LESSONS OF THE CRISIS

STATEMENT BY AMBASSADOR RUBENS BARBOSA
AT THE 2^{nd} WORLD COFEE CONFERENCE
OF THE INTERNATIONAL COFFEE ORGANIZATION

Salvador, Bahia, 23 September 2005

My most intensive activity in the area of coffee coincided with a period of recovery in world coffee prices. I was Chairman of the Association of Coffee Producing Countries (ACPC) from 1995 to 1999. During this period, the ICO composite indicator price averaged US$1.14, well above the US$0.54 of the period 2000 to 2004 and the US$0.79 of the last twelve months of 2005.

At that time, I worked very hard to promote a thorough reform of the ICO, which was going through an identity crisis following the failure of the International Coffee Agreement in 1992. I was one of those who helped to introduce a number of changes in the Organization, including the creation of an international forum along the lines of what is today the World Coffee Conference, now holding its second meeting in the historic city of Salvador, Brazil's first capital.

Gradually, I am returning professionally to coffee matters and it gives me great pleasure to re-encounter old friends from London and resume contact with the challenges posed by the present time for producers and the industry.

I am very grateful to the organizers for having invited me to participate in this Conference and, without further delay, will proceed to speak on the theme of this panel: lessons emerging from the crisis of the last five years and new paths and challenges for the coffee sector.

The scenario of the last few years

At the beginning of the present Millennium, the world coffee sector experienced a depression that lasted five years, beginning in 2000 and only recovering in the second half of 2004. During these five years the ICO composite indicator price averaged 54.3 US cents/lb compared to the average of 113.8 US cents/lb in the previous five years (1995 to 1999).

At the height of the crisis, in the years 2001 to 2002, the average ICO composite price slumped to 46.7 US cents/lb, equivalent to US$61 per bag ex-dock, and total earnings by producing countries from exports of coffee averaged US$5.5 billion, a marked difference in relation to the time when coffee was known as "the second most valuable commodity in international trade after oil", a position it held until the end of the 1970s.

The current situation in perspective

More recently, on the basis of the estimates of Cecafé[1] for the twelve-month period ending in June 2005, the average ICO composite price was nearly 80 US cents/lb while the value of the international coffee trade began to recover, reaching a level of more than US$9 billion, which

[1] *Council of Coffee Exporters of Brazil*

is almost 50% above the average for the period 2000 to 2004 and allows Brazil to anticipate export earnings of more than US$2.5 billion in 2005 compared to an average of US$1.6 billion in the period 2000 to 2004.

If we place this recovery in perspective, we must bear in mind that, despite its importance, the total income of US$9.4 billion earned by producing countries from coffee exports is still 20% below the value of US$11.6 billion for the period 1995 to 1999 and still below the value of Brazilian soybean exports.

Importance of the coffee sector

Should we conclude, on the basis of these data, that the sector has become less relevant, accounting for only a small share both of international trade and Brazilian exports?

The first mistake would be to underestimate the enormous economic and social importance of coffee in dozens of countries in Latin America, Africa and Asia. In Brazil alone more than a million jobs are generated by the coffee industry.

The second would be to underestimate the upstream economic consequences of coffee, which can be divided into two stages: the sale of industrial products to business companies and families (roasted and soluble coffee); and the sale of cups of coffee to consumers by these same companies (Horeca, coffee vending machines).

According to recent Cecafé estimates, the value of retail sales of processed coffee (roasted and soluble) is in the order of US$35 billion, while the retail value of coffee sold by the cup (accounting for 20% to 30% of world coffee consumption outside the home) can be conservatively estimated at over US$120 billion. Whereas the first stage involves sales by producers of roasted and soluble coffee, an area in which concentration has increased considerably in the last 20 years, the second stage involves an agglomeration of small businesses (e.g. cafés) which generates employment in developed countries, mostly in the OECD.

What lessons can be learnt from the crisis of the last few years?

1) The prices of processed coffee products are more stable than the raw material

The economic literature unequivocally records the way in which terms of exchange favour industrialized products in comparison with inputs and primary products.

One of the greatest challenges for developing countries is to increase the share of higher added-value products in their export schedules.

This is a problem for Brazil and for developing countries in general.

Recently, with the increase in prices of primary products and commodities, there has also been an increase in prices of industrial products.

The situation is no different in the case of coffee.

It is worth examining the new IPEV[2] indicator recently published by Cecafé which shows the relationship between the international share of green coffee and the retail trade in processed coffee.

The IPEV indicator reflects the share of coffee exporting countries in earnings from retail sales of processed coffee in industrialized countries.

Until the late 1980s, specialization by coffee producing countries in the export of the raw material reflected a satisfactory international division of labour since the price of green coffee accounted for around 50% of the final retail price.

Since the 1990s this share plunged to around 20% and was only 16% in 2001.

The IPEV indicator has been improving, rising to 23% in 2004 and nearly 28% in the 12 months ending in June 2005.

In the twelve-month period ending in June 2005, the value of the international coffee trade was around US$9.4 billion, compared to US$7.4 billion in 2004, as a consequence of the increase of nearly 30% in the average prices of Arabicas and Robustas, reflected in the rise of the ICO composite indicator price from 62 US cents/lb to 79 US cents/lb between the consecutive twelve-month periods ending in December 2004 and June 2005.

The value of world coffee exports shows a marked recovery in relation to the average of US$6.3 billion recorded in the period 2000 to 2004, but is still below the average of US$11.8 billion of the preceding five-year period (1995 to 1999).

Using retail prices in the American market as a basis, proceeds from retail sales of processed coffee in importing countries can be estimated at US$34 billion in 2005 compared to US$32 billion in 2004.

We should not, of course, abandon efforts to export more green coffee, but price fluctuations and volatility affect not only producers but also exporters and the industry faced with a lower-quality product when prices are low.

The data I have given shows how important it is for producing countries to take steps to increase the share of processed coffee exports both in soluble form (a category in which Brazil has been a significant presence for many years) and in roasted and ground form (which accounts for 85% of total world consumption). The first steps in this direction are now being taken. Brazil already exports 3 million bags of soluble coffee and so it should not prove too difficult to achieve an export goal of 1 million bags for roasted coffee.

This may be a first lesson of the crisis. The stability of industry earnings in comparison with the decline of producer incomes makes it advisable to make an effort to increase processing in order to obtain higher added-value for the product.

It also makes it advisable to ensure greater transparency in statistics and information on production and stocks, factors which can increase price volatility with the negative consequences already indicated.

---

[2] *Index of international share of green coffee in retail processed coffee trade.*

2) The importance of the producer's share in the FOB price

The question of the producer's share in the FOB value of Brazilian exports of Arabica coffee has become a relevant factor.

According to Cecafé's IPEP index, in recent years around 90% of the FOB price may have gone to producers, which is probably the highest share among coffee producing countries.

After the failure of the International Coffee Agreement at the end of the 1990s Brazil took drastic measures that have produced significant results: it reduced the coffee area, introduced zoning, cut taxes and increased productivity. Brazilian producers played an important role since the sector had been deregulated with the abolition of the IBC.

Maximizing the producer's share in the export price proved to be the way to cushion the impact of the crisis and increase producer incomes when prices were favourable; this was accompanied by investments in quality-improvement.

Deregulation and free-market orientation proved effective, leading to greater efficiency, improved productivity and better logistics.

3) The need to increase consumption in consuming and producing countries

As we know, coffee consumption has been growing at a steady rate of between 1 and 1.5 %. This growth rate is well below that for food products as a whole which, according to FAO data, is 4% a year.

Changes in eating habit and the growing consumption of other beverages are largely responsible for the stagnation of coffee consumption.

It would be important to establish a goal for increasing coffee consumption. An increase from a growth rate of between 1 and 1.5% to between 2 and 2.5% may not be an unrealistic goal if countries make a real effort.

In addition to any promotion activities which may be undertaken to increase consumption in consuming countries, additional efforts must be made in producing countries along the lines of what is being done in Brazil, which is now the world's second biggest consumer market for coffee.

Lastly, a continuing effort must be made to increase coffee consumption in non-traditional markets. New markets like China, Russia and Korea warrant special attention. In 1998 the ICO initiated efforts of this nature with campaigns in China and Russia which should be continued.

4) The need for a joint effort between producing countries and the coffee industry to promote generic coffee advertising

Since the late 1990s it has become evident that in order to encourage consumption and so increase coffee prices in consumer markets, a joint effort must be made by producing countries and the industry in consuming countries to actively promote generic advertising of coffee.

This generic advertising should not be seen as solely the responsibility of consuming countries. In the best interests of all concerned, the coffee industry, which spends 5% of its earnings on advertising its own brands, should also participate.

Joint efforts to achieve a specific goal for the increase in consumption would be important from the social viewpoint since it would help to improve the well-being of producers who are mainly smallholders.

5) Low prices do not increase demand and could be the result of a disorderly growth in supply

The drastic slide in coffee prices in the period 2000 to 2004, which were down to as little as 46 US cents/lb in 2001, had no effect on demand, which showed no increase in its growth rate.

Since coffee production employs a labour force estimated at around 25 million families by the ICO and accounts for more than 50% of export earnings in many countries, an increase in consumption favouring a gradual rise in world prices would be a positive factor for economic growth and increased per capita incomes in these countries.

Any incentive given by national and international entities to the disorderly growth of supply without a corresponding increase in consumption should be monitored and avoided.

6) Reduction of tariff barriers for the soluble coffee industry

Notwithstanding the importance of the effort to add value to the raw material, along the lines of what is done in other sectors, processed coffee is also subject to protectionist restrictions by some developed countries.

Discrimination against Brazilian soluble in the context of the Stability and Growth Pact (SGP) in Europe in the 1990s provoked a response by the industry, backed by the Brazilian Government. When it risked losing the dispute under the Geneva mechanisms for solving disputes and complaints, the European Union proposed an agreement eliminating discrimination and re-establishing the competitiveness of the Brazilian product.

Ten years later, with the enlargement of EU membership and the decision of the WTO at a panel initiated by India to question the prevailing SGP rules, the European countries decided to change these rules.

New Brussels regulations came into effect in June and Brazilian soluble coffee is once more subject to discriminatory treatment.

The changes introduced could be harmful to Brazil's soluble coffee exports.

We are studying these changes very carefully to establish whether the new criteria are compatible with or harmful to Brazilian interests.

This review will take account, among other points, of the possibility of discrimination against Brazilian products and a comparison with the EU tariff reductions granted to Brazil's direct trade competitors who, according to the Brazilian soluble coffee industry, have benefited from tariff exemption.

This discrimination against efficiency and competitiveness has created conditions for concrete and potential losses for the industry and, if it proves to be incompatible with WTO rules, may be challenged by the sector and the Brazilian Government.

As a first step, it is likely that there will be a request for informal consultations in Brussels to clarify some aspects of the new regulations and their compatibility with WTO free trade rules.

The case of the EU and soluble coffee is in many points similar to that of the banana issue. After eliminating tariffs following a WTO decision, the EU discriminates between ACP countries and other Latin American countries.