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Informed Analysis, Expert Opinions

Executive brief

Coffee sector

1. Background and key issues

The share of ACP countries in world coffee exports has almost halved over the last 20 years, partly because of the rise of production in non-ACP countries such as Indonesia and Vietnam. However, production in ACP countries has been growing since 2006/07, and at a higher rate than in non-ACP countries. All major ACP producers are in Africa with the exception of Papua New Guinea. In addition, low volumes of high quality coffee production takes place in the Caribbean. The EU accounts for over 40% of total consumption of coffee in importing countries, and remains the dominant market for ACP producers.

The International Coffee Organization (ICO) operated a quota regulation system until 1989. Since then, production has risen dramatically and has remained over 100 million (60 kg) bags every year, with a peak in 2010 of 133 million bags. Prices fell sharply to the lowest level for a century in the period from 2000 to 2004, but recovered thereafter and have experienced a sharp increase since late 2009. Along with a more general commodity price boom, since 2007 the average ICO composite indicator price has reached and remained over the US$1 per pound (US$/lb) mark, with the US$2/lb mark being exceeded in February 2011. Stocks in producing countries are at the lowest levels in recorded history. Market analysts expect prices to remain high at least until 2012/13 when an increase in output is expected. Some analysts, however, have argued that recent price hikes have been also driven by speculative activity and are unlikely to be sustained (see *Agritrade* article 'High coffee prices expected to endure throughout 2011', May 2011). Price transmission to farmers seems to have taken place efficiently in the past 5 years, but much less so in robusta markets in the past season or so. Arabica farmers in ACP countries such as Ethiopia and Kenya are more likely therefore to have realised larger income gains than robusta farmers in Uganda and Côte d'Ivoire. Potential gains for farmers have also been significantly eroded by high oil prices (via increasing costs of farmers' inputs).

Along with increasing prices, the coffee industry is witnessing a rapid growth of coffees certified according to designations such as organic, fair-trade, 'Rainforest Alliance certified', 'Utz certified', sustainable, and others. According to recent estimates, the certified sustainable market accounts for 8% of exports, up from 1% in 2003. This comes on the back of the rapid development of the speciality coffee market in the 1990s. The financial and economic crisis does not seem to have had major repercussions in the coffee market. Coffee consumption overall is holding up well in traditional coffee consuming countries, and is increasing steadily in emerging markets.

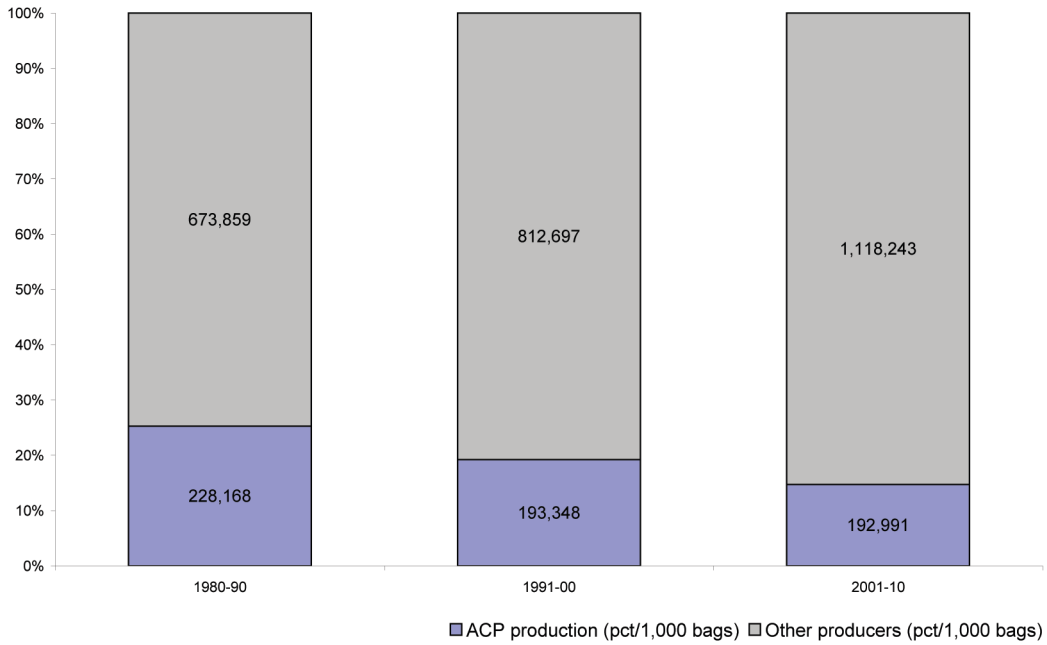
Increasing and sustaining coffee farmers' (especially smallholders') incomes in ACP countries is an important policy goal. The current hike in international prices provides opportunities for ensuring that such gains are transmitted to the farm level and that quality-based differentiation leads to insulation from extreme price volatility. High international prices provide the stimulus for stabilising gains in the future via investments in – and 'aid for trade' support to – better quality, improved agronomic practices, the promotion of speciality and sustainable coffees and the capturing of value-added through systems of indication of geographic origin and the registration of trademarks.

2. Latest developments

Production and trade

ACP countries accounted for under 15% of total coffee production in the period 2001–2010. This is less than the 19% share that they held in the 1990s and 25% in the 1980s (see Figure 1). In 2009/10, they accounted for 19.8 million bags out of a world coffee production of over 130 million bags. However, in 2009/10 ACP production increased by almost 13% over the previous year, mostly due to output improvements in Ethiopia, Côte d'Ivoire, Kenya and Uganda. Top ACP producers in 2009/10 were Ethiopia (with almost 7.5 million bags, a 7.5% increase over the previous year), Uganda (3.1 million), Côte d'Ivoire (2.2 million), PNG (1.1 million) and Tanzania and Kenya (around 0.9 million) (see Table 1). Of the top 10 ACP producers, Ethiopia, Kenya and the Dominican Republic produce only arabica, PNG and Tanzania mainly arabica but also robusta, Uganda, Cameroon and Madagascar mainly robusta but also arabica, and Côte d'Ivoire and Guinea only robusta. Only one country, Ethiopia, figures in the top 10 coffee producers worldwide (see Table 2).

Figure 1: Coffee production in ACP countries as a proportion of global coffee production



Source: compiled from ICO data.

Production increases were more marked in countries producing only or mainly arabica than in countries producing only or mainly robusta. This trend is visible in the long-term trend but especially in the past season.

Table 1: Top 10 ACP producers and exporters in 2010

Production*	('000 bags)	Export**	('000 bags)
Ethiopia(A)	7,450	Ethiopia (A)	3,324
Uganda (R/A)	3,100	Uganda (R/A)	2,657
Côte d'Ivoire (R)	2,200	Côte d'Ivoire (R)	1,916
Papua New Guinea (A/R)	1,100	Papua New Guinea (A/R)	929
Tanzania (A/R)	917	Cameroon (R/A)	794
Kenya (A)	850	Tanzania (A/R)	564
Cameroon (R/A)	750	Kenya (A)	539
Dominican Rep. (A)	500	Guinea (R)	499
Madagascar (R/A)	500	Rwanda (A)	394
Guinea (R)	450	Burundi (A/R)	299

Source: ICO

Notes: * crop year 2010, ** calendar year 2010. A = only arabica; A/R mainly arabica but also robusta; R/A mainly robusta but also arabica; R= only robusta.

The picture for exports follows more or less the same dynamics as that for production, but with a more marked proportional fall for ACP countries in the 2000s. ACP countries accounted for 13.8% of total exports in 2001–2010, down from 20.7% for 1991–2000 and 27.1% for 1981–1990. In 2010, they accounted for 13% of total exports. Top ACP exporters in 2010 were Ethiopia (with 3.3 million bags), Uganda (2.7 million), Côte d'Ivoire (1.9 million) and PNG (0.9 million). Two ACP countries (Ethiopia and Uganda) figure in the top 10 exporters worldwide.

Consumption

Consumption data in importing countries shows a steady growth in volume, including in emerging markets (non-ICO importing members) such as China, albeit from a small base (International Trade Centre, 2010). This is compounded by healthy growth in producer countries' own consumption markets – particularly in Brazil, Mexico, Indonesia, Ethiopia, Colombia and India.

Tariff barriers

As shown in Table 2, tariff barriers on imports of coffee in the main importing countries remain low or zero for green coffee, and a little higher for roasted coffee. Potentially, roasted coffee from ACP countries could be subject to tariff preference erosion in the context of non-ACP countries' negotiations in regional or bilateral trade agreements with the EU and Japan. However, given the historically insignificant size of the roasting industry for export in ACP countries, this issue is not of major concern. The main reason is that large commercial roasters prefer to roast in facilities close to their consumption markets so that they can blend coffees from various origins before roasting, and adjust different blends and proportions according to consumption and international coffee market signals and availability at source. Single-origin coffee may in theory be roasted at origin and then shipped to destination, but in practice this does not happen very often for a variety of reasons:

- high-end coffees are roasted just before delivery to the final consumer or even on-premise;
- shipping high-end single-origin roasted coffee via regular shipping routes would significantly shorten its shelf life;
- air shipping is financially viable only for the very top (or 'cult') coffees.

Table 2: Import duties

	Green coffee	Roasted coffee
EC	MFN GATT bound 0% MFN statutory 0%	MFN GATT bound 7.5% MFN statutory 7.5%
Japan	0%	MFN GATT bound 12% MFN statutory 12% GSP 10% LDC 0% General 20%
USA	0%	0%

Source: ICO, 2008

Trends in prices, stocks and volatility

After suffering from the lowest real prices in recorded history in 2000–2004, international coffee prices have recovered healthily. They have experienced a particularly steep climb since mid 2009, with the ICO composite price doubling from July 2009 to March 2011 The composite ICO price averaged US$0.59/lb in 2001–2005 and doubled to US$1.18/lb in 2006–10 It started to exceed US$1/lb in 2007 for the first time since 1998, and in 2010 averaged US$1.47/lb before rising to US$2.13/lb in the first three months of 2011. Due to low levels of stocks, exports have been just sufficient to cover existing demand in importing countries in the past few years. As the current economic crisis does not seem to have affected the volume of demand significantly, the current situation is likely to continue in the medium term.

Once the ICO composite price is broken down in its four components (Colombian milds, other milds, Brazilian naturals, and robusta) a more complex picture emerges. Prices for the top quality coffees (washed arabicas, including Colombian milds and other milds) have increased dramatically since mid 2009. To some extent, this also applies to natural arabicas, but the price of robusta has remained relatively flat. This means that the potential benefits of higher prices to producers (see next section) are much less pronounced in ACP countries producing mainly or only robusta, such as Uganda, Côte d'Ivoire, Cameroon, Madagascar and Guinea.

Lower increases in price for robusta than for arabica can not be explained by production trends alone – overall arabica production has increased faster than robusta production in the past season. Other factors may be therefore at play, notably:

- the rise in consumption of single-origin and higher quality arabica coffee;
- the wave of purchases by 'index investment funds' that have bought heavily into commodities since mid 2010.

(See *Agritrade* article 'Few ACP countries benefit from coffee price surge', January 2011).

While in the short term investment funds may be adding fuel to the current price boom in arabica markets, a recent study by ICO suggests that in the long-term volatility levels have generally decreased (but with emergence of occasional peaks). The same ICO study also shows a reduction in supply side shocks in the last two decades. At the same time, another ICO study shows that international prices have become more sensitive to stock levels in the 2000s, and especially to stock levels in exporting countries. In other words, the lower the levels of stocks, the higher the international price.

Price transmission and the functioning of coffee supply chains

International price increases are not necessarily transmitted to the producer level with the same intensity, as this depends on the functioning of coffee supply chains from the production to the export levels. In the aggregate, producer prices seem to have increased at approximately the same rate as international prices, and thus it appears that domestic markets in producing countries are transmitting price signals to the farm gate fairly efficiently. In a 5-year perspective, the steepest price increase at the farm level has been in robusta (from US$0.21/lb in 2001–05 to US$0.53/lb in 2006–10, an increase of 152%), followed by Colombian milds (from US$0.52/lb to US$1.11/lb, +113%), other milds (from US$0.6/lb in 2000–04 to US$1.09/lb in 2006–10, +82%) and Brazilian naturals (from US$0.55/lb to US$0.92/lb, 67%).

It should be noted, however, that the potential benefits in terms of net incomes for coffee producers have been moderated by increases in the price of oil (which affects the price of fertiliser and transport). Also, focusing on the data for the past 2 years, a markedly different picture emerges. Farm gate prices increased dramatically for Colombian milds, less dramatically but still increased for other milds and Brazilian naturals, and actually decreased for robusta. While in 2008/09 international robusta prices had indeed declined, they increased in 2009/10, albeit more slowly than for arabicas. This suggests that price transmission is taking place fairly efficiently in arabica producing areas but less so in robusta producing areas, at least in recent times. A precise picture of supply chain functioning, however, can

only be constructed on a country-by-country basis.

Press releases from Kenya seem to suggest a problematic picture there, with local coffee supply 'cartels' accused of refusing to transfer the full benefits of export price increases to farmers (see *Agritrade* article 'Inequalities in supply chain hold back transmission of high prices to producers in Kenya', April 2011). However it is difficult to corroborate such statements in the absence of adequate field research. It is also not clear why price transmission in robusta has been poorer than in arabica in the past 2 years. In general, very little is known about the contemporary functioning of domestic supply chains in ACP coffee producing countries, with much of what is available based on studies carried out in the early 2000s, a time of coffee crisis and not boom.

Finally, according to the ICO, price transmission from the international to the retail levels seems to take place rapidly in periods of price hikes, while readjustment downwards (as during the coffee crisis in the early 2000s) has been much slower.

Development in the certified coffee market

'Sustainable' coffee has become an increasingly visible part of the market, with spectacular growth in the last decade. In addition to the growth of coffee certified to standards/designations such as organic, fair-trade and those of Rainforest Alliance and Utz, the past few years have seen the establishment of roasters' own certification systems on sustainability, first with the Starbucks' C.A.F.E. Practices standards and later with the Nespresso AAA Sustainable Quality Programme. Nespresso has now made the commitment to source 80% of its coffee by 2013 from farms certified as sustainable. Three-quarters of Starbucks' coffee is already meeting its C.A.F.E. Practices standards. McDonald's is also reported to have started procuring certified coffee for its outlets in New England states (US) and in selected European countries.

Another major development has been the establishment in 2009 of a secretariat and regional offices of the 4C Association (Common Code for the Coffee Community). The association is structured around three chambers (producers, trade and industry, civil society) and manages an industry-wide voluntary code of conduct, which is based on a list of 28 principles and 10 unacceptable practices. As of January 2011, 4C had verified 69 units in 20 countries against the code of conduct. A unit is a managing entity (usually groups of producers, cooperatives, mills or exporters) that can fill at least one container of coffee. But the total production capacity of these units actually decreased from 8.8 million to 8.1 million bags from 2009 to 2010. This may be indicating a levelling off of interest in the application of the 4C code. It may also reflect why, in March 2011, 4C launched a 'new business model' for the initiative, with a shift 'from a supply driven to a demand driven approach' and a focus on a 'core set of services that are beneficial to all its members'. It is not clear yet what this new model will entail in practice for registered units in ACP countries, but the message seems to be that with higher prices they are expected to be better able to fend for themselves.

At the beginning of the financial and economic crisis in 2007/08, there were expectations that certified coffees would experience slower growth because consumers might see them as 'luxuries'. These fears have not materialised. Sales of fair-trade coffee, Rainforest Alliance-certified and Utz-certified coffees continued to grow strongly. Globally, in 2009 about 8 million bags (around 8% of all green coffee exports) were sold as certified, with at least 25 million bags available in the market as certified against one or more of these schemes.

Despite the growth of sustainability certifications and codes of conduct, it is still not clear what kinds of benefits accrue to the target beneficiaries – coffee producers and their communities. A study by Giovannucci and Potts (2008) reports the results of a preliminary survey conducted among over 50 coffee farms that are certified against one of the main existing sustainability initiatives. It found that farm performance along social, environmental and economic indicators is highly variable, depending on location and the type of certification. Certified farms overall seem to be better off in terms of net income, although in some cases the difference with conventional farms can be small. Slightly over 50% of farms reported improved market access as a result of certification. So far, there seems to be little evidence that certification has significant effects on the environment at least in the early years, with the exception of improved pollution management. On social indicators, certified farms seem to have better occupation health and safety, employee relations and labour rights performance (these apply mainly to estate farms, not to smallholders).

Certified coffee is now produced in around 80% of all exporting countries, allowing healthy competition and quality improvements. Price premiums at the farm level, however, have remained generally under 20% of the equivalent quality price of non-certified coffee, a fairly low proportion both in comparison to other agro-food products and in relation to the extra costs that are incurred by producers. So, while certification may help ACP producers in insulating themselves from wide price fluctuations and in improving market access, it should not be seen as a tool to be used in all circumstances.

Single-origin coffees, geographic indications and trademarks: Lessons from Jamaica and Ethiopia

In addition to certification, other tools to add value to coffee in ways that can benefit producers include marketing initiatives to promote single-origin coffee, the development of geographic indications (GIs) and/or the registration of certification marks and trademarks (both referred to as 'trademarks' from now on). Several ACP countries have been promoting single-origin coffee in line with emerging consumer trends (see *Agritrade* article 'Tanzania to increase its focus on single-origin coffee', June 2011). While these efforts may pay off in terms of lifting the price of a coffee coming from a particular area, this does not necessarily mean that farmers in that area benefit – the value-added may be retained exclusively or in large part by intermediaries, especially those in the consuming countries. GIs and trademarks are two of the few forms that can help retain value within ACP producing countries. Only a few GIs in coffee have been legally established to date (e.g. Café de Colombia) although non-legally binding geographical demarcated labels are more commonly used. These however are then linked to the use of more conventional trademarks.

Where protected trademarks have been used and GIs are being developed, the key to success has been the establishment of a local institutional set-up that allows producers to control the common resource produced under the trademark or GI, and the development of long-term commercial relationships which help build the market for the differentiated product. ACP countries engaged in these initiatives include Ethiopia, Jamaica, Rwanda, Kenya and Papua New Guinea.

Although most initiatives have realised some benefits, the experience has been mixed, with even well established trademarks, such as Jamaica's Blue Mountain coffee, facing serious commercial challenges. While Blue Mountain coffee attracts high premiums in the international market, it is bought predominantly by Japanese importers. Given the scale of economic crisis gripping Japan, Jamaican exporters are now facing a difficult dilemma: reducing their price to sustain the volume of sales, but thereby diluting the value of the brand, or maintaining prices and accepting reduced sale volumes. It is estimated that this may result in a potential loss for Jamaican farmers of some €0.87 million, but more importantly may undermine the gourmet image of the brand (see *Agritrade* article 'Market diversification is key to price premiums for Blue Mountain coffee', April 2011). These difficulties potentially carry important implications for the future development of quality-based coffee marketing strategies in the ACP.

Another instructive lesson from an ACP country comes from Ethiopia. In 2004, the intellectual property rights (IPR) office of Ethiopia, with NGO support, started to explore ways in which Ethiopia could benefit from the rights for high quality coffees originating from the regions of Harrar, Sidamo and Yrgacheffe. A decision was made to apply for the registration of these coffee names as trademarks in various countries. Registering a name as a trademark means that coffee retailers, in order to use a trademarked name, would have to obtain a licensing agreement and pay a licensing fee to the Ethiopian IPR office. If managed properly, these funds could have been either channelled to the producers of these coffees or used for community or coffee-related projects. Applications were successful in the EU, Canada and (partly) in Japan. However, problems were faced in the USA, given Starbucks' earlier registration of Harrar and Sidamo as trademarks. Despite Starbucks' ethical sourcing policy, it took two years of dialogue and mediation to resolve this dispute, with adverse press coverage seeing Starbucks' share price fall from almost US$40 in mid November 2006 to barely over US$25 in mid June 2007. This agreement saw Ethiopia granted trademark rights over the names of its speciality coffees, and Starbucks granted a royalty-free licence to use these names on its retail products.

3. Implications for the ACP

Production and trade

While expanding consumption means that price prospects for coffee look good for the coming years, if ACP producers are to capitalise on this then they will need to encourage better agro-management practices that can lead to higher yields in the short term and will need to promote value addition, which better insulates producers from longer-term swings in the international coffee price. This approach, less risky than expanding the area under coffee, would appear to be justified given the 3-year lead time on new plantings.

In terms of trade relations with the EU, since green coffee from all destinations is imported duty-free, preference erosion only affects roasted coffee. However the roasting industry for export in ACP countries is limited, and practical problems with current technologies to ensure delivery of a high quality product would appear to limit the scope for expansion. For these reasons, the issue of preference erosion would not appear to be a major issue of concern to AC coffee exporters.

Product differentiation strategies

Given growing product differentiation in the market for coffee and the rise of the discerning coffee consumer, there would appear to be considerable scope

for product differentiation aimed at securing price premiums, particularly for arabica coffee producers. There is a wide variety of routes that can be taken, but each faces specific challenges, and no single route offers immediate additional price benefits, unless accompanied by complementary marketing initiatives. Thus, while certification may help ACP producers in insulating themselves from wider price fluctuations and in obtaining preferential supplier status among buyers, it should not be seen as a tool to be used in all circumstances.

Equally it would appear to be necessary to address issues linked to the strengthening of coffee supply chains if the purported benefits of certification are actually to reach producers and workers in the coffee sector and are to yield sustainable environmental benefits. ACP countries and donors should ensure that adequate resources are allocated to examine when, where and how certifications are beneficial to coffee producers so that they do not become yet another 'add-on' required by buyers without a price premium being paid in return.

Similar issues are faced as regards single-origin coffees, where the price benefits may not necessarily be transferred to coffee farmers and issues related to the enforcement of rights may arise.

Geographic indications (GIs) and trademarks are two of the few forms that can help to retain such value creation within ACP producing countries. The Jamaican coffee brand experience cited above shows the danger of excessive dependence on a single market, and highlights the need for constant reinvestment of part of the price premium secured in marketing innovations and market diversification.

Jamaica and other ACP countries such as Ethiopia, Rwanda, Kenya, and Papua New Guinea are looking at establishing their own GIs, often alongside existing certification-mark and trademark strategies. The aim is to use GIs to overcome some of the existing problems of ensuring effective protection under national trademark and certification-mark regimes. However, as with the existing trademark and certification mark arrangements, the expensive and complex process of GI protection enforcement needs to be supported by adequate institutional structures (such as effective and transparent producer organisations) so that the value-added is actually transferred to the farmers. Since GI registration is more feasible in legal systems that have provisions for them (the EU *sui generis*), the specific option to be followed will depend on the specific market being served and the legal framework for protection that exists in these different jurisdictions.

More generally, value-addition processes – whether they seek higher quality, single-origin sales, sustainability certifications, trademark registration or fully fledged GIs – will need appropriate support in ACP countries. One of the venues that can be used for such a purpose is the All-ACP Agricultural Commodities Programme (AAACP), whose main goals are to improve incomes and livelihoods of ACP producers and reduce their income vulnerability both at the macro and micro levels. But other 'aid for trade' venues should also be a prime target for ACP countries seeking support in this area.

It is possible that such interventions at the regional level could be modelled on the EC-financed 'authentic Caribbean Rum' initiative financed under the Integrated Development Programme for the Caribbean Rum Sector. This programme aimed to differentiate Caribbean production on quality grounds, while spreading the costs of market development across a range of small volume quality-oriented producers. For example, a similar approach to quality-differentiated product marketing might be appropriate to East African single-origin coffee producers, with the costs of such a market development initiative being shared, while allowing individual producers to still retain their distinct identity and responsibility for their own marketing.

Stock levels and price volatility

Recent evidence indicates that international prices have become more sensitive to stock levels in the 2000s, and especially to stock levels in exporting countries. This means that the lower the levels of stocks, the higher the international price is likely to be – other factors being equal. Thus, if maintaining high international prices is a goal for ACP countries, they should avoid building up domestic stocks at this point. This suggests a need for some level of producer coordination if stable remunerative prices are to be sustained. Given the relatively small proportion of global coffee production produced by ACP producers, any such coordination would need to reach beyond the ACP. Such an initiative could however be taken in the context of current international efforts to curb the adverse effects of commodity market speculation, while still allowing the market to function smoothly. It should be noted however that the evidence suggests that in the longer term, volatility has actually been decreasing. So, while policy measures (such as diversification, value addition, development of internal consumption markets and risk management tools) that seek to address price volatility at the farm level in ACP countries are still relevant, they may not be as urgent in the short term.

Price transmission and the functioning of coffee supply chains

Producer prices seem to have increased at approximately the same rate as international prices, with the process of price transmission operating fairly efficiently

overall. However, when prices for arabica and robusta at the farm level are analysed, it becomes clear that farm gate prices for robusta have actually decreased in the past year, a worrying trend for ACP robusta producers. Press reports also suggest concerns in some arabica producing ACP countries such as Kenya over the functioning of the coffee supply chain. Overall, however, very little is known about the contemporary functioning of domestic supply chains in ACP coffee producing countries. This calls for thorough and up-to-date analysis of these supply chains, such as the study recently commissioned by Tanzania for its cotton sector (see *Agritrade* article 'Improving the functioning of the supply chain seen as key to Tanzanian cotton-sector revival', March 2011). This could help to establish arrangements along coffee supply chains that would better insulate producers against future price volatility. Such initiatives could for example focus on extending the use of transparent contractual arrangements within supply chains (especially in relation to single-origin sales), strengthening producer organisations and developing better links between producers and traders.

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Useful websites:

4C: Common Code for the Coffee Community http://www.sustainable-coffee.net/

All ACP Agricultural Commodities Programme (AAACP) http://www.euacpcommodities.eu/en

Fairtrade Labelling Organisations International (FLO) http://www.fairtrade.net/

International Federation of Organic Agriculture Movements (IFOAM) http://www.ifoam.org/

International Coffee Organisation (ICO) http://www.ico.org/

Rainforest Alliance http://www.rainforestalliance.com/programs/agriculture/certified-crops/coffee.html

Starbucks' C.A.F.E. (Coffee and Farmer Equity) Practices http://www.scscertified.com/csr/starbucks.html

Sustainable Coffee Partnership (SCP) http://www.iisd.org/markets/policy/scp.asp

Utz-certified http://www.utzcertified.org/

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