

AVOIDING NEW CRISES AND CREATING TOMORROW'S COFFEE BUSINESS

The Brazilian coffee sector, profoundly affected by the period of low prices, has made great efforts to become more efficient and competitive. We have emerged from the crisis with an increased share of world production, exports and consumption without neglecting, at any point, the challenge of creating a sustainable coffee business, even under adverse conditions.

In spite of the improved situation of the Brazilian coffee sector, in terms of productivity, quality, management, organization of the supply chain, consumption and exports, the recent world crisis has caused a significant loss of income to Brazilian coffee growers, who experienced a strong reduction in their welfare. Since the crisis was prolonged and prices reached very low levels, it would be premature to say that the crisis is over. We are still dealing with its consequences.

During the 2000/2004 period, the majority of Brazilian coffee farmers sold their crops at prices below production levels or at much reduced margins, which did not allow the minimum amount of capital formation necessary. Although prices have risen significantly compared with market levels twelve months ago, the recovery is still timid in comparison with historical averages.

In producing nations, many coffee growers are ineligible for new financing because of their high level of debt. In the specific case of Brazil, we are confronted, in addition, by high interest rates and, at the present time, a discouraging exchange rate, factors that call into question the economic viability of coffee cultivation for a large number of farmers. The volatility of international prices represents another serious threat to the sustainability of the coffee sector in Brazil and all over the world.

The biggest challenge is the development of mechanisms to avoid new crises, assuring a less volatile market and greater stability of income for all links in the supply chain. In other words, we must guarantee the sustainability of coffee production, a concept that is at the core of the themes discussed during this Second World Coffee Conference.

The search for the sustainability of the world coffee business in all its aspects – economic, social and environmental – means working to avoid future crises. It is no coincidence that the first aspect mentioned was economic sustainability. The order of presentation was deliberately chosen, since the pursuit of social responsibility and environmental protection becomes a daunting task without economic sustainability.

Designing a sustainable coffee sector in a free market environment signifies the creation of a positive agenda for joint action by all participants with the objective of guaranteeing fair remuneration at all points of the supply chain, from seed to cup. This positive agenda involves wide-ranging and diversified concepts, such as the reduction of price volatility, access to markets, addition of value and increase in demand, the themes which I will now discuss.

The Brazilian coffee sector has been taking relevant steps in all these areas, some of which are highly successful – such as research and development, crop estimates, innovative risk management instruments and the increase in internal consumption. However, further actions require the cooperation and support of other producing countries and also of the other components of the supply chain, especially the coffee industry, in order to achieve success.

This Conference is an important opportunity for us to discuss this international cooperation and the creation of free market instruments that assure a more equitable distribution of income among all members of the world coffee business.

Brazil has had a very positive experience with the coffee options program. We must now improve this instrument in order to lay down clear rules for entry and exit, that is, to establish technical and objective criteria, free from political considerations, for the purchase and sale of public stocks.

The systematic use of options and their articulation with minimum price policies forms a set of actions that indicate to producers and the market that short-term surpluses can be acquired for the formation of the country's strategic stocks. They also indicate that there is a floor for the prices of the bean.

The challenge is now to implement these or similar mechanisms in the main producing countries, which have a significant impact on the formation of international prices. An even greater challenge is to build market mechanisms that enable policy coordination by these countries. One possible path may be the creation of a secondary market for these options, thereby reducing the volume of funds necessary from producing countries and diluting the risks of the operation.

Also with regard to the reduction of price volatility, Brazil has achieved success in two other areas, whose procedures and techniques we are willing to share with other producing countries: the Cédula do Produto Rural (CPR) [Rural Product Bond] and crop forecast technology.

The CPR is a title issued by coffee farmers and guaranteed by the financial system, which enables forward sales to exporters and industry, which are able to lock in prices and guarantee supply in the future. The CPR enables producers to anticipate income and to make their cash flow more flexible, while simultaneously assuring buyers that they will receive the coffee purchased at a fixed price, independently of price fluctuations. The CPR helps to decrease the volatility of Brazil's internal market. The use of this instrument by other producing countries could play an important role in the establishment of orderly export flows.

Brazil exerts a strong influence on the formation of international coffee prices because it is responsible for a substantial share of world production and exports. Today, the strategic decision-making of the world coffee business is supported by Brazil's modern crop forecast system, based on the analysis of satellite imagery allied to ground-based mapping and monitoring of the crop. The efficiency and credibility of this system will undoubtedly grow as its forecasts become increasingly accurate.

The adoption of reliable crop forecast systems by producing countries is an important instrument for the reduction of price volatility. Brazil is at the disposal of other producing countries for the development of similar systems for application in producing regions all over the world. (Information about the Brazilian crop forecast

system can be obtained at the stand of CONAB – Companhia Nacional de Abastecimento – in the lobby outside this auditorium).

The stock counts and crop forecast system used by the ICO during the enforcement of quotas can also be used in a free market environment to increase the credibility and transparency of producing country crop forecasts and to reduce price volatility.

Market access and value addition are two intimately connected themes. 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 market, the European Union, as well as in other countries. This taxation is not uniform, but benefits one producing country over another, unjustly discriminating against certain producers and generating market imperfections. In an event for the debate of market instruments for the creation of a sustainable coffee sector, I could not fail to urge the immediate removal of these unjust and discriminatory customs barriers, which protect certain markets and, even worse, increase prices for the final consumer.

An effective way to improve the efficiency of the world coffee industry would be to absorb consumption increases in coming years by the installation of roasting facilities in the main producing countries, as already occurs in the case of soluble coffee. Within the spirit of cooperation that has always characterized the relations between the Brazilian coffee sector and international buyers, I wish to express our willingness to receive all roasters and manufacturers of soluble coffee that wish to use Brazil as a base for the export of industrialized products. At the same time, I encourage Brazilian businessmen to continue their struggle to introduce their industrialized products on the international market, preferably under Brazilian brand names, but also under buyer-owned labels.

Adding value to products is one of the best market instruments for a more equitable distribution of income throughout the supply chain. Nevertheless, it is not our intention that value addition takes place exclusively in producing countries, at the expense of industries located in consuming countries. If we desire to reduce the

protectionist barriers that affect our coffee, we must also open our country to foreign industry.

Value addition can also be achieved by increasing quality. And better quality signifies greater consumption, as clearly demonstrated by the Brazilian experience. The Purity Seal Program restored consumer confidence and stimulated coffee consumption, which grew from 6.5 to 15 million bags in the 1989-2004 period. The new Coffee Quality Program, launched in 2004, aims to increase consumption by means of a continuous improvement in quality, adding value from the farm to the final consumer. The initial results are starting to emerge: Brazilian consumption increased 9% in 2004, about 6 times more than the world average. These figures make us confident of raising consumption to 20 million bags by 2010, at which time Brazil is expected to have become the world's largest coffee consuming market.

Last but not least, I will address the growth of world consumption. In fact, this is the most important theme for our discussions, since increasing consumption is the most efficient way in which to add value to coffee, to increase the income of all members of the supply chain and to distribute this income more equitably using market mechanisms.

Estimates from a variety of sources indicate that, thanks to the explosive increase in Brazilian consumption, some dynamic patches in producing countries, the growing presence of coffee in emerging markets and in spite of the steadily slower growth of consumption in traditional consuming countries, it is possible to forecast an increase in world demand of approximately 25 million bags in the next 10 years. As significant as this increase may be, the world coffee community must not take this growth for granted.

Without specific promotional activities, such as those implanted by Brazil institutionally in its domestic market and by individual firms in emerging markets, this growth may be frustrated. Producing and consuming countries – including producers, trade and industry – must make coordinated efforts to reach this mark of 25 million bags in ten years or even to exceed it.

We cannot cross our arms and wait in the hope that consumption will increase as the result of isolated and uncoordinated actions when we are aware, based on our past experience, that this growth can be optimized and maximized by the coordination of activities and institutional programs. It was thanks to actions of the ICO, with a decisive contribution from Brazil, that the Japanese market was opened and became the world's fourth largest consuming market. It was an institutional program organized by the ICO that laid the foundations for the specialty coffee movement in the USA, a dynamic segment of the market that grows at a very strong rate.

The Brazilian case shows how joint promotion, on an institutional basis and by individual companies and their brands, can maximize growth rates and serve as a reference for other countries. The ICO itself has recognized this fact by using the Brazilian experience as the base of its Guide to Promote Coffee Consumption.

The increase of world consumption is a basic instrument for assuring the sustainability of coffee as a business. Therefore, this item must receive priority from multilateral agencies, such as the World Bank and the Common Fund for Commodities, from the overseas development aid of developed nations and from our own countries.

I see a bright future for our business if we can, in conjunction with the ICO, develop a program for increasing consumption in which we, as producing countries, first commit ourselves to growth targets for our internal markets. Secondly, producing countries should develop joint programs with the industry in emerging consumer markets. Thirdly, the industry should make a commitment to take institutional actions in order to halt the falling per capita consumption and increase consumption growth rates in traditional markets, by amplifying and diversifying its efforts, as shown by the successful program in the area of coffee and health, now being undertaken under the aegis of the ICO. In fact, this third point – institutional programs in mature markets – could be the obligation of the industry within the sustainability codes that are under discussion today, where a greater balance is required between the rights and obligations of producers/suppliers and those of industry/buyers.

As a farmer and the representative of a producing country, I find it difficult to comprehend the emphasis of so-called sustainability platforms on social and environmental aspects while the question of economic sustainability is not treated with equal emphasis. Is it not the case that these platforms are treating the symptoms while ignoring the root cause of the problem, i.e. the lack of income?

One form of compensation by the industry would be, I insist, to undertake an institutional effort to increase consumption and, in turn, the income of farmers. As the Minister of Agriculture of Brazil, I consider myself in a very comfortable position to propose to the coffee world an aggressive program for the increase in consumption, since my country has already done its homework and has shown that it is prepared to do even more. Brazil increases its production in a responsible manner, compensated by increased consumption, a factor which helps us to overcome periods of crisis.

This positive agenda for the construction of a sustainable coffee sector in a free market environment, which I leave here as a proposal for your discussion – reduced volatility, access to markets, added value and increased consumption – is concentrated on economic sustainability without omission of social and environmental aspects, as I stated at the beginning. Brazil can be considered to have already solved the problem of social and environmental sustainability, to the extent that coffee producing regions are considered to be paradigms of sustainable development in our country. In fact, the question of income in producing countries is today the Achilles heel of the world coffee sector.

The prospects are good for the coffee world: today's demand is 115 million bags to be compared with a production of 110 million bags. World stocks are falling. The Brazilian carry-over in May 2006 will be the lowest in the last decades. It is high time to organize this market.

Thank you