

# Markets in Action: The Market for Coffee

Each day nearly 2.5 billion cups of coffee are consumed. It is the fifth most widely traded commodity in the world and millions of people depend directly or indirectly on the production and sale of coffee for their livelihoods. The global market for coffee is characterised by volatile prices and production levels which impacts directly on the incomes and survival of producers.

## The Coffee Paradox

“While espresso, cappuccino and latte drinkers are bringing huge profits to some of the world's biggest multinationals, the place where coffee originated remains one of the poorest on Earth. Around the world more than 2 billion cups of the stuff are consumed each day. In Starbucks in south London the cheapest shot of espresso costs £1.35. A coffee worker in Ethiopia earns less than half of that in a day.

“The importance of coffee to Ethiopia is difficult to overstate. The country is the largest coffee producer in Africa and the sixth- biggest in the world. Coffee accounts for no less than 90 per cent of Ethiopia's exports, half of which go to EU countries. The trade generates some 54 per cent of Ethiopia's gross domestic product.”

*Source: Adapted from the Independent, October 2006*

Experts on the world coffee market often make reference to the “coffee paradox”.

- A **coffee crisis in producing countries** with a trend towards lower prices, declining incomes and profits affecting millions of people in the world's poorest countries.
- A **coffee ‘boom’ in consuming countries** with rising sales and profits for coffee retailers and roasters
- A **widening gap** between producer and consumer prices only partly offset by the growing influence of [Fair Trade](#) in the coffee industry.

The [World Bank](#) estimates that out of 140 developing countries, 95 depend on exports of commodities for at least 50 percent of their total **export earnings**. Coffee is an example of “**commodity-dependency**” representing, for example, 75% of the total exports of Burundi and 54% in Uganda. About 25 million families produce and sell coffee for their livelihood and most are **small-scale farmers** with limited financial resources and scope to diversify out of coffee.

Globally, **coffee sales** each year exceed \$70 billion, but coffee producing countries only capture \$5 billion of this value, with the bulk of revenues retained by developed countries. A recent [Oxfam research report](#) showed that Ugandan coffee farmers only get about 2.5 percent of the final retail price of their coffee in the UK market.

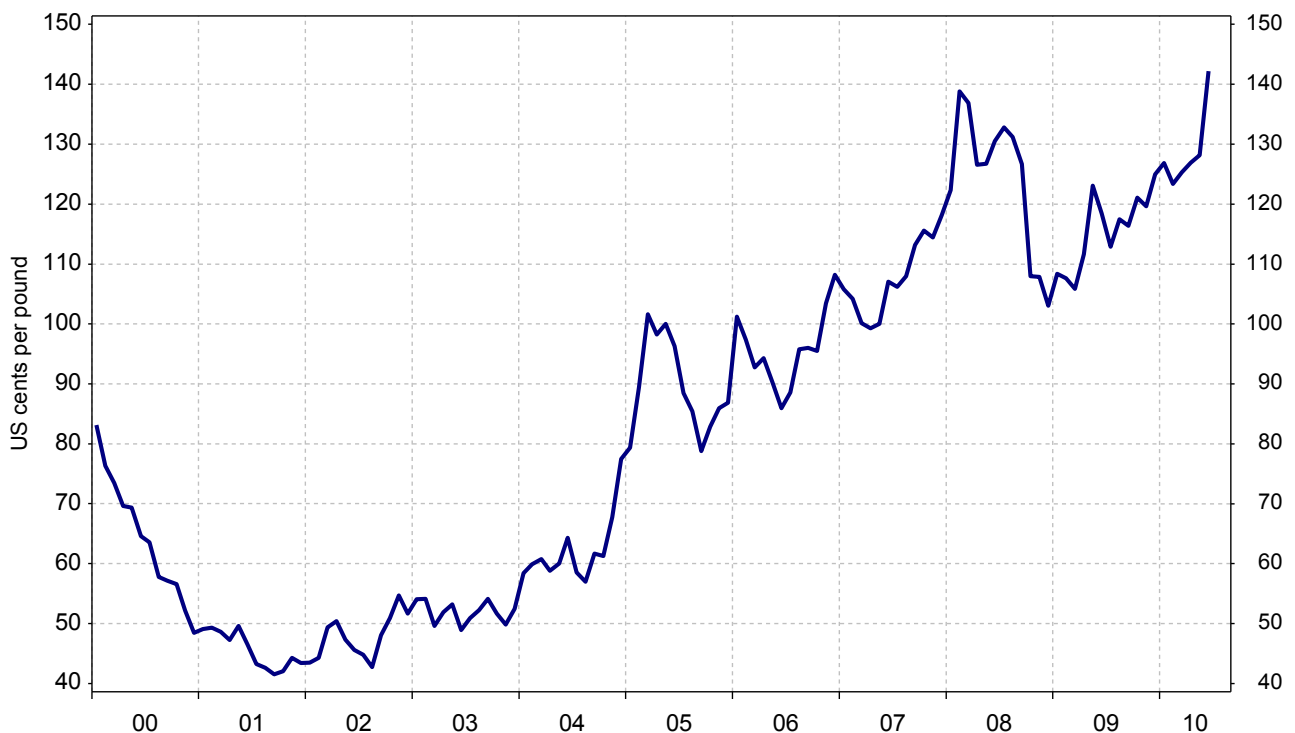
Because the supply-side of the world coffee market is fragmented – with millions of small-scale producers – much of the market power lies with the **coffee roasting companies** who buy raw coffee beans and process them into coffee-based products. When buyers have power over the market price, this is **monopsony**. And this buying power can force down the price that farmers receive for their products – creating poverty and damaging the chances of sustainable development for regions dependent on coffee production.

There have been no price controls in the global coffee trade since 1989, when the **buffer-stock system** run by the [International Coffee Agreement](#) broke down. Since then prices have been determined by the market supply and demand. As the chart below confirms, over the last ten years coffee prices have been volatile – collapsing from \$1.30 per lb in 1998 to less than \$0.40 in 2002. In the last four or five years there has been a recovery in prices – but they remain below the levels seen in the mid 1990s.



## World Coffee Prices

Monthly average composite price, US dollars per pound, ICO: International Coffee Organisation



Source: International Coffee Organisation

## Consumption of coffee and price elasticity of demand



Coffee consumption worldwide in 2007 was estimated at around 122.7 million bags - up from 121.08 million bags in 2006 and 118.1 million bags in 2005.

Demand has been stagnating in many of the richer nations of the world but consumption growth has been stronger in emerging market countries and especially in some of the former eastern Bloc countries most of whom have recently joined the European Union.

The main buyers of raw coffee beans are the largest multinational buyers, dominated by four firms: Nestlé, Kraft, Procter & Gamble and Sara Lee.

**Coffee consumption** has been growing at a steady rate of between 1 and 1.5 % per year; a growth rate is well below that for food products as a whole which is closer to 4% per annum. Changes in eating habits and increased demand for alternative drinks to coffee are largely behind this relatively slow growth of global market demand. Even the sharp fall in coffee prices during 2000 - 2004 seemed to have little impact on world demand, suggesting that coffee has a low price elasticity of demand.

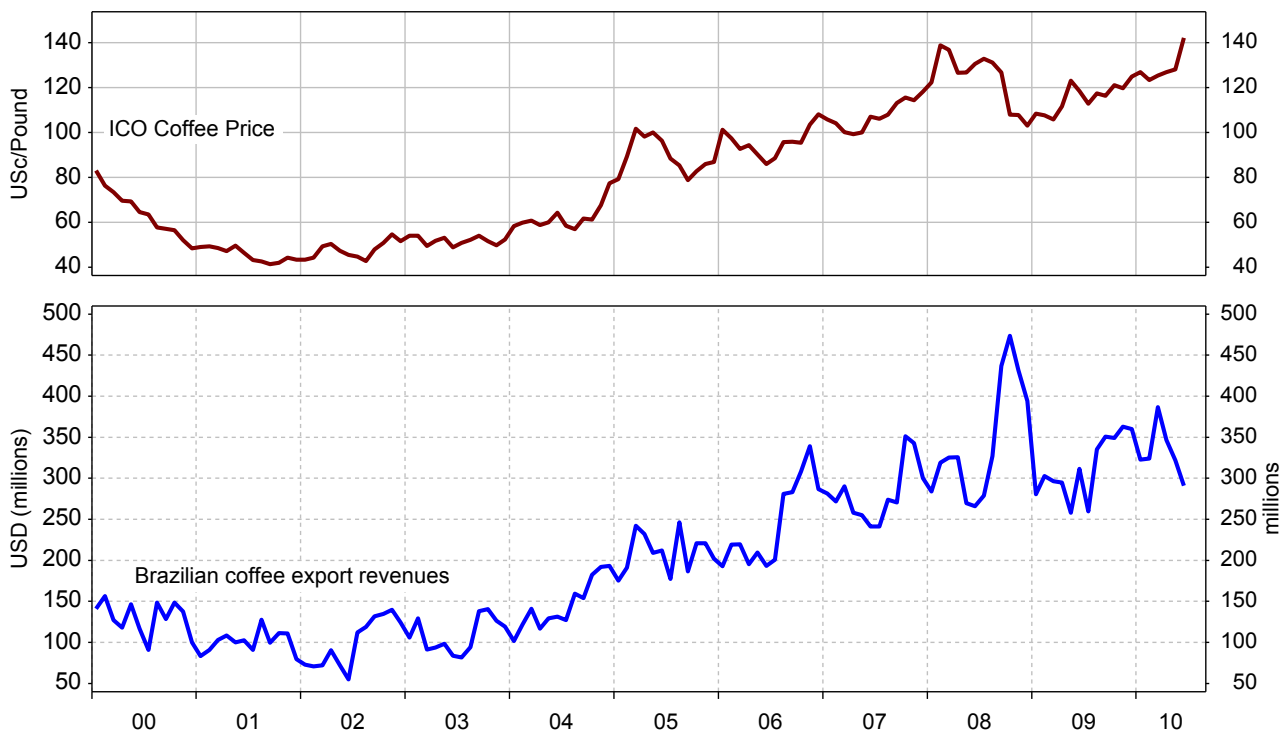
## Employment in coffee producing countries



Coffee production employs a labour force estimated at around 25 million families by the ICO and accounts for more than 50% of **export earnings** in many countries, an increase in consumption favouring a gradual rise in world prices would be a positive factor for economic growth and increased **per capita incomes** in these countries. In Brazil alone more than a million jobs are generated by the coffee industry. According to the International Coffee Organisation “25 million small coffee farmers and their families who produce 90% of the world’s coffee are particularly affected by **fluctuations in market prices** and imbalances in supply and demand.”

### Coffee Prices and value of Exports of Brazilian Coffee

Monthly value of exports, \$ million (bottom pane) and world price (top pane)



Source: Reuters EcoWin

### The International Coffee Organisation (ICO)

The [International Coffee Organization](#) (ICO) brings together producing and consuming countries to tackle the challenges facing the world coffee sector through cooperation.

**Brazil** is effectively the “swing producer” for the global coffee markets, in other words, since Brazil is the largest coffee producer, changes in Brazil's supplies of coffee account for a large portion of the change in the world total supplies of coffee which then directly affects the prevailing international price.

There is a relationship between the current world price and the value of exports of coffee from nations such as Brazil. Factors such as changes in the exchange rate can influence the income that coffee exporting countries will generate from their overseas sales as coffee is traded in US dollars.

