



International Coffee Organization
Organización Internacional del Café
Organização Internacional do Café
Organisation Internationale du Café

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Projects/Common Fund

Executive Board
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Project proposal

Coffee price risk management in Eastern and Southern Africa (Ethiopia, Kenya, Tanzania, Uganda and Zimbabwe)

Background

1. This project proposal is a follow-up to the coffee market development and trade promotion project in Eastern and Southern Africa that has just started and to the work carried out by the International Task Force on Risk Management coordinated by the World Bank. This document contains an outline for a new project designed to establish a coffee price risk management system in Eastern and Southern Africa to assist farmers in accessing commodity price insurance and to exploit the synergies between the two projects.
2. The Executive Board approved this project in principle in September 2000 (see document WP-Board No. 884/00).
3. The present document is an outline of the full proposal submitted for consideration by the Consultative Committee of the Common Fund for Commodities (CFC) at its meeting in January 2001.

Action

The Executive Board is requested to take note of this project outline.

I. PROJECT SUMMARY

The International Coffee Organization (ICO) has submitted the following project proposal with its recommendation for financing through the First Account Net Earnings of the Common Fund for Commodities (CFC). The proposal was approved by the Executive Board of the International Coffee Organization on 26 September 2000 following the recommendation of the Executive Director of the International Coffee Organization.

Project title:	Coffee price risk management in Eastern and Southern Africa
Duration:	Three years
Location:	Ethiopia, Kenya, Tanzania, Uganda, and Zimbabwe
Nature of the project:	Price risk management instruments for small scale farmers
Estimated total cost:	US\$1,829,142
Financing from the Fund:	Grant: US\$1,829,142
Counterpart contribution:	In kind contribution
Project Executing Agency:	United Nations Office for Project Services (UNOPS)
Supervisory body:	International Coffee Organization (ICO)
Collaborating institutions:	Ethiopia: Coffee and Tea Authority Ethiopian Coffee Exporters' Association Kenya: Coffee Board of Kenya Uganda: Uganda Coffee Development Authority Uganda Coffee Trade Federation Tanzania: Tanzania Coffee Board Tanzania Coffee Association Zimbabwe: Coffee Mills (Grain Marketing Board) Agricultural Commodity Exchange

**Objective and scope
of the project:**

The central objective of the project is to provide a suitable and sustainable price risk management scheme to reduce the exposure of coffee farmers to fluctuations in world market prices and secure better incomes from coffee growing. The project will promote their access to risk management instruments, and will address two types of price risk including the price risk for the farmer during the period before he can harvest and sell, and the price risk for the local exporter for the period between buying and selling. Although the first type of risk is the main focus of the project, addressing the second one could, however, have a positive impact on the incomes of farmers and is, therefore, also largely covered in the project.

Estimated starting date: January 2001

II. PROJECT BACKGROUND

1. For numerous developing countries coffee exports constitute a substantial source of foreign currency earnings and represent a large proportion of the tax receipts and gross domestic product. Fluctuations in production and prices are thus one of the major concerns of these economies that are highly dependent on coffee.

2. For more than a decade, the structure of the majority of the world's commodity markets has pursued a radical new approach, characterized by the almost complete disappearance of supply and demand intervention mechanisms. In fact farmers producing primary commodities in developing countries were in many cases protected against price fluctuations in world markets.

3. In the coffee sector, these changes have resulted in a direct and full exposure of farmers, exporters and the country itself to the fluctuations of prices in the world market. The countries concerned are therefore forced to redouble their efforts to adapt to the changing and unstable economic environment. A mastery of the new techniques of risk management would therefore improve sales transactions and conditions.

4. It was in this context that the World Bank, after consultations with many stakeholders, convened an International Task Force (ITF) on commodity risk management in developing countries to explore new, market-based approaches to assist developing countries better manage their vulnerability to commodity price fluctuations.

II.1 The relation of the proposed project to the objectives and policies of the Common Fund's First Account Net Earning initiative

5. The project has been designed to assist farmers and local exporters to access price risk management tools to reduce their risk exposure through appropriate intermediation. The results of the proposed pilot project will not only assist the five participating countries but also the other coffee-producing developing countries in Africa to function more effectively in a liberalized global economy.

6. The policy, in particular its micro-policy aspects, will focus on operational measures to strengthen farmers' institutions, including human resource development, and expand the agricultural credit system, so that the foundations will be laid for more effective production and marketing of coffee in the future.

II.2 Consistency of the project with ICO strategy for coffee development

7. In its development strategy (document EB-3531/95 Rev. 2) the ICO recognizes that with the transition in many exporting countries to liberalized coffee sectors care is needed to ensure that the benefits of increased market flexibility are not jeopardized by the elimination of necessary functions undertaken by the marketing boards and similar regulatory bodies.

8. The proposed project includes concrete actions that need to be taken to achieve these core objectives of the long-term coffee development strategy.

III. RELATED PROJECTS AND PREVIOUS WORK

9. The present project comes as a follow-up to the "Coffee market development and trade promotion in Eastern and Southern Africa" project covering Uganda, Tanzania and Zimbabwe. This project identified clearly that market risks (technical and price risks) were a consequence of underlying constraints that had first to be addressed before introducing standard price risk management involving the application of futures trading. These constraints included the availability of trade and pre-export finance, quality assurance and consistency, the policy and legal framework, etc.

10. The above-mentioned project tries to address these constraints and includes components that may prove very useful in their implementation to the present project and include:

- promotion of a privately run warehouse system and establishment of a collateralizable warehouse receipt system;
- development of a basic market information system for coffee production and marketing;
- development of coffee quality assurance and certification system.

11. These are the preconditions or prerequisite of establishing some of the envisaged instruments of price insurance such as commodity exchanges. The synergy between the two projects is consequently evident.

IV. Project Logical framework

12. Estimated starting date: 01/2001 - Estimated completion date: 12/ 2003 - Date of this summary: 12/2000.

Narrative summary	Verifiable indicators	Means of verification	Assumptions
<p>Broad goal Reduction of the exposure of coffee farmers and small buyers to world price fluctuations, therefore, better security of income from coffee production</p>	<ul style="list-style-type: none"> - awareness of cooperatives, farmers, local banks and exporters; - an increase in per capita income; 	<ul style="list-style-type: none"> - number of farmers and cooperatives engaged in these schemes - volume and number of transactions under the schemes 	<ul style="list-style-type: none"> - Existence of real interest by co-operatives and farmers in reducing prices instability; - Government maintains supportive policy, legal and regulatory framework.
<p>Specific objectives - test suitable price risk management systems in different environments - facilitate access to credit for farmers - develop proper instruments with a market based approach to reduce price instability for coffee farmers; - develop awareness of risk management tools; - disseminate experience learned in other producing countries</p>	<ul style="list-style-type: none"> - prices received by farmers under the scheme compared to prices without the scheme and management decisions taken by them during crop year; - use of the scheme as credit support by banks; - improvement in the marketing chain (fluidity and transparency); - existence and quality of instruments such as warehouse, etc; - other producing countries implementing similar model. 	<ul style="list-style-type: none"> - data bank on farmers (prices, use of inputs, income) - commercial banks reports; data from farmers associations; - data on instruments (warehouses, commodity exchanges) - monitor enquiries and follow up actions of other exporting countries for similar instruments 	<ul style="list-style-type: none"> - Farmers are willing to use the schemes and their cooperatives are capable to do so; - Farmers' price volatility makes the strategy attractive; - Model proves to be economically sustainable
<p>Outputs - report on existing marketing chain; - price risk management schemes with appropriate instruments suitable for farmers and small buyers, exporters, etc ; - practical training of participating banks, farmers, cooperatives, exporters.</p>	<ul style="list-style-type: none"> - participants for test case; - systems for contract compliance designed and instruments put in place (exchanges , warehouse); - price volatility with and without the project; - staff and suppliers of services capable of handling the use of price risk management instruments 	<ul style="list-style-type: none"> - detailed survey on the impact of the project; - bank statistics and put up instruments statistics; - government statistics; - farmers survey 	<ul style="list-style-type: none"> - Instruments promoted through the "coffee market development and trade promotion in Eastern and Southern Africa" project put in place or decided upon; - Project becoming fully operational;
<p>Inputs and activities - carry out baseline survey to identify users, providers and existing instruments such as warehouses; - set up instruments, contracts, schemes according to cases; - carry out training programs for participants;</p>	<ul style="list-style-type: none"> - Component 1: - Component 2: - Component 3: - Component 4: 	<ul style="list-style-type: none"> - PEA progress reports - Project evaluation 	<ul style="list-style-type: none"> - Availability of funds for monitoring and for purchasing inputs disbursed in time; - Governments remain committed to promote farmer's standard of living - PEA and collaborating institutions co-ordinate and execute the project efficiently and effectively.