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Photographs by Kathleen Dooher

trouble in coffee lands

The current crisis is the latest and most dramatic in a long history of

Juan Valdez and his mule are out of business. Coffee prices have plummeted to 30-year lows, hitting a historic bottom of under 39 cents a pound last October. The price drop, 82 percent from just four years earlier, forced the National Federation of Coffee Growers of Colombia to pull the plug on one of the world's most successful marketing icons.

Coffee is not a trivial matter in the developing world. Coffee is the second-largest export earner for developing countries, and is the main source of foreign exchange for several nations, accounting for over half of export earnings in countries like Burundi and Uganda. The situation is placing Mr. Valdez's real-life counterparts under economic hardship. This downturn directly affects approximately 20 million families who live

industry ups and downs

in the world's coffee-growing belt—between the tropics of Cancer and Capricorn—and depend on the beans for their main source of income. In March, the United Nations' World Food Program began an emergency operation to assist 155,000 people in Guatemala where a severe drought that killed subsistence crops coincided with the low coffee prices.

But, for the most part, the circumstances affecting producers have gone largely unnoticed in the United States, the world's largest coffee consumer. Americans have not seen equally steep price declines for coffee in their supermarket aisles. In fact, changes in supermarket prices have been obscured by the much more dramatic expansion in the variety and sophistication of the coffee menu available to ordinary consumers. From the humble cup of Joe sprang the latte, the flavor-of-the-day coffee, and the gourmet whole bean—not to mention the iced moccachino. Going for over $2 a cup in many of its gourmet incarnations, coffee has become an "affordable luxury."

The stark contrast between developments in consuming and producing countries is helping to bolster the arguments for "Fair Trade" coffee: a movement that guarantees small producers a fixed minimum price for their product—between two and three times the unsubsidized market price in the current price slump. By buying Fair Trade coffee, consumers in developed countries can feel that they make a positive difference by ensuring good working conditions and higher prices for farmers in poorer countries. And the firms that engage in Fair Trade also benefit by gaining a public relations advantage. But, though this clearly improves the lot of a small share of farmers, long-term options to protect a larger share of developing-country producers from tanking prices are far more complicated.

Problems in producing countries have gone largely unnoticed in the larg

BETWEEN THE TROPICS OF CANCER AND CAPRICORN

The economics behind the current drop in coffee prices is as simple as the solution has proven intractable: supply far outstrips demand. For the 2001-2002 crop year, for instance, the U.S. Department of Agriculture estimates world coffee production to be almost 116 million 60-kilogram bags, while consumption is estimated to fall short of this figure by around five million bags (about 600 million pounds). And the excess supply is widened by already existing stocks, as green coffee can be stored for up to one year (it quickly goes stale after roasting).

The coffee trade has been particularly hard hit, but it is part of a more widespread phenomenon. The average dollar price of developing countries' non-oil primary commodity exports fell by 9 percent in 2001. While coffee prices were down 30 percent in 2001, cotton prices also declined 20 percent, and rice prices fell 15 percent with respect to the previous year. A global economic slowdown and the existence of large supplies of most commodities were largely responsible for this wider trend.

The most visible factor behind this imbalance in the specific case of coffee is the forceful entry of Vietnam into the trade. "Ten years ago Vietnam was not even a blip on the screen of the world coffee market," says Mark Pendergrast, author of *Uncommon Grounds: The History of Coffee and How It Transformed Our World*. From the backbenches of coffee production in 1990, Vietnam has expanded its production by about 1,400 percent over the decade and, by 2000, had displaced Colombia as the world's second-largest coffee grower after Brazil (see chart, page 9).

Many longer-established coffee producers blame the price plunge on Vietnam's meteoric rise. Some have pointed accusing fingers at the World Bank, claiming that it encouraged the growth of the Vietnamese coffee industry. But the World Bank refutes those accusations. It says it resumed lending to Vietnam in 1994, after the country's coffee expansion was already under way and that, though $16 million from a loan to the Agricultural Bank was used to finance coffee farm rehabilitation, it has not lent directly to the coffee sector. "While $16 million is a considerable sum of money in a poor rural economy, such an amount would finance very little, less than 5 percent of Vietnam's coffee expansion," note Daniele Giovannucci, Panos Varangis, and Bryan Lewin of the World Bank.

Moreover, the impressive growth of Vietnam's coffee sector is not the only contributor to the coffee glut. According to the U.S. Department of Agriculture, Brazil has been producing above 30 million bags a year since 1998-1999—up from 28 and 23 million bags in 1996 and 1997, respectively—and the total number of coffee trees in Brazil has been growing steadily since 1998-1999.

Perhaps the clearest culprit in the oversupply of coffee is the coffee tree itself. It takes at least two years (more for some varieties) for new trees to produce sufficient yields to justify the costs of harvesting. This means that production is slow to react to price changes. "High prices encourage new planting, but the new trees do not have any immediate effect on prices, and there is a tendency towards overplanting," points out Colby College sociologist John M. Talbot in an article in *Studies in Comparative International Development*.

Today's bountiful coffee harvest is to a large extent due to a series of severe frosts that affected Brazil, the world's largest coffee producer, in 1994 and led to rising prices that continued

est consuming country

through the summer of 1997. This encouraged new tree plantings whose harvests are in the market today.

Once coffee trees are in production, they continue to bear coffee "cherries" for over a decade. So, when prices fall, the areas of coffee cultivation don't shrink accordingly. Coffee growers limit inputs like fertilizer and this can lower yields. But they are unlikely to uproot their trees in order to plant something else. Moreover, governments often pay out subsidies to coffee growers during periods of low prices to diminish the social and political consequences of the crisis. The Colombian government, for instance, is guaranteeing a $13 subsidy per bag through the end of September. While this helps tide over the coffee industry, it also helps prolong the low-price period by maintaining the coffee supply at unsustainably high levels.

THE CAFÉ SCENE

Consumers unwittingly bear part of the responsibility for the glut. World coffee consumption has grown slowly over the past decade. The vast majority of coffee produced, about 75 percent, is consumed in developed countries far from the tropics. Undeniably, more Americans are drinking gourmet coffees, which include specialty-grade quality coffees, espresso-based beverages, and iced or cold coffee drinks. From only about 450 gourmet coffee houses in the country in 1991, there were closer to 10,000 of them last year, according to Gary Goldstein of the National Coffee Association (NCA). But this doesn't mean that per-capita coffee consumption is up in this country. In fact, the number of pounds of coffee consumed per person each year has been in a steady decline from its historic peak in 1946, according to Pendergrast. In 1962, for instance, Americans age ten or over were consuming an average of 3.1 cups a day. During the 1990s, per-capita consumption stayed between 1.6 and 1.9 cups. While the growth in specialty coffee consumption has been impressive, it doesn't come with an equivalent growth in total coffee imports that would help absorb some of the surplus produced.

The crux of the problem is that, when it comes to coffee (and other addictive substances), consumers are not very responsive to price changes. For many other goods, changes in retail prices help clear excess production. But, lower prices don't lead to large increases in coffee consumption. By the same token, most studies indicate that coffee drinkers are loath to restrict their coffee intake in response to moderate increases in coffee prices. "A 10 percent increase in price, if taking place in the normal range of prices, leads to a small (2 to 4 percent) decrease in the quantity demanded," points out Harvard professor Robert Bates in *The Political Economy of the World Coffee Trade*. (On the other hand, if coffee prices go up dramatically, consumers make their unhappiness known. Rising coffee prices led to Congressional hearings three times in the last century, according to Pendergrast.)

Taken together, the wide swings in coffee production and the relatively stable demand by consumers mean that the commodity price of coffee, like that of other commodities, fluctuates easily by as much as 50 to 150 percent over a few years.

WHAT'S IN THE CUP?

How is it then that, at a time of historically low prices, American consumers are paying $2 and more for their lattes?

In part, they are paying for a lot more than coffee beans. When Americans buy a prepared coffee drink—be it a cappuccino or one of its humbler relations—coffee is one of the smallest components in the product. One pound of beans makes about 40 cups, according to Don Schoenholt, a well-known coffee enthusiast and owner of Gillies Coffee Company, based in Brooklyn, New York. Even if the beverage is made from great coffee beans—the type that roasters buy for $4 to $5 a pound—the value of the coffee is about a dime per cup. Just "the cup and the lid are about 20 cents... the Equal packet often costs the restaurant as much as the coffee," says Schoenholt. More important, the price of each beverage also has to cover the cost of prime real estate rents, U.S. salaries and benefits for the café employees, research and development, taxes, and marketing expenses, among others.

When it comes to roasted coffee sold for home consumption, the story is slightly different. Coffee accounts for a larger share of the costs of the final product. And the retail prices of these products have gone down accordingly. The average store price for a pound of roast and ground coffee peaked at $4.67 in August of 1997 and then steadily declined to $2.86 in March of 2002, the latest figure available from the Bureau of Labor Statistics. Still, retail prices did not fall as much as international prices in percentage terms: While retail prices fell by 39 percent, international prices saw an 82 percent drop from peak to trough (see chart, page 12).

Here again, coffee is but one of the ingredients. In his midsize specialty roaster wholesaler (about $5 million in annual sales), Mr. Schoenholt estimates that coffee represents roughly a third of the sale price of his products. Because of this, changes in the price of coffee result in less-than-proportionate changes in the retail prices. A 30 percent drop in the international price of coffee could lead to only a 10 percent decline in the price his company charges.

The most visible factor behind the growth in supply is the forceful entry

Coffee companies could still be making higher profits from the record-low international prices. Given that consumers don't rush to the store to buy more coffee when retail prices drop, firms have little to gain from lowering prices. Moreover, the coffee market is not a perfectly competitive market with many small companies fighting each other for customers by lowering prices whenever possible. The bulk of coffee sold in the United States is dominated by three major companies: Philip Morris, which through Kraft General Foods owns Maxwell House and other brands; Procter & Gamble, owner of Folgers among others; and Sara Lee, owner of Chock full o'Nuts and Hills Brothers.

But determining whether big companies are seeing increased profits from the drop in coffee prices is extremely difficult. "The largest players in these markets are huge, diversified transnational corporations, and it is almost impossible to sort out how much profit they make on their coffee operations as opposed to their other product lines," writes Colby sociologist Talbot. "Information on costs of production can legally be considered a 'trade secret,' which does not have to be disclosed."

of Vietnam into the market

CUSHIONING THE BLOWS

The current crisis is only the latest, if among the most dramatic, in a rocky history of ups and downs. Because these price swings can be devastating, all players in the market have sought for ways to buffer themselves, with greater or lesser success.

The New York Coffee Exchange, for example, was created in the 1880s after a steep plunge in the price of coffee led to widespread ruin and loss among U.S. coffee importers. As the price collapsed, the American firms were left holding large stocks of coffee that suddenly were worth only a share of what had been paid for them. Today, large coffee importers and roasters can hedge their exposure to price swings by buying coffee futures and options in what is now the Coffee, Sugar, and Cocoa Exchange in New York.

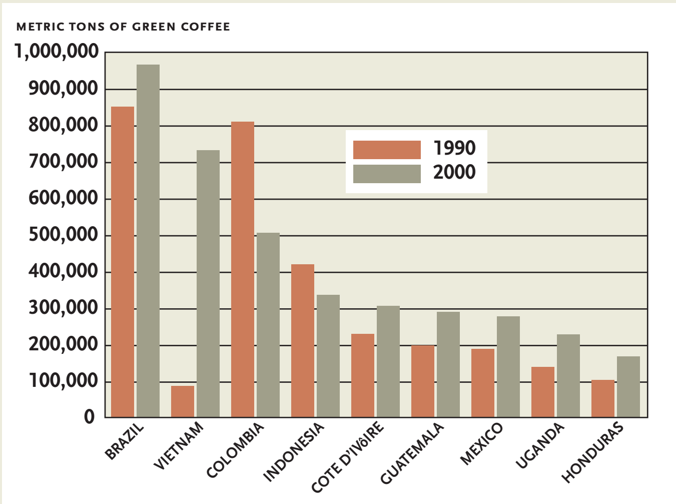
Coffee-producing countries have tried to protect themselves from prices dipping too low by attempting to control supply. In the early twentieth century, for instance, Brazil was by far the dominant coffee producer in the world, accounting for almost 70 percent of production, according to Bates. The Brazilian government began to purchase coffee to limit exports and ensure a high international price. But, such attempts to control the market have always failed, as they require a high degree of international cooperation and the incentives to cheat are always present. When Brazil attempted it at the turn of the century, the high prices encouraged new plantings and the development of the Colombian coffee industry. Not unlike Vietnam's entry today, Colombia's exports rose from 600,000 bags in 1900 to 3.5 million in 1932. And Brazil was unable to control the price on its own.

Arguably, the most successful effort to control supply was through the International Coffee Agreement that was in place from the early to mid 1960s through 1989. Despite smuggling and cheating, the quota system helped to moderate coffee prices from falling too low. To the extent that this effort was successful, it owed its enforcement in large part to the United States, which joined the agreement as a way to prevent poverty and communism from destabilizing its Latin American neighbors. But, as incentives changed, the United States pulled out from the agreement in 1989, and the volatility of coffee prices increased markedly.

Coffee-producing countries have also attempted to cushion growers from the swings of the market more directly. "Before the 1990s, about two-thirds of the coffee-producing countries counted on government-controlled coffee boards that participated in extension services, quotas, price controls, coffee taxation or subsidies, marketing, and even credit," write Varangis and other World Bank economists. But, beginning in the 1980s, international organizations like the World Bank and the International Monetary Fund exerted pressure on developing countries to get the government out of the production and marketing of products. Though this may have helped diminish

top exporters

Brazil, the largest coffee producer in the world, accounted for 17 percent of all green coffee exports over the past decade. Vietnam went from growing less than 2 percent of total exports to 13 percent during the same time.



SOURCE: Food and Agriculture Organization of the United Nations.

inefficiency and corruption, there is widespread agreement that not enough thought was given towards putting safety nets in place. "Despite increased exports, many producers, who are often among the poorest, are left in a position of greater exposure to risk, particularly to price risk," adds Varangis.

Although farmers in developed countries, such as the United States, are also subject to the vicissitudes of weather and other forces, they have access to generous government subsidies and market-based tools that help buffer them from the blows. In many cases, the industry is dominated by corporate behemoths that, by virtue of their size, have access to ample sources of credit and to market products that have been developed to manage such risks. Additionally, small farmers tend to have diversified sources of income, with family members working outside the farm (often out of necessity) bringing in a steady salary independent of the crop's fortunes. By contrast, the failure and the dismantlement of past efforts by developing countries to cushion coffee growers from market risks, have led to the precarious situation they find themselves in today.

Interestingly, one of the newest strategies to protect developing countries' farmers is coming directly from consumers in industrialized countries. In response to growing concerns over the fortunes of those who make the products they buy, some consumers are trying to foster equitable labor practices and better standards of living through the purchases they make. The "Fair Trade" movement attempts to eliminate middlemen in the chain and guarantee a higher price to growers. As a widely traded commodity with connections to many developing countries, coffee was a natural fit and one of the first items to be targeted. Today, American consumers can buy Fair Trade certified coffee, which is grown by small owners organized into farmer cooperatives that meet the requirements and pass the inspection of the international Fair Trade labeling group, TransFair USA. Fair Trade coffee guarantees farmers a minimum price of $1.26 a pound. This price was arrived at by looking at the price pegged by the defunct International Coffee Agreement, according to Rob Everts, codirector of Equal Exchange, a coffee importer and roaster based in Canton, Massachusetts, which deals exclusively in Fair Trade coffee.

By guaranteeing a minimum price, Fair Trade makes planning easier and removes a share of the producer's downside risk (not necessarily all of it because often farmers are only able to sell part of their harvest as Fair Trade). But it cannot hope to solve the problem for all growers. Fair Trade coffee does not protect the laborers who work on the larger plantations. And, so far, there is much more coffee that qualifies as Fair Trade coffee than there are buyers willing to pay for it. Fair Trade coffee is less than 1 percent of the market in the United States and in Europe, according to Pendergrast. So far, it has been the high-end coffee shops and some certified roasters that have proven venues for the product, not the big roasters that account for the bulk of the trade.

If the Fair Trade movement grew large enough to significantly involve the large companies and cover even the daylaborers, the movement would have to find ways to limit the growth of coffee cultivation, which is encouraged by the guaranteed high prices. Otherwise, its very success could bring its downfall by, once again, leading to an oversupply of the product.

Even with the rise of specialty coffee, U.S. per-capita consumption has be

UNCERTAIN HORIZON

There are no easy solutions to the problems of low coffee prices, and no solutions that will take care of everyone. The long his-

coffee dependence

Some of the world's smallest coffee producers are heavily dependent on revenues from coffee exports. In contrast, semiconductors, the largest export earner for the United States, only accounted for 5.6 percent of total exports in 2000.

	VALUE OF GREEN AND ROASTED COFFEE EXPORTS (US$1,000)	COFFEE AS % OF TOTAL EXPORTS	EXPORTS AS % OF GDP
Burundi	30,951	56	8
Uganda	308,721	52†	12†
Rwanda	17,402	27*	6*
Ethiopia	255,336	26	16**
Honduras	410,039	16	42
Nicaragua	134,826	15	37
Guatemala	575,357	15	20
Ecuador	24,349	11	42
Papua New Guinea	164,305	10*	47*
El Salvador	340,342	9	28

*1999 data **1998 data †1996 data

SOURCES: Food and Agriculture Organization of the United Nations, International Monetary Fund.

en in steady decline since 1948

tory of price swings serves as a stark reminder of the difficulties in finding lasting solutions to the instability of coffee prices and the income of the farmers who grow and depend on it. And there is reason to think that the current trough in coffee prices may be among the longer lasting.

Industry insiders and World Bank experts agree that the coffee industry is undergoing fundamental changes that will prevent prices from rebounding to previous heights anytime soon. Vietnam's increased role in coffee production has implications that go beyond the cultivation-and-price roller coaster. It is a move that signifies a shift towards growing cheaper coffee in a lower-cost region—not unlike the way that American manufacturing moved first from the Northeast to the South, and then abroad.

"The costs of production range from country to country, perhaps from 60 to 90 cents for a pound of the arabica variety," says Equal Exchange's Rob Everts. But Vietnam faces costs well below this range. Labor is cheaper in Vietnam and, moreover, the bulk of the country's coffee production is comprised of the robusta variety, which is significantly less expensive to grow. As its name indicates, robusta tends to be more resistant both to hot weather and diseases—requiring fewer pesticides. It can be grown at lower elevations, with flatter terrain, and the trees have higher yields.

Beyond the lower-cost issue, the expansion of robusta in the market has the effect of dragging down the prices of most other varieties of coffee. "Robusta beans are noteworthy for their harsh, dirty flavor and abundant caffeine—twice as much caffeine, in fact, as is found in arabica beans," write Kevin Knox and Julie Sheldon Huffaker, authors of *Coffee Basics*. Their inferior taste means robusta beans sell well below the price commanded by standard arabicas. But roasters are able to substitute the cheaper beans into their blends—up to a certain point—before consumers notice or react to the difference in quality. According to World Bank economist Panos Varangis, the share of the more expensive mild arabicas in blends has fallen from 50 percent in 1989 to about 35 percent in 2001. At the same time, robustas and (cheaper) natural arabicas have seen their shares increase. If this change persists, coffee prices could remain low, at least for the near future.

The coffee that goes into a cup costs only about a dime, even for high-qua

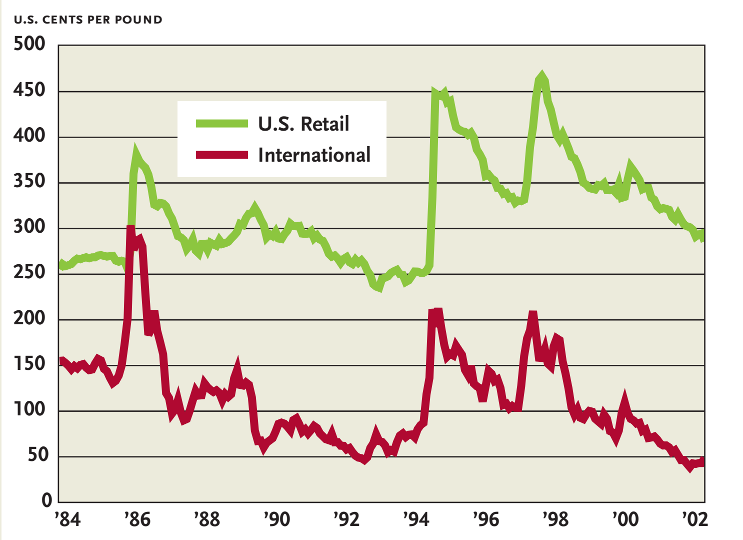
Those hardest hit are Latin American countries with relatively high production costs. These countries can try to find ways to lower their costs or find niche markets that command price premiums, such as organic or environmentally friendly shade-grown coffees that provide needed habitats to migratory birds. But such options will not help everyone. Many growers will ultimately have to move to other more lucrative products.

In the current price slump, enough farmers will eventually be driven out of business that the price of coffee will likely rise again. That means another potential shortage is looming in the future, particularly for the higher-quality coffees that are more costly to produce. And this shortage may drive prices high enough to encourage overproduction once again.

It is not clear whether, or perhaps more aptly, when, this damaging cycle will repeat itself. What is clear is that new and better solutions are needed to help diminish the human price, a price that is now being paid mostly by the most vulnerable workers in already poor countries. ✻

the price roller coaster

The supermarket-aisle price of roasted coffee goes up and down with the international price. But because retail prices are higher overall, changes in the international price are much larger in percentage terms.



SOURCES: Bureau of Labor Statistics, International Coffee Organization.

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