

EFTA Fair Trade Yearbook 1997

January 1998

Coffee

A Speculator's plaything

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Cost-conscious consumers will not have failed to notice that, against all expectations, coffee prices rose significantly in 1997. The principal coffee variety, Arabica, showed an almost threefold price increase on the New York futures market between December 1996 and June 1997. The coffee trade points an accusing finger at the speculators at the coffee exchange. Douwe Egberts, one of Europe's leading coffee roasters, says the main cause for the price explosion was "the overstrained interest among investors and speculators".

Later in 1997 prices declined somewhat, but still remained high. After the low prices of 1996, coffee growers can now enjoy the higher prices. But this higher price level also means that the middlemen have thrown themselves into the coffee trade again. They offer the farmers tempting amounts in hard cash, whereas small producer co-operatives usually lack the working capital to pay cash, and may therefore struggle for survival in the face of competition from the middlemen. But as soon as coffee prices start to fall again

- * which experts say is only a matter of time
- * the coffee growers will need their co-operatives very badly.

Speculators dictate the free coffee market

The coffee market was relatively calm until 1989. Although coffee prices rose to peak levels in the 1976/77 and 1985/86 seasons due to frost in Brazil, the market was fairly stable in the intervening years. This was mainly the result of the International Coffee Agreement (ICA), which kept the coffee market in balance by applying a system of export quotas and agreed minimum and maximum prices. But the 4th of July 1989 was "independence day" for the coffee market. The consuming and producing countries failed to reach consensus on the conditions of a new agreement, and the quota system collapsed. This put an end to a long period of market regulation: for the first time in 27 years, the market was controlled by the forces of supply and demand. The coffee-producing countries almost immediately dumped the stocks accumulated during the last few ICA years onto the market. The result was plummeting coffee prices, which reached an absolute low in the Autumn of 1992 when the price for Arabica coffee dropped below 50 US cents per pound on the New York exchange - a level comparable to that of the 1930s.

Prices did not recover until the second half of 1993, when a price increase was initially brought about by an export restriction imposed by the ACPC, (the Association of Coffee-Producing

Countries). It was reinforced by the disappointing coffee crops in the 1993/94 resulting from low prices in previous years. This effect was strongly escalated by two successive night frosts in Brazil and within a few weeks prices rose to new record levels. In September 1994, Arabica coffee exceeded 250 US cents per pound in New York, five times higher than in 1992! It declined again later that year, when it became clear that there would be no shortages. Apart from a few brief upswings, this drop in prices continued in 1996. After the high prices of 1994 and 1995, the coffee trade expected sharply rising production and a corresponding fall in prices.

But early in 1997 the unexpected happened - coffee prices soared rapidly, initiated by speculators on the coffee market.

Attracted by the low 1996 prices, investment trusts had bought coffee contracts on a large scale. A "self-fulfilling prophecy", their purchases immediately pushed up prices in the coffee market, which was already "tight" because the stocks held by businesses and industries had diminished considerably since the boom of 1994/95.

Incidents such as disappointing harvests in the low-lying coffee areas in Central America, a dock strike in Colombia (coffee producing country number 2), the decision by the Association of Coffee Producing Countries to reduce exports, and disappointing harvest prospects in Brazil (coffee country number 1) caused major panic on the coffee market and resulted in extreme price rises. Speculators, always highly active in hectic markets, also did their bit. Prices went up and down like a yo-yo. Both big and small coffee farmers became nervous and wanted to sell their coffee as fast as possible. And the coffee traders bought every kilo of coffee they could get.

In May 1997 the price per pound for Arabica coffee on the New York futures market broke through the 300 US cents barrier, the highest price in 20 years and almost a threefold increase over that of December 1996. In June, after speculators took their profits, prices dropped below 200 US cents per pound and remained at this level all summer. The coffee market is expected to remain tense for a while. In the long term, however, a declining price trend is anticipated, simply because high coffee prices always boost production.

It seems as if the coffee market fluctuates almost 'by nature'. High prices encourage producers to take greater care of their coffee bushes and to plant new ones. After a few years, these investments lead to greater supplies and put pressure on the prices. When prices are low, producers will tend to neglect their coffee bushes, leading to a gradual decrease in supplies and the resumption of the same cycle.

It would, however, be an oversimplification to attribute price developments exclusively to the laws of supply and demand. Although almost any price increase or decline has an underlying "physical" cause, coffee prices have been increasingly affected by big financial investors ever since the creation of the free market in 1989. As soon as coffee prices are low and a shortage is expected, as was the case in early 1994 and 1997, investors throw themselves into the coffee market with large amounts of capital. They are not interested in the coffee itself, they merely buy it speculatively with the intention of selling it later in the hope of making large profits. Their sudden great "demand" pushes up prices automatically, until the moment they decide to reap their profit and the prices plunge again. Speculators thus reinforce the "natural"

up- and down-swings in prices. Sometimes they actually govern the price, as in 1994, when prices showed a threefold increase within three months when there never was any real shortage of coffee.

The sad part of this price story is that the producers get little change out of it, not to mention the consumers. Yet, speculators have always had a function in the coffee market. The coffee traders and industries who want to hedge against price risks, need opponents who are willing to venture the opposite. But the futures market has all the appearances of leading a life of its own in recent years; the relationship with the physical market is often completely absent.

Cooperatives threatened

Coffee is the most important cash crop for the Third World, with over a hundred million people in developing countries depending on coffee as their only serious source of income. A number of countries show a similar degree of dependence. For about ten countries, mainly in East Africa, coffee is the primary export product. The economies of Uganda, Burundi, Rwanda and Ethiopia, depend on coffee exports for more than half their foreign exchange. Coffee is also the backbone of the economy in a number of Central American countries. Given the unpredictable nature of the coffee market, this is an unhealthy situation.

For the world's two biggest coffee-producing countries, Brazil and Colombia, coffee plays a relatively minor role, accounting for less than 10% of their export earnings.

The current higher coffee prices evidently benefit the producers. However, the profits of a sudden rise in prices accrue primarily to the business enterprises or speculators who have supplies that are instantly available, either physically or on paper. The small farmers are not usually among those holding stocks. Hard-pressed for money, they sell their coffee as quickly as possible, sometimes when the berries are still on the bushes. They are definitely not in a position to bargain for the best prices, let alone to wait for better times to arrive.

Moreover, the high coffee prices affect the functioning and survival of small farmers' cooperatives. When supplies are limited, prices are high, and coffee is in great demand. Local buyers offer the coffee growers tempting prices for their crops and pay them cash on the nail. Cooperatives lack the working capital to offer more at that stage; since they must first sell the coffee themselves. Even though the price they eventually pay to the farmers is higher, many producers find it hard to resist the temptation of the immediate cash payments offered by the middlemen. Following a period of low prices, the small farmers want to share in the benefits of the upturn. Cooperatives see, with regret, their members turning to middlemen. This situation places a heavy mortgage on the future of some of the weaker cooperatives. If they break up, their members will again be completely dependent on the middlemen. This is a bleak prospect if prices drop again in a year or two.

The position of coffee pickers on plantations is a bit different. Plantation owners are unlikely to use their increased revenues to raise the total amount of wages (higher wages and/or more workers), because pickers' wages are determined in part by the local labour market. However, investments in the expansion or improvement of production, which is almost a matter of course after a period of high prices, could create more employment for coffee pickers.

Trade restrictions

Coffee cannot be transported across the globe without restriction. The European Union (EU), for instance, applies a range of regulations, periodically adjusted, to control the coffee trade. Moreover, a new GATT Agreement (General Agreement on Tariffs and Trade) was concluded in 1994, the effects of which are now being felt in the coffee trade.

European Union and Lomé

All coffee entering the EU is subject to an import duty. The higher the level of processing, the higher the tariff. This so-called "tariff escalation" is to protect EU roasters against competitors outside the EU (in other European countries and North America). By far the largest amount of coffee is therefore imported in an unprocessed state, i.e. in the form of unroasted green coffee beans. Under the recent GATT Agreement, the EU has committed itself to reduce its tariffs. Over the next five years, the tariff on unroasted green coffee will thus be reduced from 4% to zero, that on roasted coffee from 13.8 to 7.5%, and that on roasted decaffeinated coffee from 16.5 to 9%. Although this is a considerable reduction, it is far from an elimination of import duties, and the system of tariff escalation will remain in place.

The existence of import duties offers the possibility of granting tariff advantages to particular coffee-exporting countries. After all, a lower tariff is a competitive advantage for the countries concerned. This is a popular instrument in the EU. For example, within the framework of the Lomé Convention (an agreement between the EU and former colonies in Africa, the Caribbean and the Pacific), coffee from these ACP countries has free access to the EU market. Also the Least Developed Countries (LLDCs, which to some extent overlap with the ACP countries) are exempt from import duties on processed and unprocessed coffee. The same goes for four South American countries (Bolivia, Colombia, Ecuador and Peru) and a number of Central American countries (Panama, Costa Rica, Honduras, Nicaragua, El Salvador and Guatemala). These are temporarily exempt from import duties to prevent coffee producers from succumbing to the temptation to switch to the production of cocaine.

The effect of all these preferences is that a limited number of countries - Brazil, Mexico, Indonesia and Vietnam - are excluded from all special arrangements, which is effectively a form of discrimination. The impending reduction of the general import duties on coffee, and the 0% tariff on green coffee in particular, largely removes this inequality.

To what extent do these escalating tariffs impede the emergence of a coffee-processing industry in the developing countries? From an economic point of view, the development of such an industry would mean a significant step forward. However, a number of obstacles must be overcome to achieve that aim. The first is that whereas green unprocessed coffee can be stored, processed coffee has a relatively short shelf-life. It is therefore preferable that processing be located as close to the consumers as possible, both in terms of time and distance. Secondly, most coffee brands are composed of various blends from a variety of countries. Roasting, grinding, and blending in developing countries would therefore involve a substantial shift in trade flows. Lastly, blending requires a thorough knowledge of (varying) consumer preferences. Although these difficulties are not insurmountable, they do make things more complicated. Another important aspect is that trading and processing are strongly

dominated by a small number of transnational companies (TNCs), making it almost impossible for newcomers to enter the market. Any significant relocation of processing from the "North" to the "South" will, sooner or later, come up against the interests and strategies of these TNCs. It is clear that tariff escalation is only one of a number of relevant factors.

Twenty-five years of fairly traded coffee

Coffee has always been the single most important fair trade product. In 1973, Fair Trade Organisatie in the Netherlands imported the first fairly traded coffee from small farmers' cooperatives in Guatemala. Twenty-five years later, fair trade coffee has become a household concept. Hundreds of thousands of coffee farmers have come to benefit from the fair coffee trade. A growing number of consumers in Europe drink fair trade coffee, but the enormous growth of the past few years appears to have slowed down since 1996.

'Coyotes'

Fair trade promotes the interests of small-scale coffee farmers who, together with plantation workers, are the weakest party in the coffee sector. They have hardly any grip on market developments, either at a local level, where they depend on intermediaries, or at an international level, where they are subject to the price determination mechanisms of the world market. Fair trade offers the farmers an alternative in both respects, with the ultimate aim of enabling them to operate independently in the market. By purchasing the coffee directly from the farmers' organisations, fair trade bypasses the local intermediaries, the so-called "coyotes", who are notorious for abusing their strong position. Direct purchasing allows the farmers not only to eventually receive a higher price, but also to become directly involved in coffee exports and thus to gain a better insight into the overall coffee trade. By paying a fair price, fair trade takes the sting out of the farmers' dependence on the price determination process of the world market. This is because, in addition to a premium price of 5 US cents/pound on top of the world market price, the coffee farmers receive a guaranteed minimum price at all times. This has frequently turned out to bring considerable relief. Between 1989 and 1994, and in 1996, the world market price was below that minimum price, (in 1992 and 1993 falling 50% below).

The conscious choice to focus on disadvantaged producers may require the provision of additional assistance, in particular in the case of young farmers' organisations without any export experience. It can take a variety of forms, such as technical assistance to improve the quality of the coffee, or support to strengthen farmers' organisations. Credit facilities also form a particularly important element, as small farmers' organisations have hardly any opportunities to obtain loans from local banks. Finally, there may be support for investments in, for example, a new coffee processing plant or a new lorry. Some fair trade organisations have set up special assistance programmes, (for example Traidcraft Exchange in Great Britain and Fair Trade Assistance in the Netherlands).

Fair trade marks

A major incentive to fair trade in coffee has been the introduction of fair trade marks or labels, which allow mainstream trading companies, coffee roasters and supermarkets to become involved in fair coffee trade, alongside fair trade organisations and world shops. Every coffee importer or roaster who satisfies the established criteria, in terms of price and prefinancing, is allowed to use the mark, enabling consumers to distinguish what coffee on the supermarket shelf has been traded fairly. The organisation which administers the mark monitors whether importers and roasters satisfy the conditions.

In 1988, the first fair trade mark for coffee was introduced in the Netherlands under the name Max Havelaar. Today, there are fair trade marks for coffee in about ten European countries and in some outside Europe. In addition to the Netherlands, the Max Havelaar coffee mark now also exists in Belgium, France, Switzerland and Denmark. A similar initiative is the TransFair label, applied in Germany, Austria, Italy, Luxembourg, Canada and Japan. The Fairtrade Mark is used in Great Britain and, since 1996, in Ireland. The three marks apply identical criteria. Countries which are about to introduce fair trade labelled coffee include Sweden (in 1997), Canada, Spain, Norway and Finland.

After the explosive growth in the first half of the 1990s, there has been a moderation in sales growth. Turnover showed only a slight increase, except in countries, such as Ireland and Denmark, where fair trade labelling has only recently been introduced. Turnover even decreased somewhat in Germany, Switzerland and France. It seems that further growth will be difficult without new efforts. According to Max Havelaar in the Netherlands, new market strategies are required to enlarge the market share. Such an increased market share would imply extra earnings for small coffee growers, as well as forcing the mainstream players to start trading coffee in a more sustainable way. The present market share of 2.6% is insufficient to achieve that aim; at least some 10% would be required. Market research has shown that more and more people regularly buy fair trade coffee, but that they do not stop buying 'ordinary' brands. Max Havelaar intends to direct its new campaigns towards this group of people. International Coffee Agreements

Coffee-consuming and coffee-producing countries have concluded five International Coffee Agreements (ICAs) since 1962. The aim of the ICA was to stabilise the coffee price. The system worked as follows. As soon as market prices fell below a certain fixed level, a quota arrangement came into effect, restricting the producing countries' coffee exports to the level of their individual quotas. In 1989, however, the fourth agreement collapsed. The producing countries failed to reach consensus on the distribution of the quotas. The consuming countries wanted to put an end to cheap coffee sales to non-ICA-member consuming countries in Eastern Europe and the Middle East, and sought a different distribution of the quotas for the various coffee varieties. This was more than the ICA could take in July 1989, and the coffee market has been free ever since. It is true that the ICA members concluded a new agreement in October 1994, but this fifth ICA incorporates no instrument whatsoever to intervene in the market. It is no more than an empty shell, at best a platform for producer and consumer countries to meet from time to time.

Association of Coffee Producing Countries

Forced by the low price level in preceding years, in 1993 a number of exporting countries reached an agreement on so-called voluntary export restrictions. This Association of Coffee Producing Countries (ACPC) started with 28 members, representing approximately 85% of total coffee production. Indonesia, joined later in April 1994. It should be noted that not all coffee-exporting countries are members. Mexico, for example, is not among them, partly because its main business partner, the United States, is strongly opposed to this infringement of the market mechanism.

Since 1993, the ACPC has regularly decided to impose export restrictions, in most cases (e.g. in 1993, 1995 and 1996) designed to reverse a decreasing price trend, but sometimes (e.g. early 1997) to reinforce an early price increase. Experts disagree as to the effect of these export restrictions. Although the futures markets always responds instantly to the announcement of an export restriction, the effect tends to subside in the longer term.

For the time being, the ACPC is the only mechanism allowing coffee-producing countries to stand up for themselves, given the fact that the coffee trade is controlled by a small number of large international enterprises. An elite group of some 20 companies has succeeded in capturing more than three-quarters of the total coffee trade. Only one of them originates in a producing country. With their advantages in the fields of knowledge, trade agreements and so on, these businesses firmly control the entire production chain from harvest to consumer. They can benefit from prices below the world market price by insisting on "special deals", e.g. by guaranteeing to buy particular quantities.

Gordon Nyendwoha, a coffee farmer in Uganda

Uganda and coffee are inextricably linked. Coffee is the main source of income for peasant farmers and it forms the heart of the Ugandan economy. Three-quarters of the population earn money from the cultivation of or trade in coffee. Depending on its price, between 65 and 95% of foreign exchange is obtained through coffee.

Gordon and Monica Nyendwoha, members of the "Banyankole Kweterana Co-operative Union" are one of the millions of Ugandan families who rely on coffee. They grow their own food on their "shamba", but coffee is their only source of cash income. The fluctuation of coffee prices on the world market therefore has a direct impact on everyday life for the peasant families. "Today I receive only half last year's price", Gordon said in 1996. The year before he had put a new corrugated iron roof on his house and had been able to pay secondary school fees for his eldest child. But this year he cannot afford it. What would he do if the coffee paid more? "Send all my children to school, of course! To allow them to do better than me."

Fair Trade trading

Fair Trade trading conditions

- * direct purchasing: all coffee is purchased directly from small coffee growers
- * a fair price: a premium of 5 US cents/pound (454 grams) on top of the world market price as well as a guaranteed minimum price (126 US cents for Arabica coffee)

- * prefinancing: credits of up to 60% of the sale price at the beginning of the harvest
- * security: annual contracts determining the coffee purchases and long-term cooperation

Coffee farmers' own coffee brand

One of the main goals of fair trade is to enable coffee farmers to face the market on their own. In 1996, Union de Ejidos de la Selva, Uciri in Mexico and Ucraprobex in El Salvador took a new step in this direction: they launched their own brand of coffee on the market. After roasting it themselves, they sell the coffee in their own packaging on the local market. They have even opened their own coffee shops and restaurants. It looks like a new trend, initiated a few years ago by Coocafe, in Costa Rica, which succeeded in penetrating the American market with its own brand of coffee. Ucraprobex's organic coffee brand "Caf Orgánico Pupl" won the national environmental prize in El Salvador.

Support for organic farming

"For us Indians, the earth has a very special meaning. God has given us the earth to sow and reap, thus allowing us to live. That is why our coffee cooperative is changing over to organic farming." These are the words of Andrés Quic Ramos. He is both a coffee farmer and an environmental instructor at La Voz que clama en el Desierto ('The Voice that Sounds in the Desert'), a coffee co-operative in Guatemala. With support from Fair Trade Assistance, Andrés and twelve colleagues from other cooperatives have been trained as environmental instructors. They, in turn, can teach the coffee growers organic methods of cultivation. In Andrés's opinion, "The prospects for the Guatemalan environment are not too bright. The large cotton and coffee plantations use a lot of chemicals. The plants have become less resistant and carry a lot of diseases. The earth is being destroyed....". He explains that "the starting point of organic farming is to preserve the soil, to prevent fertilizer and earth being washed away. Therefore we build terraces and plant shady trees to shield the soil and the coffee bushes from the sun. Finally, we use organic fertilizer, made of coffee pulp, leaves and earth. This prevents the soil from being exhausted. The earth is our life. That's why we call it Mother Earth."