

and AGRARIAN REFORM in LATIN AMERICA

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## Chapter 5

# The International Coffee Market: Implications for Latin American Exporters

by

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### INTRODUCTION

Although present (1977) market conditions have driven the price of coffee to record levels, the governments of producing countries know that their gains will be short-lived. The international market for coffee is characterised by a constant tendency to overproduction among existing producers. Furthermore, although the 1975 Brazilian frost disaster along with civil war in Angola and political difficulties in Uganda have put extreme strain on production and stocks, in "normal" times stocks held in exporting and importing countries are usually much higher than amounts required to maintain supply and distribution pipelines at full-capacity. It is estimated that production and prices will return to previous levels by 1978-79, provided weather conditions remain favourable.\*

After analysing the general long-term characteristics of the international market, this chapter examines the attempt of coffee producers to form a cartel in 1973 and the main features of the international coffee agreement of 1976. It demonstrates that continued participation in the present world coffee market by existing Latin American producers, with the farming techniques now being used, will do little to accelerate their economic development.

The study points out that the 1976 ICA discriminates against low cost producers and removes pressures for cost reduction in coffee production. It notes, however, that to a very limited extent, some improvement in production and real incomes of growers and farm workers is occurring in certain exporting countries. The tendency for strong competition between exporters and the social and political rigidities of the *minifundio-latifundio* system lead to the conclusion that current practices will be followed as long as the present

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\* Editor's note: Coffee prices did indeed fall back to 1976 levels during 1978. At time of publication, the price of coffee, adjusted for inflation, is below the December 1975 level.

system of landholding and farm management persists. Misallocation of resources, and lower real incomes to growers and farm workers is the inevitable result.

### GENERAL DEMAND FACTORS

In general, demand for coffee seems to be (per capita) income elastic. For moderate price changes, the price elasticity of demand is certainly below unity. Of course, very large price increases as we have seen recently, if maintained for several years, would result in much lower consumption. Coffee is not an essential good, has no nutritional value, and many substitute (and imitation) beverages are readily available at low cost.

World demand is relatively stagnant, growing at about 2% to 3% per year. It is heavily concentrated in North America and Europe. However, by using modern marketing techniques, it may be possible to increase demand because there are wide variations in per capita consumption within the consuming group, especially within Europe and also Japan.

Table I

#### Latin American coffee exports

	Unit price index 1960-72 Average 1967-69 = 100	% world trade value	Value of coffee exports 1960-72 \$ Millions	Volume 1000's of metric tons
1960	104.1	75.7	1439.9	1817.9
1961	99.9	75.0	1379.5	1813.6
1962	95.3	73.2	1368.1	1887.2
1963	91.7	71.8	1434.2	2054.5
1964	117.1	67.9	1622.3	1819.9
1965	120.5	68.6	1528.3	1667.3
1966	108.7	65.7	1575.4	1904.7
1967	98.2	64.6	1466.4	1963.0
1968	103.7	65.4	1672.2	2118.3
1969	98.1	64.5	1601.6	2145.2
1970	130.2	64.7	1982.0	1999.8
1971	103.9	61.5	1679.0	2082.5
1972	116.7	62.4	1972.4	2221.1

Source: Inter-American Development Bank: *Latin America in the World Economy*, Washington, 1975, pp. 57, 58, 61, 84.

Table II

Country	Contribution of Latin American countries to total value of world coffee exports — 1970-72 averages	Contribution of coffee to total value of exporter's commodity exports 1970-72 averages
	%	%
Bolivia	0.2	2.0
Brazil	47.4	27.9
Colombia	22.6	49.2
Costa Rica	3.8	28.9
Dominican Republic	1.2	8.6
Ecuador	2.3	16.2
El Salvador	5.5	39.6
Guatemala	5.5	33.4
Haiti	1.0	43.4
Honduras	1.4	14.0
Jamaica	0.1	0.4
Mexico	4.1	4.8
Nicaragua	1.6	15.2
Panama	0.1	1.0
Paraguay	0.1	2.1
Peru	2.3	4.4
Trinidad and Tobago	0.1	0.4
Venezuela	0.8	0.4

Source: Inter-American Development Bank, *Latin America in the World Economy*, Washington 1975, p. 48, 50.

### GENERAL SUPPLY FACTORS

Except for small quantities produced in Hawaii and Puerto Rico, all coffee traded on world markets is produced in developing countries. World production is concentrated among a small group of countries in Latin America and Africa. The leading growers are Brazil, with 30-35% of world output, Colombia with about 12%, Ivory Coast, Angola, Mexico, El Salvador, and Guatemala. Latin American producers account for about 60% of total world output but the African producers are becoming more important as time passes (see Table 1, second column). In all, there are 42 countries exporting about 55 millions — 60 kilogram bags of coffee annually.

Coffee represents 11.7% of Latin America's exports. Based on 1970-72 average trade data, Brazil accounts for 47.4% of the total regional export earnings from coffee, Colombia 22.6% and Central American countries 17.8%.<sup>1</sup>

<sup>1</sup> Cf. Inter-American Development Bank, *Latin America in the World Economy*, Washington, 1975, pp. 47-48.

Table III

% world trade in coffee accounted for  
by principal exporters and principal importers.  
1971-73 average trade values.

	<i>Exporters:</i>	<i>Importers:</i>
First country (A):	Brazil	U.S.A.
% world total:	33.2	37.9
First 3 countries (B):	A + Colombia + Ivory Coast	A + Germany + France
% world total:	50.2	55.5
First 5 countries:	B + Uganda, Angola	B + Italy & Netherlands
% world total:	60.6	64.7

Source: Inter-American Development Bank, *Latin America in the World Economy*, Washington, 1975, pp. 54-55.

### RECURRENT OVERSUPPLY

Producers have been unable to come together to deal with their recurrent supply problem. After the 1968 International Coffee Agreement (ICA) collapsed at the end of 1972, Brazil, Colombia, Ivory Coast, and Angola did join together in a cartel-type arrangement, but their arrangement collapsed due to poor timing, lack of cohesion between producers, and a very large crop in 1974/75. With the new 1975/76 sellers market, there are rumours that producers are working together to push up world prices. Producers have been collecting export taxes which have increased with the price of coffee (\$1.47 per pound in Colombia; \$0.80 per pound in Brazil), but this is nothing new and has been done for years. Certainly, it is not unique to coffee exporters. These taxes are an important source of revenue to exporting governments. However, what is essential about the 1977 market is that producers are still competing in "free" market conditions. Weather conditions, rather than a united producer action, have reduced the amount of coffee produced in Brazil, and thus the amount Brazil will put onto the market.

As a result of this cutback in Brazilian production, we have seen sophisticated exporters experiment with price increases to capitalize on the price inelasticity of demand for coffee (up to about \$3/lb.). But it is very doubtful that coffee prices will remain at present levels because this would attract much new production and within three years the over-supply problem would probably push prices to record lows. Also, at such high prices, consumers may start switching to other beverages and, just as important to producers, no progress is

to be expected in increasing per capita consumption in Europe and Japan.\*

### *PRODUCER CO-ORDINATION OF SUPPLY*

As the above discussion points out, coffee producers have very little chance of succeeding in the formation of a producers' cartel which would restrict supplies and keep prices high.

The first essential ingredient for an effective cartel is cohesion between exporters, but this seems to be totally lacking among coffee producers. During previous coffee agreements (where producers were asked to respect export quotas), there was a constant tendency to sell outside the ICA quotas at cut prices.

Perhaps the nature of coffee production is a greater obstacle to effective producer cartelisation. Unlike some other commodities such as oil, it is most difficult to cut back production. For oil producers, it is simply a matter of turning a tap and leaving the oil in the ground; not many persons are thrown out of work. Coffee production is much more difficult to curtail in the short term.

New investment can be diverted out of coffee production by heavier taxation, lower (imposed) domestic prices, or access to credit for diversification. The variable costs involved in coffee production however are very low, and it would take drastic measures to cut back production quickly. One of the several alternatives to reduce production is the destruction of trees. But even such programmes have been known to fail as peasant farmers destroy only the low-productivity trees, or farm the remaining trees more efficiently. If trees were to be destroyed on a large scale, many people would become unemployed and in most countries it would be difficult to find alternate employment.

The other alternative for producers wishing to restrict supply is to pick and store the beans. This is very expensive, and the existence of huge producer stocks would be a constant temptation especially to those exporting countries in extreme need of foreign exchange.

### *INTERNATIONAL COFFEE AGREEMENT*

A new traditional-style agreement between producers and consumers has been in force since October, 1976, although no export quotas will come into effect until the price of coffee comes down to

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\* Editor's note: As Brazilian production has recovered from its 1975 frost damage, Brazil has competed aggressively in order to restore its market share to pre-1976 levels. In December 1979, Brazil was offering its coffee on much more favourable terms than any other exporters. Brazil's actions pushed prices down and led to the break-up, in Autumn 1980, of the Latin American producers' price support group, known as Pan Café.

a trigger price, probably in the neighbourhood of 60 to 70 cents per pound\*.

Generally, the ICA is established to deal with conditions of serious oversupply. The agreement (like the previous ones) works primarily through a system of export quotas. Previous agreements were only mildly successful in overcoming the cyclic problem of coffee, which involves excess planting in periods of high prices leading to constant overcapacity. Most trees bear fruit three to four years after being planted, but bear fruit for over twenty years. Although almost all coffee is exported from developing countries, the agreement is not meant to be an instrument to transfer resources on an "aid" basis, but rather a price stabilization scheme. Like its predecessors, the 1976 ICA is open to all the arguments for and against this type of supply control through export quotas.<sup>2</sup>

Clearly, the quotas discriminate against new low-cost producers and do not provide pressures for cost reduction which would exist were there no agreement in force.

Even less helpful are the recommendations stated in the UNCTAD integrated programme, to include coffee as one of the commodities to be considered for stockpiling from a "common fund". The entire programme is to be negotiated over the next few years. In this regard, Brazil and Colombia have proposed the establishment of a 10-million bag stockpile, but it is this author's view that in the case of coffee, such a stockpile would merely allow the usual stockholders to shift part of the responsibility and *costs* of holding normal stocks to the financing members. However, recent events illustrating the range of prices in which the price elasticity of demand for coffee remains low, and profits made on last year's stocks, may make coffee exporters less anxious to transfer control of coffee stocks to international managers.

The key to the 1976 ICA, as with others, is that its effectiveness is determined by the willingness of exporters and importers to adhere to its clauses. Since no international authority exists to enforce agreements, and since all states pursue their own (short-term) self interests, most states tend to stray from the agreement when it suits them. Low cost exporters, supplying a small part of the world market will always want to increase their market share. Some exporters may find it difficult to remain in the agreement while their large stockpiles rot or are attacked by fungus. The ICA is enforced

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\* Editor's Note: The 1976 ICA was replaced in October 1980 by a similar type of agreement, based on a trigger-price mechanism that raises export quotas when prices go up and lowers them when prices go down.

<sup>2</sup> See Irving B. Kravis, "International Commodity Agreements to Promote Aid and Efficiency: The Case of Coffee", *Canadian Journal of Economics*, I, (May, 1968), pp. 305-317. Similar arguments apply to most recent ICA signed in October 1980.

by importing countries which are asked only to allow the importation of regulated coffee. As with any agreement, there are always loopholes or ways around the clauses as exemplified by "tourist" coffee<sup>3</sup> in previous agreements. In effect, when a consuming country enforces the rules as written, it is giving a sort of foreign aid. The continuation of this "aid" may be subject to a number of criteria, which are beyond the scope of this paper, but fortunately treated at length in the literature on "aid".

### BEYOND THE ICA

While the 1976 ICA may be able to cope with future periods of oversupply, in the long term, it is clear that the ICA does *nothing to reduce incentives to produce coffee*. Unless they learn to cooperate with rather long-term objectives in view, producers will always be in intense competition, especially to increase exports, and the size of their stocks, and thereby, their allowable quotas in periods of oversupply (Article 30).

Because of the large numbers of countries which could and would move into coffee production at sharply higher prices it seems that the international market for coffee will always tend towards a buyers' market. This implies that in the long term, the price of coffee cannot be expected to increase significantly in real terms. (The author concedes that a coffee-exporters' cartel *could* operate successfully for a *short* period of time, especially if there were a succession of poor crops caused by weather conditions, natural disasters or civil unrest). It should be pointed out, however, that most Latin American producers could still increase their factorial and income terms of trade through greater productivity in the coffee sector.

Depending on whether a given exporter is a high cost or low cost coffee producer, the grade of coffee being exported, and on whether soil conditions permit production of other commodities which may be consumed domestically, or produced for export more efficiently than coffee, several alternatives would be viable:

1. Maintain acreage presently devoted to coffee cultivation but do not expand this area. Increase productivity through better yields per acre. This has been the plan adopted by the National Coffee Association of Guatemala (Asociación Nacional del Café — ANA-CAFE).<sup>4</sup>

A promising experiment in this area is the establishment of growers cooperatives, or *campesino* groups for collective farming of their (small) properties, or in some cases, land owned by the State.

<sup>3</sup> Tourist coffee is coffee exported to a country which is not a signatory of the ICA, and then re-exported from that country.

<sup>4</sup> Inter-American Development Bank, *Economic and Social Progress in Latin America*, pp. 298-99.

Supported by credit, farm extension, marketing and social welfare programmes, such programmes will contribute to increasing productivity and improving rural living standards.

2. For the largest exporter, Brazil, the soundest strategy would be to maintain existing production and export levels, but to withdraw land from coffee production (to be used for other commodities). The CIDA *Brazil Report* estimated that by using modern planting methods, applying farm and soil management techniques, and taking precautions against diseases, coffee production could be increased 100% in existing growing areas (p. 44). If these resources were employed in alternative uses, real incomes would increase significantly.

3. Low cost producers, presently supplying a very small portion of world demand, could increase coffee production and exports through increased productivity and increased cultivation. Of course high cost producers should attempt to move either into more profitable exports or into production for domestic consumption.

A basic problem with the above strategies is that they are based on improving farm management policies. Productivity in coffee growing in Latin America could be increased by applying existing technology and farming practices. While of course there is a clear economic motivation to do so, in many Latin American exporting countries, vast social and political barriers to change exist.

Some producers, such as those in Central America seem tied in to existing practices by antique agrarian social structures and the land holding system. There is a lack of education in the rural areas and slowness implementing land reform measures. Peasants and small farmers have very limited access to existing channels of credit and related services.

Clearly, goals must be politically desired as well as economically sound. While a given strategy may well increase national welfare levels, it will not be accepted if resistance comes from well-organized and influential landholders who may feel that bettering the lot of the peasants could lead to political disruption and a weakening of their privileged position. This seems to be the only way to account for the fact that very poor farm management policies prevail in many coffee growing areas.<sup>5</sup> Analysts have found that a large number of coffee growers are not interested in improving their plantations, but in continuing the monoculture without technological changes. Because of their fear of a disruption of their position in society, they are openly opposed to social progress for the workers, which would be the inevitable consequence of technological progress.<sup>6</sup> For example, "with the exception of the newer agricultural enterprises of southern Bra-

<sup>5</sup> See Comité Interamericano de Desarrollo Agrícola (CIDA), *Guatemala Report*, p. 81; CIDA, *Brazil Report*, pp. 488 ff.

<sup>6</sup> Ernest Feder, *The Rape of the Peasantry*, New York: Doubleday, 1971, p. 77.

zil,..., methods of farming are no better than those of the Indians generations ago.<sup>7</sup>

A second set of alternatives would involve coffee exporters attempting to process and market green coffee. Gains could likely be made by low cost processors because historically exporters have received from 33% to 40% of the final shelf price of coffee in the developed countries. Other costs involve transport, packaging and marketing. Of course in this area, exporters of processed coffee may encounter difficulties in gaining access to developed markets. This occurred in the 1960's when powerful refiners in the U.S.A. succeeded in obtaining import quotas to stop Brazilian penetration of the American instant coffee market. Here again, co-ordinated producer action would doubtless meet with more success than individual producer actions.

The problems of Latin American coffee exporters can be summed up as follows:

1. There has historically been an oversupply problem in the international coffee market.
2. Governments have been unable to co-operate to co-ordinate supply.
3. Competition between coffee producers has made coffee a "bargain" commodity for developed importers, especially since the price elasticity of demand appears to be very low up to about \$2.50-3.00/lb. (After which demand may drop off sharply).

Given these conditions:

4. International coffee agreements appear to be the best alternative open to existing producers in the short run.
5. In the long run, coffee producers should diversify production, attempt to process green beans where this is economical, and reduce costs of production through better farm management and soil conservation. It is noted that access to developed markets for processed beans may be most difficult without greater producer co-ordination of production, or voluntary concessions made by importers in multilateral trade negotiations. The indicated solution for individual exporters appears to be to implement programs to increase farmer productivity, and to use freed resources to diversify into other production and to attempt further processing of coffee where economically feasible. Of course, these changes may mean drastic modifications to existing political structures and so, while economically sound, may not be politically or socially feasible. Indeed, inflexible domestic conditions may cause resistance to any change in current practices, in the coffee production sectors of many exporters' economies.

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<sup>7</sup> *ibid.*, p. 78.

6. Until there is a transformation of these domestic structures, there will be a misallocation of resources, which if used in alternate production could raise real incomes of the coffee-producing countries. Internal income distribution is a political question, but surely greater real incomes must be allowed to growers and farm workers to induce them to change from the status quo. In some exporting countries, increases in productivity along with improvement in the living conditions of growers and farm workers could result from a reorganization of domestic marketing structures to eliminate the numerous intermediaries in the marketing of coffee. Here the co-operative concept may have useful applications. In most exporting countries however, a political decision to adopt such restructuring would meet with strong opposition from present wealthy and powerful intermediaries.

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