THE COFFEE CRISIS IN THE WESTERN HEMISPHERE

HEARING

BEFORE THE

SUBCOMMITTEE ON
THE WESTERN HEMISPHERE

OF THE

COMMITTEE ON
INTERNATIONAL RELATIONS
HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

JULY 24, 2002

Serial No. 107–106

Printed for the use of the Committee on International Relations

Available via the World Wide Web: http://www.house.gov/international_relations

U.S. GOVERNMENT PRINTING OFFICE

80–964PDF WASHINGTON : 2002

For sale by the Superintendent of Documents, U.S. Government Printing Office
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THE COFFEE CRISIS IN THE WESTERN HEMISPHERE

WEDNESDAY, JULY 24, 2002

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON THE WESTERN HEMISPHERE,
COMMITTEE ON INTERNATIONAL RELATIONS,
Washington, DC.

The Subcommittee met, pursuant to call, at 2:30 p.m. in Room 2200, Rayburn House Office Building, Hon. Cass Ballenger [Chairman of the Subcommittee] presiding.

Mr. BALLENGER. The Subcommittee today meets to consider changes in the world coffee market and their impact on the Western Hemisphere.

In the span of just a few years, Vietnam has emerged as the second leading exporter of coffee in the world. This new Vietnamese production, coupled with over-production by Brazil, the world's leading exporter of coffee, has led to a glut in the coffee market. These two countries produce significant amounts of robusta coffee, which is of lesser quality and cheaper to grow than the arabica coffee produced throughout Latin America.

Last year, 115 million bags of coffee were produced globally, while only 108 million bags were consumed. This oversupply has driven coffee prices to their lowest level in 30 years to just a fraction of what they were a few years ago.

The coffee crisis is devastating the economies of many countries in Latin America and the Caribbean which depend on coffee as a critical export crop. Hundreds of thousands of laborers have lost their jobs, and many more are working for decreased wages. For most farmers, the production costs are too great to be recovered in today's market, and many are abandoning their crops.

In Colombia, coffee revenues have dropped by half in just 5 years. In Peru and Colombia, some coffee farmers are beginning to harvest illicit crops such as coca plants and poppies for opium. Some unemployed former agricultural workers are coming to the United States looking for work.

All this is of great concern to the Subcommittee because the countries affected by the crisis are friends and neighbors of the United States whose stability and prosperity matter a great deal to us, countries such as Mexico, Colombia, El Salvador, Peru, Guatemala, Nicaragua, Honduras and Venezuela.

I particularly hope that our witnesses today can help us to understand not only what is happening, but what the United States may be able to do to help the countries in the Western Hemisphere suffering from these great changes in the coffee market.

Would you have an opening statement?

Mr. DELAHUNT. Yes. Thank you, Mr. Chairman. I appreciate you holding this hearing. Obviously, I am fully familiar with your passion and affection for the people in Central and South America. This is an important hearing because this is a very important issue.

The slump in world coffee prices is turning into an unmitigated disaster for Latin America. Across the hemisphere, families are cutting back on food. Children are not going to school, and medicines are becoming a luxury. There is little immediate relief and no easy solution.

Some in Central America are comparing the coffee crisis to Hurricane Mitch, which in 1998 flattened sections of this already poor region, washing out entire villages. I would submit that the potential impact of this crisis is even worse, and we, the United States, cannot stand idly by for both pragmatic and moral reasons, because it does directly affect our national interests.

In southern Mexico and Central America, the crisis has led to an increasing number of migrants. Many producers told hundreds of thousands of itinerant workers not to show up for the autumn, 2001, crop since prices were too low for harvesting. It is difficult to quantify the direct effect of the coffee crisis on illegal migration to the United States, but in May of last year six of 14 migrants found dead in the Arizona desert were identified as coffee workers.

In Colombia, Peru and Bolivia, the situation is somewhat different. Small coffee farmers are increasingly tempted to turn to coca and poppy production. Coca and poppy crops are much more profitable than coffee, and the collapse of prices have made them even more so. In Colombia, the U.N. International Drug Control Programme reports opium poppies are appearing on what was once traditional coffee land.

Over the past 2 decades, South and Central America have endured rebel insurgencies, financial crises, hurricanes, earthquakes and corruption scandals. The lack of hope for the millions of people who rely on coffee for their livelihoods could present an even greater challenge, and we cannot afford to walk away.

Mr. Chairman, this morning there was a hearing with the principal witness being Senator George Mitchell before the Full Committee on a Marshall Plan for the Middle East. I know that my Ranking Member, who I am sure will come later, has for years now put forth a similar concept for Latin America. I suggest it is long overdue. It is long overdue, and we really have to enhance our engagement and make a long-term commitment to our neighbors to the south.

This crisis leads me to question the wisdom of trade policies over the past 15 years that have benefitted mostly large international firms at the expense of workers and small producers. I would hope that the Administration takes these effects into account when working on FTAA. I certainly will when voting on it.

I look forward to hear what USAID is doing to alleviate the effects of depressed coffee prices. Beyond feeding programs and immediate humanitarian assistance, I hope to hear that we have developed a comprehensive, long-term plan to provide opportunities and hope for rural populations affected by this crisis.

I also ask my colleagues to look at options beyond aid, including legislation that would improve the environmental policies of our trading partners, as well as protecting the rights of small producers and workers.

Again, Mr. Chairman, thank you for this hearing. It is an important hearing.

Mr. BALLENGER. And the senior Member of our International Relations Committee, Mr. Gilman?

Mr. GILMAN. Thank you, Chairman. I would like to thank you for calling this important hearing and bringing this important issue to our attention. I have had a number of calls from constituents who are related to some of the Central American countries, and they have said it is a major crisis in Central America today.

With almost all of the public's attention being focused on our war against terrorism for the past few months, the economic disaster encompassing many areas of Central and South America caused by severe drought and extremely low coffee prices has been neglected. I am pleased that you are focusing attention on this problem.

Expanded coffee supply has caused coffee prices to drop to their lowest level in over 100 years. I understand that a major cause of this is when we boosted the Vietnamese coffee production, and that flooded the supply around the world. With coffee prices not covering the cost of production, farmers are abandoning or selling their farms to raise money to pay smugglers to take them into the U.S.

This crisis, the impact of which has been compared in financial terms with Hurricane Mitch, has triggered a massive migration from many areas of Central and South America, the social and economic cost of which may prove to be disastrous.

Mr. Chairman, I would like to thank our good witnesses for taking the time and effort to help us. With their knowledge and experience, in particular Adolfo Franco who is one of our former staff members and has worked with our Full Committee, and also Mr. Franklin Lee from the Agriculture Department and our other witnesses following this panel.

I hope this hearing will provide us some insight into the actions that the Administration and Congress can take to help alleviate the anguish of those suffering from the current crisis in Latin America.

I am also concerned that the farmers who now have no livelihood are going to turn to raising some of the illicit drug crops, heroin and coca. We cannot afford to have that kind of increase. We have a hard enough battle right now trying to reduce the drug consumption coming out of that part of the world.

Thank you, Mr. Chairman.

Mr. BALLENGER. Congressman Farr, who is vitally interested in this and was one of the idea men in having this hearing? Sam, it is up to you.

Mr. FARR. Thank you very much, Mr. Chairman. I really appreciate you having this hearing, and I would like to submit for the record my statement and just make a few brief comments.

Mr. BALLENGER. Without objection.

[The prepared statement of Mr. Farr follows:]

PREPARED STATEMENT OF THE HONORABLE SAM FARR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Chairman Ballenger, Ranking Member Menendez, Members of the Subcommittee, Witnesses and invited guests:

I would first like to recognize the generosity of the Subcommittee for allowing me to participate in this important hearing. This hearing represents an important step in addressing a crisis that has been going on for too long, and which has had devastating effects in the developing world, particularly in the Western Hemisphere. In the past five years, producer coffee prices have declined by 70 percent. This has resulted in severe hardship for 25 million coffee growers worldwide, in over 50 developing countries, which depend heavily on coffee for export revenue. Latin America is particularly hard-hit in this regard. In Nicaragua, thirty percent of export revenue is from coffee; twenty-six percent in El Salvador; twenty-five percent in Honduras, twenty-one percent in Guatemala, and seventeen percent in Colombia.

Coffee, however, represents more than just export revenue for the countries of Latin America. Working as a Peace Corps Volunteer in Antioquia, the heartland of Colombian coffee-growing, I became intimately familiar with the central role that coffee has played in the economic and social infrastructure in countries like Colombia. The coffee industry provided for health services, schools, roads, and, of course, the backbone for rural livelihoods. The same could be said for rural communities throughout the Andes, as well as in Central America and Mexico. The collapse of the coffee market, however, has changed all that. With the cost of production exceeding the benefit of sales, farmers are abandoning the coffee fields. They are leaving their rural communities and moving into the cities, or across borders, in search of employment. The disappearance of a viable coffee sector has undermined years of social and economic investment by the industry. These people have not only lost their livelihoods, they have lost their way of life. As I am sure these witnesses will testify, the entire fabric of rural communities in Latin America is being destroyed by the coffee crisis.

I say that this hearing is an important step, because it represents an increasing awareness of the coffee crisis, and with an increasing awareness will come the political will to respond and make a difference in the lives of all these people. Before I continue, I feel obliged to underline that the coffee crisis is a *global crisis*, with important effects and consequences for much of the developing world. I stated before that many Latin American countries are heavily dependent on coffee for export revenue. The same is true, and in an even more exaggerated form in Africa, the birthplace of coffee. In Burundi, eighty-percent of export revenues come from coffee, in Ethiopia sixty-seven percent, in Uganda fifty-five percent, and in Rwanda forty-three percent. Clearly addressing the coffee crisis should figure prominently in U.S. assistance plans for Africa as well as Latin America. The role of Asia in the crisis must not be overlooked either. The arrival of Vietnam to the market as a major producer can be seen as the primary cause of the overproduction and consequent collapse in the world price of coffee. In ten years, Vietnam went from an insignificant producer, to the second largest exporter of coffee in the world (second only to Brazil). It must be recognized that the international community played a role in helping Vietnam increase its coffee production. Consequently, any plans to address the crisis must include Vietnam, and other major producers in Asia such as Indonesia. In sum, while we contemplate today what can be done to address the crisis in the Western Hemisphere, we should also be conscious of the global nature of this problem, and should seek solutions that can be applied on a global scale.

As for solutions, I believe that all of us—producers, roasters, consumers, governments and multinational organizations—have a role to play. I would like to highlight two concrete approaches. These are minimal and discreet actions which, I believe, will have significant effects on the coffee crisis. First, I recommend that those interested in helping small coffee farmers—individual consumers, and institutional consumers such as the House of Representatives—make an effort to purchase sustainable coffees. These are coffees that are certified by third parties and guarantee livable income to coffee farmers. Fair Trade is a good example of sustainable, certified coffee. Fair Trade guarantees the farmer a floor price of $1.26 per pound, more than double the world market price for coffee. The guarantee is based on a contract, which certifies that farmers are organized in democratic cooperatives and are farming in an environmentally sustainable manner. Other certification systems follow a similar model: Smithsonian, Bird-Friendly, Shade-Grown, Organic, Rainforest, etc. These certifications allow farmers to access premium markets, which provide them with sustainable incomes.

Purchasing sustainable, certified coffees, however, is a longer-term solution. It is based on educating the consumer about where the product comes from and how it is produced. Consumers are becoming more educated about coffee, but this is a gradual process. Moreover, while Congress can help inform the public about the crisis, the purchase of sustainable coffees is primarily driven by consumer interest and action. In the meantime, we need to find solutions which have a more rapid effect on the crisis. One approach, which has been suggested by both producers and roasters, is to increase the purity standard of coffee imported into the United States. As the world's largest consumer of coffee, the consumption patterns of the United States will have a great effect on the market, both in actual fact, and in demonstration effect. Currently, the United States lags behind international standards in terms of the purity level of coffee imports. While the International Coffee Organization (ICO) and European countries require that ninety-five percent of coffee imports be coffee product (allowing only five percent to be non-coffee substances—black or sour beans, sticks, rocks, etc.), the United States has a guideline that requires only seventy-five percent of imports to be coffee products. That means twenty-five percent of the bags of coffee imported into the United States is made up of bad beans, sticks and rocks. How do you think consumers would feel if they knew about these standards?

By raising the bar on "triage" coffee, as it is known, approximately 8–10 million bags of coffee would be removed from the marketplace. With an estimated 18 million bags of surplus coffee currently on the market, this action would significantly reduce overproduction. In addition, it would help create incentives for producers to shift to quality over quantity, which represents the future of the coffee market. As important, a new coffee purity standard will provide U.S. consumers with the wholesome coffee product they believe they're getting.

I am very pleased that we have this opportunity to discuss these issues with such a distinguished and informed group of witnesses. I am particularly happy to see Colleen Crosby on the panel. Colleen was the first person to bring the coffee crisis to my attention. Her personal involvement and commitment to the cause of helping coffee farmers has consistently served as an inspiration to me and my work on this issue. I look forward to hearing from her, and from the other witnesses, who will give us a broad view of the crisis and their opinions on how best to respond. I am especially eager to hear the testimony of the National Coffee Association, which represents the largest coffee roasters. These roasters, who make up the overwhelming majority of the coffee market, will play a key role in helping to respond to the crisis. I know that some companies, such as Kraft and Proctor & Gamble, have begun investing in capacity-building for small farmers. I look forward to hearing more about this work, and how public-private partnerships can provide the basis for effective and comprehensive policy.

Let me thank, once again, the Chairman, Ranking Member and Members of the Subcommittee for allowing me to participate in this hearing. I look forward to a fruitful discussion today, and to working on concrete measures to assist coffee farmers and the coffee market in the future.

Mr. FARR. I think both of you gentlemen have been really leaders in Congress in being able to bring the attention of Latin American issues to the United States Congress.

I come to this hearing with my background of in the 1960s serving in the United States Peace Corps as a Peace Corps volunteer in Colombia. I remember when I was a Peace Corps volunteer there and we were working with the Alliance for Progress and working with the American Embassy and particularly with the Colombians.

One thing the Colombians kept saying is more than any other foreign aid that you could send, you would most help this country if you would just allow us to get one cent more per pound of coffee. I thought well, that is probably just a typical thing to say when, you know, the people know there is one big export. I found out that there are lots of exports from these countries, but it rings more true now than it ever did.

Frankly, here we are as a nation in Latin America. We put a lot of money into trying to help. We have been down there with you, Mr. Chairman, seeing the effects of Hurricane Mitch in El Salvador, Nicaragua and the Honduras and Venezuela. We went back to El Salvador after the earthquake, and we have come back here in the Appropriations Committee and appropriated a lot of money to try to bail out and help with the infrastructure.

Then we concentrated on Colombia with Plan Colombia, which was, you know, last year about $1.2 billion I think, Mr. Gilman, and a lot of that went to purchase equipment to help in the overall attempt by Colombia to recover their country from violence and so on.

It seems to me that what is happening in the coffee crises is the production prices are down because the supply is up. The purchasers of that supply on that world market are American companies, so I am back to, you know, the right hand and the left hand need to be brought together here. We cannot as an American policy say that one of our most important policies in Latin America is trying to stabilize a country and at the same time drive down the principal product of those countries to a rock bottom low. It just does not make sense.

We have got to start developing our business practices to be consistent with our foreign aid practices and with what we think is just good humanitarian sense. The percentage of export coffee in Nicaragua is down 30 percent, and yet we are trying to get the production up to sustain that country that was hit by Hurricane Mitch.

In El Salvador, production is down 26 percent on top of the fact that they had, you know, one of the worst earthquakes in this hemisphere in history. Honduras and Hurricane Mitch, a very poor country, down 25 percent, Guatemala down 21 percent and Colombia down 17 percent.

I suggest that there are two things that I think Congress can do. First of all, we ought to support helping these small coffee growers and individual consumers and institutions, and we ought to really look at all the public institutions in America that use taxpayer dollars to buy food and do whatever we can to insist, and that may be too strong of a word, but to encourage that these entities purchase sustainable coffee. It is good public policy. It is good expenditure of taxpayer money.

Fair trade is a good example of sustainable certified coffee. Fair trade guarantees a farmer a floor price of $1.26 per pound, more than double the world price for coffee. The guarantee is based on a contract which certifies that farmers are organized in democratic cooperatives and are farming in an environmentally sustainable manner. It meets essentially all the bells and whistles that we are using in our own ag bill in the United States.

The second thing that I suggest that we do is I think we ought to increase the purity standard for coffee imported into the United States. It is more a short-term solution, but as the world's largest consumer of coffee the consumption patterns of the United States will have a great effect on the market, both actual and fact.

The United States lags behind the international standard. This is what is really remarkable. I did not know this, but the international standards in terms of purity of coffee. The International Coffee Organization in European countries require that 95 percent of the coffee imports be coffee product, allowing only 5 percent to be non-coffee.

From a wine producing state like California, I know what this is like. The same thing with selling grapes. When you take a raw product in the market, you have things that get caught up in the harvesting of that crop. In grapes, you know, you get rotten grapes. You get the vine.

Mr. BALLENGER. I hope the rest of your statement is not quite as long.

Mr. FARR. You get leaves. I am just finishing right now. Thank you very much.

Mr. BALLENGER. Okay.

Mr. FARR. What you do is you have all this stuff in the coffee as well.

Our guidelines are only 75 percent of the imports, so that means 25 percent of the bag of coffee imported to the United States is made up of bad beans, sticks and rocks, and we ought to change that policy.

Thank you, Mr. Chairman.

Mr. BALLENGER. I am sorry about the needle, but I know we are going to be short on time.

Let me introduce you both and hope that we can start the statements, but I know there is going to be a call for a vote in just a minute.

First of all, let me introduce Mr. Adolfo Franco. On January 31, 2002, Adolfo Franco was sworn in as Assistant Administrator for Latin America and the Caribbean of the U.S. Agency for International Development.

Before joining USAID, Mr. Franco served as Counsel to the Majority on the International Relations Committee and is a former President of Inter-American Foundation, an independent government agency dedicated to the promotion of grassroots development in the western hemisphere. Mr. Franco holds both Bachelor's and Master's degrees in history from the University of Iowa and a law degree from Creighton University.

Our second member is Mr. Franklin Lee, who currently serves as Deputy Administrator for Marketing and Commodity Programs for the Foreign Agricultural Service of the Department of Agriculture. He is responsible for international marketing, agriculture intelligence and analysis of foreign markets, the Market Access Program and the Quality Sample Program, to name a few.

Mr. Lee received a Bachelor of Science degree from Southern University and a Master's degree in Economics from Louisiana State University.

Mr. Franco, if you would please go right ahead?

STATEMENT OF THE HONORABLE ADOLFO FRANCO, ASSISTANT ADMINISTRATOR FOR LATIN AMERICA AND THE CARIBBEAN, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

Mr. FRANCO. Thank you. Thank you very much, Mr. Chairman, and thank you to my former boss, Chairman Gilman, for attending the hearing as well as Mr. Farr. I know your interests on the Committee and your record on Colombia, and particularly Latin America, is longstanding. We really appreciate the opportunity to be here and to give our testimony. I know Mr. Delahunt's commitment from my work on the Committee is longstanding.

This is a wonderful opportunity to appear before the Subcommittee on what I consider, and I share your view, is a vitally important issue that has dramatically and directly affected the welfare of millions of Latin Americans. The coffee crisis in its broader context poses a serious threat to the prospect for prosperity and continued stability in the Western Hemisphere. The crisis is of intense concern to the President of the United States and to our government, and it serves as the focal point for planned USAID programs in the future.

In Central America, specifically where economies remain reliant on coffee as a primary export and where the coffee crisis has converged with drought and other natural disasters, as the Members of the Committee have explained, it is not an overstatement to refer to the coffee crisis as the economic equivalent of the hurricane, as Members have mentioned. Due to the sharp decline in prices, it is estimated that farmers in Central America have lost more than $1.5 billion this year alone, and close to 700,000 permanent and temporary workers face layoffs by this fall.

For the short-term situation in Central America, USAID has taken important steps to alleviate the effects of the drought and the unemployment due to the coffee crisis. In Nicaragua, USAID worked with the U.S. Department of Agriculture and U.S. private voluntary organizations such as CARE, Save the Children and Catholic Relief Services to deliver more than $8 million in emergency food, medical and health assistance in late 2001 and an additional $2.9 million in emergency food and household supplies so far in 2002. In Honduras, USAID delivered nearly $3 million in emergency food and other commodities in 2001–2002. In Guatemala, USAID's humanitarian response has included over $6 million in emergency rations and medical supplies.

While these emergency measures are vital, as Mr. Farr has indicated, the focus of my testimony today is the broader context of the coffee crisis and how it has shaped in particular USAID's priorities in new directions for Central America and Mexico. The coffee crisis has reduced revenue available to national governments, weakened financial sectors and is serving as a primary fuel for overall social and economic instability across the countries of the region.

While the crisis has been acute in Central America, depressed coffee prices also make even more challenging the achievement of our government's objectives, such as those directed to helping farmers in the Andean regions where they seek to find viable economic options to coca, an area that I know Chairman Gilman has dedicated a great deal of his career to address.

These challenges that stem from the coffee crises have the potential to undermine the political processes and the effectiveness of newly-elected governments in the region and could ultimately lead to greater regional conflict. Given the broader context of the coffee crisis and its particular impact and consequences for Central America, USAID has developed a significantly enhanced overall program to set priorities for promoting trade-led growth in the region.

Our programs and priorities not only recognize Central America's difficulties, but also the unprecedented and as yet unrealized opportunities for promoting greater prosperity in that region. The commitment of the hemisphere's leaders to enter into a Free Trade

Area of the Americas for 2005 and President Bush's announcement to explore a free trade agreement between the United States and Central America are excellent tools we can use in achieving a healthier economic environment.

The path to resolving the coffee crisis and to fostering greater economic prosperity in Central America and indeed throughout the hemisphere will be easy or difficult depending on the extent to which these countries can become more competitive in regional and global markets and increase their levels of trade and investment.

Working toward these various trade agreements will help create new income opportunities for those involved in coffee production and help ease the impact of low coffee prices. To assist countries on this path, USAID is launching this year a new trade-led rural economic growth initiative for Central America and Mexico termed the Opportunity Alliance.

To begin the Opportunity Alliance, USAID has immediately reallocated $8.5 million this fiscal year, including $6 million to jump start a regional quality coffee program. In fiscal year 2003, USAID plans to allocate $30 million for the Opportunity Alliance for Central America and Mexico to continue these programs.

Activities will focus on building trade capacity, diversifying the rural economies of Central America, including the continuation of the quality coffee program in the rural sector and reducing the region's vulnerability to disasters and environmental degradation affecting income.

USAID's Opportunity Alliance is in direct response to the coffee crisis and the economic and social difficulties facing the rural poor. It provides broad based solutions to those most affected. These are the small-scale farmers in rural areas. It builds directly on successful USAID experiences in the field. Activities will help prepare Central American countries to participate in the Free Trade Area Agreement, the FTAA, and the U.S.-Central America Free Trade Agreement, CAFTA, should it become a reality, as is our vision.

We will expand a successful USAID-funded regional program that has helped Central America drop average tariff rates from 20 to 7 percent between 1990 and 2000, streamline Customs procedures and be in greater compliance with multilateral trade agreements, including key labor and environmental provisions that I know are of great concern to Members of this Committee.

USAID's Opportunity Alliance will also help broaden opportunity and foster sustainable improvement in the livelihoods of the poor through diversification of agriculture, including quality coffee and the non-agriculture arena to reduce over reliance on traditional crops.

In this region, rural households strategically pursue diverse sources of income, often including migration of family labor to urban jobs. Recognizing this pattern, USAID has developed a concept of diversifying the rural economy by viewing agricultural investments within a broader rural enterprise approach. This approach taps into Central America's potential for ecotourism, aquaculture, certified timber and other forest products, artisan crafts and rural services.

USAID's programs will provide demand-driven business development and marketing services to help small- and medium-sized farmers, including coffee farmers, improve competitiveness, as well as tap into new markets. This will expand successful programs such as those in Honduras where our work with non-traditional agricultural producer associations has led to significant increases in export sales and new jobs following Hurricane Mitch.

The Opportunity Alliance will also assist countries in better managing the climatic and environmental risks in the region. Coffee trees, for example, now play a significant role in holding the soil and preserving the watershed in many areas in Central America. Massive shifts out of coffee production could impact on the environment. Consequently, protecting the gains from trade-led growth through USAID assistance for disaster preparedness and mitigation and watershed management is vital to sustainable prosperity in the region.

Given the magnitude of the economic difficulties and the need to leverage our efforts, USAID is engaging the U.S. private sector and coordinating our response with key donors such as the Inter-American Development Bank and the World Bank.

As part of our coordinated response, USAID, the Inter-American Development Bank and the World Bank co-sponsored in April, 2000, a stakeholders meeting in Guatemala with Central American Ministers of Agriculture and about 250 coffee producers, directors of coffee buying and roasting companies and consumer and environmental organizations.

USAID and the banks presented a joint evaluation and set of coordinated recommendations that underscored the systematic nature of the coffee crisis without offering to bail out farmers unwilling to help themselves. Rather, the recommendations stressed the need for producers to improve competitiveness and to diversify production.

Mr. Chairman, I would like to enter into the record the USAID/IDB/World Bank discussion document outlining our joint recommendations entitled Managing the Competitive Transition of the Coffee Sector in Central America.

Mr. BALLENGER. Without objection.

Mr. FRANCO. Thank you, Mr. Chairman.

Based on these recommendations, USAID has developed a new demand driven regional coffee program designed to assist Central American coffee producers in enhancing coffee quality, improving business practices, promoting market-based policies and securing long-term contracts and contracts. This regional program is an initial element of the Opportunity Alliance given Central America's natural geological and climatic advantages which present opportunities to raise the region's competitiveness in producing quality coffee and tapping promising specialty markets around the world.

As part of a broader global effort coordinated with USAID's other regional bureaus, USAID is seeking to engage corporate allies interested in investing jointly in local projects or signing long-term purchasing contracts with small-scale and medium-scale coffee producers. These are already examples of this cooperation in our region and other parts of the world.

As just a few examples, USAID has partnered with Conservation International and Starbucks Coffee to create new opportunities for small-scale farmers in southern Mexico via technical assistance, marketing and production assistance. USAID is also supporting efforts by the Specialty Coffee Association of the Americas to conduct international Cup of Excellence programs that help raise the quality awareness and ultimately bring small-scale producers closer to buyers.

A recent competition in Nicaragua demonstrated that small-scale producers could produce high quality coffee and secure unprecedented prices for coffee through internet auctions. This is something that just happened a few weeks ago where we were able to link producers in Nicaragua to the Cup of Excellence program with buyers in the United States for coffee that sells in the United States for $11 a pound.

Additionally, USAID, working together with Proctor & Gamble, has begun to identify schools in Guatemala for social investment grants in coffee producing regions hit by the crisis.

The interests of the region, donors, consumers, environmental groups and industry have never been more intertwined as they are currently. USAID's coffee program, as well as the other element of the Opportunity Alliance, will take advantage of this convergence of interest, leverage resources and maximize the impact of our development activities.

USAID's coffee response and broader efforts under the Opportunity Alliance are a strong signal of its commitment to our friends and neighbors in Central America and Mexico. This initiative is highly complementary of President Bush's vision for a new foreign policy for Latin America and trade policy objections in the region that will lead to the signing of a Free Trade Agreement for the Americas in 2005, as well as to ongoing regional initiatives such as Plan Puebla Panama.

More importantly, by promoting greater economic opportunities, trade, investment and market integration, the Opportunity Alliance will be an essential element of our efforts to directly address and counteract the root causes of economic migration, illegal immigration and regional instability.

Thank you again, Mr. Chairman, for the opportunity to participate in this hearing today. I welcome your questions, as well as those of the other Members of the Committee.

[The prepared statement of Mr. Franco follows:]

PREPARED STATEMENT OF THE HONORABLE ADOLFO FRANCO, ASSISTANT ADMINISTRATOR FOR LATIN AMERICA AND THE CARIBBEAN, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

Thank you, Mr. Chairman, for the opportunity to appear before the Subcommittee on the Western Hemisphere today on a vitally important issue that is dramatically and directly affecting the welfare of millions of Latin Americans. The coffee crisis, and its broader context, pose a threat to prospects for prosperity and continued stability in the Western Hemisphere. The crisis is of intense concern to the United States, and it serves as a focal point for current and planned USAID programs in Latin America.

With coffee an important export for over 50 developing countries, the effects of coffee prices dropping to the lowest levels in 30 years have been felt globally. But the coffee crisis has been most severe and felt most acutely by our friends and neighbors in this Hemisphere, where 44 percent of Latin America's permanent cropland is used to grow coffee. In Central America, where economies remain reliant on coffee as a primary export, and where the coffee crisis has converged with drought and other natural disasters, it is not an overstatement to refer to the coffee crisis as the economic equivalent of a hurricane. Consequently, today my testimony focuses primarily on USAID's response to the coffee crisis in Central America, which is a principal element of USAID's Opportunity Alliance for Central America and Mexico, a new initiative designed to focus resources on catalyzing trade-led rural economic growth.

A worldwide oversupply of coffee is primarily responsible for the steeply depressed prices for farmers, resulting in substantial losses of income for workers in the coffee sector, numbering more than two million in Central America alone. Over the past five years, the world coffee market has undergone significant changes on the supply side, reflecting a steady increase in world production and export levels. This oversupply is due largely to production increases in Vietnam and Brazil, and is compounded by the change in consumer demand away from lower grade commercial coffees.

At the epicenter of the crisis, in Central America, it is estimated that farmers have lost more than $1.5 billion this year alone, and more than 400,000 temporary workers, and 200,000 permanent workers face layoffs by the fall of 2002. Making the situation even worse, many of the region's coffee growers are small farmers living in remote rural areas who are already poor and vulnerable. As a result, in countries like Guatemala, alarmingly high levels of acute child malnutrition are being observed. The lack of other opportunities in the coffee-growing areas means that unemployment and income loss from the coffee crisis has led to flight from the rural areas. Mass migration from countries like Nicaragua to Costa Rica, and increased illegal immigration to the U.S., are exacerbating already high levels of crime and violence in urban centers.

The coffee crisis is reducing revenue available to national governments, weakening financial sectors, and is serving as a primary fuel for overall social and economic instability across the countries of the region. The challenges stemming from the coffee crisis go beyond the coffee sector, and are more than economic. The challenges have the potential to undermine political processes and the effectiveness of newly elected governments in the region, and could ultimately lead to greater regional conflict.

While we are deeply concerned about the long-term impacts threat to stability, we should also be concerned about the immediate effects that we are seeing now, and over the past two years USAID has taken important steps to alleviate the effects of drought and the coffee crisis. In Nicaragua, USAID worked with the U.S. Department of Agriculture and U.S. Private Voluntary Organizations such as CARE, Save the Children, Catholic Relief Services, and the Adventist Development and Relief Agency to deliver $8.2 million in emergency food, medical, and health assistance in late 2001, and an additional $2.9 million in emergency food and household supplies so far in 2002. In Honduras, nearly $3.0 million in emergency food and other commodities was delivered in 2001–2002. In Guatemala, USAID's humanitarian response has included over $6.0 million in emergency rations, medical supplies, diarrhea and pneumonia treatments, nutrition education, and child vaccinations.

While these emergency measures are vital, the focus of my testimony today is the broader context for the coffee crisis, and how it has led to the development of USAID's Opportunity Alliance for Central America and Mexico, an initiative that recognizes not only Central America's difficulties associated with the coffee situation, but also the unprecedented and as yet unrealized opportunities for promoting greater prosperity in the region. The agreement of the Trade and Economy Ministers responsible for trade at the last World Trade Organization (WTO) Ministerial at Doha, the commitment of the Hemisphere's leaders to enter into a Free Trade Area of the Americas by 2005, and President Bush's announcement to explore a free trade agreement between the U.S. and Central America are excellent tools we can use in achieving a healthier economic environment.

The path to resolving the coffee crisis, and to fostering greater economic prosperity in Central America, and indeed, throughout the Hemisphere, will be easy or difficult depending on the extent to which these countries can become more competitive in regional and global markets and increase their levels of trade and investment.

To assist countries on this path, USAID is launching this year a new trade-led rural economic growth initiative for Central America and Mexico called the Opportunity Alliance. To begin the Opportunity Alliance as rapidly as possible, USAID has re-allocated $8.5 million in FY 2002, including $6 million to jump-start a regional quality coffee program. In FY 2003, USAID plans to allocate $30 million for the Opportunity Alliance for Central America and Mexico. Activities will focus on building trade capacity; diversifying the rural economy, and reducing the region's vulnerability to disasters and environmental degradation effecting income.

USAID's Opportunity Alliance is in direct response to the coffee crisis and the economic and social difficulties facing the rural poor. It provides broad-based solutions to those most effected—small farmers in rural areas. It builds directly from successful USAID experiences in the field. Trade capacity activities will help prepare Central American countries to participate constructively as members in the World Trade Organization, the Free Trade Area Agreement (FTAA), and U.S.-Central America Free Trade Agreement (CAFTA) should it become a reality, and to make necessary reforms in commercial law, property rights, and contracts enforcement. This trade capacity assistance will expand a successful USAID-funded regional program that has helped Central America drop average tariff rates from 20 to 7 percent between 1990 and 2000, streamline customs procedures, and be in greater compliance with multilateral trade agreements, including key labor and environmental provisions.

USAID's Opportunity Alliance will also help broaden opportunity and foster sustainable improvement in livelihoods (income) of the poor through diversification of agriculture, including quality coffee, and the non-agriculture arena to reduce over-reliance on traditional crops. In this region, rural households strategically pursue diverse sources of income often including migration of family labor to urban jobs. Recognizing this pattern, USAID has developed a concept of diversifying the rural economy by viewing agricultural investments within a broader rural enterprise approach. The approach taps into Central America's potential for ecotourism, aquaculture, certified timber and other forest products, artisan crafts and rural services. USAID's programs will provide demand-driven business development and marketing services to help small- and medium-sized farmers, particularly coffee farmers, improve competitiveness as well as tap new markets. This will expand successful programs such as in Guatemala, where tens of thousands of rural residents were raised above the poverty line with USAID assistance for the Peace Accords, and in Honduras, where our work following Hurricane Mitch with nontraditional agriculture producer associations led to significant increases in export sales and new jobs.

The Opportunity Alliance also will assist countries in better managing the climatic and environmental risks in the region. Coffee trees, for example, now play a significant role in holding the soil and preserving the watershed in many areas in Central America. Massive shifts out of coffee production, even in nonproductive and noneconomic areas, could have impacts on the environment. Protecting the gains from trade-led growth (e.g., quality coffee) through USAID assistance with disaster preparedness and mitigation, and watershed management is vital to sustainable prosperity in the region. USAID also will work on protecting vulnerable coral reefs and helping Central American countries control and manage forest fires.

Given the magnitude of the economic difficulties, USAID will maximize its engagement and coordination with the U.S. private sector as well as with key international financial institutions. USAID worked closely with the Inter-American Development Bank (IDB) and the World Bank in developing a coordinated framework for responding to Central America's coffee crisis. In April of this year USAID, IDB, and the World Bank co-sponsored a stakeholders meeting in Guatemala with Central American Ministers of Agriculture and about 250 coffee producers, directors of coffee-buying and roasting companies, and consumer and environmental organizations. USAID and the banks presented a joint evaluation and set of potential recommendations. These recommendations underscore the systemic nature of the crisis while offering no "bail outs" to farmers unwilling to help themselves. Rather, the recommendations stressed the need for producers to improve competitiveness and to diversify production.

Mr. Chairman, with your permission I would like to enter into the record the USAID/IDB/World Bank discussion document outlining our joint recommendations entitled "Managing the Competitive Transition of the Coffee Sector in Central America."

USAID's new demand-driven regional coffee program is designed to assist Central American coffee producers to enhance the quality of coffee, improve business practices, promote market-based policies, form new market linkages, and secure long-term contacts. Under the regional program, the USAID program and industry alliances will play a catalytic role in helping small- and medium-sized farmer organizations identify and market higher quality and specialty coffee to U.S., European, and Asian coffee markets, as well as assist them to diversify their export base.

This regional coffee program is an initial element of the Opportunity Alliance given Central America's natural geological and climactic advantages which present opportunities for raising the region's competitiveness in producing quality coffee and tapping promising specialty markets around the world. USAID is engaging corporate allies interested in investing jointly in local projects, or signing long-term purchasing contracts with small- and medium-size coffee producers. As just a few examples of this cooperation, USAID has worked in partnership with Conservation International and Starbucks Coffee toward creating new opportunities for small-size farms in southern Mexico via technical assistance, marketing and production assistance. USAID also is supporting efforts by the Specialty Coffee Association of the Americas (SCAA) on international cup-of-excellence programs. These programs are already helping Nicaragua's small-scale producers secure unprecedented prices for coffee through internet auctions. Additionally, USAID, together with Proctor and Gamble, have begun to identify schools in Guatemala for social investment grants in coffee producing regions hit by the crisis. By working closely from the outset with industry, USAID's assistance to producers will be demand-driven and based on market potential and will encourage coffee producers that cannot be competitive to diversify out of coffee to other commodities. Diversification from coffee to other farm and non-farm sources of income will be facilitated similarly by providing business development and market access services in alliance with private industry. The interests of the region, donors, consumers, environmental groups, and industry have never been more intertwined as they are currently. USAID's coffee programs, as well as the other elements of the Opportunity Alliance, will take advantage of this convergence of interests, leverage resources, and maximize the impact of our development activities.

USAID's coffee response and broader efforts under the Opportunity Alliance are a strong signal of its commitment to our friends and neighbors in Central America and Mexico. These initiatives are highly complementary to U.S. foreign and trade policy objectives in the region, as well as regional initiatives such as Plan Puebla Panama, the joint U.S. accord with Central America (CONCAUSA), and the U.S.-Mexico Partnership for Prosperity. More importantly, by promoting greater economic opportunities, trade, investment, and market integration, USAID's Opportunity Alliance is an essential element of the U.S. Government's effort to directly address and counteract the root causes of economic migration, illegal immigration, and regional instability.

Thank you again, Mr. Chairman, for the opportunity to participate in this hearing today. I welcome questions from you and members of the Subcommittee.

INTER-AMERICAN DEVELOPMENT BANK
UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT
THE WORLD BANK

DISCUSSION DOCUMENT

MANAGING THE COMPETITIVE TRANSITION OF THE COFFEE SECTOR IN CENTRAL AMERICA

Prepared for the Regional Workshop:

THE COFFEE CRISIS AND ITS IMPACT IN CENTRAL AMERICA:
SITUATION AND LINES OF ACTION

Antigua, Guatemala
April 3-5, 2002

PREFACE

This discussion paper is a joint effort of the Inter-American Development Bank (IADB), the World Bank (WB), and the United States Agency for International Development (USAID). This document was prepared as the background for discussion of the main issues facing the coffee sector in Central America in a regional workshop, "The Coffee Crisis and its Impact in Central America: Situation and Lines of Action," to be held in Antigua, Guatemala from April 3 to April 5, 2002.

This initiative is part of the response to requests by several Central America governments for assistance in addressing the effects that the current crisis is having on their economies. The discussion paper attempts to define the nature and magnitude of the crisis and delineate possible strategies to ameliorate its effects within the framework of a competitive transition for the sector and development of the rural economy more broadly. The discussion paper is intended as an input to the discussion in the workshop and does not represent a statement of policy of the three sponsoring institutions.

The paper is divided into six sections. Section I describes the nature of the crisis and its magnitude. Section II examines ways to improve the quality of Central American coffee, as a strategic competitive response to the crisis. Section III focuses on market opportunities and marketing management issues to be considered by coffee growers. Section IV discusses diversification programs as possible alternatives for non-competitive coffee farmers. Section V centers on environmental issues of coffee production. Finally, Section VI examines the role of public and private institutions: steps they can take to facilitate the competitive transformation of the coffee sector in the region and efforts to lessen the negative social impacts of the crisis.

EXECUTIVE SUMMARY

The coffee-producing nations of Central America are at a crossroads. Coffee prices are at record lows, global over-production has led to accumulation of inventories, and competition is intensifying. Prospects for price recovery in the 2002/03 season and the near future are not encouraging. Indeed, the current crisis appears to be structural in nature, and is shaped by changes in demand as well as supply. Meanwhile, unemployment in the sector has soared and wages have plummeted, and export revenues have dramatically decreased. The situation is especially critical because the majority of coffee producers are smallholders living in remote rural areas, who depend heavily on the cash income from their own harvest and temporary picking work for survival. A crisis in the sector creates social imbalances, accelerated migration to urban areas, and instability. At both the micro and macro level, Central American economies and societies are being severely affected.

Coffee growers in the region are facing a new market structure, and new challenges. All these factors call for new strategies, the centerpiece of which must be sustainable economic development of the rural economy.

The region's competitive advantage in the coffee market lies in having the adequate agroecological conditions to produce high quality coffees. To manage the competitive transition of the coffee sector in Central America, this paper advocates two potential lines of action over the medium to long term:

- Enhancing coffee quality, efficiency, and sustainability in the regions with comparative advantage (specifically, the zones with adequate altitude); developing value added; and pursuing effective promotion and marketing; and
- Promoting diversification into other agricultural and non-agricultural alternatives, for regions without potential for producing quality coffee.

Social vulnerability also must be reduced, in both the short and long term. To assist coffee producers, workers, and their families, better social protection is needed (particularly short-term actions such as social safety nets and food security networks). To protect small coffee producers who are vulnerable to price shifts, price risk insurance mechanisms and similar instruments need to be developed and adopted.

These lines of action need to be supported with appropriate and effective public policy and investment instruments, private investment, and backing from civil society

To be effective, a quality enhancement strategy would need to be comprehensive, and be applied throughout the entire coffee production chain. Special focus should be devoted to three areas:

- Identifying and supporting the geographic areas with suitable agroecological conditions for quality production;
- Guaranteeing the production of quality beans, by designing and implementing broad coffee bean management and programs aimed at reducing defects; and
- Pursuing value-added and marketing strategies aimed at building partnerships and long-term market links, receiving higher premiums for quality, and accessing high revenue segments of the market.

These strategies require sector-wide interventions focusing on targeted programs that intervene at critical points. Some actions for Central American players---public institutions and organizations---might include:

- Adopting industry-wide norms and standards for quality;
- Identifying the high quality coffee areas and supporting them with incentives; and
- Reviewing trade regimes, and including coffee in trade negotiations (especially in new markets and internal Latin American markets).

Any economically sustainable diversification strategy should provide alternatives for those growers in Central American countries who will not be competitive in coffee, but would allow them to continuing farming as an agricultural enterprise. These strategies should consider secondary goals such as:

- Employing displaced coffee labor;
- Being self-sustaining when projects end, so that producers do not return to coffee production when prices improve; and
- Promoting profitable and sustainable land use.

Developing a successful strategy for agricultural diversification requires a systems approach, covering both agricultural and business constraints, along with environmental and social issues at the same time. Factors to be addressed should include reliable agricultural support services; research and extension in production, marketing, and promotion; credit; infrastructure; technical assistance and training in business and risk management; and market intelligence and regulation.

Finally, a sustainable strategy for the transition of the coffee sector must protect the environment. Sound environmental management can enhance coffee quality and productivity, profitability, competitiveness, and sustainability of coffee systems. In addition, it maintains land productivity and provides value-added market opportunities (such as conservation coffees and environmental services). At minimum, any quality and diversification strategies to be implemented should not have negative impacts on the environment, especially on biodiversity and water use. More positively, strategies must work with environmental programs, exploring the potential positive externalities between environmental sustainability and actions to promote coffee quality enhancement and diversification. Similarly, social impacts of any strategies should be considered. Active partnerships with NGOs, as well as work with research and extension centers with expertise and experience in environmental management, can serve these ends.

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ABBREVIATIONS

ANACAFE	*Asociación Nacional del Café*
CATIE	*Centro de Agricultura Tropical, Investigación y Enseñanza*
CIMS	*Centro de Intelingencia Sobre Mercados Sostenibles*
CIRAD	*Centre de Coopération Internationale e Recherche Agronomique pour le Dévelopment*
G & S	Grades and Standards
GIO	Geographic Indications of Origin
IADB	Inter-American Development Bank
ICAFE	*Instituto del Café de Costa Rica*
IHCAFE	Instituto Hondureño del Café
IICA	*Instituto Interamericano para la Cooperación en Agricultura*
INCAE	*Instituto Centroamericano de Administración de Empresas*
MIS	Market Information Systems
PROMECAFE	*Programa Cooperativo Regional para el Desarrollo Tecnólogico de la Caficultura en Centroamérica, República Dominicana y Jamaica*
SCAA	Specialty Coffee Association of America
USAID	United States Agency for International Development
WB	World Bank
WTO	World Trade Organization

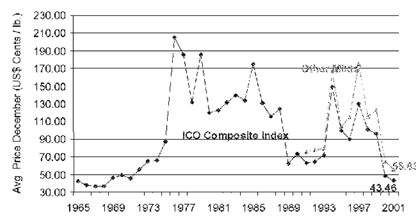
I. THE NATURE AND MAGNITUDE OF THE COFFEE CRISIS AND ITS IMPACT ON CENTRAL AMERICA

Over the past five years, the world coffee market has undergone important changes in the supply side, which reflects a steady increase in world production and export levels. The current crisis in prices is not only part of a cyclical phenomenon; but also, it is a direct consequence of the new structure of the market, which is exacerbating the problem for Central American producers.

Structural Changes in the World Coffee Market

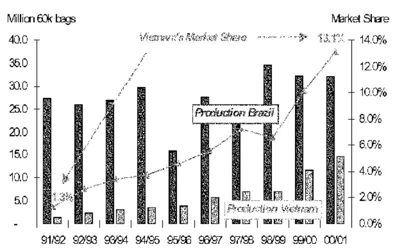
During 2000 and 2001, worldwide oversupply caused coffee prices to drop to their lowest levels in 30 years---or to a 100-year low, if adjusted for inflation (see figure I-1). Coffee prices have plummeted below the cost of production for many coffee producers, causing financial and social hardships to farmers and laborers.

Figure I-1: Average Coffee Prices



Source: International Coffee Organization (ICO), 2002

Figure I-2
Annual Production and Market Share: Brazil and Vietnam

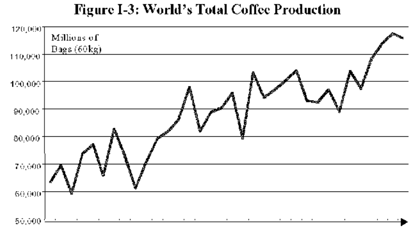


Source: Own calculations, with information form ICO, 2002

During the 1990s, prices of coffee were mainly affected by shifts in Brazilian production (caused mainly by frosts), subsequent adjustments by coffee suppliers responding to price shifts, and a slow but steady expansion of coffee production in other countries, especially Vietnam (see figure I-2). This period contrasted to a generally downward trend in prices from highs in the mid-1970s. The loss of about 13 million bags of Brazilian production in the mid-1990s pushed prices to a high level.

By the end of the 1990s, however, Brazilian post-frost replanting----freed from government constraints on tree density and planting techniques, as well as the opening of new production areas----has increased production and, hence, increased world supply (see figure I-3). In addition, new investments in Vietnam and increasing production from other traditional producing countries led to a substantial coffee surplus.

Figure I-3: World's Total Coffee Production



Source: Own calculations, with information form OIC, 2002

Total current production of green coffee is about 115 million bags (60 kilo net). This exceeds consumption of about 105 million bags (80 million in importing countries and 25 million in producing countries). Over-production has led to the accumulation of inventories in producing and consuming countries and the drop in world prices.

Apart from over-supply, two other principal factors are underlying the current crisis: structural changes in demand, and changes in the nature of the supply of quality coffee from Brazil and Vietnam.

Changes in demand

Overall, world demand has recovered from the small drop that resulted from the price increase in 1994/95. As a result of economic liberalization and growth in emerging countries, notably in Eastern Europe, parts of Asia, and Latin America (especially Brazil), world demand has reached about 105 million bags. This world total masks a number of trends:

- Aggregate demand in the major importing countries is growing slowly, if at all. This suggests that increases in the high quality end of the market are being partly offset by losses elsewhere. Meanwhile, new non-traditional markets are emerging and growing quickly, driven by the availability of cheap coffees in soluble form.
- Roasters have learned to increase the absorption of natural and robusta coffees by such processes as steaming to remove the harshness of taste.
- Roasters have learned to work with lower working stocks. This has increased the requirements on the logistical capabilities on suppliers. This, in turn, has favored large trading companies, and has led to consolidation of the supply chain in fewer major traders.
- Roasters have become more flexible in their ability to make short-term switches between coffee types.
- The consolidation of roasters in periods of oversupply has led to a situation where prices at the retail level hardly reflect the reductions in green coffee prices in the world markets.
- A small but viable segment of the market has emerged that focuses on quality and product differentiation (specialty and gourmet coffees).

In addition to these trends, income effects are proving to be a significant factor in coffee consumption. Consumption in northern Europe, particularly in Germany, is stagnant, but is increasing somewhat in southern Europe, and growing in much of Eastern Europe. However, the increase in consumption in Eastern Europe and in parts of Asia recovering from economic problems is being driven by the high availability of cheap robustas, which have allowed roasters to make a product available at affordable prices. In Brazil, roasters have taken an opposite approach, concentrating on labeling and quality in the domestic market. This has allowed Brazil to increase domestic demand and become the world's second largest consumer. This example is relevant for a Central American strategy.

Changes in quality

While supply has expanded, the quality of green coffee in some parts of the world has also been improving. Higher quality beans from Brazil, derived from better washing capabilities and quality controls, are intensifying the competition against "Extra Hard," "Prime," and "Extra Prime" coffees from Central America. Improvements in quality in Vietnam---as evidenced by the favorable grading results from the coffee futures markets---are allowing roasters to use more of these coffees.

The projections for the 2002/03 crop season are not encouraging. With demand growing slowly and global production still at high levels, most analysts predict that coffee price recovery is likely to be slow, at least for the near term. This threatens the sustainability of coffee production.

The Impact of the Recent Coffee Crisis on Central America

Low coffee prices are causing unemployment to reach critical levels in Central America. In the last two crop seasons, seasonal employment has decreased by more than 20 percent, while permanent employment has plummeted by more than 50 percent (see table I-1). More than half the permanent labor force is now working at less than half capacity. Wages have also plummeted as farms have suffered lower coffee revenues and the supply of labor has swelled through unemployment.

Table I-1. Decline in Employment in the Central American Coffee Sector, 2000-2002 (thousands of workers)*

Worker / Crop year	*2000/ 2001*	*2001/ 2002*	*Change (%)*
Seasonal	1,700	1,350	-21%
Permanent	350	160	-54%

* In Guatemala, Honduras, El Salvador, Nicaragua, and Costa Rica
Source: IADB/USAID/WB studies

The situation is especially critical because, unlike other crops, the majority of coffee producers are smallholders living in remote rural areas, who heavily depend on their own harvest and extra cash from temporary picking work. These growers depend on this cash income to pay for food and other essential items such as school fees and health care, and they have no cash reserves on which to draw from in hard times. A crisis in the sector creates social imbalances, a general downturn in the rural economy, accelerated migration to urban areas, and instability.

At the macroeconomic level, national governments and banks are also affected by the loss of trade-generated cash. Central American countries have suffered a 44 percent decline in revenue from coffee exports in one year (see table I-2). Export revenues from coffee dropped from US$1.7 billion to US$938 from crop year 1999/2000 to 2000/2001, and are estimated to fall further to about US$700 million in 2001/2002. The decrease in exports hurts the balance of payments and significantly affects overall economic activity. The coffee sector debt and past due loans hamper the financial sector, limiting banking activity and financing to other economic sectors.

Table I-2. Decline in Coffee Export Revenues, 2000-2002 (US$ million)

Country / Crop year	*2000/ 2001*	*2001/ 2002*	*Change (%)*
Guatemala	598	400	-38%
Honduras	345	167	-33%
El Salvador	276	108	-61%
Nicaragua	170	85	-50%
Costa Rica	289	178	-52%
Total	***1,678***	***938***	***-44%***

Source: IDB/USAID/WB studies

It appears that these changes in the structure of the world coffee market are not transitional. Accordingly, the impact of the crisis in Central America could be long lasting, if proper actions are not taken. The remainder of this document presents a framework for initiatives to cope with the crisis and facilitate the competitive transformation of the sectors.

II. IMPROVING THE QUALITY OF CENTRAL AMERICAN COFFEE

The structural nature of the coffee crisis, the relatively high importance of the sector in Central America, and the impact of the crisis in the poverty of hundreds of thousands of families in the rural areas makes development of the rural economy the centerpiece of strategies to overcome the crisis.

Against the backdrop of rural economic development, and given the competitive advantages of the region, the competitive transition of Central American coffee falls into two potential lines of action:

- Supporting *the regions with the potential to produce quality coffee* (specifically, the zones with adequate altitude)to effectively generate, preserve, and extend this quality ; and
- Supporting *the regions without potential to produce quality coffee* to diversify into other areas, with the goal of reaching economic sustainability in the medium to long run.

These lines of action need to be supported with appropriate promotion and marketing, and effective public policy and investment instruments, private investment, and backing from civil society and NGOs.

A strategy that supports quality improvements is key for Central America for several reasons. First and foremost, because of the favorable agroecological conditions of the Central American highlands, the region has a comparative advantage in this segment of the coffee market. Second, consistent quality coffee fetches a price premium. Finally, improvements in quality can also drive increases in consumption.

Improvements in quality offer other benefits as well. Increasing quality can help national coffee sellers develop and strengthen their long-term relationships with exporters, importers, and retailers, and increase their ability to negotiate prices, including premiums for quality. This will empower national coffee sellers. Improving quality can also help national coffee sellers develop direct links and access to international markets.

Quality as an Option for Central America

Central American countries have the necessary elements to compete in the high quality segments of the coffee market. Many areas have ideal agroecological conditions (altitude, agroclimate, and soil conditions). The region has a tradition of producing coffee, and a recent and growing experience in the differentiation of coffee based on quality. Finally, it has production structures in place, including an abundance of labor.

For Central American countries, developing an economically sustainable strategy focused on quality requires several steps:

- *Understanding and evaluating the quality of coffee* in terms of its attributes and market preference;
- *Identifying the key problems* that affect quality and its consistency throughout the entire production chain;
- *Defining the alternatives for overcoming these problems;* and
- *Determining public policy and investment instruments and private investment* that will facilitate the adoption of such alternatives.

Understanding and evaluating quality

Quality is an attribute that has a specific technical meaning, which can be measured and evaluated. Ultimately, quality is reflected through the organoleptic characteristics of coffee (that is, the taste and smell) and identified and measured by professional "cupping" (sampling by taste and smell).

The agroecological conditions in the coffee fields directly determine the quality of the harvested bean. Additionally, defects from production and processing have a direct effect on the quality of the green bean.

The altitude of the crop is the criteria of quality most recognized by coffee buyers and the easiest to identify and measure. Altitude is directly correlated with the acidity of coffee. In general, fields above 1,200 meters sea level have a higher potential to produce high quality coffee (including gourmet and specialty coffee), while those located below 800 meters lack the potential. "Extra Hard," "Prime," and "Extra Prime" beans, produced between 800 and 1,200 meters can achieve a high quality and could potentially be marketed in the specialty coffee segment. Achieving and maintaining good quality for high altitude coffee depends on processing the coffee without defects, to effectively differentiate it from similar coffees produced in Mexico and Brazil.

Coffee defects are imperfections that affect the natural characteristics of the bean. They are detected visually and/or through cupping. Defects may arise because of plantation conditions (fungi, viruses, and insects); harvesting (using unripe or overripe cherries, or introducing molds or foreign matter); prolonged storage or transportation delays (over-fermentation), or processing (over-fermentation, pollution, improper storage, improper drying); insufficient air circulation; or improper setting of equipment, among others).

Evaluating quality

There are two basic methods to evaluate coffee based on its quality: physical evaluation of the bean, and cupping. Cupping is the most comprehensive method.

The physical evaluation consists in the classification of coffee based on its number of physical defects. The most used methods are the SCAA and Brazil/New York.*

The evaluation of physical defects is complemented by professional cupping, performed by technical experts who value the organoleptic characteristics of coffee (fragrance and aroma, body, acidity, flavor, aftertaste). The assigned grade (from 50 to 100 points) reflects the sensory characteristics of coffee.

Physical evaluation and cupping are procedures performed by coffee importers on samples that they receive before shipment. One key element to improving and maintaining quality is developing the capacity to evaluate coffee with the same standards as the buyers. In addition to this, assuring commercial consistency in lots and confidence in delivery, are essential to developing long-term relationships with buyers.

Improving Quality

A strategy of improving quality entails managing the entire coffee productive process in an integral way, from the coffee plantation and harvesting to the storage and shipping of green coffee. Starting from the necessary conditions in primary production (that is, planting in ideal agroecological conditions, particularly altitude), producers must manage a variety of elements to avoid defects and maintain quality during the production and milling processes.

<u>*Key elements in primary production*</u>

- *Adequately preparing the harvest.* Preparation begins with the adequate care of the plantation, diligent plant renovation and maintenance, and efficient pest and disease control. Contributions from research and extension institutions are essential in the identification of varieties for quality production (such as Typica and Bourbon, among others), adequate planting densities, agronomic and cultural practices, and in the application of harvesting and pest/disease control methods.

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* The "SCAA Green Arabica Coffee Classification System" classifies coffee in "Exchange Coffee", "Premium Coffee" and "Specialty Coffee", based on the number of primary and secondary defects. A coffee with more than eight defects (up to 23, measured in 300-gram samples) is "Exchange Coffee" (quality typically traded in the "C" Market). The "Premium" classification is assigned to lots with less than eight full defects, and the "Specialty" grade to lots with a maximum of five defects. Performing physical evaluations is key in improving quality to reach a desired classification.

- *Supporting incentives for harvesting quality coffee.* It is crucial to establish incentives to encourage producers to harvest cherries in their ideal maturity stage and to avoid mixing in foreign matter during harvesting. Mechanisms should be put in place at the coffee collecting centers to measure quality and compensate the producer for the delivery of quality coffee. An adequate compensation scheme is one that recognizes quality differences and effectively transmits prices throughout the entire coffee production chain, from the final consumer to the producer.

- *Improving transport.* A large number of high-altitude coffee plantations are located in remote areas, with poor road infrastructure or no roads at all---and very limited transportation. This results in an inefficient transport of the cherry coffee (or coffee coming from wet mills), which severely affects the price received by the producer and contributes to the deterioration of quality. It is not unusual to find good quality cherries damaged by fermentation because of transportation delays. The improvement of the transportation infrastructure is vital. However, it may be difficult to justify investment based on a simple cost-benefits analysis because of the remoteness of these areas.

- *Strengthening cooperative approaches.* Supporting producers (especially the small ones) in developing organizational and cooperative approaches will help overcome many managerial problems and improve quality. For example, cooperatives can help producers work with quality standards and guidelines in harvesting, and empower producers in price negotiations. Supporting activities can incorporate elements of rural development, such as education and health services.

- *Supporting differentiated coffee (such as Organic, Fair Trade, and Eco-friendly).* These coffee segments are relatively smaller in size and of limited access. Maintaining quality is an essential component for their success. Supporting necessary extension, training and certification of these coffees can increase producers' income (because these segments carry a price premium and are experiencing strong market demand). They can also generate significant externalities, such as improving environmental management (for example, resistance to drought and erosion) and promoting community-level organizational support. Cultivating Organic and Eco-friendly coffees can provide many of the necessary training steps in establishing and maintaining international level standards, such as field-to-consumer traceability, farm inputs accounting, and residue-free harvests.

<u>Key elements in coffee milling</u>

Mills can become pivotal elements for introducing the total quality concept throughout the entire production chain, from the preparation of the fields to the establishment of long-term sale relations to reach the international markets.

- *Minimizing defects in the milling.* The inadequate processing of coffee in the wet and dry mills can affect the quality of previous stages. For example, equipment malfunctions can damage the beans. Inadequate drying can alter the flavor and spread molds. Overheating of the ovens, inappropriate storage, and overfermentation also affect quality. Equipment and procedures in the mills should be maintained to protect and enhance quality. Finally, coffee must be delivered under conditions of adequate humidity, in accordance with the agreements with the exporter.

- *Cupping.* Adequate tools must be used to measure and evaluate the "cup-value" of coffee samples. This requires establishing adequate cupping laboratories in the mills. Laboratories need to receive institutional support for the training and certification of expert cuppers, including setting up groups of master cuppers, who can train other cuppers.
- *Business development.* The transformation of the mill from a coffee-processing center to a business enterprise will result in many positive effects. Correcting the over-capacity of mills can become part of this transformation. There are examples of producers and millers groups that, working in cooperatives, have introduced improvements in production processes and directly accessed new markets. Similarly, entrepreneurs have developed successful businesses supported with good innovative management tools and technologies such as the Internet.
- *Strengthening marketing.* Mills that improve the quality of their coffee potentially develop better negotiation capacities with exporters. For example, they can enter into contracts that specifically recognize and reward quality or add flexibility to receive higher compensations for quality improvements. Improvements in quality and consistency will help increase the confidence of exporters and buyers in general to negotiate long-term contacts with millers.

Public policy and incentives are important elements in improving the quality and competitiveness of the coffee sector and easing diversification strategies. These elements are discussed further in this study, especially in Section VI.

III. Marketing and Value-Added Issues for Central American Coffees

By differentiating and increasing the quality of their coffees, Central America has the potential to improve their overall competitive position in international markets, through enhanced reputation, quality orientation, and income. To be able to enter and develop the emerging higher revenue segments of the market with differentiated coffees requires the development of value-added strategies and marketing, to be able to distinguish Central American coffees from those of other parts of the world. Before designing such strategies for coffee, it is important to understand the characteristics and trends of consuming markets.

Macro Trends in Established Consumer Markets

Quality and value will continue their emergence as competitive standards, against the backdrop of continued but more modest prosperity in the European Union and the United States. In these markets, post-war baby boomers will drive growing demand for specialized products. Mass-market brands are particularly vulnerable to intense competition. Quality coffees---although not necessarily only specialty coffees---will likely continue their strong growth trend, while standard brands remain stagnant. These standards, commercial brands will likely retain the lion's share of the market, based on their price and promotion. However, out-of-home consumption, food service, and private-label programs offer alternative and increasingly larger channels of distribution that have much lower barriers to entry. Over the next ten years, these segments are expected to capture nearly two-thirds of new consumer food spending in the United States.

Another source of the drive for quality are elevated food safety concerns, particularly in the United States and Europe (Giovannucci 2000). This implies a fundamental shift in the role of Grades and Standards (G&S) from merely reducing transaction costs to serving as strategic tools for market penetration. This shift is furthered by changes in the regulatory, business, and consumer environment (Giovannucci and Reardon 1999). Several of the "sustainable" coffees intrinsically incorporate improved G&S in their certification standards and also appear to meet consumers demand for specialized and "safe" products. They should therefore be considered as a potential part of any producing country's strategy.

The growing interest in sustainable coffees---defined generally as those whose production is certified by a third party to combine economic, social and environmental benefits---has fueled their dramatic growth in recent years (see definitions and characteristics, Annex A). Nevertheless, the markets for these coffees---primarily organic, fair trade, and shade-grown---should be approached with caution. They are still limited in size and can require considerable farmer effort to adapt to their more stringent requirements (Giovannucci 2001). Other specialty or differentiated coffees, such as gourmet, appellation, and single estate, also show considerable potential and, in some cases, promise considerably larger markets.

To both assess and access markets, quality information---and the ability to make use of it---is needed. Business skills to manage such transactions as contracts, shipping, and credit are also vital. The single most important factor to enable small businesses and smallholders to reach markets is the institutional strengthening of associations and cooperatives. They are *the delivery mechanism* by which coffee producers/sellers can:

- Better manage their affairs as businesses;
- Negotiate with coffee buyers, transporters, processors, and input sellers;
- Aggregate larger quantities and lower costs of marketing;
- Negotiate and manage larger financial transactions and access global commodity markets; and
- Facilitate efficient relations and transactions with NGOs, international organizations, extension services, and certifying agencies.

Market Differentiation

Market differentiation can be a valuable tool with which to earn higher revenues and achieve superior market reputation. The differentiated markets can and often do overlap. They consist of various types of coffees that are not the usually traded as commodities, for example (see Annex A):

- Geographic Indications of Origin (appellations);
- Gourmet;
- Organic;
- Fair Trade; and
- Eco-friendly or shade-grown.

Differentiated markets are important because of their high growth rates, as well as their ability to command a price premium. Moreover, they can access market niches that are competitively different, and often involve direct relationship with buyers. Moreover, they address global social and environmental concerns, and have the added advantage of provide positive externalities in the field, such as biodiversity conservation. The comparative characteristics of differentiated coffee markets are summarized in table III-1.

Table III-1. A Comparison of Conventional and Differentiated Coffee Markets

Conventional	Differentiated
–International price volatility	–Consistently higher prices
–Reward for quality and price	–Reward for quality and process
–Easy market access	–Limited market access
–Intense competition	–Moderate competition
Extension support from governments	Limited extension support
Broad market size	Very limited market size

Source: Elaborated by D. Giovannucci, World Bank.

Increasing Value-added

For decades, most countries have passively accepted their role as a supplier of green beans in world coffee markets. Meanwhile, on the demand side of the market, roasters have shown a remarkable capacity to add enormous value to green beans, by targeting increasingly segmented and fragmented consumer markets. As a result, multinationals and firms in consuming nations have captured huge downstream margins. Meanwhile, producers' share of total value has declined considerably: from approximately 30 percent to 10 percent in the last two decades. To increase their share of total value and to add value, producers need to simultaneously develop downstream supply chain linkages and pursue promotion strategies that feature their coffee's comparative advantages. Some process-oriented approaches include:

Working with retailers. Certain countries can work directly with retailers. Indeed, retailers' ability to develop private labels and otherwise bypass the traditional trading channels is fast emerging as a critical competitive factor. Such labels are taking a fast-increasing share of grocery sales, even at the high-end of the market. Moreover, they do not require costly market entries or direct competition with current buyers. However, only the more organized producer groups and associations will have the capacity to deal with them directly.

Cutting out the middleman. Among the various methods to increase the overall share of value added, one of the simplest and most frequently discussed is the reduction of intermediation---or cutting out the middleman. While this has obvious appeal, inexperienced farmers or farmer groups should consider it with caution. Middlemen, although often derided, have been shown to perform valuable and sometimes very cost-effective functions by providing credit, agglomerating volume, finding buyers, and providing transport---all with considerably more efficiency and tolerance for risk than many farmers.

Capturing product-oriented value by marketing processed or transformed coffee (for example, soluble or roast and grind) can require considerable expertise and investment, particularly if the target market is overseas. Process-oriented value (Organic or Eco-certification) can be less costly and in the long run has the distinct advantage of providing a higher percentage of benefits and income directly to the producer. Whether a coffee is roasted domestically or overseas rarely affects the price the producer receives. Another producer-oriented way of capturing value is to exploit Geographic Indications of Origin (GIO) or appellations that distinctly connect quality/value to a particular and specific origin.

Brand recognition is a valuable asset in an increasingly competitive coffee market. Brands are essentially a symbolic embodiment of reputation. They require long-term investment and a strong commitment from the stakeholders involved in developing them. For producers that feature a coffees with GIO, this means a quality commitment throughout the appellation; this is necessarily born of a strong organizational structure that provides adequate information and technical training to the farmers in that area. Appellation-based brands initially require considerable work to develop (for example, terrain analysis, stakeholder negotiations, and legal definitions and regulations). However, in the long run, they may also be more beneficial to the local farmers who share ownership. This may make them more sustainable, given that invented labels, unlike a specific terrain, are easily copied and, like fashions, can come and go.

None of these process-oriented approaches can be replicated with cookie cutter simplicity because they require adaptation in different geographical regions. Their benefits are best reaped by first working with those farmers that require only modest adaptation, notably well-known GIOs or organized organic growers. Then, more complex incentives can be structured to encourage conventional producers. This conservative sequencing is also relevant because it correlates to the gradual development of a market that, while fast growing, is still relatively quite small.

However, market access is not the most important basis for deciding to adopt improved or differentiated production methods. Indeed, it is vital that promotional policies focus on the local benefits---rather than the price premium or market benefits, which may be evanescent in small markets. Organic, Fair Trade, and shade-grown coffee can offer considerable environmental, social, and even health benefits to growers and their communities.

In addition to improved sustainability, farmers in some areas could also benefit by combining shade-grown organic coffee production with eco-tourism. These natural production areas have been proven to draw increased numbers of birds and wildlife. In some rural areas, eco-tourism can be more economically important than agriculture. Coffee-growing areas in El Salvador, Mexico, and Colombia are already associated with national parks. A European trend that has spread to other parts of the world, including Costa Rica, is agro-tourism. Diversified and well-managed coffee farms lend themselves to this concept and could be important tourism destinations.

Promotional Strategies for Coffee

The traditional marketing efforts of most small countries are often a waste of resources. Promotions that are designed to impact on consumer decisions in foreign target markets are simply unwise without multi-year million dollar budgets and access to distribution channels (e-commerce may be an exception). Given limited promotional resources and the changing levels of competition, marketing efforts must be judiciously targeted and professionally developed. The most efficient approaches focus on relationships such as roaster visits and trade shows, rather than on untargeted advertising.

Promotional strategies can be linked and supported with e-trade and business development, internal consumption campaigns, and Market Information Systems (MIS).

E-trade and auctions

The Internet offers novel opportunities for marketing coffee directly to roasters, and in some cases, even directly to consumers. Internet-based coffee auctions have been tested for three years with some notable success, albeit on a very limited scale. Businesses like Comdaq are providing solution platforms for developing coffee e-commerce. The experience of the Specialty Coffee Association of America (SCAA) is also useful and available to producers. Direct mail and targeted promotion strategies are other ways of reaching far downstream, but require market partners since they are much more costly and difficult to manage, especially small order fulfillment.

The Internet can be used for more than just traditional marketing. The ability to share new forms of information can expand the possibilities to include support systems for land use monitoring, certification, and GIOs or Appellation. One pilot program in Peru is successfully testing these possibilities online. Their mapping system serves as a prototype for the SCAA denomination of origin/marketing partners project.

Increasing domestic promotion and consumption

One of the opportunities in a low price market is the development of domestic markets. With adequate stimulus, the results can be considerable. A prime example is Brazil. Domestic consumption has dramatically responded to quality and promotional initiatives in recent years, which have helped make Brazil one of the world's major consumers of coffee. Moreover, increased internal consumption can improve familiarity with the characteristics of good coffee and contribute to improvements in production quality.

Market Information Systems

Information is the lifeblood of efficient agricultural markets. The availability of accurate price and other market information helps reduce risks and transaction costs and better enables market participants to plan and coordinate their production and trading activities. Market information is a public good and can be jump-started with public funds. However, around the world, many efforts to develop public sector Market Information Systems (MIS) have failed. Most MIS's have lacked commercial utility and have been unsustainable. To avoid the most common failure factors, four issues must be addressed:

- Ways and means are needed for private, non-governmental management.
- Cost recovery mechanisms must be devised.
- The systems must be established on a modest scope (at least initially).
- Finally, a participatory process is needed that is user-defined and incorporates feedback.

An excellent example of a sophisticated MIS is an evolving project developing information on "green" markets, run by Centro de Intelingencia Sobre Mercados Sostenibles (CIMS), based in San Jose, Costa Rica, under the aegis of the *Instituto Centroamericano de Administración de Empresas* - INCAE (e-mail: info@cims-la.com). All Central American countries can use this system. Simpler coffee-oriented systems could also be effective. Organizations like cooperatives and trade associations can be excellent conduits of specialized market information. Indeed, this is a significant service they can provide their constituents---but one that has proven difficult to manage and sustain without efficient organizations. Valuable market information is also passed through market alliances and is another reason to support integrated supply chain development.

For some producers, marketing efforts and value-added based on quality improvement are simply not viable options. For these producers, diversification away from coffee is a better choice. Such a strategy is examined in the next section.

IV. Diversification Strategy

The current coffee crisis in Central America is primarily an issue of improving the competitiveness of smallholder and medium size agricultural producers within the global economy. The agricultural sector represents an important pillar of the economy of Central American nations and the coffee sector is one of the most important components of the agricultural sector. The coffee sector, however, is a mature industry and will likely become more competitive and less profitable as time goes by. The heavy reliance of Central American economies on coffee renders them vulnerable to market downturns and the consolidation that will eventually occur in the industry. Non-competitive coffee farmers may have to switch, partially or totally, to other agricultural or non-agricultural enterprises for their livelihoods. Their farm laborers likewise will need to identify alternative livelihoods.

National policies should aim to help small farmer organizations identify and market higher quality and specialty coffees to the U.S., European, and Asian market, and help them diversify their export base. In addition, non-agricultural economic activities should be promoted in the rural sector. Some ideas include light industry, adventure tourism, social services (health, education, transportation), and technical training (mechanical, woodcraft, plumbing).

While there are strategies that could be taken by the coffee industry in Central America to improve on the current situation, these are unlikely to result in a quick recovery of world prices or farms' profitability. Under the circumstances, coffee producers have two options: to stay in the coffee business or to exit it. Those who stay can decide both to prune the trees and wait two to three years to see if the market recovers, and/or to increase the quality of their coffees. For those who decide to exit coffee production, options include selling or abandoning the farm, or diversifying into other crops or products.

This last option is what this study calls "diversification." This strategy is restricted to non-coffee agricultural diversification. It considers any agricultural activity or practical combination of activities not related to coffee production that will generate positive net income on the farm. For non-competitive coffee producers, diversification could be a viable alternative to achieve economic sustainability in the medium to long run.*

The primary goal of diversification is to provide alternatives for those growers who will not be competitive in producing coffee---alternatives that will allow them to keep the farm as an agricultural enterprise. As a secondary goal, the alternatives should help make the growers self-sustaining, so they will not return to coffee when prices improve. Alternatives should also aim to employ displaced coffee labor and should favor land use practices and patterns that are both profitable and environmentally sustainable.

The dangers of unbalanced reliance of an economy on a few agricultural commodity crops has long been recognized and efforts for the diversification of agricultural economies are not new to Central America or to coffee growers. Over the last thirty years, many efforts for agricultural diversification have been made and have had varying degrees of success in the region. Nevertheless, some important diversification efforts have been made. Lessons learned from the implementation of those projects are summarized in box IV-1.

Box IV-1. Lessons Learned from Previous Diversification Efforts in Rural Central America

1. Improved *quality* of output is no less important than increases in *quantity* of output---and possibly more so.
2. Achieving quality-based competitiveness takes time. This process is greatly aided by partnerships and match-making arrangements with the private sector (including foreign firms). National institutions can offer support to farmers in the form of appropriate technologies, technical assistance, and financial and marketing services.
3. Experience in marketing new agricultural products domestically is often the first step in the successful development of export marketing.
4. Governments can support diversification by facilitating foreign and joint venture investments, as well as transfers of production and processing technologies from abroad.
5. Successful diversification programs that support sustained production and export expansion include new types of financial and marketing arrangements (such as joint ventures, vertical integration, and investment incentive programs). Public investments are also needed in human capital and support structures (education and health, water and sanitation, rural infrastructure, research and extension).
6. Successful diversification programs start by considering the agro-ecological characteristics of the areas to be diversified. Extensive market research and marketing planning of potentially successful crops are also needed before any crops are chosen.
7. One of the more successful approaches in diversifying agricultural capacity has been to add value to a crop that is familiar: one that has already been grown in the area and whose agricultural practices and post-harvest handling requirements are known to local producers. Adding value to the product may make it commercially successful, while increasing farmers' incomes.
8. Production, financing, processing, and marketing should be left to the private sector.
9. Farmers cannot assume all risks involved in the new crops. Incentives should exist for collaborative research/analysis, technical and marketing assistance, and to finance the setting up of production---but not for the production itself.

* The term "non-competitive" is used here to describe coffee farms that cannot compete in world markets, either because their cost structure does not allow them to be profitable by competing in the "exchange-grade" segment of the market or because of the agroclimatic conditions of their farms cannot produce coffees to compete in the "high quality" segment.

10. The public sector should focus its efforts on providing transportation and communications infrastructure, marketing infrastructure (such as auction/terminal markets and cold storage), standards and quality control services (such as product and factory inspection and certification), market information services, and new product market and trade promotion assistance.
11. Strong institutional capacity within cooperatives is crucial to the success of a diversification program. In general, private agribusiness firms have been more successful than cooperatives diversifying their production. The limited success of "campesino" farmer cooperatives could be attributed to a lack of flexibility, sophistication, and quick response, as well as excessive costs. When working with a perishable product, quick response is needed to correct problems and react to changes in the market. Cooperatives must arrive at consensus before responding to change, whereas individual entrepreneurs need only to make up their own minds.
12. Diversification initiatives have faced critical and sometimes insurmountable issues of sustainability at the farmer level. Farmer-centered research and extension is perhaps even more important for the adoption of appropriate sustainable farming methods by small farmers than the correct macroeconomic policies.
13. However, the correct macroeconomic policy environment is crucial for the sustainability of the entire diversification program.
14. Where diversification programs were successful in increasing agricultural exports, they were also successful in attracting foreign investment to the countries' agricultural and food sectors.

Elements of a Diversification Strategy

Diversification is not easy, especially when it entails a movement away from a relatively nonperishable cash crop like coffee. Growers themselves, responding to market's conditions and government's incentives, will determine how much coffee should be phased out. Developing new niches with premium prices does not necessarily imply the phasing out of a part of current production. However, continued production by unprofitable producers or in inefficient coffee production areas should not be subsidized.

To be self-sustainable economically, socially, and environmentally, ideally alternatives should be labor-intensive and appropriate to farm conditions. They should utilize sustainable production practices. They should exploit profitable market options, and aim for long-term markets.

A diversification program for coffee growing areas must start by addressing particular farmer objectives defined according to local necessities: notably, income diversification, improved food safety, planting of other more profitable coffee varieties, or any combination. It must then help farmers assess these specific issues:

- Potential markets for different possible crops;
- Risk management;
- Barriers to entry (investment costs, infrastructure requirements);
- Necessary skills and resources (information, technical capacity, financing);
- Environmental and economic advantages for production; and
- Challenges pertaining to commercialization (logistics, quality, quantity).

Government-backed Initiatives

Development of strategy for agricultural diversification must follow a systematic approach, dealing with both the agricultural and business environment constraints at the same time. It should be consistent with the development of the rural economy as a whole. In analyzing the elements that have combined to make strong agricultural sectors in developed nations, several factors stand out:

Market research. Solid research is needed to identify markets and study demand for agricultural products in short supply, whether for domestic or export markets. Specialized organizations are often well suited to this task. An example is INCAE's new Centro de Inteligencia Sobre Mercados Sostenibles (CIMS).

Technical assistance. Appropriate integrated technical packages must be designed for products deemed promising (to address the agronomic, environmental, sanitary and phyto-sanitary problems, and quality requirements the farmer may face). This can be accomplished by a variety of partners, both governmental and non-governmental, in partnership with the private sector. Technical assistance could be offered through extension services managed and funded by local authorities, thereby ensuring their active participation.

Agricultural support services. The underpinning principles of an agricultural trade program must be built upon scientifically based sanitary (animal and human health) and phytosanitary (plant health) measures. Accordingly, it is essential for any program that supports trade in agricultural products to incorporate the principles set forth in the internationally recognized measures (or regulations) to protect human, animal or plant life or health: notably, the World Trade Organization Agreements on the application of Sanitary and Phytosanitary Measures and the Technical Barriers to Trade. The WTO signatories believe that trading rules based upon science and transparency will promote fair competition and provide predictable and growing access to markets.

Marketing and logistics. To facilitate the efficient commercialization of agricultural products, bottlenecks must be identified and solutions proposed and implemented. One arrangement that has considerable potential for raising incomes of small farmers is contract farming. Processors provide growers with credit and technical assistance, in exchange for delivery of a crop at a fixed price at the time of harvest.

Credit support. Targeted support programs can finance the investments needed to begin production. Some modest scheme may be necessary to support the individual producer's income temporarily during the unproductive phase. However, such support should be minimized and should not unduly distort the necessary market-oriented rationale for diversifying.

Community organizations. Locally based groups can support producer and/or trade organizations. These groups could gradually take over the processes discussed above and provide necessary linkages to markets.

Unfortunately, all these forms of support may not be in place or may not fall into place at the same time. The more factors that are present at a given moment, the greater the chances for a successful agricultural structure. Addressing one factor at a time will not move diversification along as fast as it needs to move to keep up with the changing trends and requirements of the markets for agricultural products.

Aside from socioeconomic factors, there are cultural factors to be considered as well. It may be difficult to convince coffee producers to produce something else. Generally speaking, producers have a long tradition of coffee production, which may be difficult to overcome. Any diversification strategy must consider this sort of resistance, and other such cultural aspects, when designing programs---especially for areas that cannot produce coffee competitively.

Not every farmer can be assisted with a non-coffee agricultural alternative. Other alternatives need to be considered for marginal farmers or those beyond the means of an agricultural solution. Those who face any or all of the following constraints: The slope of the land is too steep, or the soil is too thin and non-fertile. The farm size is too small, or the farm is too remote. There is not enough rain for rain-fed agriculture and no water for irrigation.

These growers may need to find employment in light industry associated with non-agricultural activities. All of these activities would require manufacturing in the production area or nearby, offering employment alternatives for displaced growers. Such a manufacturing base requires skilled labor. That labor should be trained, so it is ready to work once the industry is established.

For land that does not lend itself to any other agricultural pursuit and for important watersheds and forests, payments for environmental services may be a viable alternative livelihood, or at least a potential supplemental revenue stream from sound land use. Land can be set aside for forest preservation, for water and carbon sequestration, for public parks, or for other environmentally beneficial uses.

The next section examines environmental considerations in greater depth.

V. Environmental Considerations

The traditional way of producing coffee in Central America, using naturally growing trees as shade, not only conserves soil and water like a forest, but also supports a variety of plants and animals and serves as a natural moderator of the microclimate. Over the past five decades, coffee production has intensified and "technified," with the introduction of high yield varieties and the intensive use of agrochemicals, in an attempt to compete with low cost/high volume producers worldwide. In some cases, this has forced traditional coffee producers to cut down shade trees and abandon the biodiversity and the inter-mixed crops.

Site-specific environmental conditions, including soil and microclimate, determine whether the use of the new technologies of coffee varieties and agrochemicals is appropriate. In cases where the adoption of new varieties and agrochemicals were introduced as a "package," without due regard for environmental sustainability, increased production was achieved. Unfortunately, however, the decision to "technify" production has sometimes been a "lose-lose" proposition;

new varieties and increased use of agrochemicals have not resulted in higher yields. The implementation of the new technologies has altered the natural ecosystem, forcing coffee producers to continually increase the amount of agrochemicals they use. These practices have not only been damaging to the environment, but have also undermined the cost-competitiveness of the coffee enterprises themselves.

Environmental issues in coffee production are common to all levels of technification, from small farmers using low-input traditional methods to large enterprises employing substantial amounts of inputs to achieve high yields.

General Environmental Considerations in Coffee Production

The main environmental considerations of coffee production, from cherry to roasted coffee, are the management of the coffee plantation, preservation of biodiversity, soil and water conservation, agrochemical use, and the consumption of water in the post-harvest processing. The most noticeable environmental problems are caused in these areas and are directly related to lack of environmental awareness and sustainability.

Farm management and land use. No matter the method used for coffee production, good management of the plantation is key, including:

- Appropriate use of agrochemicals for pests control (pesticides) and yield improvement (fertilizer);
- Maintaining not only the coffee plants, but the shade trees, and, using adequate types and densities;
- Conserving soil and water through erosion control with contour planting and appropriate ground cover;
- Managing waste on plantations, including recycling of residues (pulp, water).

However, small coffee producers have other priorities and pursue other activities. Accordingly, the effort seems to be focused on the harvest, more or less leaving the plantations to themselves the rest of the year.

Biodiversity. Traditional coffee plantations used to have levels of biodiversity similar to natural forests. As the amount of agrochemicals has increased with the "technification" of the coffee production, the natural levels of biodiversity have slowly disappeared. Preservation of biodiversity is a fundamental part of sustainability, as coverage provides shelter to animals and maintains the balance of pests and diseases found naturally in the ecosystem. The intensified coffee production, on the other hand, sees any crop apart from coffee as a potential competitor. In some cases, coffee is produced in areas better suited for other crops/forests, with negative consequences for biodiversity and the ecosystem.

Soil and water conservation. "Technified" coffee production with intensive use of agrochemicals leaves the soil in a state of ecological imbalance, lacking the capability to recycle the necessary nutrients and hampering the ability of the soil to contain water. Furthermore, the risk of erosion increases without sufficient groundcover to hold soil and help water infiltrate to the aquifer and keep the soil moist. Given the fact that coffee is often cultivated on slopes, there is an even higher risk of losing the top fertile layer of humus, which is essential for the quality of the coffee.

Use of water. Wet milling coffee requires large amounts of water (200-500 liters to produce 46 kg of green beans). The process is the same whether it takes place in big mills or by individual coffee farmers. Given the large amounts of water used, mills tend to be situated near a river (and in some cases in the river). Water used in the milling process is highly contaminating, containing sugar from the pulp and residuals from the fermentation. Discharging the water directly in the stream or river not only pollutes the water, destroying aquatic flora and fauna as well as the surroundings, but also contaminates the drinking water for communities downstream. During the peak of the harvest, the individual farmer re-uses water to speed up the fermentation process of the next lot. However, recycling fermentation water can affect the quality of the coffee.

Environmental Problems Arising from the Coffee Crisis

Environmental issues are the last priority to many farmers struggling to cope with the coffee price crisis. Existing environmental problems have worsened. Meanwhile, some new environmentally related problems have intensified, such as destruction of shade forest---followed by decreasing biodiversity---and destruction of ecosystems and natural habitats. Some of the key environmental problems arising from the crisis are the following:

Abandoning the farm, or growing new crops instead of coffee. The low price of coffee especially pressures small farmers to grow other crops to supplement or substitute for coffee, in order to survive. The new crops might not be adequate for the soils and slopes in the coffee regions, and introducing the inadequate crops could cause serious erosion problems. Furthermore, abandoning the coffee plantation and leaving cherries unharvested can cause serious plagues and infestations of pests the following year, making it difficult to reinitiate any agricultural production.

Destroying the shade forest. The coffee crisis drives traditional coffee producers to cut down and sell the shade forest as timber or firewood. Introducing new crops as a substitute for coffee can provoke clearing of the coffee plants and surrounding areas, using slash and burn techniques.

Limited implementation of cleaner technology. Over the past years, an increasing number of wet mills have implemented water and energy saving measures, and promoted their mills as environmentally friendly or certified. The coffee crisis will prevent new mills from implementing such measures.

Environmental Aspects of Strategies to Ameliorate the Coffee Crisis

In deciding whether to pursue a strategy of quality improvement or diversification, producers make an indirect choice regarding the impact in the environment. It is difficult to determine the precise impacts of each strategy, whether positive or negative. Some potential linkages between quality, diversification and the environment are discussed below.

Environmental Impacts of a Quality Improvement Strategy

- *Biodiversity.* Aiming toward specialty coffees entails managing the shade forest and taking a proactive approach to improve biodiversity and the ecosystem, as well as soil and water conservation. Apart from benefiting the environment, the strategy can yield economic benefits to the producer if it opens access to markets selling environmentally friendly products, at premium prices.

- *Implementation of cleaner technology.* Water-saving and recycling measures implemented in both large and individual mills can indirectly be linked to quality management.
- *Farm management.* Good management procedures include erosion control, the sound use of agrochemicals, and shade and waste management, along with the use of resistant varieties, harvesting of ripe cherries, and proper preparation and cleaning of the plantation after the harvest. A well-managed plantation from the environmental perspective has direct positive linkages with quality: for example, through the prevention of defects and uniformity of the harvested cherries.
- *Organic coffee.* Organic coffee production involves several activities with positive impacts on the environment. Decreasing the use of agrochemicals and focusing on shade management increases the level of biodiversity. Moreover, it increases the environmental awareness of the consumer.
- *Knowledge and information.* Improvement of coffee quality requires knowledge and information. This can be provided through technical assistance to the small coffee producer in remote areas, and could be offered through NGOs and other scientific institutions conducting research in coffee production.

Environmental Impacts of a Diversification Strategy

- *Biodiversity.* The biggest negative impact of diversification into other crops or non-agricultural activities includes the possibility of destroying the existing shade forest. The clearing of land to develop non-agricultural activities will have a negative effect on the ecosystem, biodiversity, and soil and water conservation, if the necessary measures are not taken. An environmental impact assessment in every case can assure that only activities with *no* negative environmental impacts will be implemented.
- *Agroecological conditions.* Crops intermixed with coffee and/or new crops might not be adequate for agroecological conditions, potentially causing negative environmental impacts.
- *Technical assistance.* Access to technical assistance is the key element to make a qualified decision as to introduce new crops or other non-agricultural activities. This is especially true when diversifying into crops that are less known by the farmers.

Including Mid-size and Large Farms and Farm Workers in Sustainable Coffee Programs

There are important reasons for including mid-size and large farms in sustainable coffee programs. The participation of mid-size and large producers is essential to any rural development plan or landscape-level conservation initiative. Some of the mid-size and estate farmers have important marketing contacts, skills, and experience. Small, neighboring farmers can ride their coattails into premium markets.

Finally, rural development programs will not be equitable or successful if they do not include farm laborers, especially migratory and seasonal workers---perhaps the most neglected and disenfranchised sector in the region. In fact, smallholders, no matter how poor, have more options and support than the landless poor who work seasonally on the farms of others.

This document now turns to an examination of the institutional and incentives framework needed to support the competitive transition of the coffee sector.

VI. INSTITUTIONAL AND INCENTIVES FRAMEWORK

Since the 1990s, the global coffee sector has undergone important structural changes. These changes will shape the course of the industry during the next decade and beyond. To support the industry in the future, coffee institutions in Central America need to revise their role and strategies and help identify new opportunities.

From ministries and national coffee institutes and councils to private associations, research and extension institutes, to NGOs and regional entities, many institutions and organizations operate in the coffee sector in Central America. Private sector groups also play an important role in such areas as banking, technology transfer, and market information.

Clear differences in the scope and strength of institutions exist in Central America. Some countries have strong institutional capacity with clear strategies and well-defined technical, social, and economic programs; others have public institutions with well-defined roles but weak institutional capacity. In many countries, fragmented producer associations contrast with strong milling and exporter associations. Some countries suffer from an absence of cohesive national coffee policies and strategies to guide and regulate the large number of institutions serving the coffee industry.

The objective of this section is *not* to present an exhaustive review of the performance of coffee institutions and organizations in the past. Rather, the approach is forward-looking: to identify areas where these entities can play a key role in facilitating a competitive transition for the coffee sector and sustainable development of the rural economy. The section concentrates on three areas. First, it considers how institutions and organizations can support the development and competitiveness of quality coffee A special focus is on appropriate trade policy. Second, it examines credit and banking services to competitive producers. Third, it considers ways to reduce social vulnerability. In particular, social protection for poor producers and laborers, and others in the rural economy, and risk insurance mechanisms for small coffee producers, are examined.

Supporting the Competitiveness of Quality Coffee

The role of national ministries, coffee institutes, councils, and associations in supporting quality begins with definition of, and consensus about, a strategy. Coordinated measures will reflect a combination of social priorities, economic capacity, and political resolve. These must be harnessed in long-term programs that produce some clear results in the short term.

Interventions could include:

- *Defining standards and incentives for quality production and competitiveness.* Identifying, assessing, and supporting production of quality coffee requires, first and foremost, reaching consensus among the key coffee institutions on what quality coffee means. This can include the legal recognition of market-defined norms and standards. Once quality is defined, it can be followed with institutional support to the competitive production and processing of quality coffee. Establishing and putting in place the right incentives for quality recognition at the different stages of the production chain will motivate better quality production.

- *Promoting quality certification.* In the long run, support can be extended to creating a credible, impartial, and independent system for quality certification: one that responds to market requirements with respect to taste and environmental and social concerns of consumers. Other incentives that promote production and consumption of quality coffee in the domestic market can be implemented. A positive example is Brazil. Its certification programs have promoted domestic consumption while improving quality.

- *Supporting the organization and consolidation of smallholder production.* Institutions can help support the consolidation and integration of the coffee industry, especially by working with small and medium producers to enable them to achieve better economies of scale, adequate volume, improved quality control, and higher market access.

- *Providing technical assistance and research and extension services* to coffee producers and millers. This can be a key element for empowering smallholders and enhancing quality. Support can be pursued in two areas: adopting best practices for quality production and prevention of defects, and capacity building for quality measurement, through cupping and physical evaluation. Entities such as IICA, CATIE, CIRAD, the regional coffee institute PROMECAFE, national coffee associations and institutes, and NGOs have been working in these areas, in addition to independent experts.

- *Building partnerships.* National institutions and privately held associations have developed alliances with national and global organizations. These vary in purpose and focus, although all aim to provide better services and secure higher incomes for their members and for the coffee industry in general. For example, ANACAFE, IHCAFE, and ICAFE have undertaken individual arrangements with financial institutions to provide technical assistance required for credit to members. Coffee associations and the Specialty Coffee Association of America (SCAA) have signed letters of understanding for training and assistance.

- *Improving market access.* Partnership building is also important for improving market access. For example, cooperative associations have negotiated quotas for members' coffee in higher-priced alternative markets such as Fair Trade, as well as long-term contracts with roasters, guaranteeing the use of their members' coffee in the roasters' blends and brands. The development of a legal framework in which international coffee contracting laws can be sustained can both facilitate and encourage the development of long-term contracts, and secure partnerships between sellers and buyers under which both parties can be sure of performance. Other steps could include developing market information systems for coffee producers regarding prices and potential markets, and facilitating technical assistance for brand development, partnership building, and market access.

Promoting the competitiveness of coffee also includes defining and implementing adequate trade policies and incentives for market outreach. The indirect effect of higher competitiveness and improved production and certification mechanisms will be higher quality product; this, in turn, could increase demand. Starting from the Central America region, greater openness in the coffee trade could encourage national industries to improve, forcing non-competitive suppliers---which are typically protected----to exit and shift to other sectors.

Trade Policy

Trade barriers directly impact the competitiveness of coffee and indirectly undermine the potential of quality improvement. Traditionally, coffee has suffered discrimination in trade and exchange policies. The current policy framework has been improved by policy reforms, particularly in the 1990s, but important issues still remain (see table VI-1).

The region is still feeling the effects of export quotas established by the International Coffee Organization, which required strong intervention of the coffee markets at the time of their implementation. The export quotas were discontinued in 1989. Central American countries have had an asymmetrical treatment of imports and exports. While imports were typically protected, exports were subject to discrimination. As part of this asymmetric treatment, coffee has been traditionally discriminated by trade and exchange policies, resulting in many cases in a negative rate of protection.

Complex export procedures and taxation schemes act as disincentives for quality production and the quality coffee competitiveness and profitability. It is important to revise and correct policies that reduce the competitiveness and profitability of Central American coffee exports. Policies may include: defining region-wide standards and protocols that establish criteria for the recognition of coffee regions (such as Antigua coffee); extending tax incentives for importing technology and operating environmentally friendly coffee processing technologies; eliminating remaining export taxes for coffee; and reducing transaction costs by streamlining exporting procedures.

Coffee should receive at least the same free trade status as firms in free zones, which are routinely granted exemption from tariffs, export taxes, and other trade taxes, and benefit from expedited customs procedures. These are not subsidies; they are necessary to grant the firms free trade status, allowing them to compete against firms in foreign countries. These preferences can be granted to coffee exports. At the World Trade Organization ministerial meeting in Doha, Qatar, in November 2001, Central American countries, among others, fought for and obtained an extension of the period for which subsidies to firms operating out of free trade zones will be allowed.

Finally, it is important to include coffee in trade negotiations, especially in new markets and internal Latin American markets. Import tariffs on coffee from countries in the region must be revised. Lower tariffs are related with higher competitiveness, larger profits and, potentially, quality increases.

Table VI-1. Coffee Trade Policies in Central America

Issue	Implication
Coffee was excluded from free trade in the Central America Common Market Agreement signed in 1960.	Domestic coffee markets are small, and coffee firms do not have the possibility of benefiting from the larger Central American market envisioned in the customs union agreement. Inter-regional coffee trade is treated as third county imports, restricting coffee trade and investment in the region. This also restricts coordinated region-wide responses to the coffee crisis.
Nations collect export taxes and charges for coffee institutes and coffee funds. Foreign exchange earnings are surrendered at official rates.	The taxes and charges and the exchange rate penalty reduce price-competitiveness. The tax and charges reaches an annual amount of US$25 million for the whole region. Collection of these charges introduces additional transaction costs for regulatory compliance, reducing cost-competitiveness. Rather than the existing practice of discrimination, the environmental benefits of coffee farming (carbon sequestration, water flow regulation, erosion abatement) justify subsidies.
Exporter registration and bonding requirements. Requirement to present export contracts to government institutions before shipment. Export certificate are also required, as well as a central bank export permit for each shipment.	Barriers to entry are erected and transactions costs are considerable. These are somewhat diminished through "one stop export shops," but are nonetheless significant. This tends to concentrate the players and increase the bargaining position of traders and exporters who are already in the export and trading business, further restricting farmers' share in the value of their product.
National export quotas were prevalent in previous ICO agreements. The current ICO does not include quotas.	However, those quotas left a legacy, which includes coffee laws, and quasi-public agencies, which administered these quotas, among other responsibilities. These organizations concentrated on taxation and burdensome regulations and did not pay enough attention to trade promotion, trade facilitation, and quality enhancement.
All these trade controls, largely without constructive purpose, exist in an industry largely made up of poor farmers, who are unable to withstand price or weather crises, and who still must realize quality improvements.	Coffee agencies and councils should refrain from interfering in trade regulation, collect their fees before the export stage and with a minimum distortion effect on the market (particularly separating the funding requirement from export regulatory requirement and burdensome transaction cost).

Providing Credit and Banking Services to Competitive Quality Producers

The crisis in coffee prices has severely affected the banking sector. Several banks in the region have already failed, and a number of countries are looking for ways to restructure bank balance sheets to allow continued lending. The dominant philosophy seems to be to find measures to prevent large-scale take-over of farms by banks.

The most immediate response has been to withdraw credit to the coffee sector, particularly producers. Banks and rural financial institutions are not willing to extend new credit to the coffee sector as long as prices remain depressed and old debts are not cleared. For this reason, agricultural producers have turned to informal credit sources such as suppliers of agricultural inputs or coffee intermediaries, with correspondingly stricter conditions and higher interest rates.

While supporting the financial sector, national public institutions are working to define alternatives for producers and millers with severe debts and working capital requirements. With coffee emergency funds already exhausted, arrangements in several countries involve longer-term restructuring of commercial bank loans, by transferring them to trust funds. In return for the transfers, banks receive government bonds to be revalued in their balance sheets. While retaining ultimate liability for their individual components of the fund, they take write-offs against reserves at a very slow rate, or when the payer does finally default. Schemes like these have been designed to solve short-term problems, but do not address the consequences of extended periods of low prices, starting with the next crop.

The situation in the banking sector is evidence of clear market failures in the system. The formal financial sector does not have an adequate risk model to evaluate credit-worthiness in the agricultural sector, and has difficulties in predicting sectoral slowdowns and in forecasting commodity prices.

The market failure has been traced to asymmetry of information, lack of adequate guarantees, unfamiliarity with rural production needs and seasonality, and perceived low internal rates of return (Marlunda Consultores 2000, 2001). Against this background, it is important to develop appropriate coverage mechanisms that differentiate between market risks (involving output, prices, and quality) and financial risks (rates of interest, liquidity, and rate of exchange). Developing incentives to stimulate the financial sector's involvement in agricultural projects is also required.

Regional banks are examining and putting in place special borrowing conditions that include a pre-agreed schedule for sales and forward contracting that ensures that all coffee prices are fixed before the end of the season. Borrowing and debt restructuring for coffee producers and millers should also be aligned with long-term economically sustainable programs such as renovation projects, and quality and marketing initiatives for improving exportable coffees. Ideally, these should be linked with technical assistance components. Implementing and providing access to risk-management instruments and hedging products to the sector, including to small producers, will help both lenders and creditors reduce the uncertainty of income streams and thus in debt repayment.

Reducing Vulnerability

A third area of institutional and organizational support is reducing social vulnerability, in both the short and long term. To assist coffee producers, workers, and their families, better social protection is needed (particularly short-term actions). To protect small coffee producers vulnerable to price shifts, risk insurance mechanisms and similar instruments need to be developed.

Production decisions at the farm level are directly influenced by price shifts. The current crisis has brought many consequences in terms of investment, employment, and production, which are directly linked to vulnerability. Recent studies conducted in Nicaragua and El Salvador to assess producers responses to low prices and risk perceptions indicated that the immediate responses is to reduce costs, particularly of labor and inputs. The likelihood of reducing labor increases significantly with the farm size (World Bank 2001, 2002). Farmers' willingness to harvest all the coffee from the fields suggests that they are paying only for one cut of coffee, instead of financing additional cuts for ripe cherries.

Most farm households also reduce their short-term consumption. Small farmers, more than others, increase informal borrowing and become especially vulnerable to loss of other employment. Almost all producers, regardless of size, ranked coffee price shifts as the most important risk they faced.

Social vulnerability and the institutional response

Historically, when governments have attempted to respond to a "coffee crisis," they have focused attention on coffee producers: notably those with outstanding loans, which are typically medium and large coffee producers. Sometimes, small producers have also benefited from government assistance. An example is a current program in Mexico to compensate small coffee producers for low prices.

Coffee laborers have not tended to benefit from direct government assistance. Large proportions of coffee laborers are classified as "poor" by various poverty assessments. Indeed, coffee laborers tend to be overlooked. This is important because, in times of economic crises, medium and large coffee producers tend to cut back on their use of purchased inputs and labor. With less demand for labor, wages tend to fall. This can have serious negative impacts on poor coffee laborers, a large proportion of who are also small producers.

Since many small coffee producers and laborers also cultivate staple foods for home consumption, any concurrent weather-related risks, such as drought, can exacerbate the negative welfare impacts of low coffee prices. This is currently the case in many Central American countries, where yield losses from drought are compounding the downside shock on small coffee producers and laborers.

Moreover, others in the rural economy---including coffee input suppliers, processors, and providers of household goods and services---are also impacted by low coffee prices and low coffee-related incomes. Like coffee laborers, they also do not tend to benefit from any direct government assistance in time of crisis.

Recognizing these problems and making them visible to governments is an important first step in suggesting any possible social protection strategies and options. Additional institutional responses to address social vulnerability can include:

- *Providing assistance to unemployed coffee workers and their families.* Nicaragua offers an example. A work-for-food program has been recently set up in partnership with coffee producers. Participants are employed on private coffee farms and receive partial payment from owners; food allotments to make up the difference. The reduced wages allows coffee producers to employ more laborers than they could have otherwise in this crisis situation. This program aims to help both coffee laborers and larger producers.

- *Improving safety net programs.* There is a need for safety net programs for coffee laborers, small producers, and others in the rural economy: both targeted and self-targeted programs. These programs could include food aid, food-for-work, and temporary employment. They should also include assistance for families and children. Such programs will require a case-by-case analysis in different countries and regions, and where possible should be mainstreamed into existing safety net programs for the rural poor. A key issue in the design of safety nets will be the fact that many coffee laborers are seasonal migrants. This can make geographic targeting difficult.

- *Assisting coffee laborers and small producers in skills development and training* to improve their mobility, either within or beyond the coffee sector. The high supply of unskilled rural labor puts downward pressure on wages; skills development can offset this. Moreover, laborers will probably need new skills as part of the process of diversification.

- *Promoting the use of price risk management instruments.* To provide unemployment insurance to laborers and/or to fund alternative employment, medium and large producers could be given incentives to use instruments such as commodity price insurance. Possibilities could also be explored for governments to use price risk management instruments to help fund safety net programs for coffee laborers and others.

- *Providing assistance to link the laborers' associations with the producers' associations* to help identify common issues and capabilities to respond better to crises.

Managing price risk and volatility

Coffee farmers face at least two distinct sets of problems associated with prices: the outright price level, and volatility. Coffee prices have been the most volatile of all commodity prices. Price volatility was particularly pronounced during the 1990s, and is expected to continue, together with the downward tendency in coffee prices. Volatility is the result of an inelastic demand curve and supply shocks, mainly caused by past production disruptions in Brazil (mainly because of frosts), production adjustments in response to price increases, and policy changes (such as the suspension of the economic clauses of the International Coffee Agreement).

Cyclical price volatility, particularly within the crop season, can be dealt with through price risk management instruments. However, the secular price trend requires other longer-term elements, such as diversification or improvements in quality and productivity.

Speculative behavior also needs to be addressed. This was one of the sources of the banking problem. In the past, many farmers chose not to fix coffee prices, even after their crop was exported; rather, they retained futures-linked positions with exporters. The lack of coverage in a period of decreasing prices led to the reduction in their ability to repay their loans.

Tools to manage price volatility already exist. However, small and medium-size agricultural producers in developing countries are, in general, unable to access them. Impediments to their use by producers include inappropriate instruments to suit their needs, high transaction costs, and little understanding of their use. Additionally, in the developed world, many producers frequently do not access risk management instruments directly. Some options to manage lower and volatile prices are described below.

Lower-scale risk management instruments

Ways in which coffee producers can get access to risk management markets are the focus of studies underway in El Salvador and Nicaragua. Two key issues are to develop competent aggregators of risk management instruments, and to examine ways in which risk management instruments can help unlock access to credit. Local aggregators for demand for risk management instruments could be producer organizations, cooperatives, rural credit institutions, and traders. Preliminary results indicate that it is critical to strengthen the capacity of producer organizations and cooperatives to deal with price risks and improve their marketing of coffee. Approaches being explored are:

- *Attaching price insurance to a loan agreement.* A farmer who borrows with price insurance should be a better credit risk than one who borrows without it. From the perspective of the lender, a portfolio of debt that is insured should strengthen the lending institution. It should also improve the flow of credit for farmers who agree to buy price insurance. This arrangement may be useful to countries seeking to improve the flow of credit to coffee (and other agricultural) sectors.

- *Adopting sales management techniques,* such as hedging strategies, for cooperatives that manage sales on behalf of their members. These techniques could have a double benefit. They enable a cooperative to pay a higher proportion of the market value of the coffee to a producer. They also protect the ability of the cooperative to make payments in the future.

- *Using inventory management.* Cooperatives and other producer organizations may not wish to sell all their coffee immediately after harvest. This way, they can spread their sales more evenly throughout the crop year and take advantage of price rises later on. This provides a level of flexibility in selling. Price risk management would allow producers to protect the value of their inventories from unexpected price declines during the crop year.

- *Aggregating crops,* so even farmers with a relatively small quantity of a commodity can enter into purchase contracts. Grain elevators and crushing plants are useful in this regard. Tools like this have arisen in developed countries, along with sophisticated purchasing contracts that have risk management tools embedded in them. Entities able to provide this type of purchasing arrangement rarely exist in the developing world. The potential for developing them needs to be discussed.

- *Using guarantee contracts.* There are arrangements in place between farmer organizations and users that provide price protection to these farmers; Fair Trade is one of them. Fair Trade guarantees a price to farmers that is not only higher (around \$1.20 – to \$1.30 per lb., when prices are \$0.50 to \$0.60 per lb.) but also fixed. This is another effective way to provide price protection to coffee producers.

Programs should be linked to technical assistance packages designed to assist farmers in understanding the role and operation of forward and physical markets, as well as the positive impact of price risk management instruments.

Other risk management instruments

Weather risk management. Weather often has an impact on coffee yields. Recent developments in weather-based insurance could allow producers to obtain protection against severe weather events such as hurricanes, mud slides, excess rain, or drought. Weather-based index insurance is based on the occurrence of a certain event that can measured and verified independently. This lowers administrative costs and reduces the usual of moral hazard and adverse selection problems often associated with traditional crop insurance.

Risk management and environmental sustainability. Sustainable production methods incorporating soil management and localized input methods can also provide useful risk management support, especially for poor rural smallholders. These methods diminish costly dependence on agrochemicals, reduce the impacts of drought, and encourage on-farm diversification for food security and income protection.

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Mr. BALLENGER. Mr. Lee, we look forward to your testimony. Go right ahead.

If you will pass the microphone to Mr. Lee?

Mr. FRANCO. Oh, yes.

Mr. BALLENGER. This is a cheaper place. We do not have but one microphone.

STATEMENT OF FRANKLIN LEE, DEPUTY ADMINISTRATOR FOR COMMODITY AND MARKETING PROGRAMS, FOREIGN AGRICULTURAL SERVICE, U.S. DEPARTMENT OF AGRICULTURE

Mr. LEE. Thank you, Mr. Chairman. I would like to have my full statement entered into the record, but I would like to read just a few remarks and highlights on those remarks.

Mr. BALLENGER. Without objection.

Mr. LEE. Mr. Chairman, Members of the Subcommittee, I am very pleased to be here today to discuss the world coffee situation with the Subcommittee.

The U.S. Department of Agriculture would like to be as helpful as possible to the Subcommittee with regard to information on coffee imported into the United States. The USDA's Foreign Agricultural Service tracks the supply and demand of coffee and forecasts production for the current year. USDA sets quality and grading standards for many food and agricultural products. However, USDA has no such standards for coffee.

Today's world coffee situation is characterized, as you pointed out so eloquently, by record production and low world prices. Producers around the world face a bleak situation. Many are being forced to abandon their coffee trees or lower their production costs in order to survive. Governments also face difficult consequences. Rising unemployment and reduced export earnings are hurting the budgets of many countries.

This year, this crop year, 2002–2003, world coffee production is forecast to increase at a record 10 percent over last year, fueled mostly by the increases from production in Brazil. The global supply, which includes carry in stocks plus production, are forecast to reach nearly a 6-percent increase over the previous year, again fueled by the increase in production from Brazil. We have not seen supplies at this level since the early 1990s. According to our assessment, this situation is not likely to lessen any time soon.

Although world coffee exports are forecast up by nearly 4 percent, and again this is fueled by production in Brazil, the bottom line is that export growth is not going to boost prices, given especially that the rise in production, along with record price and static consumption levels, will mitigate that.

World coffee consumption has been stable in both the world and in the United States in recent years. Due to a lower supply situation, coffee prices continue to decline. Brazil's arabica—you pronounced the word correctly, sir—is down 17 percent from last year and down over 75 percent from 1997.

According to some reports, inflation adjusted prices for coffee beans are now, as one of the Committee Members mentioned earlier, at a 100 year low. That is absolutely correct. These low prices are severely affecting countries that depend heavily on coffee export earnings.

Producers in Central America and Africa have been particularly hard hit as coffee exports are crucial to export earnings. Some countries in Africa reportedly realize 60 to 70 percent of their export earnings from coffee. Some countries have been trying to help farmers by assisting them to diversify into other crops, but farmers are reluctant to give up their coffee trees. It has taken them many years to get their trees into production, and in some countries there are very, very few alternatives, as you pointed out.

I appreciate the opportunity to present this information to the Committee. I will be happy to answer any questions that you may have. Thank you.

[The prepared statement of Mr. Lee follows:]

PREPARED STATEMENT OF FRANKLIN LEE, DEPUTY ADMINISTRATOR FOR COMMODITY AND MARKETING PROGRAMS, FOREIGN AGRICULTURAL SERVICE, U.S. DEPARTMENT OF AGRICULTURE

Mr. Chairman, members of the Subcommittee, I am pleased to be here today to discuss the world coffee situation.

The U.S. Department of Agriculture would like to be as helpful as possible with regard to information on coffee imported into the United States. The United States is a net importer of coffee, the largest single user in the world. Our private sector imports coffee from all over the world to keep pace with domestic demand.

USDA's Foreign Agricultural Service tracks the supply and demand of coffee and forecasts the production for the current year. USDA sets quality and grading standards for many food and agricultural products. However, USDA has no such standards for coffee.

PRODUCTION AND SUPPLY UPDATE

Today's world coffee situation is characterized by record production and low world prices. Producers around the world face a bleak situation. Many are being forced to abandon their coffee trees, or lower their production costs in order to survive. Governments also face difficult consequences: rising unemployment and reduced export earnings are hurting the budgets of many countries.

This crop year, 2002/03, world coffee production is forecast at a record 122.1 million bags (1 bag = 60 kilograms or 132.276 pounds), up 10 percent from the previous year's level, fueled largely by record production in Brazil.

In addition to Brazil, major production increases this year compared to last include: Mexico, up 500,000 bags; Nicaragua, up 300,000 bags; Thailand, up 157,000 bags; Kenya, up 130,000 bags; and Madagascar, up 100,000 bags.

Producers being pinched by low prices have reduced tree maintenance, which has led to lower yields. Countries where production is forecast to decline in 2002/03 include: Vietnam, down 1.75 million bags; Dominican Republic, down 200,000 bags; Indonesia, down 200,000 bags; Zaire, down 170,000 bags; Honduras, down 150,000 bags; India, down 150,000 bags; Costa Rica, down 114,000 bags; and Colombia, down 100,000 bags.

Total global supply (carry-in stocks plus current production) in 2002/03 is forecast to reach 143.6 million bags, up nearly 6 percent over the previous year, and again largely as a result of the large Brazil crop. We have not seen coffee supplies reach this level since 1991/92. Brazil is expected to account for about 37 percent of total supplies, with Colombia's and Vietnam's share forecast at 8 percent each. In comparison, during 1991/92, Brazil's share of total supply was 34 percent; Colombia's, 16 percent; and Vietnam's share, only 1.5 percent. This oversupply is not likely to lessen anytime soon.

Although world coffee exports are forecast up nearly 4 percent over last year's, the bottom line is that export growth will not boost prices, given rising production and near-record supply levels. Total coffee exports in 2002/03 are forecast at 92.0 million bags, up nearly 4 percent over 2001/02, with Brazil accounting for most of the increase.

I would like to take a few moments to highlight the current situation in the two leading Western Hemisphere coffee producing countries.

BRAZIL

Brazil's coffee production forecast in 2002/03 (July-June) is a record 46.9 million bags, up 39 percent, or 13.2 million bags from the previous year. The arabica coffee production is forecast at 35.5 million bags, while robusta production is forecast at 11.4 million bags.

Brazil's coffee exports are forecast at 28.6 million bags, a 15-percent increase compared to last year. Brazil's coffee is expected to remain competitive internationally due to the availability of product, low domestic prices, and the steady devaluation of the Brazilian currency compared to the U.S. dollar.

COLOMBIA

Colombia's coffee production for 2001/02 was estimated to reach 11 million bags, up from 10.5 million in 2000/01. This increase, in the face of low global prices, is because 200,000 hectares of coffee trees renovated during the 1998–2000 period under a National Coffee Federation incentive program are now entering into full production. However, in 2002/03, production will not benefit as much from this factor and will begin to decline due to reduced use of inputs.

Production in 2002/03 is forecast at 10.9 million bags. If low international prices persist, further decreases in production are almost certain. The historically low international coffee prices over the past year and a half, which on average are below the break-even point for growers, have forced farmers to sell off assets to generate working capital. The combination of reduced farmer assets, difficulty in obtaining credit, and lack of resources in the National Coffee Fund make any recovery in Colombia's coffee sector largely dependent upon a recovery in international prices.

In addition, low international prices have eliminated the contributions made by growers and exporters to the National Coffee Federation. As a result, many of the social and production-related programs supported by the Federation have been almost completely eliminated, with the remaining programs dependent upon fund transfers from the government and loans from overseas financial entities.

COFFEE PRICES

I would now like to comment briefly on the price situation.

Due to the over supply situation, coffee prices continue to decline. Brazil's arabica coffee price (the type most widely consumed in the United States) in June 2002 was $.43 per pound, down 17 percent from the June 2001 level, and down over 75 percent from the June 1997 level. According to some reports, inflation-adjusted prices for coffee beans are now at a 100-year low. Low coffee prices are severely affecting those countries that heavily depend on coffee export earnings. Unemployment is increasing as some farmers have abandoned their coffee trees. Many growers report that production costs are above the market price. As a result, lower fertilizer and chemical inputs, such as pesticides, are affecting yields. In those countries that produce higher quality arabica coffee beans, this has resulted in a drop in supplies. Producers in Central America and Africa have been particularly hard hit as coffee exports are crucial for export revenue. Some countries in Africa reportedly realize 60–70 percent of their export earnings from coffee.

Some countries have been trying to help farmers by helping them to diversify into other crops, but farmers are reluctant to give up their coffee trees. It has taken them many years to get their trees to produce and in some countries there are few alternatives.

DEMAND

World coffee consumption has been stable in recent years, averaging about 111 million bags per year. U.S. coffee consumption has likewise been stable, averaging about 18 million to 19 million bags per year.

However, due to large carry-in stocks, U.S. coffee imports declined nearly 11 percent during calendar year 2001. The United States continues to buy primarily from Brazil, Colombia, and Vietnam.

CONCLUSION

I appreciate the opportunity to present this information to the committee. I would be happy to try and answer any questions you might have.

Mr. BALLENGER. Thank you. In the discussion we have had and the statements we have had, the price is going down for everybody.

Mr. LEE. Yes.

Mr. BALLENGER. The people cannot make a living off of the coffee that they have in the small countries, and yet in Brazil it appears that the continued increase in production of coffee must be making money for those people. Is it because of the volume, the area that is in growth?

Is there an answer to the question as to why they can produce more and still continue to make money while the rest of them cannot?

Mr. LEE. I am not sure if there is a correct answer to that, Mr. Chairman, but it is not only in coffee that Brazil continues to produce excess quantities and compete in other commodities directly with us. Soybeans, for example.

Mr. BALLENGER. Yes, I know.

Mr. LEE. In the case of coffee, my only assumption or my only assertion here is that perhaps they are trying to expand production in those regions simply to provide work for laborers and provide a way for farmers to make some money.

As we have pointed out here in both statements, world low prices caused them to take a serious look at what is happening there. Their production is increasing again this year, up by I think it is 43 million bags, which is a tremendous amount of coffee that is coming out of Brazil. I am not sure if there is a right answer to that.

Mr. BALLENGER. I drink four or five cups of coffee a day, and I have never seen the price go down. The bottom of the market has collapsed. Maybe I should get off the powdered coffee and start grinding my own or whatever it is you do.

Mr. LEE. Well, you know, Starbucks is Starbucks.

Mr. BALLENGER. I do not use Starbucks. It is too expensive.

Mr. LEE. They are doing very well, though, sir.

Mr. BALLENGER. Right. Is there a reason why? I mean, it must be highly profitable for somebody. I am a businessman. If my raw material prices go down and I do not cut my price, I make more and more money. Is that likely to be occurring?

Mr. LEE. That is good, pure economics, sir, and that is absolutely correct. We have noticed in many countries that economics do not always enter into the picture.

I have spent a lot of my time in Central America and South America. Many of these governments want the rural population to stay in the rural areas, so they do have some funds, and they do depend on other international donors.

USAID is one of the organizations that supports their efforts to increase the livelihoods of the people of the rural areas. They simply do not want their population to migrate into the cities. This is one way to keep the rural areas occupied. You are right. I have no answer to your question, sir.

Mr. BALLENGER. Yes, sir?

Mr. FRANCO. If I could comment on this, this is more Mr. Lee's area, but the reason, Mr. Chairman, you do not see a lower price for coffee, although the prices are very low, is that the actual commodity is a very small portion of the actual cost of the product that we purchase here, the coffee that is either purchased by the cup or by the can or coffee beans here. That is one of the issues that we are trying to tackle at USAID.

I was at a coffee producers and growers conference in California a couple of months ago, and in Latin America the number of middle men and the procedures for export were just staggering. In Ecuador, Colombia and so forth, the number of processes, the taxes, the requirements to export the product were very, very high. That is where most of the costs were being incurred.

Part of our competitiveness initiative and our efforts to streamline economic policies in Latin America in preparation for the Free Trade Agreement for the Americas is to address those concerns. That would hopefully lower the price for the consumer in the United States, but that is not our ultimate goal. It is to leave more in the pockets of the people who produce the coffee.

Mr. BALLENGER. A penny more on a cup of coffee is not going to hurt anybody in this country.

Mr. FRANCO. Correct. That is right.

Mr. BALLENGER. Let me ask one more question. Since the Agriculture Department does grade just about everything else we eat, how difficult would it be? My understanding is that especially the Vietnamese coffee comes almost completely ungraded with all kinds of strange and wonderful things mixed in with the coffee.

If grading were used, possibly the price of really well produced coffee might go up. What difficulty is there in grading coffee, and would that solve the problem in your opinion?

Mr. LEE. At the Department of Agriculture, we have an agency called the Agricultural Marketing Service that is responsible for setting grades and standards for the products that are produced in this country.

I will not pretend to speak for them here, but I think that it would be a very good question to ask them to take a look at that because that is probably a possibility. I cannot commit their resources, but certainly that is something they can look into and review. I am not sure that it is going to reduce cost in this country or perhaps——

Mr. BALLENGER. I do not think we are really worried about cost in this country.

Mr. LEE. Not cost. I mean prices in this country or raise prices in the exporting countries because for this country we are, as you pointed out in your opening remarks, sir, the world's single largest importer of coffee. The duty on coffee coming into this country is very low.

The way coffee is purchased in the private sector, we have you might say a de facto set of standards because coffee produced or arabica produced, for example, in Brazil may garner a premium price versus that produced in another region of the world.

A.M.S. is the organization that would have to be asked to look into that situation.

Mr. BALLENGER. Mr. Delahunt?

Mr. DELAHUNT. Thank you, Mr. Chairman.

Reflect on the price to the consumer staying the same and the price paid to the producer, to the grower, is going down. Somebody is making money somewhere.

I have before me a *Wall Street Journal* article. Let me just quote one paragraph.

"In the U.S. and the rest of the developed world, the price of coffee on supermarket shelves has fallen, but considerably less than the price paid to growers. That translates into record sales and profits for some of the corporations that process and market coffee."

It goes on to say that there are four giants, Proctor & Gamble, Philip Morris, Kraft, Sara Lee and Nestle, and they control about 40 percent of the world's coffee. Do you think it might be a problem of concentration?

Mr. FRANCO. I will just take a stab at part of the question.

Mr. DELAHUNT. I mean, there is a big chunk of money there.

Mr. FRANCO. Yes. I understand. Yes.

Mr. DELAHUNT. Profits are going up. We all believe in free enterprises and free trade, but it does not sound to me—let me make a supposition.

Is it possible that there is over concentration by these giants in terms of the marketplace itself, thereby resulting in substantial corporate profits while the producers and the growers and the campesinos in these various countries are really having a problem?

Mr. FRANCO. Mr. Delahunt, I will try to answer that question within the purview of my agency's mandate and work and expertise. Some of this has to do with things outside what we do, but it is a good question.

A couple things. I am reminded of the same questions that were asked in our own country with respect to products such as cereal that people purchase while commodity prices for wheat and corn decline precipitously. Consumers in this country continued to pay $3 and $4 and $5 for a box of cereal. I know your colleague, Mr. Schumer, held some hearings on this some time ago and was very concerned. How could this be happening?

From the standpoint of USAID and what we do, which is development work in Latin America, and I tried to respond previously to another question that the Chairman had, we see rising costs in terms of the transportation and the number of regulations.

Mr. DELAHUNT. I understand that, Mr. Franco, but what the *Wall Street Journal* is saying is that—and I will grant you that maybe there are rising costs—the profits are increasing even more significantly.

Mr. FRANCO. Right. I really——

Mr. DELAHUNT. I can appreciate that maybe the costs are a component, but——

Mr. FRANCO. Right.

Mr. DELAHUNT [continuing]. This is the *Wall Street Journal*, you know, the paper of record of capitalism. We know we can trust it.

Mr. FRANCO. I know.

Mr. DELAHUNT. Everything in here has to be the truth.

Mr. BALLENGER. Let me just preface this. I own stock in several companies he has mentioned. I do not want the market to collapse.

Mr. FRANCO. Let me just say I do not know the answer to that. I really do not know what the profits have been for the companies, but I will say this. I have spoken to producers in not only Latin America, but producers here. Many of them, by the way, are Americans that own stock. They are losing money, a lot of money.

What they have told me repeatedly is that the biggest impediment has been the middle men. That is what I have been told, and I have been told that in Ecuador, in Central America, in Colombia. You do not know how many people are taking a piece of this pie.

I asked the same question. Why is it still $3 or $4 for the cheap coffee? The answer to that is there are too many people taking——

Mr. DELAHUNT. If that is part of the solution, I will accept it. I am unaware. What I am saying is our purpose here in terms of trying to address this problem is not to increase the profits of, you know, Nestle and Sara Lee, but to insure that those who produce, those who grow in Central America and South America are surviving because it is our national interest that there be stability.

Mr. FRANCO. Sure.

Mr. DELAHUNT. What we see happening in South America today, and we can start with Argentina and go all the way up to Central America. You know, let us be really honest. We are on the verge of seeing an implosion in terms of that economy. We are really in trouble big time.

Mr. FRANCO. I cannot agree enough. I will turn to Mr. Lee in just a moment, but I will say this. Based on our discussions with the coffee buyers in this country, and they are the large ones as well as the specialty coffee, and I know you have other witnesses today that will testify on this. I can tell you that industry is concerned about what the profits are.

I think the industry is very, very concerned with what has happened to coffee prices. They are very concerned about it. They have a vested interest in the long term to make sure that there is stability in the market and there are reliable and good producers.

Mr. DELAHUNT. Let me just finish up with a comment because I do not want to take any more time. I think it is really incumbent on the Administration, if you will, to call for a coffee summit to bring all of the stakeholders to the table to sit around whether it takes 2 or 3 days and really take a hard look at this problem.

Maybe we even have to go beyond that because simply to extract coffee from these economies is a false road to go. We ought to be looking overall in terms of, as you suggest, diversification, et cetera.

Thank you, Mr. Chairman.

Mr. BALLENGER. Thank you, sir.

Mr. Gilman?

Mr. GILMAN. Thank you, Mr. Chairman.

Mr. Franco, a constituent of mine sent a report that people in the Guatemala Highlands are in dire need of food because of the coffee crisis. Have you explored that? What is the incidence of hunger in Central America as a result of all of this?

Mr. FRANCO. Yes, Mr. Chairman, we have explored that, and we have responded to it. I can tell you that the food storage situation in Guatemala and Honduras is quite serious. We have provided approximately $20 million of emergency assistance to the region. Guatemala is, you are correct, sir, the most acutely hit. We have a coffee crisis compounded, as I said in my testimony, with a very serious drought, so we have the worst possible situation.

Our response has been working with Central American governments, particularly in Guatemala and Honduras, to provide a significant amount of emergency food and medical supplies and other relief.

Mr. GILMAN. Have those supplies been distributed already?

Mr. FRANCO. Yes, they have. We have provided $20 million in emergency supply. I will add that this is the right thing to do, but I know Members of the Committee are right. This is a band-aid. We are not viewing this as the long-term solution.

Mr. GILMAN. Mr. Franco, how is USAID addressing the situation by which the farmers are abandoning coffee production and shifting over to illicit crops and narcotics?

Mr. FRANCO. I know this is a very keen concern of yours, sir, and you have asserted a lot of leadership particularly in Colombia and elsewhere.

I can report to you that we have not yet seen that as a problem in Central America. However, it looms as a very serious concern. We continue to monitor it. That is why we want to make the investments we can right now to address the coffee crisis there.

Unfortunately, in Colombia this is a very serious problem. We are trying to address this principally through some diversification. The downside about Colombia is it is a current problem and is a concern. I have to report that to you. The positive side of Colombia is unlike Central America, the Colombian economy is larger, more sophisticated. There are other opportunities for diversification in the rural sector.

Indeed, my visits to Colombia as well are even to set up small production activities that are not agriculturally related in the rural areas of the country, so we will try to do this. We are very concerned about it particularly in Colombia.

Mr. GILMAN. Is there any alternative crop program for these countries?

Mr. FRANCO. When we refer to alternative development, we have learned a lesson at USAID, and that is not to simply identify alternative crops that might have short-term economic benefit, but are unsustainable over the long-term.

We look at that in consultation very closely with our partners, our non-governmental organization partners in Colombia, as well as with their PNDA.

Mr. GILMAN. Thank you, Mr. Chairman.

Mr. BALLENGER. Congressman Farr? I know we have cut your time short, but fire away.

Mr. FARR. Thank you very much.

Mr. Lee, let me ask Mr. Franco first. In USAID, how many people work in USAID?

Mr. FRANCO. In the entire agency?

Mr. FARR. Yes.

Mr. FRANCO. We have approximately 1,200 direct hires, and then in addition to that we have Foreign Service nationals and contractors.

Mr. FARR. In your facility here in Washington, do you serve fair trade coffee?

Mr. FRANCO. Do we serve fair trade coffee? We do not serve coffee.

Mr. FARR. Where do the 1,000 people drink coffee?

Mr. FRANCO. I believe they—what is that called? County Buck or Buck County is downstairs in a food court. We do not have coffee. We do not purchase coffee at USAID for employee or visitor consumption.

Mr. FARR. Well, you lead by example. If you are going to do a stakeholders meeting, maybe you ought to get the 1,000 stakeholders to drink coffee to use their market leverage and insist that the vendor sell that coffee that you want the rest of the world to buy.

Mr. FRANCO. I will look into that, sir. I do not know what they are serving downstairs, but I will look into that.

Mr. FARR. Congress is serving it just for that same purpose.

Mr. FRANCO. Okay.

Mr. FARR. I mean, I think you do have to lead by example.

Mr. FRANCO. It is a private vendor downstairs, but I will do that.

Mr. FARR. So is the one here.

Mr. FRANCO. Okay.

Mr. FARR. They do not get to do business here if they do not do it by our rules.

Mr. FRANCO. Okay.

Mr. FARR. Mr. Lee, first of all, how many ag products do we import that have purity standards?

Mr. LEE. Purity standards?

Mr. FARR. Grade standards.

Mr. LEE. The products that we call purity standards are under the purview of the Food and Drug Administration, so the food and cosmetics.

Mr. FARR. But we have grades, though.

Mr. LEE. We have grade incentives for products that are produced in this country and if there are products that are imported, sir, into this country that compete or complement what we produce here in this country.

Mr. FARR. But we could adopt the International Coffee Organization in the European countries where they have 95 percent of coffee imports have to be coffee beans? We could just do the same thing here?

Mr. LEE. That I would have to defer to our investigators over at the Agricultural Marketing Service.

Mr. FARR. Would you check with them?

Mr. LEE. Yes. Absolutely, sir.

Mr. FARR. Also, would you check for me to see whether Sara Lee, Kraft, Proctor & Gamble or Nestle USA get any benefits from the Department of Agriculture in market promotion or loan programs or inspection or certification or anything like that?

Is there anything that the USDA does to assist these companies to do their job well in the United States? To me, that sounds like fun.

Mr. LEE. It sounds like fun. Sir, within the Foreign Agricultural Service I oversee most of the market promotion budgets.

Mr. FARR. As a Member of the Appropriations Agricultural Subcommittee, I oversee your budget.

Mr. LEE. Yes, sir. I appreciate what you have done this year in increasing our budget.

Mr. DELAHUNT. That is so far, though. There is another round to go.

Mr. LEE. Another round to go.

Mr. FARR. If you could find that out, I would appreciate it, too.

Mr. LEE. Okay. We can do that.

Mr. FARR. Thank you very much. Thank you, Mr. Chairman.

Mr. BALLENGER. Let me just tell everybody that we have three votes that will probably take a half an hour. This panel, we greatly appreciate your being here with us. If the second panel would bear with us, we will be back in roughly a half an hour.

[Recess.]

Mr. BALLENGER. Mr. Silva, we will let you go first knowing that you have time limits. Let me introduce you, if I may.

Mr. Silva, a native of Colombia, is the general manager of the National Federation of Colombian Coffee Growers. The Federation invests in the research and development of coffee plants, provides technical and other assistance to help foster the production of high quality coffee by the Federation's 500,000 coffee farmers.

Mr. Silva earned a degree in Political Science from the University of the Andes in Bogota, Colombia, and holds a doctorate degree from Johns Hopkins University of Advanced International Studies.

Knowing that you have a time schedule that you have to meet, Mr. Silva, we will go ahead and start with you and follow with the others after you finish.

STATEMENT OF GABRIEL SILVA, GENERAL MANAGER, NATIONAL FEDERATION OF COFFEE GROWERS OF COLOMBIA

Mr. SILVA. Thank you very much, Mr. Chairman. I am very pleased to be here, and I would like to submit my written statement for the record if I may.

I want to thank you for this hearing. It has been decades since this Congress took up the issue of coffee and discussed the issue of coffee. I think that in itself is a very strong signal that we are experiencing very difficult times, and we in Colombia thank you for that effort.

I must say that this is not the first time that I have appeared before this Committee. In my previous incarnation as National Security Advisor of Colombia and Ambassador to the White House, I came here several times to request your support, to request your help and to request your participation in a fight that was also very difficult when we confronted terrorism from the cartels.

We were able jointly to devise a way to confront the threat and be successful. Now the cartel leaders are either dead or in jail, and most of it was achieved through the joint cooperation, the joint understanding of a common threat.

Now, I am coming back to ask you to also understand this problem, and I have seen in your statement, and Congressman Delahunt, Congressman Farr and Congressman Gilman's statements, a clear message that encourages us in believing that you are aware of the issue and that you are aware of the very difficult circumstances that we are currently experiencing in the coffee growing countries.

The crisis is characterized by low prices, as you have all said, but these low prices do not impact all the coffee growers in the same manner. The segment of the coffee industry that is hardest hit is the coffee growing countries that offer and provide the best quality coffees.

Why is that? Because those coffees require a lot of investments, a lot of effort, a lot of labor to make sure that it is picked right, it is dried right, it is processed right and make sure that it protects and keeps its quality. Those countries are in general higher cost producing countries, and they are certainly affected by these low prices. They cannot survive at the current prices.

We have been in this situation for the last 5 years. I personally have witnessed the impact on the social and political situation in Central America and, of course, in my own country of Colombia. We just this week had a meeting of the countries of Mexico, Central America and Colombia, and all my colleagues from those countries were desperate to send you also a message and to ask me to bring you their voices and to join their voices to seek understanding and cooperation between the U.S. and our countries.

The income derived from coffee has fallen more than 50 percent in these countries, as you have said. I want to highlight the fact that 10 years ago the global coffee industry was worth around $35 billion, and the coffee growers received $11 billion, almost a third of it.

Nowadays, the global coffee industry is worth approximately $55 billion, and the coffee producing countries get around $7 billion. You can see that the share——

Mr. BALLENGER. Seven?

Mr. SILVA. Seven. Yes, sir. The share of the income generated by the coffee business is going down significantly and is really much less both in percentage and absolute terms than in the past.

I want to highlight that this issue goes beyond just economics, particularly for my country. As was mentioned here, there is a serious threat that with the reduction in income from coffee that coffee growers who actually live in areas that are growing illicit crops, turning to those crops, and I have to report that unfortunately that is happening. I brought with me some pictures that I want to show you that a technician that we sent to certain areas took to illustrate what is going on.

These are seedlings. Half of what you see there are coca trees. Half of them are coffee trees. These are coca trees surrounded by coffee trees, and they basically protect the coca trees with these crops. You see here a row of coffee trees followed by a row of coca trees.

This is just an example of some of the many areas in which we are perceiving that. Thank God it is still located in a marginal area, but we see the pressure from drug traffickers and paramilitary groups and guerilla groups to force the peasants out of their tradition of growing coffee into illegal crops. That is a reality. That is something we have to confront. The best way that we know to do that, to support coffee growers, is basically trying to improve their income and their revenue.

We think that the problem has many origins. One origin in fact was mentioned here, an excessive production from certain sources that are not the best quality sources. Also, there is an increasing concentration that was mentioned here on the side of the consuming side of the industry, and that has reduced the options with some of the producers.

Also the presence of bad quality coffees in the market that are not really coffee. They are really a mixture of byproducts and other materials that I think are not appropriate to be consumed by anyone and certainly not by the U.S. consumer. I do not want to extend myself too much, and I prefer to address your questions, Mr. Chairman.

We believe that we need to find solutions that are a positive sum, not zero sum. Many people see the prices of coffee as a zero sum problem. Whatever the producer wins, the industry loses.

We are seeing that there are ways to build solutions in which we all can win and we can support and defend an industry that is critical for all of us. That is why we should talk more about a coffee community more than coffee industry because everyone who is involved in the coffee industry has a stake in making this viable and long-term.

We believe we can find solutions that are the result of dialogue, but at this point we also are convinced that we need very strong and quick action on very particular items. One of them is the establishment of quality standards. If we are able to establish minimum standards such as the ones adopted by the ICO for export coffee, certainly you it will serve two purposes. One, you will help the peasants who produce the best coffees to protect their participation, their share of the market.

Second, you will do something very important, too. You will allow the American consumer to know what is in their cup. When they serve a cup in the U.S., it is very difficult to know what you are getting. I think the American consumer has the right to know what he is drinking.

That is what we want. We do not want quotas. We do not want subsidies. We just want the ability to tell the coffee consumer that we are offering a quality coffee and that he knows what he is drinking. That simple measure will be in itself a tremendous boost for the industry and will support the coffee growers not only in Colombia, but in many other countries.

Mr. Chairman, I will stop here. I want to just say that a very, very deep and serious political and social crisis is brewing under the coffee trees.

Thank you very much.

[The prepared statement of Mr. Silva follows:]

PREPARED STATEMENT OF GABRIEL SILVA, GENERAL MANAGER, NATIONAL FEDERATION OF COFFEE GROWERS OF COLOMBIA

Mr. Chairman, Members of the sub-committee.

Good Afternoon. My name is Gabriel Silva. On July 15th I became the General Manager of the Colombian Coffee Federation. I am very pleased that one of my first official acts as General Manager is to appear before this subcommittee to discuss the crisis in the coffee industry. I have to admit, agreeing to take the helm of this venerable federation of coffee growers in the midst of the worst crisis ever to hit the coffee industry was a decision that gave me some sleepless nights. However, the concern that members of this subcommittee have shown for the crisis, particularly Chairman Ballenger and Congressman Farr, is very gratifying and provides me with optimism that together we can turn this crisis around.

TESTIMONY OVERVIEW

I want to focus on a few key points about the coffee crisis that has brought us all here today. First, this crisis is devastating rural areas in Colombia, Central America and Mexico. Second, the crisis will have serious economic and foreign policy repercussions for the United States. Third, down the road, the crisis will injure the U.S. coffee industry and U.S. consumers. Fourth, the crisis cannot be resolved solely by market forces because, to a great extent, the crisis is the result of market distortions and market interventions. Fifth, this Congress's can and should act to help resolve the crisis.

EFFECTS OF THE COFFEE CRISIS ON COUNTRIES IN THE WESTERN HEMISPHERE

First let me speak briefly about what I know best, the impact of this crisis on coffee growers and others who depend for their livelihoods on coffee production. Coffee growers around the world are suffering through the worst crisis ever experienced by the coffee industry. Prices received for green coffee are at historical lows. Farmers in Latin America are now receiving less than 50 cents a pound, an amount far below their 80-cent a pound production and export costs and the average of 96 cents received in the past. That translates to a devastating loss of income for countries like Colombia. To put it in perspective—in the 1980's when consumers spent about $30 billion a year on coffee, coffee producers share was one-third or $11 billion. Today consumers spend about $56 billion on coffee annually but growers receive less than one-sixth of that—about $7 billion a year. Colombia lost close to half of its coffee revenue in the last decade. Unfortunately, these lower prices have not been passed on to consumers, who are being forced to drink lower quality coffees at significantly higher prices.

Coffee is very important to the economies of Latin America. In Nicaragua, coffee accounts for 7 percent of GDP. In Colombia it accounts for 2 percent of total GDP and 22 percent of agricultural GDP and 35 percent of rural employment. For comparison purposes, consider that all of U.S. agriculture accounts for less than 2 percent of GDP and steel, an industry with economic woes that has recently captured much attention, accounts for less than 1 percent of U.S. GDP. But these are only numbers; there also a dreadful human toll.

The tales of the crisis from coffee growing regions around the world are alarming. Mexico has tens of thousands of small coffee farmers. This year a significant portion of the crop in Mexico may not be harvested because the farmers would lose money on the harvest. Chiapas, the southern state where the notorious sub-commandante Marcos and his Zapatista Rebels operate, is the hardest hit. Farms lay untended and many unemployed former coffee farm workers inevitably attempt the dangerous migration to the United States. In Nicaragua, thousands of small growers face losing their land and have had to lay off thousands of pickers and other workers. There is no safety net for these workers. In Nicaragua's coffee regions, coffee workers are struggling to survive by panhandling along the Panamerican Highway. In El Salvador and Honduras, the misery is similar. If something is not done, malnutrition and homelessness are sure to create long-term problems in Central America.

These problems are not limited to Latin America. Some countries in Africa are even more dependent on coffee. Uganda and Burundi, for example, rely on coffee for more than two-thirds of their export earnings. Throughout Africa coffee farmers cannot afford medical care, are taking their children out of school and are unable to maintain their coffee trees. Loss of coffee earning is undermining the benefits of debt relief given to African countries.

In my country, the toll in human misery has not been as severe because the Colombian Coffee Federation provides a safety net for farmers by supporting the price of coffee with profits earned in better times. However, the Federation cannot fully compensate for today's low prices nor can it continue to provide price supports forever. In fact, our recent efforts have exhausted decades of savings. In coffee regions of Colombia, the unemployment rate is growing and incomes are falling. The Federation, which has traditionally supplied funding for health, education and infrastructure projects in coffee regions, is no longer able to provide such funding. Similarly, the funding for technical assistance and agricultural extension services to coffee farmers has also dried up. What may be the most immediate and serious impact of the crisis, however, is the political and social instability that is beginning to infiltrate the coffee regions of Colombia.

I don't need to tell this Sub-Committee that Colombia is a country affected by terrorist violence arising from drug trafficking activities and the related guerrilla and paramilitary groups, such as the FARC. What may be news to you, however, is that the coffee crisis is aggravating the problems in Colombia and contributing to destabilization of rural areas. Despite the violence and instability in other regions of the country, Colombia's coffee regions have traditionally been havens from the violence that plagues other rural areas. We know the drug traffickers are actively recruiting coffee farmers to grow opium poppies and coca trees. Kidnappings in the regions have increased. There are more than 500,000 coffee farmers in Colombia and more than 3 million people whose livelihoods are dependent on coffee. If coffee prices are not turned around, the coffee regions are at risk of becoming mired in narcotic cultivation and violence.

EFFECTS OF THE CRISIS ON THE UNITED STATES

The crisis has serious domestic and foreign policy implications for the United States. From an economic standpoint, the traditional producing countries in Latin America represent an important export market for U.S. goods. From a foreign policy perspective, the United States depends on political stability in coffee producing regions—rural poverty drives not only guerillas and narco-terrorism but migration—both to the United States and urban areas in Colombia and Latin America.

Although they may be unaware of the lower prices paid to coffee growers, U.S. consumers are already experiencing the effects of the declining producer prices and a deterioration in the quality of coffee. A smaller and smaller percentage of the coffee imported into the United States is flavorful washed arabicas from Colombia and Central America, resulting in a less appealing and flavorful coffee cup for the average consumer. If the crisis continues it will be the Colombian and Central American producers of washed arabicas who are forced from the market. The labor intensive, careful process of preparing the highest quality beans is costly and cannot be maintained indefinitely at current prices. It is a vicious cycle. If washed Arabicas, which are widely recognized as the highest quality and best tasting of coffees, are forced from the market it will be impossible to increase coffee consumption. Washed arabicas give coffee the flavor consumers desire and expect. The current market conditions conspire to expropriate the right of the consumer to enjoy a full flavored, rich cup of coffee.

CAUSES OF THE PROBLEM

The problem has been created by explosive growth of coffee production, in robusta and unwashed arabica producing countries. Speculative and government-driven expansion of areas dedicated to coffee-growing is harming all of us.

At the same time, we are seeing ever growing amounts of low quality coffee (that is coffee filled with defective, moldy, unripe beans and foreign matter). The oversupply, low price, poor quality combination has set off what you might call 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. More coffee means lower prices. In this market, lower prices do not raise consumption because eventually, as quality declines the coffee industry loses consumers, plus, the lower prices paid to farmer are not being passed on to consumers but retained as large margins for the middlemen and retailers.

SOLUTIONS

Some producing countries have tried to take action. They have retained part of their crops and agreed to a plan to destroy the lowest quality coffee produced in their countries. Last week I attended a ceremony of voluntary destruction of low-quality coffees in Costa Rica where the washed arabica producing countries of the Americas issued a strong joint statement asking the United States not to abandon them. I have attached a copy of the resolution to my prepared statement. I have also brought a sample of the destroyed coffee with me to illustrate the kind of coffees we want out of the market. But past experience has taught that unilateral action by coffee producing countries will not address the problem. Producers cannot beat this problem with out action by the consuming nations, particularly the United States.

Furthermore, we recognize and appreciate the efforts made by some U.S. roaster/retailers like Starbucks and Procter & Gamble who have instituted targeted aid programs for some coffee growers. However, small, targeted programs are not going to resolve this crisis. The crisis is world wide and systemic and requires steps to create a level playing field for washed arabica producers. Social and political unrest is rapidly brewing under the coffee trees around the world. We need decisive action.

I am here today to request the commitment of the United States in adopting and implementing concrete and far reaching solutions. For there to be free and fair trade in coffee (fair to producers and consumers) coffee quality cannot be allowed to decline. Producers cannot be allowed to sell defective beans and foreign matter at fire sale prices while calling it coffee. Importers cannot be allowed to fill cans with defective beans and call it coffee. At present, U.S. standards are all but non-existent. Any mixture of moldy, black, under-ripe, broken and insect damaged beans can be marketed as coffee. A standard in the U.S. that prevented sale of defective beans and foreign matter would level the playing field for traditional coffee producers who have long worked to ensure that end consumers in the United States are receiving high quality and pure product. We believe that such measures will benefit the entire industry. The outcome will be social justice on the coffee farm and a happier and healthier consumer.

Thank you again Mr. Chairman.

Mr. BALLENGER. I do not know what your time schedule is, sir. They told me that you are short of time, and you might have to leave.

Mr. SILVA. No, Mr. Chairman. This is my priority. I will stay here until whenever you decide.

Mr. BALLENGER. I am just wondering. Maybe we ought to just go ahead and have the rest of the panel if you have time.

Mr. SILVA. Yes, sir.

Mr. BALLENGER. Ladies being first, let me introduce you. I have a written introduction here for you.

Colleen Crosby is co-founder and partner of the family owned Santa Cruz Coffee Roasting Company, a wholesale roasting and retail company. Ms. Crosby has traveled extensively throughout the coffee producing regions of Latin America, giving her a unique understanding of the coffee industry.

She has written a number of articles on the coffee industry and has produced a documentary on challenges facing coffee growers. Ms. Crosby received a Bachelor of Arts degree in Economics from the University of California-Santa Cruz.

Ms. Crosby, go ahead.

STATEMENT OF COLLEEN CROSBY, PARTNER, SANTA CRUZ COFFEE ROASTING COMPANY

Ms. CROSBY. Thank you, Mr. Chairman, and thank you, congressmen, for hearing this issue. From my travels, I really appreciate that I can feel honored as an American that this issue is being brought forward before our Congress.

I want to especially thank Sam Farr, who has been so encouraging and so supportive of these issues that are facing coffee growers.

Last Friday, in a congressional hearing here in the offices I heard a statement that I would like to quote again. Through the conduct of business, human happiness or misery is inextricably woven.

I am going to read some excerpts, and I would like to submit my total statement. During my first visit in January of last year to Nicaragua, I witnessed the hardships that the farmers suffered from the low prices; not enough food or clothing for their family, malnourished children whose smiles had missing teeth and were frequently sick because they lived in shacks with dirt floors that did not protect them from rain or cold.

During this tour of the coffee countries, I met Jaime Azcarate, a member of the Colombian Coffee Federation. As we traveled through Nicaragua I asked him. Are other coffee farmers suffering the same way in other countries? Are coffee farmers this poor everywhere? Can they not feed their families? Can they not clothe them? Are the schools closed in the coffee farmlands? What do the children do?

Jaime told me that the coffee crisis has affected all the countries in Central and South America he has visited. He said farmers are being abandoned, and farming families are fleeing to the cities. He also said that being poor in the city was even more difficult than being poor on a farm. In the cities, disease spreads rapidly, and gangs dominate the streets.

In Managua, we saw children living in playhouse-sized cardboard huts in parks and sniffing glue to diminish hunger pains. I could then understand why families clung to the farm to avoid the living hell of these horrific slums and replaced coffee with cocaine in order to keep their farm.

For the next 6 months, Jaime and I e-mailed each other almost daily. I received an e-mail from Jaime on the first round of layoffs in the Colombia Coffee Federation. He wrote that the women and men in the offices were crying as they were given their termination notices, that unemployment was around 20 percent in Colombia at the time, that these layoffs would increase the unemployment rate and that with armed conflict increasing there was no future.

Soon another layoff happened at the Federation and then another, and as the coffee prices continued to fall, still another. In another e-mail he wrote that the Federation had begun terminating critical social programs provided to the farmers. He was worried about the impact this would have on the farmers' communities and their future.

Shortly after the SCAA 2001 convention, the Colombian Coffee Federation invited me to Colombia. I visited mills, schools and farming communities. I met with the COSURCA farmers from Popayan in Southern Colombia whose families had been growing coffee longer than our family has been roasting it.

They remembered how decades ago their entire family sat at dinner together. They remembered their sons leading the family prayers. They remembered the pride of their fathers watching them learn the family trade and eventually taking charge of the family farm.

When coffee prices continued to crumble, farming coffee no longer provided food for their families. They were forced to continue with the only crop they knew could generate good cash income, one of the few crops that grows at these high altitudes and is also a cash crop, heroin poppies.

Their eyes conveyed the tragedy that soon followed. They told me that as the drug lords came into their community to buy this new crop, heroin, that the lords would force their sons to join the drug lord's army. As the farmers spoke to me, they expressed much sadness and anger as they recalled the loss of their sons to the lords. Soon the farmers had no choice but to grow heroin, and if they stopped the drug lords would kill them. The farmers lost their sons, their culture and their community.

Then the farmers told me that they took a stand against the lords, which meant that some farmers sacrificed their lives. They organized a Fair Trade Coffee Cooperative. They began to replace the heroin poppies with coffee trees, more than 1,047 acres. Europe had been purchasing their fair trade coffee for a few years, and by receiving that price the farmers continued to take back their community. Because of fair trade prices, they have now been able to prevent the planting of close to 4,500 acres of coca and poppy plants.

We visited another group of young farmers who recently formed a cooperative. We drove in jeeps to their farms in the mountains of Valle del Cauca, where in spite of the armed conflicts these young farmers proudly focused on producing a premium quality coffee. They once lived in Cali and other major cities without the possibility of ever providing a real home for a family. The ASOJAV Cooperative is devoted to training young people from these cities in order to provide them with a future.

These future farmers are necessary for the continuing supply of coffee to our world. Living in a bamboo house he had built by his hand with newborn twins to feed, we visited one of these farmers, Jose Angel Garzon, who grew coffee on the slopes of Seville. He is a proud, strong and determined farmer, but in the last e-mail I received from Francisco, an agronomist in Colombia, he stated that Jose was struggling to feed his family and that his twins were sick. Francisco also wrote that a month ago during the armed conflict in the hills bombs destroyed the water lines to the coop's farms.

Jose Angel Garzon asked me in front of 65 young farmers at the ASOJAV Coop meeting in the Federation offices why do Americans not care? I faced the farmers and answered his question. Americans care. Americans have a big heart. They just do not know. The news is not informing them. When they are informed, they do care. When they know how to make a difference, they act. In Santa Cruz, where I am from, they know about fair trade, and they buy it. They value the quality of life and the quality of coffee derived from fair trade.

Jose is still determined. He is preparing to harvest the crop next month in September and plans to ship it to America in October. With all his hard efforts to farm during the armed conflict, he hopes he will get a fair price that covers his costs to produce coffee and provides him with some extra to feed and clothe his twins.

Two months later, my family and I went to Nicaragua to film the documentary In Our Hands: Sustainable Relationships in Specialty Coffee. Coffee prices had continued to fall, and conditions had worsened. Miles of coffee farmlands were abandoned and overgrown with weeds. In southern Nicaragua, we visited Jinotepe. The mayor told us that unemployment had escalated to 80 percent in his city. He said farmers who do not sell coffee do not buy bread from the bakery or meat from the butcher.

In northern Nicaragua, we saw thousands of families who were living under plastic sheets on the streets of Matagalpa and San Ramon. We purchased a truckload of food and drove it to the mayor of San Ramon. He thanked us and said the truckload of food would feed the families for 1 day. A few days later in Matagalpa, the Nicaraguan newspaper reported that three children died of the coffee families from starvation that week and that 12,000 coffee refugees were fleeing the farmlands to set up camps in the city.

Peter Fritsch has written in the *Wall Street Journal*,

> "The collapse of world coffee prices is affecting an estimated 125 million people, resulting in a combustible brew of unemployment, hunger and migration."

I want to close with my opening statement that through the conduct of business, human happiness or misery is inextricably woven. I urge the U.S. Government and all consumers to purchase certified fair trade coffee and to support the H. Resolution 491 and also to work hard on this quality control issue.

Thank you.

[The prepared statement of Ms. Crosby follows:]

PREPARED STATEMENT OF COLLEEN CROSBY, PARTNER, SANTA CRUZ COFFEE ROASTING COMPANY

As a roaster who has conducted a family business in the US for twenty-four years, I am embarrassed to report that until the SCAA Convention of 2000, I was unaware of how low prices had destabilized whole communities in Central and South America. At that same convention, I learned about the powerful alternative of Fair Trade.

During my first visit in January of last year to Nicaragua I witnessed the hardships that farmers suffered from the low coffee prices: not enough food or clothing for their family, mal-nourished children whose smiles had missing teeth and were frequently sick because they lived in shacks with dirt floors and slat walls that didn't protect from rain or cold.

During this tour of the coffee countries, I met Jaime Azcárate, a member of the Colombian Coffee Federation. As we traveled through Nicaragua, I asked him: "Are other coffee farmers suffering the same way in the other countries? Are coffee farmers this poor everywhere, can they not feed their families, can they not cloth them? Are the schools closed in the coffee farmlands? What do the children do?" Jaime told me that the Coffee Crisis has affected all the countries in Central and South America he has visited. He said farms are being abandoned and farming families are fleeing to the cities. He also said that being poor in the cities was even more difficult than being poor on a farm. In the city disease has spread rapidly and gangs have dominated the streets. In Managua we saw children living in playhouse size cardboard huts in parks and sniffing glue to diminish hunger pains. I could then understand why families clung to their farm to avoid the living hell of these horrific slums and replaced coffee with cocaine in order to keep their farm.

We visited fair trade farmers in Esteli, Nicaragua who had been able to hold onto their land because they received a fair price for their coffee. The fair trade cooperative provided the farmers with an education and the ability to plan for their future. These farmers had hope and were able to support their families. I saw the Fair Trade Cooperatives schools that were built. I visited Community Centers that provided health care and vaccination programs for children. I witnessed that through Fair Trade Coops farmers attained a sustainable income and did not have to rely on Illegal Trade or U.S aid.

For the next six months Jaime and I emailed each other almost daily. I told him how the news was beginning to inform American consumers about the coffee crisis, and how Fair Trade Certified was beginning to be recognized and demand was growing in the US.

But it seemed hopeless at times that it wasn't growing fast enough. I received an email from Jaime on the first round of layoffs in the Colombian Coffee Federation. He wrote that the women and men in the office were crying as they were given their termination notices, that unemployment was around 20% in Colombia at the time, that these layoffs would increase the unemployment rate and that with the armed conflict increasing there was no future. Soon another layoff happened at the Federation and then another, as the coffee prices continued to fall. In another email he wrote that the Federation had begun terminating critical social programs provided to farmers. He was worried about the impact that would have the farmers' communities and their future.

In April that year, Jaime and I met again at the SCAA. I was a speaker on a panel presentation on the success of marketing Fair Trade coffee at the SCAA National Convention in Miami. I encouraged roasters and retailers to promote Fair

Trade coffee because I witnessed how it saved the lives of children and how it help to build self-reliant communities no longer dependent on charity or US aid. I spoke about how fair trade was absolutely necessary to guarantee the future supply of specialty coffee and how it was vital for our own survival.

Shortly after the convention, the Colombian Coffee Federation invited me to Colombia. I visited mills, schools and farming communities. I met with the COSURCA farmers from Popayan in Southern Colombia whose families had been growing coffee longer than our family had been roasting it. They remembered how decades ago their entire family sat at dinner together. They remembered their sons leading the family prayers. They remembered the pride of their fathers watching them learn the family trade and eventually taking charge of the family farm. When coffee prices continued to crumble, farming coffee no longer provided food for their families. They were forced to continue with the only crop they knew could generate good cash income, one of the few crops that grows at these high altitudes and is also a cash crop, heroin poppies. Their eyes conveyed the tragedy that soon followed.

They told me that as the drug lords came into their community to buy this new crop, heroin, that the drug lords would force their sons to join the drug lord's army. As these farmers spoke to me they expressed much sadness and anger as they recalled the loss of their sons to the lords. Soon the farmers had no choice but to grow heroin, if they stopped growing it the drug lords would be kill them. The farmers lost their sons, their culture, and their community.

Then the farmers told me that they took a stand against the drug lords, which meant that some farmers sacrificed their lives. They organized a Fair Trade Coffee Cooperative. They began to replace the heroin poppies with coffee trees, more than 1047 acres. Europe had been purchasing their fair trade coffee for a few years, and by receiving that price the farmers continued to take back their community. They introduced me to two of the young men from their community; they said they were learning the trade of farming coffee instead of heroin farming. We shook hands and I promised that as soon as their coffee came to the US, I would purchase and inform our community about their lives and their struggle. A few months later, their first shipment of a container of fair trade coffee was shipped to the US and I emailed them that our customers loved the great quality and appreciated their efforts to take back their community. The container of coffee was soon completely sold and we had to wait for the next shipment to purchase more. Because of Fair Trade prices they have been able to prevent the planting of close to 4500 acres of coca and poppy plants.

Especially appreciative of the farmer's lives in Colombia was Mr. Alejandrez from Barrios Unidos of the United States. He had joined me on this tour of Colombia. We had visited another group of young farmers who recently formed a cooperative. We drove in jeeps to their farms in the mountains of Valle del Cauca where, in spite of the armed conflicts, these young farmers proudly focused on producing a premium quality coffee. They once lived in Cali and other major cities without the possibility of ever providing a real home for a family. The ASOJAV Cooperative is devoted to training young people from the cities in order to provide them with a future. These future farmers are necessary for the continuing supply of coffee to the world. Living in a bamboo house he had built by hand and with newborn twins to feed, we visited one of these young farmers, Jose Angel Garzon, who grew coffee on the slopes of Seville. He is a proud, strong and determined farmer. But the last email I received from Francisco in Colombia stated that Jose was struggling to feed his family and that his twins were sick. Francisco wrote that a month ago during the armed conflict in the hills, bombs destroyed the water lines to the coop's farms.

Jose asked me in front of the 65 young farmers at their ASOJAV Coop meeting in Federation Offices of Tulua: "Why don't Americans care?" I faced the farmers and answered his question: "Americans care, Americans have a big heart. They just don't know, the news isn't informing them. When they are informed they do care. When they know how to make a difference, they act. In Santa Cruz where I am from, they know about Fair Trade and they buy it. They value the quality of life and the quality of coffee derived from Fair Trade."

Jose is still determined; he is preparing to harvest the crop next month in September and plans to ship it to America in October. With all his hard efforts to farm during the armed conflict, he hopes he will get a fair price that covers his costs to produce coffee and provides him with some extra to feed and clothe his twins.

This farmer's pride brought tears to the eyes of Mr. Alejandrez, director of Barrios Unidos, a national organization in the US that works to bring Latin youth out of drug gangs and into recovery and cultural programs. Mr. Alejandrez told us in the jeep as we left Seville and the young farmers, that he was crying because on the Barrios Unidos financials there is a funeral expense account for unknown American youths that will die this year due to drugs and gang violence. He hoped the Latino youths at risk in the United States might learn from these young farmers in Colombia and develop that same pride and spirit of determination.

Two months later, my family and I went to Nicaragua to film the documentary "In Our Hands: Sustainable Relationships in Specialty Coffee." Coffee prices had continued to fall and conditions had worsened. Miles of coffee farmlands were abandoned and overgrown with weeds. In southern Nicaragua we visited Jinotepe; the mayor told us that unemployment had escalated to 80% in his city. He said farmers who don't sell coffee, don't buy bread from the bakery or meat from the butcher. In northern Nicaragua, we saw thousands of families that were living under plastic sheets on the streets of Matagalpa and San Ramon. We purchased a truckload of food and drove it to the mayor of San Ramon. He thanked us and said the truckload of food would feed the families for one day. A few days later in Matagalpa, the Nicaraguan newspaper reported that three children of coffee families had died from starvation that week and that 12,000 coffee refugees were fleeing the farmlands to setup camps in the city.

Peter Fritsch reported in the Wall Street Journal: ". . . *the collapse of world coffee prices is affecting an estimated 125 million people, [resulting in] a combustible brew of unemployment, hunger and migration."*

I urge the US government and all consumers to purchase Certified Fair Trade Coffee. While Fair Trade is certainly not the only solution to this crisis facing millions of people in the coffee growing world; it has provided more than $10 million in additional income for small farmers. Out of 170 million lbs. of coffee sold by these farmers, only 31 million are fair-traded.

Santa Cruz Sentinel Newspaper: Coffee's Untold Story
February 17, 2001
By COLLEEN CROSBY
Special to the Sentinel

FIELDS TRIP STRENGTHENS FAIR TRADE RESOLVE

The following is an excerpt from a travel journal kept by Colleen Crosby, co-founder and co-owner of the Santa Cruz Coffee Roasting Co. Colleen just returned from a trip, for people who are in the coffee business, to the coffee farms of Costa Rica and Nicaragua. No one could ever have guessed (including Colleen) how deeply this trip would affect her and how much it would serve to strengthen her commitment to Fair Trade practices.

Colleen writes:

What you will read here is all true. No exaggerations. No embellishments. My narrative is not meant to scare you. But this heartfelt account is meant to stir up your passions as you read about mine and, most importantly, to show that you can easily take action to help—right now.

With the price of coffee as low as it is, coffee farmers barely eat. Most of the farmers can't read or write or perform any math. Without an education, they can't plan for the farm, so saving a little for the hard times doesn't happen. But then, all the times are hard times.

Unfortunately, prostitution is the alternate source of income for a woman who has no other way to get medicine for her baby. When her baby gets a bacterial infection and ends up with diarrhea, it dies without antibiotics. And when all the income from their farm barely puts food on their plates, prostitution is what a woman does to buy that medicine to keep that baby alive.

On the coffee farms of Costa Rica and Nicaragua, I saw how illness from a poverty diet dominates lives. Teeth fall out at an early age and smiles have big gaps. Extreme poverty means you don't read, you don't have an education, and you don't file birth certificates or get marriage licenses, so you don't get married, and you never know exactly how old you are. Ask a farmer how old he is, and he'll say: "Well, I was born probably in April, maybe in June, I think it was toward the end of the month. I think I'm 23, but I may be 18." That means they never celebrate a birthday. They don't celebrate much of anything. If they don't work almost every day, all day, picking or planting or weeding or something else, they don't put food on the table.

How skinny they were! How skinny the women were. Their children! Health is something I take for granted. I eat healthy and can see a doctor when I get sick, and I certainly can get basic medicine. Somehow, these people shouldn't have to live such unhealthy lives, and it gets worse as the coffee prices drop and drop—their lives go from tragic to more tragic. The low prices paid for the non-Fair Trade coffees, instant coffees, canned coffees and even major gourmet coffees, have a major impact on these farmers' lives. Non-Fair Trade coffee literally means starvation for the farmer's children, and simply no education at all.

We listened to the improvements made in a community where a Fair Trade Coffee Co-op operates: a community room for a rudimentary education, a place where a doctor can come during the week and check to see who's sick, how the pregnancy is going and control outbreaks of contagious diseases. I felt so glad to know that Fair Trade coffee was a working idea, glad to know that it could put a drop of hope into an ocean of pain and poverty.

We stayed at a hotel one night in the city of Matagalpa. There, too, the poverty was horrible and heartless. It was now very difficult to hold back the tears. We traveled across barren, arid land with millions of one-room mud houses filling my view, all with dirt floors and aluminum outhouses. And it was like this for hours and hours, on the bus, outside my window. I had no idea how massive the poverty was in Nicaragua. This extreme poverty never ended. It wasn't just a pocket. Poverty seemed to go on forever. I don't care who fixes the problem. I just want the problem fixed.

Again, the Fair Trade Co-op offered some real solutions for its community, a small step and maybe insufficient, but a step in the right direction. It offered minimal health care, a beginning to eliminating the proliferation of diseases. The best part is that fair trade is a sustainable practice. The farmers actually learn how to do business. They learn math, so they can keep some simple records. They learn to read, so they can set up some rules for the co-op and learn which ones work. They learn how to plan, so they can make it through when the coffee prices plummet and put all the other farmers into a living hell. Fair trade isn't perfect, but it does make a small difference and above all it's sustainable. It's not charity that's here today and gone tomorrow, stealing the farmer's pride.

We arrived at the house of a farmer named Santiago. The house was just like all the others: a dirt floor, mud brick walls, a bench in the kitchen that held a bowel for cleaning a dish, an adobe fire pit for cooking, board beds, a ceiling with light passing through the boards that weren't tightly fitted, an open space in the adobe wall that we would call a window, pictures of Christ, a cross on the wall near where they ate, and the Virgin Mary everywhere. Their life was just too hard to believe, poverty I couldn't imagine, coming from America.

Santiago took us to his coffee trees and mill. We hiked with him up a steep path that went for miles. We reached the top exhausted. On the sides of these steep mountains, Santiago and his family pick coffee. They hold on to one tree while picking cherries from the next. Then they carry the heavy sacks on their backs for hours till they get down the mountain. Picking coffee is even harder when it rains. They slip on the muddy inclines. And they strain their backs to pick the rain-fallen cherries from the muddy ground.

The work at the coffee processing mills is equally strenuous: lifting the heavy sacks all day and sorting millions of coffee beans on a continuous conveyor built. Coffee harvesting and milling is a hard, intense laborious process. Despite this hard work and the sweat that goes into our coffee, these people are barely surviving.

Santiago and his family held a feast for us. They had so little food, but they were dying to be generous. We had to eat, even if the bacteria were going to make us sick. You don't refuse the generosity of a poor farmer. Later I gave him a T-shirt from Barrios Unidos, with the Fair Trade logo on the front. On the back was printed "Changing Our World, one cup at a time." He loved it!

In the lush, tropical rainforest of Nicaragua, we visited another house. A mother was rocking her child in a small hammock, smiling as I approached. I could see 10 flies sitting on the baby's face. I smiled at her and said, "Es bonita (the baby is beautiful)." I got the camera out, and she swept the flies from the baby's face. I learned that she'd had 10 children, but seven of them had died. Only three survived. She didn't want to bury any more and started using birth control, so her man left her. She was left alone now with three kids to care for and nothing for a living except the bare minimum from the land.

There's a program that subsidizes education if enough children attend. Some of the children hike three hours to school. Unfortunately, teachers are hard to come by. Very few want to live in this desolate condition, in this poverty. They come for a month, find it too difficult, leave and the school looses funding. The children have no place to go, so no one reads, no one writes, and no one plans a future.

I hope this story helps to show what far-reaching affects purchasing Fair Trade coffees can have. It probably won't change your life to spend those few extra dollars a month to buy Fair Trade coffees at their slightly higher prices. But it most definitely will change theirs.

The Fair Trade label comes from a non-government organization that makes certain the farmers and their families actually receive that money. The purchase of coffee (and other crops) with the Fair Trade logo on it ensures a positive affect on the people who bring the coffee to your cup.

The Wall Street Journal: Coffee-bean oversupply deepens Latin America's woes
Monday, July 8, 2002, Peter Fritsch, Associated Press

LA DALIA, Nicaragua—Antonio Luna thought he had seen the worst life had to offer during the 1980s, when his village in Nicaragua's coffee-rich northern highlands sat in the crossfire of a guerrilla war between U.S.-backed "contra" rebels and the Marxist Sandinista government.

That was before this May, when his family's home became a plastic tarp pitched along the roadside here. Huddled with about 3,000 other unemployed coffee pickers, Mr. Luna is a hungry refugee from a potentially more devastating conflict than any he has known before: a global brawl over the $55 billion coffee market. The fight has left the world awash in java and has driven inflation-adjusted prices for beans to their lowest levels in more than a century.

"We've had no work since February and are here begging for our lives," says Mr. Luna, a listless 33-year-old, surrounded by a group of visibly malnourished, unshod children. They are living on wild bananas and the charity of passersby. "At least during the war there was food," he says.

In lush coffee-growing regions from Central America to Africa, the collapse of world coffee prices is contributing to societal meltdowns affecting an estimated 125 million people. In former Cold War proxy battlefields such as Nicaragua, the result is a combustible brew of unemployment, hunger and migration. In countries such as Uganda and Burundi, which get 70 percent of their export earnings from coffee, the severe price drop has blunted benefits from international debt relief.

The oversupply of beans driving the crisis won't ease quickly because so many small growers see few alternative crops that are profitable and legal.

In the U.S. and the rest of the developed world, the price of coffee on supermarket shelves has fallen—but considerably less than the price paid to growers. That translates into record sales and profits for some of the corporations that process and market coffee, according to industry officials. Four giants—Procter & Gamble Co., Philip Morris Cos.'s Kraft Foods Inc., Sara Lee Corp. and Nestle SA of Switzerland—control about 40 percent of the world's coffee. They buy it in bulk and then roast, grind and blend it into brands such as Kraft's Maxwell House and P&G's Folgers.

The low bean prices fueling corporate profits are "causing entire rural communities to disappear and forcing desperate peasants into everything from crime and illicit crops to illegal migration," says Nestor Osorio, a Colombian who heads the International Coffee Organization in London, which represents producing nations. He predicts more tragedies like that which befell 14 out-of-work coffee pickers from Mexico's Veracruz state. They died of dehydration in Arizona in May 2001 while trying to cross the Sonoran desert to a new life in the U.S.

Until the 1990s, the desire for international security made propping up coffee prices a crucial instrument of U.S. foreign policy toward places such as Nicaragua, where coffee supports more than 40 percent of the rural labor force. The world's most-traded commodity after oil, coffee was seen during World War II as key to thwarting the spread of fascism among German immigrants in countries such as Guatemala. During the Cold War, coffee wasn't only a morning pick-me-up but a bulwark against Communism.

At the time of the 1962 Cuban missile crisis, Sen. Hubert H. Humphrey told Congress that ensuring healthy coffee prices for Latin American campesinos "is a matter of life and death. . . . Castroism will spread like a plague through Latin America unless something is done about the prices of raw materials produced there."

That year, 66 coffee-importing and -exporting countries created the International Coffee Agreement. The deal imposed strict limits on each exporting nation. Actively promoted by the U.S., the world's largest coffee consumer, the agreement artificially propped up prices for nearly three decades. But when the Berlin Wall collapsed in 1989, so did the coffee deal.

In its place arose a new ideology of free trade, championed by the U.S. Many producing nations ended coffee-buying and stockpiling programs that controlled supply. That enabled Procter & Gamble, Nestle and other large foreign buyers to purchase directly from relatively small growers, giving the buyers more muscle to negotiate favorable prices. The result: free-for-all coffee exports and a production boom that continues to generate more beans than the world needs.

Brazil and Vietnam, which emerged as a coffee-growing giant in the last five years, have flooded the market in a battle for dominance. That has left the global market with an annual coffee excess of almost two billion pounds.

At the end of the 1980s, coffee-exporting nations received about $10 billion of a $30 billion annual retail market. Today, the total market has nearly doubled, but with big buyers able to play growers against each other, exporting countries receive less than $6 billion, according to the International Coffee Organization.

Coffee prices on New York's Coffee, Sugar and Cocoa Exchange—which provides the industry with its benchmark for beans—currently hover around 50 cents a pound, down more than 80 percent from their brief peak of $3.15 in May 1997. But production costs in Central America are about 80 cents a pound. That adds up to insolvency for many farmers.

"On my farm, I usually have about 100 permanent workers, but now I have just 20," says Jose Angel Buitrago, who has grown coffee in Matagalpa, Nicaragua, for 30 years. "I'm out of money, and in the next few weeks I'll have to let them go, too. They'll end up on the highway begging for food." When they have work, coffee pickers earn less than $2 a day in most of Central America. Mr. Buitrago is lucky to have held out this long. Neighboring farmers have already abandoned the business, leaving their land overgrown with weeds.

The social impact on countries still emerging from the debt crises and wars of the 1980s and 1990s is profound. In Central America and Mexico—where some of the world's highest-quality coffee is grown—the World Bank estimates that 600,000 permanent and temporary coffee workers have lost their jobs in the past two years alone. Relief agencies estimate more than 1.5 million peasants in the region lack food.

In Guatemala, where a 36-year civil war with rural guerrillas ended in 1996, relief workers say about 6,000 children of out-of-work field hands face starvation—a situation exacerbated by a fierce drought. U.S. government officials say struggling coffee growers in Colombia who had resisted the drug trade are now turning to heroin poppies for a living.

The collapse of coffee prices has been a boon for the big companies that process the beans and sell the final product. While prices paid to growers have tumbled more than 80 percent since 1997, average retail prices for ground roast coffee in U.S. cities have fallen only 27 percent, according to the U.S. Bureau of Labor Statistics. Accordingly, the price differential between international wholesale and U.S. supermarket prices ballooned to $2.54 in May, compared with $1.50 five years ago.

Increasingly, big corporate buyers are substituting less expensive "robusta" coffee from Vietnam and Brazil for the higher-quality "arabica" variety commonly grown on the cloud-wreathed mountain slopes of Central America. "Up to 75 percent of a typical can of coffee is now made up of the cheap stuff, which they then cut with Central American or Colombian (arabica) beans so your coffee doesn't taste like a shoe," says Eric Poncon, director in Nicaragua of ECOM Group. ECOM, a major coffee trader and unit of Brazil's Esteve SA, does business with Kraft and the other big coffee sellers.

Some of the industry's leaders have taken note of the widening gap between the haves and have-nots. In March, Howard Schultz, chairman of Starbucks Corp., urged fellow coffee executives in a speech at the National Coffee Association's annual meeting to "share the blanket" of prosperity with growers. The Swiss Coffee Federation has called for an "ethical coffee tax" of more than one cent per pound to be invested in community programs in the developing world—a proposal the industry hasn't rushed to embrace.

Human-rights advocates and others in the so-called fair-trade movement have pressured big companies to pay coffee prices that will sustain poorer growers. Some upscale coffeehouse chains, including Starbucks, now pay a premium for quality coffee. But bigger buyers typically don't.

Rather than pay above-market prices for coffee, says P&G spokeswoman Tonia Hyatt, the maker of Folgers prefers to provide community aid. She says the company's offices in Mexico, Brazil and Venezuela contributed a combined $10 million last year for things such as community health centers and schools. "We care very much and want everyone in coffee to have a sustainable business along the whole line," she says.

Kraft, Sara Lee and Nestle say they, too, go out of their way to help small growers. Sara Lee says it tries to buy at least 10 percent of its coffee from small planters and cooperatives. Nestle buys 13 percent directly from farmers, "ensuring that they receive the full value of their crop," says spokesman Francois-Xavier Perroud. But he adds that increasing demand for coffee "is the best way to ensure a long-term future for the farmers." Kraft has helped educate Peruvian growers, among other programs, but it, too, believes that its "most important contribution" is to promote demand, says spokeswoman Patricia J. Riso.

Coffee consumption in the U.S. is growing by about 1 percent a year, but that offers no panacea. Per capita consumption in the U.S. is about 20 gallons a year, down from about 37 gallons in 1970.

Sara Lee's coffee-and-tea division had sales of $2.9 billion last year and income "after accounting for non-recurring items" of $495 million—its best financial results in at least five years, says spokesman Joost J. den Haan. P&G'S coffee business, with about $1 billion in annual sales, had "a record year" in 2001, according to the company's annual report. P&G declines to comment on coffee profitability, as do Nestle and Kraft. But Nestle did say that coffee sales by volume hit a record in 2001.

To farmer Buenaventura Gutierrez, sitting in the dusty headquarters of the Nicaraguan Coffee Growers Union in downtown Jinotega, corporate talk of sustaining small planters sounds hollow. "In two or three years, most of our industry will be gone," he predicts. "This is dangerous because we are still coming out of a revolutionary, guerrilla environment in this part of Nicaragua."

No one believes Nicaraguans are inclined to take up arms again. But the coffee crisis is complicating a fragile political situation and eroding confidence in the free market.

Coffee-related protests and the restructuring of coffee debt have become daily thorns in the side of the new administration of Nicaraguan President Enrique Bolanos. In the impoverished countryside, frustration is keeping alive the political hopes of former President Arnoldo Aleman and former Sandinista leader Daniel Ortega.

The rehabilitation of coffee fields after the devastation of war and Sandinista mismanagement was a pillar of the government of Violeta Chamorro, who defeated Mr. Ortega at the polls in 1990. "We all just wanted to forget politics and get back to work," recalls coffee grower Miguel Gomez, a former Sandinista official.

In the 1990s, some plantation owners who hadn't been in the coffee business took advantage of loan programs offered by the government and a regional development bank. "Though coffee has been in Nicaragua for well over a century, a lot of the businesses are relatively new, with very small capital bases and lots of debt," says Julio Solorzano, a coffee grower and special adviser to the Ministry of Agriculture.

The borrowing continued through the mid-1990s as frosts affecting Brazil's huge crop helped boost international prices temporarily. By 2000, Nicaragua's 32,000 farms had boosted coffee crops back to 1979 levels. But by then, falling prices had rendered grower debt, estimated at $100 million, more difficult to pay off. While the cash-strapped government is trying to help growers postpone repayment of some of what they owe, there is little money to help starving field hands, officials say.

Mr. Solorzano, one of the struggling growers, struck a deal with his remaining workers: They get paid two weeks salary for every three weeks they actually work. His employees, rather than lose their jobs, agreed to let him try and make up the difference at some point in the future.

Other farmers talk of switching crops. They are discouraged, however, by the experience of farmers who have grown peanuts and sesame. Those growers now find themselves on the verge of bankruptcy after trying to compete against U.S. farmers receiving generous subsidies from Washington.

With a lack of competitive alternative crops, "the only viable diversification alternative for workers is mass migration," says Mr. Poncon, the coffee trader. An estimated 400,000 Nicaraguans now live in Costa Rica, many of them recent arrivals. They scrounge for work in competition with Costa Ricans unhappy to be their hosts.

The coffee crisis has prompted some fanciful proposed solutions. In Mexico, state oil company Petroleos Mexicanos has been looking at the possibility of using excess coffee to absorb oil spills. Other ideas include using coffee as animal feed and as fuel. International charity Oxfam has suggested a mass destruction program funded by a windfall tax on the big international companies—an approach the companies reject.

The answer for a handful of Nicaragua's best-run farms is selling to the so-called specialty coffee market, which pays a premium for top-quality branded coffee. But this niche market is small—about $100 million a year—and the high-end brands have a hard time winning supermarket shelf space when pitted against powerful marketers such as Procter & Gamble.

The U.S. National Coffee Association is hoping to stimulate more consumption by focusing "on more scientific research on the health benefits of coffee," says Robert F. Nelson, the trade group's president. "There's a lot of bad science out there," he says.

AID POLICY & PRACTICE
A brief paper from the Centre for Development Research, Copenhagen

THE COFFEE CRISIS

JANUARY 2002

International prices for green coffee have more than halved from January 1999 to November 2001. Coffee is grown in over 50 developing countries, and low coffee prices are affecting the livelihoods of an estimated 100 million people involved in its production. One of the factors behind the crisis has been oversupply in the global coffee market: supply has outstripped demand in the last three seasons. Yet, it is often forgotten that one cause of oversupply was the push to promote export earnings under market reforms. Vietnam, for example, produced less than 4 million 60-Kg bags of coffee in 1995/96. In 2000/01, it produced over 11 million. Furthermore, the crisis is not simply a matter of oversupply but also of deregulation of international and domestic markets and of shifting power balances within the global coffee chain. This document briefly analyses the factors behind the coffee crisis, and highlights some of the options available to farmers, producing country governments and the donor community.

Factors behind the crisis

In the period between 1962 and 1989, the international coffee market was regulated by successive International Coffee Agreements (ICAs). The ICA system set a target price (or a price band) for coffee and allocated export quotas to each producing country. When the indicator price calculated by the International Coffee Organisation (ICO) rose over the set price, quotas were relaxed; when it fell below the set price, quotas were tightened. Although there were problems with this system—such as free-riding, squabbling over quotas, and the emergence of a parallel coffee trade through non-member importing countries—most analysts agree that it was successful in raising and stabilising coffee prices.

During this period, domestic markets in most producing countries were controlled by the public sector through marketing boards, stabilisation funds, or quasi-governmental producer associations. Regulation often required specific quality control procedures at various stages in the domestic marketing chain. In some countries, governments even set prices and quotas allocated to private operators. These systems were plagued by a number of problems. Export quotas were allocated to traders on a political basis. Farmers received a low share of coffee export prices. Corruption and graft were common. On the other hand, farmers received stable prices, and were often rewarded for a higher quality product with higher prices. They had easy and cheap access to inputs on credit, and were able to make informed investment decisions over the mid-term.

The author, Stefano Ponte (Ph.D.), is a Researcher at CDR within the programme 'Globalisation and Economic Restructuring in Africa' (GLAF).

Main coffee exporting countries in 2000 (60-Kg bags)

Brazil	18.024.742
Vietnam	11.608.206
Colombia	9.175.370
Cote d'Ivoire	5.909.414
Mexico	5.303.704
Indonesia	5.193.534
Guatemala	4.846.257
India	4.486.704
Honduras	2.879.133
World total	88.720.630

Source: ICO.

A combination of political and administrative factors—plus the withdrawal of consuming country support for the quota system—led to the collapse of the ICA in 1989. At the same time, producing countries started liberalising domestic coffee markets. In consuming countries, the international trade and roasting segments of the marketing chain became more concentrated. International coffee prices fell and price volatility increased. However, retail coffee prices declined only marginally. As a result, a sizeable slice of the total income generated in the coffee chain moved out of producers' hands and was captured by operators in consuming countries.

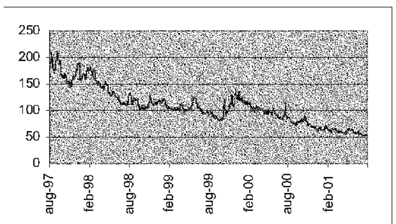
Furthermore, market liberalisation in producing countries resulted in the breakdown of quality control measures in the domestic trade and in declining levels in the overall quality of coffee. Systems of input provision on credit for smallholders collapsed, leading to lower input use. A more efficient marketing system has meant that producers receive a higher share of the export price. Yet, because of declining international prices and deteriorating coffee quality, the overall result is that farmers make less money for the coffee they sell. For example, farmers in Kilimanjaro (Tanzania) received an average coffee price of 1.9 USD/Kg between 1995 and 1999. In 2000, they were paid less than 0.75 USD/Kg.

Policy and aid options

A new role for international regulation. The revival of the ICA system with quotas and price bands does not seem possible in the short term. There is no public or political support for a quota system in consuming countries nor—with the end of the Cold

War—is there a foreign policy reason for it. Retention schemes through producer cartels, such as the recent effort organised by the Association of Coffee Producing Countries (ACPC), have not been able to influence markets in the presence of a fundamental excess of supply.

New York coffee futures prices; nearby contract (UScts/lb) August 1997 - July 2001



A second option that has been proposed recently is the establishment of quotas on production. This could be, in theory, a better solution but is opposite to what governments have been promoting in the past in their own countries, that is higher—not lower—production.

A third and more promising option, at least in the short-term, is the withdrawal of low-quality coffee beans from the international market. This option has been discussed within the ICO and has found support from consuming country governments. An ICO Quality Committee is presently discussing a minimum coffee quality standard for export. The basic idea is to reduce supply in the short term and raise the overall quality, therefore value, of coffee exports.

Improving quality. Whether the ICO 'quality initiative' succeeds or not, solving the current crisis requires initiatives aimed at improving coffee quality, raising the reputation of individual origins, and refining marketing skills in producing countries. The key for would-be producers of high quality coffees is to know how to sell the right coffee to the right people. They need to know which quality characteristics are appreciated where, what kind of premium will be paid, and what are the motivations that are needed for consumers to take a product seriously. Selling a 'story' is particularly important. Small estates and/or co-operatives could be helped to become better at exploiting their 'stories' than they are doing now.

Coffee is a labour-intensive cultivation, and quality improvement does not necessarily require large capital outlays. Groups of smallholder farmers in Tanzania, with the help of NGOs, have been able to produce high quality coffee that is sold directly at the export auction. The higher prices they fetched generated positive returns to the extra efforts required. This shows that smallholder (and often poor) farmers can produce and handle high quality coffee, get higher prices and improve their livelihoods—if they receive institutional support and are exposed to quality-related market incentives.

Unfortunately, the tendency for traders in many producing countries after liberalisation has been to buy all coffee at one price. No price differentials are offered to smallholders for good quality coffee, which reduces their incentive to improve quality. Exporters who cater to speciality markets are increasingly relying upon estates through vertical integration or long-term contracts. Small farmers are being marginalised.

Producing countries need to support small farmers in achieving—and reaping the benefits of—coffee quality improvements. They can do so by:

- (re-)establishing regulation requiring traders to pay farmers higher prices for higher quality coffee;
- tackling market failures in input and credit markets;
- facilitating the establishment of farmer groups and producer associations.

Promoting 'conscious consumption'. Donors and producing country governments should also increase their efforts in promoting 'conscious consumption' for it can provide an extra channel for small producers in recapturing a higher proportion of the total income generated in the coffee chain. One way is through increased promotion of fair trade. Fair trade operators pay a minimum floor price to registered producer organisations and co-operatives. They also offer financial and technical support. The relative success of fair trade in Europe in the 1990s has shown that some consumers are available to pay a premium for coffee so that farmers receive a just payment for their effort. However, fair trade coffee still represents only a minor proportion of global coffee sales.

Other forms of 'conscious consumption' are consumption of organic, shade-grown and bird-friendly coffees. The transition to organic farming is relatively easy in Robusta coffee cultivation, especially in Africa where chemical input use is low. Many producers are already growing organic coffee, but are being paid prices for non-organic coffee. They lack information on certification processes and on how to approach certification agencies. The development of sun-resistant large-scale coffee plantations has led to the uprooting of trees and loss of bio-diversity—except where coffee is cultivated in areas of natural savannah. These trees used to provide shade to coffee bushes and a natural habitat for birds in more 'traditional' coffee farming systems. Again, smallholders cultivate coffee under shade trees already, but consumers are not paying a premium for it.

'Cultivating' consumers rather than more coffee. While the markets for 'conscious coffees' are growing and constitute important means for channelling value added to producers, they are likely to remain niche markets in the near future. The ICO idea of a ban on exports of low quality coffee is a good one, but it is unlikely to be supported by consuming country governments in the long-term. The speciality coffee market certainly offers new openings for some producers. However, any long-term solution to the historic slide of coffee prices needs to target the 'mainstream market' as well.

Policy and aid options at a glance

- Support the ICO-led scheme banning the export of low-quality coffee.
- Promote consumption of fair trade, organic, shade-grown, and bird-friendly coffees.
- Improve coffee quality in producing countries and re-establish pricing systems that allow farmers to receive higher prices for higher quality.
- Tackle market failures in input and credit markets; facilitate the establishment of farmer groups and producer associations.
- Stop projects and programmes promoting coffee production, or switch the focus from quantity to quality.
- Promote an educational campaign among 'mainstream consumers' about the many qualities of coffee.

Most mainstream consumers buy branded coffee. They rely on the brand for a consistent consumption experience in time and in space. Branded coffee roasters, however, are more concerned with homogeneity in the short-term than in maintaining a high quality profile in the long-term. It is widely known in the coffee industry that coffee quality in the mainstream market deteriorated dramatically in the USA in the last 30 years. Coffee blends in Germany were using strictly Arabica coffee as recently as a decade ago. Now Germany imports a sizeable proportion of Robusta. The proportion of Robusta employed in espresso blends in Italy has increased as well. These are indicators that brands are not necessarily an insurance against deteriorating quality in time, although they tend to ensure a relatively homogeneous consumption experience in space.

Much branded coffee consists of a blend of various coffee types and origins. Some branded coffee also specifies whether it consists of 100% Arabica or not. When consisting of a single origin coffee, branded coffee can also be sold with the identification of the producing country. However, in the mainstream market, there is little information available to consumers about the coffee they drink. Branded roasters never specify the composition of a blend in terms of origin and coffee type. Perhaps, the most problematic aspect is that consumers do not know how to assess coffee quality. They simply do not have the language and the knowledge to discern the many characteristics of coffee.

This relative ignorance mirrors to some extent the situation of the wine market until 20-30 years ago. Most mainstream consumers did not know much about wine or how to assess its quality. Nowadays, a large proportion of these consumers has at least a rudimentary knowledge of different types and origins, their taste characteristics, and on how to match food with a particular wine. It has become fashionable—not only among the wealthy—to be a wine expert, tasting courses have become fairly popular, and most restaurants offer a wide selection of wines.

On the contrary, most coffee consumers are left in the dark. They may know of Colombian coffee, for example, but little on why it is special. Few know that particular coffees go better with milk than other coffees, or that you could match a dessert type with a specific kind of coffee. Even fancy restaurants that offer an impressive selection of food and wines, often serve unspecified coffee.

One of the main differences between the wine and coffee industries is that the wine industry was able to undergo a radical transformation in absence of a strong branded environment. In the coffee industry, branded roasters have no interest in providing information that 'waters down' brand identification and attachment. Yet, consumers who have already learnt how to appreciate good wine, are also likely to be interested in widening their 'tasting knowledge'. The fact that the vocabulary used in professional coffee tasting borrows heavily from wine tasting could help.

A consumer who knows how to discern the intrinsic qualities of coffee will look for particular kinds of coffee and be willing to pay more for its specificity. If the added value of 'informed consumption' is then transferred up the marketing chain, it can have a positive impact on producers. More informed consumers are also a market-based guarantee for higher demand of better quality coffee. Finally, they can address power imbalances in the global coffee chain by facilitating market fragmentation in consuming countries.

The ICO, international NGOs, aid agencies and producing country governments should build alliances and promote initiatives aimed at 'cultivating' consumers rather than more coffee. At a general level, they should include the organisation of tasting sessions in coffee bars or institutional environments, where consumers could receive basic information on types and origins of coffee and acquire the basic language and techniques of tasting. This should be coupled with a wide-ranging information campaign in the media and in coffee retail outlets (coffee bar chains, speciality coffee retailers, and selected supermarket chains).

Strategically, these initiatives should not be marketed under a 'developmental' agenda. They should be directed to mainstream consumers for the sake of increasing their perception of sophistication. This potential market is much larger than the segment of consumers who are interested in development or environmental causes.

However, even if these initiatives worked in fragmenting and upgrading coffee consumption, the developmental impact in producing countries would not appear unless a basic condition is met. There needs to be a mechanism ensuring that higher prices paid at the consumption level are transmitted all the way to producers.

Financing mechanisms

Most producing countries do not have the resources for financing the initiatives described above. Funds presently available though multilateral agencies and donors are also insufficient. Various options can be explored, and all need to involve consuming country governments:

- Donor agencies could increase direct contributions to the initiatives outlined in this document.
- In the EU, a small coffee tax could substitute the diverse array of taxes currently in use in member countries.
- A one-time tax could be imposed on large coffee roasters.
- A small tax could be imposed on transactions in the coffee futures markets (a sort of 'Tobin tax' on commodity trade).

Political resistance is likely to be a major hurdle in mobilising finance through these channels. However, recent successes of international NGOs in drumming up public opinion for debt cancellation and for price discounts for retroviral drugs suggest that it may be the right time to press large roasters and consuming country governments to accept their part of responsibility in tackling the coffee crisis. Poverty alleviation can be attained not only through interventions in aid recipient countries, but also through the promotion of 'conscious' and 'informed' consumption in donors' own countries.

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Mr. BALLENGER. Let us go ahead and finish the panel so that we can then ask questions.

Next I have, according to my thing right here, Robert Nelson. Robert is the President and Chief Executive Officer of the National Coffee Association of the United States. Since naming Mr. Nelson President, the National Coffee Association has experienced its largest growth in a decade.

As CEO, Mr. Nelson leads the Association's public relations, government affairs, scientific research, membership, education and marketing programs. It sounds like you do not have any staff.

Mr. NELSON. I lead them.

Mr. BALLENGER. Thank you for coming, and please proceed.

STATEMENT OF ROBERT NELSON, PRESIDENT AND CEO, NATIONAL COFFEE ASSOCIATION OF U.S.A., INC.

Mr. NELSON. Mr. Chairman and Members of the Subcommittee, thank you very much for the opportunity to testify on this vital issue, one that the National Coffee Association has been interested in for a number of years.

The global coffee market today is experiencing a period of extraordinary price deflation. The cause is oversupply of coffee from producing nations. The result is significantly increased production exceeding slow growth in international demand.

This is not a short-term cyclical downturn, but a long-term structural imbalance between supply and demand brought on by significant new production increases. There continues to be a downward pressure on prices due to an increase in supply from countries that have a low cost of production; for example, Brazil, which continues to increase its output, and Vietnam, which has increased its exports from four million bags in 1995 to 15 million bags in 2001.

The fact is we are concerned about the effects that the current situation is having on the 25 million farmers who grow coffee and on the long-term sustainability of the industry. As the U.S. industry, the most important contribution that we can make to the long-term health of the coffee sector, including the sustained well-being of producers, is to increase consumption, and in fact U.S. coffee consumption continues to grow, although not as fast as production.

As we work to address this imbalance, let me assure you that the NCA is committed to working with producers, governmental bodies and development agencies in seeking solutions that will make a difference. Recently we convened an international summit of global coffee leaders from producing and consuming nations, as well as international development organizations and USAID.

Although time limits do not allow me to present the summit conclusions now, summit participants identified eight options that might be considered to address the current situation. I would direct your attention to my written testimony for these options.

With regard to the role of quality standards, the concept was recently debated at the International Coffee Organization, and producing and consuming nations alike elected to adopt an export based quality standard. Let me be clear that the National Coffee Association supports efforts by producers to improve the quality of their products.

At the same time, we support current FDA import standards which focus on the protection of the health and safety of the American consumer. Moreover, the National Coffee Association strongly opposes changing an excellent, decades old FDA standard that is based on health and safety to meet a totally different objective of supply management.

Since the United States imports only 25 percent of the world coffee exports, if the U.S. alone were to adopt import standards for the purpose of supply management, any coffee restricted from U.S. entry would simply find an alternative destination. The most likely effects would be competitive disadvantages for American companies and higher prices for American consumers with no change in income for coffee growers.

I would also add a caution about executing government policies specifically designed to artificially increase commodity prices. The ordinary effects of increased prices are an increase in production and a decrease in consumption. The history of coffee consumption in the States over the past 50 years is a clear case in point. Simply put, government policies designed to increase prices are not viable options for alleviating a structural imbalance in the world coffee market. For these reasons, the NCA supports free markets for coffee.

There are effective roles the U.S. Government can play in insuring the sustainability of the coffee industry. The U.S. is uniquely placed to provide incentives and guidance to producing nations to help them address the structural imbalance and to provide assistance in developing diversification programs for coffee farmers. Of course, inherent in developing attractive alternatives to supplement coffee production is a need to review U.S. policy, which currently limits market access to many alternative agricultural products.

We encourage the Subcommittee to urge Congress to look at all forms of governmental barriers to trade such as U.S. farm subsidies and restrictive tariffs that often close our own markets to foreign agricultural exports. In this regard, we urge Congress to pass HR 3009, the Andean Trade Preferences Act.

In fact, U.S. agricultural policy results in low worldwide price levels for the very crops that are best suited for Latin America to diversify out of coffee. The region could easily produce more sugar, but U.S. law restricts the importation of sugar through quotas. The same holds true for cotton and other commodities.

This type of policy, which effectively limits access to the U.S. market, makes it difficult to impossible for Latin Americans to participate in the marketplace for a range of commodities. It prevents them from diversifying into other agricultural products and generates unemployment and emigration.

Before closing, I would like to express the National Coffee Association's support for U.S. membership in the International Coffee Organization, and in closing I would like to say that I am optimistic that we can identify a variety of effective approaches where there is support for the global coffee community, governmental bodies and development agencies.

We are faced with a challenge that will require far reaching and common support as we develop and implement approaches designed not so much to manage the industry for tomorrow, but to build it for future generations. National Coffee is committed to working with Congress, the appropriate Executive Branch agencies, producer organizations and consumers as we all act to address this vital issue.

I would ask, please, Mr. Chairman, that a full copy of my written testimony be entered into the record, and certainly when we are finished——

Mr. BALLENGER. Will do without objection.

[The prepared statement of Mr. Nelson follows:]

PREPARED STATEMENT OF ROBERT NELSON, PRESIDENT AND CEO, NATIONAL COFFEE ASSOCIATION OF U.S.A., INC.

Mr. Chairman and members of the Subcommittee, thank you for the opportunity to testify on this vital issue, one which the National Coffee Association of the USA (NCA) has been interested in for a number of years.

The National Coffee Association membership is comprised of importers, specialty and commercial roasters, wholesalers, and coffee retailers. NCA members conduct approximately 90 percent of all coffee commerce in America.

The global coffee market today is experiencing a period of extraordinary price deflation; the key cause is an oversupply of coffee from producing countries, which has resulted from significantly increased production exceeding slow growth in international demand. This is not a short-term cyclical downturn as we have seen in the past, but rather appears to be a longer term structural imbalance between supply and demand brought on by significant new production increases.

In 2001 global coffee production was approximately 117 million bags, while global consumption was only about 108 million bags. In fact, global production has exceeded demand, which has remained relatively flat, for each of the past several years and, according to published data, continues to do so today, resulting in the continued buildup of stocks.

There has been continued downward pressure on prices due to an increase in supply from countries that have a low cost of production. For example, through economies of scale and the erosion of the Real against the Dollar, Brazil, which continues to increase its output, has become a low cost producer. Vietnam, another low cost producer, has increased export output from 4 million bags in 1995 to 15 million bags in 2001.

We are concerned about the effects that the current situation is having on the 25 million farmers who grow coffee in 50 countries that export the commodity, especially given that 70 percent of the world's coffee farms are less than 4 hectares in size.

The most important contribution the US coffee industry can make to the long-term health of the coffee sector, including the sustained well being of producers, is to increase consumption. In fact, consumption in the United States continues to increase at a steady pace, though not as fast as production growth. In 2002, the NCA determined that 109 million American adults drink coffee every day and an additional 52 million Americans drink coffee occasionally. This represents 1.2 million more daily drinkers and 9.5 million more weekly drinkers than in the previous year.

Further, the National Coffee Association is committed to working with producers, governmental bodies, and development agencies in seeking solutions that will make a difference. In fact, we are in regular contact with producers, and agencies such as US AID and the World Bank.

The National Coffee Association recently convened an international summit of global coffee leaders representing growers, exporters, and foreign coffee trade associations, as well as importers, roasters, retailers, and international aid organizations, such as the Inter-American Development Bank, World Bank, and US AID.

Summit participants identified eight options that might be considered to address the current situation.

1. Farmer education regarding crop diversification.
2. Roaster consideration of long-term, independently arrived at, contracts.
3. Emphasis on health benefits of coffee consumption, scientifically confirmed, in marketing and promotion.
4. Advocating sound government agricultural policies which minimize market distortion.

5. Increasing accessibility, convenience, and quality choices for coffee consumers.
6. Encouraging governments to establish a revolving fund to balance social needs in select producing countries.
7. Development of meaningful, transparent statistical data from producing countries.
8. Development of farmer risk management and marketing skills.

Although the NCA is focusing our efforts on the following Summit options, we are actively encouraging other entities to consider all of the options as may be appropriate:

- Emphasis on health benefits of coffee consumption, scientifically confirmed, in marketing and promotion.
- Advocating sound government agricultural policies which minimize market distortion.
- Increasing accessibility, convenience, and quality choices for coffee consumers.

The Subcommittee has expressed interest in the role of quality standards. The concept of quality standards was recently debated at the International Coffee Organization (ICO), and the producing and consuming nation members elected to adopt an export-based quality standard. The National Coffee Association supports efforts by producers to improve the quality of their products.

At the same time, the National Coffee Association supports the current FDA import standard, which focuses on the protection of the health and safety of the American consumer. Moreover, the NCA strongly opposes changing an excellent, decades-old FDA standard that is based on health and safety, to meet the totally different objective of supply management.

Since the United States imports only 25% of the world coffee exports, if the US alone were to adopt an import standard for the purposes of supply management, any coffee restricted from US entry would simply find an alternative destination. The most likely effects would be competitive disadvantages for American companies and higher prices for American consumers, with no change in income for coffee growers around the world.

Further, the assumption that a higher quality standard for coffee will lead to increased consumption is without merit. The fact is, American consumers today enjoy a wide variety of quality coffee products. Consumer demand dictates the range of qualities provided by the coffee industry.

I would also add a caution about executing government policies specifically designed to artificially increase commodity prices. The ordinary effects of increased prices in any commodity market are an increase in production and a decrease in consumption. The history of coffee consumption in the United States over the past 50 years is a clear case in point. The NCA's annual consumption survey has shown that, in periods of sustained high prices, consumption has declined. Even after price equilibrium returns, one can never totally recapture lost consumption. Simply put, government policies designed to increase prices are not viable options for alleviating a structural imbalance in the worldwide coffee market. In fact, it is during periods of high prices that production has increased and created an imbalance between supply and demand. This, in part, is why the National Coffee Association supports free markets for coffee.

We do however believe that there are effective and significant roles the US government can play in ensuring the sustainability of the coffee industry, although legislating quality would not be an effective option. The United States is uniquely placed to provide incentives for and guidance to producing nations to help them address the structural imbalance in global supply and demand.

Further, the United States government can provide assistance in developing diversification programs for coffee farmers. Inherent in developing attractive alternatives to supplement coffee production is a need to review US policy, which currently limits market access to many alternative agricultural products. The National Coffee Association recommends that the Subcommittee urge Congress to look at any and all forms of governmental barriers to trade, such as US farm subsidies and restrictive tariffs that often close our own markets to foreign agricultural exports. In this regard, we urge congress to pass HR 3009, the Andean Trade Preferences Act, soon to be reported out of conference committee.

In fact, United States agricultural policy results in low worldwide price levels for the very crops that are best suited for the lands and people of Latin America to diversify out of coffee, if they choose to do so. The region could easily produce more sugar, for instance, but US law restricts the importation of sugar into the US through quotas and also provides US farmers with price supports. The result is that futures prices for US sugar are today more than 20 cents a pound, while world futures prices for sugar are at 6 cents a pound. Nearly every country in Latin America could produce sugar at 10 cents a pound, but under existing quotas, only a very small amount would ever be allowed into the United States.

The same is true for cotton and other commodities. Twenty years ago, Central America produced 2 million bales of cotton; today, the region produces fewer than 200,000 bales, and a key reason is US subsidies to American farmers. While the world price for cotton today is at 40 cents a pound, the US government guarantees that American farmers receive 70 cents a pound.

This type of policy, which effectively limits access to the US market, makes it difficult to impossible for Latin Americans to effectively participate in the marketplace for a range of commodities, prevents them from diversifying into other agricultural products, and also generates unemployment and emigration.

The United States government could also encourage producing nations to adopt agricultural policies that are consistent with effective crop management and provide assistance with quality management at the farm and milling levels.

With an eye toward increasing consumption, Congress could also play a role by encouraging the National Institute of Health (NIH) to support the Institute of Coffee Studies, a research institute focused on identifying positive health effects of coffee, and housed at Vanderbilt University's Medical School.

Finally, the National Coffee Association supports the United States rejoining the International Coffee Organization.

In closing, I am optimistic that we can identify a variety of effective approaches where there is support among the global coffee community, governmental bodies, and developmental agencies. We are faced with a challenge that will require far-reaching and common support as we develop and implement approaches designed not so much to manage the industry for tomorrow, but to build it for future generations. The National Coffee Association is committed to working with Congress, the appropriate executive branch agencies, producer organizations, and consumers as we all act to address this vital issue.

Mr. BALLENGER. Mr. Ted Lingle has served as the executive director of Specialty Coffee Association of America since 1991. As its first full-time employee, Mr. Lingle has successfully guided the activities of the Association, including its efforts to establish a number of technical standards for quality.

Through his efforts, the Specialty Coffee Association has grown from 350 members in 1991 to over 2,400 members today. For his efforts to improve coffee quality, Mr. Lingle was awarded the 1998 National Medal of Merit for the Federation of Coffee Growers of Colombia.

Mr. Lingle has earned a Bachelor of Science degree from the United States Military Academy at West Point and a Master's of Business Administration from Woodbury University.

I look forward to your testimony. Please proceed.

STATEMENT OF TED R. LINGLE, EXECUTIVE DIRECTOR, SPECIALTY COFFEE ASSOCIATION OF AMERICA

Mr. LINGLE. Thank you, Mr. Chairman. I am delighted to be here and very much appreciate the invitation. We realize that there are many important issues before the Congress and really would like to express my appreciation for taking your time to deal with this one, which is an issue very near and dear to the heart of the specialty coffee industry.

I have spent my entire career in coffee. Before assuming this position, I was in the roasting business, a small, family business started by my grandfather in Los Angeles. I have lived through the boom and bust cycles of coffee that characterized the 1970s, 1980s and 1990s. I have seen it firsthand.

The first point I would like to make from my perspective is this is not the issue of the boom or bust over production. This is a structural problem that is going to require a structural solution. We cannot wait and ride it out until some weather disaster happens in Brazil.

Second, if you look at the overview of things that have happened, I think we have to accept responsibility for part of this within the policies of the U.S. Government, particularly as it relates to our farm sector. I share Mr. Nelson's view on this. It is simply because we close out the opportunity for many of these rural Latin American countries to produce agricultural products that would compete with the U.S. farmer, so there is an element of policy here.

I would also like to reinforce the conclusions that you were coming to earlier with the first panel that there is a growing disparity between retail prices and agricultural prices. I think you need to understand that and what is causing it to get a sense of what is happening in the coffee industry.

I think you covered well the issues about this continued decline in the real price of coffee and the devastation it will bring to Latin America, particularly in terms of problems of illegal immigration and illicit drugs. The two are tied together. We see this very clearly in Colombia where it is critically important that our coffee policy, if we can develop one, be consistent with our foreign policy because in Colombia they collide.

It was really the Kennedy Administration back in the 1960s and the Alliance for Progress that Congressman Farr addressed that drew this parallel between changes in the price of coffee offsetting any foreign aid that we can deliver. The two are inextricably tied together.

We see this today in our border states; Texas and California particularly, but Florida as well, about problems created as workers needing jobs move north illegally across the border. It is happening throughout all of Latin America. The problem is if it continues for any length of time then it is a permanent dislocation of workers. Once they leave the rural communities, they do not go back. It is overburdening the major cities in Latin America.

We talked a little bit about the source of the crisis, and the two countries that have come under scrutiny are Brazil and Vietnam. It is important to understand the differences that relates to these two countries. Let me deal with Brazil just quickly to get this one understood.

Essentially, the growth in Brazilian expansion has come from private investment. With the collapse of the quotas and the restrictions, the Brazilians feel that it is in their best interests to increase or recapture their market share. They have worked very hard at becoming efficient producers, so their cost of production is much below the cost of production in the rest of Latin America. As you would expect, a country with the resources of Brazil have become very efficient farmers.

Vietnam is a much different case, and the reasons that make Vietnam a different case first has to do with the investment that has been made in the coffee sector did not come from earnings. It was not growth through earnings, which would have brought a more slow evolution of the sector. It came from outside investment.

The Vietnamese Government, the French Agricultural Development Agency and the Asian Development Bank all invested outside funds in the Vietnamese coffee structure. Unfortunately, they did it in a way that did not lend itself to producing a quality product and so we had this unprecedented growth of a country going from roughly one million bags of production in 1990 to almost 15 million bags by the year 2000 and virtually without any grading standards.

In addition to the problem of foreign investment to disrupt a market, we have this loss of standards. Standards have to do with export grades. It is a matter of industry's way of dealing with-in effect-defective items in coffee.

I brought some examples that I would like to show you, but I would first like to tell you that defects are part of every harvest in every producing country. They are not unique to Vietnam. What makes Vietnam somewhat unique is they are virtually shipping all of their defects because they have no internal consumption. You do not have to be a coffee expert or a grader to recognize that.

If I may?

Mr. BALLENGER. Please do.

Mr. LINGLE. The sample tray on top is what you would expect in getting a good delivery from a country like Colombia. The sample tray that follows would be a good delivery of a robusta coffee from not only Asian origins like Vietnam or Indonesia, but also African origins. The sample tray below represents the material that was removed from the harvest that represents standard defects found in coffee commerce.

The problem today is that under sort of international trade rules, all three of those products can be labeled as coffee when clearly you can see the latter samples stretch that definition to the limits.

To give you an example of the differences, if coffee is delivered against the market in New York, the New York Board of Trade, you are allowed roughly 15 to 20 defects per 350 grams, whereas if you tender robusta coffee in London against the London market, you are allowed as many 450, so a wide diversity.

If we compare that to the current FDA standard, which is really in our view an arcane 1920s regulation, it allows for up to 850 defects per I think it 375 grams. How this gets to be significant is that when we are looking to bring coffee supplies in balance in demand, the strategies are either retention or diversion.

Retention simply does not work because the marketplace waits for the coffee to be released. They know that producers cannot afford to hold it forever. Even Brazil with its resources has trouble holding it forever.

Diversion is a much better strategy. In diversion it causes what we feel are classified as coffee byproducts to be used for other purposes. A good example of the third tray, the triage, is diverting that product into an alternative energy source. It is very cheap, and it is very renewable.

If we were to do that, the economics greatly favor the producer. In an ICO study that was done a couple of years ago, their economist calculated that for every million bags of coffee that are removed from the market, the price will increase two cents a pound. If you look at world production today in the world in producing 118 million bags, it is also producing 11 million bags of triage. That is two times 11 or 22 cents a pound. It does not sound like much, but that translates into roughly $30 a bag of coffee.

If we took Colombia's exports at nine million bags, that is $270 million every year that goes back into the economy of Colombia. If we apply that across the major producers in Latin America, that is increasing the revenues they receive by some $800 million every year.

More important than the diversion aspects of this, and the economics say that diversion is a very sustainable strategy, we will also eliminate the breaks to consumption, and that will allow us to do the NCA strategy of market building because the coffee will taste better, and we will consume more of it.

I realize I am exceeding my time a little bit and would simply close by saying a crisis of this magnitude is going to take a global strategy, and we would definitely encourage the United States to become a player again in the international coffee arena in part by rejoining the international coffee agreement so that our voice is heard in those circles.

Thank you very much for your attention.

[The prepared statement of Mr. Lingle follows:]

PREPARED STATEMENT OF TED R. LINGLE, EXECUTIVE DIRECTOR, SPECIALTY COFFEE ASSOCIATION OF AMERICA

Mr. Chairman, Members of the Committee.

Good afternoon. I am Ted Lingle, Executive Director of the Specialty Coffee Association of America, or "SCAA." It is an honor for me to be asked to speak about this important issue before you today. I hope that my testimony will be of some help to you in your efforts to address the coffee crisis.

Nearly my entire career has been spent in the coffee industry. My grandfather and father were coffee roasters, and I spent the first twenty years of my coffee career working at Lingle Bros. Coffee, Inc., a small wholesale business started by my grandfather and his two brothers in Los Angeles in 1920. Since 1991 I have held my current position at SCAA. SCAA is a nonprofit trade association representing the specialty coffee industry at every stage of production, from farmers to importers and from roasters to coffee retailers. My work brings me in contact with the entire coffee supply chain, from small growers in Hawaii and Latin America to local specialty roasters in downtown Santa Cruz like Ms. Cosby, from large roasters like Starbucks and Folgers to Mom & Pop coffee cafes on Main Street. As demonstrated by the worldwide growth in specialty coffee during the past ten years, this segment of the industry is becoming the catalyst for change for the entire coffee industry.

I am here today to tell you about the conditions in the world coffee market that may soon precipitate a worldwide economic and political crisis with implications far beyond the impoverished farmers in Latin America.

OVERVIEW

Lets look at a few facts:

- On the producing side, coffee is grown in more than 50 countries and on more than 11 million hectares of land, a remarkable 1 % of the world's land area. It generates nearly $7 billion in export earnings for developing countries and is second only to oil as the largest globally traded commodity.
- The coffee industry provides employment to over 25 million people in some of the poorest countries in the world, and smallholders on farms less than 5 hectares produce about 70 % of the world's coffee.
- On the consuming side, as the world's largest coffee consuming nation, importing about 20 million bags annually or approximately 25 % of world exports, the US is a major factor in international coffee commerce. When combined with the import volume of the European Union, which represents roughly 50 % of world exports, and Japan, which accounts for an additional 8%, the major industrialized countries consume over 80% of world coffee exports.

- Also on the consuming side, the industrialized countries that consume more than 80% of world coffee production are providing over $360 billion dollars in farm subsidies annually, almost $1 billion dollars per day, to protect their own domestic farm industries. These subsidies often prevent developing countries from venturing into agricultural products other than coffee.
- In addition, there is a growing imbalance between the behavior of export and retail prices. In the 1980's, the final consumer spent around $30 billion annually on retail coffee sales; of this total, exporting countries took in $9–10 billion, representing 30–33%. Today, the latest estimates indicate that final consumption now accounts for around $55 billion in annual retail sales, with exporting countries receiving approximately $7 billion, representing only 15%.

IMPACTS ON COUNTRIES IN THE WESTERN HEMISPHERE

The magnitude of the economic and social crisis facing coffee-producing countries in Latin America is staggering. Years of little to no natural asset investment (soil, land, water, flora, fauna) have left many coffee producing areas to become the poorest, most economically degraded, and socially unstable regions in their countries. As the price of coffee continues to drop in real dollar terms, many coffee producing areas are ripe for conflict, natural disaster, environmental collapse, and diversion into illicit activities. Inattention to this "disadvantaged and left-out rural sector" has affected the competitiveness of other industry sectors in these regions, such as tourism and commerce, and it has exacerbated ethnic, regional, and class conflicts that affect the political stability and economic growth in many coffee producing countries. Colombia is a classic case in point of the need to coordinate US coffee policy with US foreign policy. While the US has committed hundreds of millions of dollars for economic assistance, US efforts have been significantly marginalized by Colombia's loss in coffee export earnings, which currently exceeds $600 million annually.

An international crisis of this magnitude has political implications for the US, has potential for elimination of traditional coffee sources in Latin America for the US coffee trade, and has the probability of extreme price volatility for US coffee consumers. As the crisis continues to affect countries in Latin America, particularly Mexico, Guatemala, Honduras and Nicaragua, it has the potential to cost jobs for those Americans working in export oriented markets. The kind of poverty provoked by the coffee crisis promotes economic instability in Central American countries that leads to illegal immigration and costs US taxpayers in the Southern Border States from Texas to California billions of dollars annually in order to deal with the crime, health care, and educational demands of these displaced workers. In addition, as coffee and coca and opium poppies compete for the same land, crop substitution for increased exports of illegal drugs into the US becomes an increasing social problem and criminal justice cost to the US Government.

SOURCE OF THE CRISIS

Today the coffee market is in grave danger—threatened by a vast a growing oversupply of ever-lower quality coffee that have driven green coffee prices to historic lows. This is not the temporary boom and bust cycle coffee cycle of the past. It is structural. It is not, and will not be corrected by market forces in the short run.

The crisis has been caused by a large increase in coffee production over the past several years by two countries—Vietnam and Brazil. In the case of Vietnam, within ten years this country grew from a relatively insignificant producer to the world second largest—ahead of Colombia but behind Brazil, now producing well over 10 million bags annually and accounting for approximately 12% of world exports. The unprecedented growth of the Vietnamese coffee industry is the result of loans from the Asian Development Bank, the French Agriculture Development Agency, and the Government of Vietnam. The Vietnamese coffee trees were planted at a time when prices were relatively stable and coffee was a good cash crop. However, the funders lost sight of market economics and failed to consider the impact on prices of increasing supply by 10 to 15 % in so short a period. The problems with Vietnam's coffee production go way beyond the issue of volume. It is also one of export grades. Unlike Brazil, which has traditionally established minimum export grades, Vietnam has virtually none. The intractable nature of this crisis arises because much of the coffee that has been added to the world market is of an extremely low quality.

Coffee grades are a measure of the defects remaining in the mixture of coffee beans after the harvest. It is what we in the trade describe as "triage." It can be described as the "sick, dying, and dead coffee beans," along with sticks, stones, leaves and other foreign matter that come out of the coffee fields as the trees are harvested. And, here I must turn to my props to make my point. . . . More and more of what we are seeing on the market today is "triage." Normally, these sick, dying and dead coffee beans, along with the foreign are cleaned out of the coffee prior to export. Sticks, stones, leaves, dirt and other foreign matter are also removed. While triage is a natural part of every harvest of every coffee producing country in the world, exports of triage coffees are not. To give you an idea of the magnitude of the difference, grading standards at the New York Board of Trade for wash mild Arabica coffees (the coffee produced in Latin America) allow for 15 defects per 350 grams sample, whereas standards for Robusta type coffees (the coffee produced in Vietnam) allow for 450 defects per 500 grams sample. These standards were actually lowered to accommodate coffees from Vietnam. And while there is a difference in price, because both items can be labeled as "pure coffee" in international commerce, the price levels tend to move in tandem, as one product can be a substitute for the other.

Although some exporting countries (and Hawaii) have strict standards of quality that do not allow significant number of defects in green coffee, the United States has no laws or regulations governing purity of coffee. The only thing that passes for quality control in the United States is an FDA "guideline" for import inspectors from the 1920s that urges inspectors only to reject in any coffee with more than 810 defects per 375-gram sample. To put that in percentage terms, the FDA guideline allows a mixture that contains up to thirty (that's three, zero) percent defects to enter the United States and be sold as pure coffee. For comparison purposes, the lowest Hawaiian standard allows export from Hawaii of coffee that contains no more than 5 percent primary defects such as sticks, stones and defective beans.

In recent years, explosive growth in production and sale of low quality coffee has set off a chain reaction of overproduction and falling prices. Low prices mean farmers invest in less of the quality control required to remove defects from coffee. 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. More defects mean more coffee. More coffee means lower prices. Bad coffee is driving good coffee from the market.

POLICIES THE UNITED STATES COULD PURSUE TO ADDRESS THE SITUATION

The crisis is a structural one that is not going to resolve itself via market forces. In April 2001, the Presidents of 12 Latin American countries called attention to this situation in their Quebec Declaration in which they outlined the strategies for correcting the situation:

- Strengthen the mechanisms of cooperation and consultation between producing countries that allow the establishment of concrete solutions.
- Invite the United States of America and Canada to rejoin as members of the International Coffee Organization, so that within this forum, and in dialogue with producing countries, there is an analysis of the possible solutions to the coffee crisis.
- Instruct ministers to search for formulas for consensus, designed to confront the problem, including the organization of supply and demand for coffee, or measures such as the establishment of quality standards for coffee intended for export.
- Reach an agreement with multilateral, global and regional credit organizations that they will not grant loans or donations intended for further expansion of world coffee production.
- Promote the creation of suitable financial tools for the regional development banks, that will allow an orderly management of the world coffee supply, by way of, amongst others, instruments of price coverage and the financing of inventories in producing countries.
- The implementation of the initiatives and policies mentioned above would allow producing countries to promote the establishment of a Second Generation International Coffee Agreement.

SCAA has endorsed the Quebec Declaration. We feel it is a good plan with a high likelihood of success, *IF the US Government will support it as well*. As the world's largest single coffee consuming nation, we have to take the lead in finding a long term, market based solution to this crisis. It is truly in our nation's best interests, both economically and strategically.

SCAA has also become a leading advocate for establishing minimum coffee purity standards. Markets are most efficient when "tiers" and "transparency" are the regulating factors. We see this in any number of agricultural products from meats to eggs, from milk to juices, from produce to jams and jellies. Minimum purity standards in the United States would go a long way toward resolving the problem. Standards would ensure that U.S. consumers were not mislead about the content of the can of coffee, because they would know it met a purity standard to be labeled as "pure" coffee. Commercial roasters would not have a short-term incentive to buy triage for 10 cents on the dollar to create a "price blend" that ruins the coffee market for the long term. Specialty coffee roasters would continue to have access to a wide diversity of high quality coffee beans for their roasting operations. And, the coffee industry would not have to fight an uphill battle for consumer's palates.

A recent resolution by the International Coffee Organization commits member countries to purity standard that is approximately 95 percent. If the US does not follow suit with similar standards, it is hard to envision the ICO's action will have any impact in the world market place. More likely, the US will become the buyer of last recourse for the world's low-grade coffees, and as a result US commercial consumption will continue to decline further exacerbating the crisis.

SCAA is also working with USAID to form a Global Development Alliance for market access and development assistance in coffee producing countries. I feel very strongly that for all of Latin America, except for Brazil, coffee needs to become a value added agricultural product, similar to grape production for the wine industry. Beyond threatening the farmers in Latin American and Africa, the crisis is also threatening the livelihood of U.S. coffee roasters and retailers. In particular, the businesses that make up the membership of the Specialty Coffee Association of America count on a reliable supply to high quality Arabica coffee beans that are not contaminated with defects and impurities. Even the producers of high-quality coffee, who sell the beans that are roasted for specialty coffee, receive an unsustainable price for their product. On a larger scale, when important suppliers of the specialty coffee industry are forced to close their doors, the entire industry is threatened with permanent change, since high quality beans become unavailable. Central American producers in particular, who historically produce very high quality coffee, will be hard-hit. Currently, many farmers are not even harvesting their crops since the amount they would receive would not even cover the cost of production; much less give them a profit as income. It is economically more feasible for them to let the coffee rot in the fields. If pure high-quality coffee is driven from the market the U.S. specialty coffee industry will cease to exist. A market-based solution requires coffee to become a family of differentiated products, whose prices reflect their individual costs of production and not general commodity market prices.

IN CONCLUSION

As the world's largest coffee consuming nation, the US has more than a role to play in resolving the coffee crisis. It has a responsibility. The cost of maintaining our current "laissez-faire" posture on international coffee policy is increasing exponentially. We are precipitating a worldwide economic and political crisis with ramifications far beyond the impoverished farmers in Latin America. As a representative of the specialty coffee industry, we want to express to you our sincere appreciation for your timely interest and investigation of these issues. We are fast approaching a critical juncture in coffee's future and sustainability in Latin America.

Mr. BALLENGER. Thank you.

I would like to ask Mr. Nelson one question. In all the propaganda that I was given to read before we had this hearing, we read about the production and standards for Hawaiian coffee. They evidently have a very strict manner of grading what they produce in Hawaii.

Is that difficult for other producers? I mean, I do not even know what the grading is, but it evidently produces a much cleaner brand or better brand of coffee.

Mr. NELSON. I think Hawaii is a unique place in the country, and it is very difficult to compare the Hawaiian model, which is probably the ideal model, to the rest of the industry.

It is not an issue of grading standards necessarily that results in the high quality Hawaiian, but it is a result of the husbandry and the geographical location of the trees.

Mr. BALLENGER. Do you mean the altitude and so forth? I have always heard that coffee produced at higher altitudes or something was better under the canopy of the jungle.

Mr. NELSON. Generally I think people would argue that in Hawaii it is a very unique situation in that it is an island. It happens to be produced almost at ocean level in some cases, as well as up in the mountains, so it is really a different situation. It is very difficult to compare Hawaii to the rest of the producing world, I think.

Mr. BALLENGER. Mr. Lingle, were you talking about burning this stuff to generate energy?

Mr. LINGLE. They did a study in Guatemala where they converted it. The pelletized it and used it as a fuel to drive an industrial furnace that made bricks.

I just got back from Brazil, and in Brazil I visited a farm where they pelletized that material and used it as part of the drying process for the coffee.

Mr. BALLENGER. And it was efficient?

Mr. LINGLE. Yes.

Mr. BALLENGER. It produced enough heat that you could actually——

Mr. LINGLE. Coffee contains sugars, fats and oils, so it is a very efficient fuel.

Mr. BALLENGER. Ms. Crosby, I am just curious about that visit you had. When was that?

Ms. CROSBY. Last year I went to Nicaragua twice, and I went to Colombia in June.

I just want to also state that it is 125 million people we are discussing, the lives of 125 million people as we talk about this commodity. I think sometimes it is easy to think you are just exchanging money when you are talking about a commodity. You are also exchanging human lives. Sorry.

Mr. BALLENGER. No. Actually, I have been to Matagalpa and have helped them build homes there.

Ms. CROSBY. Excellent.

Mr. BALLENGER. I recognize the crowds of people that have come from the coffee farms into town that makes it really a frightening situation.

Ms. CROSBY. Twelve thousand people.

Mr. BALLENGER. Mr. Silva, do you remember the earthquake in Armenia? Your President invited me to come down, and we went to Armenia. It looked to me like the most fabulous coffee growing area I had ever seen. Everywhere you went they had these little coffee trees under every bush in preparation for I guess transplanting into something greater and so forth.

Is that area suffering as well in this whole problem that Colombia has now?

Mr. SILVA. Yes, sir. The situation is affecting the whole country, all growing areas. The price of coffee right now barely covers 70 percent or 65 percent of the average cost of production. It is across the board.

In some cases when you are talking about peasant farms, because they devote their own labor, you do not see the impact as much because they do not have to pay for external workers. Certainly it is affecting the whole area.

The ones who are most affected are the smaller lots that are in the less productive areas. They are the ones who are actually more vulnerable to these pressures.

Mr. BALLENGER. Right. Mr. Delahunt?

Mr. DELAHUNT. Thank you. I want to applaud Ms. Crosby for her social conscience. It is very refreshing.

Ms. CROSBY. Thank you.

Mr. DELAHUNT. Let me ask you a question, Mr. Nelson. This article that I read from by Peter Fritsch; is it true that the corporate profits rise as retail prices fall far less than wholesale?

Mr. NELSON. I have no knowledge actually of the corporate profits other than what my own stock portfolio does, which is not good.

Mr. DELAHUNT. We are all experiencing that, though. Who makes up the trade association that you represent?

Mr. NELSON. Our members are importers and roasters of coffee. They range from small companies, specialty roasters, to large companies that are specialty and/or commercial roasters.

Mr. DELAHUNT. But they do not involve Proctor & Gamble and Philip Morris and Kraft Foods, Sara Lee?

Mr. NELSON. They include those and a couple hundred more. However, I do not track the members' profit levels. They are members, along with others. Yes, sir.

Mr. DELAHUNT. So they are members?

Mr. NELSON. Yes, sir.

Mr. DELAHUNT. And you do not know how they have been doing?

Mr. NELSON. Not on their profit levels, sir.

Mr. DELAHUNT. You do not?

Mr. NELSON. No. The only thing that we track with regard to money, if you will, is the price of coffee.

Mr. DELAHUNT. Yes. I understand that. I mean, I just thought maybe curiosity might motivate you.

Mr. NELSON. No, sir, it does not.

Mr. DELAHUNT. Okay. At the same time, presuming that this statement is accurate, I do not know Peter Fritsch. He might be an excellent journalist, yet again maybe he is misrepresenting the market conditions. I do not know.

I am really confused. Corporate profits are up. Retail prices, maybe they are falling. I have not noticed it when I buy my fair trade coffee at the Starbucks franchise here, but yet we have 125 million people who are experiencing real pain and anguish. It just makes me wonder. There is something wrong there somewhere.

Then I read it is 40 percent. Let me ask others. Ms. Crosby, do you sense that the options that are available for the producers are limited, and does that have an impact on price?

Ms. CROSBY. When I was interviewing the mayor of Jinotepe, he said he wished he could talk to the U.S. Congress directly and that he could talk to the President.

Mr. DELAHUNT. Well, you do it for him.

Ms. CROSBY. He said if he could talk to the President he would say, and I wish I had brought the notes with me from the interview. He said that his whole city is suffering from extreme, low prices, and he knows that they are selling on the grocery shelves here in America for so much more.

Mr. DELAHUNT. I understand.

Ms. CROSBY. He has asked, "Where does the money go to?"

Mr. DELAHUNT. Right, but here is my question. Does he have any choice?

Ms. CROSBY. What he said to me after that is he was talking about what Nicaragua was working on in terms of alternatives to coffee, and he said one of the problems is that when you go to make a transition to an alternative crop, you are talking about years in order to make it really, truly productive. The crisis is now.

Mr. DELAHUNT. Okay.

Ms. CROSBY. The economist magazines said 5 years; at least 4 or 5.

Mr. DELAHUNT. I understand that and alternative uses, but what I am talking about is now. In other words, at the production level are there choices? Is there competition for the purchase of that coffee that is produced in these countries, or is the marketplace so restricted, so concentrated——

Ms. CROSBY. The marketplace is extremely concentrated.

Mr. DELAHUNT. See, I am starting to get a sense of that when I read the *Wall Street Journal*.

Ms. CROSBY. The American consumer frequently in the mainstream buys by brand and not by quality. The branding has caused a high concentration in the marketplace in the U.S.

Mr. DELAHUNT. You know, it is a 40 percent concentration level here, so is it a free market? Is a healthy, great dynamic of capitalism going on, or is it just a lot of big players that are controlling the market, and there is limited opportunity to sell if you are a campesino up in the hills of Nicaragua or in Colombia? Mr. Lingle?

Mr. BALLENGER. Mr. Silva, I think you mentioned the growth of a cooperative. I do not know whether this would apply as well in Nicaragua, but I think you were the one that made the presentation that the cooperative started with 300 acres and then went to membership and so forth and so on.

Mr. SILVA. Yes, sir. The structure of coffee marketing in Colombia is interesting because 30 percent of it is done by the Federation, and it is based on cooperatives. Basically what we do is market for those coops, and also we have the private sector exporters involved.

In the areas in which we cannot be present, the prices, the local prices that the grower gets, are between 20 and 40 percent less than the areas in which we have a presence, so community organizations, cooperatives and direct producer controlled channels to the market increase the price for the final producer, but, at the same time, when we take this coffee to the world market we are limited by the realities of the price.

Mr. DELAHUNT. I understand, but is the world market dominated by so few purchasers, so few wholesalers, let us say, that they, in effect, dictate the price? It is monopolistic, if you will.

I mean, do we have a problem in terms of such a concentration that there are the few players that can really dominate, and I do not want to use the term price fixing, but dominate the market to the point where you are out there?

I understand that excessive production seems to be a problem, but is it compounded by the fact that there are not enough wholesalers, and the marketplace is concentrated with those who can purchase the coffee and, therefore, few options?

Mr. SILVA. On that particular point, Congressman, in one of my inauguration speeches for the Federation I stated that we are starting to see the early stages of an oligopsonic market structure, meaning basically a reduced number of buyers.

Mr. DELAHUNT. Right.

Mr. SILVA. I will agree. I would not dare to say that we are, as you mentioned, close to a price fixing situation, but the options and the channels available are being reduced and increasingly concentrated.

The ability of the exporters to differentiate their coffees is critical to finding options, and what we are really asking for is allowing us to show the consumer. Let us bypass the strict and the private ways to present our coffee to the consumer. Allow us to tell them what those coffees are, and allow us to take our coffees to them.

Mr. DELAHUNT. You have no problem with that recommendation, Mr. Nelson, the request by Mr. Silva? You would agree?

Mr. NELSON. I have no problem with a good information flow back and forth.

Mr. DELAHUNT. No. You would not have a problem with his recommendation?

Mr. BALLENGER. Did Juan Valdez have any effect on your operation? I mean, I know it did on yours, but I was just wondering. You built a quality image with Juan Valdez, and I think that is what Bill was talking about. What effect did that have on the purchasing of coffee by your group?

Mr. DELAHUNT. Mr. Chairman, could I?

Mr. BALLENGER. Yes.

Mr. DELAHUNT. That is okay. There is some banter here, but I guess I need from Mr. Nelson to know that, you know, the grade of coffee, if it is part of the label, for example, I think that is what you were getting to, Mr. Silva.

You do not have a problem with that? In other words, so I, as an avid coffee drinker, know what I am drinking. You do not have a problem in terms of whether I am drinking this or whether I am drinking this. Where is the free flow of information?

Mr. NELSON. And in the United States coffee is regulated under the law with regard to what is in it. If a coffee container is marked coffee in the United States, under U.S. law it must be coffee.

Mr. DELAHUNT. No, no. I am talking about I want to know what I am drinking. I want to know the quality of what I am drinking. I can read. I know if it is coffee. I can figure that one out on my own, but what I want to know is what the hell these beans are. Are they good beans, or are they bad beans?

I cannot imagine that you would have any objection to having that information as part of what is available to the consumer on the can. Maybe I am incorrect, but if you could tell me specifically yes or no or maybe?

Mr. NELSON. We have not taken a position as the Association on labeling. I did not discuss it with the members prior to this hearing.

Mr. DELAHUNT. Great. Thank you.

Ms. CROSBY. Could I quickly just talk about the mainstream? I just found a paragraph on an issue paper for the Center of Development Research in Copenhagen on foreign aid policy and practice. Could I read two paragraphs real quick? They are short.

"International prices for green coffee is more than half from January, 1999, to November, 2001. Coffee is grown in over 50 developing countries, and low coffee prices are affecting the livelihoods of an estimated over 100 million people involved in its production.

"One of the factors behind the crisis has been oversupply in the global coffee market. Supply has outstripped demand in the last three seasons. Yes, it is often forgotten, but one cause of oversupply was a push to promote export earnings under market reforms. Vietnam, for example, produced less than four million bags of coffee in 1995. In 2001, it produced over 11 million.

"Furthermore, the crisis is not simply a matter of oversupply, but also deregulation of international and domestic markets and of shifting power balances with the global coffee chain. A combination of political and administrative factors, plus the withdrawal of consuming countries' support for the quota system, led to the collapse of the ICA in 1989.

"At the same time, producing countries started liberalizing domestic coffee markets. In consuming countries, the international trade and roasting segments of the marketing chain became more concentrated. International coffee prices fell, and price volatility increased. However, retail coffee prices declined only marginally. As a result, a sizeable slice of the total income generated in the coffee chain . . ."——

Mr. DELAHUNT. Ms. Crosby, can I suggest that you submit that to the Committee?

Mr. BALLENGER. Right. We will be glad to have that in the record.

Ms. CROSBY. Okay.

Mr. DELAHUNT. I have to depart. I apologize, but I have another meeting.

Ms. CROSBY. All right.

Mr. DELAHUNT. Mr. Farr I know——

Mr. BALLENGER. Sam may want to pick up on that, or he can do as he wishes.

Ms. CROSBY. All right.

Mr. FARR. Thank you, Mr. Chairman. I think submitting it for the record will be fine.

I, first of all, want to really thank you as Chairman of this Committee for having this hearing, and I hope you will allow some questioning here because I really think this is a very important issue.

I want to ask Mr. Lingle. Do you support the ICO? You know what the ICO stands for, the International Coffee Council's Resolution 407, which was adopted and approved at their meeting in February of this year.

Mr. LINGLE. This is the standards and purity resolution?

Mr. FARR. Yes.

Mr. LINGLE. Very definitely. Our association has passed a resolution stating that we should not only support that, but we should come here to Congress to ask you to support it as well.

Mr. FARR. Thank you.

Mr. Nelson, do you support this resolution, the Association?

Mr. NELSON. We support that and all efforts that the producers make to improve their quality.

Mr. FARR. Pardon me?

Mr. NELSON. We support that and all the efforts the producers make to increase quality.

Mr. FARR. Do you support Resolution 407 on the quality standards?

Mr. NELSON. The export standard, yes.

Mr. FARR. And the certificates of origin and so on? Okay.

Is there any other product that we import—perhaps, Mr. Nelson, you would know this—that has the socio-economic structure of coffee growing? As I understand it, and Mr. Silva's presentation pointed out that 35 percent of the rural economy of Colombia is in the coffee production. Thirty-five percent of the rural economy. Not a large part of the entire country structure, but still significant, particularly when you look at that segment of society, and that the average coffee plantation, so to speak, is about four hectares.

Is there any other commodity that is grown in such small size, units, that we import as an ingredient? I mean, is chocolate or coca? It seems to me that what I am getting to, and maybe I am not asking the question right. Is the sociology of coffee, the manufacturing of the beans on the plant and how that is agriculturally done, different than any other crop that we have?

Bananas are grown on big plantations. We import those. Wheat and corn, obviously we know all that. We produce those by machines, but coffee and the micro climate that it grows in sort of requires that it is a very labor intensive crop.

Is there anything else that can be grown in such small percentages, or are there huge coffee plantations that are just machine driven?

Mr. NELSON. The only part of the question that I can answer to is with regard to the coffee specific question. To answer that, yes, there are huge coffee plantations where coffee is harvested by machines.

With regard to other imports or how other agricultural products are produced in producing nations, I would have to say that I am simply not familiar with the overall rural economy or agricultural sectors.

Mr. FARR. I drew the similarity to grape harvesting because I represent a lot of grape growers, and I have done a lot of work with them on quality and labeling and that kind of stuff.

I think there is a similarity between wine and the niche out there and the marketing and the boutique of it as you are seeing in coffee as people are now labeling coffee from different regions of the world and different kinds and classes of coffee. It is getting very boutique in many ways. Then you have certainly the coffee houses of America that were not around when I was in college that are all over college campuses.

Probably we ought to look at some of the similarities between those specialty crops because there is always supply and demand, but it seems what is moving in that industry is upgrading the quality and then the buyers, the wineries, are essentially paying better prices for better quality grapes. We ought to be probably trying to support that in whatever similar type ag policy we can develop.

Ms. Crosby, you are a business woman. You come here testifying with a social conscience that corporate America ought to have. What is it in your business sense, wearing a business hat, when you are in competition with Starbucks. You are in competition with the big chains. How do you make it?

What do you have to pay for the coffee beans that you buy? If those coffee bean prices go up, could you still stay in business?

Ms. CROSBY. We are carrying fair trade coffee so, in effect, our coffee bean prices are higher, but we can stay in business. What it takes to stay in business is really informing the consumer.

I really support the idea of a good marketing campaign of what are the qualities of coffee, and included in the qualities of coffee would be the unique taste characteristics that make up coffee, also the environmental and social concerns are also the qualities of coffee, so an educational campaign.

Mr. FARR. With all due respect, when I go into your coffee store I just order a cup of coffee. I do not know whether the beans are fair trade. I do not come in and say I want fair trade coffee.

Ms. CROSBY. When you walk into our premises, you will not help but notice. There are fair trade signs everywhere.

Mr. FARR. I know, but I do not think you need to put the burden on the consumer.

Ms. CROSBY. Quality really drives the market as well, but informed consumers are entering our premises. The difference with the mainstream is that they are not informed. I think it really takes a good educational campaign.

The quality of coffee has gone down over the last 30 years, the general, mainstream coffee. It has decreased over 30 years consistently. The decrease in prices right now has led to even further decline in the quality of coffee.

Mainstream consumers are becoming less aware what is in coffee. They are purchasing a product that is labeled coffee and is not coffee, so their lack of awareness is adding to this crisis.

Mr. FARR. Do you have competition from Starbucks?

Ms. CROSBY. Yes.

Mr. FARR. How close are they physically related to your store?

Ms. CROSBY. Across the street.

Mr. FARR. And who sells more coffee?

Ms. CROSBY. I would hate to tell you what I know. I do not know if I can reveal this or not. I know that we are extremely popular, and I understand that Starbucks may not be——

Mr. FARR. As successful?

Ms. CROSBY. As the other locations of Starbucks. I do not want to quote that. That is just from staff that happen to work at Starbucks.

Mr. FARR. The point is you have a competitor across the street, and you do better, and you have this higher standard of coffee.

Ms. CROSBY. A higher standard of coffee. We are really concerned about quality. That is what is on this video is the quality labs that we saw that were created by USAID, the company labs.

Mr. FARR. And what do you have to pay for your pound of quality coffee, your fair trade coffee?

Ms. CROSBY. I think it is about $1.38 for us. I do not remember for sure. I am sorry. I am not the person who pays the invoices when they come in.

Mr. FARR. Mr. Nelson, what is the average price they pay for Latin American coffee from coffee growers?

Mr. NELSON. The average green price of coffee?

Mr. FARR. Yes, per pound. I think it was in somebody's testimony here. Maybe it was Mr. Silva's testimony. I saw Latin American coffee at about 50 cents per pound.

Mr. BALLENGER. Mr. Silva is trying to give you an answer.

Mr. SILVA. The quoted price currently is around 50 cents. The average real price, because the lower qualities are sold at discounts, is around 32 cents per pound.

Mr. FARR. And you pay $1 and something?

Ms. CROSBY. Well, we carry organic, fair trade, bird friendly coffees, as well as conventional. We also carry some conventional coffees.

The price is important, and businesses operate fine with dealing with the price. Concentration in the market is probably more of a problem. In an econometric study that I did in the 1980s that led to the fall of a lot of coffee houses, the concentration that was happening.

The one other paragraph I think I would love to just get into the record real quick is that——

Mr. FARR. You can submit anything you want.

Ms. CROSBY. "Even if the initiatives work in fragmenting and upgrading coffees . . ."——

Mr. BALLENGER. Sam, what is the difference in price of those three?

Mr. Lingle, could you tell me if we were buying coffee? You have three different grades here. I can tell by looking at them. What is the difference in price? Is there a difference that anybody would know? I guess professionals would.

Mr. LINGLE. Well, yes. There is a great deal of transparency on the green side, so those prices are actually quoted every day in some periodicals.

If you looked at the Colombian coffees on your far right, those coffees are traded at anywhere from 10 to 15 cents a pound above what is known as the New York market. The New York market closed today at 48 cents a pound, so if I were buying that coffee I would add 10 or 15 cents a pound to it, and that would be my price. That is assuming that I am large enough to buy a container full, 250 bags.

The coffees in the center would be graded out as Type I robusta. I am not sure where the robusta market closed today. I would assume it was around 28 cents a pound.

The triage coffees are traded as a percent of the regular price, so generally those coffees are selling at about just 20 percent of the market price. If that is 30 cents a pound for robusta, then robusta triage trades at six cents a pound. That is why the economics of triage removal are so compelling.

Mr. FARR. What I am also compelled about is I am worried about the statement of Mr. Nelson sort of attacking the market, the price supports for sugar in the United States. The reason we have price supports is because there was a race to the bottom. As you know, the world price for sugar is considerably lower than the U.S. price.

We buy sugar from the very same countries we buy coffee. Those countries love being able to sell it to us as part of our foreign aid program. Why should we not do the same for coffee?

Mr. NELSON. I am unclear on your question, Congressman Farr.

Mr. FARR. El Salvador, Nicaragua, the Caribbean nations, essentially the Central American countries are all sugar cane producing countries.

Mr. NELSON. Right.

Mr. FARR. They produce raw sugar. They have access to the American market. We have a quota for their sugar, and we pay them American sugar prices and also for the Caribbean countries as well. That price, as I said, is considerably higher than the world market price, and we are able to sustain sugar production for those producers.

Why should we not, if it is good social policy and part of our international aid program, keep that agrarian economy going in agrarian countries? Why should we not have the same policy regarding the purchase of coffee beans?

Mr. NELSON. Well, we do not, I believe, have domestic prices on coffee other than in Hawaii.

Mr. FARR. No, we do not. That is what I am suggesting perhaps.

I mean, I think that there is a real responsibility here from the people that you represent, which are all Fortune 500 companies. We as policy makers have a responsibility regarding American taxpayer money, including the taxes that your companies pay and the assistance we give those companies in greater corporate America being able to do business in this country and being protected by all the laws of this country. That is why I asked the U.S. Department of Agriculture what it does to help those companies because I am sure that one way or another, there are programs where we use our government services to make sure that those companies which are dealing with food quality have standards that are protected, that protect them in the industry.

What I am trying to get at is I do believe that there is a corporate responsibility somewhat of what Ms. Crosby is talking about. She is a business woman. She talks about having this business sense of standards that really affect people's lives.

We have pointed out that in coffee production it is a unique kind of culture, particularly in Central and Latin America. So why, with this great elasticity between what you have to pay and what you sell the beans for, is there not more assistance to try to help these countries by buying these quality beans in greater quantities?

Mr. NELSON. Well, I think, first of all, that corporate responsibility is important, but I think that corporate responsibility and price subsidies are two different issues. Certainly our members promote selling coffee in the free market. Subsidizing the prices of coffee will stimulate production, and one of the main issues that we are dealing with here is over production.

Our members for the better quality coffees are paying higher prices. In fact, you talk about price elasticity, and I believe that retail prices have dropped since the high back in 1997.

Mr. FARR. Are you buying these cheap beans?

Mr. NELSON. I do not buy any coffee. I would like to point out——

Mr. FARR. Your members. Do your members buy the cheap beans?

Mr. NELSON. Our members buy a wide range of beans. What I would like to point out is that the coffee, as it is grown with other commodities, is a natural, imperfect product.

The product that the coffee industry buys as it is imported is not necessarily the product that ends up in the package. As with any raw commodity, those imperfections in the commodity are removed prior to the product being served to consumers. In fact, it is under U.S. law and FDA regulation that requires you to provide wholesome coffee; not something else, but a coffee product.

The beans that come in from an import standpoint go through many processes to clean them and to take out impurities. It is the same as wheat. We do not expect the wheat farmers to have 100 percent pure Type 1 wheat.

Mr. FARR. Can you see what I am trying to get at? If you do not want us to regulate the market, we are spending in Colombia alone $1.4 billion just to stop the coca trafficking. You saw the pictures there. Because of desperation, the best coffee growers in the world are turning to growing coca. If they are the best coffee growers in the world, they are certainly going to be the best coca growing farmers.

That is not in the American interest, and yet we have American corporations that are racing to the bottom to buy the cheapest coffee you can buy. Where are we going to be able to solve this problem if we cannot get a better price? It rests with the industry.

If the industry does not pick up the slack, then those of us in Congress are going to have to do something, and that is going to be something that your association is not going to want to do. Where is that corporate responsibility that Ms. Crosby talked about?

Mr. NELSON. To answer your first question, if I may, I think that it is very important that we as U.S. consumers, roasters rather, industry, focus on increasing consumption. I believe that the industry is doing the best it can through the development of new products.

Mr. FARR. Do you have marketing orders? Do you put private money into that as the Colombian flower growers are putting in Colombian money into the U.S. market to promote more flowers being purchased in this country in partnership with American flower growers? Do you do the same thing?

Mr. NELSON. U.S. companies spend millions, hundreds of millions of dollars, promoting consumption, and as the Association——

Mr. FARR. Of higher quality coffee?

Mr. NELSON. We promote the consumption of coffee. There are many different types of coffee. The National Coffee Association has just released to PBS and is coming out with a video that will be shown around the country on PBS regarding the varieties and growing methods for coffee.

Mr. FARR. Would your association put money into marketing fair trade coffee?

Mr. NELSON. Our association believes that fair trade coffee is an option, but that it is up to roasters, as with the other socially responsible things that roasters do.

Mr. FARR. But the quality of coffee, according to Ms. Crosby, is going down. The world production of poor quality coffee is way up, and we are out there buying it at the cheapest possible price. I do not know if I can instill upon you how important it is.

The Chairman of this Subcommittee is a private businessman. When he takes his private dollars to go down and build hospitals in Guatemala and assist—he is in the furniture manufacturing business—in getting desks into schools, he does with this corporate or private responsibility the same thing Ms. Crosby does.

What I am saying is there has to be more of a conscience in the coffee purchasing process here or we are going to run headlong into wanting to regulate your business. Because if Latin America and Colombia are failing because market prices are falling and we as a country are trying to save that country so it will not grow coca and if one of the ingredients of that is the price of coffee, you can be damn sure that we are going to pay attention to the conscience of the coffee association that you represent and its purchasing and its marketing.

If you want to market more coffee, then market fair trade coffee or market higher quality coffee. Do not market the cheap stuff, because increased consumption of cheap coffee does not solve this problem.

Mr. BALLENGER. I think I have to say that I am a free trade kind of guy, but for a quotation of coffee bearing these three plus what you pay for yours, and it goes from six cents to 30 cents a pound to 58 cents a pound to $1.58 a pound, so there is a great deal of variation in the price that is available, and obviously what you are buying is probably the highest grade that you can find.

Ms. CROSBY. A good quality.

Mr. BALLENGER. Very good quality. It appears to me that if I were trying to change the market, and I think I am with you on the idea of Vietnamese coffee, you could draw a picture of a dog or something like this. Is this the kind of stuff you really want?

To take the higher price coffee, and you all did it with Juan Valdez. I mean, I read the history of it. I do not know how effective Juan Valdez is now.

Mr. FARR. He is not now because the price has dropped so much that they cannot afford to market it.

Mr. BALLENGER. That is right. You cannot afford to carry the cost of Juan Valdez anymore.

Mr. SILVA. Mr. Chairman, we had to stop the campaign because we did not have the resources. We had to spend the resources in basically providing social services to coffee growers, and we could not advertise.

Now that you are highlighting the point, first I want to say that we do not believe in price subsidies or supports in the sense that Mr. Nelson was suggesting. We believe that the prices will come up if people are allowed to understand what they are drinking.

The fact that people are willing to pay a premium for Ms. Crosby's coffee, that is significant. A smaller premium for Colombian coffee and also a premium, for example, for certain Guatemalan coffees, shows that when people know what they are buying they are willing to pay.

Mr. FARR. Right.

Mr. SILVA. What is going on is that people in certain types of coffees, particularly the mass market coffees, are not getting through the message. They are not receiving the message.

In that sense, we advocate the fact that if someone wants to buy Colombian coffee they know it is Colombian coffee that is in the coffee and how much Colombian coffee is there because, for example, what happened with Juan Valdez is we invested $500 million during 10 years to make Juan Valdez and 100 percent Colombian coffee a symbol of quality.

Now you see some product on the shelves that says Colombian blend. They are piggy-backing on the $500 million that we spent. If you do the analysis——

Mr. BALLENGER. I am going to shut it down, Sam.

Mr. SILVA. If you do the analysis, Mr. Chairman, of how much Colombian coffee is there, you can actually trace.

Mr. BALLENGER. Right.

Mr. SILVA. You find that branded Colombian blend is less than two or 3 percent Colombian coffee, but it is sold on the perception——

Mr. BALLENGER. Right.

Mr. SILVA [continuing]. That it is a high quality coffee. It is not. We did a marketing effort, but without the support of transparency and information to the consumer that effort is being lost.

Mr. BALLENGER. Let me just say, and I do not want to keep you all here. I think we can shut it down, but I am a businessman, and I happen to represent the largest textile producing area in the United States. In defense of the situation, I say we have developed a WalMart-psyche in this country. That means no matter where you go, you want to buy the cheapest thing you can find.

As long as you do that, you are not going to find it made in the United States, and you are not going to find your coffee made in Colombia or grown in Colombia. You are going to end up with it tastes kind of strange, but I cannot tell if it is Vietnamese.

The basic idea is you need the promotion that you have and the quality that you have to tell these guys that we all ought to work together and upgrade Americans. I mean, I drink so damn much coffee toward the middle of the day I do not know what I am drinking because sometimes it is terrible. I do not know really whether it came out of a different pot or it is just that time of day that I have corrupted myself by drinking coffee.

I would say that we all, at least this group here, know that we have a real problem in our friends in Central and South America, and someone aiding them to be able to exist in a situation where the world market—really, if we could figure out a way to prove that this stuff that is grown in Vietnam is cheaper than fuel oil and we can start generating electricity with it, it would be great for the Vietnamese. They could have all the electricity they want, and we would not have to get rid of all the cheap coffee, but that is not a true answer. It is tongue in cheek as a method that might do something constructive.

I realize handling the big boys that I am a free enterprise guy, too, and I hate to say it, but government controls I do not really see. I do see when I can just in the discussion here come up with four different prices for coffee and sit here and look at it and can see the difference, but once you cook it and grind it all up, I cannot tell the difference between one and the other.

It used to be we could say Juan Valdez on the outside meant that that was top grade, but now, as you say, advertising has gotten Colombian blend in there, and we have now turned coffee into WalMart, the cheapest stuff you can buy.

I wonder. When you go to the store to buy coffee, and I do not do it so I do not know. Do people actually shop for the top grade coffee in the store? I have never been to the grocery store to buy coffee, so I do not know.

Mr. FARR. If you go to Safeway or to even Costco where you can buy coffee in bulk, the Costco bags do have Colombian coffee. In the Safeway stores where you put the bag in and you just fill it up it says Colombian.

I wonder. My question is really a lot to that. Is there anybody who really goes around and inspects that knows whether that coffee is 100 percent Colombian?

Mr. BALLENGER. That is a good question.

Mr. NELSON. I probably should let Mr. Silva answer this, but the 100 percent Colombian and the Juan Valdez logo, which many of our members use, are actually licensed trademarks of the Coffee Federation.

Mr. FARR. Yes.

Mr. NELSON. Yes. They go through like American companies to protect their trademark and to enforce their trademark, so yes.

Mr. BALLENGER. So you defend his trademark?

Mr. NELSON. Excuse me. He defends his trademark.

Mr. BALLENGER. He does, but if you use it you defend it, too?

Mr. NELSON. Absolutely. U.S. roasters have a big investment in that Juan Valdez program, and that is why they have invested in that as co-branding with the Federation, along with their own brands. Our members respect that logo.

Mr. FARR. My question is let us take Safeway. It is raw coffee. It is roasted coffee, and it is in those where you put the bag under and lift it up. You think that is Colombian. It does not say 100 percent. It just says Colombian.

Do we have any inspection mechanisms in America to know whether that is truth in labeling, that it is really Colombian coffee and not a blend?

Mr. LINGLE. Unfortunately, the answer to that is no. That is part of the reason the specialty industry grew up is the truth in labeling was a very big issue for our members.

Mr. FARR. Wow. Well, that opens up all kinds of interesting——

Mr. BALLENGER. Ms. Crosby has already proven that if you really want to make it work, that is the way to go.

Mr. FARR. If I may, this is a big crop for Colombia.

Mr. BALLENGER. Sure.

Ms. CROSBY. Yes.

Mr. FARR. They have been growing it for a long time, so they invested in the Juan Valdez logo, which was essentially a promotion not for a particular brand. There are lots of coffee growers in Colombia.

Mr. LINGLE. Right.

Mr. FARR. This was just no matter where it is grown, no matter what part of the country, it is Colombian coffee. It is sort of like Made In The USA.

Mr. LINGLE. Right.

Mr. FARR. That was so successful that you could command a higher price for it on the New York market to where it was 10 cents above the other.

Mr. BALLENGER. But the bottom fell out of that.

Mr. FARR. Now they do not have the promotion, but still people use it. It has become a marketing tool because you go in, and it is labeled on these things.

It seems to me that, frankly, part of the increased popularity of drinking coffee in the United States came from the effort of Colombians——

Ms. CROSBY. Yes.

Mr. FARR [continuing]. By advertising Juan Valdez. He is gone because they cannot afford him.

What happens now? Does this Colombian coffee come sort of from anywhere in the world? Do you just call anything you want Colombian coffee?

Mr. LINGLE. No. From our point of view, it is very important for us to protect the geographic indication of origin of our producers. Colombia is where we have the biggest problem.

Mr. Franco was talking about programs in conjunction with USAID. We just started one with USAID in Colombia, and part of that will be verification of origin. This is not a new agricultural problem.

A classic example is the potato growers in Idaho and substituting Washington potatoes for Idaho potatoes. While Washington potatoes may be perfectly good and safe for consumption, they are not Idaho potatoes. They did research with the University of Oregon and used trace mineral analysis to either confirm or dismiss claims that potatoes that were grown in Washington were in fact not Idaho potatoes.

If you use a combination of science, of industry involvement through association and create an atmosphere of respect for geographic indication of origin, you can stop what is sort of borderline consumer fraud.

Mr. BALLENGER. I think Sam——

Ms. CROSBY. There was Kona that was sold on——

Mr. BALLENGER. Excuse me. Go right ahead. I do not want to cut you off.

Ms. CROSBY. There was Kona sold that was not really Kona sold in the marketplace. That happened, too.

I also just want to share really quickly that when I was on my way to the airplane I started a conversation about coffee with about seven people in line about how 25 percent of the coffee inside of their can was not real coffee. Everybody was shocked and asking me what was I talking about. I explained it was called triage, and it is made up of bark and garbage and other things.

Mr. BALLENGER. Yes.

Ms. CROSBY. They all said the they were not going to buy any more of the canned coffee just from a quality standard, but they had no idea that this was why it was tasting so bad.

Mr. FARR. I mean, the bag may contain it, but before they roast it they filter that, do they not?

Ms. CROSBY. Sometimes it does not always get filtered, unfortunately.

Mr. FARR. I would think they would. There is an analogy there that for the standards, these ISO standards, if we can get those standards established in the United States and enforced labeling because you are going to have origin of labeling, it may help bring the price, but I also think the advertising.

Frankly, Mr. Nelson, I would be glad to go speak to the Association, that you have to help promote quality coffee in your marketing, not just coffee.

Mr. NELSON. Yes.

Mr. BALLENGER. Let me just say, first of all, thank you all for being here. I am sorry we kept you so late.

As you can tell, not only are we terribly interested in coffee, but I think along with that goes a desire on our part to see what we can do to assist the people of Salvador and Guatemala and Nicaragua and Colombia where that is a major crop.

Now, I do not know what you are going to do about Brazil because we have run into this very same situation, and I do not know if you all remember it or not, but the British and the French wanted to buy bananas from their islands that belonged once upon a time, so they had lots of little bananas that were grown there, and each little guy had a half acre of bananas. They would collect them all and sell them.

Everything was going great guns until we sued using Chiquita Banana and Dole. We sued in the World Trade Organization to say that the British and the French had to buy their bananas wherever the market was cheapest. We won the suit. From that time forward, they had to buy their bananas from Honduras and Ecuador, and it destroyed the little islands as far as the economies that they had in the Caribbean.

I have been to Dominica, which used to have its only income was growing bananas. Now you cannot give the bananas away because they cannot compete possibly with Honduras where, you know, there are 50,000 acres and so forth of bananas.

I do not want to get in that situation with coffee because there are too many people involved for us to damage the economies of all those countries, and that is the reason.

I think Sam is trying to put the screws on business, and I would not quite go as far as Sam would, but I do think that the social conscience of the big companies if they look at the idea that we can help the economies of these countries by at least properly identifying what is in the package. I do not know how you go about it, but——

Ms. CROSBY. Yes. That is critical.

Mr. BALLENGER. Right. I know we put a whole bunch of Federal money into advertising because we get a fight every time we have it up here about whether we should continue to put that money for the national firms for the international advertising they do.

Maybe we ought to force them to use that advertising and put some money in. I am kidding. Excuse me.

Mr. FARR. Mr. Chairman, I really appreciate this hearing, and I really see your sense because your interest in the well-being of the Southern Hemisphere and my interest from being on the Agriculture Appropriations Committee, which, you know, puts out about $80 billion a year for agriculture in this country. We really need to tie these two together. I think we have done it in many other policies and will find analogies to it.

We need to work with the industry to make sure that we can really kind of upgrade this sense. I think the American consumer wants to do the right social thing, but I do not think we should put the entire burden on just the consumer having to have all the knowledge and to have to have sort of the right speak and just say, you know, I am only going to ask for one type of coffee in order to help campesinos in Colombia.

I do think we can use private/public partnership ways of improving the quality of life and the quality of the economy for these countries that we are not only dependent to, but historically and physically linked to. That is why it is called Latin America.

Mr. BALLENGER. Yes. Again, let me thank you all for coming. We greatly appreciate the education you have given us.

[Whereupon, at 5:35 p.m. the Subcommittee was concluded.]

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