Macchiato Myths

The dubious benefits of fair trade coffee

Tim Wilson

The debate on the benefits of market liberalisation has shifted enormously in the past 20 years. Gone are the days when anyone seriously argues that free trade brings poverty or that socialism brings equality-based prosperity. The benefits of trade have gained such currency that even rock stars now call for trade as a means to economic prosperity. Sadly, behind their calls for greater trade opportunities lies a campaign that seeks to undermine the system that promotes the material prosperity they seek for people living in developing countries. Despite its claims to promote prosperity, the 'Fair Trade' campaign builds a bureaucracy funded by developing country farmers, based on a top-down business model that undermines productivity, quality and opportunity for poor farmers. The 'Fair Trade' campaign will undermine the economic prosperity of developing countries. Its flagship is the coffee trade.

Every few years, Australians are deluged with new data from the Australian Bureau of Statistics detailing our behaviour as consumers. While our ratio of beer to wine and milk often grabs headlines, one of the growth areas of consumption is our black bitter friend, coffee. Since the 1970s, personal consumption of coffee has doubled from 1.2 to 2.4 kilograms per year, more than thrice the consumption of tea. Historically, Australia was a coffee producer until the 1920s, when the industry was undermined because of high labour prices. Since then, Australia has imported all of its coffee, but plantations are now active in Queensland and the north-east of New South Wales, producing a high quality product that is gaining popularity on the local mar-

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ket. In the past, Australian coffee producer Jasper Coffee sold 30 per cent of its product to Australians; that has now grown to 50 per cent, with the remainder sold on the export market.

The international coffee trade

Coffee is a major international commodity traded globally in a market worth more than US$10billion per annum. It is produced in over 50 countries by up to 25 million farmers and is mostly produced in the developing world. It is also a core export for many developing countries, reaching as much as 50 per cent of total export revenue for some countries. Key producer countries lie in South America, South-East Asia and Africa.

There are two key types of coffee: Robusta and Arabica. Arabica has a mild flavour and is grown at very high altitudes. It commands a higher price than robusta which, as its name implies, has a more robust flavour and is grown more generally. There are substantial price differences within each variety. Like wine, beans are sold as single variety and blends. Coffee is a highly volatile commodity. The time it takes from plantation to harvest can be a number of years. Price hikes due to a poor harvest can easily plummet in succeeding years due to bumper crops or increased plantation to take advantage of high prices. In 2000–01, overproduction was 10.8 million bags, the following year it halved to 5.6 million and then spiked in 2002–03 to 15 million.

This volatility caused the international community to stabilise the market by managing trade through the International Coffee Agreement (ICA). The ICA was established in 1962 and is managed by the International Coffee Organisation which was founded the following year under the auspices of the United Nations. The ICA was used as a development mechanism to assist the Third World; it fell with the collapse of the bipolar architecture of the Cold War.

The aim of the Agreement was to try to stabilise coffee production internationally. It achieved this by controlling the market through quotas and by ensuring that countries withheld supply when it peaked above consumer demand, effectively controlling prices. Agreements were struck for five-year periods with extensions granted while new agreements were negotiated.

In the last 15 years, pressure on the international coffee market has been mounting. As an instrument for controlling prices and production, the ICA fell in 1989 and with it collapsed the conventional coffee trade that restricted producing countries and limited supply. An extension to the existing 1983 Agreement was struck, but with all quotas and control instruments suspended. The result was a boom in coffee production when the free market was allowed to operate. Previously locked-out producers were suddenly able to trade on the international market unhindered by multilateral agreements that controlled supply. The explosion in production had an inevitable consequence: a fall in price. By 1992, coffee futures had bottomed and the international supply had clearly outgrown consumer demand. During negotiations for an updated ICA, agreement could not be achieved to control prices and so the new ICA focused on other avenues of international co-operation. The last ICA was the 2001 Agreement that came into effect in May 2005. Its aims shifted away from regulating coffee supply and demand towards improving consumption and the quality of coffee.

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Moving beyond managed trade

Moving beyond managed trade has had a parlous affect on producers. It has been coupled with marked improvements in coffee production which have resulted in a general fall in the price of production. The introduction of Vietnam as a significant coffee producer has also had a significant impact. Brimming with cheap labour, it has increased its production from 1.4 million bags in 1990 to ten times that number in 2000. Brazil's increase in efficiency is even starker. Despite being the largest coffee-producing country in the world, with mechanisation of coffee production in the 1990s it managed to double its production from around 25 million bags in the early 1990s to 50 million bags in 2002. This growth was accompanied by depreciation in the Brazilian Real, which reduced the price of coffee on the international market even further. The increase in Brazil's output was larger than the growth of Vietnam's alone, and had a significant effect in deflating the price.

Added to a fall in price, there has been a reformation of the retail coffee industry, particularly in the United States, where quality coffee had long been a tourist attraction for holidays in Europe. New 'Grande' sized coffee retailers such as the US mega-chain, Starbucks, opened the coffee market and broadened consumers' palates. The effect was greater consumer demand for quality coffee. While retailers such as Starbucks led the pack, it also encouraged the emergence of smaller boutique coffee houses to cater for the coffee 'snobs' as Starbucks became more of a fast-food-coffee outlet than a coffee connoisseur's destination. An emerging market gap was filled by smaller coffee chains and individual retailers who could offer consumers an individualised coffee experience. In 1989, there are estimated to have been 585 coffee houses in the United States, by 1995 it was 5,000, in 2003 it was 17,400 of which 40 per cent are estimated to have been large chains. Despite anti-big business rhetoric that it preys on small business, Starbucks opened the coffee consumer market for small boutique coffee businesses.

With quality coffee comes quality prices. The consumer's experience moved from a $1 bottomless filtered coffee to a Venti Soy-Macchiato with an artificial sweetener at prices up to $5. Anti-globalisation activists expressed outrage as the retail price increased while the price paid to producers sat at market lows. Citing it as evidence that globalisation and the free market system favoured the rich at the expense of the poor, as that gap widened, so did their outrage.

What coffee crisis?

The NGO Oxfam International declared the situation as a 'Coffee Crisis' in its 2002 report, 'Mugged: Poverty in your coffee cup'. It stated that the 'crisis' was squeezing producers while the middle-men corporations such as Nestlé and Kraft were awash in cheap products that were then on-sold to retailers who sold the product at premium prices. Yet these corporations, called 'roasters' in the trade, have little or nothing to do with the increase in production. They have simply bought and sold the product on the international market and delivered small coffee producers an avenue into the coffee houses of Melbourne, New York and London. Coffee retailers have also felt the brunt of the outrage over the 'coffee crisis', citing increased prices for coffee during periods of coffee price lows. This is despite the fact that the coffee component of retail coffee amounts to an estimated 5–7 per cent of the total price, outstripped substantially by labour and rent charges at 19–20 per cent and 16–18 per cent respectively.

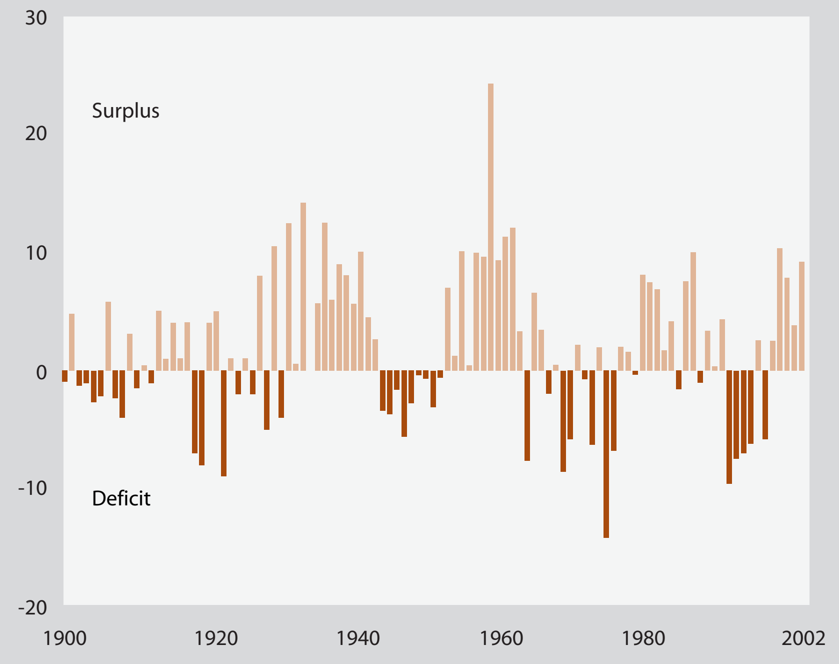
The campaign to guarantee higher returns for producers at the expense of consumers has been spearheaded under the campaign for 'Fair Trade'. In 2000, mega-coffee retailer, Starbucks, caved in to activist pressure and started selling fair trade coffee in its outlets. Other retail coffee chains, such as Hudsons Coffee and even McDonalds, have followed suit, though none has reported it as a significant contributor to sales.

From humble beginnings, 'fair trade' coffee worldwide has gone from a US$22.5m per year industry to US$87m since 1998. According to an Oxfam Australia's internal Fair Trade Coffee report, in Australia it has increased sales from $410,706 in 2003–04 to $2,032,386 in 2004–05 through extensive campaigning in coffee retailers, university activist networks and its 'Make Trade Fair' campaign. Even with such growth, it is well shy of the lion's share of the annual US$10 billion coffee trade, and its sustainability remains in doubt with Oxfam 'Fair Trade' stores and 'Fair Trade' cafés closing in Melbourne only shortly after the 'fair trade' campaign began. (The Oxfam store in Chapel Street, Prahran and the YHA 'Fair Trade' café in Fitzroy Street, St Kilda have both closed down in the first half of 2006.)

A recent article in the ordinarily free trade-sympathetic magazine, *The Economist*, described 'fair trade' coffee as a means for consumers to 'satisfy their palate and their conscience at the same time'. This was certainly its intention when the idea was founded in the Netherlands in 1989. The aim was to decouple the price paid to producers from the market price and create a 'fair' price for producers, currently registered at US$1.26 per pound. Yet, most people who buy into the kitsch fair trade brand fail to understand the full consequences of a 'fair trade' regime. The luxury of fair trade coffee is the satisfaction of guzzling down a preferred beverage and at the same time feeling you can contribute to sustainable economic development for those who need it most. If only this were the case.

One of the key platforms of 'fair trade' coffee is to re-establish an international coffee quota system in line with the previous ICA. The aim is to establish a non-price-signalled control

The volatility of coffee supply, 1900-2002, millions of 60kg bags of green coffee*



*unroasted coffee beans

Source: 'Easing coffee farmers' woes', *The McKinsey Quarterly*, February 2004 of prices and the sale of coffee on to the international market through NGO roasters from producer collectives. Under the ICA, it is not surprising that corrupt governments in developing countries allotted quotas to the highest bidder, not the best coffee producer. The fact is that the ICA inflated coffee prices above their natural price. Comparing current prices with ICA annexed prices stands no logic. Re-establishing the ICA will artificially increase the price again, distort the coffee market and directly discourage producers from tying the cost of production to the cost of sale. In this environment, everybody loses through decreased productivity, limited profit margins and increased prices for consumers which will only work to reduce consumption. Worse, by inflating prices beyond their market rate it only encourages producers to produce more, not less, coffee in search of higher profits when the price is guaranteed. Of course, the 'fair trade' campaign has developed a solution to the over-produced beans. To ensure that the price does not fall below the $1.26 rate, any over-supplied beans will simply be destroyed to assist in balancing supply with demand. A questionable outcome for consumers, producers and the environment.

'Fair Trade' rules also work against enterprising individuals. Despite its argument that it is about improving the lot of individual producers, it actively works against them by purchasing coffee only from collectives. Collectives are designed to be established along democratic lines where individual producers trade their product as a collective. Consumers would expect that this would increase their bargaining power, but, with a fixed price, there is no benefit. Profits are then returned to the collective and distributed according to its decision, creating significant opportunities for cronyism and preferential deals based on personal and political relationships, not market signals that the best producer gets the best price.

A short film shot in the UK and Ghana, *The Bitter Aftertaste*, exposes some of the home truths about the negative effects of 'Fair Trade' on the coffee industry in developing countries. The 'Fair Trade' campaign is not simply limited to a new trading system, it also promotes organic produce by placing a higher guaranteed price on organic coffee beans. The effect is to place limitations on certain products (such as fertilisers) that can be used to increase the protection of crops and boost their yields, thereby decreasing the crops that farmers can sell. Moreover, under the 'fair trade' collectives system, fair trade suppliers are restricted to small farms. Large productive farms that meet 'fair trade' requirements, even if they pay their employees good wages, are excluded.

'Fair Trade' campaigners also argue that, with a fixed price, producers are able to invest more, comfortable in the knowledge that they will receive a return so that they can produce higher grade, quality coffee. Yet under the collective regime, each producer's coffee is blended with the coffee of other producers in the collective, effectively ensuring that no individual producer can claim product differentiation. Instead it works to discourage quality control as producers can invest less and still ensure a guaranteed return.

The support to provide a 'fair trade' system does not come cheaply. One of the great unknowns of the 'fair trade' coffee label is the enormous bureaucracy that supports it to ensure that coffee is produced only from collectives and meets any number of 'fair trade' certification standards. Perhaps the most honest in the campaign for 'fair trade' is Hudsons Coffee, whose 'fair trade' coffee is labelled 'Fair Trade certification requires a "premium" to be paid for having its label'; and the premium does not come cheaply. To become a fair trade supplier, producers are required to pay a single registration fee of between US$2,000–$4,000, with additional annual fees. The fees are even higher to gain certification as a 'fair trade organic' producer. These fees are used to guarantee certification under the Fairtrade Labelling Organisation International and to support its bureaucracy.

Despite its failings, 'fair trade' coffee remains a bourgeois luxury. Starbucks supplies fair trade coffee in only 17 countries internationally, despite operating stores in more than twice that number of countries. Not surprisingly, the 17 countries are almost entirely rich, developed economies. In 2004, Starbucks' total sales of Fair Trade coffee represented only 1.6 per cent of its total coffee sales.

The explosion in the coffee industry following the collapse of the supply-controlled ICA is hardly surprising. For many people in developing countries an opportunity arose to lift themselves out of poverty by producing a product that was subject to increasing demand. The increase in supply outstripped demand and the price decreased. This is not a failing of the free market system; rather, it highlights the failings of the ICA and how it limited the capacity of some of the poorest people on earth to improve their lot. Instead, the free market has driven increases in productivity and higher quality product in the interests of producers and consumers. There is no doubt that the oversupply is deflating the price of coffee and that consolidation is needed. Following the removal of any regime like the ICA, an increase in supply was inevitable. But so too was a contraction in the production market as supply realigned itself to demand, some producers simply got out and others realigned their product to high quality products to increase the demand for their produce. The market is now reaching its equilibrium, aligning prices to market demand. The campaign against free trade coffee will only work to realign the coffee market in the interests of the select few and against the interests of non-fair trade producers and consumers.

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