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**Lessons from the world coffee crisis: A serious problem for sustainable development**

A copy of the Executive Director's submission to UNCTAD XI Conference, "Lessons from the world coffee crisis: A serious problem for sustainable development" is attached. The Conference took place from 13 to 18 June 2004 in São Paulo, Brazil.

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# LESSONS FROM THE WORLD COFFEE CRISIS: A SERIOUS PROBLEM FOR SUSTAINABLE DEVELOPMENT

*Submission to UNCTAD XI, São Paulo, Brazil, June 2004*
*by Néstor Osorio, Executive Director of the International Coffee Organization*

## The coffee price crisis

The world coffee economy has evolved over the last few years in a manner which may be qualified as erratic, disorderly and even contradictory. The relative supply scarcity of the mid 1990s, caused largely by climatic conditions, was followed by a short period of moderately high prices that compensated for the losses incurred by the dismantling in 1989 of the International Coffee Agreement's quota system. However this situation prompted a surge in production that altered substantially the global supply structure and was the cause of the worst coffee crisis ever seen in terms of growers' incomes.

In contrast, the evolution of the coffee economy in importing countries has shown a completely different and in fact very positive pattern. The industry has flourished, new products have been developed, the value of the retail market has more than doubled, and profits have risen. This is something to celebrate, but the question must nevertheless be asked as to how long such a state of affairs can be sustained. Coffee farmers have shown enormous resilience and one way or another most have managed to survive and continue to produce. But not all and not at any cost. It now seems likely that, if ways are not found to improve trading conditions in producer countries, this precious commodity, and what is worse, the human beings who grow it, will progressively decline to the point that, in a not too distant future, there may be insufficient coffee and certainly an insufficient quality range of coffee, to trade and to drink.

The adversity endured by coffee growers in Africa, Asia and Latin America has also been encountered in other agricultural commodities originating in developing countries. In fact the drop in earnings from these commodities constitutes one of the most important causes of world poverty. This was clearly stated in November last year by the Deputy Secretary-General of the United Nations in a statement to the General Assembly, when she pointed out that "the decline in prices for commodities such as coffee, which now receives roughly a third

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of the prices that prevailed in the mid-1990s, contributes to increased poverty and makes it more difficult to reach the millennium development goals. Lower revenue from coffee exports has also endangered the HIPC initiative (for Heavily Indebted Poor Countries)." Several studies coincide in assessing the fall in prices of the major agricultural commodities as between 50 and 86 per cent in the last 20 years, with coffee showing the greatest fall. Certainly the figures for coffee are clear: in the late 1980s and part of the 1990s earnings by coffee producing countries in terms of exports f.o.b. were around US$10-12 billion per year but they have now dropped to around US$5.5 billion. This contrasts with the continued growth in the value of retail sales in consuming countries from around US$30 billion in the 1980s to around US$80 billion at present.

This loss in income has had a significant impact on the economic and social life of many developing countries. The governments of Member countries of the International Coffee Organization (ICO) have reported[1] on the impact on poverty of the coffee crisis and referred specifically to the economic, social and environmental consequences as follows:

*Economic*

Abandonment of farms, widespread loss of jobs, reduced fiscal revenue, knock-on effect on other economic sectors, reduced export earnings (*Cameroon, Central African Republic, Côte d'Ivoire, El Salvador, Ethiopia, Nicaragua*).

*Social*

Migration from the countryside to cities, emigration abroad, less money available for health care and education, increase in households living under the poverty line, increased incidence of malnutrition, increased indebtedness, growth in illicit crop production (*Cameroon, Central African Republic, Colombia, Costa Rica, Ecuador, El Salvador, Ethiopia, Nicaragua, Papua New Guinea, Vietnam*).

*Environmental*

Abandonment of shaded plantations, often representing small remaining forested areas; cutting down shade trees for timber (*Ecuador, El Salvador, India*)

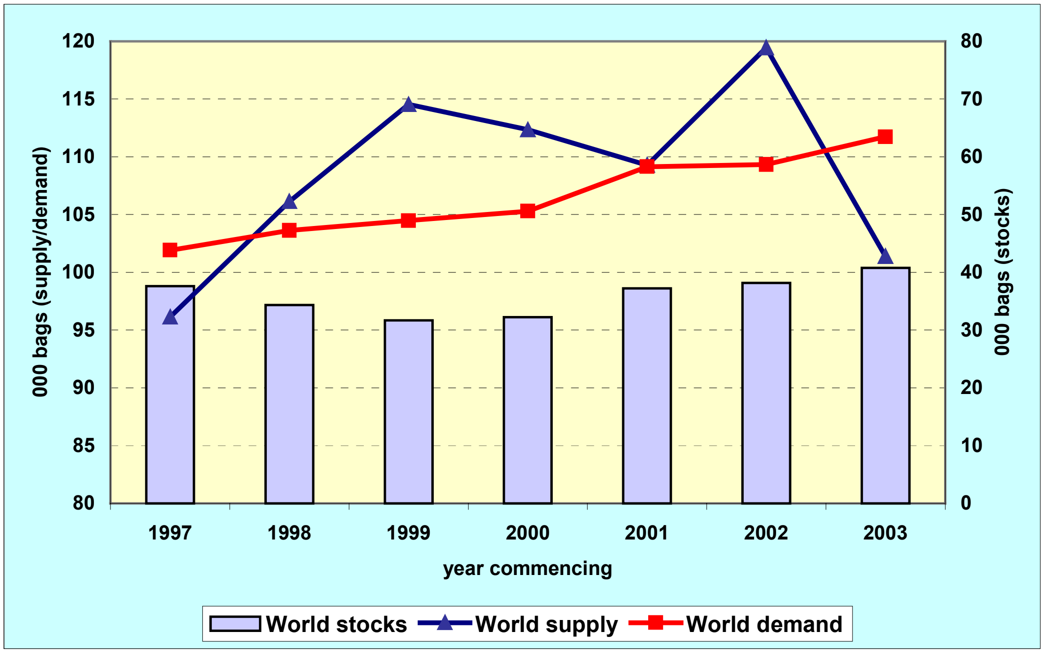
In general a number of countries have made it clear that the coffee crisis has been disastrous for their economies.

**Causes of the crisis**

Essentially depressed coffee prices have been caused by five consecutive years (1998/99 to 2002/03) in which total coffee production has exceeded demand, as illustrated, together with the effect on prices, in the graphs below.

[1] *See ICO document ICC-89-5 Rev. 1 for full details.*

## WORLD SUPPLY AND DEMAND FOR COFFEE




## WORLD COFFEE PRICES

Increases in production have been particularly important, for a number of reasons, in Brazil and Vietnam and, although the current 2003/04 crop year shows production as inferior to demand, fears that this situation will not last into 2004/05 coupled with the existence of significant carry-over stocks, have led to only a very modest rise in prices relative to the lowest levels reached.

**The search for sustainable solutions**

In looking for solutions it is crucial to understand that there are severe constraints in many coffee-growing areas for alternative economic activities arising from environmental and infrastructure factors, the perennial nature of the coffee tree requiring typically a 3-4 year lag between planting and initial cropping, and because of limitations on market access for otherwise viable alternatives.

During almost three decades in the last century there was a consensus between producers and consumers on the need for agreements and rules aimed at achieving an orderly market and equitable coffee prices, with guaranteed supplies for the coffee industry. This consensus, generating specific measures implemented through the ICO, was a means of reducing poverty in developing countries dependent on a handful of commodities, improving their share in world trade and, ultimately, contributing to the construction of peace.

In the last 15 years this consensus was replaced by the fashionable doctrine of liberalization. Although promoted as a means of increasing farmers' revenues this proved in many but not all cases to be a serious blow to producers of coffee and other tropical products, and their vulnerability was clearly exposed. Ironically at the same time as the abolition of institutional support was being advocated, the developed countries were strengthening the defence and support of their own agricultural product sectors, mainly for political and social reasons but in some cases to ensure the continued availability of speciality products.

This new approach has helped to accentuate the commodity-dependence of many developing countries, particularly since diversification options are frustrated in view of the difficulty of access to markets for other agricultural and industrial products. For this reason if a market-oriented approach is promoted as ultimately the best way to secure optimal resource allocation for commodities it must be consistent by also promoting the removal of the non-market-oriented protectionist measures used in too many countries which curtail market access and hence diversification options for coffee producers. This is one of the reasons why a successful conclusion to the Doha Round is so important.

Sustainability is a term that is heard in more and more contexts in recent months. The International Coffee Organization under the International Coffee Agreement 2001 aims to encourage Members to develop a sustainable coffee economy. The ICO is also encouraging efforts to create a degree of coordination between several initiatives currently addressing sustainability in coffee and will promote this goal within the context of UNCTAD'S proposed International Task Force on Commodities (ITFC).

There is no doubt that the overriding need at present remains to guarantee the future of coffee through addressing the problem of economic sustainability, i.e. to ensure that coffee production does not continue to entail a loss to growers. Of course it may be argued that production should best be concentrated in a few main areas or countries where this is not the case but, apart from the immense social costs arising from such an approach, this would lead to a huge potential loss in quality and variety which could pose a serious potential threat to sustained consumption.

For many months now the ICO has attempted to alert the international community of the consequences of a problem caused in essence by the continued excess of supply over demand. The problem was analysed in depth at the World Coffee Conference in 2001, more recently at a Round Table held jointly by the ICO with the World Bank in May 2003 and at regular sessions of the International Coffee Council. The issue has been raised at the Johannesburg World Summit on Sustainable Development in 2002, with the governments of developed countries and with international bodies such as the WTO. Although a number of interesting ideas have emerged, it is vital not to lose sight of the pressing need to take substantive measures to maintain greater market equilibrium.

Basically the process of analysis has been completed and must now give way to implementing solutions. Apart from direct market intervention, which politically and technically is likely to be unfeasible or extremely difficult, these include creating an environment that facilitates economic diversification, and measures designed to restore some balance in the market by increasing demand.

There are of course many projects and programmes around which address specific issues of concern to individual countries such as pest control, capacity-building, development of niche market coffees, establishing improved and widely accepted codes of practice for sustainable coffee production, or access to risk-management instruments. However I must reiterate that the main priority must be measures which can actually restore some market balance. In fact many more specific projects can often only be successful if a market balance restores prices to levels at which the cost of such initiatives can be absorbed. It is essential to grasp that coffee price recovery is vital because of the present lack of viable alternative activities in many coffee areas and the social costs associated with the destruction of the sector.

There is a limited number of market-oriented measures that can directly address the supply-demand balance. On the supply side two policies are possible:

a) to use the experience of the coffee crisis to create awareness – best achieved through the ICO – in national and international bodies of the danger of embarking on any projects or programmes which will further increase supply; and
b) working to increase the benefits accruing from value-added products rather than traditional bulk commodity exports.

But it is also vital to recognize the need for market development to increase demand, with a full recognition that projects to benefit the supply chain should involve action not just from farmer to exporter but from farmer to consumer. This should include:

a) support for the ICO's Quality-Improvement Programme as a means of improving consumer appreciation and consumption of coffee
b) action to increase consumption in coffee-producing countries themselves, which should have a number of positive effects such as providing an alternative market outlet, increasing producer awareness of consumer preferences, stimulation of small and medium enterprises, etc. as well as acting to increase demand;

c) action to enhance knowledge and appreciation of coffee in large emerging markets such as Russia and China, following the successful ICO campaigns in the 1990s; and

d) protecting consumption levels in traditional markets through quality maintenance, development of niche markets and dissemination of positive information on the health benefits of coffee consumption.

The ICO last September approved an Action Plan to increase consumption and, in cooperation with the Private Sector, has embarked on the first stage of a wide-ranging project designed to increase consumption in producing countries. Further projects, including re-launching programmes in emerging markets such as China, are envisaged. In view of the static or declining per capita consumption figures in traditional markets such action is becoming more and more urgent. Nevertheless securing funding for the Action Plan has proved difficult.

Market development programmes as outlined are highly acceptable to most parts of the coffee community, especially the private sector. Recognition of this is now needed from multilateral financing institutions and donor Governments. There are large amounts of funds in multilateral and national institutions earmarked for development projects but not at present readily available for the coffee sector initiatives outlined above. This must change. If direct supply management is not possible, diversification is difficult but actions for market development and quality improvement are broadly acceptable, steps to allocate funding for such projects need to be taken without further delay.

Of course one reason adduced for not funding market development is that the matter is best left to the private sector. Certainly the private sector has a key role. But experience shows that in cases such as promotion in producing countries themselves or in emerging markets the most effective action is rather that of a loose Public Private Partnership, which in principle should be an acceptable model by donors. For instance the ICO was able to act as a catalyst for cooperation from the private sector by staging coffee events in China and Russia in the 1990s, which made a big contribution to stimulating consumption in those markets. The point here is that private companies by themselves do not in underdeveloped markets have the resources or ability to undertake a coordinated effort, which is facilitated by cooperation with an Organization such as the ICO that involves the whole coffee sector and can mobilise government support. The acceptance of this concept would be an important challenge to the ITFC, involving a genuinely innovative and effective approach to problems of commodity trade, but also requiring some changes in conventional thinking.

This issue highlights the role of international commodity bodies such as the ICO in the context of genuine partnership between developed and developing countries since these bodies represent a unique forum where all stakeholders are represented on an equitable basis and where the needs and priorities of the major players can be fully represented. In this context our approach, in seeking a sustainable market balance, is not to intervene in the market but to influence the variables which determine it.