EASTERN AFRICAN FINE COFFEES ASSOCIATION

POLICY CHANGE AND IMPLEMENTATION IN EASTERN AFRICAN COUNTRIES: THE CASE FOR COFFEE INDUSTRY REFORMS

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ABBREVIATIONS

AGGDP	Agriculture Gross Domestic Product
AKSCG	Association of Kilimanjaro Specialty Coffee Growers
BCC	Burundi Coffee Company
CBK	Coffee Board of Kenya
CDU	Central Depository Unit
CMB	Coffee Marketing Board
CMBL	Coffee Marketing Board Limited
CMU	Coffee Management Unit
CPDC	Coffee Plantations Development Corporation
CPDE	Coffee Planting Development Enterprise
CRF	Coffee Research Foundation
CTA	Coffee and Tea Association
CWD	Coffee Wilt Disease
CWS	Coffee Washing Units
EAFCA	East African Fine Coffee Association
ECAPAPA	East and Central Programme for Agricultural Policy Analysis
ECEA	Ethiopian Coffee Exporter Association
ECEESC	Export Enterprise Share Company
ECMC	Ethiopian Coffee Marketing Corporation
EU	European Union
FA	Farmer Association
FLO	Fair-trade Labeling Organization International
FOB	Free on Board
FOR	Tree on Rail
FOT	Free on Truck
GDP	Gross Domestic Product
ICO	International Coffee Organization
ISABU	Agricultural Science Institute of Burundi
ISAR	National Research Institute
KARI	Kenya Agricultural Research Institute
KCA	Kenya Coffee Auction Limited
KCU	Kagera Co-operative Union
KNCU	Kilimanjaro Native Co-operative Union
KPCU	Kenya Planters Co-operative Union
MCTA	Mild Coffee Trade Association
NARS	National Research System
NGOs	Non Governmental Organizations
NICVS	National Input Coffee Voucher Scheme
OCIBU	Office of Coffee Board of Burundi
OCIR CAFÉ	Coffee Board of Rwanda
OTA	Ochratoxin A
PCB	Private Coffee Board
PRSP	Poverty Reduction Strategy Paper
SACCO	Savings and Credit Co-operative Society
SAP	Structural Adjustment Program
SCIPII	Second Coffee Improvement Program
SOGESTALS	Coffee Washing Units
TACRI	Tanzania Coffee Research Institute
TCMB	Tanzania Coffee Marketing Board
UCDA	Ugandan Coffee Development Authority
UNEX	Union of Export Services
URC	Uganda Railway Corporation
WB	World Bank

EXECUTIVE SUMMARY

(i) Introduction

1. Countries that are members of the East African Fine Coffees (EAFCA) comprising of Kenya, Uganda, Tanzania, Burundi, Rwanda and Ethiopia are well known for production of high quality Arabica and Robusta coffee. The region produces over 500,000 tons of some of the best quality coffee in the world. The current coffee marketing challenges in the world market demand a change in marketing strategies in order to target coffee quality and ensure adequate supply of the given quality through the guaranteeing of large volume of the high quality. There are merits therefore in approaching the coffee marketing in a regional level to increase the competitive of coffee from this region. This is the mission for EAFCA. To achieve this EAFCA intends to lobby to member governments to adopt policies that could encourage transparency in coffee marketing, establish long-term partnership between private and public sectors leading to the establishment of strong farmer organizations. But as a first step, EAFCA intends to understand the dynamics of these policy changes in each EAFCA countries therefore necessary for the enhancement of EAFCA's role and mandate in the region. Policy changes therefore becomes a necessary and sufficient for promoting the production of high quality coffee in the region.

2. The main thrust of the study therefore is to take stock of the policy changes in EAFCA countries that have taken place since reforms in the coffee market began in early 90s. The study identifies the reform process for each country and possible impacts on coffee production, processing and marketing analysed. The study also identifies coffee marketing chains and analyses the prevailing constraints. Finally, constraints and opportunities in coffee production, processing and marketing are identified and suggestions made on how these constraints could be alleviated to improve the production of the high quality coffee in the region.

3. The study was carried out in Uganda, Kenya, Tanzania, Rwanda, Burundi and Ethiopia. Country level studies were by individuals subcontracted by EAFCA. The study was both empirical and analytical in approach. Desk research and literature review was done to obtain the bulk of the material and trace the key policies pursued before and after reform which was augmented by key informant interviews of government officers, various coffee regulatory agencies in all the six countries, farmer representatives, producer organization, processors and processors association, exporters and exporter associations, cherry traders, commodity exchanges and key exports in coffee in each country. The report is divided into four sections. Section one is the introduction, purpose of the study, data collection and data analysis the economic status, importance of coffee in the region, population, and coffee production and exports from the region. Section two identifies the justification of reform and discuses the paces of reform undertaken in each country. Section three identifies the effects of reform across in the region and discusses the commons themes arising from the different types of reforms undertaken by these countries. Section four summarizes the findings of the study identifying the emerging and possible actions that EAFCA could embark on to address the key constraints that influence coffee production and quality.

4. The six EAFCA countries have a combined population of a bout 175 million people with total Gross Domestic Product (GDP) estimated at 35 billion United States Dollars. The average income in the region is about $ 250 per capita. Both Burundi and Ethiopia having per capita incomes lower than this regional average. Average economic growth rate in the region is about 4.4 % per annum with Ethiopia; Uganda and Rwanda's economic growth is above the regional average growth rates. Kenya has the lowest economic growth rate in the region. The economies of all these countries are agricultural based with over 80 percent of the population living in the rural areas. Agricultural also accounts for about 40 percent of the GDP. Agriculture is therefore the most important source of livelihood for the people in this region.

5. Coffee is important in terms of foreign income earning and has created employment to about 5 million people. The value of coffee export is quite high estimated at about US$ 790 million equivalent to the entire GDP of Burundi.. Currently, coffee contributes about 35 percent of the total export earnings down from 65 % ten years ago. The contribution of coffee to export earnings in Countries like Burundi, Ethiopian and Uganda has remained high at about 50 % of the total export earnings. Total area under coffee in EAFCA countries is estimated at 1.3 million hectares and is largely dominated by the high quality Arabica types. Ethiopia has close to half a million hectares of mainly the Arabica type. The total production from the region is about 580, 000 tons while the total exports are estimated at 440, 000 tons. The difference between production and exports is accounted for by domestic consumption mainly in Ethiopia. Ethiopia on average consumes about 50 percent of its production. Domestic consumption in the rest of the EAFCA countries is less than 5% of the production.

(ii) Reforms and their implications

6. Coffee markets in all the six EAFCA countries have been liberalized since the beginning of the 90s. In general, liberalization involved moving away from government controlled marketing system to one that is largely dominated by the private sector participants. The pace of reform among these countries has varied. Uganda, Tanzania and Rwanda and to some extent Ethiopia have fully opened up all stages of coffee production, processing and marketing to the private sector. However, there is still some degree of government or government related institutions participating in some commercial activities such as coffee marketing and production in Kenya and Burundi. In Kenya for example, coffee marketing was removed from the Coffee Board of Kenya – a semi government organization -- and was passed on to three coffee millers one of which though is a farmer owned organization is still government controlled. Non-milling private sector coffee marketing agents who have qualified to market coffee according to the new coffee regulations have not been licensed.

7. In Burundi, the government owned Coffee Board of Burundi (OCIBU) is still involved in running some coffee washing stations (SOGESTALS). OCIBU also owns and runs a coffee roasting plant in total competition with the private sector and continue to provide coffee farmers with pesticides and fungicides on credit in competition with the upcoming input stockists. OCIBU also run a fleet of trucks that correct coffee from farms, an activity that is inefficiently managed and is therefore expensive to coffee farmers. It is also true that both Kenya and Burundi were also the last countries to liberalize coffee marketing with most of the changes taking place after year 2000. Combining the commercial and regulatory roles by these boards has caused a conflict of interests on the part of

the boards. The processes of reform by these late reformers have also been characterized by controversies and interim arrangements that could have led to further distortion coffee marketing thereby adversely affecting coffee production and quality.

8. Changes in coffee production in the six EAFCA countries over the period of reform have not been uniform. Even in areas where the production has changed, not all the changes could be attributed fully to reforms. It is particularly noticeable that gains of reforms could have been eroded by the rapid fall in coffee prices that has characterized coffee marketing in the last decade. Nevertheless, changes in coffee production over the last ten years are partly as a response to a series of incentives provided for by the liberalization process. Coffee production in Uganda has increased by about 21% over the last 10 years. Similarly, the periods of reform has corresponded with a 12% increase in coffee production in Ethiopia. The four countries have recorded a drop in coffee production during the period of reform. Kenya and Rwanda have the largest drop in production. The increase in production in Uganda could be primarily attributed to better payments to farmers, higher growers returns and prompt coffee payments. Reform increased competition thereby raising prices received by farmers. It also increased promptness in coffee payments. In case of Kenya, the continued domination of coffee marketing by the government agent, CBK, and lack of private sector participation in coffee marketing have adversely affected payments and hence coffee production.

9. Reforms in countries where the inputs were supplied by the marketing boards affected their availability and costs. Subsidies on farm inputs in countries like Tanzania and Ethiopia led to a increase in input prices thereby contributing to reduction in their use by farmers. Some stockists and associations responded to the reform in input market and are now supplying inputs to farmers. However, these stockists lack sufficient capital and the relevant knowledge on input supply. These emerging private sector initiatives in input supply thus require support to deepen their understanding of input supply business, acquire necessary knowledge and capital in order to make the input supply business reliable.

10. This study has also revealed that most of the coffee from the EAFCA region is sold mainly to the mainstream international trading and roasting companies. Only small quantities of coffee is traded in the niche or the specialty markets. Ethiopia for example, sold about 483 tons of coffee to the Fair trade markets through the cooperative unions out of total exports of about 120,000 tons. Rwanda sold 12 tons of coffee to Union Roasters of London and 18 tons to Jacksonville in United States out of about 18,000 tons exported. The mainstream coffee market is suffering from oversupply of low coffee quality and therefore declining prices. In contrast, the niche markets are expanding and demand high quality coffee is therefore increasing. Access to the niche market is however facing additional non tariff barriers such as the need for the coffee sold to the niche market to comply with certain social and environmental conditions as is set out by organizations like the international labour organization requirements. It also require that coffee qualifying for the niche market particularly the fair-trade and organic and shade coffee be certified by an internationally recognized organization and has met standards of organizations such as the Fair-trade Labelling organizations international (FLO).

11. The other constraint that have limited the farmers from this region to benefit from the niche markets is that despite production of the high quality coffee, these countries have not branded their coffees by either their countries or the specific regions where coffee is being produced. These countries therefore have been unable to develop a name in the niche market unlike other coffee producing countries like India, Jamaica and Colombia. There is therefore need to target this premium end of the market by identifying the different coffee qualities that exists in the region, branding these coffee, certifying the brands, supporting farmers or farmers groups in the production and marketing of this kind of coffee.

12. Liberalization of the coffee industry could also have led to a decline in coffee quality. This could have been the case particularly the time following liberalization. Liberalization led to the stiff competition among coffee buyers. This could have created market for poor quality coffee thus resulting in mass purchase of coffee. For example markets for unprocessed coffee increased thereby giving incentives to farmers to strip picked the coffee trees and thereby adversely affecting coffee quality. Coffee payments systems also have not been based on clear coffee standards or grades. Lack of clear incentives to compensate for quality usually results in lack of investment in coffee quality production. Even where standards exist like in the case of Kenya, the regulatory authorities have been unable to enforce them because of lack of producer's interests. Reduction in coffee quality could lead to an increase in the level of Ochratoxin A (OTA), a toxic substance to humans.

13. The initial liberalization process was characterized by serious liquidity problems on the part of producers and the local private and cooperative traders. This inhibited effective competition in the market thus resulting into market concentration discussed above. Liberalization resulted in the dismantling of commodity marketing boards, which used to provide input credit to small producers. This decline or lack of input finance has lead to reduced coffee production, reduced yields, reduced quality control, reduced investment in the sector and reduced income for small producers. Most of the banks which went into the sector to cover the gap left by the Marketing Boards lost money because there was no system of collecting loans advanced to small producers. Similarly, local commercial banks which are meant to facilitate trade by provision of crop finance, charge very high interest rates that have become prohibitive to commodity trading. The high interest rates arise out of lack of knowledge about the commodity they finance and low credit rating on part of the players. The high default rate also increased the risk premium by lending organizations thereby escalating the interest rates. In Kenya, Tanzania and Uganda, cooperatives have been unable to provide farmers with input credit because the recovery built in producer price that was centrally market broke down when they were allowed to sell directly.

14. Liberalization entailed the removal of fixed prices by coffee marketing boards. This exposed the actors in the coffee value chain to the vagaries of the volatile international price movements. Even though fixed prices for the growers in a non-liberalized (regulated) system were usually a lower percentage of the international sales or export price, the growers and other players in the marketing chain at least knew the magnitude of the risk they faced and could work their business costing accordingly. However, deregulation of prices caused huge financial losses to the private sector and it has greatly affected their investment decisions. The worst hit category is the internal middle market-chain trader who became directly exposed to the risks of price fluctuations. This class

of traders either speculate or trade back-to-back whereby coffee is sold as is purchased from growers with no risk management techniques employed. The exporters too, are also affected by the volatility but are usually aware of the market trends because of having access to information and risk management skills. Nevertheless, local traders and exporters, with no linkages to international trade houses or multinational companies tend to be more vulnerable and often suffer loss due to lack of appropriate risk management tools.

15. Due to the high political influence and domination of cooperatives in most coffee producing countries in Africa, reform also implied changing the way the cooperatives operated to make them more commercially oriented and more effectively represent the interests of their members. This however implied opening up the producer organizations to competition from the private sector and removal of the protection that these organizations enjoyed during the control era. The producer associations have therefore been unable to cope with the challenges facing the farmers in a liberalized environment thereby rendering them vulnerable and less positioned to play their roles efficiently and effectively. Lack of training and preparedness by cooperatives also weakened the cooperatives further because the process of reform was normally poorly sequenced and led to the loss of domestic protection and inadequate legal reforms to back the political reforms and to some extent the dishonesty in cooperatives leadership.

16. Funding of coffee research in some EAFCA countries has been the responsibilities of governments and is conducted through the National Research Systems (NARS). Under this arrangement coffee research is given same priority with the other agricultural commodities. Funding under these arrangements has been inadequate and unsustainable. In the case of Kenya, coffee research is conducted outside KARI by a coffee research institute the Coffee Research Foundation (CRF) financed by coffee farmers through a levy. In Tanzania, the coffee industry is about to establish a new research institute - Tanzania Coffee Research Institute (TACRI). The fund source will be from deductions from coffee sales. In Uganda, there are proposals now to have Kituza Coffee Research Institute (CORI) to be financed directly by the coffee industry using a levy. But this form of funding has suffered particularly at times when the coffee prices are falling.

(iii) Emerging Issues

17. Countries that fully opened up their coffee industries to the private sector participation are the ones that have attained success in the liberalization process. However those countries that pursued a slow and non-sequenced, non monitored process have not fully attained the desired effect in terms of improved coffee production, coffee payments and a reduction in transaction costs. Countries that have gone through a successful liberalization process also are those that prepared the liberalization process in advance as this removed the uncertainty involved in the process thereby enabling the emergence of new institutions that ensured continuity of provision of services in the liberalized markets. Reforms have also worked well when the role of government in the post reform era has been that is targeted to improve the responsiveness by the private sector. Following these potential benefits from complete reform in coffee industries, EAFCA should use the information on the differences between these sets of countries to advocate for further reform of coffee in the region.

18. The East African region has the potential to produce high quality coffee that creates its special niche in the world market. With the supply glut of coffee in the market, quality rather than quantity will dictate coffee prices more. High quality coffee could earn premiums above the average prices for washed Arabica and Robusta. There is therefore potential to increase the proportion of the fine coffee in this market and thus tap into the existing market potential for the high quality coffee in the world market. EAFCA should embark on improving coffee for sale in the niche markets by assisting the individual countries to identify the rarity value of coffee and establish its background history, brand it by origin, certify it and support farmers to produce it. Further EAFCA should also encourage its members to reorganize the internal marketing systems to be more aliened and get more responsive to these emerging markets.

19. EAFCA should also explore how it could assist in coffee certification through working with organizations such as the Fair-trade Labelling organizations international. Producers will also have to ensure that they consistently provide high quality coffee to the niche market. There is thus need to increase awareness of quality in a consistent manner across the entire marketing chain. EAFCA thus could ensure that it embarks on increasing the quality awareness through increased training of coffee liquorers, traders and exporters. In particular, EAFCA could embark on a regional sensitisation on OTA, which could threaten the coffee market in the region if not well managed. EAFCA's participation could also involve the training of more liquoring or cupping experts in each member country and introduction of cross-country sharing of experiences. EAFCA could also spearhead the establishment of system that could reward farmers for producing better quality coffee. Coffee traders could then use the reward system to pay coffee farmers for differentiated coffee quality.

20. Producer organizations were weakened when coffee marketing was liberalized thereby creating a gap in provisions of services in processing, credit, market information transportation and marketing. But the reform has caused the emergence of a number of other industry-related groups/associations to advocate for the rights of their members. These institutions may not be doing well. EAFCA should therefore support these emerging producer organizations in order to strengthen their operations. It should identify those that are working well with a view to making the poor performing organizations learn from the strong ones. This includes assisting them acquire the necessary technical, managerial and financial capacity.

21. The region has wide past experience in trading of coffee in auctions that have lead to price discovery thereby providing price guidelines to producers and traders. Some auctions have the potential of being transformed to an Exchange there is the capacity for creating a regional fully-fledged commodity Exchange and thereby provide a mechanism of price risk mitigation through hedging mechanisms and the introduction of futures in the trading floor. EAFCA could therefore explore the possibilities of transforming these coffee auctions into a commodity exchange. EAFCA should also assist the coffee auctions in the region to reconcile the inherent advantages and disadvantages of the system while also allowing an alternative coffee marketing window so that the farmer may choose whatever method deemed best and thereby access the speciality coffee markets

22. Reforms in countries where the inputs were supplied by the marketing boards have affected availability and access to farm inputs. The emerging private sector initiatives in input supply require support to understand the business of input supply, acquire necessary knowledge and capital in order to make the input supply business reliable. EAFCA could establish a training program for the input distributors in order to build the relevant knowledge on the input marketing including making them a source of technical information to the farmers on input use.

23. The high cost of money for trading has literally forced many would be local entrepreneurs out of business, thus the apparent concentration evident in the industry. The region however has the potential to increase the liquidity of producers and traders and encourage competition amongst the traders through the introduction of the Warehousing Receipt Facilities. EAFCA could therefore establish mechanisms through which countries that are not participating in the CFC funded Warehousing project could learn from those countries within EAFCA that are currently participating. This includes establishment of an enabling legal and regulatory environment and the establishment of institutions that could licence and inspect the warehousing facilities.

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CHAPTER 1

1.0 Background information on EAFCA Countries

1.1 Introduction

1. As at the time this study was conducted, the members[1] of the Eastern African Fine Coffees (EAFCA) were Kenya, Uganda, Tanzania, Burundi, Rwanda and Ethiopia. These countries are all well known for production of high quality Arabica and Robusta coffee. The region produces over 500,000 tons of some of the best quality coffees in the world. Each country separately organizes coffee marketing using different strategies to access international coffee markets. But conditions in the world coffee market arena have been changing. The market now faces serious challenges that may warrant changes in coffee marketing strategies if these countries will remain competitive. Over-supply of coffee coupled with a decline in prices and an increasing importance in social environmental requirements by consumers requires the EAFCA countries to address the world coffee market as a bloc. The EAFCA members could therefore target to improve coffee quality and ensure adequate supply of large volumes of to exporters. This only way to secure market security which individual countries will be unable to do. There are merits therefore in approaching the issue of coffee marketing as a block to increase the competitiveness of coffee in the region.

2. The main goal of Eastern African Fine Coffees Association (EAFCA) is to raise the quality and competitiveness of coffee from member countries in order to secure coffee markets and thereby raise incomes for producers. EAFCA expects that governments within the region can adopt policies that could encourage transparency in coffee marketing, establish long-term partnership between private and public sectors leading to the establishment of strong farmer organizations. This could improve the efficiency of coffee trade and encourage intra regional trade within the EAFCA countries. EAFCA recognizes that one way to achieve this objective is to advocate for policy changes that could promote partnerships and form networks amongst the stakeholders from the region including producers and processors, with the exporters, coffee trade houses and, consumers. Adoption of national and regional level policies could encourage the partnerships between governments and the private sector to improve accountability and transparency of different players. Implementation of the right policies could in turn ensure sustainability in production of high quality coffee thereby creating confidence in coffee from the region in the global market. Coffee production, processing and marketing in these countries must be viewed in line with the domestic and international circumstances particularly the changing roles of governments in producing countries and the changing demand for coffee in the international markets. Understanding the dynamics of the policy changes in each EAFCA countries is therefore necessary for the enhancement of EAFCA's role and mandate in the region. Policy changes are therefore necessary and sufficient to promote production of high quality coffee in the region.

[1] In the intervening period, Zambia and Malawi have become additional members of EAFCA

3. Policy advocacy in the EAFCA must nevertheless recognize that different countries in the region are at different stages of formulating and implementing market reforms in coffee industry. These policy changes have been carried out to restructure coffee production, processing and marketing. The aim is to reduce the role of state in performing direct commercial activities while at the same time creating an enabling environment for the private sector to undertake these functions. The main objective is to reduce the role of the state to the level of providing the necessary regulatory framework to encourage competition and ultimately increase returns to producers. Reforms in these countries are therefore in line with EAFCA's objective.

4. The main thrust of the study is therefore to take stock of the policy changes in EAFCA countries that have taken place since reforms in the coffee market began in early 90s. The study identifies the reform process for each country and the possible impacts on coffee production, processing and marketing analyzed. The study also investigates coffee-marketing chains and analyzes the prevailing constraints. Finally possible opportunities in the coffee industry are identified and suggestions made on how they could be explored to improve production of the high quality coffee in the region.

1.2 Specific Objectives

5. The specific study objectives are to:

- Analyze the extent of reforms of the coffee sub sectors and identify the current status of policy profiles in the industry for each country;
- Assess impacts of the reform process;
- Identify and analyze the prevailing coffee constraints across the coffee chain;
- Identify the existing reforms and strategies that are being applied to address these constraints;
- Make policy recommendations that could address the constraints in the coffee industry encourage transparency in marketing, enhance partnership between private and public sectors and support the evolution of sustainable farmer organizations to improve efficiency of coffee trade.

6. To bring forth suggestions on how to promote policy and shade light on the strategy options that would improve the efficiency of coffee sectors and raise the welfare of coffee farms and firms involved in coffee production, processing, marketing, storage, finance, and/or product manufacturing and promotion. EAFACA could in addition support policies that support intra region trade and ultimately enable member countries to transact coffee freely.

7.

1.3 Information gathering and Analysis

8. This study was carried out in Uganda, Kenya, Tanzania, Rwanda, Burundi and Ethiopia. Country level studies were by individuals subcontracted by EAFCA. They are:

- Julius Madira of Ugandan Coffee Development Authority
- Kennedy Gitonga & J.K.Nyoro of the Coffee Research Foundation Ruiru and Tegemeo institute, Egerton University respectively.
- Getinet Kelkele of the Association of Coffee Exporters in Ethiopia
- Patrice Ndimanya who is a private consultant in Burundi
- Venuste Rusharaza who is a private consultant in Rwanda
- Swai, Joseph; Kimaryo, Primus & Karau, Titu all of the Eco Program in Tanzania

8. The study used an empirical and analytical approach. Desk research and literature review was done to obtain the bulk of the material and trace the key policies pursued before and after reform. This was augmented by several key informant interviews that included government officers, various coffee regulatory agencies in all the six countries, farmer representatives, producer organization, processors and processors association, exporters and exporter associations, cherry traders, commodity exchanges and key exports in coffee in each country. Individual country studies took about three months to organize between May and June 2003. The final report comprises of a synthesis of six separate country studies.

9. The report is divided into four sections. Section one is the introduction which highlights the purpose of the study, data collection and analysis, economic status, importance of coffee in the region, population, and coffee production and exports from the region. Section two identifies the justification of reform and discuses the paces of reform undertaken in each country. Section three identifies the effects of reform across in the region and discusses the commons themes arising from the different types of reforms undertaken by these countries. Section four summarizes the findings of the study identifying the emerging and possible actions that EAFCA could embark on to address the key constraints that influence coffee production and quality.

1.4 Basic Information about EAFCA countries

10. Ethiopia, Kenya, Uganda, Tanzania, Burundi and Rwanda are the members of EAFCA. Recently, Zambia became the seventh member of the Association. The six member countries have a combined population of a bout 175 million people. Ethiopia has the highest population of about 67 million people that is equal to that of Kenya and Tanzania combined. (Table 1). The total Gross Domestic Product (GDP) from the region is estimated at 35 billion US Dollars with Kenya having the highest GDP followed by Tanzania, Ethiopia and Uganda in that order. Rwanda and Burundi have the lowest national income. The average income in the region is about $ 250 per capita. Both Burundi and Ethiopia have per capita incomes lower than the regional average. With a regional average economic growth rate of 4.4 %, Ethiopia, Uganda and Rwanda have an economic growth rate that is above the regional average. But Kenya has the lowest economic growth rate in the region. Uganda combines a higher economic growth rate with an impressive per capita income. It is also clear that the economies of all these countries are agricultural based with over 80 percent of the population, living in the rural areas. Agriculture accounts for an average amount of about 40 percent of the GDP in the region. The proportion of agriculture to the GDP is however higher in the case of Burundi, Ethiopia and

Rwanda. Due to its importance, agriculture is the most important source of livelihood for the people in the region.

11. Among the agricultural commodities produced in the region is coffee, which is important in terms of foreign income earning and has created employment to about 5 million people. The value of coffee export is quite high and is estimated at about $ 790 million, which is equivalent to the entire GDP of Burundi. This value however has fallen in the recent years following the decline in the price of coffee in the world market. Currently, coffee contributes about 35 percent of the total export earnings down from about 65 % ten years ago. The contribution of coffee to export earnings in countries like Burundi, Ethiopia and Uganda has remained at about 50 % of the total export earnings. In deed coffee exports in early 90s accounted for over 80% of exports in Burundi, Uganda and Ethiopia.

Table 1.Population and national Statistics of EAFCA Countries 2001/2002

Country	Population (millions)	Per capita income us$	GDP (current $)bn	Annual growth rate	GDP amount on bn US$	Proportion (%) of Agriculture to total GDP
Burundi	6.7	100	0.70	3.2	0.4	50
Ethiopia	67.0	167	6.20	5.8	3.0	48
Kenya	30.0	368	11.10	1.1	2.7	24
Rwanda	8.7	274	1.70	6.7	0.9	50
Tanzania	37.0	270	9.30	3.3	4.1	45
Uganda	25.0	320	5.70	6.4	2.4	42
Total/Average	174.4	249.8	34.7	4.4	13.4	43

Source: Country draft and World Bank Country Reports

12. The total area under coffee in EAFCA countries is estimated at 1.3 million hectares and is largely dominated by high quality Arabica types. Ethiopia cultivates close to a half million hectares of Arabica type. The total production from the region is about 580, 000 tons while the total exports are estimated at 440, 000 tons. The difference between production and exports is accounted for by domestic consumption mainly in Ethiopia. Ethiopia on average consumes about 50 percent of the production. Domestic consumption in the rest of the EAFCA countries is less than 5% of the production. Kenya and Ethiopia produce high quality Arabicas while Uganda's coffee is dominated by Robusta coffee. Though Tanzania, Burundi and Rwanda produce mainly Arabica coffee they received low prices i.e. less than a half that received by Kenya.

Table 2. Coffee Production and Exports (1997-20020)

Country	Area Harvested (Ha)[2]	Production in tons	Quantity exported (tons)	Value of production ($) (000)	[3]Price/kg in $
Burundi	85,180	18,000	18,000	10,180	1.17
Ethiopia	475,000	231,000	110,000	49,688	2.34
Kenya	165,000	64,000	64,000	124,978	3.44
Rwanda	49,000	17,500	17,500	17,888	1.31
Tanzania	251,000	45,000	43,000	67,615	1.51
Uganda	264,000	195,000	190,000	52,511	0.96
Total	1,289,180	570,500	442,500	322,860	1.79

Source: Country data, FAOSTAT and World Bank Country reports

[2] Coffee area, production, exports and Value of exports are the 5 year averages for each country and may therefore not represented figures for any specific year.

[3] These prices are five-year averages computed from export value and actual coffee exports over the same period.

CHAPTER 2

2.0 Country specific Policy reform and implementation

11. In this section, reforms in each EAFCA country are discussed in detail. The situation before reform is identified, justification for reform, the reforms themselves, their impacts and the current coffee production, processing and marketing., Suggestions are also made that could alleviate any post reform constraints for each country.

2.1 Ethiopia

12. Coffee is an important crop to the Ethiopian economy in terms of contribution to GDP, employment and foreign exchange earning. It accounts for about 10% of the GDP and contributes between 70 %(1997/98) and 40 %(2001/02) of the foreign exchange earnings making it the main foreign exchange earner for the country. It is also estimated that about a quarter of the population depends on coffee either directly or indirectly. Under the previous Ethiopian government, the National Coffee Board of Ethiopia was initially the sole body responsible for all coffee activities. It was later transformed to Coffee and Tea Authority (CTA) and later into the Ministry of Coffee and Tea. Since the regime was of socialist orientation, it strengthened state ownership of the means of production while minimizing participation of the private sector. The ministry managed all aspects of the Ethiopian Coffee and was involved in research, extension, cooperatives and trade. It also had parastatals that dealt with state farms, coffee processing, internal and coffee export trade. The ministry was also involved extension staff to impart extension advice and in assisting coffee farmers to replace old coffee trees with disease resistant and high yielding varieties.

13. To minimize further the role of private traders in the internal coffee trade, farmers were organized into Farmers' Associations occupying 800 ha of coffee. Five or six Farmers' Associations had a cooperative. The cooperatives marketed the farmers' produce and delivered essential goods to farmers at prices much lower than in the private traders' shops. They had access to bank loans and the full range of technical and administration support from the government. In an effort to further boost coffee production and foreign exchange earning, the government operated national coffee farms under the Coffee Plantation Development Corporation (CPDC). The CPDC functioned with the support of the government treasury to manage about 10,000 hectares of coffee. In order to improve coffee quality, the Coffee Processing and Engineering Enterprise, which was a World Bank, sponsored project, invested in establishing coffee washing stations and the construction of feeder rural roads.

14. Export and internal coffee trade was under the authority of the Ethiopian Coffee Marketing Corporation (ECMC) to compete with the private traders in the interior trade as well as in the export trade. As the corporation strengthened, participation of the private was minimized. Towards the end of the period of the regime ECMC handled 90 % of the exports. In the interior trade it had 126 hullers. State farms, producer cooperatives, cooperatives delivered their coffees to the corporation. It also purchased coffee from the private trader. The price paid by the corporation depended reflected auction prices and the prices were broadcasted daily on the national radio..

15. Individual farmers, producers' cooperatives, state farms and common farms owned by Farmers' Association (FA), thus produced coffee. Individual farmers delivered fresh cherries to cooperatives, but sold dry beans to collectors. Private wholesalers bought coffee from collectors and trucked their coffees to the terminal markets. The Ministry of Coffee used to set annual purchase price of red cherries for the cooperatives. The cooperatives paid this price to farmers as a first payment. After selling the coffee, the cooperatives retained 20% of their balance and distributed the rest to the farmers as a second payment according to their respective deliveries. The cooperatives only dealt with washed coffee and were advised against engaging in the business of sun-dried coffee to minimize their exposure to risk due to fluctuating world coffee prices.

16. The other participants in the interior trade were the coffee collectors and the wholesalers. In an effort to collect as much coffee as possible from the farmers the Ministry of Coffee and Tea used to issue licenses to small traders who went to village markets to collect coffee. Given the scattered nature of coffee farmers and their small size holding, collectors were an effective means of bringing coffee into the pipeline. There were 1,229 collectors in the coffee regions. The wholesalers (Akrabis) purchased coffee from collectors. The Akrabis had hullers to process their coffee for dispatch to the terminal markets. While the Akrabis were restricted to purchase coffee from collectors, the collectors were limited in area. There were 137 Akrabis in the coffee producing areas.

2.1.1 Coffee Marketing

18. After collection and processing, coffee was dispatched to the terminal markets of Dire Dawa and Addis Ababa for auction. To supply coffee to the auction centers, the government used to set targets for delivery for each coffee growing region. The regions established coffee task forces at the different administrative levels and engaged them in the effort to supply their targets of coffee. This approach of coffee collection and supply helped a great deal in bringing as much coffee as possible to the auctions. Since the purchase price was low, the tendency was to sell coffee to the parallel markets. Though the tasks forces had helped to deliver quite substantial amount of coffee, a great amount of coffee was diverted to the parallel markets despite of risk of losing coffee when caught in the act of moving unofficially.

19. Coffee at the terminal market was inspected for quality before it was put on auction. Though both types of coffees were inspected, the washed coffee was not put on auction. Washed coffee was delivered to the coffee marketing corporation after the usual inspection and cup tasting. The prices paid varied according to grades of the washed coffees. In the case of sun dried coffee visual inspection only was applied. Samples of green beans together with the results of visual inspection were displayed in the auction for exporters to select the type and grade of coffee they wanted before the auction begins.

20. Each day a ceiling price for each type of coffee was calculated and exporters were allowed to bid below those prices. In fact, these were not auctions in the real sense, instead, they were systems used to distribute the coffees or allocate quotas to the exporters. The greatest share of about 90 percent was allocated to the State run Ethiopian Coffee Marketing Corporation (ECMC) and the rest distributed among the 13 private exporters based on the criteria of capacity,

number of employees and the like. The exporters processed further and blended to fetch higher prices. The Ministry of Coffee controlled coffee stocks for each exporter while the Coffee Marketing Corporation set prices for the various rejects. The Corporation was the only one allowed to release coffee for domestic consumption. Coffee found unfit for export at the auction was also delivered to the Corporation at set prices. Coffee was sold to overseas markets by an irrevocable letter of credit. Each exporter registered sales contracts with the National Bank of Ethiopia. Since 90% of the coffee export was by the Coffee Marketing Coffee exporters used the Corporation's sale prices as a guide for registration of sales since the corporation exported over 90% of the crop.

21. Since the Birr, was pegged at 2.07 to a US Dollar, the coffee producers suffered from implicit taxes due to the overvaluation of the local currency. There were surtax; cess, duty and transaction taxes imposed on coffee export that also ultimately affected the prices paid to the farmer. The share of these taxes of the FOB varied between 35 to 40%. The heavy tax burden together with the highly overvalued currency depressed coffee prices leading to disincentives to produce and quality coffees improvements. Since the ICO quota system was in force, there was no problem to export coffee and the prices of coffee were three times than they are now.

2.1.2. Justification of Reforms

22. Reforms in the coffee industry in Ethiopia started in 1991 when a more capitalistic oriented government took over power. It had become evident that economic policy of the country pursued by the previous regime was incompatible with the international economic order especially with the collapse of communism in Eastern European countries. Realizing the unstable economic order the country was facing, the regime proclaimed mixed economy policy and started to invite the private sector in limited sectors of the economy. The new government therefore, declared market economy policy and undertook major liberalization of the economy. The international donors came to the help in the reconstruction of the economy and thereby made economic reform a pre requisite for aid. The reforms thus involved divestiture of government from direct commercial activities in coffee and the incorporation of the private sector.

2.1.3. Situation after Reform

23. Coffee actors in the chains of coffee trade have not changed much with the reform of the coffee industry. The relative share, however, has changed significantly. Individual farmers, private investors and the state Coffee Plantation Development Enterprise (CPDE) now produce coffee in Ethiopia. Cooperatives, private suppliers/ investors and CPDE process either washed or unwashed coffees. The processed coffee is brought to the auction by either the cooperatives, the private suppliers or the CPDE for the coffee they produce. The government through Ethiopian Coffee Export Enterprise Share Company (ECEESC) and the private exporters buys coffee that is put on the auction. The former actor is the ex-ECMC that used to export 90% of the country's coffee. These actors purchase nearly all coffee that arrives at the auction.

24. An insignificant share of coffee from some exporters and that from the cooperatives is allowed to bypass the auction directly into the market. This is a

privilege granted to investors in coffee plantations. The other coffee that bypasses the auction is from co-operative unions. These unions are allowed to have the status of the investors because they deal with the coffees from their cooperatives. Coffee from these actors is however registered at the auction but not put on auction. This channel is allowed to enable these operators to enter directly through the Fair trade market. The coffee export business is on the other hand dominated by the private sector. During the last four years, the share of the private traders/investor in coffee exports has been over 90%. The state body exported 8 % and about 1% from mainly the Oromia cooperative. The other two cooperative unions, the Sidama and the Yirgacheffe unions, have been at the formative stage.

25. The private sector therefore responded favorably to the liberalization of the economy. Private commercial farms have been established without any limit on land size. Many of them are also in the establishment process. In coffee collection, farmers, cooperative and the state coffee procurement corporation handle nearly all of the coffee supply to the auction centers. In the last three years for example, the private traders supplied about 90 percent of the coffee to the market. The state run ECMC that before reform exported about 90% of the crop has almost ceased operation. Only the Ethiopia Coffee Development Enterprise now exports less than 2% of the coffee mainly from their farms. The private sector, which had a share of 10% in coffee export, has now a share of about 98%.

26. The number of coffee exporters has also increased following the liberalization process. The number increased from 13 before the liberalization, to 200. However, not all of those licensed are active. Out of the all the licensed exporters only about 64 were active in 2002. All in all it can be said that the response of the private sector to liberalization has been overwhelming.

2.1.4. Coffee marketing system

28. Currently, most of the coffee trade in Ethiopia takes place in two coffee auctions in Dire Dawa and Addis Ababa. The Coffee and Tea Authority of Ethiopia run the auctions. The auction facilitates the businesses of exporters and suppliers and provides the farmers with coffee price information. Currently the coffee auctions could be facing several challenges in that as the auction system allows revealing of a supplier's name before auction, exporters know their coffee and bid at any price. Coffee exporters are also allowed to become coffee suppliers to the market. This system could distort the price discovery merit of the auction system. Similarly, the quantity of coffee that bypasses the auction system to be exported directly is very insignificant and is often less than 5% of the total exports. However, coffee from these sources is expected to grow in the near future, thereby adversely affecting the auction system as more coffee is sold outside the auction.

29. The Ethiopian government like many others that have adopted coffee auction systems have realized the challenges facing auctions particularly its spot sale nature and its inability to facilitate future trading of coffee. Strategies to modify the action system therefore are to make the auction system more transparent and to possibly convert it to a coffee exchange center with or without future trading. The coffee auction systems being a spot market, only physical coffee exchange is the basis of trade. This tends to expose the suppliers and exporters

to risks. One approach that is been envisaged to overcome this problem is to allow exporters to sell ahead and make them buy coffee in the auction where delivery can be differed in future but still within their contract period. The suppliers would also be selling coffee well in advance. The suppliers having secured the price would in turn purchase the coffee from farmers well in advance. This Forward Delivery Auction (FDA) system could eventually replace the spot auction sales if it proves to be better off. It is envisaged that an independent body under the Coffee and Tea Authority will be the clearinghouse where banks, insurance companies, exporters and suppliers are all expected to be members. Although this system is being proposed in Ethiopia, it is a new concept and will require to be managed carefully. Currently the proposal for FDA is being proposed for trials under the auspices of the International Finance Development (IFAD) and the World Bank.

2.1.5. Current Role of Government

30. Coffee and Tea Authority (CTA) continues to provides training, logistical support and technical assistance and also financing their trading. It is also involved in establishing coffee nurseries through donor supported nurseries, research to develop disease resistant varieties, establishment of coffee genetic conservation in three localities, running the two coffee auctions recording coffee arrival and export statistics and disseminate information for local or international use and promoting coffee together with the Ethiopian Coffee Exporters' Association.

2.1.6. Impacts of Reforms

31. Coffee production has increased since the reform started. But due to lack of reliable data, on coffee yield and production, coffee arrivals[4] is a proxy. Coffee that arrives at the auction is what is recorded. It is less than production due to coffee consumed locally or diverted elsewhere. Prior to reforms, coffee arrival was about 100,000 tons and have increased to 180, 000 tons by 2001/2002. Coffee export also has increased from less than 80,000 thousand tons in 1990 and to reach a peak in 1997/87 of 121,000 tons. In 2001/2002, coffee exports were about 109,000 tons. The increase in coffee production could therefore be attributed to reforms and the increase occasioned by the planting of the disease resistant varieties done extensively during the earlier regime.

32. On coffee quality, there is no empirical information to show how the coffee quality has been affected by the reforms. However, one can only infer that quality of Ethiopian coffee has increased slightly as result of the increased investment in coffee washing stations. This new and additional processing technologies, especially, in the production of washed coffee has not maintained the necessary spatial distance between them. However stiff competition between private coffee buyers could have adversely affected coffee quality as the washing stations purchase cherries without discriminating ripe from unripe cherries. To some extent this could have adversely affected coffee quality. This situation is now

[4] Coffee arrivals are a term in Ethiopia that denotes the quantity of coffee that gets to the auctions. It is a proxy for coffee exported as it is the difference between local production and consumption between the farm level and the auctions

exacerbated by the current low coffee prices and the indiscriminate purchase by collectors has adversely affected the quality of coffee. Also the fact that buyers do not provide individual incentives for high quality coffee discourages the farmers from, investing in quality enhancing techniques. At the processing level, a number of coffee exporters have invested in coffee liquoring facilities within their premises.

33. Farmers are now paid promptly although the decline in world coffee prices has resulted to a fall in income The prompt payments have provided incentives to improve coffee. Lack of proper systems of disseminating coffee prices at the farm gate also adversely affects the process that coffee fetches at the farm gate. Most times, lack of market information by the farmers has affected the prices they receive. Similarly, inaccessible roads prevent many coffee farmers from getting premium prices because of high transportation costs. It is only those farmers within easy reach from washing stations who can manage to get a premium price for their coffee.

34. Unlike in other African countries, reform in coffee in Ethiopia has created a new producers' organization while dissolving others. Producer's cooperative organizations, which were formed without the willingness of farmers, dissolved immediately after the government changed in 1991. On the other hand, cooperative unions have been formed since recently and the trend seems to suggest that more will be formed in the near future. These unions supplement the efforts of cooperatives by exporting their coffees. The coffee unions exports have ended in the niche markets thereby enhancing the earning of the producers.

35. Most coffee research activities have been financed through external sources mainly through grants from donors. When the fund earmarked is used up the activities could be left unattended. It is also important to include the coffee buyers and exporters in the evaluation of new coffee varieties. In the past, these people had been excluded leading to development of varieties that may not be attractive to the buyers

2.2. Burundi

35. Burundi essentially is an agricultural based country with agricultural GDP accounting for approximately 50% of the total GDP. Agricultural exports are valued at 94 % of total exports. Coffee is the most importance commodity for Burundian economy accounting for about 80 % of the total export earnings and provides a livelihood to a 2.5 million people. The production is dominated by Arabica coffee, which covers a surface of 85,180 ha compared to the 756 ha occupied by the Robusta coffee. In the 2002/2003 seasons, about 75 percent of the Arabica coffee was washed. This strategic commodity chain for the Burundian economy is - like the other countries within the Eastern Africa - engaged in deep structural reforms since the beginning of 1990s although it was not until 2002/2003 that the coffee industry started to undergo serious market reforms.

2.2.1. Situation Before Reform

36. Prior to 1990, the Office of Coffee Board of Burundi (OCIBU) (dominated coffee processing and marketing. The Ministry for Agriculture intervened in distribution of pesticides, coordination of application and authoritatively ensured that recommended technical standards are adhered to. More than 60% of harvest was pulped and washed by the farmers in manual pulping centers or by means of a millstone produced by the local craftsmen. After pulping, farmers delivered the coffee parchment to collectors on prices set by the State. There was a network of the stations of pulping-washing that processed about 38% of the national production. All coffee payments to farmers were also managed by the State.

37. The coffee treated by the factory or the farm was then forwarded to OCIBU. The Board was also mandated to; construct and maintain the manual pulping centers; Provide farmers with pesticides; Provide coffee collectors and pulping-washing factories with credit and manage coffee stabilization funds. All the coffee was exported through the Burundi Coffee Company (BCC), which was a monopoly public company. OCIBU made payments to all these intermediaries without any regard to their efficiency or the professional performance. Such a situation discouraged creativity and encouraged inefficiency. The BCC did not engage in aggressive marketing but instead entered into expensive monopolistic arrangements with coffee buyers that adversely affected coffee prices. As a result, payments to farmers were very low and was most times delayed. All the coffee was then sold in the auction under full management of OCIBU and with no private sector participation. Similarly, OCIBU was unable to recover money it was advancing to the coffee collectors, which again ended up eating into the farmer's payments. These situations thus were unsustainable and following additional pressures from donors and in line with the market reform euphoria in developing countries; the liberalization of coffee in Burundi could not be left behind.

2.2.2. Nature of Reform

38. Key reform measures undertaken since the beginning of the 90s are the renting of coffee washing stations and hulling units to private companies with possibility of selling them later, introduction of the weekly coffee auctions managed by OCIBU although retaining establishment of a minimum price to the producer, transferring extension activities to decentralized units of the Ministry of Agriculture supported by the treasury and the intention to stop supplying farmers with inputs and equipment. It was then planned that OCIBU, which had a key position within the old structure, would see its functions limited to co-coordinating and internal monitoring of the sector and developing coffee policies. OCIBU was also mandated to provide coffee statistics, estimation of harvests, promotion and presentation of the country at the international level, management of auction systems (planning of sales, holding of audit sessions, management of contracts with the exporters, determination of quality standards classification systems, promotion of the private sector. The board was also in charge of arbitration of disputes, supervision of payment systems.

39. However, given the natural weak inclination to give up the power, the OCIBU was unable to oversee the entire reform process and therefore sought for excuses to maintain the status quo. OCIBU continued to supply input and technical support to growers, maintain the coffee washing station although rented out to the private

sector, determine level of coffee payments to farmers, coffee grading and classification of green coffee, and maintaining coffee stabilization fund. OCIBU thus continued to have commercial, regulatory and arbitration roles. There was thus a lot of resistance to change by OCIBU to the detriment of the farmers themselves.

40. The private sector responded to the reform by investing in input supply and in the pulping/washing, parchment, and marketing and roasting. But the reforms did not stop there. Pressure for further reform intensified during the 2001/2002 periods. As a result, OCIBU's accepted to break the monopoly on the inputs and equipments supply of the coffee sub-sector a role that was taken up by some cooperatives and some private sector stockiest. Pulping or washing stations were also rented out to five companies some of which were in deed government parastatals. The newly privatized washing stations were renamed SOGESTAL (Coffee Washing Unit Management Companies).

41. At the parchment level, the most significant answer of the private sector was the construction of two private factories for parchment of Arabica type coffee since the 1996/97 campaigns despite the hesitations of the sector authority, in this case, OCIBU. At the marketing level the approach adopted from the beginning of the reform implementation is the sales in auctions following the English model-taking place weekly. The participants in auctions are either brokers or agents appointed by the buyers. The agents are simple sales representatives of importers and participate in auctions to put bids until the price fixed by the employer is arrived at. The minimum price is determined by OCIBU commercial unit based on the New York market price, quality and FOB charges.

42. The auctions are also characterized by high concentration. It is indeed rare to observe more than four exporters in competition for one batch. Only two or in best of cases three players actively go bargaining during a session. In 1995, there was only one active player for 11.3% of the batches presented to auctioning, 2 actors for 63.4% of batches, 3 actors for 21.6% of the batches, 4 actors for 3.1% of the batches, and 5 actors for 0.6% of the batches. Apparently, the situation has not evolved, considering the strong domination of some exporters. There is also no provision for selling coffee outside the auction particularly in the niche market because all coffee must be sold through the auction. These and the other shortcomings of the auction have warranted OCIBU and the Burundi government to rethink the role of the auction. The challenge is to be able to maintain the auction system intact while also encouraging an alternative marketing system outside the auction or direct sales without undermining the auction system. Burundi government is therefore explore the possibility of introducing an alternative coffee marketing window that could enable coffee processors to negotiate with buyers in the specialty market and to establish contracts outside the auctions. Auctions will however continue to provide the reference prices for the alternative marketing system. This process is in progress and will require to be monitored when implementation begins.

43. Prior to 1998, coffee roasting was OCIBU's monopoly. Approximately 90 tons of green coffee was roasted annually against a capacity of about 1,200 tons. The intention was to promote Burundian coffee both inside and outside the country. In addition, two privately funded roasters were started to supply the local market and another roasting unit. However, the key shortcoming is that the private roasters cannot have access to coffee directly from farmers.

2.2.3. Impacts of reform

44. Reforms in the coffee industry in Burundi have been mixed as expected. Coffee production fell slightly over the decade of reform although in actual fact the production has kind of stabilized between 30,000 and 35,000 tons. But the production could also have been adversely affected by the war in Burundi that started in 1991. Coffee quality has also declined despite the additional investments made in coffee washing stations and the increase in the proportion of washed coffee. It is also clear that without the involvement of the private sector, coffee production could have declined further.

45. Quality also declined during the ten years of reform. There was a decrease in the proportion of premium grades of f w super, extra,wo2 and 3a. As a result of the decline in coffee quality, the premiums received by the Burundian coffee have declined faster than that of similar coffee from Kenya and Tanzania. The other advantage of the reform of the coffee industry was the reduction of the period required to transport coffee to Dar es-Salaam from 133 days before reform to 33 days after the reform.

46. There has also been an increase in producer associations dealing with coffee thanks to the support by privately owned SOGESTALs and the Non Government organizations (NGOs). These producer groups organize their activities around the coffee washing stations and negotiate prices with SOGESTALs on behalf of the members. They however intend to get more organized so that they could venture into coffee exports in the specialty and Fair trade markets. These associations are however very weak financially and in management. They also lack accounting skills and professionalism in handling their affairs. The producer organizations thus require a lot of support before they can start venturing into the more complicated areas such as coffee marketing.

47. Reform of coffee marketing has also affected availability and access to farm inputs like fertilizers, fungicides and small implements. Prior to reform, OCIBU was importing all the inputs and distributed them to farmers. About 10% of the total coffee areas thus received fertilizers through OCIBU. Some stockists and associations supported by the SOGESTALs and a local NGO have, however responded to the reform in input market and are now supplying inputs to farmers. Unfortunately these stockists lack sufficient capital and the relevant knowledge on input supply. Thus these emerging private sector initiatives in input supply require support.

48. Sustainability of research activities at the Agricultural Science Institute of Burundi (ISABU) also is an issue. Currently, bilateral and multilateral donors fund most of the research activities, with limited direct support from government. Both the funding and revision of research agenda require to be addressed.

2.3. Rwanda

50. Rwanda is basically an agricultural country with close to 85 percent of the people living in the rural areas and deriving their livelihood directly from agriculture. It is estimated that about a quarter of the 8.5 million people in the country depend on coffee income as a key source of livelihood. With a per capita income of about $275, its economy is largely dependent on agricultural exports. Both coffee and

tea contribute between 70-85% of total foreign exchange earnings with coffee alone contributing approximately 40%. Following the decline in coffee prices, this contribution had dropped from 33% in 2001 to only about 24 % of the export earnings in 2002. Currently, Rwanda has about 49,000 hectares with a production of about 18,000 tons of Arabica coffee with Robustas coffee production being less than 3 percent of the total production. About 98 percent of the coffee is produced on less than a hectare with an average of about 155 trees per holding. Under the World Bank sponsored Poverty Reduction Strategy paper (PRSP), coffee is identified as an important commodity for raising foreign exchange earnings and the commercialization of Rwanda's rural economy and thus contribute towards the goals of poverty reduction

2.3.1. Situation Before Reform

51. Prior to 1990, all aspects dealing with coffee production, processing and marketing activities were the direct responsibility of the Coffee Board of Rwanda (OCIR CAFÉ) in collaboration with the Ministry of Agriculture, Animal Resources and Forestry. The Board was in charge of coffee from the farm level and ensured that farmers did proper coffee management. Farmers were provided with inputs such as fertilizers, pesticides and fungicides, scissors, secateurs, pulping machines, on credit. OCIR CAFE also provided farmers with seedlings of improved coffee varieties for establishing of new coffee plantations or replacement of old coffee tree stocks. OCIR CAFÉ in collaboration with National Research Station (ISAR), carries out research and development programs for the development of new technique for increased production and quality improvement. No other private actors existed with regard to coffee input supply. There were also no farmers' organizations that existed, since no policy existed to enhance farmers' capacity for efficient management of the coffee sub-sector. However a few farmers' co-operatives existed, but were poorly managed and were interfered with by the State. .

52. Primary coffee processing was performed at the farm level using mechanical hand pulpers, which were supplied and maintained by OCIR CAFÉ. However the Board also run the two coffee washing stations one in NKora Gisenyi and another in Masaka (Kigali rural) on commercial basis. Both the washed and unwashed coffee was collected from firms by collectors and delivered to RWANDEX, a secondary processing or hulling plant whose majority shares (51%) were owned by OCIR CAFÉ. Prior to 1994 only RWANDEX existed after which, many other companies initiated investments in the area, mostly in Kigali. In 1995 there were about 9 millers, but currently there are only five companies in operation, namely; RWANDEX, RWACOF, AGROCOFFEE, SICAF and CBC.

53. Only three coffee exporters existed in the country: OCIR CAFE, ETIRU and RWANDEX. However RWANDEX was the major coffee exporter, the other two (OCIR CAFÉ and ETIRU) were partially involved in coffee export business. OCIR CAFÉ was allowed to export up to 30% of the total national coffee production. OCIR CAFE was the major shareholder within RWANDEX, which basically exported about 90% of the Rwandan coffee. The price of coffee was fixed at the beginning of each coffee season, and farmers were paid a fixed price. The price was fixed based on the situation at the international market, as well as the costs supported by the intermediaries involved in the coffee chain.

54. The system of fixing prices by government was however costly to the government given that there had to be a certain price stabilization fund to protect the intermediaries from possible losses in case of negative variation of coffee price at the international market. The government also maintained a coffee price stabilization fund. To maintain the fund the government injected money into the fund in times of low world prices to compensate coffee exporters and therefore protecting them against losses. When prices were good, the benefits was split and shared between exporters and the price stabilization fund.

55. Officially, OCIR CAFÉ was responsible for promotion and marketing activities, but no coherent marketing program existed within the sector. There was non-contribution of the private sector to the marketing and promotion activities. OCIR CAFÉ was also responsible for the regulation of the coffee sub-sector including participation and the preparation of the coffee sector policy and strategy formulation, participation in the preparation of the coffee sub-sector's policy and strategies; Issuance of certificates of origin as well as quality; determination of the sliding scale parameters used to determine the minimum fixed price paid to coffee producers during the coffee campaigns; representation of the coffee sub-sector at the international scene in negotiation and conclusion of agreements related to the coffee industry; and the organization of coffee production and promotion campaigns.

2.3.2. Justification for Reform

56. The Government of Rwanda subscribed to Economic liberalization policy that consists of the withdrawal of the public sector from production and commercialization activities, and replacement of the same by the private sector. Due to the domination of the government, the running of the coffee industry was characterized by lack of efficiency in all the coffee activities including processing, marketing, export and promotion. Coffee processing was in a poor state because of lack of proper maintenance. This led to the deterioration in coffee quality of the coffee produced by coffee farmers. The lack of competition in coffee processing also adversely affected coffee quality and the payments to farmers. The fixing of coffee prices at the beginning of each coffee season did not give farmers enough incentives to produce high quality coffee, as the system did not reward for high quality. The maintenance of the stabilization fund also became a drain to the Treasury at a time when the government was experiencing serious fiscal constraints as more money was required to stabilize prices. Rwanda coffee was also poorly promoted in the world market because the marketing was dominated by one single semi public organization. This situation has led to a serious disincentive to smallholder coffee producers, to the extent that a significant proportion of them withdrew from the business. Thus reducing foreign exchange earning capacity from coffee. This situation was taking place against a backdrop of an unfavorable coffee trade environment at the international market where prices were constantly falling thereby necessitated the initiation of reforms of the coffee sub-sector, with the objective of increasing the incomes accruing from the coffee business.

2.3.3. Nature of Reforms

57. As a way of redressing the deteriorating coffee industry, the Rwandan Government undertook major reforms in the coffee industry in order to reorganize

the coffee organization, OCIR-CAFÉ, into an industry-based organization, and also withdrawal the active role of Government from coffee production, processing and marketing activities thereby inviting the private sector to fill the void left by the government's withdrawal. These included the withdrawal of the state from coffee production as well as commercialization activities where OCIR CAFÉ was no longer involved in coffee primary (farm gate) processing activities. Central CWS that used to belong to OCIR-CAFÉ, including Masaka and Nkora were privatized and are managed by private business people. Roles of OCIR-CAFÉ were redefined and limited to those of regulating the industry. They included participation in developing coffee sub-sector development policies and strategies, and following up their implementation, setting up coffee quality standards and issuing certificates of origin and quality, collecting and disseminating pertinent information on the coffee sub-sector; fostering good understanding between the various stakeholders in the coffee industry, collaborating with research and extension services in the coffee sub-sector; and participating and follow up negotiations and conclusion of the international agreements regarding coffee production and marketing.

58. Restructuring of OCIR-CAFÉ has been the change in the composition of the Board of Directors of OCIR-CAFÉ. The board comprises members from the private sector directly involved in the coffee sub-sector, including farmer groups (association and cooperatives), coffee processors and exporters, as well as other stake holders of the coffee industry such as banks, transporters, insurance agencies, etc.

2.3.4. Current Structure of the coffee industry

59. One of the key elements of the reform agenda is the reorganization of coffee production. Farmers, although still producing coffee at individual farms, are now being organized into associations capable of handling most of the activities that used to be provided by the public sector. Currently, there exist about 80 coffee farmers associations at different levels of evolution and organization. The farmers associations that are now taking production and processing functions from OCIR CAFÉ including the procurement of manual processing equipment as the farmers still use hand pulpers to process coffee. There are now about 15 coffee washing stations (CWS) as opposed to only two before reform. Three of the new washing stations are owned by the cooperatives. The washing stations are producing coffee to sell to the exporters or by direct export by the cooperatives themselves.

60. There currently five private sector coffee millers who also double up as up as coffee exporters. OCIR CAFÉ is no longer participating in coffee export activity, except in exceptional cases when initiating farmers associations involved in production of high quality coffee. These initiatives stem from the fact that there is a growing interest in investing in the sector for a better quality required for farmers to get good prices in international coffee markets. Premium prices are currently offered through the sale of high quality coffees through the specialty coffee and the Fair-Trade markets.

61. The local coffee market is fully liberalized. The farm gate price is no longer fixed, but is negotiated between farmers and the buyers (collector or millers) based on an indicative price weekly published by OCIR CAFÉ. The indicative coffee

prices are set every Tuesday by representatives from OCIR CAFÉ, coffee processors, representative of coffee associations/cooperatives coffee buyers and traders association. The agreed indicative price is transmitted to radio Rwanda every day of the week. The same information is dissemination through the local administration, announcements on meeting and public notices at the ward, sectors, district, provinces and coffee extension system of the ministry of agriculture.

62. With the involvement of the private sector, marketing and promotion activities are becoming more and more of a major issue in the coffee sub-sector reform agenda. Private companies involved in coffee production as well as some coffee farmers' association involved in quality coffee production are becoming more aware of the necessity to lay down aggressive and efficient marketing and promotion strategies. This is directly related to the growing feeling within the coffee sector that no better performance can be achieved unless all production and quality efforts are directed toward quality improvement. With the initiation of the reform agenda, the specialty coffee market has been more and more attractive, and more effort is now being deployed for exploring those niche markets.

2.3.5. Role of Government

63. There is still a great percentage of the reform agenda to be executed. The reason for the delay in implementing the reforms was partly due to the lack of preparation on the side of the private sector, including coffee growers, to assume responsibilities that used to be under the Government. On the other hand, there was also lack of preparation on the side of the government to properly guide the private sector into new production and quality improvement initiatives.

2.3.6. Impacts of reforms

64. Farmers complain of very low farm gate prices that are lower than the costs of coffee production. Farm-gate price for Rwanda coffee, which is about 37% of the international of or FOB price are low. Transport costs alone accounts for about 9% of the FOB. The low coffee prices to farmers are a strong disincentive to increasing production. Coffee buying by the collectors also do not reward for quality thereby further limiting the improvement of quality.

65. Although there is no empirical information available, coffee quality is said to have been declining despite the additional investments in coffee washing stations. This situation is now expected to change as the private traders gear up to improve coffee quality and thereby compete favorably in the world market. The 15 coffee washing stations will have a capacity to produce about 2,000 tons of clean coffee when they are in full operational. However, this strategy to modernize the coffee processing units should be accompanied by proper incentives to farmers to reward high quality coffee. Coffee processing costs also increased due to the low capacity utilization of the new coffee washing stations and the hulling plants. The primary and secondary coffee processing costs are high. Processing losses are also high due to low outturn ratios. High processing costs reduce the prices payable to the farmers as the farmers bear ultimately bear this additional cost.

66. Reform in the coffee sector has opened up new opportunities for marketing coffee. Currently, most of the coffee from Rwanda is exported to Western by

exporting companies which process coffee and sell to international coffee trade houses or roasters. In 2001, Rwanda sold about 12 tons of coffee in the speciality market to the Coffee Roasters in London and another 18 metric tons were sold to the United States. The coffee sold to the specialty market was certified by the *Fair Trade Labelling Organization"* based in Bonn, Germany. The organization has representatives within the region, and they visit producers to inspect whether the set standards are adhered to, before offering certificate of approval. The prices for the coffee to the speciality market fetched more. These are however only very limited quantities, and opportunities for selling additional coffee to the speciality or Fair Trade market remain largely untapped.

67. Reform of the coffee sector also led to the demise of some cooperatives as they were out competed by the private sector operators. There are new cooperatives that have been formed. Currently, it is estimated that Rwanda has about 80 cooperatives although their performance is poor. Some of the weaknesses are embezzlement of funds and mismanagement by the leadership of the associations and cooperatives. This has an overall negative impact on the coffee production and overall performance of the sub-sector. Access to coffee production and primary processing inputs together with other benefits associated with associations/cooperatives are not fully exploited, as a result of lack of information and training. It is important to note that with the recently established National Decentralization Policy, there will be improvements in the association/cooperative movement, especially, in the area of coffee extension systems, access to simple rural credits etc., which would benefit the coffee stakeholders. Most cooperatives and associations have invested in washing stations with a view to start exporting coffee particularly to the specialty and Fair trade market. However poor management and limited funds make it difficult to infiltrate this market. The need to assist the growers to make transition to higher value coffee supply chain is critical and is achievable, including the grading preference and the type of coffee is demanded in the various targets markets. By also marketing coffee directly, the cooperatives and associations reduce the coffee marketing chain. This would however require more transparency and trust by members as a necessary condition for entering into the "Fair-Trade" market.

68. The void created by the exit of OCIR CAFÉ in input supply and distribution to coffee farmers has been difficult to fill. The response by the private sector has been slow and irregular, including the producer associations and cooperatives, due to the lack of capital, the lack of inadequate information and technical knowledge on the area of input stocking. On the demand side, the use of these inputs by farmers is not yet fully developed. This sometimes creates a feeling that there is need for the government to continue intervening in the inputs market during this transition period. However, this continued presence by government is likely to stifle further the emergence of the private sector input distribution systems. It is important therefore to support and strengthen the private sector capacity and that of the associations and cooperatives and other stakeholders including input traders and stockists, as well as extension agents. Other post reform issues affecting coffee in Rwanda coffee include the lack a better price discovery mechanism such as a coffee auction an is the case in Burundi, Tanzania, Kenya and Ethiopia, lack of appropriate coffee research funding and generation of technologies to improve production and coffee quality including that of developing high yielding disease resistant varieties, lack of adequate financing for replacement of old coffee trees with the new ones and the need to undertake a coffee marketing study to advise on the way forward for the emerging processors cum exporters and new coffee washing stations.

2.4. Uganda

70. Coffee is a leading agricultural export commodity in Uganda accounting for a large proportion of the total foreign export earnings. Although its contribution has fallen from 30% to 60 % to due to the slump in world coffee prices it is a major source of foreign exchange earnings. Coffee also provides direct and indirect employment to nearly 5 million people and is also a major source of livelihood for a large proportion of the rural people in Uganda. Coffee is therefore of fundamental importance to the Ugandan economy and its social economic aspects. About 90% of the coffee produced in Uganda is of the high quality Robusta some of which is washed while the rest 10% of the total production is the Arabica type.

2.4.1. Situation Before Reform

71. Prior to 1990 all the affairs of the coffee industry in Uganda were under the responsibility of the Coffee Marketing Board (CMB). The CMB was given monopoly powers to promote, control quality, and marketing coffee. There was thus very limited participation of the private sector and Cooperatives who merely processed coffee at the primary level. However, following the embracing of the World Bank spearheaded Structural Adjustment Programs in the late 80s and early 90s; coffee industry was targeted for further reform under the Agricultural Sector Adjustment Program (ASAP). This was also a time when the government was faced with declining coffee (revenue following the suspension of the economic clause of that ensured stabilization of coffee prices.

72. The coffee industry in Uganda was therefore fully liberalized beginning 1990. The Uganda Coffee Development Authority (UCDA) took over the regulatory, promotional, and quality assurance roles replacing the CMB while the trading activities were vested in Coffee Marketing Board Limited (CMBL), a limited liability company owned by Government. Co-operative Unions and the private firms were also allowed to participate in coffee export marketing. It was then expected that with the reforms, prices payable to farmers would be made more transparent. The marketing systems would also be made more efficiency from the competition of the participating firms, which in return would improve the farm-gate price. Problems of crop financing would also be resolved as the private firms were expected to attract foreign capital for the crop financing.

2.4.2. Justification of reform

73. Like most other African government, the reasoning behind this consolidation of power was prompted by the government's need to have control over foreign exchange earnings, coffee export taxes, protection of coffee growers from unscrupulous traders and shielding them from price fluctuations. Control over foreign exchange was necessary because the local currency was overvalued in relation to the parallel market. Prior to these reforms, the coffee industry was experiencing high explicit and implicit taxes such as the coffee export tax whose rate ranged between 40 and 100%. Producers were also offered low producer price, which was a fixed 20% of the border price. The high and overvalued exchange rate also implicitly taxed the coffee farmers. The difference between the producer price and the border price formed a valuable source of revenue to

Government. Farmers were therefore paid one uniform price irrespective of the quality. The coffee pricing system therefore lacked an in-built reward/incentive to the farmers with good quality coffee. Coffee payments were usually delayed, which adversely affected farmers.

74. The central bank provided crop finance for stock management, which had inflationary tendencies and destabilized the macroeconomic environment hence necessitating keeping the producer prices low to reduce the amount of crop finance required, narrow the budget deficit and to control inflation. Marketing was inefficient and raised transaction costs, thus affecting the competitiveness of Uganda coffee on the global market. All these problems that the coffee industry was going through set the stage for further restructuring of the coffee industry to make it more responsive to the dictates of the market and to recognize the role of the private sector as the engine of growth.

2.4.3. Nature of Reform

75 Liberalization of the coffee industry entailed direct and indirect policies changes affecting the industry. Indirect policy changes entailed changes in a number of macro-economic policies among them the liberalization of foreign exchange, which allowed free flow of foreign exchange and exporters were allowed to operate foreign exchange accounts. Investors were guaranteed to repatriate profits thereby enhancing the flow of pre-finance. Road transport also was allowed to compete with Uganda Railways Corporation (URC) thereby deregulating transportation of coffee to the ports of exit; this changed the mode of export, which shifted to Free On Rail/Truck making Kampala as an in-land port as opposed to F.O.B Mombasa/Dar-Es-Salaam. This policy change greatly enhanced the inflow of foreign exchange earnings since exporters were now paid against documents in Kampala. Quick payment of export proceeds trickled down to farmers who got paid in cash besides increasing the turn around of the exporters' finances. The minimum price requirement for export coffee was done away effective March 1, 1995 and it was replaced by an indicative price. The indicative price guides the exporters in negotiation with overseas buyers. Similarly, all forms of taxes on coffee were scrapped with the last one being the coffee stabilization tax which was abolished in 1996; and export licensing was converted into export registration and the requirements for registration were simplified.

76. Within the coffee industry, the reforms involved changes in the way coffee was produced. Before reform, once the coffee was harvested and dried, it was procured by either the private buyers or the cooperatives. After processing particularly the Robusta coffee, from the cooperatives or private mills, it was then delivered to Coffee marketing Board for export grading and sale to the exporter markets.

2.4.4. Response by the Private Sector

77. Immediately following the liberalization, the private coffee exporters immediately seized the opportunity to participate in the Ugandan coffee sub sector. Within the initial six years of reform, the private sector had virtually taken over the coffee export trade in Uganda. Although in 1990/91, immediately after liberalization, CMBL a Government company, was controlling 93% of the total coffee exports,

by 1997/98 they ceased to operate (Figure 1). The number of primary private processors also increased drastically out competing the Unions and CMBL. Today virtually all the primary processing is done by the private sector.

78. The chain in the coffee export business in Uganda starts from the farmer to the coffee exporters. While the farmers in Uganda are numerous, the number of coffee exporters has been reducing with time. The coffee collectors sell coffee to merchants. The first actors are the coffee farmers, followed by the "Debe Boys" who are traders riding around the village on a bicycle and buy the coffee in metallic tins. These in turn sell the coffee to the private stores. The private stores will then sell the coffee to the primary processing factories or they may prefer to offer the coffee to be processed at a fee and then sell the coffee to the exporters so as to earn a better margin. Another major group of actors in the chain who have recently emerged are the coffee "merchants. These are traders who mobilize processed coffee from the countryside and sell it to the coffee exporters. The middlemen are either independent or field agents of the exporters. Ideally, middlemen try to ally themselves with a specific exporter and negotiate a margin with him. Because the primary processing factories are scattered, most coffee exporters prefer to employ the services of the merchants and therefore wait for coffee at their factories or stores. This enables the coffee exporters to avoid the hassle of looking for coffee at exorbitant prices.

79. In the Arabica producing part of Eastern Uganda, the Bugisu Cooperatives Union still gets some coffee from primary cooperative societies. This is due to the good relationship, which was build during the period when the Union had a monopoly in the area. The exporters are normally the people who buy and process coffee for export. Typically, exporter's field agents buy coffee and instruct the head office immediately as to the price received. The head office in turn will execute a sales agreement with a buyer based on this price information, and the quantities procured.

2.4.5. Role of Government

80. The government's interest after the liberalization of the coffee sector is represented by UCDA whose role is to regulate and supervise the entire coffee industry. They also inspect and monitor the performance of the entire coffee industry, promote Uganda's Coffee together with the Exporters Association, conduct research to improve quality and productivity and advise government on policies related to the sub-sector. Although the reform process is complete in Uganda, some issues remains outstanding. They include developing mechanism to improve coffee quality, mechanisms to reduce coffee price volatility and promotion of value addition to Uganda coffee. New mechanisms needs to evolve to shield the indigenous traders against predatory pricing by large multinational firms that could be engaging in unethical business practices. In addition, the government could support the new and emerging producer organizations particularly those that are endeavouring to sell coffee in the Fair Trade market and other specialty markets where the costs of compliance and certification may be a hindrance. Similarly, there is need to support the producer organizations and input stockist to supply the coffee inputs at the right times and with correct technical information.

81. The Coffee Wilt Disease (CWD), which has had devastating effects on coffee in Uganda and is currently hampering the effort to increase coffee production. Solutions to CWD need to be identified and shared with others in the region.

Uganda through EAFCA could also explore the development of a coffee auction and exploring the possibilities of developing a regional coffee exchange that could cater for the EAFCA countries. This would make the Eastern African region a regional hub for coffee marketing in Africa..

2.4.6. Impacts of Reforms

83. The price proportion of the Free On Truck (FOT) or Free On Rail (FOR) in Kampala getting to farmers increased drastically from 20% before liberalization to the current level of about 70%[5] of FOT. The abolition of the compulsory minimum price and its replacement with the UCDA indicative price has offered coffee exporters flexibility to transact business freely and improve on their efficiency. The period of reform has also corresponded to an increase in coffee production. The improved prices provided farmers with necessary impetus to tend well their coffee trees. Ten years before coffee industry was liberalized, Uganda produced an average of 146,658 tons. The decade after coffee liberalization saw an increase in production to 185,854 tons an increase of about 27 percent. But the increase in production could also be attributed to the replacing the old age non-productive trees with the high yielding, disease resistant coffee varieties. Due to the interest farmers showed in the crop, the government initiated a replanting program to replace the old coffee trees. The replanting program led to high demand for planting materials, which the Ministry of Agriculture could not cope with. This consequently led to immediate divestiture of government nurseries to private proprietors.

83. Coffee quality has declined on average after the reform. The high competition among buyers and lack of an inbuilt quality reward incentive for high quality coffee has contributed to a decline in the coffee quality. Farmers have responded by producing of low grades; at times some dishonest traders adulterate the good coffee through recycling with these low grades. But this average decline in coffee quality in the country overshadows the individual efforts by farmers and exporters to improve coffee quality. Some farmers have invested in processing facilities at primary and secondary levels to improve quality. Similarly, exporters have invested in export grading facilities. For example, there was only one export-grading factory with an installed capacity of 4 million bags per year, but due to increased number of exporters need arose for more facilities to the extent that currently, the export processing capacity hovers around 17 million bags.

83. Exporters are now free to choose their own method of selling coffee (private treaty, tender, etc.). Because of the free movement of hard currency in and out of the country, exporters freely bring in money; a practice that has greatly eased the perennial problem of crop finance. Crop finance, that used to be a responsibility of government is now entirely on the shoulders of the exporters with their financiers, local or foreign. Due to the high level of efficiency as a result of stiff competition, marketing and processing costs have been declining. This is confirmed through results of a random survey carried out by UCDA. During the 2000/2001 coffee seasons, coffee-processing business remained profitable for the efficient processors, despite the continued fall in world coffee prices.

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[5] Although UCDA claims that the farmers receive 70% of the FOR/T Kampala, there was no evidence to this extent. This could be the price received by either the collectors or the coffee merchants. Lack of market information about coffee prices could adversely affect the prices paid to farmers.

83. But reform of the coffee industry has increased price risks since prior to reform farmers were paid a fixed price earlier determined by government. Although the price was low, it was predictable. Reform epoch however is characterized by price volatility leading to unpredictable incomes thereby affecting planning and investments. The Ugandan government is yet to develop suitable mechanisms to reduce price risk occasioned by this price volatility.

2.5. Tanzania

85. The Tanzanian economy, like the other economies in the region, is agricultural based. Agriculture thus is the leading sector of the economy and accounts for about 51% of the GDP and 75% of the foreign exchange earnings. Apart from providing food, agriculture remains the country's main source of income, which forms 80% of its 37 million people. Smallholder farmers dominate Tanzania is agriculture with farm sizes ranging between 0.5 to 3 hectares. Coffee is therefore a very important commodity to the Tanzanian economy to an estimated 500,000 families who derive their livelihood from the commodity.

86. Coffee contributes between 15 and 17% of the total GDP and is therefore one of the key foreign exchange-earners followed closely by cashewnuts and tea. The average production of coffee from Tanzania has been 50,000 and 40,000 tons produced on about 260,000 hectares. Both Arabica and Robusta coffees are produced with Arabica accounting for about 75 percent of the total area. In terms of production, Arabica types accounts for about 60 % of the production and is mainly the high quality type. To make it play its rightful role in the economy, the coffee sector has undergone a series of reforms, aimed at particularly increasing the private participation in coffee business. This has improved competition and the performance of the sub sector.

2.5.1. Situation Before Reform

87. Prior to 1993, the coffee market was completely controlled by the state. Farmers delivered parchment coffee to primary cooperative societies and received an initial payment based on a state-mandated price, which was similar for all farmers throughout the season. Farmers also secured inputs at their primary cooperative societies which was recovered upfront upon sale of the crop. Parchment coffee was taken from cooperative societies to a coffee curing factory by the state supported cooperative union, which controlled the factory. Once it had been milled and graded, the 'clean' coffee was then delivered to the Tanzania Coffee Marketing Board (TCMB), where private exporters were allowed to purchase the coffee through an open auction. The TCMB was the only organization that could legally sell coffee or coffee inputs.

88. The TCMB purchased and distributed inputs through the cooperative unions, which extended them on credit to the cooperative societies at subsidized rates. Auction realizations were remitted to the cooperatives unions, which deducted processing costs and charges for input credit and transferred the balance to cooperative societies. The cooperative societies then made final payments to farmers to cover the difference between their initial payments and the auction realization minus costs.

2.5.2. Justification for Reform

89. The single pricing mechanism of coffee resulted in creating disincentives for high quality coffee production. Similarly, inefficiencies and poor management of the cooperative societies and unions caused delay of payments to coffee farmers, culminating into poor quality production of coffee and consistent losses and inefficiency in cooperative unions. The cooperative unions thus continued to suffer losses to the extent that farmers could not be paid for their coffee between 1989 and 1993. This resulted in financial support by government to unions to pay the farmers thereby increasing the government's budgetary deficits. TCMB was also unable to recover the the money loaned in form of farm inputs during this period. As a major foreign exchange earner, the government and its multilateral donors were concerned that this continued poor performance of the industry could adversely affect the government revenue and its budgetary provisions.

2.5.3. Nature of Reforms

90. Reforms undertaken included those that were general to the economy and others that were very specific to the coffee industry. Among wider economy wide reforms were currency devaluation and trade liberalization, elimination of subsidies in all agricultural inputs, removal of price controls and removal of all state and marketing monopolies. In the coffee industry, private companies were allowed to participate in internal coffee marketing. The private sector participated in all segment of the coffee chain from the private coffee buyer (PCB), cherry buying, coffee curing, warehousing and export. Most of the companies involved were also exporters. The private buyers established parchment-buying posts as points of purchase. The private firm's participation exhibited in all coffee chain, from production, processing, warehousing and exporting. Most of the coffee exporters were vertically integrated from procurement of cherry, in some cases estate production and primary processing (central pulperies) to the curing. In 1999/00, three export companies fully or partially owned coffee estates.

91. The Tanzania Coffee Board (TCB) replaced the TCMB and continued to operate the export auction, issue export permits and licenses for domestic trade and to monitor the industry. The TCB then became the arm of the government on all matters relating to coffee production and marketing. Input subsidy by the government was abolished and private traders, mostly coffee buyers engaged in input provision.

2.5.4. Response to the reform

92. Private traders accounted for 13% of auction deliveries in 1994, 41% in 1995, 69% in 1996. By 1996/7, private buyers of parchment coffee were responsible for 45% of coffee curing and 84% of coffee exporting. The coffee hulling capacity has increased from 75 tons before reform to 145 tons. The number of the hulling plants also has increased from three before reform. The market share of cooperatives nose-dived immediately following liberalization, from 100% before liberalization to 12.3% in 1997/98 but has since increased to about 26%

following their reorganization. The government continues to play its role through TCB, which mainly has been that of regulatory and facilitation of the coffee industry. Coffee farmers were paid promptly as there were no more payment delays to farmers as was the case with cooperatives.

2.5.5. Current Structure of the coffee industry

94. Farmers now sell their coffee through either the primary society, associations/groups[6] or directly to the private buying companies. Farmer groups through prior payment arrangements by NGOs such as Technoserve, deliver their coffee to the private cherry buyers who pay the farmers through their associations. Those selling directly to (PCB) are paid prices similar to those received by farmers selling through their associations. The farmers selling through the cooperatives also receive prices similar to those paid to other farmers who sell through their associations or to the PCBs directly. The cooperative societies when joined together they fall under cooperative unions. These are like Kilimanjaro Native Cooperative Union (KNCU), Kagera Cooperative Union (KCU) or the Bukoba Cooperative Union among others. Principally, all the primary cooperative societies are members of the cooperative unions and their relationship in the coffee chain is direct, in that coffee bought or collected is purchased by the cooperative union from where the membership originated. Other local traders can also buy coffee. These traders normally buy coffee seasonally through informal arrangements with farmers and sometimes PCBs to procure parchment coffee.

95. Coffee once purchased is sent to the private or cooperative owned hulling or curing factories. After which, coffee samples of clean coffee are taken to TCB for classification, cataloguing and auction process. Cooperatives similarly send their coffee to the auction through this process. Coffee auctions take place every Thursday of the week every month except when it is off-season. All exporters who may include some cooperatives compete through bidding process, which is done electronically by pressing of buttons. Each exporter has three button with different bidding value; 20, 40 and 100 US cents. Electronic system started last year September 2002 replacing the old system of open cry; it is more efficient and transparent, also resulted into proper records keeping. The catalogue, representing coffees stored in different warehouses is distributed with coffee samples to exporters one week before the auction. The majority of PCBs were also exporters who bought back the coffee they had purchased from farmers at the auction thereby effectively paying themselves for their coffee. This as the

[6]Farmer Groups emerged as a result of poor prices given by cooperatives and PCBs. Examples of farmers group are *Association of Kilimanjaro Speciality Coffee Growers (AKSCG), GOMATA* and others. Farmers decided to add value by curing their coffee and selling it directly to the Auction.

case for Ethiopia where the private buyers form vertical companies could undermine the auction by creating artificially high coffee prices.

96. Multinational companies export Tanzanian coffee to mainly Germany, Japan and Belgium Other countries where coffee is exported include; Italy, Finland, United Kingdom and USA. But recently some cooperative unions, such as Kilimanjaro, Dodoma and Kagera have been able to buy coffee from the auction for export mostly to the Fair Trade and Organic coffee market outlets. Last year, KNCU sold 115 containers of 18 tons of coffee, and 16 of these went to the fair trade market worldwide. Under the rules of fair trade, the producers received a minimum of $1.26 per pound of coffee, and a minimum of $1.41 per pound of certified organic coffee for all of the beans they sold to the fair trade market. This was two to three times the price received by farmers who sold their coffee directly to the PCBs.

2.5.6 Impacts of reform

97. Since the liberalization of the industry, Coffee production has remained fairly constant between 40,000 and 50,000 tons. Yields are quite low being less than 0.2 tons per hectare. Contribution by the small-scale farmers has declined while that from the large-scale farmers has improved. The decline in the coffee quality could have resulted because coffee payments do not seem to compensate for good quality. Such a system does not therefore encourage high quality coffee production. All coffee is sold at the same price, which is a major disincentive to the farmers who produce high quality coffee. The proportions of coffee in classes 1-5 have reduced while the proportion of the poorer classes of 11-13 and 14-17 have increased. This, occurring at a time when the world coffee market has been flooded with poor quality coffee, has exacerbated the decline in prices.

98. Reforms also led to the weakening of producer associations. Stiff competition by the private sector weakened cooperatives. This took place at a time when the cooperatives were themselves suffering from inefficiencies caused by poor management and political interference. However, Unions like Kilimanjaro, Kagera, and Bukoba are getting started again and are set to enter into the specialty coffee market. Currently, these organizations are getting support from local NGOs, which could further be strengthened.

99. Reform also led to the withdrawal of subsidized coffee inputs to farmers through the cooperative societies and unions. This therefore has adversely affected coffee production. Although inputs are now available through private stockists their use has been limited due to falling coffee prices especially for smallholder and generally input usage has been dramatically reduced following reforms. In 1997, the EU and Coffee Management Unit (CMU) established a scheme to enable farmers to use inputs without cash transactions. The EU assisted the first printing of Vouchers, whereby PCBs would buy vouchers equal to 20% of the parchment value expected to buy from farmers plus 5% as commission (operation) costs. When buying coffee from the farmers, the PCBs will pay money plus the voucher of which the total equal to the purchase value of coffee. Farmers would go with their vouchers to registered stockists (which are about 80) and take the item of input (only for coffee) they wanted. The stockists would then forward the vouchers back to NICVS office and get his money back.

100. Although the National Input Coffee Voucher Scheme (NICVS) does not provide credit as such the system encourages self-financing and therefore appear sustainable. The current low coffee prices, limited the coverage and amount of vouchers circulating to farmers, hence there is still low usage of inputs than expected. Farmers now receive about than 30 percent of the FOB price, which is low by the regional standards. Coffee taxes are particularly high and continue to eat into the farmers' payments. In deed, coffee taxes are highest in Tanzania compared to other countries within the region. The taxes and levies for services charged are about 21% compared to 18% in Kenya and 5.2% in Uganda. In the 2001 – 2002 coffee season for example, there were about 26 different taxes, levies and licenses imposed on the Tanzanian coffee industry. This has a great burden on the income received by farmers especially during the current low coffee prices.

101. Most multinational coffee buying companies are now trying to vertically integrate their activities to include production, processing and trading in coffee. They have therefore been establishing own coffee estate production. Therefore they are able to have multiple licenses in coffee business. This has transferred the monopoly system from the co-operatives to the international companies, which are also major players on the consumption side. As a result, the auction may not be very competitive as different actors buy back the coffee they supplied to the auction. Poor management of cooperatives unions has affected their market share in the auction, which has dropped, although it has started to pick up again. The local trading companies also lack a sound financial base and are undercut by the multinationals making them exit from the coffee trade.

102. The coffee auctions are also characterized by high market concentration as a result of very few active dealers. Although, for example, TCB has registered about 40 dealers, only 20 renewed their registration in the 2002/2003 periods. And of the twenty that renewed their licenses during this period, only five were active throughout the season that traded with over 90 percent of the crop. Efforts by the cooperative unions to differentiate coffee by branding and appellation by coffee growing areas for trading in the Fair Trade and specialty market is commendable. However, volumes exported are limited. The bulk market still dominates the coffee market.

103. In recognition of the need to change the coffee marketing system to incorporate sale of coffee outside the auction—direct sales to the specialty market-- while also maintaining the auction as a price discovery and maintain a competitive environment, the Tanzania government enacted the Coffee Act 2001 and related rules and regulations. In the new legislation, the government has established a two tie coffee marketing system in which high quality coffee could be sold to the specialty market directly without going through the auction system. However, coffees, which do not meet the criteria of specialty, or the coffees intended for the specialty market but fails to get a buyer, could be sold in the auction as a last resort Coffee sold directly outside the auction must however meet certain conditions as spelt out in the rules, which are that:

- Coffee produced shall possess quality standards that are higher than those of similar types or grades of coffee sold at the auction;
- Coffee sold directly shall fetch higher prices than those normally obtained at the auction for similar types or grades of coffee;
- Exporters of coffee to the specialty market shall be required to pay all relevant fees to the Board;

- Producers wishing to sell outside the auction shall be required to register annual production and sales estimates with the Board before commencement of coffee season and;
- An application for direct export license is accompanied with relevant proof, indicating the applicant's qualification for exemption.

103. The anticipated changes in the way coffee is marketed in Tanzania is challenging to the industry and demands a lot of preparation before it can successfully be implemented and enforced. Heavy investment in terms of human resources and others will have to be made to facilitate the enforcement of the law and monitoring for compliance. It also requires for this system to assist particularly small-scale producers, are encouraged to form groups that will emphasize on quality and high yield production. These groups will also be trained to manage themselves and access services such as extension to make it economical, efficient and cost effective. Under the old marketing system, private buyers will be allowed to buy coffee from individual and group of farmers in the village. But with the introduction of direct sales, farmers could choose to sell to buyers as was the case before or could integrate production and marketing through respective producer groups. The act if implemented, could lead to payments of high prices to farmers and therefore improve quality and quantity of coffee produced in Tanzania.

2.6. Kenya

103. Kenya like all the other Eastern African countries is basically an agricultural economy with agriculture contributing about 25 % of its GDP. About 80 % of the population of its 30 million people live in the rural areas and derive their livelihoods directly from agriculture. With a per capita income of at $ 368 and secular decline its economic growth in the last decade; Kenya's agriculture must spur the much-needed growth if the country is to meet its many challenges such as providing enough food for the population, employment and foreign exchange earnings. Coffee accounts for about 10% of total export earnings. Although coffee earnings have dropped from about $ 200 million in 1996/97 to a mere$ 80 million in 2001/2002 following the decline in production and the prevailing low world coffee prices, it is important to the economy due to foreign exchange earning potential. Coffee is now ranked fourth, in terms of foreign exchange earnings, after tea, horticulture, and tourism. Nevertheless, coffee is still a major source of income to many rural households in Kenya.

104. The rural based small-scale producer's account for 70% percent of the total coffee area and about 55 percent of the total production. It is estimated that about 700,000 growers, both smallholder and estates, are engaged in coffee production. Nearly one-half a million workers are directly employed in the coffee plantations, pulping stations and mills during peak season. Being a small-scale dominated crop, coffee production ensures an equitable distribution of income particularly to the large number of small-scale producers and improving the quality of life in rural areas. In the last 15 years, coffee production has declined from about 130,000 tons to about 50,000 tons, thereby adversely affecting rural incomes, employments, food security and overall agricultural growth.

2.6.1. Situation Before reform

105. The coffee industry has undergone a slow and sometimes controversial reform since the beginning of the 90s. Prior to these changes, the small-scale farmers delivered coffee cherry to a pulping factory owned by a cooperative society in which the farmers were registered members. Smallholder coffee was thus collectively processed, bagged, and transported to Kenya Planters Co-operative Union (KPCU) [7]stores. A coffee cooperative society has one or more coffee factories. The main role of the society is to supervise the operations of member factories. Expenditure by the societies was charged to the coffee factories depending on the volume of coffee processed. The large-scale growers have their own pulping factories and delivered coffee after primary processing to the KPCU for milling. KPCU milled about 90 percent of the Kenya coffee before the reforms.

106. Coffee after milling was passed on to the Coffee Board of Kenya (CBK), a government parastatal whose sole function was to market coffee on behalf of farmers. Other functions of CBK included providing technical advisory service on crop husbandry, and inspectorate services, warehousing, licensing of planters and millers, pre-financing of coffee before sales, payments to producers, and coffee research and development under the Coffee Research Foundation. CBK also undertook coffee promotion and maintained a liaison office in London for this function. CBK activities were financed through a variable levy on coffee proceeds that ranged between 1 and 3 percent of the coffee gross income. But in addition to the levy, the Board deducted expenses from the farmer's proceeds for the marketing activities.

107. CBK also classified all the coffee and prepared a farmer's out-turn statement which indicated the quality classification. Coffee was also graded on the basis of the bean size. The liquoring and classification samples were then passed on to the Kenya Coffee Auctions Limited (KCA), a brokerage and subsidiary of the Coffee Board of Kenya to facilitate the preparation of catalogues for the coffee auction. KCA also was the sole monopoly auctioneer of the coffee. Sale samples of each lot of coffee were passed on to licensed coffee dealers about 10 days before the date of the auction so that the dealers could prepare for the auction.

108. All the coffee was sold in a central auction in Nairobi, which was held weekly throughout the year. At the auctions, coffee was offered at a reserve price that was pegged to prices at the New York coffee market. After adjusting for quality, 15 to 20 percent was loaded to the New York prices. The rules followed in the auction were set by an organization of coffee traders called Mild Coffee Trade Associations of Eastern Africa (MCTA). KCA called out coffee lots on the catalogue and coffee dealers competed against each other bidding for the best prices. The auctions therefore were run and managed by the Coffee Board of Kenya. After the purchase of coffee at the auction, payments were made to CBK after which the coffee would be ready for export. Co-operative societies paid farmers after deducting various costs incurred such as the handling, processing and management costs by the co-operative societies and factories. CBK in addition would deduct marketing and handling expenses, taxes and levies and handling costs it incurred on behalf of farmers.

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[7] KPCU is owned and managed by coffee farmers both large and small and is charged with coffee milling, handling payments and sometimes providing farmers with inputs and recently became one of the four licensed marketing agents

109. The cooperative societies having realized the need to gain economies of scale from their operations amalgamated to form district level cooperative unions. The initial objectives of the union was to coordinate coffee movement from affiliated societies by organizing pooled transport on behalf of the cooperative societies, supply bulk farm inputs and organize credit facilities to the farmers. Through their respective cooperative societies the unions employ centrally the cooperative society management staff, maintain the societies' books of accounts, provide extension, education and training of farmers in collaboration with the Ministries of Agriculture and Cooperative Development.

110. Coffee was grown under strict regulations as the Coffee Act gave the government extensive control of all aspects of the coffee industry. The Ministry of Agriculture, through the Coffee Board of Kenya would gazette production areas, provided technical and infrastructure support to coffee farmers, and farmers had to seek authority to uproot coffee trees. The coffee reform discourse thus needed to realign the coffee industry with the rest of the economy because coffee sector was lagging behind in the reforms promoted in most sectors. At the marketing level, the CBK was granted monopoly-marketing powers and being the organization that also was in charge of regulating the sub sector, the arrangement had entrenched complacency and conflict of interests.

2.6.2 The reform Process

111. The first movement towards reforms in the coffee industry was the introduction of sale of coffee in US dollars. Farmers were also allowed to maintain foreign currency accounts and trade in the same in the then fledgling foreign exchange markets. Also introduced at this time was an alternative payment system, the "direct payment system". The prevailing payment system at that time was based on a "pool system". Farmers received an evened-out price, paid in instalments, for a given quality standard, irrespective of the actual realization at the auction. Under the direct system, however, farmers or co-operatives receive their payment, less statutory deductions, as soon as the buyers had paid for their coffee. The pool system had the inherent problems of delays and cross-subsidization amongst farmers. In retrospect the switch to the new system hardly benefited the smallholders as pooling is still necessary at the co-operative society level. In 1993, the *defacto* milling monopoly enjoyed by the Kenya Planters Co-operative Union (KPCU) was removed following the licensing of four new commercial millers. Another reform measure was to reduce the licensable threshold for coffee estates from 10 acres to 5 acres.

112. In 2001, the government initiated further reforms aimed restructuring the coffee industry to allow for separation of the marketing, regulatory and research functions. Other changes introduced included the licensing of marketing agents and other participants to take over the marketing functions previously undertaken by the Coffee Board of Kenya, reinforcing the central auction as the preferred mode coffee sales, establishment of a Coffee Development Fund, placing the management of the Nairobi Coffee Exchange (NCE) under a new entity the Kenya Coffee Producers and Traders Association (KCPTA). From the foregoing it is clear that most of the reforms efforts in Kenya's coffee have all along been fixated on the marketing functions formerly undertaken by CBK. It appears that there was an assumption that once the marketing problem was fixed, prices would improve and farmers would be motivated to resume

production. A further expectation was that apex market operators would develop backward integration strategies to support production and reduce transaction costs.

2.6.3 Situation after reform

113. Owing to mismanagement of cooperatives, the number of small estates has increased rapidly over the last five years. Most of these estates have set up low capacity motorized and hand-operated pulping units. Poor governance and high communal debts in the co-operatives have also fuelled the growth of the small estates. The exit of high performing farmers from the co-operatives coupled with generally low productivity amongst smallholders has resulted into low capacity utilization in coffee co-operatives. This in turn led to the spiralling of operational costs in the coffee co-operatives. At the secondary processing level, milling is the key activity and is usually integrated with other functions e.g. transportation and warehousing. Milling involves hulling of parchment followed by polishing, sorting and grading. Currently there are four licensed commercial coffee millers. Under the Coffee Act (2002), the millers may also render extension or other services to the growers at a fee or credit by hypothecating coffee directly or through cooperatives. The average national milling capacity utilization since 1999 has been 45% of installed capacity. Milling capacity is expected to increase due to on going upgrading of regional mills owned by KPCU and also due to construction of new mills as attested by the increased number of applicants seeking milling licenses. The effect of this on transaction costs cannot be ascertained at the moment.

114. All the coffee is still being sold in a centralized coffee auction at the Nairobi Coffee Exchange. One of the merits of the system is to enhance price discovery due to its public nature and concentration of demand and supply. However, questions are being asked as to the prudence of taking all coffees through the system. For instance, the handling costs of the lower-end coffees appear to be far higher than what they fetch at the auction. The modernization of the auction appears to have been just a technological epoch rather than a marketing strategy to capture more value and reduce transaction costs. The products on offer at the auction have remained essentially the same. While this may be partly explained by the limitations of the existing legislation, there has also been lack of marketing innovation. For instance, Kenya has so far no framework to auction of value added and specialty coffees e.g. organic, estate and fair-traded coffees. This has stifled production initiatives for these types of coffee, despite being some of the fastest growing coffee market niches.

2.6.4. Response by private sector

115. The process of reform raised expectations among the various private sector players in the industry. There was great anticipation that the reforms would open up more business opportunities as well as improve returns to investment. The level of response to reforms by various participants have been mixed. The greatest interest from private sector has been exhibited in regard to the marketing functions. The invitation of applications to engage in the businesses of marketing agents, coffee dealer, auctioneers, roasters, and packers elicited close to 200 responses. The processing of these licenses has however been

characterized by suspicion and inordinate delays. To date only interim marketing agents have been licensed.

2.6.4. Role of government

116. The role of the government roles are now restricted to policy and industry regulation. They are carried out by the CBK, a statutory body that has been vested with some specific functions. These include registration of growers and intermediaries, monitoring coffee quality, coffee information management, representing the government internationally, arbitration, and advising on policy issues in the industry. The reforms not outstanding, several activities need to be addressed. Some have been affected by the slow implementation phase, while others were not provided for in the policy and the legal framework. Some of these issues include licensing of marketing agents, opening up of alternative marketing channels, activation of the Coffee Development Fund, a production financing mechanism and restructuring of debt problem in the co-operative sector.

2.6.5. Impacts of Reforms

117. The net effect of the initial reform measures was largely positive. The changes in the exchange rates policy removed implicit taxation on farmers on account of currency over-valuation. Farmers also could access foreign currency. However, the move also increased farmers' risk exposure to exchange rate movements. Liberalization of milling did not however lower the milling charges. The milling capacity increased by 65% against a backdrop of declining coffee production. This resulted in a fierce competition for market share amongst millers and antagonism in co-operative societies leading to split of co-operative societies into small often-unviable units. The phenomenal growth in the number of small estates affected the cooperatives as more of their better members left to process coffee on their own.

118. Coffee production has fallen from a high of 130,00 tons in 1987/88 to a low of 548,000 metric tonnes IN 2002/2003 with average yields at between 0.2 and 0.6 metric tonnes per hectare for smallholder and estates respectively. An interesting aspect of the production trend is that in 200/2001, the estate sector overtook the smallholder sector, for the first time in nearly 35 years. The decline in coffee production could be attributed to many factors including the fall in world prices and the poor weather conditions.

119. It is difficult to assess the impacts of reform on coffee quality particularly for a case like in Kenya where the exporters subject coffee to further processing after purchasing it at the auction. However, the overall situation is that the quality has slightly declined. In the cooperative sector, the proportion of the top class 1-3 has declined from 22 to 16 % of the total coffee produced by the cooperatives. Correspondingly, the proportion of the lower quality classes of 4-6 and 7-10 have increased slightly from 59% to 70 % . But because the quality of coffee in the estates has not changed, the overall change in coffee quality has been minimal.

120. The farmer's margin as a proportion of the Fob price increased slightly after reform from about 58% of the Fob to about 63% although this improvement was not felt by farmers due to the declining coffee prices in the world coffee market. Reforms are still continuing and it may therefore be premature to make a definite assessment on the effects of reform on marketing costs. Nevertheless, previous reforms did not significantly reduce the marketing costs. In milling, for instance, the licensing of more millers did not lead to a reduction in milling costs.

121. Reforms in the coffee sector also had impacts on key producer organizations in coffee the Co-operative societies. These institutions were weakened by the reform as they were subjected to stiff competition from the privates sector. They also were characterised by poor management. Following liberalisation of the sector and failure to realign their businesses, most of these organisations have become redundant. Cooperatives are also suffering from a high level of indebtedness. In total coffee co-operatives owe the Co-operative Bank of Kenya around US $ 85 MILLION (Ksh 6.4 billion) arising from Second Coffee Improvement Program (SCIP I1) loans of which around US $ 7 million (Ksh 550 million is termed as bad debts). In addition co-operatives owe another US $ 145 million (Ksh 1.1 billion) arising from SCIP I project, debts that date back to 1989.

122. The other effects of reform have been availability of farm inputs. The inputs sector was among the first to be liberalized in early 1990 and this had a major impact on their cost and availability. The liberalization of the inputs sector attracted more private sector participants and therefore improving access by farmers. However, prices of most inputs have been on an upward spiral in the last decade. For instance the price of fertilizers has increased by over 500 percent between 1994 and 2001.

123. The rural savings and credit co-operative societies (SACCO's) are the most important financial institutions in coffee: SACCO's were formed as autonomous organizations to provide financial services to farmers. However, due to a weak regulatory framework under the Co-operatives Act, governance problems have started creeping into these hitherto efficient institutions. The weakening of the cooperatives also reduced access to credit by farmers.

124. The other effects of reform have been an increase in market concentration in coffee marketing. At the auction close to 70 dealers are licensed. However, buying activity is concentrated only amongst a few. Out of the 53 active dealers, 10 associated firms share more than two thirds of the market, while the remaining 43 shared the rest. Six of the firms are associated though trading under separate identities. The rest of the dealers are unable to participate actively and regularly in coffee trade mainly due to financial constraints. Local coffee roasters also participate in the auction where they buy raw coffee for further processing. However their market share is only around 5% and has been declining. Of interest is the significant representation of the world's leading roasters and traders through subsidiaries or financing deals. There also has been a lot of talk about a cartel existing at the auction that fixes coffee prices to ensure that farmers are paid very low proceeds while the same coffee is subs3equnrtly sold outside the auction fetching 10 times the FOB price thereby undermining the principles of the auctions.

125. All the Kenya coffee is sold at the auction as one homogenous product that is differentiated by taste and grades only. Unlike other coffee growers like Columbia, Kenya has not branded its coffee. It has however been shown that

branding of coffee and promoting these brands in the world market particularly in the specialty market have improved prices. Lack of differentiation limits the marketing of Kenya coffee by the varying taste characteristics with different appeals to different groups of consumers.

126. Most of the coffee from Kenya is exported to mainly to the Western Europe dominated by Germany, United Kingdom and the Scandinavian countries either directly to international coffee roasters or through dealers who in turn process the coffee and sell to processing companies and international coffee houses. This market is suffering from oversupply of low quality coffee and therefore declining prices. The niche markets are at the same time growing and offering premiums for good quality coffee. Furthermore coffees sold in some of the niche markets such as shade and organic coffee offer added advantages to smallholder farmers with small farm sizes as they encourage multi-cropping systems. Coffee farmers in Kenya and in particular smallholder farmers produce high quality coffee that qualifies to enter these emerging niche markets. Nevertheless, Kenya as a country lacks a comprehensive coffee production and marketing strategy that is geared towards these markets. But coffee from the participating co-operatives has somehow been given preference by coffee buyers who target the specialty markets in USA and EU.

127. The role of coffee marketing agents has received the most attention from industry stakeholders and is the key subject of the on-going reforms. The performance of the marketing agents could shape the future of the industry and influence grower decisions. Marketing agents are expected to manage sales logistics such as transport to central warehouses, classification, auction schedules, deduction of levies and payments to growers. There are fears that overall transaction costs may actually go up.

128. Although the case for opening up other marketing outlets besides the auctions has been in the back banner it has not been entirely rested. There is increasing appreciation of the fact that coffee sales in Kenya are purely spot markets (auction), with a reserve price set as differential to prevailing futures prices. To avoid misappropriations of the farmer's money, the marketing agents are required to get huge bank guarantees as a fall back position in case of default. The facilitation from the banks is likely to raise the transaction costs. It is therefore proposed that that coffee should instead operate a Central Depository Unit (CDU) owned and managed by the marketing agents, the auctioneers and brokers, the farmer and trader associations, financial institutions and others. These institutions and other service providers would operate under irrevocable instructions from farmers and other agents to manage the CDU. These are only proposals to the government. There also are proposals to convert the current Nairobi Coffee auctions into a regional Coffee Exchange though again this is only at the proposal stage only.

129. Despite the enactment of the enactment and implementation of the new coffee Act, 2001, little has so far been achieved in improving the coffee productivity and incomes. Issues such as whether the new legislation adequately addresses the emerging national and international challenges in the coffee sub-sector have also become important and necessary to address. The new government through the Economic Recovery Strategy Paper for Wealth and Employment Creation for 2003-2007 has also recognized the need to reverse the downward trends in the coffee industry as a way of revitalizing the agricultural sector, thereby creating the much needed jobs in the rural areas as promised in its

manifesto. In view of these concerns, the government appointed a Task Force on Coffee Marketing in June 2003 to address the issue of reviving the coffee industry. The Task Force's mandate is to review the current position of the industry's development policies. It would also propose measures of expanding and improving production, value adding funding and marketing, review the functions of the Coffee Board of Kenya, audit the coffee Act 2001 to identify the legal constraints and propose the necessary amendments. The Task Force was also expected to make recommendations on the way forward to effect the institutional and structural reforms in coffee sub-sector as provided for in the National Rainbow Coalition (NARC) manifesto to empower the stakeholders (Build up/strength model from the grass-root level similar to that in the Tea industry). The Task Force is expected to produce a report before the end of September 2003. Relevant amendments to the Coffee Act 2001 will then be made before end of the year. It is expectations that the Task Force will also consider introducing an alternative coffee marketing, as this has been the trend in most auctions based coffee production systems.

CHAPTER 3

3.0 Coffee Market Liberalization In EAFCA Countries

3.1 Coffee Industry Reforms

130. Coffee markets in all the six EAFCA countries have been liberalized since the beginning of the 90s. In general, liberalization involved moving away from government controlled marketing system to one that is largely dominated by the private sector participants. The pace of reform among these countries has varied. Uganda, Tanzania and Rwanda and to some extent Ethiopia have fully opened up all stages of coffee production, processing and marketing to the private sector. However there is still some degree of government or government related institutions participating in some commercial activities such as coffee marketing and production in Kenya and Burundi. In Kenya for example, coffee marketing was removed from the Coffee Board of Kenya – a semi government organization -- and was passed on to three coffee millers one of which though is a farmer owned organization that still government controlled. Non milling private sector coffee marketing agents who have qualified to market coffee according to the new coffee regulations have not been allowed to market coffee.

131. In Burundi, the government owned Coffee Board of Burundi (OCIBU) is still involved in running some coffee washing stations (SOGESTALS). OCIBU also owns and runs a coffee roasting plant in total competition with the private sector and continues to provide coffee farmers with pesticides and fungicides on credit in competition with the up coming input stockists. OCIBU also runs a fleet of trucks that collect coffee from farms, an activity that is inefficiently managed and is therefore expensive to coffee farmers. It is also true that both Kenya and Burundi were also the last countries to liberalize coffee marketing with most of the changes taking place after year 2000. Whereas in the mid 90s had liberalized the coffee marketing, Kenya and Burundi governments were still in control of coffee marketing even by 2002. Combining the commercial and regulatory roles by these boards has caused a conflict of interests on the part of the boards. The processes of reform by these late reformers have also been characterized by controversies and interim arrangements that could have led to further distortion coffee marketing, thereby adversely affecting coffee production and quality. Table 3 shows the regulatory functions that are undertaken by the semi government regulatory bodies. Burundi and Rwanda continue to pursue some commercial functions such as providing or guaranteeing credit to the producers, operating processing units and providing transport of coffee from the farm to the washing stations.

Table 3. Activities of regulatory Bodies after reform

Activity	Ethiopia CTA	Uganda UCDA	Kenya CBK	Burundi OCIBU	Rwanda OCIR CAFE	Tanzania TCB
Training	+	+		+	+	
Research Support	+	+		+		+
Managing auctions	+		+	+		+
Coffee statistics	+	+	+	+	+	+
Legislation/licensing	+	+	+	+	+	+
Liquoring services	+	+	+	+	+	+
Promotion	+	+	+	+	+	+
Export Certification	+	+	+	+	+	+
Coffee Policies	+	+	+	+	+	
Pres-shipment inspection	+	+	+	+	+	+
Establishing [8]nurseries	+	+		+	+	+
Extension	+			+	+	+
Arbitration	+	+	+	+	+	+
Proving inputs to farmers					+	+
Processing coffee						+
Providing credit				+	+	+

Source: Author's compilation

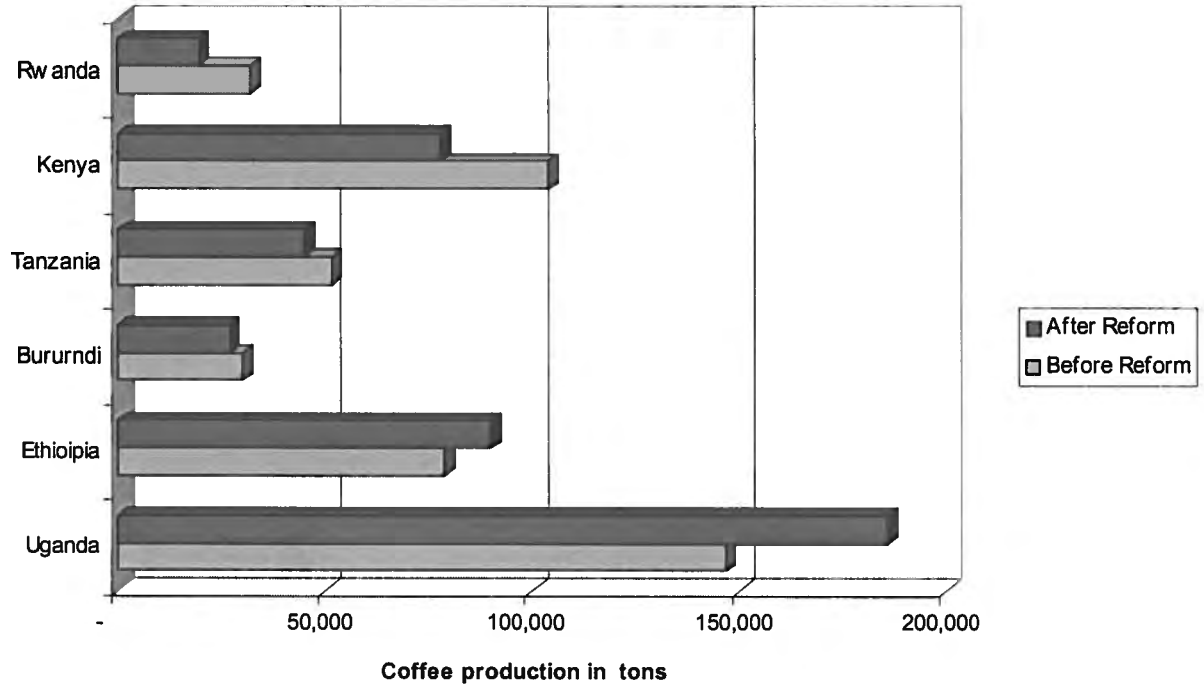
3.2. Impacts of Reform

3.2.12. Coffee Production

131. Changes in coffee production in the six EAFCA countries over the period of reform have not been uniform. Even in areas where the production has changed, not all the changes could be attributed fully to reforms. Other important factors that influence the production include coffee prices to producers, weather, economic and political stability of each country, availability of credit and agricultural inputs, and the profitability of coffee vis-a -vis other enterprises. It is particularly noticeable that gains of reforms could have been eroded by the rapid fall in coffee prices that has characterized coffee marketing in the last decade Nevertheless, changes in coffee production over the last ten are a response to a series of incentives provided for by the liberalization process. Coffee production in Uganda has increased by about 21% over the last 10 years. Similarly, the periods of reform has corresponded with a 12% increase in coffee production in Ethiopia. The rest of the four countries have recorded a drop in coffee production during the period of reform. Kenya and Rwanda have the largest drop in production. The increase in production in Uganda could be attributed primarily to better payments to farmers higher growers returns and prompt coffee payments. In case of Kenya, the continued domination of coffee marketing by the government agent the CBK and lack of private sector participation in coffee marketing have adversely affected payments and hence the coffee production.

[8] UCDA no longer establish nurseries any more. All coffee nurseries are now privatised although over the last three years in an effort to support farmers whose coffee was wiped out by the Coffee Wilt Disease, UCDA has paid privatise nursery operators to supply coffee farmers with new planting materials

Figure 1. Coffee Production Before and After Reform



132. Market liberalization has increased competition throughout the marketing chain thus raising prices the farmers receive from coffee buyers in addition to getting prompt payments for their crop in cash. Before liberalization farmers had to wait for long periods sometimes as long as a year before they could receive their payments. Initially, farmers were paid high prices as the private operators competed for a larger share of the market but these prices were artificially high and could therefore be impossible to sustain.

3.2.12. Inputs distribution

133. Prior to reforms in the agricultural sectors and more particularly the coffee industry, supply of farm inputs like fertilizers fungicides and pesticides was the responsibility of the coffee marketing boards. These boards controlled both the distribution and pricing. Inputs in some cases were also heavily subsidized. In Burundi for example, OCIBU supplied farmers with inputs and farm implements and deducted the costs from coffee sales upfront before paying the farmers. OCIR CAFÉ and TCB were also responsible for procuring inputs on behalf of farmers in Rwanda and Tanzania, respectively. In Kenya, however, the distribution of inputs was in the hands of the private sector and the cooperative societies and unions. Distribution networks were established according to demand. In the main production areas, a number of stockists competed for business of inputs supply. Reforms in countries where the inputs were supplied by the marketing boards have therefore affected availability and access to farm inputs. Removal of subsidies raised the price of the inputs thereby contributing to reduction in their use. Some stockists and associations supported by NGOs responded to the reform in the input market and are now supplying inputs to farmers. However these stockists lack sufficient capital and the relevant

knowledge on input supply. These emerging private sector initiatives in input supply thus require support to understand the business of input supply, acquire necessary knowledge and capital in order to make the input supply business reliable.

3.2.12. Access to the Niche Market

134. This study has also revealed that most of the coffee from the EAFCA region is sold mainly to the mainstream international trading and roasting companies. Only small quantities of coffee is trade-in the niche or the specialty markets. In Ethiopia for example sold about 483 tons of coffee to the Fair trade markets through the cooperative unions out of total exports of about 120,000 tons. Similar, Rwanda sold 12 tons of coffee to Union Roasters of London and 18 tons to Jacksonville of the United Stated out of about 18,000 tons exported. The mainstream coffee market is suffering from oversupply of low coffee quality and therefore declining prices. In contrast, the niche markets are expanding although demanding high quality coffee. The niche market is therefore an escape route for farmers and regions that would like to break out from the low price low quality trap. Furthermore coffees sold in some of the niche markets such as shade and organic coffee offer added advantages to smallholder farmers with small farm sizes as they encourage multi-cropping systems. Whereas it is appreciated that the niche market is small and with limited demand while also becoming very competitive, it could benefit the coffee farmers who are gearing up to produce high quality coffee. It therefore is potential lifeline for many producers as the market commits to pay farmers a fair price, which covers costs and is stable. Access to the niche market is however limited because of requirements such that demand to be met such as those that guarantee that coffee is produced under certain social and environmental conditions that reflects the international labor organization requirements. It also requires that the coffee qualifying for the niche market particularly the fair-trade and organic and shade coffee is certified by an internationally recognized organization and has met standards of organizations such as the Fair-trade Labeling Organizations International (FLO).

3.2.12. Coffee Branding and Appellations

135. The other constraint that has limited the farmers from this region to benefit from the niche markets is that despite production of the high quality coffee, these countries have not branded their coffees by either their countries or the specific regions where coffee is being produced. These countries therefore have been unable to develop a name in the niche market unlike other coffee producing countries like India, Jamaica and Columbia. There is therefore need to target this premium end of the market by identifying the different coffee qualities that exists in the region, branding these coffee, certifying the brands, supporting farmers or farmers groups in the production and marketing of this kind of coffee. The region as a block producing about 500, 000 tons and with a potential to guarantee about 1million tons of high quality mainly Arabica and some Robusta coffee has the ability to deliver a consistent quality, ensure reliability of exporters and honoring contracts and also deliver coffee to the niche market at a competitive price.

136. Coffee branding could further be facilitated by an appellation system that regulates how regional names are used to define individual brands. The appellation name is

made known to the consumers due to the recognition of the area name, which comes about through quality differentiation by the producers. Regions of origin and authenticity are what sets apart coffee as unique and distinctive. It is this uniqueness and distinctiveness that attracts consumers and better coffee process for an appellation. For the appellation system to be effective, it must be organized and administered and enforced by a government agency that ensure that the production levels match the description of the brand and is presented and promoted as a distinct brand. Government in the EAFCA countries should therefore be encouraged to take up coffee appellations as a way of adding value to the coffee from the region.

3.2.12. Market Concentration

137. It is recognized that liberalization has created an element of competition and efficiency in the entire marketing chain, leading to a progressive increase in farm-gate prices, a drastic reduction in processing costs and free entry and exit in and out of the industry. The competition though initially recording a high increase in companies trading in coffee, most of these have been unable to actively participate in the markets leaving only a few large ones to dominate the market. In Uganda, for example, the total number of exporters progressively increased to a maximum of 117 in 1994/95 before falling to the current level of 28 in 2000/01 (Table 4). However, the competition eroded the market shares of CMBL and Union of Export Services (UNEX) for the cooperatives. Even within the private exporter category there was concentration whereby the top 5 took around 60% of the market. In Kenya, more than 50 percent of coffee trade is controlled by less than 15 percent of the active coffee dealers. In Tanzania, the trade is dominated by a few large multinationals that purchase coffee directly from farmers and also participates in the auction. Local companies though registered; as dealers have therefore been unable to effectively compete in the coffee market.

Table 4. Market Concentration

			Market Concentration	
Country	**Number registered**	**Number active**	**Companies : No:**	**Market shares %**
Burundi	20	15	5:60%	3:85% 16:85%
Ethiopia	200	64	10	70
Kenya	70	53	15	65
Rwanda	15	4	3	85
Tanzania	na	na	Na	Na
Uganda	28	28	16	85

Source: Author's compilation from various country reports

3.2.12. Lack of product differentiation

131. Liberalization of the coffee industry could also have contributed to a decline in coffee quality. This could have been the case particularly the time following

liberalization. Liberalization led to the stiff competition among coffee buyers. This could have created market for poor quality coffee thus resulting in mass purchase of coffee. Markets for dry coffee instead of green coffee also was created thereby leading to an increase in the number of dry beans as farmers strip picked the coffee trees. Farmers mixed the poor and good coffee thus compromising coffee quality further. Coffee payments systems also have not been based on clear coffee standards or grades. Lack of clear incentives to compensate for quality usually results in lack of investment in production of quality coffee. Even where standards exist like in the case of Kenya, the regulatory authorities have been unable to enforce them because of lack of producers' interest. In Uganda for instance, liberalization attracted many internal market dealers who did not have sufficient product knowledge, thus leading to quality deterioration. The responsibility of drying coffee is gradually shifting from farmers to processors/exporters due to stiff competition in the internal market. This could lead to an increase in the level of Ochratoxin A (OTA), a toxic substance to humans. The large number of players in the market in relation to a limited crop led to deterioration of coffee quality due to mass purchases from the farms.

132. The cutthroat competition in the internal market and the excitement among farmers for the prompt cash resulted in deterioration of coffee quality immediately after liberalization. In addition, some unscrupulous coffee dealers literally mixing the clean coffee beans with extraneous matter in order to cheat on weight; and they also adulterate the high premium Bugisu arabica with washed arabica (Wugar) from Paidha. In Tanzania, coffee quality at the farm gate has been compromised due to the scrambling for quantity by mixing all coffees bought regardless of quality. This is mainly due to the scramble for quantity by buyers. Kenya has a distinct coffee classification and grading system that should provide incentives to pay for quality. This system of coffee classification has served the farmers well and has also helped to maintain the unique character of Kenya's coffee in the world market. However, the systems have best served the large estate farms who are paid for the quality they produce, but not the individual small-scale producers who market through the cooperative societies. The cooperative farmers are forced to pool their quality at the factory level thus depriving them of system that could adequately compensate for quality coffee production at the individual producer's level. There is therefore, need to carry out studies that could identify how returns from high quality coffee could be sustained. Lack of clear incentive systems for high quality coffee production could have compromised the premiums enjoyed by Kenya coffee in the recent past.

3.2.12. Lack of sustainable financing arrangements

133. The initial liberalization process was characterized by serious liquidity problems on the part of producers and the local private and cooperative traders. This inhibited effective competition in the market thus resulting into the market concentration discussed above. Liberalization resulted in the dismantling of commodity marketing boards, which used to provide input credit to small producers. This decline or lack of input finance has lead to reduced coffee production, reduced yields, reduced quality control, reduced investment in the sector and reduced income for small producers. Most of the banks which went into the sector to cover the gap left by the Marketing Boards lost money because there was no system of collecting loans advanced to small producers. Similarly,

local commercial banks which are meant to facilitate trade by provision of crop finance, charge very high interest rates that have become prohibitive to commodity trading. The high interest rates arise out of lack of knowledge about the commodity they finance and low credit rating on part of the players. In Tanzania and some parts of Uganda, the cooperatives were unable to continue providing farmers with input credit because the recovery built in producer price that was centrally marketed broke down when they were allowed to sell directly. In Kenya, although liberalization has not allowed direct purchase of the crop at the farm gate thus maintaining the interlocking system of input credit with coffee marketing, the liberalization process weakened the cooperatives thereby rendering them vulnerable and less positioned to continue providing the producers with inputs, a role they used to play previously very efficiently and effectively.

3.2.12. Price volatility

134. Liberalization entailed the removal of fixed prices by coffee marketing boards. This exposed the actors in the coffee value chain to the vagaries of the volatile international price movements. Even though fixed prices for the growers in a non-liberalized (regulated) system were usually a lower percentage of the international sales or export price, the growers and other players in the marketing chain at least knew the magnitude of the risk they faced and could work their business costing accordingly. However, deregulation of prices caused huge financial losses to the private sector and it has greatly affected their investment decisions. The worst hit category is the internal middle market-chain trader who became directly exposed to the risks of price fluctuations. This class of traders either speculate or trade back-to-back whereby coffee is sold as is purchased from growers with no risk management techniques employed. The exporters too, are also affected by the volatility but are usually aware of the market trends because of having access to information and risk management skills. Compared with the internal traders, the exporters are much more placed to handle risks than farmers and other chain traders. In case of Uganda, the UCDA in conjunction with other sub sector associations has continuously provided the various industry players with training in risk management techniques. Uganda and Tanzania have also supported the establishment of a warehouse receipt system through which small traders can raise the required quantities for hedging. In Kenya, the Nairobi Coffee Exchange has acted as a price discovery mechanism that have mitigated the price risks. Plans are now underway to transform the Exchange into a fully-fledged Commodity Exchange, which would then encourage hedging against risk and sale of coffee in the futures markets. In Ethiopia and Burundi, the price discovery has also been attained through coffee auctions. It is only in Rwanda where no active price discovery system exists. The requirements in that coffee must be sold at the auction and not directly to exporters implies that domestic traders are subject to all price risks between the time of purchase from farmer and its sale at the auction.

3.2.12. Producer Associations

135. Due to the high political influence and domination of cooperatives in most coffee producing countries in Africa, reform also implied changing the way the cooperatives operated to make them more commercially oriented and more

effectively represent the interests of their members. This however implied opening up the producer organizations to competition from the private sector and removal of the protection that these organizations enjoyed during the control era. The producer associations have therefore been unable to cope with the challenges facing the farmers in a liberalized environment thereby rendering them vulnerable and less positioned to play their roles efficiently and effectively. Lack of training and preparedness by cooperatives also weakened the cooperatives further because the process of reform was normally poorly sequenced and led to the loss of domestic protection and inadequate legal reforms to back the political reforms and to some extent the dishonesty in cooperatives' leadership. The collapse of some of these organizations has resulted in loss of money by the producers such as in the collapse of the Cooperative Bank of Uganda and the cooperative unions in Kenya and Tanzania. Extremely high levels of non-performing loans that have crippled their activities also characterize the organizations. They are also unable to mobilize rural savings and transform them into investments. In Tanzania, the cooperative market share of coffee fell from 100 % prior to the reform to about 26% in 2001. In Ethiopia, the market share by the cooperative societies and unions also dropped. They no longer distributed basic goods to their members like they used to do before reform. They also have discontinued providing short-term credit to their members. It is only now that the four unions are repositioning themselves to start trading and exporting coffee. Rwanda and Burundi have however experienced an increase in the number of producer organizations, mainly cooperatives. These are, however, still very small and are poorly managed thus making them start on a rather shaky ground. The challenge is therefore how to strengthen these organizations and make them remain member controlled so that they provide credit, extension, market information, marketing and other coffee production services to their members.

3.2.12. Taxation in Coffee

136. Coffee traditionally has provided governments with easy source of tax revenue. The tax levels however determine the proportion of the coffee price that is paid to growers. The higher the tax, the lower the price that farmers receive. Prior to reform most EAFCA countries had high implicit and explicit taxes in coffee. Following the reform process however, these taxes such as the export tax were removed and implicit ones were made more explicit. Currently, coffee tax types and rates vary by countries. According to a study by Technoserve on coffee taxation in Tanzania in 2001, the tax rate for coffee in Tanzania 2001/2002 was 21% of the farm gate prices compared to 18.7% in Kenya, 5.2 % in Uganda and 4.2% in Ethiopia. The study therefore shows that the taxation rate has therefore remained high in Tanzania despite having fallen slightly by 3% from 24% to 21% between the 19996/97 and the 2001/2002. Out of the tax, only about 37.2 percent of the taxed fund is reinvested back into the coffee industry in Tanzania, whereas about 95.7% of the tax funds in Kenya is reinvested back in form of coffee research, promotion, improvement of infrastructure and extension services. Evidence from other countries show that changes in structure of taxes and its reduction does lead to transfer of a higher proportion of price to farmers which could have a supply response of high quality coffee particularly when coffee prices are falling like has been the case recently. The lost tax revenue arising from the reduction in the tax rate in coffee could therefore be compensated by the increase in production. This has also resulted in the widening of the tax base in other areas. There are proposals to reduce taxes in

coffee particularly that which is not reinvested back to coffee. Framers could also be involved in making decisions in those investments done on their behalf by either the coffee authorities, central and regional governments.

3.2.12. Increasing Costs of Production

137. Liberalization could also have resulted in a increase in the production costs following the removal of input subsidies by states. In Uganda and Tanzania, farm inputs like fertilizers and pesticides were subsidized. The cost of production faced by farmers thus was lower. But liberalization meant that such services were withdrawn and the farmers now must meet all the production costs. However, in Kenya, the input may not have been subsidized, cooperatives used to enjoy special privileges in allocation of foreign exchange for input importation. Farmers also could access free extension service from government. With the liberalization of the coffee industry, indications are that the producers will have to finance their extension services, which definitely will increase the production costs.

3.2.12. Sustainable Research Funding

138. Funding of coffee research in most of the EAFCA countries has been the responsibility of governments and is conducted through the National Research Systems (NARS). Under this arrangement coffee research is given same priority with the other agricultural commodities. Funding under these arrangements has been inadequate and unsustainable. In the case of Kenya, coffee research is conducted outside KARI by a coffee research institute, the Coffee Research Foundation (CRF) financed by coffee farmers through a levy. In Tanzania, the coffee industry is about to establish a new research institute - Tanzania Coffee Research Institute (TACRI). The fund source will be from deductions from coffee sales. In Uganda, there are proposals now to have Kituza Coffee Research Station be financed directly by the coffee industry using a levy. But this form of funding has suffered particularly at times when the coffee prices are falling. The coffee research institutes must also link directly with the private sector in order to tap more additional funds that could finance collaborative research projects. The Research funds raised from farmer's levies have also been inadequate for research activities particularly when coffee prices are falling. Governments must therefore support the research activity to augments the support from farmers in order to make the research sustainable.

CHAPTER 4

4.0 Emerging Opportunities

This chapter summarizes the key findings of this study and suggests areas that EAFCA could explore to intervene in order to raise the quality of coffee in this region.

4.1 Coffee Industry Reforms

139. This study reveals countries that have been successful in the liberalization process are those that fully opened their coffee industries to the private sector participation. However those countries that pursued a slow and non-sequenced, non monitored process have not fully attained the desired effect in terms of improved coffee production, coffee payments and a reduction in transaction costs. Countries that have gone through a successful liberalization process also are those that prepared the liberalization process in advance because this removed the uncertainty involved in the process and thereby enabled the emergence of new institutions that ensured a continuity of provision of services in the liberalized markets. Reforms have also worked well when the role of government in the post reform era has been that is targeted to improve the responsiveness by the private sector. The role therefore has been facilitative rather than to hinder or compete with the operations of the private sector. The major role has been that of regulating and monitoring the marketing environment. Following these potential benefits from complete reform in coffee industries, EAFAC should use the information on the differences between these sets of countries to advocate for further reform of coffee in the region.

4.2 Potential for High Quality Coffee Production

139. The East African region has the potential to produce high quality coffee that creates its special niche in the world market. With the supply glut of coffee in the market, quality rather than quantity will dictate coffee prices more. Uganda is for example renown for the production of high quality dry and washed Robusta coffee and still has tremendous potential existing to increase its proportion of the washed Robusta. It also produces high quality Arabica. Kenya is well known for the production of high quality washed Arabica that have consistently earned the country premiums above the average Colombian mild washed Arabica of anywhere between 15 and 20 percent. This high quality coffee is mainly used for blending the poorer coffees. There is potential to increase the proportion of the fine coffee in this market and thus tap the existing market potential for the high quality coffee in the world market. EAFCA should therefore embark on improving coffee for sale in the niche markets by assisting the individual countries to identify the rarity value of coffee and establish its background history, brand it by origin, certify it and support farmers to produce it. For the fair and organic market, EAFCA should explore how it could assist in coffee certification through working with organizations such as the Fair-trade Labelling organizations international.

140. Producers will also have to ensure that they consistently provide high quality coffee to the niche market. There is thus need to increase awareness of quality in a consistent manner across the entire marketing chain. EAFCA thus could ensure that it embarks on increasing the quality awareness through increased training of coffee liquorers, traders and exporters. In particular, EAFCA could embark on a regional sensitisation on OTA, which could threaten the coffee market in the region if not well managed. EAFCA's participation could also involve the training of more liquoring or cupping experts in each member country and introduction of cross-country sharing of experiences. EAFCA could also spearhead the establishment of system that could reward farmers for producing better quality coffee. Coffee traders could then use the reward system to pay coffee farmers for differentiated coffee quality.

4.3 Auction and Direct Coffee Sales

141. Kenya, Ethiopia, Burundi and Ethiopia are the four of the EAFCA countries that have adopted coffee auctions as their main coffee marketing strategies since coffee marketing reform began in early 90s. These countries however have now to contend with the need to balance the merits and demerits of coffee auction at a time when directly coffee sales particularly to the speciality markets become more attractive and offer better prices. That the auctions have enhanced the value of coffee countries where it is used cannot be overemphasized. Many countries are however experiencing the shortcomings of auctions systems particularly in their inability to provide for risk management thereby increasing risks for producers and suppliers. In other cases auctions have been seen not discourage other innovative marketing systems such as that in the Niche markets and more so in the Fair Trade Market. As a result, several countries are now introducing other marketing systems while still retaining the auction system. There is no doubt that this balancing system could be very delicate and will require skilful planning and monitoring if the systems will augment rather than compete with each other. EAFCA could play an important role is monitoring the implementation of the alternative coffee marketing systems in Kenya, Tanzania and Burundi and the introduction of Forward Sales in the Ethiopian Auction systems. By keeping an eye on these systems, a better and controlled implementation system could benefit the producers if the two systems work well. This could also provide enough lessons for other EAFCA countries without an auction system but could be willing to introduce one is use and existsing one in the region.

4.4 Producer Associations

142. The study also reveals that most producer organizations become weaker when coffee marketing was liberalized and have been unable to compete favourable with the private sector. This has created a big gap in the provisions of services such as processing, provision of credit, market information transportation and marketing. In some countries, reform has caused the emergence of a number of industry-related groups/associations sprung up to advocate for the rights of their members. These include Coffee Farmers Association, Coffee Processors Association, and Coffee Trade Federation. Some of these producer associations may not be doing well for various reasons, the region has a potential of using the past experience to form efficient producer associations that will serve as

vehicles through which services to producers would be channelled in order to reduce their transaction costs. EAFCA should therefore support this emerging producer organization in order to strengthen their operations. It should identify those that are working well with a view to making the poor performing organizations learn from the strong ones. This includes assisting them acquire the necessary technical, managerial and financial capacity.

4.5 Price Risks Mitigation

143. The region has wide past experience in trading of coffee in auctions that have lead to price discovery thereby providing price guidelines to producers and traders. In some countries, the coffee auction has the potential of being transformed to an Exchange and has the capacity of making it a regional fully-fledged commodity Exchange. Four out of the six EAFCA members have coffee auctions some of which could be linked into a regional commodity exchange. These auctions therefore have the capacity of being transform into a regional commodity exchange that could provide a mechanism of price mitigation through hedging mechanisms and the introduction of futures in the trading floor. Within the potential of trading close to 1 million bags of coffee, the region could become an important price reference point for Africa and other coffee producing countries outside Africa. EAFCA could therefore explore the possibilities of transforming these coffee auctions into a commodity exchange.

4.5 Input Distribution

132. Reforms in countries where the inputs were supplied by the marketing boards have affected availability and access farm inputs. But to fill the void left by these semi government organizations, some stockists who are now supplying inputs to farmers. However these stockists lack sufficient capital and the relevant knowledge on input supply. These emerging private sector initiatives in input supply thus require support to understand the business of input supply, acquire necessary knowledge and capital in order to make the input supply business reliable. EAFCA could establish a training program for the input distributors in order to build the relevant knowledge on the input marketing including making them a source of technical information to the farmers on input use.

4.6 Structured Finance For Traders and Producers

144. The high cost of money for trading has literally forced many would be local entrepreneurs out of business, thus the apparent concentration evident in the industry. The region however has the potential to increase the liquidity of producers and traders and encourage competition amongst the traders through the introduction of the Warehousing Receipt Facilities. This is structured systems warehouse finance for exporters and traders. The system allows owners of stock in the warehouse to use it as collateral in accessing loans from financial institutions. A more legalized and regulated secure structure of warehouse receipt financing within the country could encourage the banking sector to bring in cheaper, may be even $ based financing from abroad. There is an ongoing project currently been undertaken in Tanzania and Uganda on ware housing financed by the Common Fund for Commodities (CFC) that started with the exporters but will also benefit players further down the chain at a later stage. This mechanism once tried in these countries could be used in

others to encourage small-scale producers and overcome trade concentration. EAFCA could therefore establish a mechanisms those countries that are not participating in the CFC funded Warehousing project could learn from those countries within EAFCA that are currently participating. This includes establishment of an enabling legal and regulatory environment and the establishment of institutions that could licence and inspect the ware housing facilities.

145. There is also the case for promoting domestic coffee production and value addition in the region. In most of the countries except Ethiopia, less than 5% is consumed locally. Local consumption is an important aspect especially in times of low prices. It is also one way of creating more employment and value addition.

CHAPTER 5

5.0 Proposed Interventions by EAFCA

146. This study has shown how important it is to approach coffee marketing at a regional level under the banner of EAFCA as a way of augmenting the strategies being implemented in each individual country. Within the potential of trading close to one million bags of coffee, the region could become an important price reference point for Africa and other coffee producing countries. To achieve this, EAFCA should utilize the emerging challenges and opportunities in production, processing and marketing of coffee in the eastern African region. The following are suggested areas that EAFCA could consider for intervention:

147. In view of the fact that different countries are in different stages of liberalizing their coffee sub sectors, EAFCA should use the information on the impacts on reform from these differences to advocate for further reform of coffee in the region by organizing policy forums for policy makers in the region.

148. Different countries have adopted different methods of marketing coffee. Countries that have maintained coffee auction systems are all in the process of modifying the marketing systems to allow selling directly to the speciality market and others. Some countries are also incorporating forward sales in the auction as a way to manage risks. A balance must however be maintained between the direct sales and the auction to avoid undermine the price discovery mechanism through the auctions. EAFCA should therefore assist individual countries to monitor the implementation of the alternative coffee marketing systems.

149. Due to the increasing importance of the speciality market and likely increase in competition buy the participants in this market, EAFCA should assist countries wanting to sell their coffee to the speciality market by linking them up with the buyers either directly or through various regional speciality associations.

150. EAFCA should also explore the possibilities of transforming the country specific coffee auctions into one regional coffee exchange with possibilities of forward selling and hedging for price and foreign exchange fluctuations. EAFCA could also become a labelling organization in the region for coffees that require certification for qualification in the Ethical and Fair Trade Coffee markets.

151. In view of the weakness identified in input distribution following the reform in input markets in the region, EAFCA should establish a training program for the input distributors in the region to build the relevant knowledge on the input marketing to the upcoming private sector operators. EAFCA could also encourage associations in input distributors in each country and in the region. In collaboration with the East and Central Africa Programme for Policy Analysis (ECAPAPA), EAFCA should advocate for harmonization of policies in inputs like fertilizer and planting materials to enhance free trade of inputs including the coffee planting materials in the region.

152. To improve the liquidity of coffee buyers, traders and exporters in the region, EAFCA should engage in the establishment of warehousing receipts scheme in collaboration with the Common Fund for commodities. The scheme, which is being tried in a few countries, should be expanded to other EAFCA members. EAFCA's role could include its promotion and advocating for creating of enabling legal and regulatory environment and the creation of institutions that could licence and inspect the ware housing facilities.

153. Producer organizations in the region are either weak or are lacking. EAFCA could therefore consider spearheading the establishment of an incentive system that could reward producer organizations that assists farmers in producing better quality coffee.

154. The region has been slow in branding its coffees for entry into the speciality market and other market niches. EAFCA should therefore assist member countries to brand their coffee to target this premium end of the market. By identifying the different coffee qualities that exists in the region, branding these coffee, certifying the brands, supporting farmers or farmers groups in the production and marketing of this kind of coffee EAFCA achieve the promotion of coffee in the region.

155. To facilitate branding of coffee, EAFCA could in conjunction with individual government in each countries and the coffee producers engage in appellation of coffee in the region. The association must however embark on a sensitisation and advocacy program with Government in the region to encourage them take up coffee appellations as a way of adding value to the coffee from the region.

156. Except in Ethiopia, coffee Consumption in EAFCA countries is low. EAFCA in collaboration with the private sector operators and the regulatory coffee agencies in the region could therefore embark on a coffee consumption campaign in the region.