THE CENTRAL AMERICAN COFFEE CRISIS:
EFFECTS AND STRATEGIES FORWARD

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Structural changes in the global coffee market: the impact on Central America

After surpassing 100 million 60-kg bags of coffee in annual production in the 1998-1999 crop year, a worldwide glut took place. This triggered a severe crisis for the Central American coffee sector, as international prices plummeted and coffee began to be bought and sold as a generic product. The crisis in the coffee sector continues. Its impact cannot be understated, since coffee constitutes the livelihood of an estimated 25 million families around the world. In world trade, coffee is the second leading commodity, after petroleum. The worldwide coffee market spans some 71 countries, of which 51 are significant producers and 20 are key consumers.

As shown in Figure 2, the Composite Indicator Price and the price of other mild arabicas declined substantially over a ten-year period, falling 65.8 and 58 percent, respectively. Even when prices have experienced fleeting increases, they have not risen high enough in proportion to costs to make coffee production actually profitable for most Central American producers.

Economic effects of the coffee crisis

Coffee production continues to decline in comparison with the 1999-2000 crop year. Coffee revenues, as a component of aggregate exports, dropped by almost half between 2000 and 2003, which reduced regional earnings by $801.9 million. From the 1999-2000 harvest to that of 2003-2004, the total decline equaled 34 percent. Real output diminished in all the Central American countries: El Salvador (-45 percent), Nicaragua (-36 percent), Guatemala (-20 percent), Costa Rica (-18 percent), and Honduras (-16 percent).
Region-wide, coffee production as a share of overall and agricultural GDP fell in all countries, with rural coffee producing areas being particularly hard hit. However, the impact is highly localized. The macro effect of the coffee crisis is disguised as the Central American countries have diversified their economies. Families, well accustomed to shocks in Central America, have developed coping strategies and in many cases have found alternate livelihoods, but only after considerable hardship and unemployment in the coffee communities.

It is estimated that from 2000 onward the total number of hectares dedicated to coffee growing has been decreasing 5 percent per year, forcing many small farmers into hiring themselves out as unskilled labor, or increasing migration flows, with the inevitable consequences related to social uprooting and family disintegration.

**Effects of the crisis on employment in the coffee sector**

Labor statistics, which have fallen in all coffee producing countries worldwide, are even worse in Central America than production statistics (see Figure 3). While coffee production has fallen by 15 percent, jobs in the sector have plummeted 42 percent. The worst labor contraction involves seasonal work during the coffee-picking months. But both seasonal and permanent employment have been affected by the crisis, contributing to the persistent migration of significant contingents of the economically active population (e.g., from Nicaragua to Costa Rica).

Throughout Central America, the significance of the coffee sector as an employer in rural areas also has decreased, from 30 percent of the total to only 18 percent. Between 2001 and 2003 the level of overall employment in the rural areas of Central America fell by 728,000 jobs.

Models for estimating employment based on production volumes suggest there has been a decrease in the number of farmers. Countries, such as Costa Rica and El Salvador, estimate that their number of coffee farmers may have shrunk by 10 percent in the course of the crisis.

The increased unemployment in the coffee sector has affected all producers and workers in the supply chain, and where alternate employment was not secured, it affected the affordability of health care, education, food, clothing, housing and other key indicators of quality of life in rural areas. The rising indebtedness of coffee producers has, in turn, affected their ability to maintain coffee production or even retain their farms.

**Yields and production costs**

During the period under study, Central American countries maintained their relative positions of efficiency regarding average yields per hectare, even though productivity decreased in all of them. Production costs are likely to remain high vis-à-vis incomes, particularly in light of the recent increases in oil prices and its derivatives, which are a key input for coffee production. This situation is unlikely to change in the short-term.

**Responses to the crisis**

After the collapse of the International Coffee Agreement in 1989, Central American countries implemented programs involving emergency price-support funds. At present, however, even after the restructuring and refunding of all these funds by some governments, they remain in the red.

Credit for yearly farming operations has been sharply curtailed. Banks provide “special customers” (large, well-connected operations) with loans to cover costs until the next harvest has been liquidated (paid in full), based on prior volumes harvested and delivered to processing plants. Nevertheless, these loans generally do not cover the costs of maintaining, much less improving, coffee plantations. It should be noted that local commercial banks have gradually reduced financing to the coffee sector to nearly the choking point, with only some banking houses providing any credit at all, while demanding greater and better collateral to participate in the risk of coffee exporting activities. To make matters worse, improving yield per hectare, or even maintaining it, cannot be affected without substantial capital investment, at a time when loans are difficult to obtain.

**Strategies for promoting competitiveness and diversification**

The marketing model and the characteristics of the market, ruled by worldwide supply and demand, means that the power of national or even regional producers to influence prices is extremely limited, if not nonexistent, depending as they do on how other producer countries behave in the face of growing competition. Quality remains of utmost importance to maintain competitiveness.

In order to successfully penetrate the market, the countries in the region have devised various courses of action within the overall approach known as sustainable agriculture. In general, these are plans and specific projects aimed at promoting innovation and protecting the national coffee sector through more competitive and efficient production.
In Costa Rica, the strategies contained in the 2000-2010 National Coffee Sector Plan have already yielded important benefits. In Central America, it is the country with the best yields per hectare and the best final price on its exports. In 2002, it held second place among the world’s main coffee producing countries. Furthermore, in the market of fine coffees, certain Costa Rican producers of gourmet coffee sell directly to Starbucks Coffee Company at an average price of $120/qq.

The Government of Nicaragua has produced a plan called the Strategy for the Competitive Transformation and Diversification of Coffee Production. It has also devised a strategy called “Coffee Clusters,” combining competitive and dynamic clusters of coffee-growing, milling and other rural productive activities with the development of new infrastructure aimed at achieving economic rural growth and improving coffee quality in the more competitively promising regions of the country. In addition to striving for greater access to coffee markets, it is intended to encourage reforestation at the individual farm level. Community organizations are also carrying out other productive activities, given market demand, including organic coffee farming, honey production, butterfly sanctuaries, natural pharmaceuticals and ecotourism.

In El Salvador, the Salvadoran Foundation for Coffee Research has developed technology packages aimed at procuring high yields through pruning, fertilization, soil management, and pest and disease control systems. Regarding diversification and quality enhancement, coffee growers and sectoral associations are promoting the production of specialty coffees. In 2003, they sold abroad 80,000 quintals of these coffees, 5 percent of total coffee exports. In tandem with sustainable coffee, such exports may have accounted for as much as 7 percent of the total. All this has been the result of participation by the Salvadoran Coffee Council in the implementation of marketing and quality control policies. Together with the Salvador Fine Coffees Association and the European Union, coffee producers in the country have created a gourmet coffee “brand” with a Geographic Indication of Origin (GIO) appellation known as Itaúco Premium.

In Guatemala, the National Coffee Association (ANACAFE) has developed different programs to improve quality, including seminars and a major program on income diversification with 20 different products, such as avocado, bananas, ecotourism, etc. The country is performing thorough GIS (Geographical Information Systems) work to better locate producing areas. This will help producers improve their quality and allow for the control of producing areas (appellation control). Guatemala can respond to the demand of the differentiated coffee market with relative ease, thanks to the existence of agroclimatic and soil conditions that are ideal for the production of gourmet coffee. The gourmet coffee brand “Coffee Time” has an intensive marketing program to increase domestic and international consumption and has a promotional website.

In Honduras, the Honduran Association of Coffee Producers has unveiled an ambitious project aimed at boosting the country’s “quality, modernization and diversification” of coffee production through technical and financial resources for the organized participation of producers to attain this goal. Honduras already has coffees with the attributes needed to participate in any international cupping event. Since farms are small, diversification efforts are being aimed at the household and local levels, in an empirical quest for profitable annual crops that do not interfere with the continued existence of coffee plantations. The overall project is also aligned with the Honduran authorities’ efforts to encourage nontraditional exports.

An Analysis of Sustainable Coffee Production in Central America

Producers see certified sustainable coffee as a means of adding value to their product. Participation in this segment of the export market is divided into four types of certification: 1) Organic, 2) Fair Trade, 3) Rainforest Alliance, and 4) Bird Friendly (see Figure 4). It has been estimated that sustainable coffee may account for approximately 2 percent of the world

Figure 4: Share of the Various Coffee Production Seals in Latin America

- Organic Only: 62%
- Rainforest Alliance: 8%
- Fair Trade Only: 15%
- Organic & Fair Trade: 13%
- Bird Friendly, Organic & Fair Trade: 1%
- Bird Friendly Only: 1%
market. In Central America, in the course of crop year 2002-2003, it stood for 6 percent of overall coffee production and 4 percent of coffee exports. It is growing yearly at a rate of between 10 and 20 percent. The mainstreaming of certified coffees, which have almost always commanded a higher producer price, into main commercial brands, is perhaps the greatest hope for sustained higher prices.

Environmental considerations

The contribution of responsible coffee producers to a healthier environment is being gradually recognized as the region adopts strategies aimed at stressing the potential benefits of continued coffee production to the conservation of biodiversity and the environment. Shade-grown coffee, which accounts for 74.4 percent of all planted surface in the region, along with “clean” production and milling practices, forestry diversification and ecotourism, are all environmentally friendly practices that reinforce each other and contribute to overall sustainability. In some cases, where alternate production is used, this has led to a decrease in tree cover as crops not requiring shade are planted instead of coffee. A larger threat thus arises: widespread deforestation affecting buffer zones vital to the preservation of wildlife sanctuaries and primary forests.

In general, coffee growing in Central America is concentrated in some of the main river basins, where springs feed the region’s main bodies of fresh water. The conservation of coffee-growing microbasins is vital for the survival of local rivers and all related flora and fauna. Water infiltration, topsoil protection, and the reduction of pollution related to agrochemicals and sewage are all being holistically taken into account in integrated basin management programs.

Recommendations

As noted, the coffee crisis is not just one of competitiveness, marketing, even production—it is systemic, affecting various sectors of the population, in turn feeding back directly or indirectly into the overall economic situation as well as the natural environment. The solution can only lie in a systemic strategy that integrates all the variables feeding into the coffee business as a whole and generates economic growth at the community level. Such strategies must contemplate alternative livelihoods and diversification, as well as ways of reengineering coffee production.

Such a perspective calls for a reorganization of agricultural and rural development by means of credit and technical assistance, marketing and promotion whose purpose must be to improve the quality of life and productive capabilities of small farmers so they can play a larger role in their own destiny.

In the Field of Coffee Production

Considering that coffee production takes place in rural areas often distant from each other, and that the implementation of sectoral and macro strategies takes place at different times in different settings, in some cases it has proven advantageous to establish or strengthen national-level steering institutions capable of centralizing decision-making in the marketing and technical development of coffee production. A steering entity of the type contemplated, together with other stakeholders such as government ministries, NGOs and producer organizations and processors, would find it far more feasible to implement successful and sustainable rural development policies and strategies. Moreover, its legal framework could ensure that all stakeholders have a say in its operations. This model may not be appropriate for all countries, however.

In the Field of Rural Development

Considering that most strategies for improving coffee production in the region go beyond strictly farming-related issues, with the goal of ensuring that value is also added to the marketing of the product, it makes sense to devise social assistance programs for high-risk rural communities, including strategies for strengthening social capital through community organizations. In turn, the dynamics of community-based rural development must promote and encourage the implementation of participatory and self-reliant development processes that can contribute to improving the organizational and socioeconomic production skills of these communities, enhancing their social conditions and quality of life.

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