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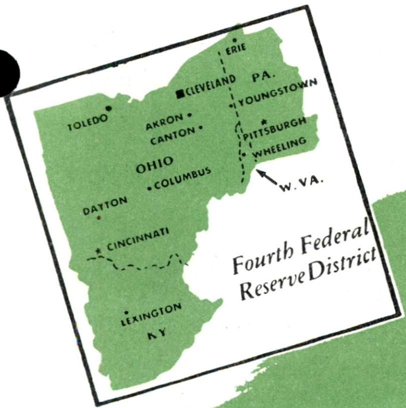

Business Trends

Prepared in the Research Department of the
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THE INTERNATIONAL COFFEE AGREEMENT

The House of Representatives currently is considering a bill that, if enacted, would empower the United States to participate in an international agreement to regulate the production and prices of coffee. Actually, the International Coffee Agreement had been signed by 54 nations in 1962 and ratified by the United States Senate in 1963. However, the Agreement needs the Congressional action now pending if the United States is to participate fully.

The pact was a result of the unstable market conditions that have beset coffee in the postwar period. For example, in the decade from 1950 to 1960, world coffee production increased nearly three times as fast as consumption. Current estimates place the world surplus in excess of a full year's production. In addition, coffee exhibits an inelastic demand that is characteristic of many agricultural products; that is, a reduction in price will not be offset by a proportionate increase in the quantity demanded. Therefore, since an increase in supply will reduce prices, total revenues will fall. Conversely, a reduction in supply will raise prices and, subsequently, total revenues. This has a traumatic effect on the income of those countries that rely extensively on coffee exports.

There are other inherent factors in coffee production that inhibit orderly marketing. The three-year gestation period of coffee trees often results in production coming on the market after demand has diminished. There is also a seasonal problem in that a sizeable portion of the world's coffee crop is harvested at the same time (late summer and early fall). Since many Latin American producers lack the storage or financial resources to hold the crop, a disproportionate amount appears on the market at one time.

There have been repeated attempts to arrive at a more orderly marketing procedure. Brazil, prior to World War II, attempted to regulate the international coffee market alone. However, as her market share fell, unilateral action became insufficient. A 1940 agreement between the United States and the Latin American producers was fairly successful, but this was primarily a wartime measure that was allowed to lapse. Discussions began anew in 1954 and proceeded slowly until the huge coffee crop of 1957-1958 dramatized the need for some control. In 1959, a one-year agreement was signed in Washington. This agreement was not entirely successful as importing nations were not members and violations occurred, but it did afford hope for a longer-term treaty.

Broadcast by Herbert M. Bernstein, Economist, Federal Reserve Bank of Cleveland, over WGAR, Cleveland, with Charles Day, News Director, Saturday, March 13, at 7:15 p. m.

On November 30, 1962, the present five-year pact was signed. The objectives of the Agreement are to lessen imbalances between production and consumption, encourage economic diversification through close international cooperation, and to assist coffee consumption through promotional campaigns and the maintenance of equitable prices.

Each member nation has voting power proportionate to the amount of coffee exported or imported but weighted in such a way as to minimize the power of the larger nations. The essential control mechanism of the treaty is the export quota. Each exporting nation is given a basic quota which remains in effect for three years unless revised by review. This quota is expressed as a percentage of total world exports. Once this has been determined, the exporting nation is given an annual quota, expressed quantitatively but in the same proportion as the basic quota. For example, if a nation is allocated a basic quota of 10% of world exports which, for a particular year, may be 50 million bags, its annual quota for that year will be 5 million bags. In addition, to ensure orderly marketing, each exporter has a quarterly quota which is 25% of the annual quota. Both annual and quarterly quotas can be adjusted because of changing market conditions.

The proponents of the Agreement, both American and foreign, have testified to the desirability of the treaty's objectives. In addition, they have maintained that stability in world coffee markets is a necessary adjunct to the implementation of the Alliance for Progress and that economic development, especially in the Latin American nations, will be encouraged by stable coffee earnings.

Opponents have countered by stating that the Agreement would increase United States retail coffee prices. In addition, those opposed to the Agreement claim that the pact may establish a precedent in redistributing the world's wealth by requiring Americans to pay more for foreign products. Also, it has been argued that the Agreement is inequitable in that the United States consumes 50% of the world's coffee but possesses only 20% of the votes.

The International Coffee Agreement currently is not fully operative until the implementation bill passes the Congress. In 1964, both the Senate and House passed a similar bill but Congress adjourned before the House could take action on a Senate amendment. This session's bill has passed the Senate and is now in the House Ways and Means Committee. If enacted, as seems likely, it may bring a measure of price stability to this important commodity.

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