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THE INTERNATIONAL COFFEE AGREEMENT

ITS IMPACT ON COFFEE PRICES; ITS ABILITY TO DEAL WITH UNFORESEEN SUPPLY AND DEMAND CONDITIONS; ALLEGED DISCRIMINATION AGAINST U.S. SHIPS IN THE CARRIAGE OF COFFEE; AND THE SOLUBLE COFFEE CONTROVERSY

REPORT

BY THE

COMPTROLLER GENERAL OF THE UNITED STATES

TO THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

RUSSELL B. LONG, *Chairman*

JULY 1973

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CONTENTS

In March of 1972, the Committee on Finance acted to extend the International Coffee Agreement until September 30, 1973. At that time the Committee asked the General Accounting Office to conduct a study of various aspects of the Coffee Agreement. This document contains the reports submitted by the Comptroller General in response to the Committee request.

Part One

The International Coffee Agreement and Its Impact on Coffee Prices

and

The Ability of the International Coffee Agreement To Deal With Unforeseen Supply and Demand Conditions

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-175530

The Honorable Russell B. Long
Chairman, Committee on Finance
United States Senate

Dear Mr. Chairman:

In response to your request dated March 14, 1972, that we participate in a comprehensive study of the International Coffee Agreement, we have completed two of the four assignments which we agreed to undertake.

Our reports on those segments are attached, as appendixes to this letter:

Appendix I - The International Coffee Agreement and Its Impact on Coffee Prices

Appendix II - The Ability of the International Coffee Agreement to Deal With Unforeseen Supply and Demand Conditions.

Our main conclusions are that the International Coffee Agreement raised coffee prices during the 1963 to 1972 period, and that the Agreement enhanced the price rises following the 1963 and 1969 Brazilian frosts and the so-called Geneva Agreement in 1972.

On December 11, 1972, the International Coffee Council ended its special session without agreement on quotas for coffee exports from member coffee-producing countries for the remainder of the 1972-73 coffee year. The coffee year ends on September 30, 1973, which is the expiration date of the present International Coffee Agreement.

However, the controls system for insuring compliance with quotas on exports from member coffee-producing countries will continue in force, although there are no

B-175530

longer any Agreement-sanctioned quotas on exports from member coffee-producing countries, and quotas for imports from nonmember countries will also continue in force.

We briefed your staff on these developments, but we did not discuss them in the appendixes because it is too early to evaluate them. More recently, there have been reports that the U.S., Brazil, and other major coffee consuming and producing countries have agreed to recommend a 1-year extension of the International Coffee Agreement.

In view of the interest in the Committee in receiving the reports as soon as possible, no formal written comments on the reports were obtained but drafts were informally discussed with officials of the Departments of State, Commerce, and Agriculture. We wish to note the cooperation our staff received from these agencies.

We believe that these reports would be of interest to other committees and Members of Congress as well as to the Departments of State, Commerce, and Agriculture, and others. However, we will not release the report unless you agree or publicly announce their contents.

Our work is continuing on the remaining two assignments and we expect to be able to report the results to fit in with your overall plans for completion of the Committee's final report around June 1.

Sincerely yours,

James B. Staats

Comptroller General
of the United States

APPENDIX I

UNITED STATES

GENERAL ACCOUNTING OFFICE STUDY OF

THE INTERNATIONAL COFFEE AGREEMENT

AND ITS IMPACT ON COFFEE PRICES

MARCH 1973

INTRODUCTION

Since 1963 the bulk of coffee exports has been regulated by the International Coffee Agreement (ICA). The first (1962) agreement, which expired in 1968, was renewed in modified form in 1968 and will expire in 1973.

The objectives of ICA are:

(1) to achieve a reasonable balance between supply and demand on a basis which will assure adequate supplies of coffee to consumers and markets for coffee to producers at equitable prices and which will bring about long-term equilibrium between production and consumption;

(2) to alleviate the serious hardship caused by burdensome surpluses and excessive fluctuations in the prices of coffee which are harmful both to producers and to consumers;

(3) to contribute to the development of productive resources and to the promotion and maintenance of employment and income in the Member countries, thereby helping to bring about fair wages, higher living standards, and better working conditions;

(4) to assist in increasing the purchasing power of coffee-exporting countries by keeping prices at equitable levels and by increasing consumption;

(5) to encourage the consumption of coffee by every possible means; and

98-087 O - 73 - 2

(6) in general, in recognition of the relationship of the trade in coffee to the economic stability of markets for industrial products, to further international co-operation in connection with world coffee problems.

The United States has stressed two major interests in participating in ICA--protection for American consumers and economic development of coffee-producing countries. The President stressed these points in his 1971 annual report to the Congress on the ICA.

> It is accordingly appropriate that we join in a collective effort which serves to protect the American consumer from the extremely high prices which prevail in times of a coffee shortage. Moreover, we have an equal interest in stabilizing the export earnings of coffee producing countries, whose economic development programs we have supported, and most of which are important customers for American export products.

More recently, Mr. Charles A. Meyer, Assistant Secretary of State for Inter-American Affairs, said: "We look forward to continuing our cooperation within the Agreement to ensure that prices remain beneficial to producers and fair to consumers."

This GAO study was made to determine whether ICA in its impact on coffee prices has protected the American consumer. The focus is on prices of green coffee (unroasted coffee beans), because most of the coffee imported by the United States is in this form and these prices are under the direct influence of ICA.[1] The basic question is whether ICA has brought about higher prices than would have occurred without an agreement. A related question is whether ICA has moderated high prices.

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[1]We agree with the view expressed in the President's Report on the International Coffee Agreement (1971, p. 10) that wholesale and retail prices reflect not only the price of green coffee but also such elements as the cost of labor, packaging, transportation, etc., which are beyond the influence of ICA.

PRICES IN THE AGREEMENT AND IN THE PRE-AGREEMENT PERIODS

The following chart shows the prices of green coffee from 1947 through 1972.

No satisfactory comparison can be made between prices in the period since the establishment of ICA and those for some previous relevant period. Prices moved up in the early post-World War II period, reached a peak in the mid-1950s, and then declined until ICA was established. Since ICA prices have moved upwards.

In view of the large annual coffee surpluses in the 1963-72 period (see the following section), the potential for increased output of diversified coffee types in Africa at fairly low costs, and the history of long, cyclical downswings, it is unlikely that there would have been any significant cyclical upturns in prices without an ICA, especially one encompassing a peaking of prices. Hence, one cannot compare average prices in the pre-ICA, post-World War II period with average prices in the ICA period.

Perhaps it is best to compare prices in the ICA period with those in 1962, the year before ICA went into effect because 1962 is the only year specifically mentioned in both the 1962 and 1968 coffee agreements relating to price objectives. The agreements state that prices should not decline below those in 1962. As shown in table 1, prices in 1964-72 have been significantly above those in 1962. Furthermore, in no year since ICA went into effect have prices dropped below their 1962 level.

TABLE 1

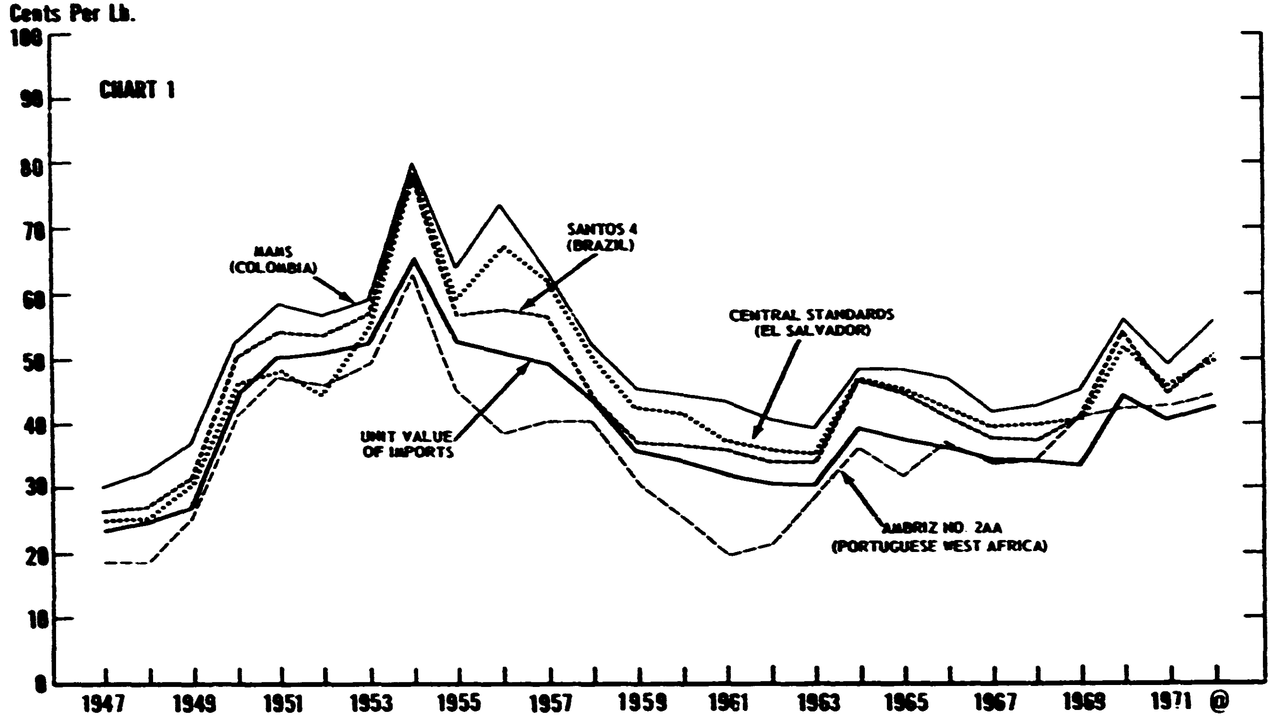
COMPARISON OF AVERAGE LEVEL OF PRICES IN 1964-72 WITH THOSE IN 1962

	1962	Average of 1964-72 (note a)
	(cents per pound)	
Santos 4	34.0	44.3
Mams	40.8	48.9
Ambriz 2AA	21.6	37.0
Central Standards	35.9	44.6
Average unit value of U.S imports	30.4	38.1

[a]Average of 1964-71 and first 11 months of 1972.

Source: Pan-American Coffee Bureau and Department of Commerce. The prices of Santos 4, Mams, Ambriz 2AA, and Central Standards are New York spot prices representing each of the four major types of coffee. The unit value of imports is the dollar value of U.S. imports of green coffee divided by the corresponding volume of green coffee imports. The year 1963 is omitted because the 1962 ICA did not become operative until October of that year.

COFFEE PRICES* 1947–72



SOURCE PAN AMERICAN COFFEE BUREAU EXCEPT 1954 PRICE OF CENTRAL STANDARDS FROM SPRAGUE & RHODES COMMODITY CORP

* THE PRICES OF MAMS, SANTOS 4, AMBRIZ NO 2AA AND CENTRAL STANDARDS ARE NEW YORK SPOT PRICES REPRESENTING EACH OF THE 4 MAJOR TYPES OF COFFEE. THE UNIT VALUE OF IMPORTS IS THE DOLLAR VALUE OF ANNUAL U S IMPORTS OF GREEN COFFEE DIVIDED BY THE CORRESPONDING VOLUME OF GREEN COFFEE IMPORTS

@ 1972 BASED ON 11 MONTH AVERAGE

With dissimilar cyclical patterns, it would be pointless to compare annual price fluctuations in the pre-ICA, post-World War II period with those in the ICA period. However, it is possible to compare price rises accompanying major frosts in Brazil, a recurring and significant cause of price rises in the pre-ICA and ICA periods.[1] See Appendix II where this is done and we conclude that prices on the average appear to have gone up as sharply in the ICA period as before.

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[1] The occurrence of a major frost is likely to overshadow underlying cyclical movements. Thus, the United States Department of Agriculture (U.S.D.A.) points out that the 1953 and 1955 frosts significantly modified the underlying cyclical pattern. Foreign Agricultural Circular, December 18, 1956, pp. 3-4.

APPENDIX I

IMPACT OF ICA ON AVERAGE PRICES

It is impossible to know definitively what the prices would have been without ICA. Only a judgment based upon the available evidence can be made about this. In our view the available evidence suggests that prices generally would have been lower in the 1963-72 period in the absence of ICA.

A major indication that ICA has raised prices is that there have been large annual coffee surpluses and a rising price trend during the period of ICA. Although there were significant surpluses in the period before ICA, these were associated with declining prices.

As shown in table 2 the supply of coffee (production plus inventories minus consumption in producing countries) generally has greatly exceeded coffee exports during the ICA period. Most of the U.S. coffee trade (importers and roasters) and representatives of coffee producing and consuming countries we interviewed agreed that on the average coffee has been in excess supply during the ICA period.

Table 2 also shows that surpluses have not been confined to Brazil, the major coffee-producing country. Although the Brazilian surplus has declined, the surpluses of other countries have increased. In 1971-72 surpluses of other countries were 22 million bags, about half of the total. Before ICA surpluses were virtually confined to Brazil (primarily) and Colombia. While Brazil, and to some extent Colombia, tried to maintain prices and consequently accumulated inventories, other countries sold their crops.

Most of the U.S. coffee trade we interviewed felt that ICA had not influenced the production of coffee. On the other hand, all the representatives of member coffee-producing countries interviewed felt that ICA had restrained production. If the representatives are right, the downward pressures on prices which would have occurred in the absence of ICA are understated by the data on actual surpluses shown in table 2.

Table 2

Supply and Exports of Coffee (note a)
(in millions of bags)

	Supply	Exports	Difference
ALL COUNTRIES:			
1963-64	120.3	51.2	69.1
64-65	110.0	41.6	68.4
65-66	136.3	47.4	89.0
66-67	131.4	47.8	83.6
67-68	132.0	54.0	77.9
68-69	122.2	52.8	69.4
69-70	112.9	53.9	59.0
70-71	98.5	49.9	48.6
[b]71-72	100.0	[c]57.5	42.5
BRAZIL:			
1963-64	81.5	19.8	61.7
64-65	70.0	12.9	57.1
65-66	89.2	15.3	73.9
66-67	84.4	16.3	68.1
67-68	81.4	18.2	63.2
68-69	71.9	19.3	52.6
69-70	58.5	19.0	39.5
70-71	41.0	15.6	25.3
[b]71-72	40.2	[c]19.5	20.7
ALL OTHERS:			
1963-64	38.8	31.4	7.4
64-65	40.1	28.7	11.3
65-66	47.1	32.1	15.0
66-67	47.0	31.5	15.5
67-68	50.6	35.9	14.7
68-69	50.3	33.6	16.7
69-70	54.4	34.9	19.5
70-71	57.6	34.2	23.3
[b]71-72	59.9	[c]38.1	21.8

[a]The data is for producing countries which are currently members of the International Coffee Organization (ICO). Coffee shipments of member coffee-producing countries accounted for 99 percent of world net coffee imports in 1970-71. Totals may not add due to rounding.

[b]Preliminary.

[c]1971-72 not comparable to other years. 1971-72 exports refer to the ICO coffee year, whereas figures for other years, as well as for other series, refer to crop years of member countries.

Source: ICO, except that supply for 1971-72 is partially based upon USDA data.

APPENDIX I

A second indication of the price-raising effects of ICA is that restrictions on exports of member coffee-producing countries (quotas), imposed under the Agreement, have been continuously in force since ICA became operative. Coffee shipments from member coffee-producing countries subject to quotas amounted to 93 percent of the world's net imports of coffee from all sources in 1970-71.[1] In addition, since 1967 nonmember country coffee shipments subject to restrictions amounted to 1 percent of the world's net imports of coffee in 1970-71.

Despite enforcement problems which were most severe during its early years, ICA has been able to control the volume of coffee exports. On the basis of information compiled by ICO, we estimate that above-quota shipments of coffee were 9 percent of annual quotas in 1965-66 and may have been as high as 8 percent in 1966-67 but since have declined significantly. Even in these years ICA restrained exports because coffee supplies exceeded quotas plus above-quota shipments.[2]

As shown in table 3, quotas have been kept well below the supply. Although quotas have at times been increased, they have never been suspended or increased to a level which could absorb all the supply. Quota increases which fall short of freeing all the supply should lead to some increase in exports, which, in turn, should temper a price rise, but the effect upon price will be much less than a suspension of quotas which frees all the supply.

The effectiveness of quota increases in tempering price rises has also been limited because a significant proportion has gone to countries which follow price

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[1]In 1963-64 coffee shipments from member coffee-producing countries subject to quotas amounted to 90 percent of the world's net imports of coffee from all sources.

[2]Exclusion of Brazil still leaves an excess of supply over quotas plus above-quota shipments.

maintenance policies; such countries are more likely to undership their quotas.[1] Thus, in 1969-70, when prices rose 22 percent, quotas were increased 6 million bags but undershipments of quotas amounted to 2.5 million bags; Brazil, which historically has followed its own price maintenance policies, received 37 percent of total quota increases (the single largest share) and its undershipments were 75 percent. In 1971-72 when prices rose 25 percent, quotas were increased 10.7 million bags but undershipments of quotas were 4.2 million bags; the so-called Geneva producers group, which agreed not to ship additions to quotas beyond the level it thought desirable (see the following section), received 85 percent of total quota increases and its undershipments were 92 percent.

Moreover, quotas are increased only when the International Coffee Council votes to do so, or, more recently, when prices advance to predetermined levels. In view of the large coffee surpluses during the 1963-72 period, it is likely that producing countries would have been able and willing to sell more coffee before quotas were increased. Additional evidence on this point, in the context of an analysis of the 1963-64 and 1969-70 price rises, is shown on the following page.

Yet another indication that ICA has raised prices is the existence of substantially lower coffee prices in the "new market" countries which are not subject to ICA quota limitations. For Japan, the major unregulated coffee market, in 1971 the average unit value of green coffee imports from Brazil was 25 cents and for the United States was 41 cents and the average unit value of green coffee imports from Uganda was 18 cents and for the United States

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[1]Under ICA producing countries are not required to export the amount of their quotas. As ICA restricts the exports of individual countries, as well as total exports, individual countries can undership their quotas without fear of sizable losses of market shares.

APPENDIX I

Table 3

Quotas and Coffee Supplies (note a)
(in millions of bags)

	Supply	Quotas	Difference
ALL COUNTRIES:			
1963-64	116.6	46.6	69.9
64-65	108.5	43.1	65.4
65-66	134.6	44.1	90.5
66-67	131.2	45.5	85.7
67-68	132.0	49.8	82.2
68-69	122.2	48.5	73.7
69-70	112.9	52.0	60.9
70-71	98.5	49.6	48.9
71-72	[b]100.0	57.7	42.4
BRAZIL:			
1963-64	81.5	18.7	62.9
64-65	70.0	16.8	53.1
65-66	89.2	17.0	72.2
66-67	84.4	16.9	67.4
67-68	81.4	17.7	63.7
68-69	71.9	18.5	53.4
69-70	58.5	19.3	39.1
70-71	41.0	18.0	23.0
71-72	[b]40.2	21.1	19.1
ALL OTHERS:			
1963-64	35.0	27.9	7.1
64-65	38.5	26.2	12.3
65-66	45.4	27.1	18.2
66-67	46.9	28.6	18.3
67-68	50.6	32.1	18.5
68-69	50.3	29.9	20.4
69-70	54.4	32.7	21.7
70-71	57.6	31.6	25.9
71-72	[b]59.9	36.6	23.3

[a]Totals may not add due to rounding.

[b]Preliminary.

Source: Table 2 and ICO supply data from table 2 and quotas have been adjusted to include only members in each year.

was 38 cents.[1] The fact that producing countries are willing to sell coffee at lower prices in unregulated markets means that prices in ICA-controlled markets are too high.

Most of those we interviewed, including representatives of the producing countries, thought that ICA raised the average prices. The representative of one producing country stated: "The International Coffee Agreement is a gift from consumers."

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[1]The figures for Japan are cost, insurance, and freight(c.i.f.) and those for the United States are free on board (f.o.b.).

APPENDIX I

IMPACT OF ICA ON HIGH PRICES

During the ICA period, prices reached highs in 1964, 1970, and 1972. The 1964 and 1970 highs were the culmination of price rises induced by major frosts in Brazil. The 1972 high resulted from a combination of frost in Brazil and actions by the so-called Geneva producers group not to ship additions to quotas beyond levels it thought desirable.

We believe that, if there had been no ICA, the price increases in 1963-64 and in 1969-70, accompanying major frosts in Brazil, would have been more moderate. In both periods there were producing countries which were able to sell more coffee than permitted by ICA quotas and which would have been willing to make additional coffee available sooner than permitted by ICA quota adjustments.

For 1963-64 this may be inferred from the fact that a majority of producing countries in November 1963 voted in favor of a proposal, which was defeated, to expand the annual quota and that quotas for countries other than Portugal and the Other Mild producers, which opposed the November 1963 proposal, were 69.4 million bags below the supply of coffee. Similarly for 1969-70 this may be inferred from the fact that African and some Central American producing countries were willing to support enlarged quotas at the time of the unsuccessful February and March 1970 Executive Board and Council deliberations and that quotas for producing countries other than Brazil and Colombia, which blocked the proposal, were 15.9 million bags under the supply of coffee. (See app. II.)

We believe also that the price increases in 1972 would have been more moderate without an ICA. The so-called Geneva Agreement contributed to an increase in prices which was greatly accelerated by a frost in Brazil. (See app. II.)

The existence of ICA facilitated the Geneva Agreement in several ways. Because of ICA controls on exports, the Geneva group did not have to worry about its own members' or other ICA members' selling coffee in unrestricted quantities. The Geneva group was thus free to concern itself only with how to achieve the reductions in quotas it desired. Because of ICA, the Geneva group had access to reasonably prompt and accurate data on coffee shipments which could be used to monitor compliance with the group's targets. ICA provided producing countries with a convenient forum for organizing their own group. ICO, through its Executive Director and staff, functions continuously, and its Executive Board, composed of representatives of eight producing countries and eight importing countries, meets frequently. Many of the countries have representatives stationed in London, where ICO is headquartered.

APPENDIX II

UNITED STATES
GENERAL ACCOUNTING OFFICE STUDY OF
THE ABILITY OF THE INTERNATIONAL
COFFEE AGREEMENT TO DEAL WITH
UNFORESEEN SUPPLY AND DEMAND CONDITIONS
MARCH 1973

The most important unforeseen situations which ICA has had to deal with are the price rises following major frosts in 1963 and 1969 in Brazil and those following the so-called Geneva Agreement in 1972.

THE 1963 AND 1969 BRAZILIAN FROSTS

Frosts in Brazil during its winter months are far from being strange phenomena. But they do not occur with regularity; nor is it known with any degree of accuracy until some time after occurrence how severe the impact on next year's crop will be.

The International Coffee Council ignored the 1963 frost when it met in August 1963 and established a global annual quota for 1963-64 at 99 percent of the basic quotas. However, at the time of the Council's deliberations, it was too early to tell whether the frost would have a major impact on production or prices. Furthermore, views may have been bearish because of the years of large surpluses and declining prices.

The International Coffee Council met again in November 1963 and considered action to expand the annual quota to mitigate the weather-induced price rise. By November the spot price of Santos 4 had risen 8 percent from the prefrost level. The Council rejected a proposal to expand the annual quota by 2.25 percent, although all consuming nations and a majority of producing countries voted in favor of the proposal.

The continued price rise prompted consuming countries to call for a special session of the Council in February 1964. By February the price of Santos 4 had advanced 36 percent from its prefrost level. This time the Council approved a quota expansion of 1.4 million bags and quota waivers (exemptions to quota obligations granted to individual member countries) totaling 948,000 bags. The price of

Santos 4 began to decline in April. In May the International Coffee Council also voted to redistribute 725,000 bags of shortfalls (indications by member countries of insufficient coffee to meet quotas), although prices had already begun to decline.

By the time of the 1969 frost, ICO had already adopted two semiautomatic systems for adjusting initial quotas in response to price movements. Under the prorata system individual producing-countries' quotas are adjusted within agreed limits and by agreed rules in proportion to their basic quotas when ICO's composite indicator price is at, above, or below previously agreed to price floors and ceilings. Under the selective system quotas of members of a group producing one of each of four different types of coffee are adjusted within agreed limits and by agreed rules if the price of coffee of that group is above or below the agreed ceiling or floor. Both adjustment methods are reviewed and modified annually by the International Coffee Council.

By the end of September 1969, coffee prices had risen 22 percent from the prefrost level, although there were selective and prorata increases of 1.3 million bags at the end of August and September to the 1968-69 quota. The impact of these increases may have been limited, because there was uncertainty as to whether a temporary cut in quotas of 1.2 million bags for July through September would be restored and because the increases occurred late in the coffee year, when the quotas soon would be superseded by a lower annual quota.

The annual quota for 1969-70 (which began on October 1, 1969) was set by the International Coffee Council at 46 million bags, a 2.5 million-bag reduction from the final annual quota for 1968-69. The Council did provide for prorata and selective adjustments which could add as much as 5.8 million bags to the annual quota, but for the first time since introducing selectivity, a ceiling was put on its increases. Moreover, the prices adopted by the Council for triggering the selective and prorata increases were well above the prefrost level. Although it was too early in August to assess the impact of the frost, the experience with the frost of 1963 should have made the Council more wary.

APPENDIX II

Coffee prices apparently continued to rise with brief respites through early October 1970, although there were selective and prorata increases of 5.8 million bags. The limited effectiveness of the quota increases may have been due to undershipping--especially by Brazil, the chief recipient of the quota increases--and to terminating selective and prorata adjustments in January and April 1970, respectively.

The United States and other consuming countries were unsuccessful in attempts before ICO's Executive Board in February and before its Council in March to remove the ceilings on the selective adjustment system, although African producers and some Central American countries were willing to have quotas increased. In August 1970 the Council adopted an enlarged initial annual quota of 54 million bags (effective as of October 1, 1970), a reserve of an additional 4 million bags for prorata increases and a selectivity system with unlimited upward adjustments.

On the basis of table 1, price performance following frosts in the ICA period appears to have been no better and may have been somewhat worse than it was in the post-World War II period preceding ICA. This does not necessarily mean that the price performance in 1963-64 or 1969-70 would have been different without an ICA.

Although the price rise following the 1953 frost was sharper than those following the 1963 and 1969 frosts, the price rise following the 1955 frost was significantly smaller than either that following the 1963 frost or the 1969 frost. Moreover, the price rise in 1969-70 was longer than that of the other frost-affected periods. (See table 1.) Although production declined more in 1964-65 and 1970-71 than in 1954-55 and 1956-57, the years most affected by the 1953, 1955, 1963, and 1969 frosts, supply as a whole (including inventories in producing countries) was more ample relating to exports in 1964-65 and 1970-71 than in 1954-55 and 1956-57.

Table 1

Percentage Increases in
Coffee Prices Following Frosts (note a)

	Santos 4	Central Standards	Mams	Ambriz 2AA	Average unit value of U.S. coffee imports
1953 Frost--Duration of upswing, 10 months	60	61	61	55	32
1955 Frost--Duration of upswing, 8 months	14	(b)	23	24	8
1963 Frost--Duration of upswing, 8 months	48	43	26	50	27
1969 Frost--Duration of upswing, 16 months	55	39	38	45	41

[a]The increase is calculated from the month before the frost to the peak month for Santos 4. In the case of the 1955 frost the initial month is January 1956 as no net upward movement in prices is discernible until early 1956.

[b]Not applicable.

Source: Price data from the Pan American Coffee Bureau, Sprague & Rhodes, and Census Bureau.

We believe that, if there had been no ICA, the price increases in 1963-64 and in 1969-70 would have been more moderate. In both periods there were producing countries which were able to sell more coffee than permitted by ICA quotas and would have been willing to make additional coffee available sooner than permitted by ICA quota adjustments. For 1963-64 this may be inferred from the fact that a majority of producing countries in November 1963 voted in favor of a proposal, which was defeated, to expand the annual quota and that quotas for countries other than Portugal and the Other Mild producers, which opposed the November 1963 proposal, were 69.4 million bags below the supply of coffee. Similarly for 1969-70, this may be inferred from the fact that African and some Central American producing countries were willing to support enlarged quotas at the time of the unsuccessful February and March 1970 Executive Board and Council deliberations and that quotas for producing countries other than Brazil and Colombia, which blocked the proposals, were 15.9 million bags under the supply of coffee.

THE GENEVA AGREEMENT

After failure to get the Executive Board of ICO to increase the 1971-72 selectivity price ranges to offset the U.S. devaluation, the Geneva group, which accounted for the bulk of coffee exports, met in Geneva in April 1972 and decided to refrain from shipping any increases in quota beyond the level it thought desirable to achieve price increases.

At the time of the April meeting, the prevailing annual quota was 49.9 million bags. The Geneva group initially sought to maintain a quota level of 48.4 million bags. This target was relaxed somewhat to accommodate individual members of the group over the next few months.

Coffee prices rose 6 percent between early April and early July 1972 and the annual quota had increased to 54.7 million bags, primarily as a result of selectivity and prorata adjustments. In the April-June 1972 period, coffee shipments were 5.9 million bags under the available quotas. On July 9, 1972, a frost occurred in Brazil. This greatly accelerated the price rise.

By early August prices had increased 26 percent from their pre-Geneva level. In view of the large increase in prices stemming from its own retention efforts and enhanced by the frost in Brazil, the Geneva group released its members from any obligation to withhold quota increases before the August 1972 annual meetings of the International Coffee Council without disbanding the group. For the coffee year 1971-72 as a whole, the annual quota had increased to 57.7 million bags and quota undershipments were 4.2 million bags, primarily accounted for by the members of the Geneva group which also received the bulk of the quota increase.

Prices were lower at the end of November than in August but were well above the 4-cent-per-pound increase previously sought by producing countries to offset the U.S. devaluation.

Because of the divisiveness over the Geneva Agreement, the International Coffee Council, meeting in August and September 1972, failed to agree on quotas for the full year

1972-73. The Council agreed only to quotas for the first quarter of the year with the proviso that this decision would lapse unless there was agreement to extend the first quarter arrangements or to adopt alternative arrangements by December 10, 1972.

On the basis of previous experience, it is not unlikely that the July 1972 frost in Brazil would have increased prices. It is also possible that something like the Geneva Agreement might have occurred without ICA. However, we believe that the existence of the Geneva group was facilitated by ICA; hence, it is likely that ICA enhanced the price increases in 1972.

The existence of ICA facilitated the Geneva Agreement in several ways. Because of ICA controls on exports, the Geneva group did not have to worry about its members' or other ICA members' selling coffee in unrestricted quantities. The Geneva group was thus free to concern itself only with how to achieve the reductions in quotas it desired. Because of ICA, the Geneva group had access to reasonably prompt and accurate data on coffee shipments which could be used to monitor compliance with the group's targets. ICA provided producing countries with a convenient forum for organizing their own group. ICO, through its Executive Director and staff, functions continuously, and its Executive Board, composed of representatives of eight producing countries and eight importing countries, meets frequently. Many of the countries have representatives stationed in London, where ICO is headquartered.

Part Two

Alleged Discrimination Against U.S. Ships in the Carriage of Coffee

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-175530

The Honorable Russell B. Long
Chairman, Committee on Finance
United States Senate

Dear Mr. Chairman:

You requested on March 14, 1972, that we participate in a comprehensive study of the International Coffee Agreement. Our report on alleged discrimination against U.S. ships in the carriage of coffee is attached as an appendix to this letter. On April 30, 1973, we transmitted reports on the International Coffee Agreement and its impact on coffee prices and on the ability of the International Coffee Agreement to deal with unforeseen supply and demand conditions.

We have thus completed and transmitted reports on three of the four assignments on the International Coffee Agreement which we agreed to undertake. The remaining report on the soluble coffee controversy is in process.

We were told that during 1968 through 1972 no complaints of discrimination were filed with the Department of State, the Federal Maritime Commission, and the Department of Commerce against U.S. ships in the carriage of coffee. However, two U.S. shipping lines told us that they have some problems of discrimination in their coffee trade.

Because of the Committee's interest in receiving the report as soon as possible, we have not obtained formal comments on the report, but we discussed an earlier draft informally with officials of the Department of State, the Department of Commerce, the Department of Agriculture, and the Federal Maritime Commission. We wish to note the cooperation our staff received from these agencies in making the review.

We do not plan to distribute this report further unless you agree or publicly announce its content.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

ALLEGED DISCRIMINATION AGAINST U.S. SHIPS IN THE CARRIAGE OF COFFEE

INTRODUCTION

Preventing discrimination against U.S.-flag ships in shipping coffee to the United States is provided for in section 306 of the International Coffee Agreement Act of 1968 (46 U.S.C. 876). Upon complaint of any interested party, the President of the United States shall make an investigation to determine whether any exporting country which is a member of the International Coffee Organization discriminates against vessels registered under U.S. laws. If the President finds that discrimination exists, he shall notify the Federal Maritime Commission (FMC) which shall make appropriate rules and regulations. If, within a reasonable time thereafter, the effect of discrimination still exists, the authority to carry out and enforce the provisions of the International Coffee Agreement would cease to apply until the President finds that the effect of discrimination has ceased to exist.

EXISTENCE OF COMPLAINTS

We were told that during 1968 through 1972 no complaints of discrimination were filed with the Department of State, the Federal Maritime Commission, and the Department of Commerce against U.S.-flag vessels by exporting members of the International Coffee Organization. However, two of the five U.S. shipping lines accounting for the bulk of U.S. coffee shipments to the United States told us that they had some problems of discrimination in their coffee trade.

SHIPMENTS FROM BRAZIL TO U.S. ATLANTIC AND GULF COASTS PORTS

Two U.S.-flag lines--Moore-McCormack Lines, Incorporated, serving the U.S. Atlantic coast ports and Delta Steamship Lines, Inc., serving the U.S. gulf coast ports--have traditionally been the predominant coffee carriers from Brazil.

During 1956 Moore-McCormack carried 47 percent of the coffee exported from Brazil to the U.S. Atlantic coast, but its share steadily decreased and was 26 percent in 1968. During 1969 its share dropped to 17 percent.

Before 1957 Delta carried over 70 percent of the coffee exported each year from Brazil to the U.S. gulf coast. From 1957 to 1968 its share decreased to about 29 percent and dropped to 17 percent in 1969.

Because of rebating, the United States was losing its share to other lines participating in the trade. Both Moore-McCormack and Delta complained informally to FMC, and on October 28, 1968, FMC initiated an investigation and hearing into malpractices which primarily involved trade between Brazil and the U.S. Atlantic and gulf ports. (Federal Maritime Commission docket number 68-44, Malpractices--Brazil and United States Trade).

FMC's presiding examiner, in his initial decision (March 16, 1971), found that:

> "* * * rebating is, and has been since 1964, a practice in the northbound trade between Brazil and the United States."

Specifically, he found three Brazilian lines, one Argentine line, and one Swedish line that violated sections 16 Second, and 18(b)(3) of the Shipping Act of 1916 (46 U.S.C. 801 et seq.) for rebating in the northbound Brazil and U.S. coffee trade. However, he found that no shipper was victim of prejudice or disadvantage.

FMC adopted the examiner's decision on December 13, 1971, and found the carriers in violation of the act and ordered them to:

> "* * * henceforth cease and desist from transporting coffee at less or different compensation than that specified in the applicable tariff."

FMC recovered civil penalties from each of the five carriers involved.

Before FMC adopted the examiner's decision, the situation concerning trade between the United States and Brazil had changed to the satisfaction of U.S. lines because of arrangements made by Brazil. In May 1970 the Brazilian Government took unilateral action to eliminate the widespread rebating alleged to exist in the trade by allocating 40 percent of coffee and cocoa shipments to the United States to Brazilian lines, 40 percent to U.S. lines and 20 percent to third-flag lines.

On June 1, 1971, the Brazilian Government changed the northbound coffee and cocoa allocations from the 40-40-20 formula to a 50-40-10 formula. It also announced a willingness to restore the 20-percent allocation to third-flag lines if the Inter-American Freight Conference[1] members concluded an agreement for allocating the market shares.

In a letter to FMC, Moore-McCormack, Delta, Companhia De Navegacao Lloyd Brasileiro (Brazilian), and Companhia De Navegacao Maritima Netumar (Brazilian) urged that "* * * all allegations now be discontinued and the malpractice proceeding be dismissed." They stated that, on malpractices themselves:

> "* * * heresay charges and countercharges of alleged malpractice and wrongdoing between carriers are things of the past and academic from a realistic standpoint."

We discussed Brazil's action of allocating coffee cargoes with several U.S. coffee roasters and importers. Generally they felt that Brazil's action had not adversely affected them. Some said that occasionally they were unable to ship coffee on the carrier they wished because the carrier did not have a sufficient allocation. The general opinion was that Brazilian-flag lines have improved their service in recent years. They would prefer to choose the carrier on the basis of service considerations alone.

In December 1972 nine international shipping companies, involved in coffee shipments from Brazil to the U.S. Atlantic and gulf coast ports, agreed to split the revenues of the trade. The agreements--one for the Atlantic ports and one for the gulf coast ports--must be approved by Brazil and FMC. These actions are expected to be only procedural since the agencies in both countries have been apprised of the negotiations. The agreements provide that 80 percent of the revenues from the movement of shipments northbound from Brazil be split equally between the American-flag lines and the Brazilian-flag lines. The remaining 20 percent will be apportioned among third-flag lines.

During the last half of 1970, the U.S. share of coffee carriage improved from its dramatic downward trend which began

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[1]Shipping conferences are agreements entered into by private shipping lines designed to regulate service, fix freight rates, and seek to control access to the freight market on established liner routes. The Inter-American Freight Conference covers northbound and southbound movements of all cargo between the U.S. Atlantic and gulf ports and the east coast of South America.

in 1967. By 1971 the U.S. carriers' share of coffee cargoes to the Atlantic and gulf ports approached its traditional level. Although the data for 1972 is not complete, the favorable trend in the U.S. carriers' share seems to be continuing. (See tables 1 and 2.)

The U.S. shipping lines serving the gulf and Atlantic ports told us that they were maintaining an adequate share of the Brazilian coffee trade. They said that they were not being discriminated against in the carriage of coffee by any country.

SHIPMENTS FROM BRAZIL TO THE U.S. PACIFIC COAST

Although the rebating charges apparently applied to only the shipments of coffee from Brazil to the U.S. Atlantic and gulf coast ports, the Brazilian allocation of coffee shipments was made applicable to the U.S. Pacific coast as well.

Prudential-Grace Lines, Inc., the only U.S. line involved in the carriage of coffee from Brazil to the Pacific coast, said that the Brazilian allocation of 40 percent of coffee cargoes to the United States had hurt it. It said that its ships could carry at least 50 percent of total coffee shipments from Brazil to the Pacific coast.

According to Prudential, the agreements concluded in December 1972 for allocating market shares among the carriers of coffee from Brazil to U.S. Atlantic and gulf coast ports would leave the 40-percent allocation of coffee cargoes to the Pacific coast unchanged. It requested an increase in its share, but Brazil decided to retain the 50-40-10 allocation formula for coffee shipments to the U.S. Pacific coast.

OTHER PROBLEMS OF DISCRIMINATION

Prudential expressed dissatisfaction to us about coffee shipments from Peru to the U.S. Pacific coast and sent us data showing that its share of coffee cargoes had declined from 82.5 percent in 1970 (Jan. through Dec.) to 43.7 percent in 1972 (Jan. through Nov.). It attributes the decline to the preferences given to Peruvian ships.

An equal access agreement for southbound government-controlled cargo between Prudential and the Peruvian shipping company was approved by FMC in January 1973, although it has not yet been approved by the Peruvian Government. The company said that the agreement should improve conditions in its northbound trade and hopefully will give it a better position in coffee cargoes from Peru.

Farrell Lines, Incorporated, which ships coffee from Africa to U.S. Atlantic ports, told us that it had had difficulties in securing coffee cargoes in reasonable relation to the service which they offered from several producing African countries. Farrell suggests that this is "* * * flag discrimination contrary to the provisions of the ICA [International Coffee Agreement]," and it believes that rebating exists for coffee cargoes from the Cameroons and Angola. It also noted that foreign-flag operators, operating within the American-West African Conference group, alleged that rebating exists for coffee shipments from the Ivory Coast. However, Farrell indicated that a great deal of the evidence was circumstantial and could not be considered definitive or conclusive in establishing U.S. flag discrimination.

TABLE 1

COFFEE CARRIED TO U.S. ATLANTIC PORTS FROM BRAZIL

FROM 1960 THROUGH 1972

Year	Total number of bags	U.S.-flag ships		Brazilian-flag ships		Third-flag ships	
		Number of bags	Percent	Number of bags	Percent	Number of bags	Percent
1960	5,410,621	2,390,250	44.2	808,852	14.9	2,211,519	40.9
1961	4,865,517	1,869,533	38.4	677,516	13.9	2,318,468	47.7
1962	5,007,748	1,899,033	37.9	602,686	12.0	2,506,029	50.1
1963	5,117,211	1,970,178	38.5	624,901	12.2	2,522,132	49.3
1964	3,993,931	1,868,554	46.8	423,399	10.6	1,701,978	42.6
1965	3,391,085	1,117,432	32.9	778,805	23.0	1,494,848	44.1
1966	3,863,675	1,669,196	43.2	265,256	6.9	1,929,223	49.9
1967	3,617,139	1,033,286	28.6	1,210,869	33.5	1,372,984	37.9
1968	4,787,734	1,228,694	25.7	2,218.138	46.3	1,340,902	28.0
1969	3,526,702	593,480	16.8	1,576,155	44.7	1,357,067	38.5
1970	2,963,356	380,315	12.8	2,024,331	68.3	558,710	18.9
1971	3,247,224	1,243,218	38.3	1,782,351	54.9	221,655	6.8
1972	3,908,689	1,286,590	32.9	2,459,661	62.9	162,438	4.2

Source: FMC and Moore-McCormack Lines, Incorporated.

TABLE 2

COFFEE CARRIED TO U.S. GULF PORTS FROM BRAZIL

FROM 1960 THROUGH 1972

Year	Total number of bags	U.S.-flag ships: Number of bags	U.S.-flag ships: Percent	Brazilian-flag ships: Number of bags	Brazilian-flag ships: Percent	Third-flag ships: Number of bags	Third-flag ships: Percent
1960	2,656,349	1,409,350	53.1	187,510	7.0	1,059,489	39.9
1961	2,507,121	1,441,349	57.5	233,364	9.3	832,408	33.2
1962	2,562,414	1,475,194	57.6	114,571	4.5	972,649	37.9
1963	2,631,893	1,340,092	50.9	224,203	8.5	1,067,598	40.6
1964	2,126,945	1,161,941	54.6	114,606	5.4	850,398	40.0
1965	1,881,942	1,151,345	61.2	257,183	13.7	473,414	25.1
1966	2,031,085	1,018,772	50.2	157,166	7.7	855,147	42.1
1967	1,759,893	615,214	35.0	712,730	40.5	431,949	24.5
1968	2,546,331	727,494	28.6	1,070,947	42.0	747,890	29.4
1969	1,682,657	287,083	17.1	666,724	39.6	728,850	43.3
1970	1,385,634	355,057	25.6	662,370	47.8	368,207	26.6
1971	1,986,812	853,303	43.0	964,237	48.5	169,272	8.5
1972[a]	634,537	350,325	55.2	223,419	35.2	60,793	9.6

[a]Based on 3 months.

Source: Delta Steamship Lines, Inc.

Part Three

The Soluble Coffee Controversy

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-175530

The Honorable Russell B. Long
Chairman, Committee on Finance
United States Senate

Dear Mr. Chairman:

This is our study of the soluble coffee controversy, which completes the four assignments we agreed to undertake on the International Coffee Agreement.

We conclude that some offset to the tax advantage of Brazilian soluble coffee exports to the United States was probably merited. The April 1971 soluble agreement provided in principle for a full offset to exports of Brazilian soluble coffee to the United States by equivalent sales of green coffee free of export tax. Only a partial offset has in fact been achieved, but a full offset may not have been necessary to protect U.S. production from exports of Brazilian soluble coffee to the United States.

We wish to draw your attention to recent developments, which are not discussed in the report, concerning the United States-Brazil soluble coffee agreement and the International Coffee Agreement.

The Government of Brazil has renounced the soluble coffee agreement. Sales of tax-free green coffee will be allowed for the October 15, 1972-January 14, 1973, period but for no subsequent periods.

The International Coffee Agreement, which would have expired on September 30, 1973, has been extended for 2 years. All the economic provisions have been dropped, including article 44 which led to the soluble coffee agreement.

In view of the Committee's interest in receiving the report as soon as possible, no formal comments on the report

B-175530

were obtained but we informally discussed an earlier draft with officials of the Departments of State, Commerce, and Agriculture. We wish to note the cooperation our staff received from these agencies.

We will release this report only if you agree or publicly announce its contents.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

THE SOLUBLE COFFEE CONTROVERSY

INTRODUCTION

In the late 1960s U.S. imports of Brazilian soluble (instant) coffee expanded dramatically. (See table 1.)

The U.S. coffee industry and labor groups complained that these imports threatened the existence of the domestic soluble industry. In response, the United States attempted to work out an agreement with Brazil which would offset the Brazilian soluble processors' tax advantage. After prolonged negotiations, the governments concluded such an agreement in April 1971.

This review assesses the impact of imports of Brazilian soluble coffee on U.S. production of soluble coffee before the 1971 agreement and evaluates the 1971 agreement.

UNITED STATES AND BRAZILIAN POSITIONS

In 1966 industry and labor groups began protesting the advent of sizable imports of soluble coffee from Brazil. U.S. Government officials became concerned about losing industry support for continued U.S. participation in the 1962 International Coffee Agreement (ICA). (See p. 6 for discussion of U.S. industry and labor views.) Discussions between the United States and Brazilian Governments began shortly thereafter.

APPENDIX I

Table 1

U.S. IMPORTS OF SOLUBLE COFFEE, 1961-72

	Volume (pounds) Total	Brazil
1961	3,506,452	-
1962	4,125,954	-
1963	6,300,436	-
1964	5,441,835	33,000
1965	2,848,540	275,641
1966	10,566,550	5,996,349
1967	27,368,837	22,453,221
1968	22,549,648	18,862,589
1969	40,252,751	28,218,851
1970	35,742,363	23,224,045
1971	36,095,173	22,059,289
1972	56,534,592	39,268,233

Source: Bureau of the Census, Department of Commerce.

Throughout the ensuing controversy the U.S. Government emphasized, in its official position, the "principle of equal access"; i.e., under a commodity agreement (in this case the ICA) limiting the availability of supply, all parties to that agreement should have equitable and nondiscriminatory access to that supply. The United States argued that Brazilian processors enjoyed two advantages which were manifestly unfair and violated the spirit of the ICA, even though not specifically prohibited by it. Brazilian processors were not taxed on exports of soluble coffee, but a tax was levied on the exports of beans used to make soluble (and roasted) coffee. Brazilian processors also could buy lower cost, lower grade coffee beans which Brazilian authorities had declared to be "non-exportable," but U.S. processors were restricted to higher cost beans even though the lower grades were suitable for making soluble coffee.

In effect, the United States contended that Brazil was using the ICA to put U.S. soluble coffee manufacturers at a competitive disadvantage. Brazil's failure to impose an export tax on soluble coffee exports comparable to that imposed on green coffee (coffee beans before roasting) purchased by U.S. producers gave Brazilian producers an unfair advantage over U.S. producers. If alternative sources of green coffee were freely available to the U.S. producer, the effect of such discrimination would be lessened. However, the ICA restricted the amount of coffee in international trade and limited U.S. soluble producers in seeking alternative low-cost supplies of non-Brazilian green coffee.

The United States also feared that the solubles dispute would undermine the price stabilization objectives of the ICA because other coffee-producing countries would attempt to retaliate against this form of price cutting by Brazil.

The Brazilians countered that the U.S. position "* * * dooms Brazil and the other developing countries to remain forever as producers and exporters of raw materials" and claimed that:

--The United States was contradicting its international aid and trade policy which ostensibly sought to provide incentives to less developed countries to industrialize agricultural production and to export agricultural goods.

--The U.S. foreign aid program had financially assisted three of their four new soluble plants.

--United States and European processors had been invited repeatedly to invest in Brazilian soluble production facilities and, thereby, to share in the incentives given to the Brazilian soluble manufacturers.

--Brazil reportedly sold soluble coffee only to established U.S. coffee firms and did not compete with them.

NEGOTIATIONS FOR AN AGREEMENT

With continued U.S. participation in the ICA at stake, Brazil accepted a new provision in the agreement's renegotiated form in 1968. Included as article 44, this provision prohibited member governments from discriminating in favor of processed coffee exports over green-coffee exports and called for arbitration procedures in case of disputes.

On December 2, 1968, after waiting in vain for Brazil to conform with the new provision, the United States invoked the arbitration procedures of article 44. In early 1969 the neutral country chairman and the U.S. member of the 3-member arbitration panel decided that a situation of the type covered by article 44 existed and that the United States was entitled to take action if Brazil failed to do so. The Brazilian panel member disagreed, stating that no injury to the U.S. industry had been demonstrated and that, therefore, the extent of discrimination, if any, could not be agreed upon.

During the proceedings the U.S. panel member estimated the extent of discrimination at 46 cents per pound of soluble coffee. (This was the export tax of about 17 cents per pound of green coffee times 2.7, the pounds of green coffee estimated to produce 1 pound of soluble coffee.) Even this figure did not account for the Brazilian processor's advantage in having access to the so-called "non-exportable" grades of green coffee. That no injury to the U.S. industry had been demonstrated and that no agreement existed on the extent of discrimination did not alter the fact, in the eyes of the U.S. panel member, that such discrimination existed and called for a remedy under article 44.

Shortly following the arbitration, the United States and Brazil agreed that Brazil would impose a tax on soluble coffee exports to the United States of 13 cents per pound effective May 1, 1969, and to a joint review of the problem in early 1970. The United States viewed the 13 cents per pound tax as a first step in resolving the problem and informed Brazil that the United States reserved the right to take action to insure the imposition of a total tax of 30 cents per pound on Brazilian soluble coffee exports to the United States if no agreement was reached by March 1, 1970. Brazil did not commit itself to the higher tax figure.

The joint review came to an impasse. Brazil stated it would not raise the 13-cent tax, while the United States maintained that further steps were required. U.S. authorities decided to let the deadline pass and to continue negotiations on a new basis since the alternatives were U.S. withdrawal from the ICA or the imposition of an import tax which would only further exacerbate relations. Moreover, important segments of the U.S. industry were changing their positions and protesting the imposition of further obstacles to importing Brazilian soluble coffee.

However, when the Congress authorized U.S. participation in the ICA until July 1971, it was made clear that further U.S. participation was contingent on resolving the solubles dispute by April of 1971. An agreement, reached on April 2, 1971, provided for: (1) a special annual allocation of 560,000 bags of Brazilian green coffee (the approximate green-coffee equivalent of Brazilian exports of soluble coffee to the United States) to U.S. soluble coffee manufacturers on the basis of their respective shares in U.S. soluble coffee production, (2) reimbursement of the tax on the special allocation to U.S. manufacturers in the form of credits against future purchases of coffee, (3) renegotiation, proposed by either country, of the level of the special allocation if Brazilian soluble coffee exports changed by more than 15 percent, (4) removal of the 13 cents per pound tax by Brazil on exports of soluble coffee to the United States, and (5) implementation of the agreement only as long as the ICA remained in force and was implemented by the two countries.

The United States believes that Brazil's soluble export tax advantage has been offset by provision (1) of the April 1971 agreement.

APPENDIX I

U.S. INDUSTRY AND THE SOLUBLES DISPUTE

U.S. industry attitudes in this dispute were conditioned by competition with Brazil and ensuing competition between U.S. firms. At first industry saw these imports as a threat, but as time went on some firms saw them as an opportunity to enhance or maintain their competitive position in the U.S. market.

Initial industry reaction to the mounting imports of Brazilian soluble coffee came in 1966 from nearly all segments of the trade--importers, U.S. soluble manufacturers, and labor. Importers reportedly feared losing commissions, as the solubles trade was largely conducted directly with the manufacturers. Soluble manufacturers feared production would shift to Brazil and to other producing countries which might follow Brazil's example. Labor groups protested layoffs, which they attributed to the growing imports from Brazil. The rapid growth in these imports showed no sign of letting up, and industry feared that its very existence was in jeopardy.

In the summer of 1966 the National Coffee Association (NCA) protested to Brazilian authorities about exports of soluble coffee to the United States which benefited from subsidies, tax relief, or other financial aid or special assistance. In the fall the NCA made it clear to the Department of State that unless the Department took some action, it would seek congressional action. U.S. Government officials were concerned about losing industry support for continued U.S. participation in the ICA. The Green Coffee Associations of New York and New Orleans and the Pacific Coast Coffee Association also protested the imports of soluble coffee from Brazil.

This seeming unity of opposition, however, was not to last. Many U.S. firms had to decide whether or not, and to what extent, to use Brazilian soluble coffee. From the import data it is obvious that many chose to use Brazilian soluble. Some firms switched totally to packaging the Brazilian soluble. Other firms blended the Brazilian product with their own.

Smaller firms which bought the Brazilian product claimed that these imports afforded them a chance to be more quality- and price-competitive with the large national brands. Larger firms often had better access to various types of green coffee. Brazilian soluble coffee, said some, helped smaller firms offset some of the advantages enjoyed by larger firms.

When the Brazilians agreed to the imposition of a 13 cents per pound tax on their soluble coffee exports to the United States, some U.S. firms objected. In May of 1970, when it appeared the United States might impose a duty to achieve an effective 30 cents per pound tax, NCA reversed its stand on the issue and publicly declared itself opposed to any additional taxes or import duties. The Pacific Coast Coffee Association went even further and announced its opposition to all taxes and duties on the Brazilian product. The Green Coffee Associations of New York and New Orleans, however, urged continuing efforts to abolish the "inequity" in Brazil's treatment of its soluble coffee exports.

U.S. INDUSTRY VIEWS ON THE SOLUBLE AGREEMENT

Industry views on the April 1971 agreement on soluble coffee, as on the entire problem, were partly conditioned by the choices made by individual firms on whether or not to use Brazilian soluble coffee. The adequacy and appropriateness of the agreement and the distribution of the tax-free coffee became the major points of contention.

Among the agreement's supporters we found some U.S. firms which stressed that a vital principle of trade--equal access--had been upheld. Some supporters thought that the agreement was a necessary compromise to a most difficult problem, even though they would have preferred to see a higher tax on Brazilian soluble coffee.

Some firms believed that the agreement tended to negate the advantage of purchasing the cheaper Brazilian soluble coffee. Yet, it was also noted that the advantage still rested with the purchase of Brazilian soluble. The agreement removed what tax there had been and Brazilian soluble coffee processors were selling their product at a lower price.

APPENDIX I

Some firms criticized the agreement as inadequate because of the removal of the 13-cent tax. They felt the agreement did not go far enough in protecting U.S. domestic production. One opinion was that, at the very least, the 13-cent tax should have been retained.

Other firms opposed the agreement on the grounds that it gave the larger U.S. soluble manufacturers an unfair advantage in the U.S. market. Some felt that the use of Brazilian soluble coffee had helped to negate some of the larger firms' advantages of access to green-coffee supplies and that the agreement only worsened what they felt to be a situation of unequal access to green-coffee supplies among U.S. firms.

Objections were also raised over the method of allocating the 560,000 bags of tax-free green coffee from Brazil. Each firm's share depended on what proportion of total U.S. soluble production (excluding imported soluble) was produced by that firm over a 2-year period. U.S. production was defined as the amount of green coffee used by U.S. manufacturers to produce soluble coffee. Accordingly, U.S. firms that simply repackaged the imported soluble were excluded from any share in the tax-free coffee and firms that blended the imported soluble had to exclude such imports from their production figures. Moreover, new firms had to establish a record of making soluble coffee without the benefit of the tax-free green coffee to gain a share of the special allocation. Some firms felt that the allocation formula should have included those firms using Brazilian soluble coffee.

U.S. coffee roasters making only roast and ground coffee voiced fears that the special allocation of tax-free coffee to soluble manufacturers could be used by those firms to cut costs in regular coffee. It was noted that, even if soluble manufacturers followed the stipulation of the soluble agreement that the tax-free coffee be used only for manufacturing soluble coffee, the savings in raw material costs could be passed on to regular coffee sales.

IMPORTS AND PRODUCTION BEFORE THE SOLUBLE AGREEMENT

Because we do not know what the trend of domestic production was, it is impossible to determine whether U.S. imports of Brazilian soluble coffee caused a decline in U.S. production from 1965, the year before the advent of sizable imports from Brazil, to 1970, the last full year before the soluble coffee agreement.

The only publicly available data on U.S. production is for exports and is inadequate to indicate domestic production because only a small proportion of domestic production is for foreign markets.

The Census Bureau publishes data on green coffee used to make soluble coffee in the United States. (See table 2.) This input data might be a good indicator of production if yields (the amount of soluble coffee derived from a unit of green coffee) remained constant and if there were no other significant coffee inputs for making soluble coffee.

However, yields have increased since the advent of sizable imports of soluble coffee from Brazil in 1966. Moreover, an unknown portion of U.S. imports of Brazilian soluble coffee is used in domestic production. Although the yields and imports of soluble coffee increased from 1965-70, those of green coffee used to make soluble coffee generally declined. Hence, we do not know whether U.S. production was up or down.

Table 2

Amount of Green Coffee Used to Produce Soluble Coffee in the United States, 1956-72

Year	Bags (note a) (000 omitted)	Year	Bags (note a) (000 omitted)
1956	3234	1964	3776
1957	3452	1965	3776
1958	3492	1966	3522
1959	3744	1967	3201
1960	3999	1968	3340
1961	4010	1969	3499
1962	4082	1970	3284
1963	3934	1971	3329
		1972	3377

[a] Each bag contains 132.276 pounds.

SOURCE: Bureau of the Census.

APPENDIX I

This does not mean that U.S. imports of Brazilian soluble coffee did not affect production in the United States. In our view, domestic production would probably have been higher without imports of Brazilian soluble coffee, but the extent of the impact cannot be determined.

The U.S. market for soluble coffee (as measured by soluble coffee available for consumption in table 3) rose 26.7 million pounds between 1965 and 1970. During the same period U.S. imports of Brazilian soluble coffee increased 22.9 million pounds. Some U.S. soluble manufacturers closed their soluble plant operations,[1] and some sold 100-percent Brazilian-made soluble coffee to American consumers.

Table 3

Soluble Coffee Available for Consumption in the United States, 1965-72

Year	Amount (note a) (thousands of pounds)
1965	175,542
1966	177,576
1967	181,564
1968	184,200
1969	212,338
1970	202,232
1971	206,268
1972	227,923

[a]Estimated by applying the soluble coffee yields estimates of the Pan-American Coffee Bureau to the data in table 2, plus imports, minus exports and reexports.

U.S. exports of soluble coffee declined before the soluble agreement. (See table 4.) Although some of this decline is associated with increased production in foreign markets, it is also at least partially associated with increased exports of soluble coffee from Brazil.

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[1]It is possible that some plants would have closed in the absence of imports from Brazil.

Japan, which used to be one of the United States' principal foreign markets, increased its production of soluble coffee from 1965 to 1970 by 9 thousand tons and imported 100 tons from Brazil in 1970. At the same time, Japan's imports from the United States declined by 3.3. thousand tons.

Canada, another major market for U.S. soluble coffee, increased both its imports from Brazil and its production. Both factors appear to have been associated with the increase in Canadian consumption of soluble coffee by 6.2 thousand long tons between 1965 and 1970. Production rose 2.9 thousand long tons, imports from Brazil rose 2.7 thousand long tons, and imports from the United States changed comparatively little during the same period.[1] By 1970 Brazil had replaced the United States as Canada's major foreign supplier.

Table 4

United States Exports of Soluble Coffee 1956 72

Year	Pounds
1956	3,066,586
1957	4,799,874
1958	4,479,323
1959	6,337,127
1960	6,796,057
1961	9,542,225
1962	12,979,879
1963	14,492,199
1964	14,884,421
1965	12,112,459
1966	7,597,137
1967	6,484,191
1968	7,636,284
1969	8,142,958
1970	4,820,791
1971	5,640,572
1972	6,068,992

Source: Department of Commerce.

[1]Imports from the United States rose 200 tons in this period. However, a part of the imports from the United States might have been reexported Brazilian soluble coffee. UNCTAD/GATT, "The Market for Soluble Coffee in Canada and Japan," (Geneva, 1971), p. 15.

APPENDIX I

Although this suggests that U.S. production would have accounted for a higher proportion of U.S. domestic and foreign markets, it does not indicate how much would have been produced without imports from Brazil. Some of the expansion of U.S. and foreign markets for soluble coffee is probably due to price competition between the Brazilian product and the U.S. product.

Lack of employment data precludes an evaluation of the impact of U.S. imports of Brazilian soluble coffee on employment in the U.S. soluble industry. However, during this period the introduction of freeze-dried soluble coffee, which is more capital intensive than spray-dried soluble coffee, may account for some of any employment reductions which did occur.

EVALUATION OF THE SOLUBLE AGREEMENT

We believe that some offset to the tax advantage of Brazilian soluble coffee was probably merited and may well be the main factor accounting for U.S. imports of Brazilian soluble coffee.[1] As previously concluded, U.S. imports of Brazilian soluble coffee probably limited U.S. production of soluble coffee, although we cannot determine to what extent.

However, it may have been unnecessary to offset fully the tax advantage of Brazilian exports of soluble coffee to the United States as provided for in principle in the soluble agreement. Before the April 1971 agreement, the United States indicated a willingness to accept a 30 cents per pound tax on Brazilian exports to the United States. This was much less than the equivalent tax on Brazilian green coffee that U.S. manufacturers used to make soluble coffee. Despite imports, the U.S. soluble coffee industry found it possible to increase its selling prices. Since the agreement, the tax advantage has not actually been fully offset by equivalent tax-free, green-coffee sales, although U.S. production of soluble coffee has apparently increased. (See p. 15.)

The formula for distributing the tax-free green coffee to U.S. manufacturers in the agreement could create some inequities. It might be difficult for firms with no shares or low shares to obtain or increase shares because the distribution is based upon prior use of green coffee for making soluble coffee. However, it is difficult to think of a better practicable alternative.

We believe that the principle of the agreement for offsetting the tax advantage without a tax on Brazilian soluble coffee is good. The American consumer benefits from

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[1]A study of the Brazilian soluble coffee problem concluded that, if the export tax on green coffee had to be paid by Brazilian processors and if reasonable profits were earned, Brazilian soluble sales would shrink drastically. A. J. Cordell, "The Brazilian Soluble Coffee Problem: A Review," Quarterly Journal of Economics and Business, vol. 9 (Spring 1969), p. 37.

the agreement because it repeals the previous 13 cents per pound tax on Brazilian soluble coffee exports to the United States. The price of Brazilian soluble coffee for the American consumer should be less than it would be with this tax. Moreover, the price the consumer pays for the U.S. soluble product may also be lower because of benefits of tax-free Brazilian green-coffee sales passed on by U.S. manufacturers receiving them.

The only possible drawback of the agreement for the American consumer is that it could lead Brazilian authorities to restrain the volume of soluble coffee exports to the United States in an attempt to hold down revenues foregone from tax-free sales of green coffee to the United States.[1] However, the agreement provides that exports of Brazilian soluble coffee may exceed by at least 15 percent the special allocation of tax-free green coffee without any increase in tax-free sales. Even if this point is reached the agreement does not provide for automatically increasing compensatory sales of tax-free green coffee.

With delays, the special allocation of 560,000 bags of Brazilian green coffee was made available for the first year of the agreement (Apr. 15, 1971, to Apr. 14, 1972). However, exports of Brazilian soluble coffee to the United States exceeded the special allocation by 22.7 percent. Although the agreement provides that either Brazil or the United States may request a renegotiation of the amount of the special allocation, should Brazilian exports of soluble coffee to the United States change by more than 15 percent from the special allocation, the United States has not done so.

In the second year of the agreement Brazil has permitted registration for the special allocation for only the first

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[1] In February 1973 Brazil imposed a quota system on exports of soluble coffee. Exports exceeding the quotas would be subject to an export tax. These measures appear to be related to ending stiff competition among Brazilian soluble coffee manufacturers for the export market.

two quarters (Apr. 15 to Oct. 14, 1972). It refused registration for the quarter beginning October 15, 1972, after the International Coffee Council on September 2 approved export quotas from ICA member producing countries for only the first quarter (Oct. to Dec.) of 1972-73. In December 1972 the International Coffee Council failed to provide for export quotas for the remainder of 1972-73. Brazil has continued to refuse registration for the special allocation.

U.S. imports of Brazilian soluble coffee were markedly higher in 1972 than in 1970. (See table 1.) Green coffee imports used to make soluble coffee in the United States were also higher, and it is likely that yields continued to increase. (See table 2.) Thus, domestic production in 1972 was probably higher than in 1970.

To what degree the higher levels of U.S. imports of Brazilian soluble coffee and U.S. soluble coffee production have been caused by the soluble agreement is problematical. Because it is impossible to determine the preagreement relationship between U.S. imports of Brazilian soluble coffee and U.S. production of it, we cannot estimate what the level of U.S. production might have been without the partial offset to the tax advantage achieved under the agreement.

Some of the increased imports may have been caused by removal of the 13 cents per pound tax. However, prices generally continued to decline after the tax was removed; this may explain, at least in part, the marked rise in U.S. imports of Brazilian soluble coffee. From August 1971 to August 1972 the unit value of such imports declined 20 percent, while the unit value of U.S. imports of Brazilian green coffee increased about 14 percent.

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