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Demand for coffee in Sweden: The role of prices, preferences and market power

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Abstract

There is a widespread belief that consumer coffee prices are high relative to bean prices and that lower consumer prices would lead to substantial increases in bean exports from Third-World countries. This issue is evaluated by analysing how retail prices, preferences and market power influence coffee demand in Sweden. A demand function is estimated for the period 1968–2002 and used, together with information on import prices of coffee beans, to simulate an oligopoly model. This approach gives estimates of the maximum average degree of market power and shows how coffee demand would react to reductions in marginal cost to its minimum level. The maximum level of market power is found to be low, but it generates large spreads between consumer and bean prices because the price elasticity has low absolute values. Moreover, the impact of a price decrease would be small because long-run coffee demand is dominated by changes in the population structure in combination with different preferences across age groups. Hence, a change to perfect competition would only have a negligible effect on bean imports.

JEL classification: F14; F23; L13; L66; L81

Keywords: Coffee exports; Coffee price; Market power; Multinationals; Sweden; Commodity markets

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Introduction

It is a common opinion that oligopolistic market structures constitute a key problem for commodity-exporting, less-developed countries (Gibbon, 2005). This view gained ground after the collapse of coffee-bean prices in the late 1990s, when they returned to the 1960s level in nominal terms. Since a few multinational companies are active in most coffee markets, both as buyers of green coffee and suppliers of processed coffee, they are held responsible, directly or indirectly, for keeping bean prices down while maintaining high consumer prices.[1] As a consequence, Third-World bean exports and bean prices are kept below the level that would prevail in a competitive market.

The issue of market power in commodity markets is analysed in some detail by Morisset (1997, 1998). He looks at coffee markets, as well as several other markets, and finds symptoms of market power in all of them. For instance, in a sample of six industrialised countries, the average spread between consumer coffee prices and world bean prices increased on average by 186% from 1975 to 1994. This is attributed to asymmetric transmissions of world price changes to consumer prices. To evaluate the consequences of the increase in price spreads for developing countries' export revenue, Morisset (1997) simulates the impact of a reduction in consumer prices to the minimum spread observed during the 1970–1994 period. It would have increased export earnings to the order of at least 20–60% annually from 1991 to 1994.

Talbot (1997) also addresses the issue of market power in coffee markets. He uses a different approach, global value chain analysis. He finds that the collapse of the International Coffee Agreement at the end of the 1980s led to an increase in market power and a massive shift of surplus from coffee producing countries to multinationals. According to Talbot, multinational companies exercise market power as buyers of green coffee by holding down prices and as sellers of processed coffee by inflating consumer prices. Global value chain analyses by Fitter and Kaplinsky (2001) and Daviron and Ponte (2005, Chapter 6) obtain similar results.

Although multinational companies may have market power as buyers of green coffee, as Ponte (2002) argues, the large price spreads seem to occur between import prices and prices of processed coffee, not between farm gate and world market prices (see Daviron and Ponte, 2005, Chapter 6). Moreover, Krivonos (2004) shows that the transmission of price signals from world market prices to coffee growers works quite well after the implementation of coffee sector reforms in the late 1980s and early 1990s. Although these results do not preclude the existence of oligopsony power, they indicate we should search for market power in consumer markets.

There are probably less than 10 studies that directly attempt to test for market power in national consumer markets (see Gibbon, 2005). Most of these find that the degree of market power is small, although there is some evidence of oligopoly power, e.g. Bhuyan and Lopez (1997). There is, thus, conflicting evidence, and the question of why the difference between bean and consumer prices is perceived to be high is not answered.

The objective of this paper is to shed light on the presence of market power in the Swedish market for roasted and ground coffee, and evaluate potential losses for coffee growers.

[1] See, for example, Dicum and Luttinger (1999), Fitter and Kaplinsky (2001), Ponte (2002), Oxfam (2002), Gooding (2003), Moore, 2003, McCorriston et al. (2004), Daviron and Ponte (2005), Gibbon (2005), and Green (2005).