

## PRICING POLICY OF COCOA IN GHANA

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### **Background**

Ghana is the world's second leading producer of cocoa with a market share of 21% of the total world volume after Cote d'Ivoire. Production is mainly by smallholder farmers (800,000 households) (Adu-Acheampong, 2009). Annual production averages 250 to 400 kg/ha, which is among the lowest in the world compared with 580 and 770 kg/ha for Cote d'Ivoire and Indonesia, respectively. Production constraints include low incomes, land tenure arrangements, limited farmer access to credit, poor availability of affordable and timely inputs, weak organisational capacity of farmers (linked to low literacy rates and political interference), poor farmer representation at policy levels and inadequate technical extension support. Low incomes have also been found to impede growth and sustainable cocoa production as farmers are discouraged from making productivity enhancing investments (*A World Bank Report*). Today, Ghana's production level is about thrice what it was 30 years ago as a result of COCOBOD's intervention to improve disease and pests control, and soil fertility and rehabilitate moribund farms.

But, the key to sustainable cocoa production also rests on policies adopted with respect to cocoa producer price incentives and other macro-economic instruments such as exchange rates, export taxes, inflation and interest rates of Government. This paper examines the issues relating to cocoa pricing policy as studied by the cocoa domain Concertation and Innovation Group (CIG) of CoS-SIS, and points out the way to provide better price incentives and welfare enhancing schemes sufficient to increase exports and improve farmers' standards of living. Issues of levying of cocoa farmers as export tax, and industry costs are also discussed.

### ***The Concertation and Innovation Group (CIG) of the cocoa domain.***

As a national priority, cocoa was selected as one of the three domains for study in Ghana by the CoS-SIS programme. Smallholder farmer constraints in the cocoa sector are complex and, therefore, needed diverse interactive individuals with mutual interest and clout to ensure that change occurs in existing policies that adversely affect farmer behaviour. The collection of individuals with diverse expertise and experience from stakeholder organisations along the cocoa value chain is what I refer to hereafter as the Concertation and Innovation Group (CIG). The CIG was formed in August 2010 and addresses constraints related to pricing in Ghana's cocoa sector. Actors were drawn from along the cocoa value chain (Figure 1) and these are expected to ensure that some identified changes take place that can improve the standard of living within smallholder farming communities. Cocoa is a national crop so the CIG operates at the national level, but actions are expected to influence behaviours at the farmer level. Current membership of the CIG is presented in Table X below:

**Table X: Members of the Ghana cocoa CIG**

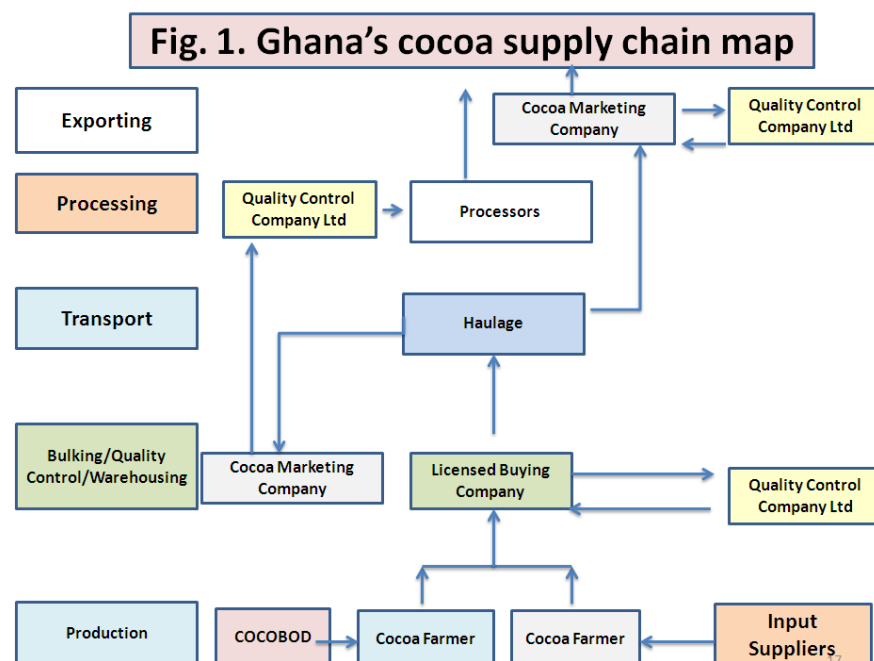
<b>Value chain actors</b> <ul style="list-style-type: none"><li>• Farmers' representative</li><li>• Kuapa Kookoo (licensed buyer)</li><li>• Cargill Ghana Ltd (local processor)</li><li>• Organic cocoa farmers association representative</li></ul>	<b>Regulators</b> <ul style="list-style-type: none"><li>• Ghana Cocoa Board (Director of research department, formerly policy advisor on cocoa affairs to Minister of Finance &amp; Economic Planning)</li><li>• Advisor on cocoa affairs to Minister of Finance &amp; Economic Planning</li><li>• Quality Control Company Ltd</li><li>• Ghana Standards Authority</li></ul>
<b>Service Providers</b> <ul style="list-style-type: none"><li>• Cocoa Inputs Company Ltd</li><li>• Ghana Cocoa Board (Deputy Director of Seed Production Unit, formerly National Coordinator of COCOBOD fertilizers and input distribution)</li></ul>	

*The hallmark for success of the cocoa innovation platform is based on the belief that the challenges are enormous; we required collective understanding of need for change, cooperation, concerted efforts and trust among members. I am happy to say initial suspicion has disappeared and support is increasing. A good number of us have benefitted from the interaction.*

The focus of the original entry point (quality-price differentiation) has somehow changed to reflect what the CIG deem as more pressing - examination of the cocoa pricing policy with the view to ensure an aggregate price increase and equity of income for all cocoa farmers.

Numbers, positions in organizations and roles of CIG members have changed over time, and this has generally worked to the advantage of the CIG. For instance, a former economist at the Cocoa Producers' Alliance's (COPAL) Headquarters in Lagos, Nigeria and now the policy advisor to the Minister for Finance and Economic Planning joined the CIG in February 2012. The then policy advisor on cocoa affairs to the Minister for Finance is now Director of Research, Monitoring & Evaluation at COCOBOD (the Producer Price Review Committee is under this office). A former national coordinator of the cocoa Hi-Tech (COCOBOD input distribution) came to speak to the CIG and his rich experience was found useful leading to his recruitment on the CIG. Since January 2 2013 he has been promoted as Deputy Director of the Seed Production Unit, a subsidiary of

COCOBOD, which oversees distribution of planting materials for cocoa planting and rehabilitation in the country.



Source: Supply Chain Risk Assessment: A World Bank Report

## Activities and findings

### Internal marketing of cocoa in Ghana

Cocoa marketing process begins with the farmer and ends with export by COCOBOD as the cocoa marketing system is not fully liberalized. Some 28 licensed buying companies (LBCs) regulated by COCOBOD buy all grades of cocoa beans from farmers at a fixed price set by the PPRC. The International Cocoa Standards require cocoa of merchantable quality to be fermented, thoroughly dried, free from smoky beans, abnormal or foreign odour and free from any evidence of adulteration. It must be reasonably free from living insects, broken beans, fragments and the beans must be seasonably uniform in size. In the past, a Produce Inspection Division (PID) existed whose staff (the traditional graders stationed in the farming communities) carried out inspection and grading of cocoa beans at the farm gate. In 1975, the PID and an Infestation Control Department of the Board were merged to later become known as the Quality Control Division, now Quality Control Company Ltd. Grading is no longer done at

the farm village level and LBC's buy all grades of beans, the fixed price and insist on weights above the stipulated to compensate for expected low quality beans. At the opening of the cocoa season (September/October each year), LBCs receive a soft loan based on their market share from COCOBOD, and they receive a commission (9%), which is based on volumes of cocoa supplied. Increasing competition pushes LBCs to offer incentives to gain access to farmer's cocoa and loyalty. Unfortunately available information shows that benefits in the farmer-LBC relationship is one sided with a lot of cheating of the former right from the weighing of the beans, forgery of records in farmers' passbooks (a cocoa sales book that every registered cocoa farmer must have for the records of output) and up to the payment of farmers' bonuses. In fact the passbooks of nearly 60% of cocoa farmers are kept by purchasing clerks of the LBCs.

#### *Issues relating to setting the producer price of cocoa*

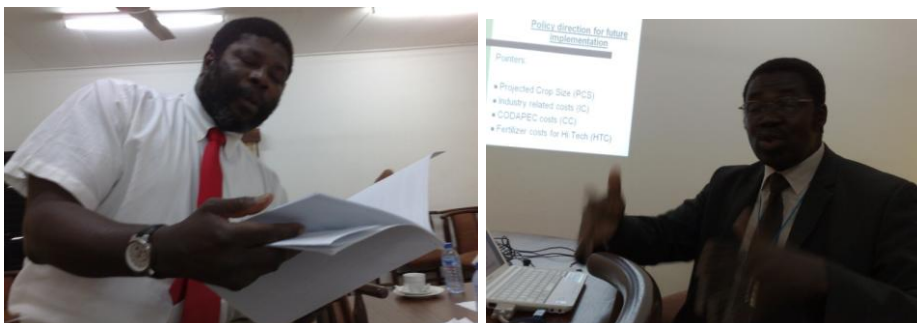
At the outset, the CIG realized that only one member had any idea about the cocoa price formation mechanism, and so we started off with deciding to find out about it. We distributed tasks among the members to find out what the situation is in Ghana and in neighbouring countries. The CIG gathered pricing information from Ghana, Cameroon and Cote d'Ivoire (as it was easy to use Cargill member on the CIG and because Cargill is a major player in the Ivorian cocoa sector). Three price regimes exist in Cote d'Ivoire: (i) farm-gate prices are the household prices that roaming collectors pay farmers and these are calculated as the average price for the six regions. (ii) an indicative farm gate price is established by the government for each cropping season, which is used only for general guidance of farmers and is not enforced. (iii) export prices are discounted world prices set by exporters as a function of cocoa future prices on international markets, and depending on the quality of cocoa beans each season, this can be lower or higher than the world average.

The pricing policy employed by Ghana, however, is based on an artificially-set proportion of the f.o.b. (free-on-board) price and not on real costs. This leaves unspecified how the f.o.b. price is to be translated into domestic currency. COCOBOD sets a cedi producer price, which given prevailing world cocoa prices and the current exchange rate meet the specified target percentage of f.o.b., and the Government anxious to raise revenue in the following year, might devalue, thus raising the cedi export price of cocoa. This would have the effect of raising domestic prices and reducing the real value of the producer price of cocoa. Usually, the board pays cocoa farmers a given percentage of the finally realized export price as a bonus if the cedi were devalued, premium (because of quality differences, Ghanaian cocoa is usually exported at a premium from the world price - generally does not exceed 10 percent) and if world prices improved. Some schools of thought argue that apart from the administrative complexity of the system, a promise of future payment to cocoa farmers is less attractive than current payment. Others argue that increase in real producer price of cocoa will have real benefit on Government revenue, foreign exchange earnings, on incomes of cocoa farmers, and indirectly on rural and urban wage rates and prices of

some food crops; the extra income transferred to cocoa farmers will be spent on taxed foods and will in part return to the Government and let consumers also share in the windfall profits from high cocoa prices. Following on reforms of the 1990s, COCOBOD aims to pay at least 70 percent of the free-on-board (f.o.b.) price after deductions of industry cost which includes that for the supply of inputs under the national cocoa diseases and pest control programme (CODAPEC). Under the programme, farmers get 'free' foliar fertilizer and pest control through spraying gangs hired by COCOBOD with pesticides and other input farmers have no control over. Information gathered by the CIG indicated that majority of cocoa farmers do not benefit from the spraying programme and there is increasing input and labour costs, inflation and depreciation of the cedi (the national currency). It is speculated that there collusion with input suppliers and pesticide companies who apparently have stopped retailing their products. Pest control currently is inadequate, and there is risk of pests becoming resistant. The CIG has pushed for a review of the country's pest control recommendation that was set in the 1950s (Adu-Acheampong et al. 2012). Table X shows calculations made by the CIG on the f.o.b. price calculation formula.

In the 2012 season for instance, the farmers' representative reported to the CIG (i.e. feedback) about meetings and discussions he had had with local, district and regional chief farmer. The outcome was that farmers' expected the producer price for the 2012/2013 season increased to GH¢250 from GH¢205 per bag of 64kg, which takes into account inflation and depreciation of the cedi. By estimation, the price of cocoa as at the time of announcement (GH¢205) was equivalent to \$136.66 at an exchange rate of GH¢1.50: \$1.00. It was noted that the producer price needed a significant upward adjustment because of inflation, increasing cost on investment and depreciation of the currency (the cedi). By July 2012, at an exchange rate of GH¢1.90: \$1.00, the 2012/2013 producer price ought to be GH¢259.65. The task to convey the farmers' concerns to the PPRC was given to the Director of Research, COCOBOD.

The key to the diverging paths between Cote d'Ivoire and Ghana perhaps is in the policies their governments have adopted with respect to farmer incentives and other policy instruments such as exchange rate, taxes and interest rates and farmers along the two borders are quick to decide in which country to sell their produce in order to make profit.



**Figure X.** Members sharing feedback: they had done their research and were reporting their findings to the CIG.

**Table X.** Variables in the free on board (f.o.b.) price calculation for the cocoa sector in Ghana

**Net Revenue = Gross Revenue – (Industry costs + CODAPEC costs + Fertilizer cost for Hi-Tech + COCOBOD Scholarships)**

Gross Revenue = Projected crop size × f.o.b. price × exchange rate  
 f.o.b. price = Total revenue of forward sale ÷ Projected forward sales

Projected forward sales is usually 60-70% of projected crop size

NR = 100%, All industry costs = 30%

Farmers' share = Net Revenue – All industry costs = 70%

### *Issues relating to the cocoa export tax*

Table X presents export and local duties on cocoa. The key question that has come up is why cocoa farmers should be subjected to a higher tax rate than non-cocoa farmers. Interestingly, these tax elements (variables) are inadvertently missing from f.o.b. price calculation as is the case in the example in Table X above. The CIG expects more transparency in the pricing, and should the government be committed to reducing overall cocoa taxation, (to make more money available to the farmer) there is need to identify alternatives to cocoa export taxation – for example oil.

<b>Table X. Some cocoa export and local duties over the years</b>						
Year ending 30 September	1971 ¢000	1986 ¢000	1994 ¢000	2001 ¢mill	2006 GH¢	2011 GH¢
Gross turnover	256,366	71,337,780	329,826,934	2,609,646	1,100,691,700	4,754,198,210
Export and local duty	116,990	30,896,345	123,923,912	299,612	61,600,000	148,679,011

Source: COCOBOD Annual Reports

### *Issues relating to COCOBOD costs*

The World Bank is said to have proposed some two decades ago that COCOBOD reduce its costs to 15% of the f.o.b. price. A ratio of COCOBOD costs on the basis of the 1950/51 f.o.b. price was 6.5% for the period 1950/51 to 1959/60. Considering that some costs are currently higher because of the need for more diseases and pest control, soil fertility improvement, cocoa rehabilitation, more research and extension, the 15% might seem reasonable. However, a recent producer price calculation (for the 2009/10 cocoa season) seems to suggest a much higher industry cost that will cause a drop in that farmers share according to the calculation in Table X above.

<b>Table X. Farmer price calculation 2009/10</b>	
Average FOB price (est.)	UD\$ 2400/metric tonne
Exchange rate (est.)	1.46 Cedis/US\$
Crop Size (est.)	700,000 metric tonnes
<b>Deductions</b>	
Disease & Pest Control	111.3 million US\$
Scholarship fund	6.8 million US\$
Jute Sacks	13.5 million US\$
CSSVD	9.6 million US\$
Cocoa Hi-Tech	47.5 million US\$
Child Labour Certification	1.3 million US\$
<b>TOTAL Deductions</b>	<b>277.9 million Cedis</b>
Net FOB Price	US\$ 2128/metric tonne
Farmer Price	US\$ 1512/metric tonne
<b>Share of net FOB</b>	<b>71%</b>

Source: Supply Chain Risk Assessment: A World Bank Report

The idea that a parastatal has the power to use part of the export earnings of cocoa for spraying gangs who use pesticides which are procured by government itself without

outside accountability is a recipe for corruption and collusion with the international pesticide industry. The fact that farmers have no say and no knowledge about the pesticides being allocated is a form of disempowerment instead of building up the capacity of farmers. Both equity and effectiveness concerns subsequently were raised by the stakeholders, including cocoa farmers' organisations. Other studies (Abankwah *et al.*, 2010) have recommended that periodic review of the producer price to compensate for increase in general price levels in the economy will improve the purchasing power of farmers.

### *Controlling Cocoa supply through consumption*

That the elasticity of cocoa supply is low (higher global output causes drop in world prices), the CIG is proposing to COCOBOD to strengthen education on cocoa consumption for better health among Ghanaians and for inclusion of cocoa beverage in the school feeding programmes and farmers through the LBCs.

### *Achievements of the CIG*

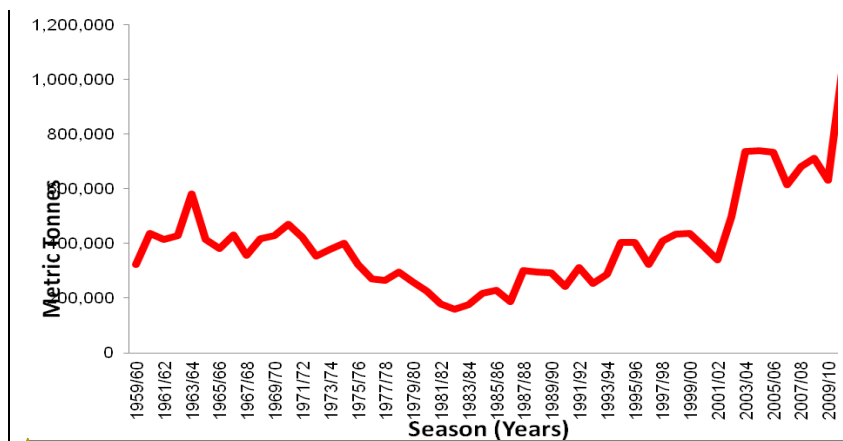
- Recent price increases, 33.3% in 2010/11 and 2.5% in 2011/12 and 3.4% in 2012/13 – (despite declining world prices) are in line with the CIG proposition that excessive costs of CODAPEC activities, inflation and devaluation of the cedi erode money that should be available to farmers. The positions and clout of CIG members did play a major part. The farmer investment response to the price increase was evident as Ghana's cocoa output rose to an unprecedented 1,024,553 tonnes in 2010/11 compared to 632,024 tonnes recorded in 2009/10 (see Figure X below). The increase in output is 62% over the previous year's – the case of what farmer incentive can accomplish.
- Advertisement of government input distribution in the national newspapers and the involvement of the private sector in government input distribution through CIG negotiation with CODAPEC and government policy makers ensures transparency in the system. Our pursuit for an exit strategy for CODAPEC, in the not too distant future means no more mass spraying but need-based on farmers' assessment of pest incidence. We also suggest further study and promotion of the potential of treatments used in the organic cocoa sector with the view of wider application in non-organic areas. A recent visit to the cocoa areas shows that with good price, farmers are ready to invest on inputs and other farm operations.

### *The future of the Cocoa CIG*

As CoS-SIS comes to an end members explored other avenues and currently have linked the cocoa CIG to a National Platform of Stakeholders under the African Cocoa Initiative



under the Ministry of Finance & Economic Planning, and funded by the World Cocoa Foundation and USAID.



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