ICO/CFC STUDY OF
MARKETING AND TRADING POLICIES AND SYSTEMS
IN SELECTED COFFEE PRODUCING COUNTRIES

COUNTRY PROFILE

MADAGASCAR

COMMON FUND FOR COMMODITIES INTERNATIONAL COFFEE ORGANIZATION THE WORLD BANK

The experience gleamed from this and eight other country studies has been incorporated into an overall project review published by the Common Fund for Commodities (CFC): Study on marketing and trading policies and systems in selected coffee producing countries. Amsterdam, 2000. CFC Technical Paper No. 3.

Sponsoring Agency:
International Coffee Organization
22 Berners Street
London W1P 4DD
England
Tel: (0044 20) 7580 8591
Fax: (0044 20) 7580 6129

Principal Funding Agency:
Common Fund for Commodities
Willemshuis
Stadhouderskade 55
1072 AB Amsterdam
The Netherlands
Tel: (0031 20) 664 6409
Fax: (0031 20) 676 0231

Principal Executing Agency:
The World Bank
1818 H Street N.W.
Washington D.C. 20433
United States of America
Tel: (001 202) 477 1234
Fax: (001 202) 477 6391

Principal Consultants:
LMC International Ltd.
14 - 16 George Street
Oxford OX1 2AF
England
Tel: (0044) 1865 791737
Fax: (0044) 1865 791739

LMC INTERNATIONAL

ICO/CFC Study of Marketing and Trading Policies and Systems in Selected Coffee Producing Countries: MADAGASCAR COUNTRY PROFILE

Principal Executing Agency: The World Bank

LMC International Ltd
14-16 George Street
Oxford OX1 2AF
England
Tel: +44 1865 791737
Fax: +44 1865 791739

LMC International Ltd
1841 Broadway
New York, NY 10023
USA
Tel: +1 (212) 586-2427
Fax: +1 (212) 397-4756

CFS 5105
March 2000

Table of Contents

List of Tables

List of Diagrams

Executive Summary: Madagascar

BACKGROUND

From the early 1970s, coffee prices and marketing were controlled by the *Caisse de Commercialisation et de Stabilisation des Prix du Café, de la Vanille et du Girofle* (CAVAGI). CAVAGI negotiated all overseas export contracts and instructed one of five state owned exporters to export coffee on its behalf. (Prior to 1975, these exporters were private French commercial firms, but in 1975 they were nationalised.) The grower price and all marketing margins were fixed before the start of the crop year in a *barème.* The difference between the export price in the *barème* and the actual export price was either paid to CAVAGI, when it was positive, or re-imbursed to exporters, when it was negative. In practice, the export price set in the *barème* was considerably below the actual export price and the resulting payments from exporters to the stabilisation fund formed an important part of government revenues.

In October 1988, the coffee sector was liberalised along with all the other major export crops. The only coffee specific measure accompanying the liberalisation process was the establishment of a *Comité National de Commercialisation du Café* (CNCC). The CNCC was primarily established because International Coffee Agreement (ICA) export quotas were still in force and a structure was needed to supervise their allocation and use. Following liberalisation, and with the ending of the ICA quotas, the coffee sector has effectively been left to its own devices.

THE REFORMS

Apart from the considerable upheavals in the international coffee market itself, the reform process must be seen against the background of an industry which had already been severely weakened with over-aged trees, very low yields and very poor infrastructure. In addition, political and social unrest in the early 1990s were followed by four years of economic mismanagement which aborted all planned post-liberalisation follow-up activities.

Following liberalisation, marketing costs have been reduced as inflated costs included in the *barème* have largely been squeezed out of the system, while banking, transport and shipping services have become much more efficient. Furthermore, the level of taxation has fallen. However, growers in inaccessible areas reportedly receive as little as half (or even less) of what growers along reasonably passable roads can obtain. With higher international prices between 1994 and 1996, grower prices rose above sustainable levels as a large number of buyers competed for any available supply. Subsequently, many have withdrawn from exporting and grower prices have returned to more realistic levels. In December 1998, exporters were paying collectors about 90% of the available f.o.b. value (after deduction of taxes), with growers in reasonably accessible areas receiving between 60% and 70% of the f.o.b. value and those in inaccessible areas obtaining not more than 40% to 50% of the f.o.b. value.

Following liberalisation, a number of groups entered the export business and the number of exporters rose from five to 35. These firms included the old, existing firms, larger collectors, operators from outside the coffee industry and speculators. Since 1996, the industry has contracted somewhat and the export trade is now dominated by a small number (between five and ten) of primarily locally based firms, most with strong links with international, and especially French, trade houses.

The inherent quality of Madagascar robusta is good and in the past the coffee ranked amongst the world's primary robustas and was prized for its good body and relatively smooth liquor. However, the crop's inherent quality had deteriorated and liberalisation has not arrested this decline. At export level, the preparation of Malagasy coffee is poor and variable. In particular, the moisture content is too high, especially at the beginning of the season. Internal traders buy coffee almost irrespective of its moisture content and most exporters accept it to maintain their relationship with the traders. The drying which does take place is usually on the ground or on the roadside which contaminates the beans and results in unpleasant off-flavours.

The coffee sector's ability to reap the benefits of the liberalisation of Madagascar's economic structure has been hampered by a macroeconomic climate which, until 1994 was unstable. Also, sharply falling international prices in the early 1990s meant that production became increasingly unprofitable for small farmers and many switched to more profitable food crops. However, efforts to reduce the budget deficit, lower interest rates and depreciation of the exchange rate have combined since 1994 to improve the sector's competitiveness. Unfortunately, conditions within the sector itself have remained largely unchanged in that the area planted to coffee continues to reduce. There has been no or very little investment in the infrastructure in the main producing areas. Poor road conditions limit the ability of many farmers to benefit fully from the higher proportion of the f.o.b. price which liberalisation has brought to those in easily accessible areas.

Another explanation for the lack of investment since liberalisation is that by the late 1980s the industry had degenerated so much that it had become unrealistic to expect a positive reaction to the price incentive which liberalisation appeared to bring. The coffee industry was, and continues to be, demoralised, it is driven purely by ad hoc events, and certainly, at the farm level, it does not benefit from any strategic planning. With the disappearance of CAVAGI, the industry broke up into its different constituents: growers have no representation at all whether formal or informal; collectors have informal representation; and exporters are formally represented by the CNCC. The CNCC, however, has a very limited mandate but could have played a more positive role if, from its inception, its membership had not been dominated by state firms.

Similarly, the services that CAVAGI rendered to the industry were also dissolved following liberalisation and the provision of supporting services remains poor. The specialist coffee extension service ceased in 1990 and was replaced by a "general specialist" Ministry of Agriculture service. The service is over-centralised with little field impact as current funding is low. Feeder roads remain poor, effective research advice and assistance are not available, new planting material is not being distributed and inputs have been subjected to import duties and value added taxes.

Since liberalisation, the government's coffee policy can be described as one of benign neglect with most efforts in agriculture directed towards promoting food crops (especially rice) and achieving food self sufficiency.

Madagascar

INTRODUCTION

Madagascar is primarily a producer of robusta coffee and an example of a *caisse de stabilisation* type of marketing system prior to liberalisation. Madagascar liberalised its coffee market in 1988 and was one of the first producing countries to do so.

Unlike in many producing countries, the liberalisation measures were not specifically aimed at the coffee sector but at all exports crops. The only coffee specific measure accompanying the liberalisation process was the establishment of an organisation to allocate ICA export quotas as they were still in force. Consequently, the coffee sector has effectively been left to its own devices since liberalisation and the sector has not been considered a government priority.

The Madagascar profile firstly provides an overview of the Madagascar coffee sector and the macroeconomic setting under which the marketing system operates. The profile then details the supporting services that are provided to the farmer and how the provision of these services has changed with liberalisation. The marketing system, both before and following liberalisation, is then described and the effects of the changes to the marketing system on pricing policy, regulation, crop finance, risk management, taxation and institutions are then discussed. Finally, the reforms are evaluated by examining changes to grower prices, quality and production. As discussed in the profile, apart from the considerable upheavals in the international coffee market itself, the reform process must be seen against the background of an industry which had already been severely weakened with over-aged trees, (very) low yields and very poor infrastructure. In addition, political and social unrest in the early 1990s were followed by four years of economic mismanagement which aborted all planned post-liberalisation follow-up activities.

OVERVIEW

Trends in Coffee Production and Exports

Production

Madagascar is primarily a robusta producer (around 98% of production). Some very small quantities of arabica are grown in the highlands and modest efforts are being made to expand its production. Production averaged 1.1 million bags during the 1980s but has fallen to below 1 million bags in the 1990s. However, production estimates are difficult to assess as during the 1980s the then Ministry of Agriculture (*Ministère de l'Agriculture et de la Réforme Agraire* (MPARA)) based its estimates on a cherry count per tree in selected areas (to determine the yield per hectare) and multiplied this by the national area assumed to be planted to coffee. Past production statistics were therefore not based on actuality and should be seen more as indicators of production potential. This still occurs today and there is considerable discrepancy between official crop estimates and those of the trade. Using actual exports as a basis for calculation of production suggests that actual production was around 50,000 tonnes (0.8 million bags) in 1997/98 (i.e. exports plus 8% to 10% rejects (sold locally) and shrinkage and local consumption). Prior to liberalisation, domestic consumption was estimated at around 4,000 tonnes, including 1,000 tonnes of arabica. An EU financed study in 1995 estimated a "reasonable" level of domestic consumption at 1.5 kgs per capita (or 20,000 tonnes), although trade sources consider this improbable.

Production of only 0.6 million bags in 1993/94 was due to cyclone damage which also reduced the planted area. The fall in production in the 1990s has been due to a combination of factors including adverse macroeconomic conditions, low producer prices (which have seen farmers increasing the production of food crops at the expense of cash crops) and an ageing tree profile (Table 1).

Diagram 1: Madagascar — Coffee Production and Grower Prices, 1979/80-1997/98

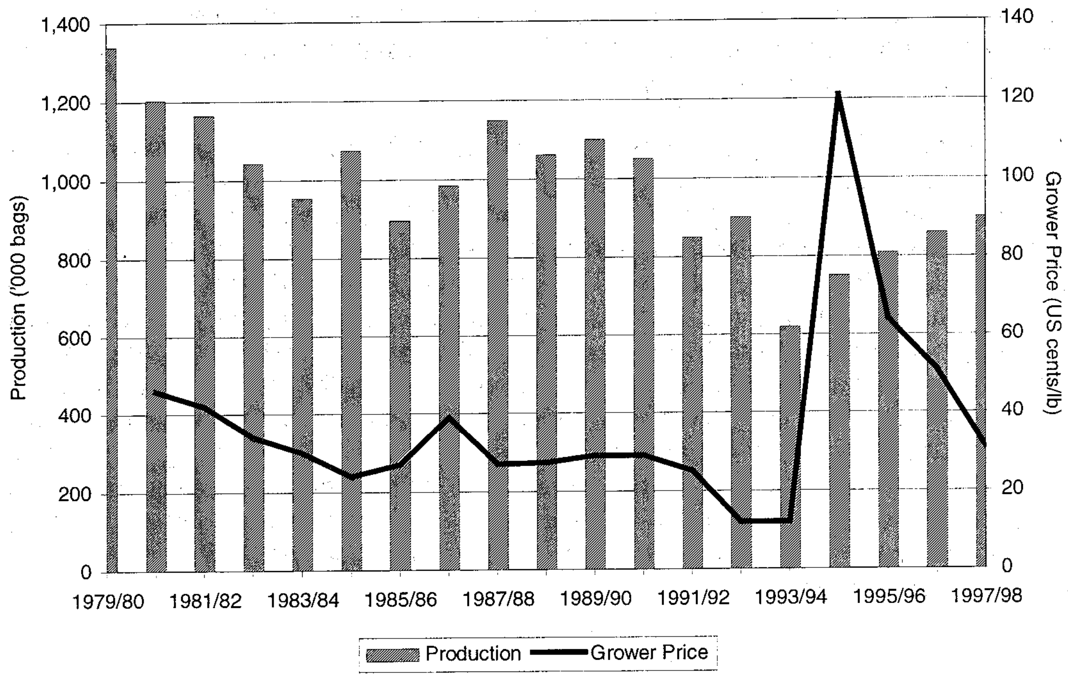


Table 1: Madagascar — Coffee Production, Trade and Prices

	Production ('000 bags)	Exports ('000 bags)	Grower Price (c/lb)	Export Unit Values (c/lb)	Grower price as % of e.u.v.
1960s (average)	947				
1970s (average)	1,072				
1979/80	1,339	1,028			
1980/81	1,203	1,007	46	95	48%
1981/82	1,165	874	42	80	52%
1982/83	1,042	850	34	103	33%
1983/84	953	868	30	121	25%
1984/85	1,074	803	24	112	21%
1985/86	896	759	27	122	22%
1986/87	984	851	39	100	39%
1987/88	1,150	700	27	79	34%
1988/89	1,062	832	27	67	40%
1989/90	1,100	870	29	35	82%
1990/91	1,050	820	29	35	83%
1991/92	850	620	25	28	90%
1992/93	900	660	12	22	54%
1993/94	620	380	12	23	51%
1994/95	750	530	121	125	96%
1995/96	810	610	64	80	80%
1996/97	860	660	51	64	80%
1997/98	900	700	31	61	51%

Source: USDA, ICO and LMC

The last known coffee survey appears to have been in 1969 which put the total area planted to coffee at about 200,000 hectares (including 20,000 hectares plantation coffee and 6,000 to 7,000 hectares arabica). Ministry of Agriculture (MOA) figures suggest that the area under coffee has declined from 240,000 hectares in 1990 to its current level of 200,000 hectares. There has been a reducing trend in planted area which is reportedly due to uprooting, failure to replant after cyclone damage and general degradation.

The 1969 survey indicated that 47% of the tree park was aged 15 years and older. However, it is now generally accepted that most of today's robusta population is closer to 70 years old which means both falling yields and bean size. The 1969 survey estimated a yield of 352 kg per hectare whereas the MOA estimated yields at 338 kg per hectare in 1996. However, the 0.8 million bag production estimate for 1997/98 and the MOA's area figure point towards yields of around 250 kg per hectare. This is likely to be fairly realistic bearing in mind that an unknown number of growers obtain very low yields because all they do is strip pick coffee once a year from what has, in effect, become "forest coffee".

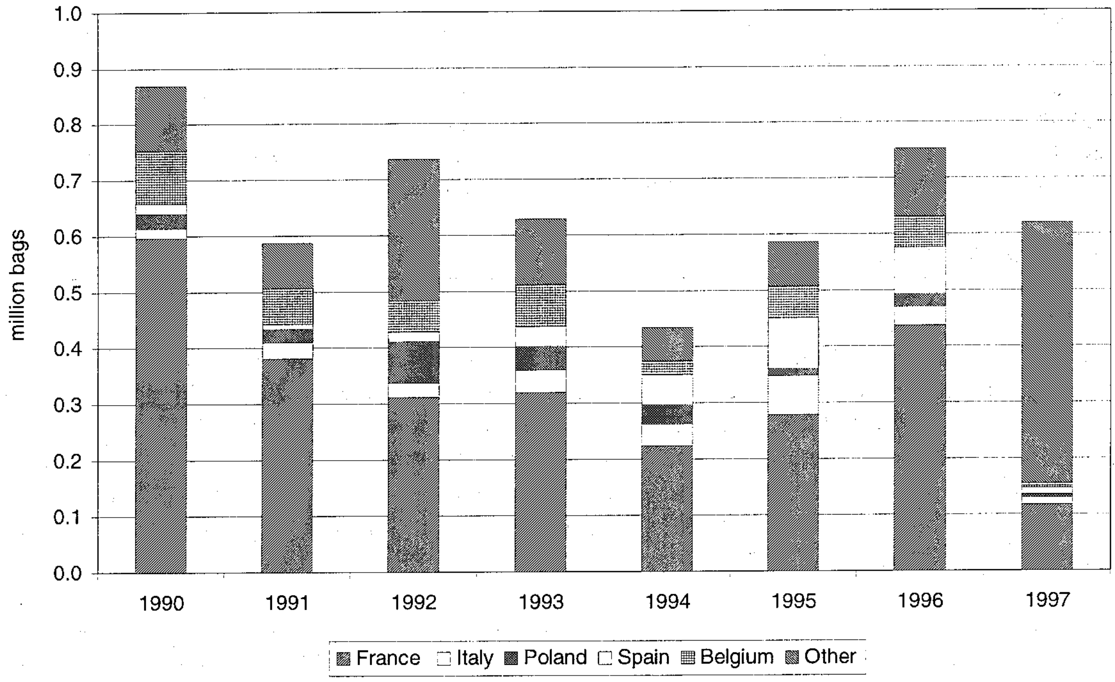
Around 350,000 smallholders account for over 90% of the total cultivated coffee area. Most farms are inter-planted with other crops such as vanilla, pepper and cloves. The average size of a small farm is 1 to 1.5 hectares, and typically coffee is grown on 10% to 15% of the farm. In addition, "mini" growers simply exploit what has increasingly become a forest crop using no inputs and strip pick whatever coffee makes it to harvest. Large commercial plantations amount to only 5% of all land under coffee, and currently none of them remain in production. Many large holdings were nationalised and distributed to co-operatives in the 1970s. Now the infrastructure is gone, the trees have been neglected for decades and the land is claimed by, in some cases, numerous individuals which renders privatisation very complex, if not impossible.

The industry's only obvious strategic advantages would appear to be that production costs are low and that, in theory, it could supply organically grown coffee. But organic certification is expensive and the organic market is much more quality conscious than are the present buyers of Malagasy coffee.

Exports

Annual exports averaged 0.8 million bags during the 1980s but have fallen in the 1990s to an annual average of 0.6 million bags due to severe cyclone damage in 1993/94. In calendar years 1996 and 1997, exports averaged 730,000 bags. The majority of exports are to the European Union and are heavily dominated by France with Belgium, Spain and Italy also important destinations (Diagram 2).

Diagram 2: Madagascar — Coffee Exports, 1990-1997



Coffee in the Economy

Agriculture is the mainstay of the economy, providing employment for 85% of the population. Main agricultural activities (in order of importance) are rice, fisheries, coffee, other export crops (vanilla, pepper, cloves, litchis) and fruit and vegetables. The sector produces 40% of GDP and generates important export earnings. Export crops are the main livelihood for a quarter of the population. Over time however, the importance of both coffee and vanilla has diminished whilst fisheries, raw materials and consumer goods have shown strong growth. Vanilla has been the big loser in recent years, with the value of exports falling from 20% of all exports in the late 1980s to less than 5% of exports in 1996 and 1997. Coffee remains the single largest agricultural export in value terms (Table 2).

Table 2: Madagascar — Export earnings (mn Malagasy Francs)

Year	All Exports	Coffee	Vanilla	Fisheries	Raw Materials
1987	336,245	98,229	89,236	34,301	48,721
1988	385,080	101,652	58,031	42,596	84,450
1989	506,193	123,105	67,540	48,889	118,614
1990	460,343	57,966	85,012	50,381	124,454
1991	559,073	51,902	84,887	74,772	180,013
1992	516,822	58,844	95,541	70,581	139,737
1993	498,996	78,279	75,209	79,281	140,256
1994	1,246,719	29,244	207,421	169,507	249,232
1995	1,569,394	378,808	162,978	234,338	427,038
1996	1,215,702	280,201	47,987	178,626	485,170
1997	1,139,066	260,017	49,196	41,423	597,163

Source: Central Bank and CNCC

Coffee's contribution to tax revenues is limited to regional and local government taxes. There are no export taxes on coffee and the sector does not make any direct contribution to central government revenues. Provincial government taxes on exports of 45,000 tonnes would raise close to 3 billion Malagasy francs (FMG) per annum whereas local government taxes raise another 1.5 to 2 billion FMG annually. Although not high by themselves, these taxes constitute an important source of revenue, especially for inland rural village councils.

Formal employment in the coffee sector is only offered in the marketing chain, mostly for the hand sorting of export coffee. This is a relatively important source of employment in the small coastal towns of the Côte-Est. Other than family members, the production cycle uses purely seasonal labour although labour requirements are much lower than those in the rice sector or in crops where post harvest care is essential (vanilla, fruit).

GOVERNMENT POLICY

Macroeconomic Environment

Madagascar is sparsely populated but well endowed with natural resources. In the decade following independence in 1960, the economy grew at around 3% per annum, largely fuelled by the performance of the agriculture sector and external funding. From 1972, sweeping changes in economic and political management were introduced, many companies were nationalised, price controls and administrative regulations adopted and the state took control over the marketing of major agricultural crops. Madagascar withdrew from the CFA Franc in 1973. Between 1970 and 1978, real GDP grew by less than 1% per annum and the agriculture sector stagnated. In 1978, a number of large public investment projects were adopted, financed largely by external borrowing. Combined with declining terms of trade, this led to a large public sector deficit, rising inflation and a large external debt burden.

A structural adjustment programme was introduced in 1981. The first programme sought to reduce the budget deficit while subsequent programmes throughout the 1980s were concerned with internal and external trade liberalisation, currency devaluation and tax reform. The Malagasy franc was devalued periodically during the 1980s. However, the government's inability to control the budget deficit and inflexible exchange rate management led to a period of exchange rate appreciation in the early 1990s and economic stagnation. GDP declined by 6% in 1991, partly due to political unrest. A further structural adjustment package was adopted in 1994. Under the conditionality for the programme, the government was to seek to maintain the floating exchange rate policy, reduce the budget deficit, increase interest rates, introduce a value added tax and remove some import controls. However, the budget deficit continued to grow, reaching 7% of GDP in 1994 and inflation increased to almost 50% in 1995 falling back to 20% in 1996.

Recently the economy has been moving toward a more stable path with steady growth and moderate, though still significant, rates of inflation. This has been partly due to a careful fiscal policy and a more aggressive approach to revenue collection. GDP has grown since 1994 and real GDP (in 1995 prices) was US$4 billion in 1997. The more stable macroeconomic environment enabled the Central Bank to lower its key lending rate from 33% in 1996 to 11% in June 1997, thus providing cheaper credit and therefore facilitating investment. The relaxation of monetary policy, by lowering interest rates, also led to a depreciation of the Malagasy franc, improving the competitiveness of exports and spurring GDP growth to almost 4% in 1997. The population is around 15 million (Table 3).

Table 3: Madagascar — Macroeconomic Conditions, 1990-1997

	1990	1991	1992	1993	1994	1995	1996	1997
Exchange Rate, FMG per US$	1,494	1,835	1,864	1,914	3,067	4,266	4,061	5,091
Real GDP Growth	3%	-6%	1%	2%	0%	2%	2%	4%
GDP (1995 prices) Billions Francs	13,854	12,980	13,134	13,409	13,403	13,629	13,922	14,431
GDP (1995 prices) Billions US$	3.67	3.12	3.35	3.78	3.22	3.20	4.29	3.93
Per Capita GDP (US$ per head)	328	272	250	273	225	216	284	253
Interest Rate (lending rate)		25%	25%	26%	31%	38%	33%	30%
Annual Inflation (CPI)	12%	8%	15%	10%	39%	49%	20%	5%
Population (millions)	11.20	11.49	13.42	13.85	14.30	14.76	*15.14*	*15.51*

Note: Figures in italics are estimates.

Source: IMF Financial Statistics, LMC.

Financial Sector Reform

The nationalisation of the country's commercial banks took place in 1975. Inadequate supervision, cronyism and simply bad banking practice, coupled with government pressure, eventually permitted the parastatals to obtain credit far in excess of their legitimate requirements. A 1985 review of the banking sector concluded that as much as 90% of all parastatal debts were non-performing which, technically at least, rendered much of the banking system insolvent.

The banking system is being progressively privatised. Between 1986 and 1989 the banks were independently audited and their portfolios were restructured to eliminate non-performing debts. The banks were then recapitalised. In addition, the government authorised the establishment of independent commercial banks and other financial institutions with private shareholdings. This resulted in the privatisation in 1990 of the BNI (*Bankin' Ny Indostria*), which is now linked with *Crédit Lyonnais*, and the establishment of an entirely new bank, the *Banque Malgache de l'Océan Indien* (BMOI). In 1995 a new banking law was passed, reinforcing supervision of monetary institutions whilst at the same time further liberalising the financial sector. Independent administrators were appointed to reposition the two remaining State banks ahead of their privatisation. These steps have led to the re-emergence of prudent lending principles and the proper credit rating of potential borrowers.

Agriculture/Coffee Production Policy

Government agricultural policy is aimed at expanding rice production and food self-sufficiency, improving the quality (not quantity) of export crop production, encouraging diversification of the agriculture sector and developing national agricultural research capacity. Under an Agricultural Sector Adjustment Credit (CASA) between 1986 and 1990, government involvement in the agricultural sector was reduced. Key components of the programme included: the elimination of direct government involvement in the rice market; the liberalisation of marketing of other major crops (including coffee); the elimination of subsidies on agricultural inputs and transfer of their supply to the private sector; and the elimination of a number of agricultural public investment projects.

The major government initiative in the rural sector currently is the *Programme d'Action de Développement Rural* which, with the help of *bailleurs de fonds* and the private sector, is expected to tackle a number of sectoral issues including: the intensification of agricultural production (research, extension, soil and water conservation); roads and transport (including intermediate transport and secondary ports); land ownership; irrigation; skills upgrading; decentralisation; rural and agricultural finance; and credit. The initiative is still in its infancy and will not take shape until sometime in the first half of 1999. Under the project the main physical investment is likely to be in the rehabilitation of roads and bridges especially in the somewhat neglected Côte-Est which remains the country's main coffee producing area. Field staff of the MOA are hopeful that the accompanying decentralisation process will empower regional and local structures and to bring producers and strategists closer together, culminating in more practical and speedier decision making.

Coffee Production Policy

Prior to liberalisation in 1989, the government intervened extensively but relatively ineffectively in the coffee sector. This was especially true in the late 1980s. Large projects like *Opération Café, Poivre et Girofle* (OCPG) and *Opération de Développement Agricole du Sud-Est* (ODASE) extended over many years but achieved few lasting results, nevertheless there was a general impression that coffee growers were benefiting from government assistance.

Since liberalisation, the government's coffee policy can best be described as one of benign neglect with most efforts in agriculture directed towards promoting food crops (especially rice) and achieving food self sufficiency.

Modest STABEX funds are starting to flow to the coffee sector, for example the EU is expanding its successful vanilla activities in the SAVA region to coffee and modest assistance is being planned for the coffee sector in the Sud-Est but, other than assistance to road maintenance, this will, at least initially, only comprise of some very specific and limited actions. Where possible, these will be in collaboration with the private sector.

Research and Extension

Coffee research does not fall under the MOA but under the Ministry of Scientific Research. The research institution is FOFIFA (*Foibe Fikarohana Momban'ny Fampandrosoana ny eny Ambarivohitra or Centre National de Recherche Appliquée au Développement Rural*). Research stations with a coffee activity are maintained at Kianjavato and Sahambavy with supplementary activity at Ilaka Est. Work on clonal selection (*Canephora robusta*) has been ongoing since the 1970s and five selections are available for distribution. "Mother gardens" of the clonal selections are maintained but the provision of cuttings has ceased, partly because OCPG was discontinued and partly because there is no demand from growers. FOFIFA's main, if not only, coffee activity would appear to be to maintain the national rootstock collections. FOFIFA's role is limited to "assisting" and "providing advice" to the sector when it is needed or requested.

The provision of agricultural research is poor, although more recently, the institute has been receiving assistance through the *Programme National de Recherche Agricole* (PNRA) which aims to rebuild (some) infrastructure, and to rationalise, retrain and motivate staff so as to recreate an environment to facilitate resumption of the delivery of meaningful services. These efforts are ongoing and immediate results are not expected in the short term.

FOFIFA plays no role in current (modest) attempts to revitalise the small arabica sector in the Central Highlands and does not supply any seed or seedlings.

Prior to liberalisation, some coffee specific extension was carried out by the *Service de Pré-Conditionnement* of *Caisse de Commercialisation et de Stabilisation des Prix du Café, de la Vanille et du Girofle (CAVAGI).* However, with liberalisation, coffee extension specialists have been replaced by general MOA extension workers who lack in-depth knowledge of coffee production.

The *Programme National de Vulgarisation* provides extension in the Sud-Est but is not specifically directed at coffee. Its activities also include the establishment of producer groups, primarily in the litchi sector.

Use of Inputs

Regular use of agricultural inputs is mostly practised in what are known as *Cultures Industrielles.* These are annual crops such as tobacco, cotton and haricot beans which are bought by industrial processors who have an interest in ensuring adequate and satisfactory supplies. The buyers of such crops supply growers with both inputs and technical advice on production and quality control. The cost is recouped through deductions in the purchase price. The rice sector is a regular input user and because there are many rice buyers who also act as stockists of inputs, their availability and use is apparently fairly widespread. Highland growers of vegetables and potatoes also use fertilisers. Imported fertilisers and other inputs are subject to both import and value added tax.

In the main, coffee growers do not use inputs on their coffee. There are collectors on the Côte-Est who stock some items but these are for other crops and there simply is no demand for inputs for coffee. The general age of the trees and the reluctance to stump would in any event limit the effectiveness of any inputs and the low yields probably render the use of pesticides prohibitively expensive.

Credit

The overwhelming majority of coffee growers have no access to any form of formal organised rural finance and only about 2% of all farmers may have access to formal commercial banking arrangements. Past attempts to establish decentralised rural financing systems not only had to deal with difficult access conditions, a widely dispersed client base, low savings rates, high costs and substantial risk, but also met with political and administrative interference. For example, the BTM Bank had to close a number of rural lending agencies due to extremely poor recovery rates, some as low as 20%, and today the bank lends very little, if anything, directly to small individual farmers.

However, during the 1990s a number of modest initiatives, essentially based on a mutualist approach, have been successfully implemented in various regions and although the commercial banks do not engage in any form of direct lending to small producers, they do support these new, NGO facilitated, micro lending initiatives. To date these initiatives have been largely aimed at rice producers who form "*mutuelles*" (groups of about 20 growers) and who then jointly obtain credit for both inputs and labour. Upon harvesting they can obtain an advance against stocks which permits them to sell their crop over the season. Formal lending is further restricted by a lack of grower organisations, crop theft and the absence of legal land title.

The overwhelming majority of coffee growers continue to depend on local village lenders for credit. These apply usury rates of interest through the settlement of debts by the supply of agricultural produce. The exact cost of this type of finance is not known but can be quite high, somewhere between 50% to 200% per annum. Along the Côte-Est coffee represents the major source of cash for many small farmers and is therefore generally used to raise funds or for debt settlement. In the latter case, it is often literally sold whilst still "on the tree". Coffee is sometimes also held back as a form of cash reserve, to be used in times of need.

MARKETING SYSTEMS

Marketing Channels

Pre-liberalisation

From the early 1970s, coffee prices and marketing were controlled by the *Caisse de Commercialisation et de Stabilisation des Prix du Café, de la Vanille et du Girofle* (CAVAGI).

Apart from areas in the North where coffee was traded as dried cherry, growers sold hulled coffee to collectors (*collecteurs commerçants),* who were typically village store owners, for either or consumer goods. Payment was made on delivery of the coffee unless there was an outstanding advance against the crop. Poor road and transport conditions meant that access to hulling facilities was poor and many growers decorticated their dried cherries manually by pounding. Where growers had easy access to a hulling facility, their cherry was hulled for a fee. Such hulling facilities usually took the form of a simple rice huller, adapted to handle coffee, operated by a village store.

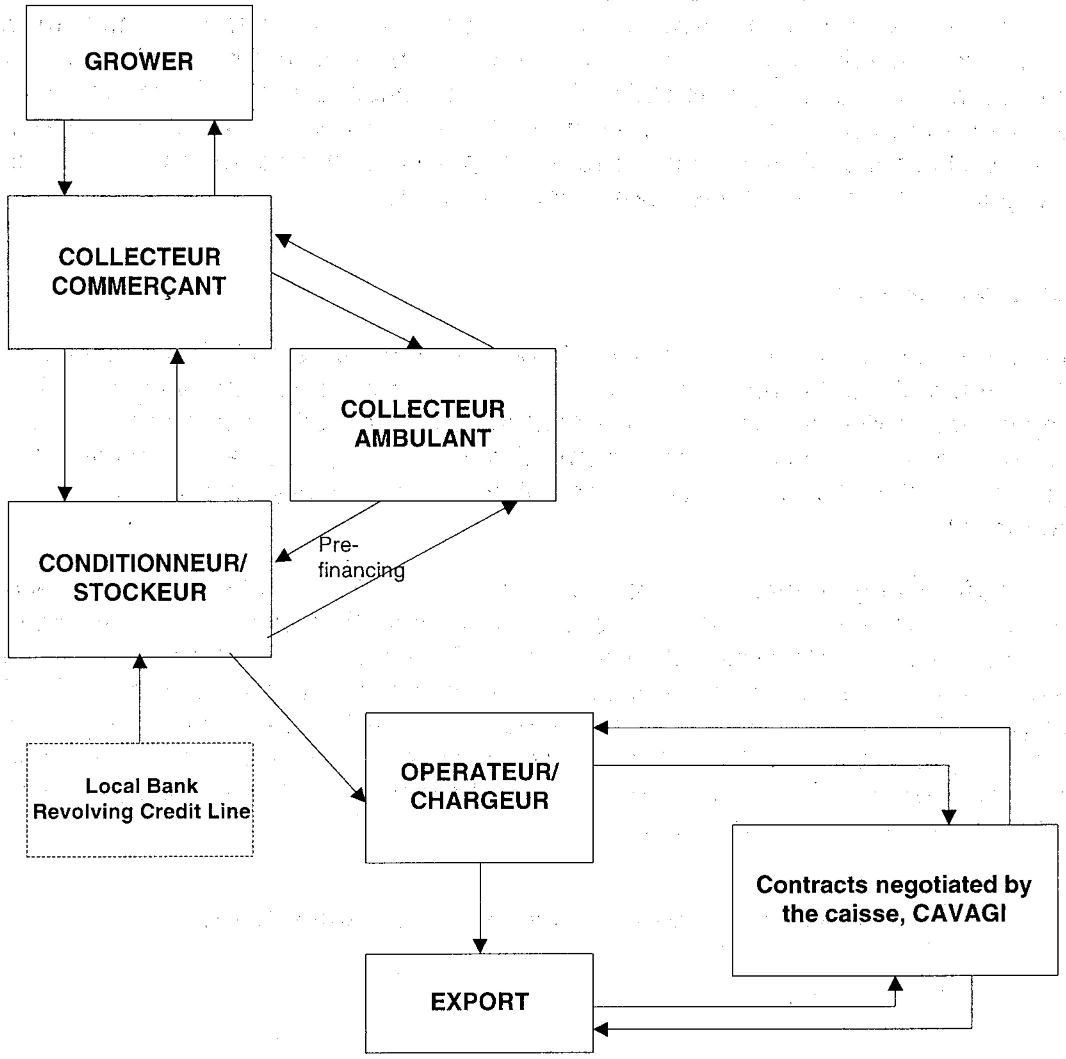
Collectors were not licensed but were required to be accredited agents of licensed processors (*conditionneurs/stockeurs).* Some collectors were also agents of *collecteurs ambulants.* These were larger *collecteurs commerçants* who had access to their own financial resources and transportation.

The processors purchased all coffee and graded and processed it to export standard. They were licensed by the Ministry of Commerce on the recommendation of CAVAGI. In order to gain a licence an applicant was required to have approved warehousing facilities, adequate processing and transportation capacity and access to adequate finance.

CAVAGI negotiated all overseas export contracts and instructed one of five state owned exporters (*operateurs/chargeurs*) to export coffee on its behalf. (Prior to 1975, these exporters were private French commercial firms, but in 1975 they were nationalised.) These five exporters undertook the administrative, financial and shipping arrangements for all coffee exports (Diagram 3).

Although CAVAGI sought to accommodate buyers' wishes as to which of the exporters would meet a contract, this was not guaranteed. CAVAGI also specified which processors would supply coffee to the exporters. All sales were on an f.o.b. basis.

Diagram 3: Pre-Liberalisation Marketing Chain



Liberalisation Process

In October 1988 the coffee sector was liberalised. The liberalisation measures (under the CASA umbrella) were not specifically aimed at the coffee sector (as may have been the case in some other countries) but at all export crops, of which coffee, vanilla and cloves were the most important. The general objective was to free producers from excessive controls with the liquidation of CAVAGI. The expectation was that this would lead to a rise in producer prices which would help to revitalise agricultural exports and increase production.

The coffee sector was far from being the major concern in the economic restructuring packages of the period 1984 to 1990. Years of economic mismanagement and decline had turned Madagascar into one of the world's poorest countries, increasingly unable to feed itself and pay for food (rice) imports and the overriding concern was to bring the country's economy back to health, starting with removing price and movement controls on rice, the nation's staple food. The only coffee specific measure accompanying the liberalisation process was the establishment of a *Comité National de Commercialisation du Café* (CNCC). The CNCC was primarily established because International Coffee Agreement (ICA) export quotas were still in force and a structure was needed to supervise their allocation and use.

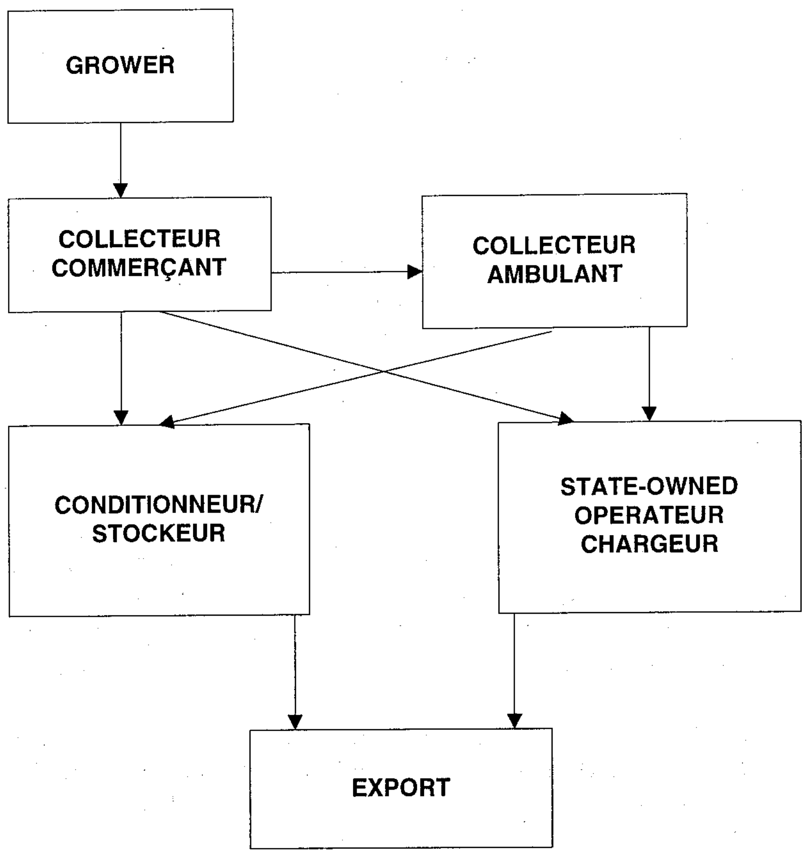
Within a larger context, more or less simultaneous moves to restructure the financial sector can only have hastened moves to liberalise the export crops which were all controlled by parastatals. Freeing the banks from direct government control (a pre-condition to re-capitalising them) would more or less have automatically ended the privileged position of the parastatals. One of the consequences of this would have been their exclusion from further borrowing due to the poor quality of their balance sheets. Without liberalisation and the return of private sector operators, the collection and export of coffee would have been severely disrupted.

Post-Liberalisation

With liberalisation, private and parastatal companies were permitted to directly export coffee. Internal marketing channels have largely remained unchanged, with the exception that collectors are now accredited by provincial authorities through the issue of a *Patente* (to enforce tax collection). Other market participants continue to be registered by the Ministry of Commerce although it is virtually an automatic process (Diagram 4).

While ICA quotas remained in place until mid-1989, exporters had to receive permission from CAVAGI/CNCC to export to ensure that exports to ICA member countries remained within the ICA export quota. Contracts with the highest prices were given priority. In 1989, with the ending of ICA export quotas the market was further liberalised, CAVAGI was abolished and exporters were free to export to any market. For a few years, the Ministry of Commerce, however, continued to conclude counter trade deals using coffee. The transparency and execution of these deals gave rise to much criticism within the export trade.

Diagram 4: Post-Liberalisation Marketing Chain



Following liberalisation, a number of groups entered the export business and the number of exporters rose from five to 35. These firms included the old, existing firms, larger *collecteurs*, operators from outside the coffee industry and speculators. The old companies included those who had operated as exporters prior to 1975. Whilst the 1975 nationalisation of exports excluded everyone except the five (parastatal) companies from exporting, most private exporters continued as *conditionneurs/ stockeurs* and there was not a general exodus of expertise.

Many inexperienced hopefuls (including a very few foreign firms) entered the local coffee trade following liberalisation only to withdraw when international prices fell. Strongly rising prices in 1994 brought a number of them back but the subsequent decline in international prices hurt many and reduced the number of exporters again. The export trade is now dominated by a small number of firms, between five and ten, mostly with strong links with international, and especially French, trade houses. Today's exporters represent a mixture of old, well established companies, some relatively new but capable ones and a certain speculative element. A number of very small exporters also exist but with shipments of one or two containers annually they do not play a role of any importance and cannot be considered part of the real trade.

The trade is as "local" as one could wish in an increasingly international, global market. That is not to say that the majority of exporters are Malgache by origin: there is a mixture of Malgache, Indian, Chinese, local French and expatriate French operators. Some of today's exporters are lacking in certain areas of expertise and need to become more professional in their dealings but there is no doubt that the export trade is locally based and controlled albeit under very firm overall influence of international trade houses.

A number of foreign coffee trade houses (mostly French) have established representations but generally, restrict their activities to buying basis f.o.b. from local exporters whom they may pre-finance and whom they monitor in terms of quality and contract execution. Very few of the foreign trade houses who handled Malagasy coffee have attempted to establish themselves. This is probably because:

- Established local expertise and old connections presented both a formidable challenge and the multinationals wished to resume past trade relations;
- The availability of coffee is insufficient to support a large number of exporters and certainly not enough to attract the direct attention of really large trade houses. Conditions in Madagascar also made it difficult to achieve sufficient volumes without being established in numerous locations;
- Trading conditions are difficult due to unstable macroeconomic conditions, poor quality, cash transactions, weight losses, delays, non respect for agreed supply commitments etc.; and
- Using pre-financing arrangements, trade houses could tie exporters to them and exercise better control over both quality and contract execution without having to involve themselves in dealings with *collecteurs* whom they neither knew nor knew how to control.

Physical Export

In the past, most coffee had to be transported by poorly managed and wrongly prioritised coaster services from the processing centres in secondary ports for shipment from the main port of Tamatave. Facilities for loading and stuffing containers at Tamatave were poor. Some coffee was sold f.o.b. at secondary ports but buyers' resistance meant so-called "through bills of lading" were an exception. Shipping industry sources state that prior to 1970 both Manakara and Manajary were in fact deep water ports whose access has since then been allowed to silt up.

In recent years, conditions at Tamatave have improved although security remains a concern. For example, once stuffed, containers awaiting shipment are stacked door-to-door to thwart potential thieves. Conditions at the secondary ports remain problematic (due to silting, inadequate equipment etc.) but since liberalisation there have been notable improvements in the quality, frequency and prioritisation of coaster services. The frequency of export sailings is much improved and there is now also a regular feeder service to the South African hub port of Durban.

Most coffee from secondary ports is now sold on through bills of lading (usually at a discount of 2 US c/lb vis-à-vis the price f.o.b. Tamatave). A new barge service between the secondary port of Manajary to Tamatave now operates through the Canal des Pangalanes (internal water way) but is hampered by silting. The absence of container cranes at Manajary also means boxes have to be stuffed on board barges and cargo space is lost.

Sometimes substantial weight losses can occur because much of the final containerisation is still done in Tamatave and weighing arrangements are not always satisfactory, even when 'supervised'. Importers comment that freight rates from Madagascar are competitive but that unreliable shipping weights are a major issue.

Pricing Policy

Prior to liberalisation, all marketing margins were fixed before the start of the crop year. At the beginning of the season, the government announced a guaranteed export price. The grower price, fees, commissions and taxes to be paid at each stage of the marketing chain were then set in a *barème.* The *barème* was set by the Ministry of Commerce in consultation with the Ministry of Agriculture, CAVAGI and, theoretically, other interested parties.

The official producer floor price was effectively a residue once costs in the marketing chain such as transport, processing and local taxes had been taken away from the guaranteed f.o.b. price. The producer price was identical for all areas while the guaranteed f.o.b. price varied by area depending on factors such as the costs of transport. The producer price was also identical for all qualities of coffee. The *barème* did provide for a theoretical premium *prime de pré-triage* to reward those supplying better quality but in practice this did not reach the producer and was absorbed by the collectors.

Post-liberalisation until 1990, a *Prix d'Achat Indicatif* was published to provide an indicative price to growers. Today no formal price indications are published and, in theory, producer prices follow the international market.

At export level, following liberalisation and prior to 1997, the CNCC was mandated to calculate and announce a weekly Minimum Registration Price *(Prix de Référence)* for all coffee sales below which no contracts were authorised. From the 1997/98 coffee season, this was replaced by a *Prix Indicatif* which is intended to advise exporters of approximate market values at regular intervals. Effectively exporters are now free to sell and export at any price.

Exporters are free to choose their own payment arrangements, ranging from Letters of Credit to sending documents on collection (CAD). Bills of lading are usually (but not obligatorily so) established in favour of the exporter's commercial bank which assures the banks that export documents of title and payments, remain within their control. Foreign exchange proceeds must be received in the country within ninety days from date of export. Non-compliance or delays can lead to the imposition of substantial penalties. All coffee exports are denominated in US dollars.

Exporters may retain 100% of export proceeds in foreign currency accounts in local commercial banks. There are no time limits on such deposits and exporters tend to exchange foreign currency according to their liquidity requirements or their judgement of potential exchange rate developments.

Taxation

Prior to liberalisation, a number of explicit taxes were applied at different stages of the collection and export chain, varying from local and provincial government taxes to turnover and export taxes. Additionally, the guaranteed export price set in the *barème* was always far below the realised actual export price with the difference accruing to a stabilisation fund (*Fonds Unique de Péréquation* (FNUP)). This stabilisation fund became an important source of government revenue.

Following liberalisation, the structure of the taxation system was changed and the main taxes were replaced by a single tax based on a Minimum Export Price. The tax was progressive and was levied at a rate of 18% when prices were below 45 US c/lb f.o.b. and rose to as much as 41% on an f.o.b. price of 93 c/lb and above. This suggests that those exporting better than average quality coffee or achieving exceptional prices were, in fact, being penalised. In 1990, this tax was modified to 7% on f.o.b. prices below 45 c/lb, rising to a maximum of 25% on prices in excess of 93 c/lb. In 1992, with disastrously low international prices, the export tax was abolished entirely.

Taxes currently being paid by the sector include communal and provincial taxes. Communal taxes (*Fokontany*) which can range from between 25 to 100 FMG per kg and are paid by collectors before coffee is permitted to be transported. An additional 50 FMG per kg is levied at district level through road barriers. Provincial government taxes total FMG 60 per kg which is paid by the exporter to the Faritany. There are also a number of "unofficial service taxes" which are estimated to amount to about 10 FMG per kg. Exporters pay these "levies" to ensure officials pay prompt and correct attention to their shipments and documents.

The current total of official and unofficial taxes is about 220 FMG per kg or around US$ 42 per tonne (around 3% of the current f.o.b. value). However, once the decentralisation policy is implemented, the new provinces *autonomes* will need to raise finance and higher or new taxes may be imposed. There is also a CNCC levy of 2,250 FMG per tonne.

Crop Finance

Prior to liberalisation, the five parastatal exporters were financed by the state owned banks. With financial sector reform, the poor quality of the parastatal's balance sheets meant that the commercial activities of the parastatal coffee exporters diminished rapidly. Not only did it become difficult (if not impossible) for them to obtain credit, but most foreign buyers of Malagasy coffee turned to the private companies which had re-entered the liberated export trade.

For the private exporters, high local interest rates (close to 40% by the mid-1990s) meant that most looked to their foreign buyers to provide pre-financing, especially following the 1994 rise in world coffee prices. Such pre-financing (in US dollars) was/is available at rates ranging from 5% to 10%. Pre-finance does not require prior exchange control approval and it is usually made available by buyers establishing red or green clause letters of credit. At times, local bank guarantees are demanded by the foreign lender which, of course, increases the exporter's costs.

Liquidity constraints in the 1990s motivated the local commercial banks to encourage the use of pre-financing and until 1997 exporters in Madagascar made substantial use of external finance. However, following sharp falls in inflation (from 37% in late 1995 to 3% in June 1997) the Central Bank eased its repo rate *(taux directeur)* to more affordable levels of around 10% and with improved local liquidity, local banks encouraged a general return to the use of local credit to finance the collection and export of coffee (and other products). Thus, a number of exporters have switched from pre-finance to using local funds to finance their operations. Should local interest rates rise then exporters may again turn to pre-financing.

Currently, there is no shortage of liquidity in the commercial banking system, although the commercial banks tend to stick to clients with proven expertise in what is after all a fairly complicated trade. Fairly strict lending rules and overdraft limits are applied which tends to preclude or limit the financing of less well established operators, specifically the old parastatals. The present day banks dislike speculative actions and actively monitor each borrower's "book". Established exporters and collectors maintain that this more disciplined approach to credit has, to some extent, reduced the total amount of money circulating in the coffee areas, thereby eliminating the excessive buying competition.

Banks engage in three types of financing at progressively reducing rates of interest:

- *Pré-financement:* open credit, at the start of the season;
- *Avance sur produit:* credit backed by coffee stocks; and
- *Décompte documents:* discounting of shipping documents.

These rates vary according to the banks' rating of each individual borrower and his (or her) backers. Local interest rates are subjected to a value added tax (TVA) of 20% which means that exporters who do not directly benefit from the commercial banks' prime rate (currently about 13 %) may face an interest rate of around 20%, once tax and commitment fees etc. are taken into account.

Coffee collectors (who buy from village shopkeepers) have various sources of finance: own funds, pre-financing from exporters (only available to larger, well established collectors), bank lending (again only available to the larger collectors) and informal lending from "*banques paralleles*" (unofficial credit societies usually found in the Chinese and Indian communities). Collectors may themselves finance sub-collectors who travel into less accessible areas. However, both exporters and collectors prefer to pay cash and offer higher prices when no credit is demanded.

Risk Management

Once coffee exportation was nationalised, market risk as such ceased to be a pre-occupation of the industry: prices, costs and margins at all levels of the collection marketing chain were pre-determined and guaranteed by CAVAGI. The commercial risk was ultimately assumed by the stabilisation fund (FNUP). Instead of trading coffee, collectors, *conditionneurs/stockeurs* and exporters became engaged in a constant battle to inflate costs to maximise revenues.

CAVAGI practised a mixed system of spot and forward sales, mostly on a fixed price basis although open price contracts were also entered into depending on market conditions. Under this scenario, there were only two risk takers: the main one was, as always, the producer due to the possibility of crop failure given the irregular occurrence of devastating cyclones and the other was the government which increasingly used the FNUP as a useful source of revenue.

Following liberalisation, all price risk has shifted to the industry participants. The risk management practices of the current exporters range from (very) conservative behaviour to quite speculative stockholding by those who use own funds. Most prefer to limit their exposure by selling regularly against purchases. Typically, a sale will not be made until at least 80% of the proposed quantity is on hand and then only if the price offered is profitable, if it is not, then exporters tend to wait for better prices unless there are signs of a sustained price fall. Short selling is not a general practice, especially for the more conservative firms who remember the heavy losses of 1994 when some exporters had sold short and were forced to buy coffee at ever increasing prices in the aftermath of the Brazilian frost or default on contracts. Purchase prices for physicals are literally set daily with few exporters offering collectors fixed prices beyond periods of one week. Commercial banks actively discourage speculative trading and tend to limit their dealings to those firms whose expertise and trading methods they know and approve of. Hedging using futures markets, either direct or through trading partners abroad, is little used if at all.

Exports are also subject to foreign exchange risk. Until the end of 1998 the FMG was loosely tied to the French Franc as most of the country's imports were denominated in that currency, and from 1 January 1999, the FMG has been linked with the Euro. Fluctuations in the US$/FMG rate expose exporters to risk for which they can not obtain any forward cover. To date the Central Bank only operates a spot market and as commercial banks are not permitted to trade currency externally, they do not offer forward cover either. Even when the banks "discount" shipping documents for exporters they only pay a provisional advance in FMG. The counter-value of the US$ invoice is only established when the foreign funds are actually received and exchanged for local currency.

The collectors face immediate price risk, in that exporters offer fluctuating prices whereas village buyers usually insist on obtaining their price, knowing that the main collector needs to purchase to make the collection trip worthwhile. Village collectors make additional profits through usury, exchanging coffee for goods and so on which puts them in a fairly strong bargaining position with farmers, an advantage which main collectors do not have.

Some exporters suggest that the prices they indicate when advancing funds to collectors are, in fact, unofficial guaranteed minima and should the market have risen upon the collector's return he will demand an additional premium whereas in the reverse situation he will insist on receiving at least the price originally indicated. In reality all exporters pay more or less the same price and take in virtually all coffee which is offered. If not it will go elsewhere and turnover suffers or advances cannot easily be recouped.

Growers are pure price takers, especially in more distant and inaccessible locations. As collectors and exporters try to cover their price risk through increased trading margins the risk expresses itself in lower farm gate prices. It is generally accepted that producer prices also fall with the distance the coffee has to travel.

The Malagasy market is small with fluctuating availability, quality and contract performance. Price information is increasingly circulating more freely but most operators lack access to modern price risk management tools (many of which are perhaps not appropriate for the market in any case). Consequently most exporters depend largely on sound judgement, on limiting their open positions, and on close collaboration with their trading partners who know, understand and appreciate the peculiarities of the origin. However, there is also a strong speculative element which is increasingly forced to rely on its own resources to finance speculative stock holdings. Obviously, the internal collection marketing system depends on margins for risk insurance and as growers are literally at the bottom of the pile they are paid accordingly. Until some form of grower organisation emerges, it is difficult to see how this situation will change.

INSTITUTIONS/ORGANISATIONS

The main organisation operating in the coffee sector following liberalisation is the *Comité National de Commercialisation du Café* (CNCC). It was established by Ministerial Decree on 5 October 1988 and mandated to:

- Analyse the market for coffee, centralise export statistics and allocate ICO export quota stamps; and
- Periodically (weekly) fix a *Prix de Référence* below which no coffee was to be exported, and on which export tax was to be calculated.

Therefore the CNCC was not, and is not, mandated to regulate or supervise the coffee industry but at the same time it is not clear who other than the CNCC is expected to exercise that function. The original mandate of two years was allowed to expire without being formally renewed but the CNCC continued functioning although strictly speaking it lacked both legal status and formal authority. After the abolition of export quotas, its main remaining regulatory function was to authorise individual exporters to ship against approved contracts. Since the abolition of the *Prix de Référence* in 1997 these authorisations would have become superfluous were it not for the continued need to collect statistical information on coffee exports and to collect the CNCC levy.

The nine members of the CNCC (all exporters) are elected by licensed coffee exporters in a general meeting and they then elect their own chairman. A representative from each of the Ministries of Agriculture and Commerce may attend meetings but they have no voting rights. In addition, the director of the CAVAGI enjoyed automatic membership which of course lapsed with the subsequent dissolution of the CAVAGI.

From its inception, the CNCC was dominated by the parastatal exporters who gained five of the nine seats on the board, including the chairmanship. Eventually this rendered the committee more or less impotent as the majority of its members, including the chair, ceased to be active coffee exporters. As a result of fairly recent membership changes to the board of the CNCC it is at last beginning to formulate pragmatic objectives and policies with the aim of becoming a service provider to the industry. One of its first tasks has been to improve the quality of coffee export statistics. The CNCC intends to gradually involve itself in establishing common ground rules for local trading, increasing professionalism amongst the exporters, improving quality through the introduction of a "Malgache quality label" and disseminating planting materials through establishment of strategic nurseries.

The CNCC is authorised to establish local "antennes" or sub-committees in coffee producing and/or exporting locations. To date, eleven such committees are operational and they generally perform a useful function. In theory, the CNCC operates under the Ministry of Commerce, but in practice it runs its own affairs.

EVALUATION OF REFORMS

Apart from the considerable upheavals in the international coffee market itself, the reform process must be seen against the background of an industry which had already been severely weakened with over-aged trees, (very) low yields and very poor infrastructure. In addition:

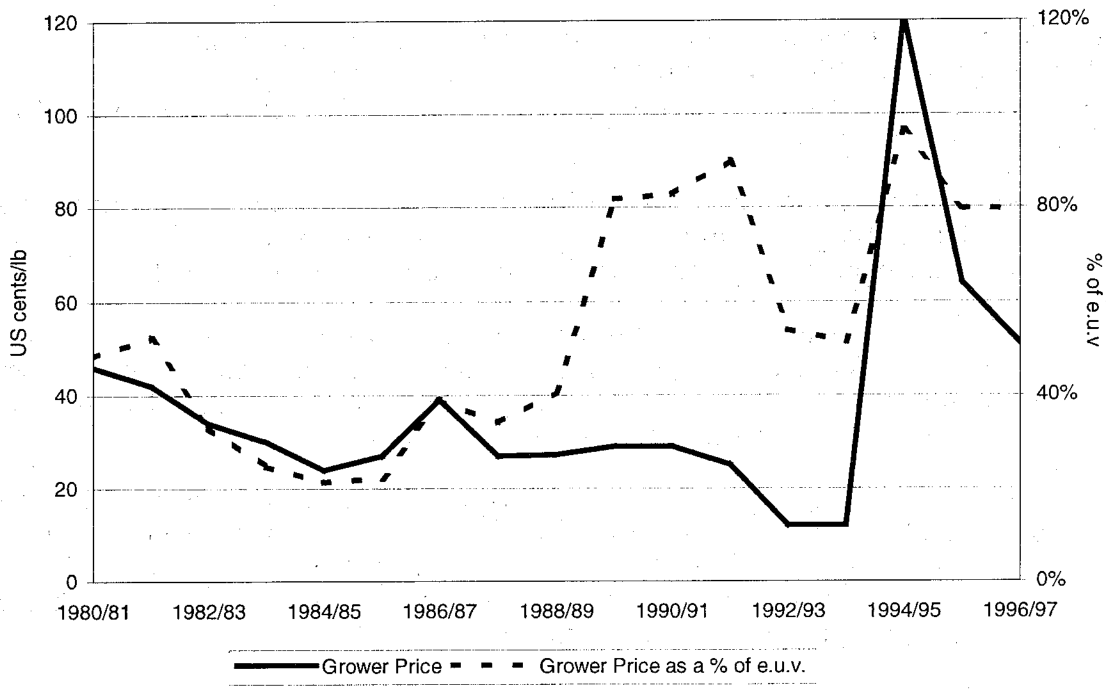
- The (sudden) liberalisation of the coffee industry was only a part of a much larger and wider package of reforms which was not aimed at the coffee sector as such and the accompanying measures to assist the process were minimal;
- Political and social unrest in the early 1990s were followed by four years of economic mismanagement (from 1991 to 1994) which aborted all planned post-liberalisation follow-up activities. This meant that after decades of total government control, the industry was left completely "on its own";
- Compared to major robusta producing countries, the Madagascar crop is the product of mostly mini-growers who are widely dispersed, often in almost inaccessible areas. Thus there is no 'industry' as such but rather a heterogeneous grouping of diverse communities whose only connection is that they all happen to harvest a little coffee; and
- In global terms, Madagascar's crop is insignificant and thus fails to generate the kind of external investment interest that other countries have attracted.

Grower Prices

Pre-liberalisation with high levels of implicit and explicit taxation, grower prices could be as low as 20% (or less) of the f.o.b. value. With liberalisation and changes to the taxation system, grower prices initially increased dramatically although, due to the decline in international prices in 1992/93 grower prices were lower in absolute terms than before liberalisation. With rising international prices and increased competition, grower prices (and the proportion of the f.o.b. price received by growers) rose dramatically between 1994 and 1996.

Available statistical information on producer prices is at best generalised and at times it probably is quite inaccurate, resulting as it does from interviews with collectors and fairly easily accessible growers. Growers in inaccessible areas (where human portage sometimes has to be used to evacuate coffee) reportedly receive as little as half (or even less) of what growers along reasonably passable roads and jungle tracks can obtain. Inadequate resources mean local MOA staff cannot access these areas which suggests information on producer prices has to be treated with some caution. Table 1 presented "best estimates" of producer prices. While they may not be applicable in less accessible areas, and they also do not necessarily match the time frame of the export data, they do demonstrate the overheating of the local market from 1994 through 1996 when a large number of buyers competed for any available supply. Subsequently many have withdrawn from exporting and grower prices returned to more realistic levels. In December 1998 exporters were paying collectors about 90% of the available f.o.b. value (once taxes have been deduced), with reasonably accessible growers in turn possibly receiving between 60% and 70% of the f.o.b. value and those in inaccessible areas in turn perhaps obtaining not more than 40% to 50% of the export price. It is generally accepted that producer prices also fall with the distance the coffee has to travel, not simply because of costs but mainly because of reduced buying interest as competition diminishes.

Diagram 5: Madagascar — Grower prices and Export Unit Values



Collectors at all levels are increasingly better informed on world market prices and some actively trade in coffee, taking their stocks from one exporter to the other in search of higher prices. Sometimes they hold stocks in the expectation of better prices. Since liberalisation, a rudimentary and strictly informal local market has emerged at the collector level. However, this has not yet happened at the producer level, although in more easily accessible areas producers too can in theory choose their buyer. There are no internal price controls nor is there any form of subsidy or price stabilisation.

Marketing Costs

Following liberalisation, marketing costs have been reduced as inflated costs included in the *barème* have largely been squeezed out of the system, while banking, transport and shipping services have become much more efficient. Marketing costs between grower and exporter are around FMG 800 per kg (Table 4).

Table 4: Madagascar — Internal Costs (FMG per kg)

Primary Transport	230
Hulling	60
Sacks	20
Handling	10
Financing (30% month)	100
Grower to shopkeeper costs	420
Collector to Exporter	
Transport to Coast	160
Sacks	20
Handling	10
Storage	10
Taxes	80
Financing	50
Overhead	50
Collector to Exporter costs	380
Total Internal Costs	**800**

Exporters' and processing costs are in the order of 1.16 million FMG per tonne, around 10 c/lb (Table 5). This implies that total marketing costs (from grower to exporter) are around 1,960 FMG per kg (around 17 c/lb).

Table 5: Madagascar — Exporters' Costs (FMG per tonne)

Export bags	75,000
Placing of empty container at warehouse *	6,300
Transport of full container to port *	12,200
Port Charges	46,800
C&F Agent's fees	27,800
Weighing	3,000
SGS Certificate	3,000
Phytosanitary Certificate	3,000
Stuffing of container	3,000
Quality Certificate Service Conditionnement	100
Customs Fees (DSME)	300
Local Government Taxes	60,000
CNCC Levy	2,250
Unofficial charges	10,000
Financing (2.5 months 18%)	276,000
Insurance to FOB 0.25% *	18,000
Grading and Sorting	100,000
Loss in Weight 3%	224,000
Handling and warehousing costs	50,000
Overhead (less sale of rejects)	200,000
Bank charges	37,450
Exporters' Costs	**1,158,200**

* A number of exporters advise they do not pay these costs.

Quality

The inherent quality of Madagascar robusta (Kouillou) is good and in years gone by the coffee ranked amongst the world's primary robustas and was prized for its good body and relatively smooth liquor with less of a 'robusta taste' than many of its competitors. However, the crop's inherent quality is deteriorating due to a number of factors:

- *Ageing tree park*: Older trees produce smaller beans and smaller beans do not deliver the same liquor quality as well developed bolder beans;

- *Poor maintenance*: Older trees require fertilising, pruning and general maintenance. Malagasy growers do not use fertilisers, resist heavy pruning and stumping because of the (temporary) crop losses and many literally practice "strip picking";

- *Ineffective Service de Pré-Conditionnement*: Prior to liberalisation, this service was charged with promoting "quality" at the producer level. However, its impact was negligible and any quality price premium, *prime de pré-triage*, was simply taken by the collectors. Therefore, the dissolution of this service after liberalisation had no adverse affect on quality; and

- *No quality discrimination, premia or discounts at the farm gate:* In general collectors buy virtually indiscriminately all that is offered and mix all coffee together. Similarly, exporters buy *tout venant* and pay a single price. Some exporters are however beginning to experiment with more discriminatory buying methods.

At export level, international trade sources are virtually single minded in their comment that the preparation of Malagasy coffee is not good enough and many add that quality is deteriorating and that liberalisation has not brought any improvement. In particular the moisture content is too high, especially in the beginning of the season. Internal traders buy coffee almost irrespective of its moisture content and most exporters accept it because otherwise their relationship with the traders will be disrupted and regular supplies may cease. What drying takes place is usually on the ground or on the roadside which contaminates the beans and results in unpleasant off-flavours (earthy, musty etc.). Mould also affects cup quality and the risk of ochratoxin is always present.

Coffee is also poorly harvested. Apart from strip picking, growers pick too early, in part due to the very real risk that the crop will be stolen. At times the unripe cherries are "boiled" or "fired" to enable the grower to separate the beans from the (immature) cherry. The beans are also often removed by pillonage or pounding. These practices increase the percentage of immature, damaged/split, and black beans.

Quality standards are twofold and based on screen size and defect count (Table 6). In practice, Extra Prima and Prima grades had fallen to 1% of total exports by 1980 and from 1983 onwards they had totally disappeared. By 1987, it was noted that Grades I and II were habitually classified as *Supérieur* while Class III were classed as *Courant*, leading to the conclusion that bean size was the only factual basis on which to quantify a deterioration in quality.

Table 6: Madagascar — Export Quality Standards

Screen Size	Quality based on Defect Count
Grade I -18 to 20 (Extra Large)	Extra Prima, Prima, Supérieur
Grade I -16 to 18	Extra Prima, Prima, Supérieur
Grade II-14 to 16	Prima, Supérieur, Courant
Grade III-12 to 14	Courant
Grade IV-10 to 12	Limite

Available data suggests the proportion of Grade I exports have fallen from 50.2% of total exports between 1980 to 1986 to 43.7% in 1997/98 (of which about 20% was Screen 18/20). The downward trend is obvious but even so it must be remembered that the standards only set the lower screen limit and, for example, a fall from screen 18 to screen 16 would not reduce the proportion of Grade I but it would very definitely reduce the "quality" of that grade.

In addition, export preparation is too variable. Export quality ranges from good to mediocre to very poor. Some exporters produce good quality but incur heavier losses in weight (more rejects removed) than do others. Buyers in Europe complain that the quality is generally too erratic and most roasters refuse to trade directly with Madagascar, preferring to buy from the international trade instead as the trade then takes responsibility for the quality. Also, the European buyers suggest that export standards are often not adhered to. Buyers have no confidence in the official quality controls, let alone the quality certificates which are delivered. For example, one of Europe's largest roasting groups will only consider Madagascar robusta ex-store Europe so each and every bag can be sampled before it is allowed to be despatched to the roasting plant.

The foregoing are generally known and accepted facts but it is difficult to quantify the suggested fall in quality because of a lack of statistics on the quality of coffee exports. The Ministry of Commerce through the *Service de Conditionnement* is responsible for quality inspection. The service is short of facilities and funding and as a result inspections are perfunctory and the accuracy and value of the quality certificates are doubtful. Since about 1994, the Service has not recorded its findings in any statistical form and is unable to offer anything but general comments on the fall in coffee quality.

Production

The coffee sector's ability to reap the benefits of the liberalisation of Madagascar's economic structure has been hampered by a macroeconomic climate which has, until fairly recently, i.e. 1994, been unstable. Also sharply falling international prices in the early 1990s meant that production became increasingly unprofitable for small farmers and many switched to more profitable food crops. However, efforts to reduce the budget deficit, lower interest rates and depreciate the FMG have combined since 1994 to improve the sector's competitiveness. Unfortunately, conditions within the sector itself have remained largely unchanged in that the area planted to coffee continues to reduce. The tree park is very much over-age, yields are low and quality generally remains poor. There has been no or very little investment in the infrastructure in the main producing areas and poor road conditions limit the ability of many farmers to benefit fully from the higher proportion of the f.o.b. price which liberalisation has brought to those in easily accessible areas.

Another and probably more realistic explanation for the lack of investment since liberalisation is that by the late 1980's the industry had degenerated to the point where it had simply become unrealistic to expect strong and positive reaction to the price impetus which liberalisation appeared to bring. The coffee industry was and continues to be demoralised, it is purely driven by ad hoc events, and certainly at the farm level, it does not benefit from any strategic planning.

Similarly the provision of supporting services remains poor. The specialist coffee extension services ceased in 1990 and were replaced by a "general specialist" MOA service. The service is over-centralised with little field impact as current funding is low. Feeder roads remain poor, effective research advice and assistance are not available, new planting material is not being distributed and inputs have been subjected to import duties and value added taxes.

Regulation

Criticism of the liberalisation process as it affected the coffee industry includes the failure to establish a formal structure which would regulate, co-ordinate and monitor the industry, and which would assume those administrative and support activities of CAVAGI. Since 1990, the coffee sector has not known any major, sustained government or donor driven assistance (and as far as is known no direct investment at all) although some modest actions are now under way.

Pre-liberalisation, CAVAGI "represented" the various groups who make up "the industry" and to a fashion dealt with industry issues by presenting them to government and financing some services. When CAVAGI was abolished as part of the liberalisation process, the services that it rendered to the industry were also dissolved. With the disappearance of CAVAGI, the industry broke up into its different constituents: growers who have no representation at all whether formal or informal; collectors who have informal representation; and exporters who are formally represented by the CNCC. The CNCC had a very limited mandate but could have played a more positive role if from its inception its membership had not been dominated by state firms.

Marketing

Although there is a strong, but mostly at arms' length, foreign influence, the local private sector has taken over the entire marketing function and after the inevitable "shake out" of new and less competent operators, the export trade is now showing signs of becoming more professional in its outlook. However, most of the local trade still satisfies itself with selling "what is available" and does not engage in any meaningful attempts to arrest the slide in quality or quantity which, in the long run will affect the exporters' future.

Outlook

Modern Madagascar does not appear to have developed a well defined coffee strategy which can be considered a prerequisite to rejuvenating the industry. A more pro-active approach to developing a strategy would be for all stakeholders to formulate a general vision for the future which will also help shape the direction of the decentralisation and the new *provinces autonomes*.

When considering coffee strategy, it is important to determine which of the three industry "components" is worth investing in. From a pure coffee production point of view it is most likely that only the larger growers, in selected areas, present a viable option. The mini growers and the old plantations do not. However, the industry needs an earlier rather than a later catalyst if the continuous decline of production is to be halted. A rejuvenation programme can only yield longer term results, especially under Malagasy conditions. On the other hand, simultaneous investment in new (initially probably smallish) modern industrial plantations (and demonstration plots) in selected areas, growing clonal coffee which retains the inherently good quality for which the country has been known would be one way to demonstrate relatively quickly that good quality coffee can be grown, that a market exists and that quality pays both in terms of value and more stable roaster interest, i.e. improved market security.

If the industry is to have a future then both producers and the industry at large, including the international trade, need to be convinced that there is potential and that investment is worthwhile. The pre-conditions for this are that the government will encourage such private investment and that land ownership issues be addressed and crop security be improved. But even so, investment capital may not immediately be easily available because of the risk of cyclone damage and venture capital support may have to be provided.