



# **Bitter Coffee:** How the Poor are Paying for the Slump in Coffee Prices

Embargoed until 16 May at 9.00 a.m.



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*'The coffee market cannot sacrifice millions of poor farmers ... Nobody should forget that it is precisely these poor farmers who, with their hard work, have fostered not only the growth of their sector, but the wealth of the world coffee industry.'*

Jorge Cardenas, President of Colombia's National Coffee Growers' Federation.

*'What has happened to the price of coffee is a disaster. Years back, when coffee prices were good, we could afford to send our children to school. Now we are taking our children out of school because we cannot afford the fees. How can we send our children to school when we cannot afford to feed them well.'*

Small coffee farmer in Uru District of Tanzania.

## Introduction

The second of these voices is that of just one of the world's many smallholder coffee farmers. Like millions of other vulnerable farmers and labourers involved in coffee production, his livelihood has been devastated by a collapse in international prices. Today, world prices for coffee have fallen to their lowest-ever level in real terms. Failure to reverse current trends will have devastating consequences across the developing world.

The price slump has created some winners. Transnational companies and 'designer coffee' retailers are posting record profits as the price of their main raw material slumps. Over the past three years the export price of coffee as a proportion of the retail price has fallen by half, to less than seven per cent.<sup>1</sup> This is good news for some. As a recent Nestlé document on its coffee-trading performance states: 'trading profits increased ... and margins improved thanks to favourable commodity prices.'<sup>2</sup> The bad news is that corporate gain is consigning some of the world's poorest and most vulnerable people to extreme poverty.

During the past year Oxfam has been monitoring the impact of falling coffee prices on communities across Africa and Latin America, talking to those most affected by the crisis. The picture that emerges is uniformly bleak. In Tanzania, smallholder farmers are being forced to take their children out of school, undermining the next generation's prospects of escaping poverty. In the State of Chiapas, in the south of Mexico, the wages of seasonal labourers already living on the poverty line have been dramatically cut, prompting 500 families each week to migrate, and raising the spectre of malnutrition.<sup>3</sup> In the Dominican Republic, women farmers report that they are now unable to meet the cost of sickness episodes. In the Kafe region of Ethiopia, where coffee originated, falling prices threaten to lead to household food shortages.<sup>4</sup> While the coffee economy generates bumper profits for Nestlé and Starbucks, it is also intensifying poverty and fuelling social dislocation in the world's poorest countries.

Left unattended, there is a real danger that the crisis in world coffee markets will undermine efforts to achieve the human development targets set for 2015.<sup>5</sup> While the most serious costs will be borne in the South, developed countries will not be immune to the consequences, given that the only alternative for many farmers in Latin America, for example, is the production of cocaine.

The underlying cause of the crisis in world coffee prices is readily apparent. Coffee production is consistently outstripping consumption, with the result that excess stocks are driving down prices. The obvious solution is to bring supply back into line with demand and to stabilise prices at more remunerative levels. However, international co-operation in this area has been lacking. Producer countries have developed a modest retention plan to restrict supplies by withholding stocks, but even if implemented – and differences between producer countries make effective implementation unlikely – it would not raise prices significantly. For their part, Northern governments have been unwilling to contemplate any support for supply restrictions, not least because oversupply means good business for politically powerful transnational companies.

This paper sets out some of the major problems facing coffee producers, and identifies some potential solutions. It has been prepared in advance of the World Coffee Conference (WCC) which will take place in London between 17 and 19 May. The conference, organised by the International Coffee Organisation (ICO), and partly sponsored by the Nestlé corporation, will gather together some of the main players in the sector in the hope of finding a solution to the slump in prices. Other key people – notably the smallholder farmers and labourers whose livelihoods are under such acute threat – will be conspicuous by their absence.

## **Livelihoods in decline: the bitter taste of coffee**

International coffee prices have now reached a 30-year low, having decreased by more than 50 per cent in the last three years (fig.1). In real terms, and taking inflation into account, prices are now at their lowest-ever levels.

Farmers in Tanzania, Mexico, Haiti, and the Dominican Republic, interviewed by OXFAM in recent months, have been deeply affected by the slump in prices. The consistent message from these interviews is that the livelihoods of smallholder producers are being destroyed by international markets which are beyond their control. The crisis in coffee markets is being felt across whole economies, with devastating implications in areas such as health and education.

Coffee plays an essential role in the livelihoods of poor people in approximately 50 developing countries (fig.2). It is estimated that about 20 million households produce the crop, which is often the main – sometimes the only – source of cash income. Revenues from coffee are used to buy food items that cannot be produced on the farm, to pay for school fees and health care, and to meet other cash expenses, such as the purchase of agricultural inputs.

As a result of the current crisis, many farmers have been forced to sell assets such as cattle, and cut down on essential expenses by taking their children out of school or even reducing food consumption (Box 1). Others give up on coffee altogether or lose their farms, and migrate towards cities in the hope of a better future (Box 2).

### **Box 1: Tanzania: Coffee-farming families can no longer afford to send their children to school.**

In the Kilimanjaro region of Tanzania, where 1.4 million people live, coffee is the main cash crop cultivated by small farmers. Kilimanjaro used to be one of the better-off regions in the country. Its social indicators reflect the positive impact of the coffee boom, with literacy reaching 95 per cent and a higher than average nutritional status in the rural areas. The incidence and severity of poverty are much lower than the national average.

But this success story is now under threat. Farm-gate prices have fallen by half in two years (down to 27 US cents/lb) and households repeatedly stress how the decline of the coffee economy has intensified poverty and increased vulnerability.

The coffee crisis had led to a reduction in school enrolment among coffee-farming communities. The average annual cost of sending a single child to school in the area is over US\$10, and with most families having four or five children, the cash demands of education impose considerable hardship.

Tatu Museyni, a 37-year old widow, is a small coffee farmer. She lives with her six children on a farm of less than one acre in a mud hut without running water or electricity. She struggles to give an education to her children. *'Education is very important. It will help my children to have a better life. That is why I struggle so hard to find the money they need to go to school.'* But this year her entire coffee crop has generated less than US\$15. She had planned to send her third child, Isaiah, aged nine, to primary school, but this is no longer an option. *'He will have to stay at home because I could not get enough for the coffee. Just to keep the other two in school I will have to sell my pig.'* Tatu plans to sell some of her bananas to raise cash, although she is worried that her children's nutrition will suffer. She will also try to find employment on other farms (earning about US\$1 a day) as well as collect and sell grass as cattle feed.

This illustrates how falling coffee prices can have the twin effect of undermining household food security and adding to the already extreme labour burden on women. Like other women interviewed, Tatu expressed fears of being unable to meet the costs of sickness episodes, especially if any of her children fall ill with pneumonia, malaria, or diarrhoea during the rainy season.

**Source:** Research carried out by Maarifa and Oxfam GB in December 2000 in Kilimanjaro, taken from Maarifa (2001) 'Cost-sharing in Education: A Case Study of Education in Kilimanjaro'.

Many coffee-producing countries suffer from high levels of rural poverty, uncontrolled rural migration to already crowded cities, growing macro-economic imbalance, and an inability to repay debts. The slump in coffee prices will make each of these problems worse. For countries such as Burundi, Ethiopia, and Uganda, where coffee accounts for more than half of export earnings (fig.3), the fall in world prices threatens to undermine prospects for growth and generate acute balance of payments problems.

The case of Ethiopia, where the first coffee crop originated, illustrates the problem. After years of war and repeated droughts, the country is now among the poorest in the world. Coffee is an integral part of the national economy and society. More than 700,000 households are involved in its production, and the livelihoods of 15 million people depend in part on the coffee economy. The crop accounts for about two-thirds of export revenues. However, Ethiopia has lost almost US\$300 million in export revenues over the

last two years as a consequence of the slump in prices, an amount equivalent to half the country's annual export earnings. In Uganda, export revenue losses over the last five years are equivalent to half of the debt relief provided under the Highly Indebted Poor Countries (HIPC) initiative.

The impact of the decline in prices has been very damaging at a household level. While the high quality of Ethiopian coffee has shielded producers from the full impact of the slump, reports from the Kefa and Sidamo regions point to deep cuts in farm-gate prices. In a country where rural incomes average less than US\$100 per annum, where 20 per cent of children die before the age of five as a result of poverty-related diseases, and where less than one in three children between the ages of 7 and 12 are in school, the human costs of falling prices are enormous.

### **Box 2: Choices in Chiapas, Mexico: Sale at a loss or migration.**

Mexico's exports of coffee are expected to fall by more than 40 per cent this year. The main reason is that many coffee farmers have decided not to harvest because prices have fallen below their production costs.

According to DESMI (Desarrollo Económico Social de los Mexicanos Indigenas), a local NGO, producer prices in the indigenous communities of Chiapas, where much of Mexico's coffee is produced, have fallen by 70 per cent in the last five years. Small coffee farmers visited by Oxfam in January 2001 reported that prices offered by coyotes – the local intermediaries – were between 20-30 US cents/lb. Average production costs were estimated at 76 US cents/lb.

Coffee-plantation workers have been equally badly hit. Salaries have decreased by half this year because plantation owners cannot afford to pay more, given the level of coffee prices. In Veracruz, a grower reported that he was only offered 10 US cents/kg of coffee cherries picked, which is equivalent to a daily salary of US\$1-2 (depending on productivity).

As a result, an estimated 500 families per week – both farmers and labourers – were leaving coffee farms in Chiapas to migrate north to work in the oil production sector in Tabasco or in maquiladoras around Tijuana. Salaries there are higher – about US4 per day. Others try to migrate to the USA, even if they have to pay 16,000 pesos to intermediaries (more than US\$1,700).

Mexico is not unique. In Guatemala, government officials are experimenting with the use of coffee for fuel to keep stocks out of the market. In other countries, such as Haiti and the Dominican Republic, coffee farmers interviewed in the course of Oxfam's research reported that many families had left their communities because of low prices. Most remaining coffee producers are just too old to migrate.

*'We are not doing too good around here. We are dependent on coffee but production has decreased (because of pests) and the price is really low. I think that two-thirds of our community has left. Many houses which are now empty are on the verge of collapsing ...*

*I produce coffee because my father did so. I won't give up on coffee. I just hope that the price gets better.'*

Primitivo de la Rosa, coffee farmer in his seventies in Cacao, in the Dominican Republic

**Source:** Interviews carried out by Oxfam in San Cristobal, Chiapas, January 2001, and in Cacao, the Dominican Republic, March 2001; Bridge News, 4 April 2001; Reuters, 11 April 2001.

## **More is not always better: the roots of the coffee oversupply crisis**

The main reason that prices are so low is the massive oversupply of coffee on world markets in relation to demand. Production has increased by 15 per cent since 1990 as a result of the planting of new coffee trees, technological innovation, and the arrival of newcomers on the market. Ten years ago, Vietnam was an insignificant exporter of coffee. Today, it is the world's second largest exporter. Other factors have contributed to the steady expansion of coffee supplies. The pressure of debt has forced countries to expand exports in order to generate hard currency. Meanwhile, the World Bank and other agencies have actively promoted export production, through project lending and wider macro-economic reforms. For example, World Bank loans were instrumental in helping Vietnam start producing and exporting coffee. In Colombia and Bolivia, farmers were encouraged by UN-sponsored programmes to switch from coca to coffee. And in Angola, the International Coffee Organisation recently provided funds for the revival of the country's coffee production, which had been shut down by war.

World demand for coffee has increased at a far slower pace than supply. In the past ten years production has increased at twice the rate of consumption. The result: massive oversupply, leading to rising stocks and sinking prices. Stocks in consumer countries, the most important determinant of price levels, currently stand at over one million tonnes.

In the absence of a drastic change in their policies, coffee-producing countries are heading for a collective disaster. Unless severe weather suddenly strikes the main coffee-growing areas in Brazil or Vietnam and significantly reduces production, the current trend in oversupply is expected to continue for the next five years, further depressing prices.

What is needed is immediate action to restrict supply. But since the demise of the International Coffee Agreement (ICA) in 1989, which regulated the volumes of coffee exports, there has been no supply management. In effect, producer countries have engaged in a 'race-to-bottom' competition. Individually, each country is attempting to increase export revenues. Collectively, however, their efforts have resulted in a huge increase in supply and a matching decline in earnings. Total coffee export revenues are lower now than they were in 1980 (fig.4).

The governments of coffee-producing countries are not the only culprits. Industrialised countries and financial institutions such as the World Bank have adopted a 'no intervention policy' since the collapse of the ICA. Despite the mounting evidence that deregulation of coffee markets has led to an economic and social disaster for the poor, the rich world has resisted efforts to get the issue of commodity price management back on to the international agenda. While the solutions are not easy, to continue on the current path of ignoring the problem is hardly a viable option.

## **Winners and losers in the supply chain**

Producers in developing countries have suffered not just from low prices but also from an increasingly unequal distribution of the wealth generated by the coffee trade. This is the result of corporate practices that seek to convert low prices into expanded profit margins, and of domestic market reforms that have deprived producers of the marketing and infrastructure support they need.

In 1997 world coffee sales reached US\$43 billion.<sup>6</sup> But while developing countries produced the raw material on which this wealth was built, they received less than one-third of the total revenue. Most of it was captured by the transnational companies which control the international trading and processing of coffee, such as Philip Morris and Nestlé, and by the major coffee retailers such as Tesco and Starbucks.

While recent price trends have been a disaster for developing countries and poor producers, they have generated windfall gains for corporations in the industrialised world. In February 2001 Nestlé reported a rise in profits of over 20 per cent, with the beverages sector performing strongly.<sup>7</sup> Starbucks, the Seattle-based coffee-shop giant, performed even more strongly, posting a 41 per cent increase in profits in the first quarter of 2001.<sup>8</sup>

Current trends in over-supply are clearly in the interest of the major players, who have conspicuously failed to pass on falling world prices to consumers (fig.5). Indeed, these trends have strengthened their market power along the supply chain, since they can pick and choose suppliers in Asia, Africa, and Latin America, taking full advantage of lower prices and exercising their market power against vulnerable producers.

Small farmers at the bottom of the supply chain typically receive much less than the export price, which means that they capture less than ten per cent of the final retail price of coffee. For instance, robusta farmers in Cameroon received ten US cents/lb for their coffee this year, which was less than two per cent of the retail price of soluble coffee sold in the UK.<sup>9</sup>

While all coffee farmers have suffered from the slump in world prices, small coffee farmers often face additional problems. Rapid market liberalisation and deregulation, often carried out under the auspices of IMF/World Bank programmes, has led to the collapse of services such as extension and marketing infrastructure, especially in the poorest areas. Inadequate investment in rural feeder roads has raised the costs of transportation and marketing. Meanwhile, many governments continue to impose heavy local or national taxation on coffee production, while at the same time imposing regulations that limit competition among intermediaries. In many cases, the result is that local traders and exporters can abuse their market power to purchase coffee at the farm-gate at exceptionally low prices.

## **Making the coffee market work for all**

Immediate action is needed to restore the balance between supply and demand on world coffee markets. Producer and consumer countries must intervene to lift coffee prices and provide much-needed relief to farmers. The World Coffee Conference provides an important opportunity to address this challenge. That opportunity will be lost without a fundamental reappraisal of strategy on the part of exporters and importers alike.

At present, the only plan of action to restrict supply is the Coffee Retention Plan developed by the Association of Coffee Producing Countries (ACPC). Under this plan, initiated by Brazil and Colombia, exporters are requested to withhold 20 per cent of their exports from the market. Brazil is thought to have stored close to two million bags of coffee. However, there are three problems with the plan.

First, it is far from clear that it has the critical mass of political support it needs. Major suppliers in East Asia, such as Indonesia and Vietnam, appear bent upon increasing their market share, regardless of world prices. The fact that Indonesia is cutting export prices to protect its market share against Vietnam illustrates the problem.



Second, export retention is costly and does little to reduce the market pressures associated with excessive stocks. This is because the retained coffee remains in stock and is not taken off the market.

Finally, even if it were implemented in full, it is unlikely that the retention plan would significantly increase world prices, since the quantities involved are too small in relation to the stocks held in industrialised countries.

The World Coffee Conference needs to propose an international initiative which will stabilise coffee prices at a more remunerative level, i.e. above US\$1/lb.<sup>10</sup> Current prices are as low as 49 US cents/lb.<sup>11</sup>

In order to achieve this goal, the WCC needs to adopt a plan which includes:

- **The destruction of 15 million bags of low-grade coffee in exporting countries to reduce exports and stocks. Oxfam estimates the cost of the physical destruction of coffee and equitable compensation to farmers to be approximately US\$250m.**
- **A three-year retention of 20 per cent of world coffee exports. Together with stock destruction, export retention will help reduce the overhang of stocks in consumer countries, which is at the heart of the current price slump. Should prices still fail to reach more remunerative levels, the retention plan should be coupled with a longer-term contingency stock disposal strategy.**
- **A windfall tax on large coffee roasters such as Nestlé, Kraft, and Sara Lee to part-finance the stock disposal plan.**
- **The development of an international fund under the aegis of UNCTAD to share the cost of stock destruction and retention between producing and consuming countries.**

These initiatives must be backed up by longer-term reforms towards a more sustainable coffee market, which secure decent livelihoods for farmers, limit environmental degradation, and provide tasty coffee to consumers. These reforms should include:

- **An end to government and donor policies favouring the expansion of coffee production, such as subsidies to land-clearing, fertiliser use, and the introduction of higher-yielding hybrid trees.**
- **The adoption of strict labour and environmental standards within the International Coffee Agreement.**
- **National policies which provide a better market environment for small coffee farmers, such as credit, technical assistance, market information, and assistance towards sustainable diversification.**

The reform of transnational company practice is also vital. Instead of seeking to generate windfall profits by exploiting low prices, the corporate sector should acknowledge its responsibility to help facilitate the development of a more equitable trading environment. Enlightened self-interest should be one of the guiding principles, since current price trends are likely to produce an increasingly volatile and unstable

market place. As powerful economic actors linking consumers in the rich world to poor producers, transnational companies need to display a greater sense of social responsibility. Above all, they need to acknowledge that it is unacceptable to provide consumers with products on terms which consign millions of people to poverty.

Fair-trade practices illustrate what could be achieved. Under fair-trade schemes such as CaféDirect, small farmer' co-operatives receive a price of US\$1.26/lb, which is 50 per cent above prevailing world market prices. Even after deductions for the costs of processing, transportation and marketing incurred by the co-operative, small farmers still receive more than they would from private traders.

The fact that these schemes are commercially viable, despite their high operation costs due to their small size, suggests that large multinational companies, which have much greater economies of scale, could easily afford to exercise greater social responsibility. The example of a small co-operative in Haiti with access to fair trade shows how more responsible business practices could make a world of difference to a farmer's life (Box 3). What is needed is leadership within the industry to integrate such practices into mainstream commercial operations. As the world's largest coffee roaster, and sponsor of the World Coffee Conference, the Nestlé corporation should grasp the opportunity to lead by good example and commit itself to a strategy for developing a fair-trade policy.

### **Box 3: Coffee farmers in northern Haiti survive the crisis thanks to fair trade.**

Fair trade was launched at the beginning of the 1990s to guarantee a better price and access to export markets for coffee farmers. The presence of a fair-trade label on a coffee product guarantees that small farmer' co-operatives were given a fair price, currently US\$1.26/lb for arabica, which is 50 per cent more than market prices.

The co-operative of Carice in northern Haiti, which sells 100 per cent of its production to fair-trade organisations, bought coffee from about 300 families this year. Last year, farmers received the equivalent of 90 US cents/lb for their coffee.\* This was 50 per cent higher than the price received by farmers outside the co-operative. In monetary terms, the net average benefit provided by fair trade reached US\$36 per member, which is more or less equivalent to one full month of rice consumption for an average family. *'I don't even want to think what would have happened without the co-operative. I could not have sent my son to school. The local intermediaries give you a miserly price for your coffee. At some point, they were giving only 18 cents/lb.'*

Mme Fabius Mirtil, member of the Carice cooperative

\* (after deductions for transportation, processing and marketing costs incurred by the co-operative)

**Source:** Oxfam GB, 'Impact Evaluation of the Carice Co-operative', March 2001.

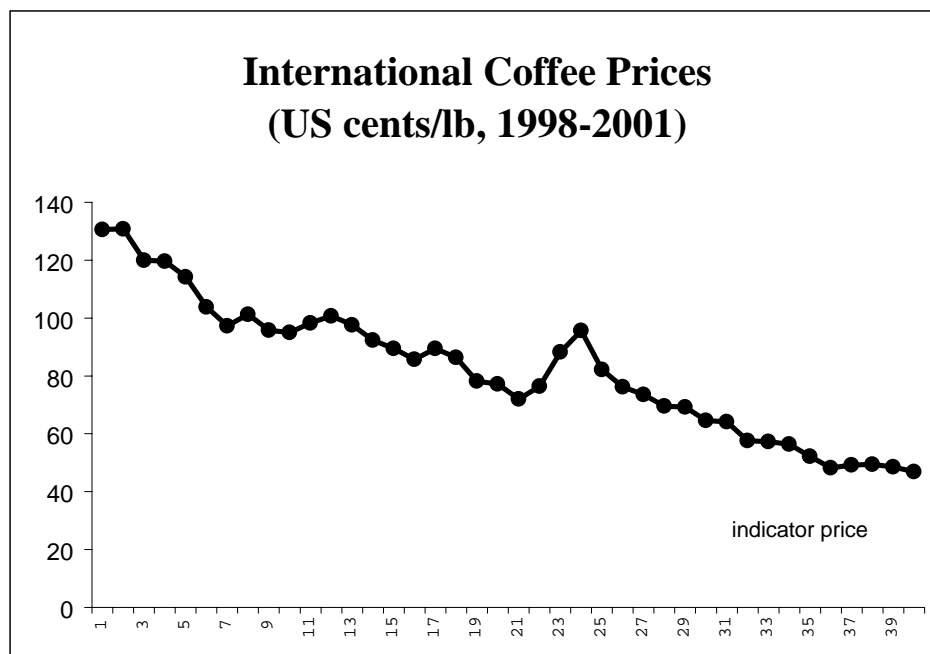
In order to emulate the model provided by fair trade, the following changes are needed along the supply chain.

- **Stable, decent, and transparent prices for small producers (close to fair-trade level).**
- **Greater use of contract farming with small producer co-operatives to share production risks, transfer technology, and promote sustainable production methods down to farm level.**
- **Monitoring of the buying practices of intermediaries.**
- **Monitoring of the labour and environmental practices of large suppliers (plantations).**
- **Decent labour conditions in coffee-processing plants in developing countries, and priority use of domestically grown coffee rather than imports.**
- **Full access and promotion of fairly traded coffee products and brands to retailing outlets, such as supermarkets and the major coffee chains.**

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## Figures

Figure 1



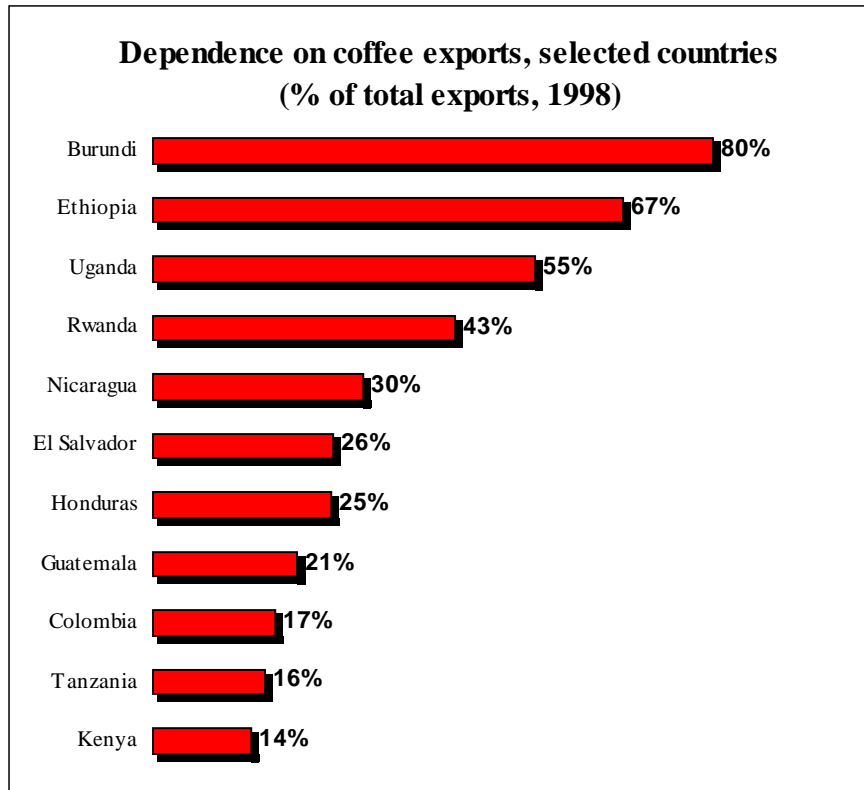
Source: ICO statistics, indicator composed of weighted-average prices of robusta and arabica.

Figure 2

<b>Coffee Producing Countries</b> (% share of world production, 1999-2000)	
<b>Americas</b>	<b>62%</b>
Brazil	28%
Colombia	12%
Mexico	5%
Guatemala	4%
Others	13%
<b>Asia</b>	<b>21%</b>
Vietnam	7%
Indonesia	7%
India	4%
Others	3%
<b>Africa</b>	<b>17%</b>
Cote d'Ivoire	4%
Uganda	3%
Ethiopia	3%
Others	8%

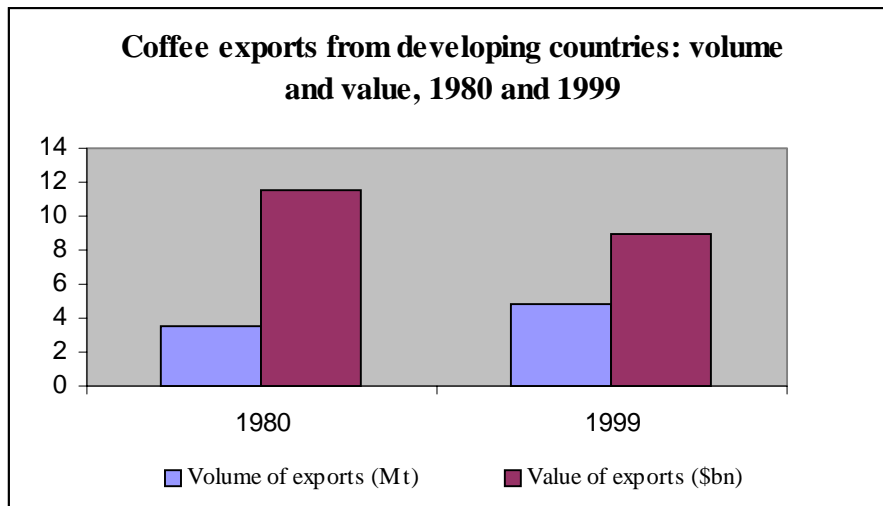
Source: LMC Statistics.

Figure 3



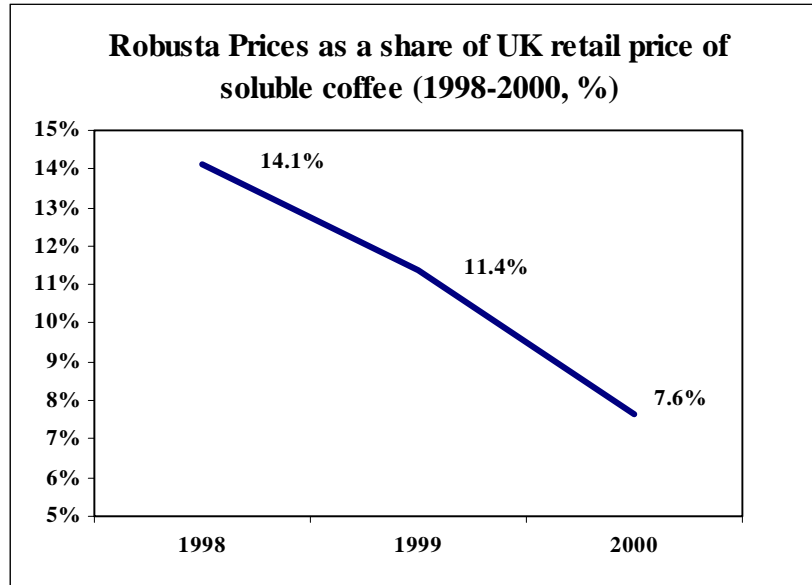
Source: FAO/IMF statistics

Figure 4



Source: FAO statistics

Figure 5



**Source:** ICO/LMC Statistics. Price of robusta coffee as a share of UK retail price for soluble coffee, given weight loss of a factor of 2.6 between green coffee and soluble coffee.

## Endnotes

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- <sup>1</sup> See fig.5. Price of robusta coffee as a share of UK retail price for soluble coffee, given weight loss of a factor of 2.6
- <sup>2</sup> Nestlé corporation Annual Management Report 2000, p.32
- <sup>3</sup> As reported in the regional press in Chiapas, January 2001
- <sup>4</sup> Reuters, 26 April 2001
- <sup>5</sup> Targets for poverty reduction, improvements in health, education, and gender equity, and protection of the environment, adopted by the World Bank, IMF, Development Assistance Committee of the OECD, and other agencies
- <sup>6</sup> MTI/ICO (1998) International Coffee File, 1998-2002
- <sup>7</sup> Times of India Online, 24 February 2001
- <sup>8</sup> Times of India Online, 27 January 2001
- <sup>9</sup> 2000/01 Robusta producer price in Cameroon (Reuters, 27 April 2001) compared with average UK retail price of soluble coffee, taking into account a weight loss estimate of 2.6 between green and soluble coffee
- <sup>10</sup> This refers to the ICO indicator price, which is a weighted average of robusta and arabica prices
- <sup>11</sup> ICO indicator price, 27 April 2001

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