

THE WORLD COFFEE MARKET: LESSONS FROM THE CRISIS AND FUTURE SCENARIOS

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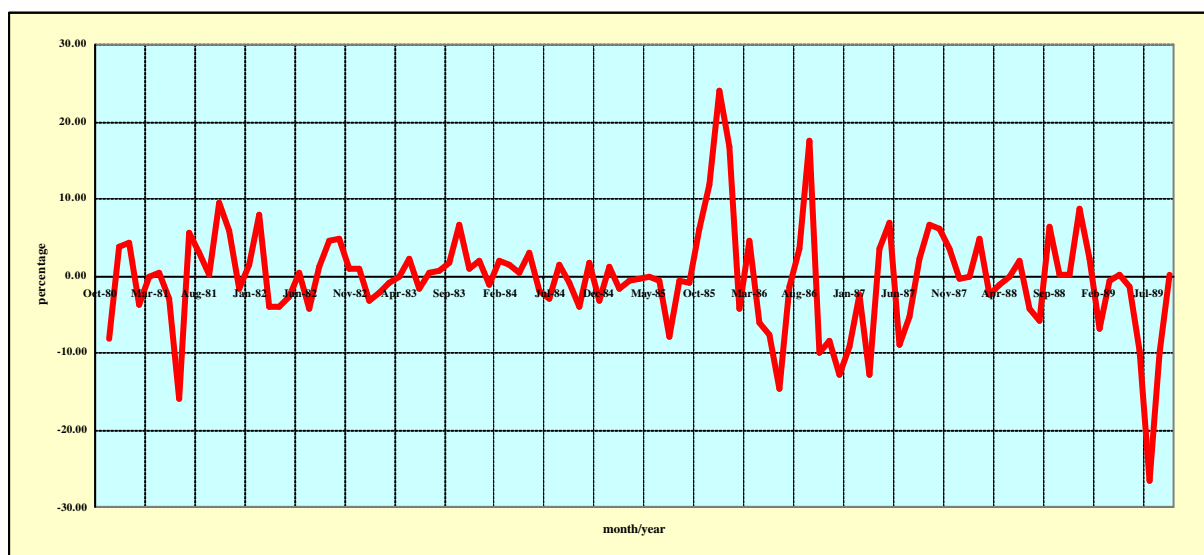
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The last 25 years

To have a clear vision of the present and facilitate an effective assessment of the future outlook I shall start by briefly reviewing the development of the world coffee market in the last 25 years. In this time the market has gone through two distinct phases punctuated by periods of volatility and, more recently, real crisis conditions for Producers.

During the first period from 1980 to 1989, the market was stabilized through the ICO quota system. As might be expected, the medium term volatility in this period was relatively low in spite of marked movements in 1986 (Graph 1). The ICO composite indicator price reached a high in March 1986 of 204.23 US cents/lb and a low of 69.05 cents in August 1989, following the suspension of quotas on 4 July 1989, giving an average price for the period of 127.08 cents (Graph 1) and 23 points of variation from the standard deviation of the average.

Graph 1: Volatility of the ICO composite indicator price – 1980/81 to 1989/90



There was one serious frost in Brazil in 1981, leading to a drop in world production of nearly 16%, followed by a price rise in annual average terms of 8% the following year (see Table 1). As is normally the case, with replantings, production rose after a 5 – 6 year lag by 27% in 1987 relative to 1981 with a corresponding drop in prices relative to that year of 14%.

Table 1: Volume of production and exports, value of exports and ICO composite indicator price – 1980 to 1989

Year	Production (crop year) (000 bags)	% variation on production 1/	Exports (calendar year)		ICO composite indicator price (US cents/lb)	% variation on ICO composite price 1/
			Volume (000 bags)	Value (million US \$)		
1980	80 726		60 248	11 778	150.67	
1981	100 496		60 517	8 087	115.42	
1982	84 685	-15.73	64 546	9 014	125.00	8.30
1983	89 263		66 258	9 243	127.98	
1984	83 991		68 623	10 680	141.19	
1985	90 170		71 359	10 831	133.10	
1986	81 194		64 511	14 309	170.93	
1987	107 914	27.43	71 951	9 589	107.81	-13.75
1988	89 461		65 816	9 437	115.96	
1989	94 120		75 912	8 683	91.67	

1/ Refers to 1981

The period of uncontrolled markets from 1990 to 2004 showed greater medium-term price volatility with highs of 202.39 cents in September 1994 and a low of 41.17 in September 2001, with 31 points of variation from the standard deviation of the average. The average for the ICO composite indicator during this period was 81.57 (Graph 2). Again, during this period there was a severe frost in Brazil in 1994. Although this led to a lower drop in world production of some 10% in 1995, compared with the 15% in 1982, with prices rising some 3%, it is interesting to note that, with replanting, production by 1999 had risen by 35% relative to 1994 and prices had dropped by 38% (Table2).

Graph 2: Volatility of the ICO composite indicator price – 1990/91 to 2003/04

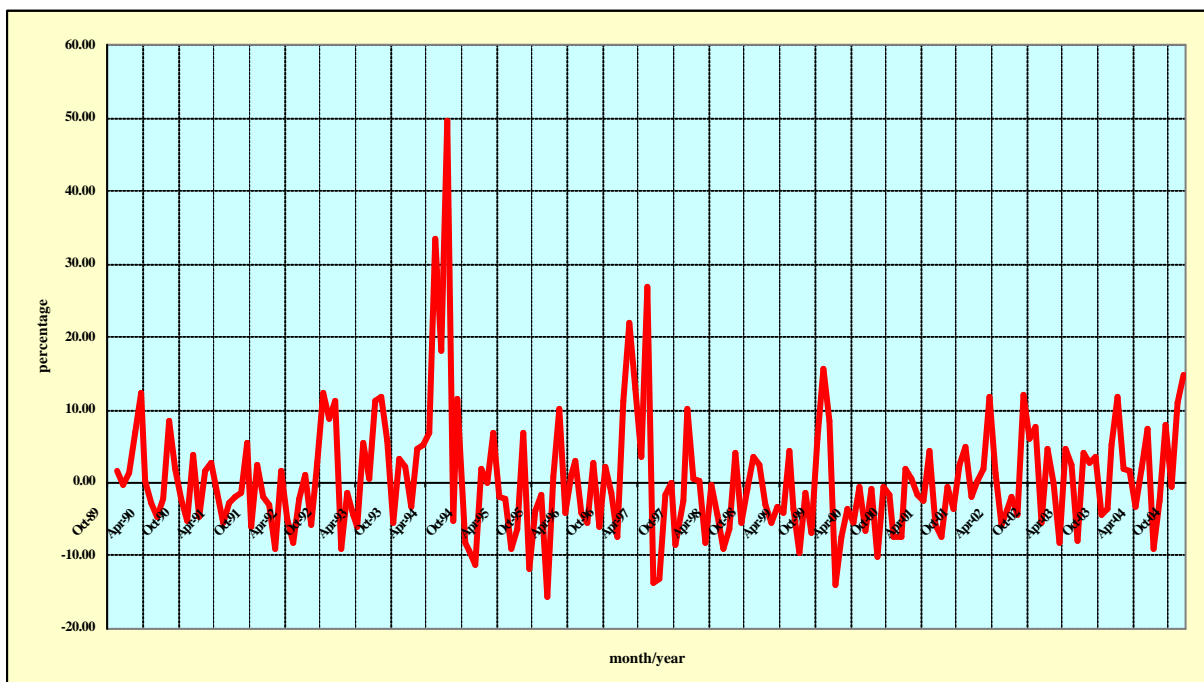


Table 2: Volume of production and exports, value of exports and ICO composite indicator price – 1990/91 to 2003/04

Year	Production (crop year) (000 bags)	% variation on production 1/	Exports (calendar year)		ICO composite indicator price	% variation on ICO composite price 1/
			Volume (000 bags)	Value (million US \$)		
1990	93 321		80 562	6 866	71.53	
1991	101 552		75 777	6 501	66.80	
1992	88 913		78 163	5 326	53.35	
1993	90 366		74 972	5 689	61.63	
1994	95 154		70 487	10 125	134.45	
1995	85 250	-10.41	67 573	11 614	138.42	2.95
1996	101 865		77 549	9 999	102.07	
1997	95 872		80 264	12 880	133.91	
1998	106 163		80 080	11 442	108.95	
1999	115 109	35.03	85 781	9 494	85.75	-38.05
2000	112 683		89 450	8 194	64.25	
2001	109 675		90 379	5 388	45.60	
2002	121 924		88 473	5 127	47.74	
2003	103 096		85 767	5 570	51.91	
2004	114 104		89 310	7 044	62.15	

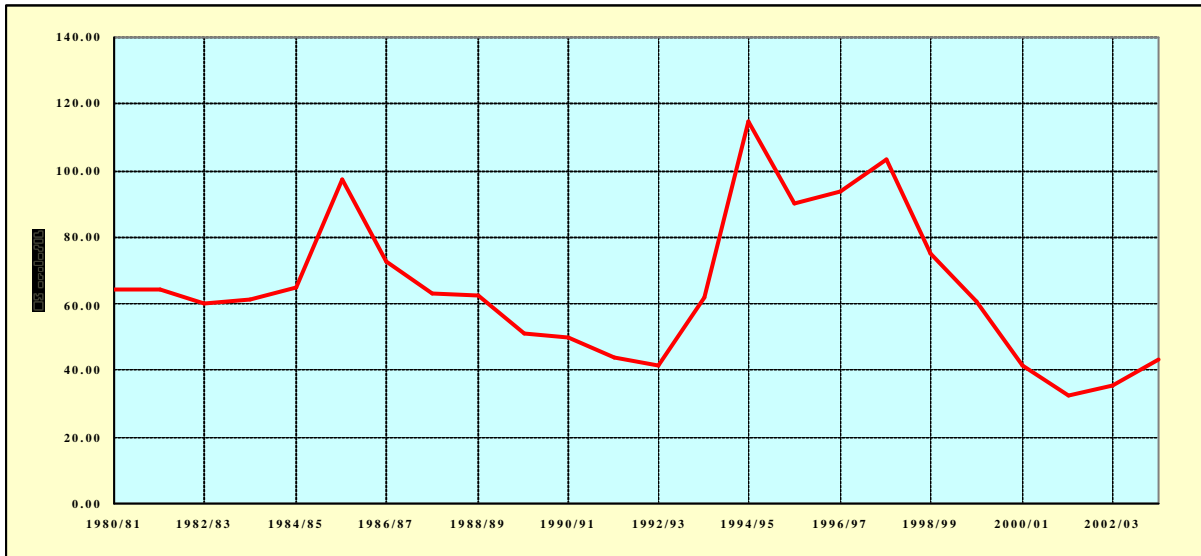
1/ Refers to 1994

Looking at prices to coffee farmers, ICO data (see Table 3) shows that in the period 1980/81 to 1988/99, prices paid to growers averaged US 67.92 cents/lb, with annual average highs of 97.6 cents in 1985, and lows of 59.7 cents in 1982/83. In the period from 1990 to 2004, the average had dropped to 63.9 cents/lb with highs of 115 cents in 1994/95 and lows of 32.4 cents in 2001/02. I want to emphasise that these are annual averages of all available country prices weighted by importance of exports; the figures will of course differ for specific countries (Graph 3).

Table 3: Prices paid to growers (weighted by exports levels) – 1980/81 to 2003/04

1980/81	64.51
1981/82	64.55
1982/83	59.65
1983/84	60.81
1984/85	65.19
1985/86	97.61
1986/87	72.84
1987/88	63.29
1988/89	62.86
1989/90	50.97
1990/91	49.56
1991/92	43.94
1992/93	41.35
1993/94	62.34
1994/95	114.79
1995/96	90.30
1996/97	93.90
1997/98	103.60
1998/99	75.57
1999/00	60.56
2000/01	41.54
2001/02	32.36
2002/03	35.20
2003/04	42.94

Graph 3: Prices paid to growers (weighted by exports levels) – 1980/81 to 2003/04



The coffee crisis

The coffee price crisis, from which we now seem to be starting to emerge, began in 2000 and continued until the end of 2004. During these five years a large number of coffee producers were unable to cover their production costs and many only continued to produce coffee because of the lack of alternatives or because they still cultivated subsistence food crops. The effects on farmers have been clearly documented by the ICO (see document ICC-89-5 Rev. 1) and include an exacerbation of poverty in coffee communities worldwide, with additional social effects such as migration to urban areas, illegal emigration, and cultivation of illicit drugs. With respect to the balance of payments of coffee producing countries, it must be noted that whereas in the late 1980s and part of the 1990s, earnings by coffee producing countries in terms of FOB exports were around US\$10 – 12 billion p.a., during the crisis years they slumped to just over US\$5 billion. On the other hand, it is good to note that the coffee market in industrialized countries continued to be relatively healthy with steadily rising retail sales, particularly in terms of value.

It is worth noting however that this striking discrepancy was recognized by many organizations concerned with development in industrialized countries, and the consequences are now being seen in the form of a number of initiatives designed to promote greater sustainability in coffee.

The present situation

As a result largely of the stresses on the productive sector worldwide caused by the crisis, the imbalance between supply and demand from 2000 - 2004 which led to the price crash has now been reversed. Our estimates for 2005/06 are for world production of around 107 million bags compared with world consumption of 114 million. At the same time there

are clear signs of a drawdown in stocks, particularly in producing countries. This has led to a marked upward move in Arabica prices. The ICO Other Milds indicator rose 74% from 3 January 2004 to 8 February 2005. Robusta prices, on the other hand, continued depressed until the beginning of January this year, where the price was virtually identical to that on the first trading day of 2004 (37.59 cents). In the last few days, there has been some upward movement here too, with the Robusta indicator reaching 41.89 cents on 8 February. Nevertheless, there is a clear difference between the supply/demand dynamics of the two main types of coffee and the differentials (Graph 4) are striking.

Graph 4: Differential between Other Milds and Robustas group indicators – October '80 to September '04



Lessons from the crisis

It is clear from the figures I have given you that climatic events or other supply shocks remain a real threat to the development of a balanced market and sustainable conditions for the world coffee economy. I believe there are four areas in which action is possible both with respect to national policies and international cooperation.

The first one is information and government and institutional attitudes to production policy. It is essential for policies in coffee producing countries to be established to create conditions for farmers to understand the perils of indiscriminate planting in periods of higher prices, and to discourage planting in sub-optimal areas wherever possible.

A second area is to encourage appropriate diversification, both in terms of national dependence on coffee and a reduced number of other commodities, and also at the farm level to create a more diversified productive portfolio, to the extent possible and using all available instruments. In this context, the ICO is giving considerable priority to diversification projects which do not eliminate coffee production but encourage alternatives and vertical

diversification into higher value types of coffee. I must add that this process would be greatly assisted by the removal of trade barriers to agricultural product imports in developed countries.

Thirdly, I also believe that adding value to coffee through increasing quality and, where conditions are appropriate, producing coffees for niche markets such as organic make sense to all stakeholders in the coffee market. The ICO's first project funded by the Common Fund for Commodities in 1995 was the gourmet coffee project, which gave considerable impetus in a number of countries to the production and marketing of high quality premium priced coffee. In Brazil, it led to a new international perception of the high quality of pulped natural Arabica (descascado) coffees and pioneered internet auctions for marketing. Furthermore, ICO Resolutions 407 and 420 stimulate producers to attain basic quality standards which can also be used in marketing programmes. The bottom line is that consumers will drink more coffee if the quality is good, leading to gains in all sectors of the market.

Finally, I believe that it is crucial, particularly in view of the promotional efforts by competitive beverages such as soft drinks, to maintain effective programmes for market development. In most industrial countries, this is already being done effectively by the private sector. However, in some areas, such as emerging markets like China, or in the producing countries themselves, the private sector lacks the strength or coordination to make a large impact. Here, the ICO has shown already that it can act as a catalyst for umbrella education and image building campaigns in cooperation with the private sector, which can have a positive effect on consumption. I am delighted in this context to note the very useful Guide, which makes comprehensive use of the experiences of Brazil, commissioned by the ICO and disseminated at our last Council Session. This gives comprehensive methodologies and techniques for the promotion of coffee consumption, with emphasis on producing countries.

While still on market development, and this affects all areas, I must add that I am delighted that the major coffee roasters in Europe are cooperating with us in the Positively Coffee Programme to disseminate objective and positive research findings which indicate real beneficial effects of coffee consumption.

Conclusion

A sustainable coffee economy requires attention to the three UN criteria of economic, environmental and social sustainability. In looking at initiatives to achieve this end, it is crucial to recall the causes and effects of the period of crisis from which we are just emerging. Not only must this be done at national level, but also in the context of international initiatives, which is why I am so pleased that the United States has now rejoined the ICO, restoring the representative nature of the Organization as a forum to develop appropriate policies to achieve a healthy and prosperous market for all players in the world of coffee.

London, 9 February 2005