstances, it is difficult to determine the correct domestic policy response to price volatility since domestic policies in producer countries are sensitive to international developments and to be effective such policies must be synchronised with an agreed international regime.

Mr. Chairman,

Given the foregoing background, it is clear that the international community is faced with a major challenge needing innovative initiatives to manage the coffee sector in the current international market economy. Let me now address some of the major persistent commodity problems which need to be addressed for reducing poverty and accelerating development, with special reference to the coffee sector, and with possible recommendations for international action.

<u>Marketing Chain</u>

An efficient marketing chain from the commodity producer to the consumer is essential. A good measure of **competition in the marketing chain will increase the possibilities for producers** to obtain a reasonable share of the price paid by the final consumer. However, currently market concentration is a recurrent feature in the commodity chain, and coffee exemplifies this situation. The current value of coffee retail sales amounts to USD 70 billion, but coffee producing countries only capture USD 5 billion of this value, with the bulk of revenues from the coffee trade retained by developed countries. Coffee farmers in producing countries only obtain a fraction of the final retail price of coffee. A recent Oxfam research showed that Ugandan coffee farmers only get about 2.5 percent of the final retail price of their coffee in the UK market.

On the other hand, it is also important to highlight that increasingly the non-coffee components included in retail price of coffee, such as wages, packaging, and marketing, have grown and represent a significant share of the final price. Nevertheless, **small-scale farmers need to be assisted through the strengthening of their association and/or organisations** so that they could export their products directly or have more bargaining position when marketing their products. It would also be important to adopt strategies to foster means by which farmers could make direct links with buyers in consuming countries.

<u>Diversification and Value Addition</u>

Resources have to be mobilised to support **actions towards diversification into non-traditional agricultural exports and adding value** by exporting processed products. Strategies should contemplate assisting regions with a high concentration of marginal coffee producers to diversify into other commodities. This is particularly important in the case of coffee farmers unable to differentiate their products or compete on price. This involves introducing new high-value "product niches" such as fruits and vegetables, or ornamental plants. In Kenya, for instance, after the adoption of a diversification strategy, exports of fruits, vegetables and cut flower have become the second biggest source of foreign exchange. The Common Fund recently approved a pilot project, in the amount of USD 4.4 million, which will finance the diversification of low-altitude coffee farmers in the State of Veracruz, Mexico to sustainable production systems introducing products such as vanilla, flowers, and pepper.

Farmers could also be assisted to diversify their coffee production by adding value, such as roasting and grinding, to capture a higher market premium on their product. There is no reason why coffee producing countries should not be assisted to build manufacturing capacity to enable them add value to the commodity so that they sell ground coffee rather than allow green coffee beans travel half the globe to be ground elsewhere where more value is reaped. Producers could also be helped to **diversify into differentiated and more remunerative markets such as**

geographic indications of origin, specialty, organic, fair trade, eco-friendly and other certified products. Of course, this market is small and producers would need to be assisted in the certification process. One clear example of such vertical diversification is Jamaica's regionally specific Blue Mountain coffee.

Addressing the issue of commodity diversification could be done through the establishment of the **International Diversification Fund**, as proposed by the Meeting of Eminent Persons on Commodities, empanelled by UNCTAD, to assist developing countries in vertical and horizontal diversification. The Diversification Fund could be operationalised under existing institutions such as the Common Fund.

<u>Commodity Price Decline and Instability</u>

As you all know, one of the original objectives of the Common Fund was the financing of international commodity buffer stocks, but for well-known reasons this arrangement has not been operationalised. It is still necessary to find a workable solution to the persistent problems of price decline and volatility. On average, since 1970 coffee prices had a 3 percentage per year decline for arabica coffee and 5 percent for robusta. Nicaragua provides a clear example of the effects of the impact of coffee price decline. Between 1998 and 2001 poverty levels increased by more than 2 percent among coffee farmers. Ethiopia is another stark example. The slump in coffee prices led to a 6 percent fall in Ethiopia's real income.

Probably the consistent decline in commodity prices is the most challenging task faced by the international community in the commodity sector. While the current price situation is positive, we cannot say that we have finally resolved the issue of price decline and instability and thus we need to seek solution for this problem. In the short-term, **market-based price and weather risk management schemes** could offer partial reprieve. These schemes could help farmers manage the risk of falling prices on global commodities markets through the use of derivatives (futures and options). However, farmers in developing countries have very poor access to these instruments. In this context, the Common Fund and the World Bank have initiated activities to combine efforts on price risk management in East Africa to explore new, market-based, approaches to assist developing countries to better manage their vulnerability to the volatility of commodity prices. In this regard, the Common Fund has price risk management projects under implementation on coffee, cotton and cocoa.

The debate on commodity price could also be assisted with the **implementation of the proposed International Task Force on Commodities (ITFC)**, as agreed during UNCTAD XI. The ITFC could serve as an important multi-stakeholder mechanism to provide guidance for building on existing and emerging co-operative initiatives and activities and helping to generate new ones to find practical solutions with regard to the commodity prices. In this regard, and to supplement the multi-stakeholder approach by the ITFC, the Common Fund intends to undertake regular **multi-stakeholder consultations** on major commodities on a commodity-by-commodity basis to determine how best the interest of producers, consumers and other relevant stakeholders are taken care of. These innovative consultations could provide the right mechanism by which to tackle the persistent coffee price fluctuations and perhaps the WTO could also provide a useful negotiating forum on commodity prices like coffee.

<u>National and International Support Measures in a Liberalised Economy:</u>

For commodity producers to become more competitive, the developing countries would need to **adopt appropriate production and processing technology, improve infrastructure (road,**

ports and communications), enhance human resources and identify market niches. Actions on these would make commodity production and trade competitive for domestic participants and create a level playing field over time. Government support is vital to establish reputation for **quality and reliability and to promote capacity building for facing new trade barriers: sanitary & phytosanitary (SPS) constraints, technical barriers to trade (TBTs)**, etc. The Government could also play a stronger role in reducing the connectivity gap, in particular by improving the use of **modern information technology to access and disseminate market information.**

The world has witnessed a diminishing role of the State, which increasingly had its role altered to that of a regulator, facilitator and creator of enabling environment which would encourage emergence of dynamic economies based on market led private initiatives. In this context, it is important to underline **the role of the private sector**, without sidelining the role of the State. Commodity initiatives have to be undertaken in conjunction and with the support of the private sector. In this regard, an important initiative refers to **national consumption promotion**. With depressed commodity prices, Governments should take the lead in promoting domestic consumption of locally produced commodities. Brazil is well known for being in the forefront of such initiatives with regard to coffee. In 1992 Brazil initiated a demand promotion programme for coffee which led to an increase in per capita national coffee consumption by more than 40 percent. In the same vein, we could also undertake **measures to expand market for coffee in China, India** and other potential markets in the South.

At the same time, it is important to point out that, at the level of the international community, one of the major obstacles to tackle the commodity *problematique* remains the lack of political will and resources towards the agriculture and commodity sector. Between 1990 and 2000 donors had cut by more than half the amount of resources earmarked for agriculture and the commodity sector in their official development assistance (ODA). The figure earmarked for agriculture has come down from USD 16 billion in 1980/1981 to USD 8 billion in 2000/2001. Very few projects in support of commodity services, such as storage, marketing and finance, have been reported in recent years. If the international community aims to meet the agreed international commitments it would need to **reverse the current trend in ODA, and allocate more resources to agriculture and commodity development measures**. In this regard, although with limited resources, the Common Fund has been an active partner of International Commodity Bodies to implement commodity development projects and it could do more if more resources were made available. This is why there has been an increasing demand expressed in many international fora dealing with poverty reduction that the resources of the Second Account of CFC be augmented.

<u>International Trade Measures in a Globalised World</u>

The nineties saw the emergence of a rule-based world trading order with the Agreements negotiated under the auspices of World Trading Organisation. This marked the arrival of the globalised free market. We all know that markets are neither fair nor free. On the one hand is the consolidation of market power in the hands of few large trading companies and on the other is the requirement of meeting the stringent conditions of entering markets directly such as quality, meeting the sanitary and phyto-saniatry requirements and burden of escalating tariffs as one moves up the value chain coupled with trade distorting subsidies given in developed countries. It is important to bear in mind that while it is rational to insist on a “level playing field” in the international trading system, yet the players in the system are not equal. It is imperative, therefore, to insist that **better trading arrangements in favour of developing countries through the provision and implementation of special and differentiated treatment measures and a predictable regime of technical assistance** be put in place to enable these countries to take advantage of the globalised economy. This would enable the producers from developing countries to embark on a path of sustained participation in new international trading system. The commodity coffee highlights well the double standards of the current trading system. While the major coffee roasters have increasing profit margins, only 6 percent of the price of a coffee bag sold at a supermarket reaches coffee farmers.

It is also important to note that the geography of trade is changing with increasing demand for commodities in and between the developing countries. The expectation is that, as their income levels rise, demand for commodities in developing countries will show a remarkable rise, as exemplified in the current case of China. Thus, sub-regional, regional and **South-South trade** will become more important. In this context, **more advanced developing countries should also play their share and assist least developed countries facilitating market access and technical assistance**. For example, the CFC project on the prevention of coffee mould formation, which is holding a dissemination Workshop at this same venue tomorrow, is a good example of South-South co-operation as it involves the sharing of knowledge of Brazil and Colombia with Kenya, Cote d'Ivoire, Uganda, India and Indonesia.

It is also important to highlight that this Conference is being held at the time when record high oil prices are being reported in the international oil market. **Increased oil prices on non-oil producing countries, especially least developed countries (LDCs),** will most likely affect the production costs of major commodities, including coffee. As you may know, the Common Fund also plays a role in the energy issue through projects which seek to enhance the use of commodity-based alternative energy sources, such as sugarcane ethanol and co-generation from bagasse. Relevant stakeholders may wish to examine the impact of the energy crisis on the coffee industry.

Mr. Chairman,

There is no doubt that this Conference is meeting at a time when the prospects for the coffee industry are not at their brightest and solutions must be found to address the crisis. I hope that the recommendations and concrete actions I mentioned above could serve as inputs to the discussion on solutions for the way ahead with regard to the commodity sector in general and coffee in particular. I would like to conclude with a fervent hope that the deliberations of this conference will identify feasible and implementable measures and actions. The Common Fund and the International Coffee Organisation will continue working together in identifying the priority areas for coffee development and we hope that the deliberations of this Conference will contribute towards making the commodity coffee, fair better in the globalised market economy.

I thank you for your attention.