

The total market demand

[Finance](#), [Market](#)



The total market demand curve is shown with the corresponding market MR curve. The cartel's MC curve is the horizontal sum of the MC curves of its members. Profits are maximized at Q_1 where $MC = MR$. The cartel must therefore set a price at P_1 (at which Q_1 will be demanded). After having agreed on the cartel price, the members may compete against each other using non-price competition to raise market share. Alternatively, they may agree to divide the market between them, where each member would be given a quota which most likely to be set accordingly to their current market share.

In many countries cartels are illegal, because they are seen by the governments as a means of driving up prices and profits. The most well-known cartel is OPEC - the Organisation of Petroleum Exporting countries (in some sources: Oil Producing and Exporting Countries). Attempts to form cartels in copper, tin, bauxite, phosphates, rubber, tropical timber, coffee, tea, cocoa and bananas have not been successful. A successful cartel needs to operate in a market dominated by a few producers. Collusion is much harder as well if the product is not standardised and if demand and cost conditions are changing rapidly.

A failure in one or more of these factors can cause a fall of a cartel. This is what actually happened to the coffee cartels. In the past, coffee producing countries co-operated to control supply and stabilise and keep coffee prices at a sustainable level (sustainable means it makes enough money for farmers, farmer cooperatives, and farming corporations and conglomerates to make a living, and even make a profit⁵), and under the "International

Coffee Agreement" (ICA) they operated a cartel. This agreement collapsed in 1989, because members were unable to agree on quotas.

Disagreement arose because many new producer countries had entered the market. They were not part of the agreement and were keen to maximise their revenue by selling as much coffee as they possibly could. Increasing supply meant that cartel members had to reduce the amount of coffee that they sold in order to maintain market prices. Due to unwillingness to reduce their income and in order to keep prices under the ICA, producers had held back some of the production in reserves. Following the collapse of the ICA, many members decided to sell the reserves creating further pressure on prices.

As a result world coffee prices fell by 50% and have remained unstable ever since. Moreover, at the same time Vietnam started growing enormous amount of low quality cheap robusta. Consumers' preferences and tastes shifted, because of a number of reasons, such as health scares regarding the high consumption of caffeine, the launch of rival drinks, particularly in the soft drinks sector. All these caused a huge oversupply on the coffee market and a further decline in prices within next 10 years.

Thus, after the failure of ICA, with the purpose of protecting the interests of coffee producing countries by sustaining balance between demand and supply so as to reduce the price instability, the Association of Coffee Producing Countries came into existence in 1993. It had 14 members, including Brazil and Colombia as two largest world producers. However, despite attempts made by the ACPC to get growers to hold back 20% of their

exports to force prices back up, only 70% of the retention target has been met and the prices slumped to a 30-year low in April 2001.

This was the final straw for the ACPC. Many countries within the ACPC, especially Africa, couldn't afford to pay their dues to the cartel. One of the problems was that not every big coffee producer was a member of ACPC and those non-member producers, such as Vietnam, were expanding their coffee plantations rapidly, and causing a further rise in production that in its turn caused flooding supply (Graphs 1; 2 above). Brazil had tried to reduce exports, but Brazilian growers suspected other countries were cheating and trying to grab their business.

Association general secretary Roberio Silva told BBC News " When the major producing countries discovered that other producing countries were not withholding their quota, they no longer wanted to comply". " This was the reason for the closure" he said. ⁸ Thus, the eight year history of the ACPC came to the end in May 2001. So how such organisation as a cartel might have prevented fluctuations in the world price of coffee? In theory, in order to fix prices the market producers must be able to exert control over supply.

That can be accomplished on the basis of a quota system. Unfortunately, it didn't work in the coffee market due to reasons discussed earlier. In reality, the incentive to cheat is too strong to resist, and once somebody breaks ranks others tend to follow. However, on the other hand, there are roasters and retailers who could have prevented the collapse in the world coffee prices by decreasing supply of coffee and increasing demand.

First of all, without a market for low-quality, cheap robusta (Table1), there would have never been a coffee boom in Vietnam, and that's exactly what the Big Four (Nestle, Kraft, Procter ; Gamble and Sara Lee), along with other large European roasters, provided. They took advantage of new steam-cleaning technology to eliminate the coffee's harsh flavour. And they benefited when the London Commodities Exchange lowered its quality standards so that Vietnamese coffee would qualify for future trading.