096309

3.51.03

72-0432

REPORT TO THE COMMITTEE ON FINANCE UNITED STATES SENATE

6

17

LM096309

The Soluble Coffee Controversy

B-175530

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

JUNE 29, 1973

~~701583~~ 096309

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

B-175530

The Honorable Russell B. Long
Chairman, Committee on Finance S 4108
United States Senate

C1

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 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

Contents

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.

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.

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.

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.

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.

[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.

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

---

[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

---

[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.

APPENDIX II

United States Senate

COMMITTEE ON FINANCE
WASHINGTON, D.C. 20510

March 14, 1972

The Honorable
Elmer B. Staats
Comptroller General
of the United States
General Accounting Office
Washington, D. C.

Dear Mr. Staats:

When the Committee on Finance acted to extend United States participation in the International Coffee Agreement it directed its staff, with the cooperation of the Comptroller General, United States Tariff Commission, and the Federal Trade Commission, to commence a comprehensive study on this Agreement. The staff has already held a meeting with Messrs. Dziadek and Brady of your staff to discuss the perimeters of the study and how best each agency can make a contribution.

I sincerely hope and expect that this study will prove helpful to the Committee when it deals with this issue again, and your cooperation to that end will be gratefully appreciated. I am enclosing a copy of the Committee report which discusses this study in greater detail.

With every good wish, I am

Sincerely,

Russell Long
Chairman

Enclosure