Boom or bust

Coffee farmers seldom benefit

Many popular and essential food and drink commodities that countries of the North depend on are produced by small farmers in developing countries. Yet as **Susan Newman** explains in the case of coffee, small producers have not benefited from rising world prices.

The food crisis of 2007 and 2008 saw a massive increase in world food prices. In the 18 months from the middle of 2007 alone, the International Monetary Fund's (IMF) food price index increased by more than 80%.

While the food crisis affected both rich and poor countries, its impacts have been most severe in the global South. The World Food Programme has estimated that the hike in world food prices, together with reduced incomes owing to the global economic slowdown has led to an increase in the number of chronically malnourished people by 115 million in 2007 and 2008.

In order to cope with rising food prices, the poor have been eating less and have switched to cheaper less nutritious food in order to survive. In South Africa, the poor have been similarly affected. Katherine Joynt's article in the June/July 2010 *SALB 34.3* tells of the devastating impact of food price increases on the poor in South Africa.

COMMODITIES BOOM 2002-8

The recent food crisis was part of a commodities boom that began around 2002 and continued until its collapse after July 2008. Between January 2002 and July 2008 energy commodity prices increased by more than 560%, metals prices by almost 250%, food by 130% and agricultural raw materials by 50%.

While the commodities boom in energy and metals was largely related to rising demand from China, the boom across a wide range of products was driven by speculation from the increasing presence of new financial investors on commodity futures markets through index and hedge funds. A futures contract is a financial contract that does not involve the buying or selling of the actual commodity. The purchasing or selling of a futures contract involves the investor speculating on whether prices will increase or decrease and placing a bet accordingly.

A recent study from the United Nations Conference on Trade and Development (Unctad) concluded that index based investment in commodity futures markets was responsible for bubble-like price increases in energy and non-ferrous metals, as well as agricultural prices between 2006 and 2008.

My research in the commodity of coffee found that changes in world supply and demand for coffee have not been responsible for increases in world coffee prices, rather speculative activities on the New York coffee futures exchange drove the price increases for Arabica coffee between 2002 and 2008.

The increase in commodity prices from 2002 saw a further upturn in July 2007 with the onset of the financial crisis. This was because with falling equity and bond prices, investors began taking their money out of those markets and channelling them into commodities. The collapse of the bonds and equity financial bubble in turn fuelled a bubble in commodity markets that also burst in July 2008.

The rise in commodity prices of course have a negative impact on consumers but do not necessarily have a positive impact on producers. This is particularly true of agricultural commodity producers in developing countries who face increasing input costs associated with rising fuel prices.

Moreover, increasing commodity prices at the world level are not reflected in the prices that farmers receive as prices from the world market are reduced by the power relations between different players along the chain that takes the commodity from production to

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consumption or in other words from the farmer to the consumer. Global commodity chains are increasingly controlled by a few large multinational retail and trading companies. These companies extract the largest share of income along the commodity chain while producers and small traders in developing countries are left with a much smaller slice of the pie.

CASE OF COFFEE

The pattern I describe above is well illustrated by the case of coffee. Coffee is one of the most widely traded commodities in the world. It is produced in tropical countries of the South and almost entirely consumed in wealthy countries of the North.

Large multinational roasting companies and trading houses control the international coffee supply system. The five largest coffee roasters, Nestle, Kraft, Sara Lee, Folger and Tchibo roasted around 50% of all coffee in the world. The five largest coffee trading houses, companies that source coffee from producing countries and sell to the large roasters, control over 55% of the world market for green, pre-roasted, coffee.

For coffee-producing developing countries, coffee makes up a major share of national export earnings. Most of the world's coffee is produced by smallholder farmers. In many coffee-producing regions it provides the only source of cash income for smallholders who plant a few trees in order to earn cash for expenses such as school fees and school uniforms. So coffee price movements have a direct impact on rural poverty.

Prior to 1989, the world coffee price was set through a multilateral agreement between coffee-producing countries and coffee-consuming countries. Since the collapse of the International Coffee Agreement world coffee prices have become highly volatile. Until the onset of the commodities boom coffee prices had been declining.

The situation of declining coffee prices became more severe for smallholder farmers as developing countries were forced to liberalise their agricultural marketing systems under the Structural Adjustment Programmes (SAPs) of the World Bank. This meant dismantling coffee marketing boards that had to some extent shielded producers from volatile international markets.

In order to deal with risks associated with volatile coffee prices, the World Bank advised developing country coffee producers to hedge on futures exchanges (enter into an agreement to buy or sell an amount of coffee for later delivery at the market price of the futures contract. This allows producers to lock in a price and shields them from a fall in price in future). The coffee 'C' contract was the most widely traded futures contract for Arabica coffees. These contracts came in units of 37 000lbs.

The World Bank's recommendations were clearly absurd given that average smallholder coffee producer in Tanzania and Uganda produce just a few pounds of coffee each year. This is not to mention numerous other technical and financial challenges that coffee producers faced in attempting to engage in futures trading.

In contrast, the international coffee trading companies have been able to successfully use futures markets for risk management purposes and have derived huge incomes from financial investment in these markets. International trading companies determine the price when they buy coffee from local exporters and traders in developing countries. This price closely follows the price of the coffee futures contract which has been increasingly influenced by speculative activities on New York and London coffee futures exchanges and less and less by actual supply and demand conditions.

Because of the collapse of the International Coffee Agreement and the liberalisation of coffee marketing systems, local producers and traders in coffee-exporting countries are bearing the full brunt of unstable coffee prices. This has been the case whether they are organised into cooperative marking systems as in Tanzania, or work through private marketing channels, such as in Uganda.

The Ugandan producers who market their coffee through private marketing chains are confronted with low prices while the local traders have to shoulder the risks associated with price volatility. Local traders are faced with volatile prices originating from the world market.

In order to cope with the risks associated with price fluctuations, local traders pay very low prices to small holder farmers in order to create a buffer. The local traders' price risk management strategy means that when there are price decreases at an international level these traders pay less to producers. However they do not pay to producers when prices go up on the international market.

In Tanzania, cooperatives are able to spread the risks of price instability across their membership, but such localised arrangements only marginally lessen the overall risks. Statistical analysis on the relationship between world prices for Arabica coffee and prices paid to Tanzanian producers found that positive price increases at the international level were less than given to producers, though it was worse in the Ugandan case.

Moreover, the 'real' price of coffee received by producers in Tanzania, measured by the cash price they receive and taking into account the Tanzanian consumer price index, has been declining.

Increasing coffee prices have occurred together with the increase in the cost of food. Since the liberalisation of the coffee marketing system in Tanzania in 1994, the real price of inputs such as chemical pesticides, fungicides and insecticides has increased dramatically. Between 2000 and 2006, the cost of one of the most commonly used chemical, Karate 5 EC, had almost doubled.

As the producers are consumers of food and farm inputs, any coffee price increase that they might enjoy in the boom period has been eaten away by rising prices in these commodities that they consume.

COMMODITY BOOM OR CRISIS?

In 1990, Alfred Maizels published *Commodities in Crisis*. Maizels was concerned with the long-term declining prices of commodities in relation to manufactured goods as well as increasingly volatile commodity prices and the implications for developing countries. In spite of the boom period between 2002 and 2007, commodities remain in crisis today.

But the crisis today is of a very different nature. It is not directly related to prices but rather to shifts in the structure of and social relations within commodity chains that result in a situation where price increases hurt the poor at both ends of the chain.

Consumers are directly affected by rising prices that do not transfer to price increases for primary producers in developing countries. International trading companies are the ones who have profited from higher prices and financial speculation on commodity futures markets and have further consolidated their power.

WHAT CAN BE DONE?

One may think that national-level collective marketing strategies could improve the share of the world coffee price received by local producers. However, this approach cannot address the drivers of inequalities in income along the whole coffee commodity chain. This is the uncontested power of international coffee trading companies which derive larger and larger shares of their revenue from trading in futures and determining the price at which coffee is traded.

There is an urgent need to rein in speculative activities on coffee futures markets. The current World Bank advice to producers is not the answer.

One approach could be to separate the process of current price determination of coffee from that of the futures contract. This means that rather than prices being set in markets where speculators create large swings in prices, prices will reflect actual demand. Such a separation has been achieved on a very limited basis for fair-trade and gourmet coffees, which represent small niche markets. Another option would be to revive, in some form, the kind of collective price agreement that was created by the International Coffee Agreement. More predictable prices would offend the price risk management strategies adopted by middlemen that result in low prices paid to farmers.

However, even if such reforms were successful in helping reduce the impact of speculation on current coffee prices, they would likely achieve little in overcoming the enormous inequalities in power and income between large international trading companies and local producers and traders in developing countries. More fundamental reforms are needed to solve this problem. LB

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