

# **GABRIEL SILVA<sup>1</sup> PRESENTATION TO THE II WORLD COFFEE CONFERENCE**

**SALVADOR DE BAHÍA, SEPTEMBER 25 2005**

## **THE PAST COFFEE CRISIS**

- The past coffee crisis left many producing countries in misery. Highly dependant countries from coffee exports income almost reach economic collapse.
- The poverty caused by the crisis increased unemployment in rural areas and exacerbated migration to urban centers, increasing insecurity and causing social unrest.
- In Mexico's coffee growing regions of Chiapas and Veracruz, as well as in Colombia, peasants reported high levels of displacement and illegal migration to the United States as a result of unemployment.
- In El Salvador the drop in coffee prices left more than 50,000 coffee workers unemployed.
- The coffee crisis tested coffee institutions from producing countries and those which were unable to respond to the crisis disappeared, abandoning coffee farmers to their own sake.
- Colombian coffee farmers had to fight back economic and ideological pressures that conspired to demolish their key institution, the Federation. Without it, the coffee crisis would have devastated our entire coffee sector and would have caused irreparable social damage. The

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governments provided help to farmers by the means of income support policies, improvements in productivity via renovation of coffee plantations, financing scientific and technical research and providing mechanism towards debt relief. Those measures were not handouts. It was a package of measures aimed at giving back a minimum portion of all of what coffee had give to the country. And even more important, it was a new policy paradigm aimed at supporting structural transformation of Colombia's coffee sector.

- Just to mention one of the results of these policies, the renovation strategy brought the average tree age from seven to five years. Thanks to these efforts we were able to maintain our market share, increase productivity by 45 % and coffee farmers received over 700 million dollars of additional income between 2002 and 2004 as a result of efficiency gains. No one can argue that Colombian farmers gave their back to market forces.
- We have to acknowledge that domestic policies in some producing countries also exacerbated the crisis by implementing expansionist strategies. The end of the regulated market was met with unrestrained euphoria that lead to higher volumes of production associated with increasingly lower revenues. Unfortunately, existing distortions did not allowed for an efficient transmission of those benefits to the final consumer. Between one end and the other of the coffee chain someone else different than the producer and the consumer was able to capture most of the margin expansion associated with increased production. Certainly, the crisis taught us that in the absence of deliberate policies, there is a significantly asymmetrical distribution of productivity gains achieved by immense sacrifices at the producers' level.

- An important lesson of the crisis was the collapse of two opposite market models. On the one side, a model that controlled the market by limiting the export volumes which also caused market distortions, and on the other hand, the collapse of the free market model, with no restrictions at all that was unable to provide the level of income required to sustain producers.
- Other important lesson from the past crisis is that in rural and fragmented economies it is essential to create competitive advantages through based on institutional collective saving instruments.

## **WHAT IS NEED TO BE DONE TO FACE FUTURE CRISES?**

- What is clear from the uncertainty and volatility observed lately in the markets is that the crisis has not ended. Actually, domestic prices in Colombia have just reached the nominal levels seen earlier in the decade. And if some of the predictions mentioned in this Conference turn to be right, the modest relief seen in the last two years is going to be ephemeral.
- That scenario is unacceptable. Another plunge in prices will certainly mean a definitive collapse of most of the coffee economies, including ours. I don't agree with those that think that the global coffee industry is better-off with a producing world with very few high yield producers of low-quality, undifferentiated and commodity coffees. If the issue is sustainability, the first priority is to guarantee long-term average domestic minimum price levels equivalent to one dollar per pound.
- Coffee growers are today at the mercy of a constellation of variables that deeply affect their livelihood and over

which they have little or no influence. Currently, speculative interventions in the commodity markets by investment funds have added volatility and uncertainty to the coffee market. Sophisticated portfolio and risk management from those funds have become a driving force, sometimes, with more influence than that provided by longer term market fundamentals of supply and demand.

- Speculative capital and excess liquidity in consuming markets, due to unrestrained fiscal policies in major economies, have led to currency appreciation in almost all producing countries. Coffee growers are being punished by the monetary and fiscal trigger-happy policies in the U.S. and Europe. Global macroeconomic trends are hitting us with a dual negative impact: weakened international price and less income in local currency.
- In addition, commodity funds have been switching their positions from coffee to oil, providing the market with a tidal wave of liquidations that pushes coffee prices down. Also, the boom of oil prices is affecting the competitiveness of coffee cultivation by incrementing the cost of fertilizers, energy and consumer goods.
- We must be cautious in accepting the fact the coffee crisis has ended, because otherwise we could enter in an optimistic mode that could stop our combined efforts to face the crisis and therefore increase our vulnerability. Producing countries always have been tempted by the idea of taking separated courses of action when the market starts to show positive signals.
- That happened in the past when the lack of coordination and excess of ambition triggered an oversupply with the erroneous idea that the plunge of coffee prices could

somehow be compensated by big export volumes. Fortunately, we witnessed yesterday the Heads of State of Brazil and Colombia, President Luis Ignacio Lula Da Silva and President Alvaro Uribe Vélez, expressing their strong political will to put in place any additional measures required to ensure the economic viability and social sustainability of our coffee growers.

- What we need to ensure is the sustainability of the current price recovery. That is a significant undertaking, but there are market oriented mechanisms that could allow us to make progress in that direction.
- How can we achieve that objective?
- Price sustainability is achievable by producing countries acting in a cooperative and coordinated manner.
- Cooperation and coordination should cover a wide spectrum of topics starting with concerted domestic production and income support strategies as well as more day to day issues such as the provision of fundamental information to the market, such as crop estimates.
- With better cooperation and coordination, producing countries can strongly influence the market and face a price crisis more adequately. Recent examples of domestic policies implemented by producing countries, like Brazil, the market oriented retention plan via the option system, or the value added policy that we are currently undertaking, could be instrumental for the defense of farmers' incomes if they are implemented within the framework of cooperation and coordination.

- The other component is readiness. Emergency measures and policies designed in the mist of the crisis tend not to be as effective because of insufficient international coordination as well as due to improvisation. We need to guarantee that we will have the battery of weapons in place way in advance of the arrival of renewed threats. Therefore, we wish to propose to the ICO to conduct a global seminar to evaluate the different and specific frameworks used by all of us, comparing the impact of such measures for the purpose to sharpen prescriptive recommendations.
- As President Lula said yesterday “the reorganization of the market is a chapter in the fight towards equitable trade in coffee. This can represent the difference between dignity and misery”
- President Uribe also said that “we have to do whatever is necessary to sustain the incomes of coffee farmers”
- We are not proposing a comeback of regulated supply or administrated markets. Today that scenario is not feasible, but coordination between producers, definitively can impact the performance of prices without rampaging the operation of free markets.
- What is true is that domestic stabilization policies are not always enough. They certainly have an impact but are not fiscally sustainable in the long run, particularly if collectively we are not capable of having a durable impact in the markets. Cooperation and coordination efforts must go beyond borders.

## **WHAT SHOULD BE THE ROLE OF CONSUMING COUNTRIES?**

- In the past crisis, consuming countries and their governments did not make substantial efforts in the front of generic promotion of coffee consumption. Some in the industry took the lead and we need to highlight the very positive long-term impact of new formats such as Nesspreso, Pods, certainly the Starbucks revolution and many others innovations. But that is not enough to achieve the levels of consumption growth required to achieve the threshold of sustainability.
- Some actions have been taken, like the *National Coffee Association* campaign to promote coffee consumption in the United States through the dissemination and funding of studies on coffee and health. Some other successful efforts have been undertaken by the ICO.
- In general, producing countries have borne the responsibility of promoting coffee consumption by providing funds and marketing plans. However, those efforts have clashed in many occasions with the stubbornness to keep up tariff and non-tariff barriers to coffee.
- We as producing countries should be audacious and invite consuming countries to develop a much more aggressive strategy to foster consumption. We should create, with the auspices of the ICO, a significantly wider Consumption Promotion Fund, structured as a matching mechanism inspired in co-responsibility. For example, Colombia is prepared to feed that fund with one equivalent bag of coffee for every bag, or the equivalent market value, contributed by the industry and by producing and consuming countries. The fund could focus on the generic promotion of consumption in new and emerging markets and in conquering the palates of billions of potential new customers.

- Governments and private sector from the consuming segment should come up with mechanisms oriented to the promotion of coffee consumption in their markets by the elimination of barriers, particularly to those which affect value added strategies from coffee producing countries.
- As was expressed by Minister Rodrigues in his speech yesterday: “one of the most efficient ways in which to add value to coffee is by exporting industrialized products, both soluble and roasted. However, imports of industrialized coffee are subject to tariffs in the world’s main consuming markets”
- We are seriously concerned with the strengthening of protectionist trends. Let me offer various examples of that. The OTA case in Germany and afterwards in the European Union, which regulated in a discriminatory manner the maximum limits of OTA in roasted and soluble coffee. Wrapped in the food safety flag, USA and EU and others are implementing unacceptable and subjective trade barriers.
- This sort of neo-protectionism is not helping producing countries to gain access to consuming markets and is affecting the benefits of globalization for coffee farmers.
- Likewise, other initiatives, apparently guided by the share responsibility of consuming countries, attempt to give support to producing countries by the establishment of sustainability based codes of conduct. We have to be clear on that. The codes of conduct must be balanced in the rights and obligations of the parties involved. Must not be burdensome for producing countries, and must not affect the overall competitiveness of coffee cultivation.

And more importantly cannot be a disguised barrier to trade.

- When we watch those discussions unfolding, it is as if the least relevant aspect of sustainability was a decent income for farmers. Let me assure you that Colombia will object to any approach that does not guarantee in an explicit manner that the industry will provide the means to growers to achieve the investments required to match the standards and that they are remunerated accordingly.

## **GLOBALIZATION AND COFFEE**

- What we have witnessed is that all the burden of the past coffee crisis was placed at one end of the coffee chain. While producers were in a struggle to survive as the prices plunged, the consumer side gained market concentration and better profitability. Most of the efforts of producing countries to increase productivity and competitiveness were in swallowed by the actors beyond borders.
- This imbalance is a reflection of the asymmetry of globalization which is not contributing to the sustainability of the coffee economies. As Stiglitz mentioned during the first World Coffee Conference: “Everybody believes in the principle of no subsidies, except in their own industry. Everybody believes in the principle of competition except in their own industry”.
- In reality, there is an uneven, disparate and unbalanced capability to capture the benefits of Globalization. The political economy of world markets has turned brutal. While large actors, such as multinationals and exporters, have the resources and the organizational tools to benefit along the different profit points of the market,

segmentation and other barriers limit the potential for less powerful participants.

- Coffee producing countries will be condemned to poverty if they do not generate the ability to capture rents beyond the coffee fields.
- If the formation of prices, and the capture of income in the global coffee markets passes inevitably through the derivative financial instruments, and the destiny of the producer of the physical good – the coffee beans- is determined as well by the intangible and arcane scenario of the futures markets, it is our duty to develop the institutional and financial tools to allow the coffee producer to participate actively in those markets; for both hedging their income and profiting from the volatility induced by the speculative actors.
- Instead being passive victims we should be prudent but active players, with the goal of maximization of coffee growers' income.
- This means in practical terms the following initiatives:
  - We will create a domestic coffee futures market in association with the Bolsa Nacional Agropecuaria to combine protection from price volatility with protection against exchange rate and differential volatility.
  - We will create an investment fund facility to participate in an organized manner in the coffee futures market. The fund will receive 500 million US dollars in resources to be invested in hedging operations for coffee.
  - We will leverage some government support budgets for income support through the structuring of OTC instruments.

- The balance of rights and obligations between producing countries and consuming countries must go beyond the coffee sphere. There are many ways to respond to the crisis of commodities, and one of them is by providing the suitable conditions which encourage alternative income to farmers.
- Those proper conditions must derive from the elimination of all forms of distortions that currently persist in developed countries
- Colombia and Brazil have worked together over the past 20 years in the GATT/WTO system to seek market oriented agricultural trade. The lack of engagement of developed countries in the current Doha negotiations has made the negotiations to fail in the objective of achieving further reforms in agriculture.
- How producing countries can be criticized by promoting policies to sustain the income of farmers, while consuming countries dump the markets with highly subsidized agricultural products. How producing countries can promote alternative development policies to diversify its agriculture, if their products cannot compete with the distortions caused by thousand of billions of dollars of exports subsidies and domestic support from the developed world?
- I hope this presentation was able to transmit a simple key message to our colleagues and friends. The task is immense but the solution is simple: we need to defeat indifference and enhance mutual responsibility. Thank you very much.