

**WORLD TRADE ORGANIZATION  
COMMITTEE ON TRADE AND DEVELOPMENT**

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**IMPROVING MARKET CONDITIONS FOR COFFEE PRODUCERS  
THE EXPERIENCE OF THE ICO**

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**Coffee in the last 25 years**

Coffee is one of the world's most important traded commodities, produced in more than 60 countries and providing a livelihood for some 25,000,000 coffee farming families around the world. Many of these countries are heavily dependent on coffee, which can account for over 75% of their total export earnings. Among consumers coffee is a universally popular drink, with over US\$80 billion in retail sales a year. There are two main types of traded coffee, *Coffea Arabica* and *Coffea canephora*, the latter usually called Robusta.

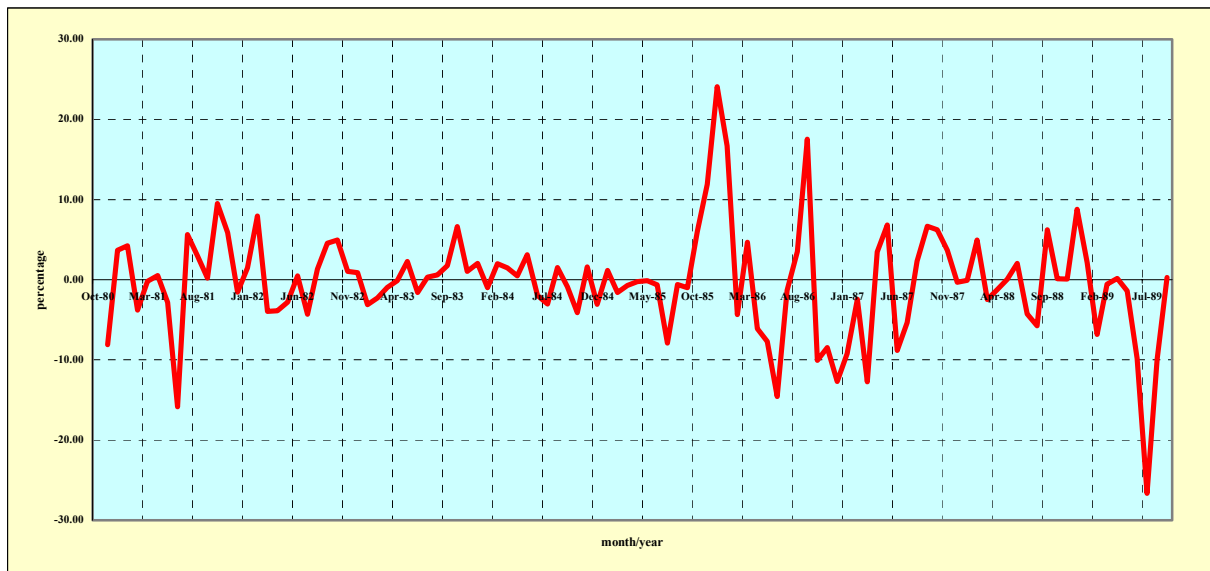
To facilitate an effective assessment of the current market situation and outlook for coffee I shall start by briefly reviewing the development of the world coffee market in the last 25 years. In this time the market has gone through two distinct phases, from 1980 to 1989 and from 1990 to the present, punctuated by periods of volatility and, from 2000 to 2004, crisis conditions for producers. As well as analysing the market I shall refer to activities pursued by the ICO designed to promote equilibrium between production and consumption. As such this paper should be seen to be complementary to the Non-Paper on the decline in prices of primary commodities circulated to the Committee by Kenya, Uganda and Tanzania in May 2003 (WT/COMTD/W/113).

Briefly I should like to remind Members of the Committee that the ICO is an intergovernmental organization established under the auspices of the United Nations in 1963 and designed to facilitate international cooperation on coffee in view of the great economic importance of the product. The ICO has continued to operate under 6 successive International Coffee Agreements since then of which the 2001 Agreement is the latest. It has 74 Members of which 44 are exporting Member countries accounting for over 97% of world coffee production and 30 are importing Members responsible for around 80% of world coffee consumption.

### Quota system period

During the first period from 1980 to 1989, the market was stabilized through the ICO export 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 and 23 points of variation from the standard deviation of the average (see Graph 1).

**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, global 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%. Again, as could be expected, average prices for the period were substantially higher than during the period when the system no longer operated (Table 2).

**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

**Table 2: Coffee prices in the last 25 years  
US cents/lb**

Period average	ICO composite indicator	Colombian Milds	Other Milds	Brazilian Naturals	Robustas
1980-89	127.97	152.02	139.94	153.43	116.00
1990-99	95.68	123.51	116.08	106.54	75.28
2000-04	54.33	77.27	71.11	59.02	34.38
2005	89.36	115.73	114.86	102.29	50.55
on 5 May 2006	93.13	114.78	112.89	102.35	61.47

The regulatory mechanisms for coffee involved the setting by the ICO of a price range agreed by both Producing and Consuming Governments, which was maintained through a system of export quotas with documentary controls both at the exporting and importing ports. Although there was some fraud this was never sufficient to impede the success of the system in maintaining the agreed price ranges.

There is no doubt that in terms of earnings the system was beneficial to producers. Table 3 shows export earnings in the 1980s (with quotas) compared with the subsequent free-market years. Nevertheless it is important to recognize that current conditions are not conducive to reinstating such a mechanism. Politically, developed countries are not in favour of measures to regulate trade; technically, without the cooperation of importing countries it is unlikely that an effective quota system can be set up.

**Table 3: Average annual coffee export earnings of coffee producing countries  
(1980-1989, 1990-1999 and 2000-2005)  
Million US\$**

Period average	Total	Colombian Milder	Other Milds	Brazilian Naturals	Robustas
1980-89*	10 165	2 281	3 020	2 599	2 265
1990-99	8 995	2 018	2 893	1 990	2 093
2000-04	6 234	1 133	2 118	1 630	1 353
2005**	8 628	1 751	2 406	2 976	1 495

\* It is assumed that there was no dual production in any country in the period

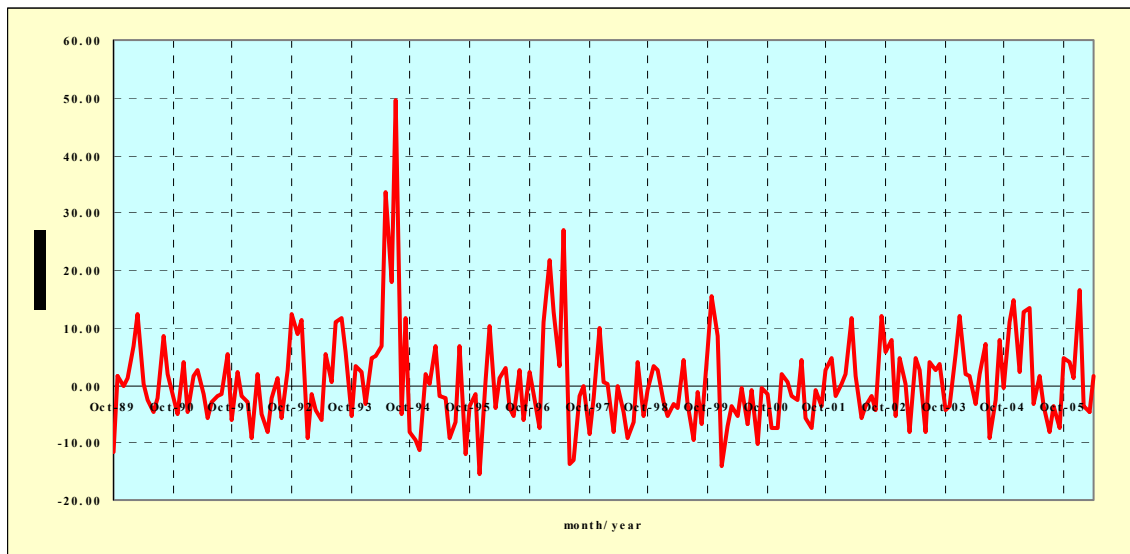
\*\* Partial - totals may include estimates for some countries

### Free market period

The period of uncontrolled markets from 1990 to the present shows 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 (Graph 2). The average for the ICO composite indicator price during this period was 82.37. Again, during this period there was a severe frost in Brazil in 1994. Although this led to a drop in world production of some 10% in 1995, compared with the 16% in 1982, with prices rising some 118% between 1993 and 1994, it is interesting to note that, with replanting, production by 1999 had risen by 35% relative to 1994 and prices had dropped by 38% (Table 4). This indicates that the global increase in production and subsequent price fall caused by climatic shocks under free market conditions was considerably greater than under a controlled market.

Moreover, contrary to what has often been asserted, the short-term price incentive caused by shortages under free market conditions appears to have caused greater over-production than under quotas, which had a built-in disincentive to produce over and above quota entitlements. In addition the mechanisms used in the regulatory period favoured stock holdings in producing rather than consuming countries, which to an extent also strengthened the Producers' position.

**Graph 2: Volatility of the ICO composite indicator price – 1990/91 to 2004/05**



**Table 4: Volume of production and exports, value of exports and ICO composite indicator price – 1990 to 2005**

	Production (crop year commencing)	% variation on production 1/	Volume of total exports (calendar year)	Value of total exports (calendar year)	ICO composite indicator price	% variation on ICO composite price 1/
Calendar year	(000 bags)		(000 bags)	(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	118.16
1995	85 250	-10.41	67 573	11 614	138.42	
1996	101 865		77 549	9 999	102.07	
1997	95 872		80 264	12 880	133.91	
1998	106 163		80 095	11 444	108.95	
1999	115 109	35.03	85 871	9 502	85.75	-38.05
2000	114 882		89 243	8 177	64.25	
2001	106 646		90 516	5 389	45.60	
2002	122 073		88 457	5 127	47.74	
2003	103 764		85 912	5 597	51.91	
2004	111 817	31.16	90 703	6 881	62.15	-55.10
2005	106 489		86 311	8 628	89.36	

1/ Refers to 1995 for 1999 and 2004, otherwise it refers to the previous year

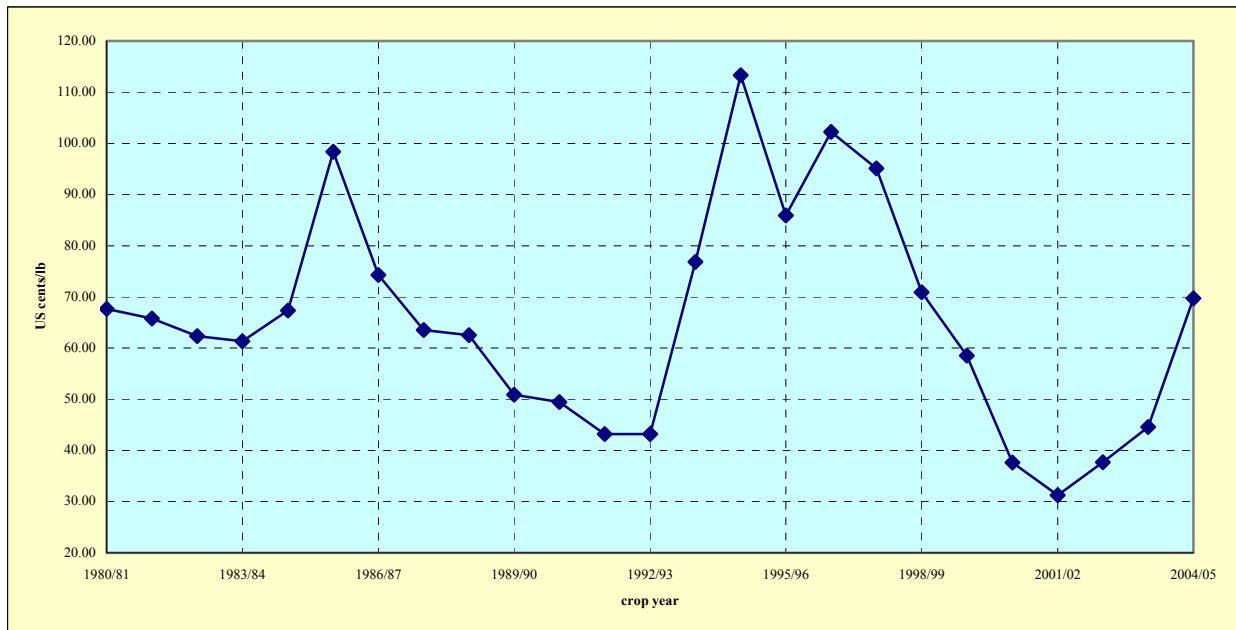
Looking at prices to coffee farmers, ICO data (see Table 5) shows that in the period 1980/81 to 1988/99, prices paid to growers averaged 69.24 US cents/lb, with annual average highs of 98.36 cents in 1985, and lows of 61.36 cents in 1983/84. In the period from 1990 to 2005, the average had dropped to 63.97 cents/lb with highs of 113.32 cents in 1994/95 and lows of 31.28 cents in 2001/02. I want to emphasise that these are annual averages of all available

country prices weighted by volume of exports; the figures will of course differ for specific countries (Graph 3).

**Table 5: Prices paid to growers (weighted by exports levels) – 1980/81 to 2004/05**

1980/81	67.65	1993/94	76.83
1981/82	65.75	1994/95	113.32
1982/83	62.32	1995/96	85.90
1983/84	61.36	1996/97	102.26
1984/85	67.36	1997/98	95.08
1985/86	98.36	1998/99	70.92
1986/87	74.28	1999/00	58.55
1987/88	63.55	2000/01	37.64
1988/89	62.53	2001/02	31.28
1989/90	50.87	2002/03	37.70
1990/91	49.47	2003/04	44.56
1991/92	43.19	2004/05	69.70
1992/93	43.18		

**Graph 3: Prices paid to growers (weighted by exports levels) – 1980/81 to 2004/05**



### The coffee crisis

The coffee price crisis 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 included 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, implying losses in earnings in excess of US\$30 billion. On the other hand, it is worth noting that the coffee market in industrialized countries continued to be relatively healthy with steadily rising retail sales, particularly in terms of value.

This striking discrepancy was publicised by the Executive Director of the ICO, for example in submissions to the G8 and to UN fora and has been recognized by many organizations concerned with development in low-income countries. The consequences are now being seen in the form of a number of initiatives designed to promote greater sustainability in coffee. Obviously, in accordance with the UN Rio Principles, this must include economic sustainability and it remains to be seen how effective these initiatives will be in this respect since several of them are unwilling or unable to address the issue of covering production costs through adequate prices. Moreover for successful implementation of such schemes representatives of producers should be involved in the decision-making process to ensure their concerns are met<sup>1</sup>. Finally care is needed that such schemes are equally accessible to small as to large producers.

### **Other ICO activities**

#### *Quality*

The ICO has strongly promoted quality through setting basic quality target standards for coffee in terms of defects count and moisture content (see ICC Resolutions numbers 407 and 420). This is seen by the ICO as a means of encouraging consumption by setting a basic standard and has the added benefits of reducing the risk of contamination by mycotoxins.

#### *Statistical data*

The ICO from its inception has disseminated statistical data on trade and other variables relevant to coffee. These are mainly disseminated electronically. In addition the Executive Director issues a Market Situation Letter every month. Great care is given to using the most reliable statistics including official data transmitted at monthly intervals by Members.

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<sup>1</sup> *Ponte, Stefano – Standards and Sustainability in the Coffee Sector; a global value chain approach. Winnipeg, IISD, 2004.*

### *Technical studies and seminars*

Regular analysis of the market situation is complemented by studies on areas such as volatility and tariffs. On technical issues the ICO has held regular seminars such as those on electronic trading and genetically modified coffee.

### *Coffee development projects*

Finally the ICO has an important projects programme, working closely with the Common Fund for Commodities, but also involving other sources of finance. During the period since 1995 the ICO has secured approval of 21 projects, mainly dealing in areas such as quality, improvement, market structure improvement, diversification, combating pests and diseases and modernizing infrastructures. This programme is worth some US\$72 million.

### *Promotion and information*

The ICO also looks at areas such as promotion of consumption, disseminating information contained in published studies on all aspects of coffee and communication and action on phytosanitary issues.

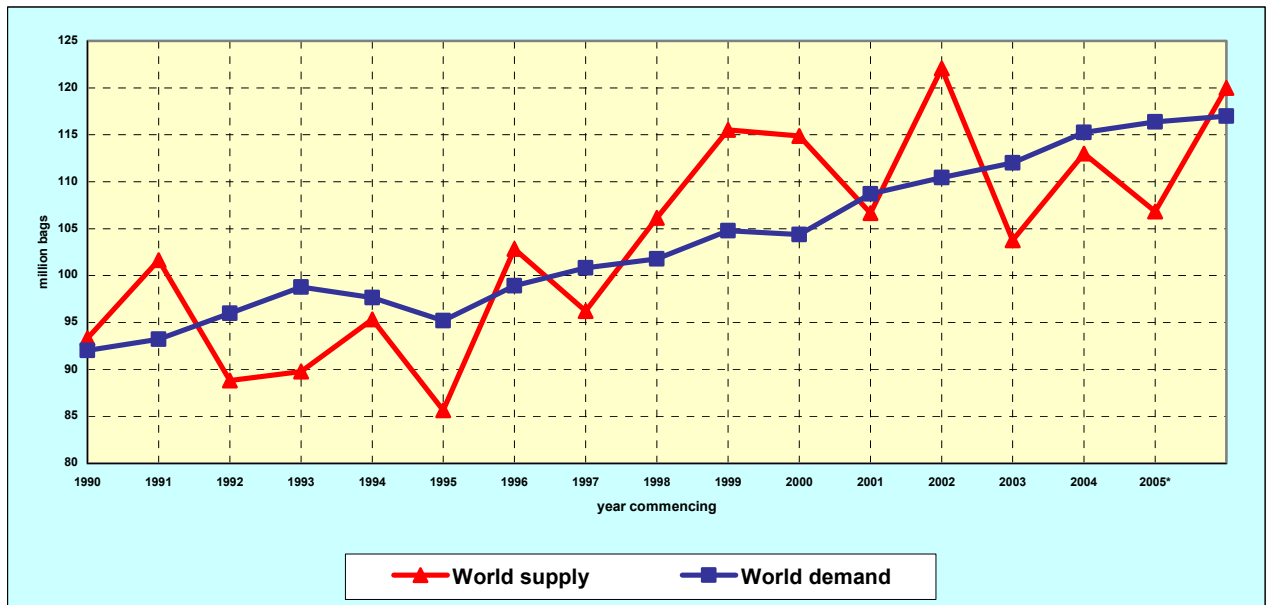
## **The present situation**

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 (Graph 4). Our estimates for 2005/06 are for world production of around 106 million bags compared with world consumption of 115 million; for 2006/07 we see a balance of around 120 million bags. There are clear signs of a drawdown in stocks in producing countries, estimated at 23.35 million bags on 1 October 2005 compared with 28.11 million on 1 October 2004. This has led to a marked upward move in Arabica prices. The ICO Other Mild Arabicas indicator more than doubled from the beginning of 2004 to mid-March 2005, with the main increase starting in December 2005 and is now (9 May 2006) 113.79. Robusta prices, on the other hand, continued depressed until the beginning of 2005, where the price was virtually identical to that on the first trading day of 2004 (37.59 cents). There has been further upward movement here too, with the Robusta indicator reaching over 61.93 cents on 9 May, a rise of around 65%. There is a significant difference between the supply/demand dynamics of the two main types of coffee.

Again it is worth noting that the price recovery still does not reach levels attained during the 1980s, as shown in Table 2.



Graph 4: Supply and demand 1990 to 2005



### Lessons from the crisis

It is clear from the figures I have given you that climatic events and other supply shocks remain a real threat to the development of a balanced market and sustainable conditions for the world coffee economy. In spite of the evidence of higher producer returns under a policy of international supply management I must re-emphasise that the political, economic and technical conditions of today rule this out as a realistic option. The challenge then is to improve the situation without overt market intervention. The whole question of learning lessons from the crisis and seeking sustainable solutions were addressed by the very important Second ICO World Coffee Conference in Salvador, Brazil last September. I would urge all interested in coffee to study the papers presented, which may be accessed on the ICO Website, [www.ico.org](http://www.ico.org).

From the experience of recent years I would like to draw your attention to six areas in which action is possible both with respect to national policies and international cooperation.

#### *Information and guidance*

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. With respect to information the ICO has emphasised communication via its website and provides important research facilities through its Library. It has also cooperated with the International Trade Centre

UNCTAD/WTO to produce a comprehensive guide for coffee exporters, now complemented by a Web-based Question and Answer service.

### *Diversification*

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 (in the last year two projects have been launched in Mexico and Ecuador) 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, and the elimination of tariffs. The ICO has recently sponsored a project, funded by the European Community and the Common Fund for Commodities, firstly to analyse coffee production costs and profitability in representative producing countries, and then following this up with an analysis of the options for diversification. The results will be presented at a Workshop at the ICO on 24 May.

### *Adding value*

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. This area is closely linked to promoting domestic consumption in producing countries since this gives invaluable experience before embarking on exports of processed coffee. Finally I should mention that new transport technologies are making it more technically feasible to export roast coffee but tariff escalation on processed coffee in many markets remains a problem (see ICO document ICC 94-6).

### *Competing on quality rather than price*

Fourthly it would be of great benefit to farmers if large roasters switched from a policy of competing on price, which is becoming (at least in mature markets) less and less effective as an incentive in terms of sales volumes, to competition on quality, where there is empirical

evidence that improved growth in sales is more likely. This is clearly demonstrated by the success of quality-oriented roasters such as Illycaffè but must be balanced by considering price pressures on mainstream roasters from supermarkets and pressure to maximise short-term margins driven by the effect on share prices of quarterly results. At present regular coffee traders in producing countries tend not to offer premiums for quality. The lessons of the ICO gourmet coffee project were that growers with a superior product must contact traders acting for roasters anxious to secure premium quality and willing to pay an appropriate premium. Hence competition on quality would effectively guarantee premiums to farmers who worked to secure a good quality crop. Some companies are beginning to do this with success but in many others a mind-set persists in which competition and price remain key linked considerations. In this context a study in 2001 concluded that “increased corporate financialisation of giant roasting firms entails that their more pressing goal is not expansion of activity *per se* any more. Their goal is rather the maximisation of profit in the short term to increase the value of shares<sup>2</sup>”. And with this perception it is crucial to acknowledge that the prime and indeed legitimate duty of large companies is to their shareholders, not to their suppliers. While this remains the case farmers must accept that they will continue to face an environment in which powerful companies endeavour to use all their organizational resources to secure the keenest prices. Any countervailing influence on this dynamic must therefore come from governments or perhaps through schemes agreed by companies in pre-competitive frameworks.

### *Capacity building*

The development of farmers’ organizations such as associations and cooperatives can help in improving services, bargaining power and access to credit and risk management instruments. It can also facilitate the work of extension services, which also need strengthening in many cases, particularly since the drive for internal market liberalisation in the 1990s often led to the weakening or even disappearance of such structures.

### *Market development*

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

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<sup>2</sup> Ponte, Stefano – *The ‘Latte Revolution’? Winners and Losers in the Global Coffee Marketing Chain*. Copenhagen, Centre for Development Research, 2001. CDR Working Paper 01.3.

to promote coffee consumption, which makes comprehensive use of the experiences of Brazil, commissioned by the ICO and disseminated at our last Council Session. The Guide can be downloaded from the ICO website ([www.ico.org](http://www.ico.org)) and is also available as a CD. This gives in English, French and Spanish comprehensive methodologies and techniques for the promotion of coffee consumption, with emphasis on producing countries. Not only does developing local consumption provide a valuable alternative market outlet but it increases producer awareness of consumer demands, promotes small and medium enterprise and provides vital experience for the eventual export of value-added products. Following this up there are now some positive signs that some international donors are beginning to recognize the importance of support for market development. We will be discussing a major project initiative in this area at our forthcoming Council session later this month.

While still on market development, and this affects all areas, I must add that I am also very pleased that the major coffee roasters in Europe are cooperating with us in the Positively Coffee Programme to disseminate a new generation of objective and positive research findings which indicate real beneficial effects on health 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 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. There is much to be gained in many areas through cooperation rather than confrontation, but to achieve this all stakeholders must be allowed an equal voice to defend and explain their legitimate concerns.

London, 9 May 2006