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**PROGRAM OF REFORM IN THE AGRICULTURAL
MARKETING SECTOR, PHASE I**

**SECOND INTRA-ANNUAL ASSESSMENT
DURING YEAR 3 (1992-93)**

FINAL REPORT

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EXECUTIVE SUMMARY

An intra-annual review of PRAMS I reform and restructuring activities in the North West Cooperative Association (NWCA) was conducted on 8-9 September 1993 in Bamenda. The review focused on program activities occurring since the last intra-annual review of 27-28 May 1993, progress made on the current Program Implementation Agreement (PIA), and preparations for the upcoming arabica marketing season.

The policy reform activities in PRAMS I are carried out at a national level. Although all of the conditions precedent to the third and fourth dollar disbursements outlined in the Program Grant Agreement have not been met, considerable progress has been made over the last three months. In June, the NWCA physically took possession of the former NPMB headquarters in Bamenda; all that remains to complete the transfer of assets required as a condition precedent to the third disbursement is for NWCA to be given clear legal title to the property. USAID has opened discussion with the GRC to establish a committee to make a recommendation concerning a graduated tax for arabica exports.

In a related development, in August, an Arabica Market Information System (AMIS) began functioning under the administration of ONCC. The purpose of AMIS is to provide current market information to arabica producers in order to facilitate the operation of a fully liberalized market for the benefit of farmers. The operation of such a fully liberalized market, without a government price decree, is a condition precedent to the fourth disbursement.

The current PIA, signed in February 1993 and terminating on 31 October, requires the adoption and implementation of a set of action plans related to preparations for the 1993-94 marketing season. All of these action plans have now been adopted. One action plan has been largely implemented--establishing a marketing department at NWCA and improving its marketing activities. All that remains is for the Chief of the Marketing Department to be formally appointed to his post--a step that should be taken as soon as possible. The action plan for dissemination of the new national law on cooperatives has been adopted and will be implemented within the next two months. An action plan related to producer pricing has also been adopted; portions of that action plan related to accounting education at the society level have been carried out; what remains is to implement an education campaign directed at enabling societies to determine producer prices during the upcoming campaign, an idea accepted in principle by the NWCA Board of Directors at the intra-annual review. The NWCA Engineering Service, in cooperation with ISTI technical assistance, has completed or nearly completed a set of feasibility studies related to coffee processing improvements. These studies will be presented at the Annual Review in November.

The critical tasks that lie just ahead include the implementation of two action plans--cooperative law dissemination and producer pricing education--both of which entail information reaching the society level. A concerted effort by all parties will be required to successfully implement these action plans. At the same time, the cooperative structure must prepare for the upcoming season by preparing and negotiating its New Internal Marketing

Arrangements (NIMAs), which consist of a set of contractual relationships between societies and their union and between unions and the NWCA. Many societies and unions, as well as the NWCA, may want to carry out additional cost-cutting measures prior to signing NIMAs. In addition, NWCA and USAID must prepare and negotiate a PIA for the coming project-year. All of this work must be complete in draft for presentation to the Annual Review of PRAMS I to be scheduled during the week of 15 November in Bamenda.

SYNTHESE

Un examen en cours d'année des activités de réforme et de restructuration du PRESCA I, au sein de l'Association coopérative du Nord-Ouest (NWCA), a été conduit les 8 et 9 septembre 1993, à Bamenda. Cet examen visait les activités du programme qui se sont déroulées depuis la dernière récapitulation en cours d'année des 27 et 28 mai 1993, en observant les progrès réalisés dans le cadre de l'Accord d'exécution de programme (PIA) actuellement en vigueur, et en vue de préparer la prochaine campagne de commercialisation de l'arabica.

Les efforts pour réformer les politiques au sein du PRESCA I se poursuivent au niveau national. Bien que toutes les conditions préalables aux déboursements en dollars d'ordre trois et quatre, dont la définition figure dans l'accord de subvention au programme, n'aient pas été remplies, on a assisté, au cours des trois derniers mois, à des progrès considérables. En juin, la NWCA a matériellement pris possession de l'ancien siège du NPMB à Bamenda; la seule étape restante pour la réalisation complète du transfert des biens matériels, transfert requis en tant que condition préalable du troisième déboursement, consiste en la cession à la NWCA d'un titre de propriété, légal et de bonne qualité. L'USAID a entamé des pourparlers avec le gouvernement camerounais en vue de l'établissement d'un comité chargé de formuler une recommandation concernant un impôt progressif pour les exportations de café arabica.

On a vu au mois d'août se réaliser une étape apparentée à cet effort: le système d'information sur le marché de l'arabica (AMIS) a commencé à fonctionner, son administration étant aux mains de l'ONCC. L'AMIS se propose de fournir aux producteurs d'arabica les données d'information sur le marché en cours, afin de faciliter le fonctionnement d'un marché complètement libéralisé, au bénéfice des exploitants agricoles. L'opération d'un tel marché complètement libéralisé, sans décret gouvernemental concernant les prix, est une condition préalable au quatrième déboursement.

Le PIA actuellement en vigueur, signé en février 1993 et venant à expiration le 31 octobre, exige l'adoption et la mise en oeuvre d'une série de plans d'action portant sur la préparation de la campagne de commercialisation 1993-94. Tous ces plans d'action se trouvent maintenant adoptés. L'un de ces plans d'action a été exécuté en grande partie - l'établissement d'une section de commercialisation au sein de la NWCA, et le relèvement du niveau de ses activités. Tout ce qui reste à accomplir est la nomination officielle du chef de cette section de commercialisation - et cette mesure devrait être prise le plus tôt possible. Le plan d'action concernant la diffusion de la nouvelle loi sur les coopératives a été adopté et sera mis en oeuvre au cours des deux prochains mois. Un plan d'action concernant la détermination des prix au producteur a été également adopté. Les segments de ce plan d'action touchant à la formation à la comptabilité au niveau des sociétés primaires ont été menés à bien; ce qui reste à faire est la mise en oeuvre d'une campagne d'éducation ayant pour objet de rendre les sociétés capables de fixer par elles-mêmes les prix au producteur lors de la campagne qui s'annonce, l'idée acceptée en principe par le Conseil d'administration de la NWCA, au cours de cet examen en cours d'année. Le Service technique de la NWCA, en

collaboration avec l'assistance technique fournie par l'ISTI, a achevé ou pratiquement achevé, un ensemble d'études de faisabilité portant sur l'amélioration du traitement du café. Ces études seront présentées à l'examen annuel de novembre.

Les tâches d'importance critique qu'il s'agit d'attaquer maintenant comprennent la mise en oeuvre de deux plans d'action - la diffusion de la loi coopérative et l'éducation en matière de fixation des prix - ces deux plans comportant la transmission de l'information jusqu'au niveau des sociétés. Il faudra un effort mené de concert par toutes les parties pour réussir dans l'exécution de ces plans d'action. En même temps, la structure coopérative doit se préparer à la campagne qui vient en rédigeant et en négociant ses Nouveaux Arrangements de Commercialisation Interne (NIMA), consistant en un ensemble de rapports contractuels entre les sociétés primaires et leur union et entre les unions et la NWCA. Il pourrait être souhaitable que de nombreuses sociétés et unions, de même que la NWCA, se livrent à des mesures supplémentaires de réduction des coûts avant de signer les NIMA. En outre, la NWCA et l'USAID doivent rédiger et négocier un PIA pour l'année-projet qui vient. Tout ce travail doit former des avant-projets complets prêts à la présentation au cours de l'examen annuel de PRESCA I qui est prévue pour la semaine du 15 novembre à Bamenda.

I. INTRODUCTION TO THE REPORT

The Program of Reform in the Agricultural Marketing Sector, Phase I (PRAMS I) is designed to liberalize and privatize the internal and external marketing of arabica coffee in Cameroon. Market liberalization is being carried out through a series of policy reforms at the national level, as stipulated in a Program Grant Agreement between the Government of Cameroon and USAID. These reforms include the assignment of export rights to marketing cooperatives and private traders, full price liberalization, and the implementation of a new law on cooperatives that allows for freedom of association and self-governing autonomy. At the same time, the process of privatization is being assisted through a program of reform and restructuring being carried out by the North West Cooperative Association (NWCA) in cooperation with USAID. Together, the policy-reform and cooperative-restructuring components of PRAMS I are designed to provide a set of incentives to (1) reduce and control marketing costs and (2) increase and sustain coffee quality in the North West Province and throughout the arabica subsector.

This assessment is based on an Intra-Annual Review of NWCA reform and restructuring activities conducted on 8-9 September 1993 in Bamenda. Participants in the review included the NWCA and union presidents, the deputy general manager and other senior staff of NWCA, union managers, the technical assistance team supplied by the International Science and Technology Institute (ISTI), Peace Corps volunteers posted to NWCA as cooperative technical advisors (CTAs), the PRAMS I project officer and PRAMS I program coordinator from USAID, and an Assessment Leader supplied by Associates in Rural Development (ARD) through the Decentralization: Finance and Management (DFM) project, AID/Washington. The full proceedings of the intra-annual review will be published by the ISTI technical assistance team concurrently with this assessment report.

The last assessment report, based on the intra-annual review of 27 May 1993, noted a number of problems and deficiencies in the implementation of the current Program Implementation Agreement (PIA), which was signed in February 1993 and terminates on 31 October. Only one of a series of action plans to be prepared in early 1993 had actually been adopted, and little progress was reported on the others. Since that time, however, all of the action plans required by the PIA have been adopted, and the cooperative structure is preparing for full implementation in 1993-94 of the institutional reform program contemplated in the Memorandum of Understanding (MOU) signed by NWCA, its affiliated unions, and USAID in 1991.

This report begins by reviewing recent policy reform activities at the national level, followed by NWCA marketing and restructuring activities. The current PIA is then reviewed, followed by an assessment of progress to date and a discussion of what remains to be done during the present project-year. The report concludes with a focus on preparations needed for the upcoming arabica marketing season and final project-year in order to ensure that the basic institutional design specified in the MOU is fully and faithfully implemented by the end of the program.

II. AN OVERVIEW OF PRAMS I

The policy reform component of PRAMS I consists mainly of two principal actions taken by the Cameroonian government:

- ***price liberalization***--moving from government-fixed to market-based producer pricing, creating a system of "free exchange" in arabica coffee, and
- ***cooperative law reform***--freeing cooperatives from government control, creating a system of "free association" among producers.

These new conditions of free exchange and free association among arabica farmers are intended to serve the following purposes:

- Price liberalization is intended to allow for competition. Competition empowers individual farmers by giving them choices, so that they are less likely to be trapped in a single arrangement for selling and marketing their coffee;
- Price liberalization is also intended to allow for market discipline. In the past, arabica farmers and their cooperatives were protected from market discipline but subject to government discipline. Price liberalization does not leave producers and their agents undisciplined, but relies on the market to discipline producers and their agents to perform efficiently;
- Cooperative law reform is intended to allow for self-governance within cooperatives, so that cooperative organizations can be accountable to and governed by their membership, not by government;
- Cooperative law reform is also intended to allow for farmers to act collectively to protect their own economic self-interest. Marketing cooperatives do this by aggregating farmers' produce to secure processing and marketing advantages and by developing and enforcing quality standards that increase the value of the entire arabica crop.

The cooperative restructuring component of PRAMS I, focused on NWCA and its affiliates, must be understood in this policy-reform context. The basic purpose of the NWCA-focused program is to enable the 35-40,000 coffee farmers of the North West Province to take full advantage of the new opportunities created by price liberalization and

cooperative law reform. To achieve this purpose, NWCA reforms are aimed at the following immediate objectives:

- **Responsibility**--each cooperative organization at each level must be responsible for conducting its own affairs, making its own decisions and accepting responsibility for the results;
- **Accountability**--each cooperative organization must be accountable to its constituents and serve their interests. Societies are accountable to farmers, unions to their member societies, and the NWCA to its member unions;
- **Transparency**--each cooperative organization must conduct its affairs openly, freely supplying information in a timely manner to farmers and others throughout the cooperative structure.

In order to facilitate these reforms, PRAMS I also pursues another objective at NWCA:

- **Capacity-building**--increasing the managerial and technical (processing and marketing) capacities of the structure, so as to be capable of performing efficiently and competitively.

Even though capacity-building is the most tangible and visible PRAMS I activity in the cooperative structure, it must be regarded as secondary to the reform effort. No matter how much capacity is increased and management improved, the sustainability of these improvements depends on successful reform.

Reforms are not desired for their own sake, but for the outcomes they produce. The expected outcomes of NWCA reforms include, in the near-term, (1) cost reduction and control within each cooperative organization, (2) the restructuring of management and production at all levels (including changes in the numbers of societies, unions, and union mills), and (3) the improved quality and reliability of arabica marketed by NWCA. The capacity-building efforts supported by PRAMS I are intended to facilitate these changes, but the motivation to introduce and sustain such outcomes depends on successful reform.

Even these short-term outcomes are desired largely for the long-term result they are expected to produce--the economic development of the arabica subsector. A responsible, accountable, and transparent cooperative structure will encourage farmers. Development means more farmers growing more coffee of higher quality and making more money. This also means, in turn, a stronger cooperative business based on larger production, higher quality, and better marketing. A stronger business also means more employment. These are the ultimate aims of reform. Such outcomes are not, however, a foregone conclusion, because reform has still not been fully achieved. Without reform, the cooperative structure will continue to serve as a shelter for the inefficient and unproductive, and farmers will continue

to be discouraged. The alternative scenario is development in reverse--fewer farmers growing less coffee of lower quality and making less money. This would mean a weaker cooperative business and, eventually, bankruptcy and failure.

The choices faced now by the NWCA are not just choices between reforms and the status quo--the basic choice is one between alternative paths to the future, one leading to development and the other leading to decline and failure. The difficulty is that reform often results in short-term economic disadvantages for individuals--such as the loss of jobs and privileges. This is why it is important to keep the ultimate end in view, for development benefits everyone while the reverse hurts everyone. If reform fails today, everyone loses tomorrow. If reform succeeds today, everyone wins tomorrow.

III. POLICY REFORM ACTIVITIES

Policy reform activity since the last intra-annual review has focused on the need to obtain compliance with conditions-precident to the third and fourth disbursements of dollars provided for by the Program Grant Agreement between the government and USAID.

In June, shortly after the intra-annual review, NWCA took possession of the former National Produce Marketing Board (NPMB) headquarters in Bamenda, physically completing the transfer of assets required for the third disbursement. The physical transfer, however, is legally incomplete. NWCA has still not received a formal deed of assignment. What remains, then, is for NWCA to receive clear legal title to the premises. The only other remaining condition to be fulfilled prior to the third disbursement is the formation of a committee to make recommendations to the Arabica Policy Coordinating Committee (APCC) concerning a graduated export tax on arabica coffee. By agreement between the government and USAID, the original requirement of enacting such a tax has been relaxed to require only a committee recommendation. The deadline established for receipt of the committee recommendation is 31 October 1993. In sum, conditions precedent to the third disbursement appear to be close to full satisfaction.

Both the third and fourth disbursements also require no reversal of conditions previously satisfied, including the repeal of monopoly privileges. In this regard, the key to both disbursements is that the government keep its commitment to full price liberalization in the arabica subsector. This will allow producer prices to be determined by market forces and create the necessary conditions for price competition. The upcoming 1993-94 marketing season is expected to be the first year for which full price liberalization is in effect.

NWCA should communicate strongly to the government its desire that price liberalization be maintained. Difficulties now being experienced with the export of robusta (noted below) are derived from the more controlled system in effect outside the arabica subsector and unaffected by PRAMS I. In order to avoid future reversals of liberalization, it is important that NWCA make its views heard. Moreover, NWCA should avoid seeking

privileges from the government because the price for obtaining those privileges could be the introduction of new controls.

Closely tied to the introduction of full price liberalization is the establishment of the Arabica Market Information System (AMIS) for the purpose of providing free public information concerning market prices to farmers. AMIS, administered by ONCC, is being implemented in three phases. In Phase 1, AMIS will broadcast and publish world market prices (the New York "C" price) and Cameroonian export prices (FOB Douala) on a weekly basis. Phase 1 got underway in September. Phase 2, slated to begin in November, will add producer prices--the price offers that buyers give to farmers--also on a weekly basis. Phase 3, to begin in September 1994, will include a report of the prices that producers are actually receiving.

It should be noted that there will be a considerable disparity between the prices that farmers hear quoted on the radio (e.g., FOB Douala) and the price offers they receive from their societies or from private traders. Although AMIS can explain that their price quotations do not take into account the internal costs of cooperatives for processing, transportation, and marketing, the principal burden will be on the cooperative to explain and justify the disparity to farmers. This is as it should be--farmers need to know how much their cooperative structure is costing them if they are to hold the cooperatives accountable for their performance. AMIS provides the necessary information for doing this, while placing the burden of justifying costs squarely where it should be--on cooperative officials and managers.

IV. NWCA MARKETING AND RESTRUCTURING ACTIVITIES

A. Marketing Report

The NWCA Marketing Department reports sales of washed arabica to date totaling 2,010 tons at an average price of 385.71 FCFA/kg. The sales represent 90.2 percent of the total purchases reported by societies. In addition, the Marketing Department reports the sale of 154.2 tons of robusta; however, NWCA is experiencing difficulties with ONCC in exporting this coffee, difficulties that may, in effect, substantially reduce the initial sales price of 265.379 FCFA/kg. The Marketing Department also reports sales of nearly all of NWCA's old stocks, including triage from 1990-93, as well as washed and unwashed arabica from 1990-91 and 1991-92. Unwashed arabica from the current season has not been sold due to its being processed later.

The Marketing Department reports that it has experienced occasional quality problems, with coffee being rejected by buyers. Common to all the rejections were stinkers (caused by over-fermentation), bad smell, and bad taste. Coffee that cannot be sold internationally will be sold locally at a much lower price. At the end of the season, rejections will be summarized on a union-by-union basis. Because the awareness of quality problems is the

essential first step in solving them, the Marketing Department is currently handling the quality problem in an appropriate manner.

The Marketing Department has compiled an excellent sales record for the current season. First, most of the washed arabica production been sold by the end of August. This is a marked improvement over previous seasons. Second, the average price obtained is well above the average price available during the season and, in fact, is close to the best price obtainable. The recorded price offers made by buyers for NWCA's "B" grade coffee--which is NWCA's average coffee--during the course of the season indicate that the Marketing Department succeeded in selling coffee at peak prices. Combined with more favorable market conditions overall, NWCA's marketing performance boosted its per kilo revenues well above last year's 272 FCFA/kg.

This improved performance can be credited to the effective implementation, earlier this year, of an action plan to reconstitute the Marketing Department and improve its operations. The marketing action plan, called for by the current PIA and developed with the help of a short-term consultant supplied by ISTI technical assistance, was the first to be adopted and implemented by NWCA. The payoff from this resolute and timely action is clear--a highly successful marketing campaign.

In addition, on 1 June the Marketing Department took over all export and port management responsibilities from UCCAO, with whom NWCA had previously contracted for these services. The Department reports savings of 4.5 FCFA/kg, totaling more than 4 million FCFA for the last 925 tons shipped. The Department also reports that their direct dealings with transit agents permit NWCA to receive payment from buyers more quickly.

The Marketing Department has also commenced publication of a very informative monthly newsletter, containing news of stocks, prices, sales, problems, and activities, as well as educational messages. The September Newsletter, distributed during the intra-annual review, was the fourth in the series. Ready access to performance-related information is absolutely necessary to the effective functioning of an accountable cooperative structure. The regular monthly publication of a newsletter by the Marketing Department represents a giant step forward in this regard.

B. Auditing/Accounting Reports

The Internal Audit Service of NWCA reports carrying out audit investigations for 11 societies, 6 unions, and 2 sections of NWCA. In addition, the Audit Service has participated in the introduction of new accounting systems at the society level, including new journals and ledgers. The Audit Service also conducted workshops at 4 regional centers to enable unions and societies to prepare for external audit, required by the new cooperative law prior to registration. Thirty societies are reported to be ready for external audit at this time.

The NWCA Board of Directors has adopted a new fiscal year to correspond more closely to the coffee season. Instead of the calendar year used in the past, the new fiscal year will commence on 1 October 1993 and thereafter.

V. CURRENT PROGRAM IMPLEMENTATION AGREEMENT: PROGRESS TO DATE

Unlike the situation that prevailed at the last intra-annual review in May, all of the action plans called for in the current PIA have been adopted.

Only one action plan, however, has been largely implemented--the plan for improving the Marketing Department. The only major step still missing from implementation of the action plan for the Marketing Department is the formal appointment of the department chief. This omission should be rectified at the earliest possible moment, so that the individual having primary responsibility for marketing has been clearly specified. Indeed, this step should be completed as soon as possible for all department heads at NWCA.

The following discussion focuses on the action plans that have been adopted since the last intra-annual review and still largely await implementation. Although implementation of these action plans has in some cases begun, it will mostly occur over the next 2 months, prior to the Annual Review in November and to the onset of the 1993-94 marketing season. The next 2 months should be a period of intense activity in the cooperative structure.

A. Action Plan on Producer Pricing

The purpose of this action plan is to prepare the cooperative structure, and societies in particular, to implement a pricing system in which each society determines its producer price offer based on its unique internal costs. The principal content of the action plan is a program of education to be carried out mainly at the society level.

The action plan, as adopted, addresses four topics: (1) society and union accounting, (2) NWCA apex accounting, (3) market information, and (4) planning for the 1993-94 season. The first topic has been addressed in a series of workshops held at each union with all society managers and union staff who can assist societies in attendance. The workshops were conducted jointly by the NWCA Internal Audit Service, Peace Corps volunteers, and ISTI technical assistance. The remaining topics will be addressed by a series of workshops to be held over the next 2 months, prior to the onset of the 1993-94 marketing season.

Central to these workshops is the method proposed for the calculation of producer prices separately by each society. The procedure includes the following steps:

- (1) The NWCA Marketing Department prepares a forecast of the world market price for average quality NWCA coffee during the coming season. The forecast should be

somewhat conservative, based on market history and informed expectations of future performance.

- (2) At the same time, societies and unions prepare a forecast of the size of the crop anticipated in each society. This estimate should also be conservative. For this purpose, the Marketing Department has prepared a recommended procedure to estimate the size of the crop. Fixed costs per kilo of coffee depend on the amount of throughput; therefore, estimates of internal costs per kilo depend on estimates of crop size.
- (3) Each cooperative organization at each level then prepares a budget estimating its internal costs per kilo for the coming season. Following negotiations, societies agree on the acceptable internal costs of their union, and the unions agree on the acceptable internal cost of the NWCA Apex.
- (4) Each society is now ready to calculate its producer price, as follows:

	Forecasted World Market Price/kg
Less	Internal Cost/kg of the NWCA Apex
Less	Internal Cost/kg of a Specific Union
Less	Internal Cost/kg of a Specific Society
	<hr/>
Equals	Producer Price/kg Offered by the Society

If and when the Marketing Department changes its forecasted price during the season, societies should revise their producer prices accordingly in order to avoid operating losses.

The introduction of this pricing arrangement is central to the reform of the cooperative structure. If the price that farmers receive for their coffee depends directly on the internal costs of their society and their union, plus the NWCA Apex, pressure will be brought to bear on cooperatives to reduce and control their costs. Should they fail to do so, farmers can take their coffee elsewhere. It is important that producer prices depend on the costs of the farmer's particular society and particular union, and not on the costs of other societies and unions. This enables a farmer to hold the particular society accountable for internal costs that subtract from the producer price. The design of this system contrasts sharply with the former block-buying-allowance (BBA) system used by NPMB, a system that failed to control costs.

If there are extreme differences in internal costs among unions or among societies, it is because there continue to be extreme differences in efficiency. If the cooperative organizations were equally efficient, the principal remaining cost differences would be for transportation. The persistence of major differences in efficiency is evidence in support of the need for producer pricing reform.

The acceptance of society-level producer pricing by the NWCA Board of Directors is, therefore, a major step forward in the successful implementation of PRAMS I in the North West Province. With this reform, cost-reduction and restructuring can not only move forward, but can become sustainable over the long term. This decision, more than any other, firmly sets NWCA on the path of real change and long-term economic development.

One shortcoming of the action plan, as adopted, is that it does not designate anyone in NWCA as the coordinator of efforts, including education, to introduce producer pricing at the society level. This should be remedied speedily.

Recommendation 1:

NWCA should immediately designate a member of the senior staff--perhaps the deputy general manager--to coordinate all efforts, including education, to introduce producer pricing at the society level.

The action plan with respect to Topic II, Apex Accounting, raises a question concerning the current accounting practice of the NWCA not to include the purchase of coffee as a cost. This current practice is entirely appropriate and simply reflects the nature of the cooperative structure, which is different in some respects from a fully independent, private, for-profit firm. The NWCA is not a fully independent business organization that buys coffee from unions; nor is each union a fully independent business organization that buys coffee from societies. The coffee transactions between societies and unions and between unions and the NWCA are internal transactions within a federated cooperative association, not market transactions between fully independent economic actors. The institutional design agreed to by NWCA, the 11 unions, and USAID in their Memorandum of Understanding was never intended to change--and does not change--this basic relationship. Once an affiliation protocol has been signed at the beginning of the season, NWCA should be understood as buying coffee from farmers through its member unions and societies at prices determined by each society. The purchase price for coffee should be entered for accounting purposes as a society cost only. In fact, all of the internal costs of the structure ultimately become society costs, as each society subtracts those costs from expected revenues in order to determine

producer price. Instead of ultimately attributing all costs to the NWCA Apex, the design of the NIMAs is to attribute all costs ultimately to each society. This design has been clearly stated since the beginning of the project and forms an essential part of the agreement between the cooperative structure and USAID.

Although NWCA is more than a broker for society and union coffee, there is no contradiction in coffee appearing only once as a cost--at the society level--within the cooperative structure. For accounting purposes, however, the NWCA acts very much like a broker, merely subtracting its internal cost before passing along the revenue received from the sale of coffee. Whatever accounting arrangement is used to document this transfer, the essential feature of the system is that NWCA is entitled to retain no more than its agreed-upon internal cost out of the total revenues received from the sale of coffee. The same applies to each union. Any other design would enable the apex organization to claim the surplus from coffee sales, directly contravening the MOU. [See VII. Preparations for the 1993-94 Marketing Season, below.]

Recommendation 2:

The accounting system throughout the cooperative structure should be set up in a way that reinforces the intended institutional relationships among the tiers of the cooperative structure. NWCA accounting practice should therefore continue not to include coffee purchases as an apex cost. Coffee purchases should appear as an accounting cost only at the society level, except for union intervention zones.

Some NWCA board members have suggested that price variation among societies should occur only with a second payment to farmers, rather than with the first payment, which would then be uniform throughout the structure. The main argument that can be made in behalf of this approach is that, if implemented, it would encourage farmers to move their cooperative membership rather than simply selling their coffee to a different society or a private trader. This would decrease uncertainty over the size of the crop to be marketed through a given society during a particular season. However, it would also reduce the immediate pressure on the cooperative structure to reduce costs. The major advantage of the first approach--varying the upfront payment to farmers--is the transparency it gives to the cost structure within NWCA. Transparency is a key objective of reform. Much of this transparency is lost if variation occurs only with a second payment. Moreover, given the historic difficulties farmers have experienced with being paid, and the importance that many farmers attach to cash in hand, each society should strive to pay farmers as much as they reasonably can in the initial payment. This strategy may also be compelled by competition from private traders. Although farmers should expect to receive a second payment, depending

on the degree of success realized in marketing, societies should not try to make farmers wait for a major portion of their total payment. Variation in the second payment to farmers can also be expected, depending in part on the accuracy of budgeting done at each society and union.

Recommendation 3:

NWCA should urge societies to pay farmers as much as they can, upfront, depending on internal costs as well as on conservative market-price and crop forecasts. This should generate variation among societies in the initial payment to farmers and increase the transparency of the cost structure that producers face.

B. Action Plan on Cooperative Law Dissemination

NWCA dissemination of information concerning the new cooperative law will occur in the context of a national dissemination campaign, just underway. NWCA representatives will participate, along with others in the North West Province, in a provincial-level seminar to be held in September, under the sponsorship of the government. The action plan then projects two provincial-level meetings for NWCA. The first, a seminar on the content of the law and decree, will be attended by one education team from each union (one union employee, the Peace Corps CTA working in that area, a society manager, and one other union representative). The seminar will be conducted by a short-term consultant to be supplied either by ISTI or by NWCA (using local currency). The second seminar will focus on training for the same participants. There will follow a series of information and educational meetings to be conducted by the union teams, with NWCA representatives participating as much as possible. Education meetings will be held in all society sections, followed by wrap-up meetings at the society and union.

The timetable for these activities anticipates NWCA provincial seminars in late October and early November, and the completion of the education campaign by 30 November. One member of the NWCA senior staff, perhaps the deputy general manager, will be designated to coordinate the cooperative law dissemination effort.

The action plan, it should be noted, addresses only dissemination and education related to the new cooperative law; it does not address implementation. The latter will entail drafting, debating, and adopting new Articles of Association for each society, union, and the NWCA. The new law creates a unique opportunity for constitutional choice among farmers. Moreover, many facets of the reformed NWCA should be written into the Articles of Association adopted at each level. The education campaign presents a useful forum in which to anticipate likely problems of implementation as the process moves forward. One of the

byproducts of this effort should be the development of a follow-up plan to assist implementation.

Recommendation 4:

Reports from union education teams involved in cooperative law dissemination should be used to make plans for assisting the process of implementation that must shortly follow. An action plan for assisting implementation of the new cooperative law within NWCA should be drafted for inclusion in the Program Implementation Agreement for the coming year. Peace Corps CTAs should participate extensively in this follow-up work.

C. Action Plan for the Internal Audit Service

Part of the planned restructuring of NWCA included the elimination of union field inspectors, whose job was to exercise audit control over societies, and an expanded internal audit office at NWCA, enabling it to produce internal audit services for unions and societies. This restructuring has two facets:

- (1) a shift from internal audit control, in a hierarchial sense, to internal audit service, in a contractual sense; and
- (2) the centralization of internal audit responsibility at NWCA. The elimination of union inspectors has been carried out, although some unions now employ a controller for providing services to societies. The present action plan is concerned with the expansion and improvement of the Internal Audit Service of NWCA.

The action plan includes a mission statement, job descriptions and qualifications, a plan for cost recovery, and a Code of Conduct setting forth internal control and accounting standards to be applied throughout the cooperative structure.

Beginning with 2 members, the internal audit staff has now expanded to 5 members, including the Chief of Audit. Peace Corps volunteers have been assisting with accounting instruction in the field, but this has occurred during a period of relatively high start-up costs for introducing new accounting systems. Only experience will demonstrate whether this number is too high or too low. Further staffing changes are understood to be NWCA's responsibility. The Board of Directors will need to reevaluate the staffing level periodically in view of the demand for internal audit services and the money being saved by making the structure more "auditable" externally. PRAMS I will support the implementation of the action plan by assisting with the payment of operating costs (not to include salaries).

D. Action Plan for the Finance and Accounting Department

This action plan contains a statement of organizational responsibilities and deliverables and a discussion of achievements and problems, as well as job descriptions for the Chief of Financial Services, bookkeeper, and cashier. This particular plan actually represents the culmination of months of work by NWCA in cooperation with ISTI technical assistance to improve finance and accounting control. Much of this work has been discussed in previous assessment reports.

E. Action Plan for the Engineering Service/Feasibility Studies

The various technical feasibility studies called for by the current PIA have been wrapped into a more general action plan for the Engineering Service. These feasibility studies are briefly reviewed in what follows.

- ***Reconfiguration of coffee processing machinery at union mills.*** This study has already moved into implementation, now underway. It involves moving machinery around for a more efficient production process and does not entail the acquisition of new equipment.
- ***Excess equipment owned by unions.*** The study has been conducted at each union and a list of excess machinery was prepared and distributed. Machinery on the list was sorted into 2 categories--those items with some potential value even if now unused and those items that should be slated for disposal. Action must now be taken by each union. The NWCA is willing to advertize these items for sale.
- ***Washing Stations and Hand Pulpers.*** These two studies were the subject of a series of meetings conducted at each Union. Farmers do not consider washing stations feasible due to scattered farms and poor roads. They suggest instead that the best way to improve the quality of farm-level processing is to provide farmers with good, "imported" pulpers, in addition to tarpaulins, handcarts, and wheelbarrows. Farmers also noted the need for chemical spraying to counteract coffee berry disease. A written report based on this inquiry is expected within 2 weeks of the intra-annual review. Still to be resolved are the modalities for purchasing and distributing hand pulpers.
- ***Spare Parts Revolving Fund.*** A study of the spare parts required to be kept on hand for the purpose of maintaining and repairing union mills has been conducted and a report submitted to USAID. Missing at this point is a proposal of how to finance and administer the spare parts fund.

- **Communications Network.** This study has been completed, and implementation is awaiting government action on NWCA's application for licensing to operate a radio-communications facility.

The great bulk of technical improvements to coffee processing supported by PRAMS I local currency has been directed to union mills. The reconfiguration of machinery now being carried out prior to the oncoming season, together with the establishment of an arrangement for assuring the supply of spare parts, will complete this mill-improvement activity.

Recommendation 5:

There would seem to be little reason to create a spare parts revolving fund, as originally specified in the MOU, at this late date in the project. The fund would "revolve" only once before the project ends. NWCA should consider proposing to USAID that a grant arrangement be substituted for the revolving fund. The grant would provide NWCA with the funds to acquire an initial stock of spare parts, but it should require that NWCA put in place a system of internal cost recovery that would enable them to replenish the stock annually. Such an arrangement would fulfill the intent of the spare-parts revolving fund provision in the MOU. The initial stock of spare parts acquired, however, should take into account potential reductions in the number of union mills in operation.

Much less has been done thus far to improve farm-level processing. Relevant to this level are both the washing-stations feasibility study and the proposed purchase and distribution of hand pulpers. It seems clear that the weakest link in the processing chain at present is on the farm. Therefore, remaining efforts to improve processing should be focused on the farm level and should include both new equipment and education/extension.

Recommendation 6:

NWCA, ISTI, and USAID should proceed with the planning needed to supply farmers with new hand pulpers, devising a system for distributing hand pulpers that is simple and equitable. Although it seems unlikely that funding for this activity, dependent on the third disbursement of dollars, will be available prior to the upcoming season, planning should proceed so that the activity can be carried out prior to the conclusion of the project if at all possible. NWCA should also draw up a long-term plan for reaching farmers with a program of education designed to improve the quality of farm-level processing.

VI. PREPARATIONS FOR THE 1993-94 MARKETING SEASON

Most of the preparations to be undertaken in advance of the 1993-94 marketing season have a bearing, in one way or another, on the New Internal Marketing Arrangements (NIMAs) designed under PRAMS I as a framework for organizing the relationships between society and union levels and between unions and the NWCA. As discussed in the last assessment report, NIMAs were not agreed to and signed for the 1992-93 season. The omission left NWCA and its member cooperatives without a contractual basis for their business relationships and effectively stalled further progress on the reform agenda within the cooperative structure. The success of the reform effort now hinges critically on the formulation and negotiation of NIMAs for the upcoming season, in accordance with the general guidelines of the MOU. With the introduction of society-level producer pricing, these NIMAs will be the first to fully implement the reform program.

The following discussion focuses on the issues that must be decided and resolved during the formulation and negotiation of NIMAs for the coming season. The general framework of the NIMAs simply presents these issues for discussion and resolution; it does not determine exactly what will be decided. Rather, the specific content of the NIMAs is a matter to be decided through deliberation and negotiation between the levels of the cooperative structure. The basic governing principle inherent in the NIMAs is the settlement of issues across the levels of the cooperative structure by means of negotiation, not command from the top.

A. Affiliation

The NIMAs must include an affiliation protocol whereby societies agree to market coffee through a specific union and unions agree to market coffee through the NWCA. In the future, this process of affiliation should be preceded by an "enrollment period," in which

farmers choose to enroll as members in the cooperative of their choice. The legal nature of the affiliation of societies is that the society (or union in the case of an intervention zone) agrees to buy coffee from farmers as an agent of the NWCA, which becomes the sole owner of the coffee for the purpose of marketing it. If, however, societies or unions find other avenues they wish to pursue for the marketing of their coffee, they are free to reject the NIMAs and operate outside the cooperative structure defined by NWCA.

B. Internal Costs and Cost Recovery

The NIMAs must stipulate an internal cost schedule expressed in per/kilo cost units. Each union is viewed as a producer of services for its affiliated societies. The internal cost of the union is the "price" of its services and the amount to be allocated to the union from coffee sales receipts. The internal cost of NWCA is, likewise, the "price" of its services and the amount to be allocated to the NWCA from coffee sales receipts.

Note that the NIMAs calculate all internal costs on a per/kilo basis, and all costs calculated on a per/kilo basis become part of the producing unit's internal cost. However, equitable cost-recovery principles sometimes indicate that an alternative basis is preferable. NWCA senior staff and ISTI technical assistance team members have engaged in considerable discussion of this point, and the use of cost-recovery principles is called for by the current PIA. If the NWCA or a union produces services on a non-per/kilo basis (such as charging for engineering or accounting services on a per visit basis or charging for transportation on a per-mile basis), the cost of this service should appear as part of the recipient unit's internal cost, not the producing unit's internal cost. If, for example, selected audit services are produced by the NWCA Internal Audit Service on a per-visit or per-hour basis, those costs should be budgeted by the recipient units, unions and/or societies, and included in their internal cost/kilo, and these same costs should be excluded from NWCA's internal cost/kilo.

There may also be other questions about what costs should be included in which levels, for example, the allocation of transportation costs for moving coffee from society to union. The fact that these costs are expected to be different from one society to another argues in favor of treating this cost as a society-level, not union-level, cost, even if the transport is actually produced by unions using union vehicles. However, a union could decide to charge for transportation strictly on a per/kilo basis, in which case transportation becomes part of the union's internal cost. Societies must agree to this arrangement, however, and there is no reason that the arrangement should be uniform throughout the structure. Each union can reach its own settlement of this issue with its affiliated societies. A society that dislikes the arrangement established in one union is free to try to negotiate a different arrangement with a different union.

In other words, the NIMAs require that the NWCA and each union decide what services they will charge on a per/kilo basis and what services they will charge on some other basis. Societies must agree to whatever the unions decide, and the unions must agree to whatever the NWCA decides.

Whatever they decide, the NIMAs must be clear about what services are charged on a per/kilo basis and thus included in the internal cost of the producing unit and what services are not charged on a per/kilo basis and thus included in the internal cost of the receiving unit (because of being charged separately on some other basis). All costs must, of course, appear somewhere in the internal cost schedule. In the case of services being charged on a non-per/kilo basis, the NIMAs should also include a statement of the services produced by each union and the NWCA together with the basis for the charge and the rate to be applied in the coming season. This gives the receiving unit a basis for budgeting and for determining its own internal costs.

C. Distribution of Coffee Sales Receipts

The internal cost schedule, discussed above, is used by all levels to budget for expenditures and by societies, in particular, to generate producer prices. The distribution of coffee sales receipts, however, is a separate issue, one that can be decided apart from the allocation of costs across levels.

Two basic approaches can be followed for allocating receipts to unions and their member societies. One method, followed by the first NIMAs prepared by NWCA under PRAMS I, is to assign to each union the receipts from the sale of its own coffee, after subtracting the NWCA's internal cost as specified in the NIMAs. The alternative method is to aggregate the receipts from the sale of all coffee (less the NWCA's internal cost) and reimburse each union at the same rate per kilo of coffee supplied by the union. In the first approach, each union would receive revenues from the sale of its own coffee; in the second, each union would receive revenue based on the average price obtained for all unions' coffee. Each of the approaches has its advantages and disadvantages.

The major advantage of the first, union-by-union, approach is that each union is rewarded for the quality of coffee it has produced. Moreover, if there is an advantage in timely production, a union is rewarded for its efforts to process coffee quickly and have it ready for sale at an early date. The advantage of rewarding (or penalizing) each union for the quality of coffee it produces, however, depends on the separate marketing of each union's coffee. Although the original NIMAs required separate marketing where practicable, the experience in marketing has so far been that is seldom is practicable. Most of the coffee sales during the current season, for example, have had to mix together coffee from several unions in order to assemble a shipment acceptable to the buyer. Moreover, the market's ups and downs are unrelated to union performance and may arbitrarily reward unions for tardy processing.

The major advantage of the second, average-price, approach is that the unions are able to pool their risk in dealing with the world market. There is always a possibility that one union's coffee might be sold when the market is down, while another's is sold when the market is up. By distributing receipts to unions based on the average price obtained from all sales, unions avoid the possibility of having to bear the entire burden of an untimely sale.

Recommendation 7:

NWCA and its unions must decide for the forthcoming season how the NIMAs should stipulate the procedure for distributing receipts. For that matter, they must also decide, in the absence of NIMAs for the current season, how to distribute receipts from the sale of 1992-93 coffee. There is no perfect way to do it, and there is no reason that the method selected one year must continue into the next. NWCA can continue to try various approaches based on its experience, as well as on changing circumstances. If, for example, the number of union mills would be reduced in the future in order to eliminate those that are inefficient, it might be feasible to market coffee separately by union and thus realize the advantage of distributing receipts on a union-by-union basis. Until that time, the advantage of being able to pool risk may outweigh the disadvantage of not being able to reward and penalize unions for the quality of coffee being produced. Pooling the risk borne by unions when facing the world market would also make it easier for societies to determine producer prices without having to factor in the possibility of an untimely sale greatly reducing its expected revenues. In this sense, distributing receipts on the basis of the average sales price would facilitate the introduction of society-level producer pricing during the upcoming season.

Thus far, the discussion of the distribution of sales receipts has presumed a surplus from sales or, at the least, revenues sufficient to cover internal costs. In the event of a surplus, sales receipts should be distributed so that each level first subtracts its agreed-upon internal cost/kilo, then passes the remaining receipts on to the next level. The surplus will then end up at the society level, and each society will be in a position to make a second-payment to farmers.

The NIMAs must also stipulate a method of distribution in the event of a loss. The best principle to follow is to require a loss to be absorbed in part by all levels. This gives each level an incentive to do its part in reducing the potential for a loss. One reasonable way to distribute receipts in the event of a loss is in proportion to the internal cost structure. Each cooperative organization would receive a percentage of its internal cost equal to its share of the total internal cost (society + union + NWCA) for the structure. This would minimize the budgetary distortion for each cooperative organization.

Whatever mode of distribution is used, whether there is a surplus or a loss, the amount actually received by unions and societies should depend on actual sales receipts, not simply on the budgeted internal cost structure. A surplus from sales is first realized at the level of the NWCA, but the surplus should not remain there, for distribution at the discretion of the Apex organization. It is a fundamental principle underlying the reform of the cooperative structure as agreed to in the MOU that primary societies are entitled to any surplus received

from the sales of arabica coffee. Societies may give up part of their surplus, during NIMA negotiations, in order to pay bonuses at other levels, but any remaining surplus must be distributed to societies.

If the NWCA apex organization were to become the sole claimant for any surplus (and the party fully responsible for any loss), too much discretion would then be vested in that level of the cooperative structure least exposed to competitive pressure and to direct farmer scrutiny. It is primarily at the society level that the loyalty of farmers will be earned, or lost to other societies or to private traders. This is the level most exposed to competitive pressures and farmer scrutiny. The society level is therefore the appropriate level to locate the principal discretion over second payments to farmers. Of course, the other levels would not be precluded from making bonus payments to farmers out of either unanticipated cost savings or other sources of income.

One remaining problem is what to do if societies (and by extension unions) fail to deliver the quantity of coffee they promise in the NIMAs. This problem was not addressed in previous NIMAs. Delivering smaller quantities of coffee increases per unit costs at both the union and NWCA levels. The internal cost schedule must presume at given amount of coffee. If less coffee is delivered than forecast, the internal cost schedule loses its validity. The NIMAs should therefore include a schedule of penalties for societies and unions that fail to deliver as much coffee as they indicate at the beginning of the season. These penalties should reflect the increased costs per unit expected if the quantity of coffee falls below the budgeted amount.

D. Acceptance, Processing, and Marketing Procedures

The NIMAs also must include agreed-upon procedures for coffee acceptance by societies, receipt at unions, processing in union mills, and export marketing by the NWCA.

Acceptance procedures are principally an instrument for controlling and rewarding the quality of parchment coffee produced and processed on the farm. Decisions must be reached on a practical and effective acceptance procedure. Whether to retain or modify the parchment classification system introduced earlier in the project is one issue to be resolved. This issue was explored in the two previous intra-annual assessments.

Processing procedures can be prescribed based on existing mill capacities and the new configuration of machinery recently installed. These procedures must also conform to the requirements of the Marketing Department.

The NWCA Marketing Department has stipulated a set of procedures to be followed in marketing coffee; these can be incorporated in the NIMAs by reference, if acceptable to unions. Efforts to market coffee on a union-by-union basis have not been successful, and these efforts may have to be temporarily abandoned. If restructuring eventually reduces the number of mills, separate marketing of each mill's output may become feasible.

VII. FUTURE RESTRUCTURING

The introduction of society-level producer pricing together with the implementation of the new law on cooperatives will set the stage for a new period of restructuring at both the society and union levels. This will be a period of considerable uncertainty within the cooperative structure. No one can say at this point how many societies, or how many unions, there will be after a year has passed. What is most important, however, is that the process of restructuring be guided foremost by the economic interests of farmers. Only those unions and societies that have a cost structure that allows them to pay farmers a competitive price will be viable cooperative organizations. The practical test for the formation of a new society or union will, and must be, economic efficiency.

The 11 unions presently operate 12 mills. Mill operations benefit from substantial, though not unlimited, economies of scale. The existence of a great deal of excess production capacity and employment in many mills indicates the desirability of consolidating mill operations. This need not require the amalgamation of unions. The responsibility of a union is to arrange for the processing of its societies' parchment coffee as economically as possible. This can mean processing the coffee in the union's own mill, or it can mean contracting out the processing of one union's coffee to another union. The number of operating mills can be reduced, and processing costs decreased, without amalgamating unions.

The number of societies, by contrast, is almost certainly expected to increase, given the sentiment prevailing in many sections of existing societies to form their own societies. Many of these sections presently operate as de facto or informal societies as so-called "union intervention zones." Each society, whether already established or in formation, must consider how it will actually operate and cover its costs while paying a competitive producer price. Many advantages may accrue to smaller societies--ease of decision-making, greater loyalty of farmers, and perhaps better quality control. Yet, such societies probably cannot tolerate an increase in their internal cost per kilo. Smaller societies will have to consider alternative modes of organization, such as part-time managers or contracting for management services from the union, in order to make their operations cost-effective.

VIII. NEW PROGRAM IMPLEMENTATION AGREEMENT AND THE ANNUAL REVIEW

In addition to NIMA preparation, NWCA and USAID must draft a new program implementation agreement for presentation to the Annual Review, to be scheduled during the week of 15 November. The Annual Review, in addition to assessing the present year's work, is intended to provide an occasion for examining the proposed NIMAs and PIA prior to final agreement. The Annual Review will allow opportunity for external assessment and the discussion of any remaining issues before these documents are finalized and signed by the appropriate parties. Unlike previous years, the NIMAs and PIA for 1993-94 are being prepared separately, and only the PIA will be signed both by NWCA and USAID.

IX. CONCLUSION

The period since the last intra-annual review has been one of rapid progress toward the successful implementation of the current PIA and the eventual attainment of basic reform objectives for NWCA and the cooperative structure. Yet, a great deal of work remains to be done, and it must be accomplished quickly. Over the next 2-3 months, key action plans are to be implemented and preparations made for the coming season. Fortunately, strong working relationships have been established among NWCA senior staff, union and society managers, the ISTI technical assistance team, and Peace Corps CTAs. The successful completion of this project year depends on continued cooperation and goodwill among these various actors.

Everyone involved will need to put forth their best effort and, most importantly, coordinate their efforts around the basic ideas outlined in the Memorandum of Understanding:

- Societies determine producer prices--the first payment to farmers--based on internal costs that reflect services rendered by unions and the NWCA. In order to maximize producer price, societies seek the most efficient channel for processing and marketing coffee.
- Societies are entitled to the surplus generated from the sale of coffee after internal costs are paid to the NWCA and unions. From this surplus, societies make a second payment to farmers and thereby earn their continued loyalty.

This "bottom-up" vision of the cooperative structure is the essential frame of reference for all reform efforts.