

WHITE PAPER:

THE GLOBAL COFFEE CRISIS

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	1
II. THE HUMAN FACE OF THE CRISIS	1
III. THE HARD NUMBERS.....	4
A. Cause of the Coffee Crisis: Structural Oversupply of Coffee, Driven Primarily by Increasing Quantities of Defective Coffee	4
B. There Has Been No Significant Consumer Benefit	10
IV. MARKET STRATEGIES FOR A HEALTHY COFFEE MARKET.....	10
A. The Role of Producing Countries: Self Help Strategies	11
1. Boost Demand While Increasing Consumers' Awareness of Quality.....	11
2. Reduce Supply: Retention Schemes	12
3. Removing Defective Coffee	13
B. The Role of Consuming Countries: Standards and Transparency.....	14
V. CONCLUSION	16

EXECUTIVE SUMMARY

INTRODUCTION

This White Paper provides background on an acute coffee crisis that threatens millions of small coffee farmers around the world and is putting economic growth, as well as social and political stability, at risk in scores of coffee producing countries in Central and South America, Africa and Asia. It also explores possible solutions to the crisis.

The United States is one of fifty coffee producing countries. Its coffee producers have been hurt by the plunge in coffee prices to historic lows, but U.S. interests go well beyond the impact of the coffee crisis on U.S. producers. The United States also has vital economic, political and security interests in Mexico, Colombia, Costa Rica, El Salvador, Guatemala, Nicaragua, Peru, and other major Central and South American coffee producing countries that have been among the hardest hit by the crisis. The implications of the crisis for the U.S. economic, foreign and social policy are very serious.

- When 44,000 coffee growers in Nicaragua cannot recoup their production costs and now face the loss of their lands, it threatens Nicaragua's political stability.
- When over 100,000 coffee farmers in Mexico may not harvest their crop because they would lose money doing so and peasants in Mexico's coffee growing regions of Chiapas and Veracruz look to migrate to the United States, it retards Mexican development and puts even greater pressure on U.S. immigration policies.
- When coffee farmers in Colombia, Peru and Ecuador have a strong economic incentive to switch from coffee production to illicit crops, it exacerbates an already serious regional concern about the spread of narco-terrorism.
- When Colombia, Mexico and Central America, which together import more U.S. made products than any country except Canada, lose significant coffee export earnings, it harms U.S. industries and workers who manufacture the products exported to those countries.

This White Paper contends that the United States and other consuming countries can take steps that will address the coffee crisis without incurring any significant economic or political costs. But the need for immediate action is urgent.

THE PROBLEM

Today's crisis in coffee, the world's most valuable (lawfully) traded commodity after oil, is unprecedented. It is structural in nature, not cyclical, and requires a structural solution. In brief, the expansion of coffee supply by non-traditional suppliers, especially Vietnam, coupled with higher output from some traditional suppliers (particularly Brazil), has created a glut of

coffee that has driven coffee prices to historic lows -- i.e., levels that are far below the farmers' cost of production. For the most part, the reasons for the glut are not market-driven.

Through concerted government intervention, Vietnam has become, in just a few short years, the world's second largest exporter of coffee. Vietnam's coffee production began to grow after the fall of Saigon to the communist government in 1975 -- the initial funding came from the governments of East Germany and France. Since 1995, the growth in Vietnamese coffee production has been explosive, with extensive government funding, an aggressive export promotion program and government seizure of the ancestral lands of Vietnam's indigenous "Montagnard" people.^{1/} Moreover, because Vietnam's coffee plantations are not, in any real sense, "market-oriented," they have put ever increasing quantities of coffee on the world market without any apparent regard for price.

The Vietnamese crop is "robusta" coffee, a lower quality, less flavorful coffee that is generally processed to meet lower quality standards than the traditional "arabica" coffee produced by Latin American growers.^{2/} Because other robusta producers (e.g., Indonesia, Brazil) were forced to follow Vietnam's pricing lead, and because the low robusta prices have prompted coffee roasters to use more robusta in their retail blends,^{3/} the price problem spread quickly to arabica coffees as arabica producers struggled to maintain their share of the coffee market.

The oversupply problem is exacerbated by increasing quantities of defective coffee beans and foreign matter in coffee mixtures as more low quality coffee enters the market. Traditionally, coffee producers would remove foreign matter and defects before exporting coffee. Today, cost cutting has resulted in less defect removal. Even more problematic is the sale of the removed defects, known in the trade as "triage," to roasters who then use them in coffee blends. Quality in the U.S. market has become so low that imports destined for low-end blends often contain defective coffee beans such as black, moldy, under-ripe and sour or fermented beans. Arabica producers are essentially being required to compete on price against substances that would not have been marketed as coffee 10-20 years ago. Furthermore, the growth of low quality coffee imports has frustrated efforts to promote coffee consumption; simply put, it is very difficult to persuade people to drink more coffee when so much of the coffee on the market is substandard.

^{1/} See "Vietnamese Coffee Floods World Market" (Press Release) Montagnard Human Rights Organization (Sept. 5, 2001).

^{2/} Ernesto Illy "The Complexity of Coffee" Scientific American (June 2002) at 86.

^{3/} See Peter Fritsch "Bitter Brew: An Oversupply of Coffee Beans Reapers Latin America's Woes" Wall Street Journal (July 8, 2002) at A10.

A SOLUTION

A group of Central and South American washed arabica^{4/} producing countries -- i.e., Colombia, Mexico, Costa Rica, Nicaragua, Honduras, Guatemala and El Salvador -- believe that the best solution to the coffee crisis is to develop and enforce quality standards that take defective coffee off the market.^{5/}

Quality standards are accepted for scores of agricultural products. They can easily be extended to coffee. But to be effective, a quality control initiative cannot be limited to producing countries; a successful initiative must be complemented by action on the part of the major consuming countries, particularly the United States. Coffee producers in Hawaii are already subject to quality controls.^{6/} The most effective means of quality control is to apply minimum standards to all coffee sold in the United States. Under this approach there would be a minimum standard below which defective coffee could not be marketed as coffee, although it could be sold for other purposes such as caffeine extraction.

CONCLUSION

This White Paper has been prepared with input from the coffee producers of Hawaii, Colombia, Mexico, Costa Rica, Nicaragua, Honduras and El Salvador and the Specialty Coffee Association of America. It is meant to stimulate discussions among coffee producers in the Americas and their governments, and U.S. coffee interests and the U.S. government. The objective is to develop as broad a consensus as possible on the solutions to the coffee crisis, bearing in mind that the situation is critical and that the need for action is urgent.

^{4/} Coffee is produced in two primary varieties: Robusta and Arabica. Robustas are cheaper, generally have a harsh, bitter flavor and are used to produce instant coffee and blended with Arabicas to produce ground roast coffees. Arabicas are milder and more flavorful. Washed arabicas are the mildest and most flavorful and are used to produce the best blends and single origin coffees.

^{5/} See Communiqué of July 19, 2002.

^{6/} See Haw. Admin. Rules, §§ 4-43-6, 4-43-7 (2001).

WHITE PAPER: THE COFFEE CRISIS

I. INTRODUCTION

The purpose of this White Paper is to provide the background on an economic and human crisis that affects the U. S. coffee producing industry, the larger security and international economic interests of the United States, and more than 22 million people around the world who produce the second most valuable lawfully traded commodity in the world: coffee.

The coffee producers in Latin America who have assisted in the preparation of this White Paper are convinced that governments in coffee producing and consuming countries must act jointly to address the coffee crisis. At the same time, they believe that action must be carefully crafted; it should not (a) lead to an artificial rise in the price of coffee to consumers; (b) violate the spirit or the letter of WTO agreements or national laws; or (c) reduce competition in the U.S. market. The entire industry has an interest in making the coffee market work for the benefit of consumers, growers, roasters, and traders, here in the United States and around the world. Such action is both possible and urgently necessary.

II. THE HUMAN FACE OF THE CRISIS

“There’s no hope anymore with coffee. The price just keeps going down.” — Mercedes Martinez, unemployed Nicaraguan coffee worker and single mother of seven.^{1/}

It is the human impact that makes the current conditions in coffee a “crisis.” Coffee provides a livelihood for over twenty-two million human beings worldwide,^{2/} but it is not an easy crop to harvest or process. Much of the farmer’s work must be done by hand, especially the work of producing arabica coffee, the fine, mild, aromatic coffee that represents a declining, but still the majority, share of the world’s coffee production. In coffee-growing regions around the world, farmers and their employees are suffering from plummeting coffee prices. As poverty and unemployment grow, social instability follows closely behind. The global coffee crisis has a human toll counted in the millions of these hard-working farmers:

- “In Tanzania, small holder [coffee] farmers are being forced to take their children out of school . . . In the state of Chiapas, in the south of Mexico, the wages of

^{1/} Laura Goering “Coffee bean glut drowns production in Nicaragua” *Chicago Tribune* (Oct. 23, 2001).

^{2/} Much of the information in the next several paragraphs is taken from the Website of the International Coffee Organization, www.ico.org, especially */story.htm*, which contains basic information about coffee culture. See also Pendergrast, *Uncommon Grounds: The History of Coffee and How It Transformed Our World*, Basic Books, 1999 [hereinafter, Pendergrast].

seasonal labourers already living on the poverty line have been dramatically cut In the Dominican Republic, woman farmers report that they are now unable to meet the cost of sickness episodes. In the Kafe region of Ethiopia . . . falling prices threaten to lead to household food shortages. . . .^{3/}

- “In Matagalpa [Nicaragua] most of the 44,000 growers are small farmers with only a few acres to cultivate farmers here cannot even recoup their production costs -- \$83 per hundred pounds. . . . The collapse of the market has set off a chain reaction that is felt throughout the region. Towns have been left to scrape by as tax receipts drop, forcing them to scale back services and lay off workers. Farms have scaled back or closed, leaving thousands of the area’s most vulnerable people with no money to buy food or clothes or to pay their rent. Small growers, in debt to banks and coffee processors who lent them money to care for the crops and workers, have been idled, and some of them are facing the loss of their land.”^{4/}
- There are over 100,000 coffee farmers in Mexico, primarily working small farms, many of whom could not harvest their crop this year because to do so would have cost more than the market would pay.^{5/} In Mexico’s coffee growing regions of Chiapas and Veracruz, peasants report high levels of migration to the United States as a result of unemployment.^{6/} Sadly, the victims of highly publicized exposure deaths in the Sonora Desert were fleeing the new poverty in coffee growing towns.^{7/} If coffee prices continue to fall more migrants will follow.
- In El Salvador the drop in coffee prices, combined with the devastation caused by the 2001 earthquake left more than 30,000 coffee workers unemployed.^{8/}
- In Colombia, coffee directly employs more than 800,000 people or about 36 percent of rural workers. An additional 3 million people are dependent on coffee

^{3/} “Bitter Coffee: How the Poor are Paying for the Slump in Coffee Prices,” (Oxfam, May 16, 2001) [hereinafter “Oxfam Report”].

^{4/} “A Coffee Crisis, Devastating Domino Effect in Nicaragua,” *New York Times*, (Aug. 29, 2001).

^{5/} See “Coffee Crisis Begins to Boil” *Financial Times* (April 10, 2001) (“The Mexican Government estimates that about 1m bags, or 20 per cent of annual production, have been left to rot in abandoned coffee plantations.”).

^{6/} See Maja Wallengren, “Coffee Crisis Sends Mexico Producers to Death in Arizona” (Dow Jones), May 29, 2001.

^{7/} *Id.*

^{8/} Gerard Greenfield “Vietnam and the World Coffee Crisis: Local Coffee Riots in a Global Context” Paper prepared for the Asia-Pacific Land-Freedom Conference.

to some degree.^{9/} Collapsing coffee prices have caused devastating social upheaval in some of Colombia's coffee growing regions. As a direct result of the crisis, the fee that the Colombian Coffee Federation earns on coffee exports, which has provided funding for a number of successful social, educational and infrastructure programs in rural Colombia, is now threatened.^{10/} According to experts on the ground, falling prices have "led to a surge in kidnappings, violence and farming of drug crops."^{11/}

- In some coffee-growing regions, coca, the source of cocaine, or poppies, the source of heroin, are the most attractive alternative crops to coffee. Officials in Peru are reporting that peasant farmers, who were given incentives to shift from coca to coffee cultivation in the late 1990s, are beginning to plant coca again in response to falling coffee prices.^{12/} The concern in Colombia is not only the evidence of coca crops intertwined with the traditional coffee plantations, but also that small farmers who produce arabica coffee at high altitudes, where opium poppies are an alternate crop, will move out of coffee into poppy cultivation, strengthening the hand of Colombia's narco-terrorists.^{13/}
- Even in Hawaii, where growers enjoy a substantial premium for their high-quality coffees, dropping coffee prices have had a negative impact. In October of 2001, Kaanapali Estate Coffee closed its doors and laid-off more than 20 employees. Kaanapali's owner cited "record-low commodity coffee prices" as the reason for the closure.^{14/}

If present conditions are allowed to continue, the impact on the coffee growing regions of the world will be irreversible. A coffee tree needs up to five years of careful cultivation before it becomes fully productive. This means that trees left untended because of the crisis cannot be replaced quickly or easily. The problem is urgent and growing. Failure to take corrective action now means long-term turmoil.

^{9/} International Coffee Organization, Coffee Profile: Colombia, (Sept. 1997), available at www.ico.org/pub.col.htm.

^{10/} See Ibon Villeda, "Colombian Coffee Growers Predict Demise of Coffee" Reuters, November 1, 2001.

^{11/} James Wilson, "Coffee or Poppies? Colombia's Growers Under the Spotlight," *Financial Times*, Oct. 26, 2001.

^{12/} See, e.g., Clifford Krauss, "Desperate Farmers Imperil Peru's Fight on Coca," *New York Times* (abstracts) (Feb. 23, 2001).

^{13/} See Wilson, *supra*.

^{14/} Harry Eagar, "Kaanapali Estate Coffee to Shut Down" *Maui News* (Oct. 18, 2001).

III. THE HARD NUMBERS

A. Cause of the Coffee Crisis: Structural Oversupply of Coffee, Driven Primarily by Increasing Quantities of Defective Coffee

Coffee is grown in 50 countries around the world, including the United States. The market for coffee has always been affected by temporary swings in supply because of changes in weather patterns and the ravages of war, labor strife and other cyclical events. However, until recently there has been a structural balance of supply and demand. In the past few years, that has changed.

There is now a structural oversupply of coffee on world markets. World production of the fastest growing type of coffee, called “robusta” (a smaller, bitter and less flavorful bean than the mild and flavorful “arabica”) grew at an astounding 19.66 percent in 1999/2000 and 12.9 percent in 2000/2001.^{15/} This has increased growth in worldwide production of all types of coffee from 85.7 million bags in 1995/1996 to 113.3 million bags in 1999/2000, an increase of about 6 percent per year.^{16/} In 2001/02, production continued to grow to 117 million bags.^{17/} Brazil’s crop alone is expected to increase by nearly 15 million bags in 2002/03, driving world production to 122 million bags in that crop year.^{18/}

Lower prices, however, have not caused increased demand. Coffee consumption has grown at an average rate, worldwide, of 1.53 percent from 1998 through 2001. Obviously, this means supply far exceeds demand on a global basis. The best shorthand evidence of the imbalance between import demand and global supply is the buildup of consumer stocks in recent years. Stock-to-use ratios, a classic measure of adequacy of supply in some American agricultural programs, are running almost 18:1.^{19/} “The market,” as virtually every knowledgeable authority would agree, “remains clearly oversupplied.”^{20/}

One would expect oversupply of this size to result in crashing prices, and so it has.

Coffee prices continue [in September 2001] to decline under the weight of heavy exports and rising consumer stocks, reflecting the huge imbalance between demand and supply. The ICO composite indicator price averaged

^{15/} Association of Coffee Producing Countries, *Coffee Market Report Number 22* (September 2001) [hereinafter “ACPC Report 22”], at 3, *et seq.*

^{16/} Green coffee is usually measured in bags. A bag contains 60 Kilograms of coffee green, about 132 pounds.

^{17/} See “FASonline Coffee Update” available at <http://www.fas.usda.gov/http/tropical/2002/06-02/Jun02txt.htm>.

^{18/} *Id.*

^{19/} ACPC Report 22 at 33, Table 13.

^{20/} *Id.*, at 27.

42.77 cents/lb in August, the lowest level . . . since September 1969, when prices averaged 40.22 cents/lb. Prices are now well below the cost of production of the most efficient coffee producer, and are imposing serious hardship on coffee farmers worldwide. . . . In September prices hit 26-year lows on the New York Coffee, Sugar and Cocoa Exchange (CSCE). . . . The situation for robusta prices is even weaker^{21/}

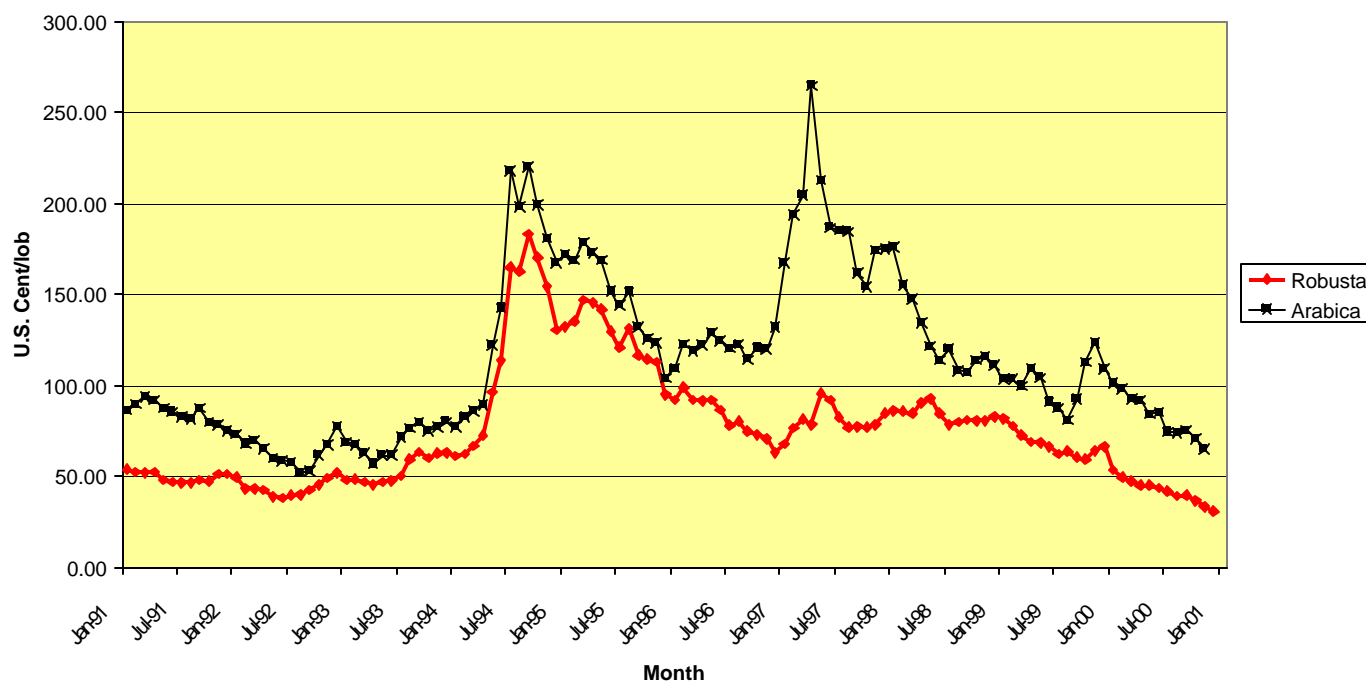
There are two reasons why increasing production of robusta causes all coffee prices to fall. The first is coffee “blending,” which is a mixing of different coffees to achieve both a taste profile and a price point. The main species of coffee -- arabica, which is grown throughout Latin America, in Central and East Africa, India and to some extent in Indonesia -- is used because of its superior taste and aroma. Robusta coffees are blended with arabica coffees to lower blend costs in order to gain a price advantage. Robusta coffees have increased their market share from about 25 percent of coffee traded on the world market five years ago to about 38 percent today, reflecting a major restructuring of the global markets.^{22/} Robusta production is not only driving its own prices down, it is also dragging down the price of arabica. This is evident from Chart 1, which shows arabica prices following robusta prices down in this crisis.

^{21/} *Id.*, at 30 (emphasis added).

^{22/} Association of Coffee Producing Countries, *Coffee Market Report Number 21* (May 2001) at 10. [hereinafter ACPC Market Report 21]

Chart 1^{23/}

Monthly Prices 1991-2000



Second, the race to produce more coffee at ever lowering prices has introduced impurities into coffee at unprecedented levels. Impurities are generally defects that cannot be transformed chemically into a roasted coffee bean during the roasting process. These impurities can include small stones and sticks, insects, moldy beans, and beans that are unripe or have fermented or turned black during harvesting. SCAA estimates that about 15 percent of each harvest is defective.^{24/} The defect ratio is generally higher for robusta coffee, due to the less rigorous picking and processing methods employed by robusta producers.^{25/}

Traditionally, defects were removed from coffee and did not enter the world market. Today defects are increasingly found in coffees destined for sale to consumers.^{26/} The defects are entering the market in two ways. First, lower prices are driving farmers to neglect trees and invest less in quality control leading to increasing quantities of defects in coffee. Second, as coffee producers seek any means of recovering costs, even those defects that are removed from

^{23/} Source: ICO Pricing Data, Robustas and Other Milds.

^{24/} Ted R. Lingle, Recommendations for a Market-Based Approach in Dealing with Coffee Price Volatility

^{25/} *Id.*

^{26/} See "Bitter Brew" Wall Street Journal at A10.

the coffee crop are now being sold on the world market.^{27/} Coffee mixtures that are largely made up of defects (known in the trade as “trriage” because it is sorted out of the coffee crop before sale) are now being sold to U.S. roasters and importers at very low prices. The roasters are then adding the triage mixture to coffee blends to even further lower their own cost.

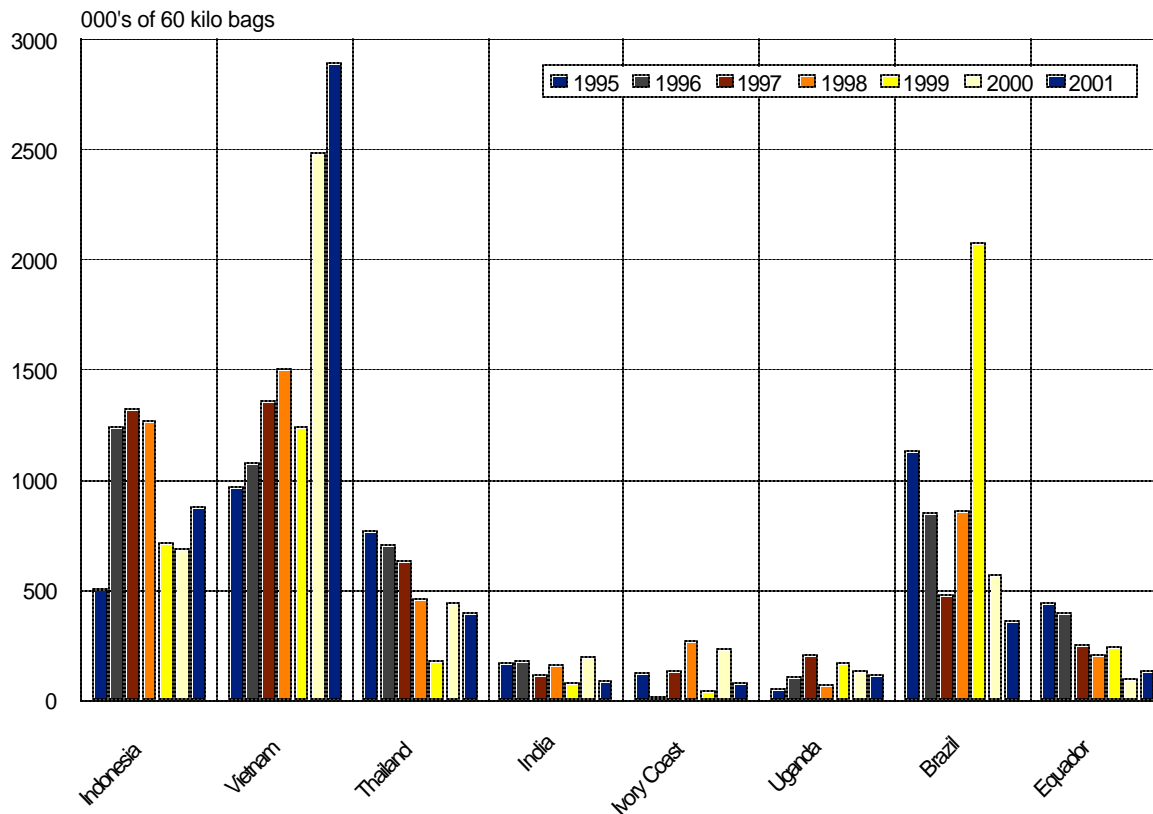
Given the growing quantities of defects found in coffee it is no wonder demand is flat, regardless of price. In effect, increased use of defective coffee in blends hinders a market-based response to the problem, namely, increased demand. Instead, as the quality of coffee drops, prices have dropped but consumption has not increased.

The consensus in the coffee industry is that the huge jump in Vietnamese supply over a very short period of time is the principal cause of the structural oversupply of the coffee market and is significantly driving the growth of defects in the market.^{28/} As Chart 2 shows, Vietnam’s share of the U.S. robusta market has been increasing faster than, and out of proportion to, any other producer:

^{27/} See Testimony of Ted Lingle, Executive Director Specialty Coffee Association, before House Subcommittee on Western Hemisphere (July 24, 2002).

^{28/} See, e.g., Robin Stainer, “Vietnam to the Fore in Coffee”, CoffeeNetwork (April 23, 2001).

Chart 2
U.S. Robusta Imports^{29/}



Vietnam’s current annual coffee production is running at “about 15 million bags^{30/},” up from 3.9 million bags in 1995/96 and enough to move Vietnam into position as the second largest producer of coffee in the world, after Brazil.

The rapid increase in Vietnamese output, which is the result of “an aggressive expansion in planted area and an improvement in yields,^{31/} has been fueled by extensive government funding, an aggressive export promotion program and government seizure of the ancestral lands of Vietnam’s indigenous “montangard” people.^{32/} VICOFA, the Vietnamese Coffee and Cocoa Association, estimates that Vietnam currently has 500,000 hectares planted with robusta

^{29/} Source: American Coffee Corporation.

^{30/} ACPC Market Report 22, at 13

^{31/} *Id.* at 13.

^{32/} See “Vietnamese Coffee Floods World Market” (Press Release) Montangard Human Rights Organization (Sept. 5, 2001).

coffee.^{33/} Even if the area planted is not extended, Vietnamese coffee production will continue to grow because many trees are just coming to maturity in that country.^{34/} Indeed, about half of all the trees in Vietnam are just at the beginning of their maximum yielding stages, with a third on their way there.^{35/} In other words, the impact of Vietnam on world coffee prices has just begun. Because it has created a more or less permanent increase in total supply that will not decline in response to the global oversupply, Vietnam has created what *The Economist* calls “chronic” oversupply in coffee.^{36/}

Ironically, the economic effect even for Vietnam is unfavorable. The world market is over-supplied because of Vietnam, but “Vietnam’s rapid expansion in production is no longer paying dividends.”^{37/} With prices for Vietnam’s coffee falling to as low as 17 cents per pound, Vietnam’s foreign exchange earnings from coffee sales dropped 18.8 percent in 1999, despite the increase in production.^{38/} Because the average price of its coffee exports has fallen to a level that is far below the cost of coffee production in Vietnam (as estimated by independent analysts), the Vietnamese government is proposing to use its Export Assistance Fund -- a subsidy -- to offer interest payment support to coffee traders.^{39/}

To make matters worse, the expansion of coffee in Vietnam has been a human and environmental catastrophe. There are reports of mistreatment of the indigenous Montagnard people, whose lands were seized to grow coffee.^{40/} Moreover, “high fertilizer use is expected to render soil infertile, and . . . forest clearing when Vietnam first began to expand coffee production has left large areas vulnerable to winds, soil erosion and landslides.”^{41/} Unfortunately, there is nothing to suggest that the Vietnamese government is sensitive to the economic and social problems that its rush into the world coffee market has created.

^{33/} Patricia Avidan, “Vietnam Coffee Strategy Includes Increased Quality, Lower Output Costs, Variety Shift” *CoffeeNetwork* (May 20, 2001) (Statement of Doan Trieu Nhan, Chairman of VICOFA).

^{34/} See Stainer “Vietnam to the Fore in Coffee.”

^{35/} *Id.*

^{36/} “Drowning in Cheap Coffee,” *The Economist*, Sept. 29, 2001, at 43.

^{37/} ACPC report 22, at 13.

^{38/} *Id.*

^{39/} ACPC Market Report 21 at 11.

^{40/} See Thomasi MacDonald “Delegation goes to New York City to Protest Vietnam Atrocities” *The News & Observer* (may 4, 2001).

^{41/} ACPC Market Report 22, at 14.

B. There Has Been No Significant Consumer Benefit

Despite the fall in prices paid to coffee growers, prices have not shown similar declines at the retail level: “In the short-term, sticky retail prices . . . have remained stubbornly high despite the sharp decline in green coffee prices.”^{42/} Traders, roasters and retailers have been earning record profits during the global price retreat (Nestle, the world’s largest coffee retailer, reported a rise in profits of over 20 percent in February 2001^{43/} and other roasters have also reported record profits^{44/}), but consumers have seen little benefit.^{45/}

Moreover, less of each consumer dollar spent goes to the growers. In the 1980s, final consumers spent approximately \$30 billion a year on coffee. Of that amount, between \$9 and \$10 billion (30-33 percent) was returned to the producing countries. Today consumers spend around \$50 billion on coffee a year, of which producers receive only \$7 or \$8 billion (15-16 percent).^{46/} Growers’ prices are declining to the lowest level in more than thirty years, even as growers’ share of the final retail price is also declining.

IV. MARKET STRATEGIES FOR A HEALTHY COFFEE MARKET

Global sales of green coffee should not be insulated from market forces; indeed, they cannot be. But the current glut is, to a significant degree, the result of nonmarket forces that have distorted markets and thereby undermined the livelihood of millions of people who have invested their labor and capital in reliance on market forces. The oversupply, low price, poor quality combination has set off a “perfect storm” in the coffee industry -- the three factors are working together and complementing each other to drive prices ever lower and at the same time pushing consumers away from the beverage. Lower prices mean less of the labor-intensive quality control required to remove defects. And paradoxically, less quality control means more coffee on the market. If defective beans and foreign matter are not removed from coffee the defects and foreign matter are sold as coffee. In this market, lower prices do not raise consumption because eventually, as quality declines the coffee industry loses consumers. Furthermore, the lower prices paid to farmer are not being passed on to consumers but retained as large margins for the middlemen and retailers.

^{42/} Association of Coffee Producing Countries, Coffee Market Report Number 21, (May 2001), at 20; *see also* “Bitter Brew” Wall Street Journal (July 8, 2002) at A10.

^{43/} Oxfam Report at 6.

^{44/} *See* Jo Tuckman, “Gourmet Cappuccino is a bitter cut for poor coffee farmers,” *The Guardian* (June 18, 2001).

^{45/} *See* “Bitter Brew” Wall Street Journal (July 8, 2002) at A10.

^{46/} International Coffee Organization, “Prices paid to growers in exporting Member Countries in US cents per lb,” www.ICO.ORG.asp/display7. *See also*, “Colombian Fin. Min.: Coffee Crisis Needs Political Action” *Dow Jones Commodities Service* (May 18, 2001).

The producing countries must develop “self help” strategies to address the imbalance in the market, but experience proves that without the collaboration of the major consuming countries, self-help is not enough.

A. The Role of Producing Countries: Self Help Strategies

The first responsibility for attacking problems of global oversupply of green coffee is properly that of the people who grow, process and sell coffee. They have an interest in, and a responsibility for, delivering a quality product to customers for a reasonable, market-driven price. To the extent permitted by national law and international trade rules, they should take the first steps. And, indeed, producers have taken important self-help measures as the coffee crisis has developed. However, each of these steps has limitations.

1. Boost Demand While Increasing Consumers’ Awareness of Quality

An obvious first step is to persuade consumers to buy coffee of high quality. Creating consumer awareness of coffee quality should moderate somewhat the price impact of low quality coffees on the market as a whole. “Quality” can mean many things in coffee, but at a minimum, it ought to mean wholesome coffee with very few defects. Consumers should also take an interest in ethical issues that markets may not take account of unless consumers insist on them: the environmental impact of how their coffee is grown and processed as well as the human impact.

The Colombian Coffee Federation has been a leader in promoting coffee quality.

“In 1960 the National Federation of Coffee Growers of Colombia invested in Juan Valdez, a friendly, mustachioed coffee grower who, with his mule, trundled his hand-picked beans down from the Colombian mountains. . . . For once, advertising hype essentially matched reality; most Colombian coffee indeed was produced on small mountainside *fincas* by some two hundred thousand families headed by men such as Juan Valdez. . . . Five months after the campaign began, there was a 300 percent increase in the number of consumers who identified Colombian coffee as the world’s finest . . . The campaign was so successful that many roasters not only bragged that their blends contained Colombian beans but also began marketing 100 percent Colombian cans. By creating a value-added product, the Colombians could command a premium price, rising above the price-cutting fray.^{47/}

Since the landmark Colombian effort, other producers have mounted similar efforts, such as in Costa Rica.^{48/} It is surely true that some consumers in the United States have begun to pay attention to quality in coffee consumption. The Specialty Coffee Association of America

^{47/} Pendergrast at 285-86.

^{48/} For examples, see “Drowning in Cheap Coffee,” at 44.

(“SCAA”), in particular, has been a leader in the quality coffee movement. It has provided a forum for industry participants whose primary concern is quality, has created a defect grading system for specialty coffee and dedicated itself to research and action to improve coffee quality and protect coffee growers. In addition, the National Coffee Association (“NCA”) of the United States supports “sustainable coffee,” defined by the NCAs “coffee . . . bought and sold based on the free trade model . . . produced with adherence to the individual country’s labor rules of law, and . . . grown and processed using environmentally sound agricultural methods.” NCA supports “any initiative that [will] further these goals.”^{49/}

At the end of the day, however, “specialty” coffees still only account for about 7 percent of U.S. consumption. While efforts to promote awareness of coffee quality should obviously continue,^{50/} they are expensive (the first Colombian “Juan Valdez” campaign cost \$1 million 40 years ago), and, more importantly, they probably cannot address the fact that most coffee will be sold as a commodity for the foreseeable future.

A question related to quality is whether it is possible to increase worldwide demand for coffee. With current average annual consumption growth, worldwide, of about 1.5 percent per year, the growth of supply is far outstripping the growth of demand. Europeans now consume about 5.5 kg per year, North Americans about 3.5, and Asians even less.

There are many ideas for increasing demand under discussion in the industry. Much has already been done. For example, many think the effort should be to increase local consumption of coffee in coffee-producing countries. Brazilians, for example, have been increasing consumption at home. It is now 4.5 kg per year. Worldwide, 22 percent of coffee is consumed in the country where it is grown.^{51/} A more promising approach, however, would be to increase coffee consumption in Asian nations. But, again, it is hard to persuade people to drink more coffee when quality is declining, and when that decline is based fundamentally on the actions of a supplier that will not respond to market signals.

2. Reduce Supply: Retention Schemes

For many years, the International Coffee Organization (“ICO”) provided an international price mechanism, which used quotas to keep the price of coffee within certain agreed bands. When the United States stopped supporting quotas in 1989, this part of the agreement collapsed. More recently, the Association of Coffee Producing Countries (“ACPC”) sponsored quota and retention plans, under which governments of producing countries voluntarily withhold set amounts of green coffee from the market. And most recently, a 20 percent retention plan was adopted in May 2000 by 14 producing countries. However, the current plan was implemented only by a handful of countries -- and Vietnam, which refused to allow inspections, is now

^{49/} “Key Issues Facing U.S. Coffee Industry,” Coffee on the Hill (undated one-page issue paper), National Coffee Association of the U.S.A., Inc.

^{50/} Juan Forero “A Coffee Icon Rides His Mule Off Into The Sunset” *New York Times*, (Nov. 24, 2001) at A4.

^{51/} Pendergrast at 411.

selling a portion of its allegedly retained coffee.^{52/} On August 22, 2001, the executive president of the Mexican Coffee Council told reporters that Mexico would formally end participation in the global retention scheme because under current conditions, Mexican farmers had to leave half of this year's crop unpicked while overproduction continued forward unrestrained by producers in other countries.^{53/}

The fact is that efforts by producers to limit stocks have been repeatedly tried for more than 100 years and they have all failed.^{54/} At best, retention is a tool suited to temporary overstocks, not to a structural imbalance. Retention, which temporarily reduces supply to bolster price, is less unlikely to be effective in dealing with the current oversupply because it raises prices but fails to address the fundamental problem of excess production. Indeed, if prices begin to rise, retained stocks are likely to re-enter the market and exacerbate the oversupply.

3. Removing Defective Coffee

An alternative to the pattern of failed retention schemes by producers, or producer and consumer efforts to "manage" coffee prices, is an effort to remove the lowest quality coffee -- i.e., "defective" coffee or triage -- from the market or at least prevent triage from being marketed as coffee. As coffee supply has increased, the volume of defective coffee available at rock bottom prices has also increased and has contributed importantly to the relentless downward pressure on market prices.

The Coffee Research Institute, organized by SCAA to provide information on quality in coffee, has developed detailed information about defects and systems for eliminating defects in coffee.^{55/} An effective system of purity, wholesomeness and quality management would remove off-grade coffee from the market (or prevent it from being marketed as coffee) and give to consumers the information they need to choose the coffee they want. Removing this material

^{52/} Marie Wolfram "Brazil Threatens to Quit Coffee Retention Plan" *Agence France-Presse* (May 16, 2001).

^{53/} *Dow Jones Commodities Service (DJCS)*, "Mexico Says Will 'Formally' End Coffee Retention Plan," August 22, 2001. Similarly, *DJCS*, "Brazil to Scrap Coffee Retention; Won't Release Stocks," August 22, 2001.

^{54/} The history of these efforts is set out in many places, including Pendergrast, pp 79, *et seq.*

^{55/} Defects creep into coffee at every stage from the moment beans are picked until their final roasting. Under the SCAA system, coffee is classified by sorting the coffee through screens because the highest quality coffee beans are more dense and larger in size than lower quality coffees. Then a sample of 300 grams of the coffee is examined for defects, and the coffee is graded as Specialty (the highest grade), Premium, Exchange Grade, Below Standard Grade and Off Grade. Specialty Grade coffee can have no primary defects (a black bean is one primary defect; 2 medium stones equals one primary defect) and number of other qualities are necessary, such as moisture content of between 9 and 13 percent. Off Grade, the lowest SCAA classification, consists of more than 86 defects in 300 grams.

from the market would help stabilize prices without denying consumers any pure and wholesome coffee.

In this connection, the ICO has launched an effort to facilitate the removal of defective coffee from the world market.^{56/} However, the ICO effort relies on efforts by exporting countries alone. Past history has taught that efforts by exporting countries without enforcement by consuming countries will not be successful. Nevertheless, Latin American washed arabica producers have committed to removing defective coffee from the market and have even begun destruction of “triage” to ensure it is not sold to consumers.^{57/}

B. The Role of Consuming Countries: Standards and Transparency

Controls by consuming countries that complement the producers’ own quality control efforts are essential for an effective market-based approach to the coffee crisis. Years of experience proves that quality (or other) controls by producing countries alone invariably fail; the incentive to cheat under a producers-only system is irresistible.

The United States and the European Union regularly impose quality-control measures with respect to both domestic agricultural production and imported agricultural products. Indeed, the U.S. coffee industry already has voluntary quality controls and grade standards on its own production and the State of Hawaii imposes mandatory grading and strict standards on all

^{56/} Recently, ICO established a Quality Committee to devise rules to facilitate measures for the withdrawal from the market of defective coffee beans and those with a moisture content above a permitted level. According to ICO:

The establishment of this Committee is designed to obtain the fullest participation of all stakeholders including the private sector to ensure that technical issues for such a programme are thoroughly reviewed and measures proposed have the highest possibility of successful implementation. (ICO Press Release 133/01, 1 October 2001.)

The committee consists of representatives of coffee producers in Latin America, Africa and Asia, and consumers in the EU, Norway and Japan. It has asked for the advice of the International Standards Organization, one of the international standards-setting bodies recognized under the WTO Agreement on Technical Barriers to trade, but has barely begun its work. The Committee recently recommended that members agree not to export green arabica coffee containing more than 86 defects per 300-gram sample and green robusta coffee containing more than 150 defects per 300-gram sample. See “Recommendations of the Quality Committee” ICO (18 January 2002).

^{57/} See July 19, 2002 Communiqué.

coffee grown in the state. It may be that the only thing that needs to be done is to apply a minimum standard to imports.^{58/}

Obviously, action by the major consuming countries of the world cannot be inconsistent with their domestic laws, their international treaty and agreement obligations under the WTO or other institutions, or their shared commitment to market economics. Within these parameters, however, much can be done.

The United States may, pursuant to the WTO Agreement on Technical Barriers to Trade, promulgate regulations that prescribe mandatory standards for any product, including a food product, so long as the standard applies equally to imported and domestically-produced goods.^{59/} Under the Agricultural Adjustment Act of 1937, the United States government assists American farmers in establishing and enforcing product quality standards by means of marketing orders.^{60/}

Marketing orders are currently in effect for dozens of agricultural products, including many that are imported into the United States. There are grade and size requirements for citrus and tomatoes. Color requirements and grading are applied to fruits and some nuts, such as almonds. Minimum size, grade and other non-sanitary requirements are imposed on imports of oranges, grapefruits and kiwis. Such orders are currently enforced by agricultural inspectors on all imports of these products.^{61/} In addition to marketing orders, the United States has established grading systems for a number of products, including many that are imported. Grading systems are in place for avocados, walnuts, nectarines, kiwis and many other products. The Food and Drug Administration also implements quality standards for many food products to protect consumers from unwholesome food as well as “economic adulteration” (i.e. adulteration that has no health impacts but deceives consumers into purchasing an inferior product).

The Hawaiian law on coffee describes various grades of coffee, as do the numerous voluntary systems of grading, such as that developed by the SCAA. In addition, a large majority of the green coffee imported into the United States is traded through a standard green coffee contract established and administered by the Green Coffee Association of New York (“GCA”). Under this contract, all coffees are graded and classified according to GCA standards, and consequently both buyers and sellers are keenly aware of the levels of defects in the coffees they

^{58/} The European Union is particularly interested in issues such as environment, sustainable production and food safety and quality. The “from farm to fork” approach is a constant element in various EU policies, notably food safety, food quality and environment. To this end, several quality assurance programs to limit levels of Ochratoxin A (OTA) permitted in imports of moldy coffee beans are under discussion at the EU. The adoption of standards for coffee to be imported into the United States may also be required to prevent the United States from becoming the “market of default” for coffees containing high levels of defects or moldy beans that do not comply with the proposed European regulations.

^{59/} See Agreement on Technical Barriers to Trade, Art. 2.1

^{60/} The provision authorizing marketing orders is found at 7 U.S.C § 608c.

^{61/} See 19 U.S.C. 608e(i).

handle, as they are specified in the terms and conditions of the sale. Provisions for quality arbitrations are part of these agreements and are routinely exercised when questions of grade are in dispute.

Establishment of a uniform coffee grading system would provide industry participants and consumers with important information about the quality of coffee and establish transparency in the industry. The key element of such a system would be a minimum standard below which a product could not be marketed and sold as “coffee”. The benefits would be two-fold. First, it would prevent sales of impure and unwholesome coffee, thus providing a floor on the market (substandard material could still be sold for other purposes such as caffeine extraction or even for consumption as long as it is not labeled “coffee”). Second, it would give consumers a basis for making an informed choice among different quality coffees. Currently there is no transparency in the coffee industry for consumers who have no way of knowing whether coffee contains defects when they buy it.

V. CONCLUSION

The current coffee glut is a structural change in the global marketplace for green coffee. The glut, and the severe disruption it is causing, will destroy the market-based production of coffee in middle and low-income countries around the world, with grave consequences for security, drug enforcement, social, environmental and other interests of the United States. While the producers of coffee have taken and will continue to take action to constrain the impact of these practices, their action alone cannot solve the coffee crisis; action by major coffee consuming nations, including the United States, member states of the European Union and Japan, is necessary.