

**Statement by the Executive Director of the International Coffee Organization,
Mr. Néstor Osorio, at the Ministerial Conference on the impact of the current coffee
crisis on the African economy and the 42nd Annual General Assembly of the
Interafrican Coffee Organisation, Malabo, Equatorial Guinea,
from 29 to 31 October 2002**

Honourable Ministers,
Your Excellencies,
Mr. Chairman of the Interafrican Coffee Organisation,
Madame the Secretary-General of IACO,
Distinguished Delegates,
Ladies and Gentlemen,

INTRODUCTION

I was very honoured to receive an invitation from the Chairman of the Interafrican Coffee Organisation and the Government of the Equatorial Guinea, to address the Assembly of IACO in Malabo. As you are aware, since I took over the position of Executive Director of the International Coffee Organization earlier this year, I have visited Côte d'Ivoire in July to share with the authorities my view of the problems created in exporting countries by the current crisis in the coffee economy. Apart from my personal satisfaction at finding myself once more in Africa among friends and eminent personalities, my presence at this important meeting in this beautiful country of Equatorial Guinea is a testimony to the very particular interest of the International Coffee Organization in the IACO, which brings together all of the African coffee community.

As an instrument of regional cooperation on coffee, the IACO has always given voice to African interests at crucial times in the life of the International Coffee Organization. It has participated actively in the work of the International Coffee Organization for many years, contributing to the implementation and success of programmes to regulate the market. But for almost 13 years now we have been witnessing a profound change, characterized by the almost complete disappearance of mechanisms for direct intervention in the market and the liberalization of marketing systems. In this free trade atmosphere, coordination of the efforts of our two organizations to support the coffee industry in producing countries becomes more vital than ever. This is of particular importance at this time when we face such major problems and challenges.

THE CRISIS

The history of coffee is one of booms and price busts in which the former almost invariably ushers in the latter. The current case is no exception. The difference is that prices are at an all-time low, and there has never been such a marked imbalance between supply and demand, a situation that has transformed the structure of the coffee world.

When the quotas agreement broke down in 1989 prices plummeted from average, long-term composite indicator prices of between 115 and 120 US cents/lb to 71.53 in 1990; 66.80 in 1991; 53.35 in 1992 and 61.63 in 1993 (annual averages).

This was a real crisis, which many of us had seen coming, but which many others denied could occur. History has demonstrated what it has meant to lose this management tool, and the price of doing so. When Governments and the coffee authorities attempted to recover that tool it was too late. A compromise proved impossible and the situation worsened. That was the moment to make the necessary adjustments, to rationalise supply and organise a return to equilibrium. The very adverse weather in Brazil, together with its retention plan, changed the outlook and prices soared. Economic well-being returned from mid-1994 to mid-1999, and the anxiety of the previous five years faded from memory. This is the root of the present crisis. Like an anaesthetic, the boom deadened the previous pain, allowing the emergence of Vietnam, the growth of Indonesia, the consolidation of India, and the modernisation of coffee-growing in Brazil to come about.

The only production policy which existed was simply to step up production, without any parallel, in-depth action to boost consumption. Importers built up their stocks once again, and the market was re-flooded. The anaesthetic wore off, and coffee prices collapsed to a greater extent than in the early 1990s, going down to an average composite price of 45.60 US cents/lb in 2001. In September that year the average price dropped to 41.17 US cents/lb. This meant that washed Arabicas were at 58.07; Robustas at 24.27; Colombian Milds at 68.80 and Brazilian Naturals at 42.42. This, in other words, was a price war, which is being fuelled continuously, with prices, in real terms, at their lowest level for 100 years.

With coffee supplies continuing to swell and grow, prices were in free fall. This is why the recourse by a few countries to a new retention scheme proved fruitless. Moreover, there was no frost this time to support it. The scheme only could have proved effective, also, if more countries had participated, there had been more discipline, and exportable production had been withheld. The percentages that were retained were calculated in relation to exports, which were continuing to grow, and since supply did not diminish no effect was achieved.

The crisis has now reached very alarming proportions and is now being felt in social, economic and political arenas. In the early 1990s earnings by coffee producing countries (exports f.o.b.)

were some US\$10-12 billion and the value of retail sales of coffee, largely in industrialised countries, about US\$30 billion. Now the value of retail sales exceeds US\$70 billion but coffee producing countries only receive US\$5.4 billion. Although prices recovered slightly in September, the levels are still very low. The drop in earnings is particularly severe for countries with high degree of dependency on coffee such as Burundi, Ethiopia, Rwanda and Uganda in Africa, and El Salvador and Nicaragua in Central America.

CURRENT MARKET SITUATION

The equilibrium situation, statistically speaking, is even more problematic for the year 2002/03 than for 2001/02.

In my monthly letter for September I carried out the relevant analysis. Clearly Colombia's recovery, the very important presence as a player of Vietnam, albeit with lower production, and Brazil's record crop, have helped to bring about abundant supply.

In fact, at the outset of 2001/02 total stocks were 36.7 million bags, world production reached 117.3 million bags, and total consumption stood at 108.2 million bags. This means that on 1 October, when the current coffee year commenced, total stocks reached 45.8 million bags. With initial estimates for production for 2002/03 running at 119 million bags, it is hard to predict a satisfactory price outlook. Some specialist analysts, such as LMC International, are predicting a total global production of 122 million bags.

Since the dismantlement of marketing boards or *caisses de stabilisation* in Africa, managing market supply has become a serious issue in countries lacking strong farmers' organizations. So the market is flooded once coffee has been harvested. Export flows concentrated within a very short period of time also contribute to depress prices.

A threat to sustainable development

It is estimated that over 125 million people worldwide are dependent on coffee for their livelihoods. But since it is a perennial crop it is not easy to switch to an alternative when prices are at today's levels. The consequences of the current situation vary but in many cases prices do not even cover the costs of production, providing a real threat to sustainability. One of the objectives of the International Coffee Agreement is to encourage its Members to develop a sustainable coffee economy. The ICO recognizes that sustainable development has an economic and social as well as environmental dimension. There is little doubt that the exodus from rural areas and increased poverty in coffee producing areas caused by the current price crisis poses a very real and wide-ranging threat to sustainable development.

Consequences for consumers

Although consumers could be expected to benefit from low prices this is not the case in coffee. Firstly, the amount accruing to the farmer from the retail sales price of a cup of coffee in a coffee shop is probably less than 2%. Secondly, excessively low prices lead to lower quality. An example is the farmer who normally pays harvesters to go through the coffee trees three times during a harvesting season to pick the ripe cherries and now sends them through once only, picking unripe and overripe beans with the ripe ones. Another is the fact that the highly appreciated mild Arabica coffees are usually produced at a higher cost than natural Arabicas or Robustas so the percentage of the former is decreasing in blends as farmers find it increasingly hard to stay in business.

CONSUMPTION SITUATION

World coffee consumption, according to our estimates, stands at approximately 108.2 million 60-kilo bags, of which 27.2 million are consumed in producing countries, and 81.0 million in importing countries. It is a similar level of consumption to 2001. If we observe consumption levels over the past 10 years, we can conclude that per capita levels have gradually fallen in importing countries. For example, in the Netherlands it has dropped by 38.5%; in Sweden by 27.8%; Belgium by 32%, and the United States by 4.5%. Germany, which is the world's third largest consumer after the United States and Brazil, is an interesting case: per capita consumption peaked in 1982 at 8.2 kilogrammes, and had dropped to 6.90 kilos by 2001. In general terms, demand is lagging behind, for while supply is growing at 3.6 percent per annum, consumption is only growing at 1.5 percent.

ADDRESSING THE CRISIS

In order to address this crisis the key actions I proposed, which were endorsed at the International Coffee Council session last September, were to try to restore market balance by promoting demand and by adjusting supply not through market intervention but through projects and programmes to diversify production and eliminate the lowest grades of coffee from the market place. More specifically:

Coffee Quality-Improvement Programme (CQP)

Resolution number 407 adopted by the Council in February 2002 established the CQP, and outlines minimum standards for exportable coffee which will play an important role both in improving the quality of coffee on the world market and in helping to reduce the current imbalance in supply and demand by eliminating low-quality coffee from the market. These standards require that exporting Members shall not export coffee that:

- for Arabica, has in excess of 86 defects per 300 g sample (New York green coffee classification/Brazilian method, or equivalent);
- for Robusta, has in excess of 150 defects per 300 g (Vietnam, Indonesia, or equivalent);
- for both Arabica and Robusta, has a moisture content below 8% or in excess of 12.5%, measured using the ISO 6673 method.

There will no doubt be obstacles and problems, but the political will to remove poor quality coffee from the world market would make it possible to boost the value of coffee exports without undermining the interest of the industry.

Diversification

There was strong support for ICO initiatives to develop a diversification programme which could play a crucial role in assisting farmers and alleviating the poverty they were experiencing, as indicated by a new Caribbean regional project. The ICO is identifying sources of funding from multilateral agencies to implement diversification projects in producing countries and will prepare an analysis of areas under coffee cultivation and potential areas for such projects for the meeting of the Executive Board in January 2003. Members are invited to make known their proposals for diversification projects and to help the Secretariat identify sources of funds.

Mobilising resources

One of the most serious problems with regard to the international agencies' utilisation of their mandates is the lack of coordination and consistency. Organizations such as the FAO, UNCTAD, the World Bank, the WTO, the Common Fund for Commodities, and the regional development agencies deal with the commodities issue in an unjoined up way.

This leads frequently to a duplication of activities and, even more seriously, to contradictory policies. This has led to some of these organizations granting finance and support to extend the borders of coffee production when the coffee world is in the throes of over-production. I have proposed to all these organizations that we work in harmony and coordination, with regular consultation fora to facilitate consistency. Also, in order to achieve this, I have requested that the heads of the organizations recognise the ICO as the focus for designing policies for this commodity, and bring forward the relevant consultations on projects or activities within the sector. I have had a wonderful welcome, and I am meeting regularly with the different representatives of the organizations. For example, I met senior officials from the World Bank and some of its directors in Washington. I also met the President of the Inter-American Development Bank, and their counterparts at the FAO in Rome and UNCTAD in Geneva.

At the end of October I will be meeting the Director of the Common Fund for Commodities, and other directors of the sector, to study and review aid policy and set future priorities. In

November at the WTO, I will be meeting representatives of the WTO, the World Bank, the FAO, the International Monetary Fund and the OECD to analyse the treatment of, and negotiation prospects for, commodities in the context of the WTO round of negotiations. Next year the ICO and the World Bank will hold a coffee conference to seek out proposed solutions to the coffee crisis.

Promotion and market development

The importance of increasing consumption in both producing and consuming countries has also been recognized.

For that reason it is essential to develop promotion projects, educating and informing the consumer about the positive benefits of coffee. Work on the health aspect cannot be postponed, particularly in the United States where this factor profoundly influences consumer behaviour. Here I have made contact with the coffee authorities and managers of private firms with a view to investment in the “coffee and health” area. Brazil has been an inspirational pioneer in this field, and it is a case which can serve as an example to others. We are planning a world conference on the subject “coffee and health” next year to mark the 40th anniversary of the ICO. With respect to producing countries a project to expand and develop the coffee market in producing countries in Africa, Asia and Central America has also been approved in principle by the ICO Council.

As far as consumption is concerned I believe that a strategy based on demand management should have an important place in discussions on the future of international cooperation on coffee. This has played a very small role compared with supply management, which has frequently required the introduction of export quotas or retention plans. Since both strategies are designed to reduce the imbalance and help to support prices, it is suggested that consideration be given to actions that make it possible to increase demand in order to reduce overproduction in the medium and long terms. From the viewpoint of encouraging consumption, the Interafrican Coffee Organisation could extend its membership to include the Maghreb countries and the Republic of South Africa, which are important areas for coffee consumption. In this regard, I would like to challenge Madame Sacko, with all due respect, to double the number of IACO Members by opening its doors to African consuming countries. My task would then be to welcome these countries as Members of the International Coffee Organization.

Coffee development projects

In many African countries, with the implementation of reforms to redress the economy and lay the basis for an environment favourable to private enterprise, the agricultural export commodities sector is undergoing a number of changes. Although the liberalization of marketing systems is an irreversible process, we must not forget that change works in both directions and may bring

difficulties as well as advantages. A sudden change may lead to some malfunctioning in the sector. These reforms should, therefore, be carried out with a minimum of precaution, taking into account possible negative consequences.

In other words, policy changes should be carefully managed to avoid a situation in which, given the absence of greater competitiveness resulting from the lack of financial resources on the part of most of the operators involved, the free market brings into play a handful of powerful buyers and a large number of relatively weak sellers. In fact, following the dismantling of marketing boards or stabilization funds, certain countries witnessed a proliferation of independently operating small traders but many were subsequently eliminated in a fiercely competitive climate, mainly because of a lack of commercial know-how but also because of financial difficulties. The survivors often have links with foreign firms; this facilitates entry into the market as well as access to indispensable financial resources. In this regard, we are glad to note that projects designed to solve problems identified in the sector can be prepared for submission to the Common Fund for Commodities for financing. In its capacity as an International Commodity Body authorized by the CFC, the ICO is in a position to provide assistance to exporting Member countries, through these projects, which are designed to improve the coffee sector in their countries. To date we have mobilised some US\$63 million of mainly grant funding for projects, many of which are in Africa, with new projects worth some US\$35 million under consideration. We are convinced that the Interafrican Coffee Organisation, in cooperation with the African Coffee Research Network, will continue to support Member countries in identifying and preparing projects.

These initiatives are all conceived within the framework of the normal dynamics of the market and do not seek to put unreasonable restraints or distorting pressures on the coffee trade.

ROLE OF THE ICO

The ICO is an intergovernmental organization and as such Governments designate their delegates and representatives according to the priority they attach to the subject. The private sector has always been linked to the ICO deliberations and negotiations. However, in recent years, the degree of attention paid to it by certain importing countries is not what it was in the time of the economic clauses. This can be explained to some extent by the fact that the commodities agreements have lost the priority they had in the old days. But I have resolved to change that attitude, for I am convinced that they still represent a valuable cooperation tool, to the extent that a large number of producing countries are still highly dependent on coffee and a further two or three commodities, such as cocoa, sugar and bananas.

With the industrialised world's agricultural subsidies running at over US\$360 billion, it makes no sense to leave the developing countries' agricultural products to drift without any protection or support whatever.

It is necessary for government and private sector representatives of Member countries to devote more energy to analysing and managing the coffee problem. Under the new Coffee Agreement a Private Sector Consultative Board has been set up, to which I attach the utmost importance, for it brings together representatives of the exporting and importing sides of the industry, that is to say the real world, which has the ability to guide and contribute to the development of effective policies.

It is in this spirit that I call on everyone to cooperate in the search for sustainable solutions for coffee growing and the coffee industry, which can and should contribute so much to the well-being of humanity.