

Raising Farm Gate Prices

Approaches to Ensure a Living Income for Smallholder Cocoa Farmers

Introduction

Over the past years, the cocoa sector has come a long way. Governments, companies and civil society have learned to engage each other in critical and constructive dialogue around diverse topics. Which approaches to reduce child labour work best, non-competitive collaboration on yield increase programmes, streamlining training curriculums and audits for certification; the sector has developed a broad and varied vocabulary in its approaches towards a more sustainable cocoa sector. On one topic, however, we seem to have far too little conversation; farm gate prices. There is no discussion on viable options to raise farm gate prices to the level that allows farmers to escape structural poverty and attain a living income. The goal of this paper is to initiate deeper discussions around cocoa farmers' incomes. To do this, the paper outlines the challenges and potential approaches to addressing the problem that have been put forward over the years.

Executive Summary

- It is a matter of urgency to find ways to raise farm gate prices, both to alleviate poverty at farm level, as well as to make the cocoa sector sustainable in the long term.
- Living income should be the aim, not just a return to pre-decline price levels. This will require common approaches to living income calculations. The focus on productivity increases currently being pursued by most industry actors will not suffice.
- In the short term, chocolate manufacturers can no longer hide behind 'the market'; prior to the next main crop season, they have the responsibility to ensure a higher farm gate price (implementing floor prices or flexible premiums). In the medium-to-long term, they have the responsibility to ensure holistic sustainability interventions, incorporating income diversification strategies and access to finance in their sustainability programmes.
- In the medium and longer term, governments are going to need develop and implement agricultural policies commensurate to the size of the challenges. They will have to ensure farming communities have access to basic needs, and they will need to work together to ensure a sustainable level of cocoa supply management.
- These approaches will require strong political will, by governments and industry alike, and will require a willingness to look beyond a business as usual approach.
- In all cases, the wellbeing of farmers and their families should be the first priority in any decision taken, with specific attention to be paid to gender issues and child-rights.

Failed Market

Since the liberalisation - under pressure of the IMF and World Bank - of the cocoa markets in the 1980's, the sector has largely avoided talking about how to raise farm gate prices. 'The Market' was expected to balance supply and demand, thereby leading to the 'right price'. However, the market has failed for the majority of cocoa farmers; they are extremely poor. The time has come to address some of the core design flaws of the system.¹

Price Decline

The past months have seen the price of cocoa plunge by a thousand dollars per metric ton since September, a loss in value of over 30%. This will have disastrous results for the already impoverished cocoa farmers of West Africa. It also poses serious problems for the Ghanaian and Ivorian governments, for whom cocoa revenues are an essential part of their GDP.

The minimum price systems in Côte d'Ivoire and Ghana have delayed the impact on farmers of the price decline, but farm gate prices of cocoa have already decreased in Côte d'Ivoire, and in Ghana they are expected to decrease significantly in real terms within the coming months, posing a risk for farmers' confidence in their governments.

One senior sector representative mentioned under Chatham House Rules in March 2017 "the price decline of cocoa will *de facto* erase all of the sustainability gains that have been achieved in the past ten years". This will harm current efforts to combat child labour, exacerbate gender inequality, foster deforestation, and contribute to many of the other major challenges facing the cocoa sector.

Living Income²

Not only is it necessary to look at ways to influence farm gate prices to protect farmers from price shocks, it is also essential to look at this topic to increase farm income in general. Even at the price levels of mid-2016, before the decline, almost all cocoa farmers were living well below

¹ Though countervailing powers do lead to a reasonable balance of price for most of the supply chain, the recent SEO research states "the main reason for the persistent poverty among cocoa farmers is the fact that most of them are price takers, with little or no market power." Nienke Oomes, Bert Tieben, et al. *Market Concentration and Price Formation in the Global Cocoa Value Chain, SEO Amsterdam Economics, p.1.*

² Living income is the net income a household would need to earn to enable all members of the household to afford a decent standard of living. Elements of a decent standard of living include: food, water, housing, education, health care, transport, clothing, and other essential needs including provision for unexpected events. *Definition of "Community of Practice" on Living Income, hosted by GIZ, ISEAL, and Sustainable Food Lab*

the poverty line. Structurally low prices (adjusted for inflation) have reduced the attractiveness of cocoa farming for several decades.³

One of the key starting points for this conversation, as we have advocated for several years now, is a common approach to a living income. It is a precondition for the approaches suggested in this paper. However, in the cocoa sector, this has turned into a largely academic discussion, with some pilots here and there, but very little movement, and no deliverables as of yet. Unless we can answer the questions “what should a farmer be able to earn”, all the approaches discussed in this paper will be looking at a worryingly incomplete finish line.

Productivity

Current industry approaches to cocoa sustainability are almost exclusively based on increasing productivity per hectare. Though this is an important variable, the current productivity approach does not provide a macro solution to farmer poverty. A recent paper commissioned by the Dutch government argues that “initiatives to raise cocoa sector productivity are not the solution for all farmers”, and that “farmers need both a major price increase for their cocoa and a substantial increase in productivity in order to make a decent living out of cocoa”⁴. The current global oversupply of cocoa (arguably one of the causes of the current price decline⁵) will hardly be dealt with by increasing productivity even further. A productivity-driven approach, therefore, might work for a few farmers but, in general, only further exacerbate the problems of the majority of farmers.

Return on Investment

Even to maintain current production capacity the ageing farmers have to invest in the rehabilitation of their cocoa trees, which are mostly at the end of their life cycle. However, investment in sustaining or improving productivity only makes business sense if the investment is expected to pay off, especially for crops such as cocoa,

³ The 2012 and 2015 Cocoa Barometers, recent research papers, as well as remarks by industry leaders confirm that the average cocoa farmer earns well below \$1.00 per day, far below the extreme poverty line.

Further reading; Gaëlle Balineau, Safia Bernath, Vaihei Pahuatini. *Cocoa farmers’ agricultural practices and livelihoods in Côte d’Ivoire*, AFD Paris, 2017; Oomes, Tieben, et al.; Oliver Nieburg. *ConfectioneryNews*. [ONLINE] Available at: <http://www.confectionerynews.com/Commodities/Even-doubled-income-for-farmers-won-t-make-cocoa-sustainable-Mars>.

⁴ Oomes, Tieben, p.11, p.76

⁵ According to Lionel Soulard, Managing Director, West Africa, Cargill Cocoa & Chocolate, the “large oversupply of cocoa beans’ ... led to a fall in [world market] prices”. Oliver Nieburg. *ConfectioneryNews*. [ONLINE] Available at: <http://www.confectionerynews.com/Commodities/Cocoa-price-for-Ivorian-farmers-may-drop-30>

which need years to reward investments.⁶ Therefore, a low cocoa price is also a threat to future cocoa production, and to the long-term profitability of the large cocoa companies.

Industry Responsibility

The simplest way to raise farm gate prices – and it almost feels too obvious to mention – is for companies that buy cocoa beans to simply pay more to the farmers. Paying the farmers more is the fastest, most efficient, and simplest way to address cocoa poverty in the short term. As long as there are no long-term solutions, manufacturers should start immediately.

Profit/Poverty

Since the mid-1980’s, transmission of price fluctuations in cocoa has been asymmetric; while retail prices rise quickly when the price for cocoa goes up, they only drop slowly when cocoa prices go down.⁷ This means that with falling prices of cocoa beans, chocolate manufacturers see an increase of their profit margins.⁸ As such, manufacturers have a short-term responsibility to ensure they do not make extra profits at the expense of extra poverty.

Price Level

What should the level of a minimum price be? When approaching this from a farmer’s perspective, clearly the price should be high enough that a farmer can earn a living income for him/herself and his/her dependents. However, because of the lack of a sector wide definition on how to calculate a living income, at present we simply can’t say how high the price should be to cover a farmer’s basic needs. Therefore, it is essential that the sector come with a clear consensus on living income and how to calculate this, within the very short term.

Inter-Crop Parity

From a market perspective, prices that are high could lead to farmers in other commodities to switch to cocoa, as well as to current cocoa farmers increasing production. This overproduction would put pressure on the world market

⁶ The Farmer Economic Model published by the World Cocoa Foundation (WCF) is a useful tool in this regard. Parameters like farm size, price, costs for inputs, costs for labour, etc. can be varied. Based on these figures the model shows which investments into a cocoa plantation and especially the rejuvenation of the trees are profitable. The future price of cocoa is the crucial and unpredictable factor in this calculation. [ONLINE] Available at: <https://hub.cocoaaction.org/econmodel/public/>

⁷ Catherine Bonjean, Jean-François Brun. *Price Transmission in the Cocoa-Chocolate Chain*. CERDI, Université d’Auvergne, 2007

⁸ This applies especially to chocolate and couverture manufacturers such as Mondelez, Nestlé, Mars, Hershey, Ferrero, Lindt, and Barry Callebaut. Barry Callebaut’s CEO highlighted the boost to margins from the “collapse” of bean prices. *AgriMoney*. 2017. [ONLINE] Available at: <http://www.agrimoney.com/news/barry-callebaut-shares-hit-all-time-high-as-cocoa-price-dip-helps-profits--10628.html>

price. This ‘inter-crop parity’ challenge will have to be addressed.

One-Size-Fits-All

A certain price might be sufficient in one region, but too low in another region. To set the level of the worldwide mandatory minimum price would be a major challenge, to a large extent repeating the same mistakes as the current one-size-fits-all world market pricing system.

Anti-Trust

Companies have been reluctant to discuss prices due to concerns around anti-trust laws. But there are indicators that competition authorities would allow conversations to take place, provided they are meant to protect human rights and combat poverty. Meanwhile, employees of these companies who know the living conditions on the cocoa farms in West Africa are well aware that farm gate prices need to significantly increase if cocoa production is to be truly sustainable. It is time for the companies to not use anti-trust concerns as a defence, to take the moral imperative, and engage in conversations around how to raise farm gate prices to ensure a living income for cocoa farming families living in structural destitute poverty.⁹ Though there might be concerns around collusion if this were to be decided upon at a collective level, there is no reason why individual companies shouldn’t be able to unilaterally decide to pay their farmers more.

(Flexible) Premiums

Premiums coupled to a certification scheme generally aren’t higher than 10% of the world market price, resulting in a marginal impact on the cocoa farmer income. If they are to be a tool to solve this issue, premiums will have to be more flexible, and will have to be a lot higher than current levels. Some smaller companies, such as Taza Chocolate, Ingemann, and Tony’s Chocology, already work with flexible premiums based on farm gate price developments.

A flexible premium system could help avoid some of the problems connected with floor prices and how companies could implement such a responsibility.

As premiums are a supply chain based approach, flexible premiums can be incorporated into contracts. Governments or regulatory bodies at the national level (such as CCC in Côte d’Ivoire, COCOBOD in Ghana), or at the international level (such as the FCC), could set up

⁹ Additionally, regulators are advised to re-evaluate antitrust legislation. Current laws seem to only attempt to protect consumers from prices that are artificially high. However, any market economist can explain that market power works both ways, both downstream and upstream. It is time for competition regulation to work both ways, and to also protect first producers from prices that are artificially low. This asymmetry is one of the prime reasons why our food system is broken, not just for cocoa farmers.

model contracts. These could be set at regional levels, avoiding a global one-size-fits-all pricing system, although approaches would need to be found to address the highly asymmetric bargaining power of farmers.

The risk of price volatility could be shared; with an upper limit for a premium threshold, there would be no premium at all if prices were high enough; with a price below that level, the premium would increase step by step, until a guaranteed minimum farm gate price is reached.

The fixed minimum prices in Côte d’Ivoire and Ghana could facilitate the implementation of flexible premiums. Currently, in both countries the minimum price is fixed at the beginning of the harvesting season, and could serve as a stable baseline for the calculation of the premium. However, these minimum prices would have to be increased significantly to ensure farmers can earn a decent income.¹⁰

A model of what such a flexible premium could look like can be found in the table below.

Flexible Premium Model (example)		
Gross Price	Premium	Farm gate
\$3,000	\$0	\$3,000
\$2,900	\$50	\$2,950
\$2,800	\$100	\$2,900
⋮		
\$2,300	\$350	\$2,650
\$2,200	\$400	\$2,600
\$2,000	\$500	\$2,500*
\$1,800	\$700	\$2,500

* Minimum farm gate price reached.

Government Responsibility

If the only intervention would be price-based industry-led solutions, within several years, there is a risk of an oversupply of cocoa. As such, price intervention must be coupled with a more long-term policy approach from producing nations’ governments looking at a coherent agricultural policy, and at some levels of global supply management. One simply cannot intervene in price and then laissez faire on supply. As such, there is also a crucial role for cocoa producing nations’ governments to take their responsibility on this issue much more seriously.

¹⁰ A full explanation of how a flexible premium system could work has been developed by the Südwind Institut, and can be downloaded at www.suedwind-institut.de. On May 16th, 2017, two members of the Barometer Consortium (Südwind Institut and Inkota Netzwerk) will be hosting a one-day conference on how this flexible premium – as well as other various best-practice models in cocoa and in other sectors – could work.

Agricultural Policies and Infrastructure

Governments of producing nations must develop and implement agricultural policies commensurate to the size of the challenges. This would include the promotion of, and accessibility to, diversified sources of income and access to credit. In addition, this will have to include the access to basic needs for farming communities. Ensuring child rights and gender equality are essential to maintain a healthy and thriving sector and cocoa communities

National Minimum Prices

The Cocobod and the CCC offer a guaranteed minimum price to the farmers. These have a necessary function of protecting farmers from day to day fluctuations in the price. Provided there is sufficient political will, it might not be impossible for one or both of these countries to raise prices nationally or regionally to a level that would ensure a decent livelihood, rather than being based on the international trading price.

Supply Management

Supply management has been a key element of the agricultural policy of most industrialised countries to protect their farmers. In fact, it has been one of the few ways by which Europe and the United States have been able to sustain their agricultural industries over the past decades.

There are various approaches to limiting the supply of cocoa, including the instalment of buffer stock funds, quotas, the introduction of an OPEC-like collaboration between the major cocoa producing nations, and the physical limitation of cocoa supplies through alternative uses of stockpiles.

Effective supply control would need to be achieved within the individual countries, as well as on a global level. At both national and global levels, this would require the establishment of workable mechanisms for (re)allocating individual production rights, monitoring quality and production methods, overcoming rent seeking, corruption and avoidance, workable mechanisms for monitoring national production and trade, (re)allocating production rights between countries, and overcoming free rider problems.

Clear lessons have to be learned from the international commodity agreements that functioned until the 1980's; as these largely failed due to a combination of not properly addressing the issues mentioned above coupled with ideological motives to deregulate and liberalise the global commodities markets.¹¹

¹¹ Niek Koning, Muriel Calo, Roel Jongeneel. *Fair Trade in Tropical Crops is Possible. International Commodity Agreements Revisited. North-South discussion paper no 3, Wageningen UR, 2004*

In all situations, a supply management solution would require significant political will. It would also require a higher level of trust and integrity at government levels than currently is the situation.

Income Diversification

In addition to ensuring a sufficient farm gate price, industry and government should promote income diversity, making farmers far less dependent on one cash crop and hence diminishing the risk that inter-crop parity concerns will over time impact the prices of a single commodity. Diversified production is also a potential useful tool within a large set of interventions for governments to implement their agricultural policies and supply management.

Current Approaches

The authors of this paper believe that new approaches are necessary to effectively tackle structural poverty and ensure a living income in the cocoa supply chain. If respondents believe current approaches are sufficient to this purpose, we invite them to provide us with the data to back such claims. If cocoa cannot drive development progress - including an end to child labour and structural poverty - then the producing nation governments should consider diversifying their development strategy.

About this Consultation Paper

This consultation paper is a first attempt to find new vocabulary on a very sensitive topic. As such, there will be mistakes and omissions in this paper. We call any and all stakeholders in the cocoa sector to provide their perspectives, corrections, additions, and responses to this paper. Feedback and input to this Consultation Paper will be used for the 2017 Cocoa Barometer, which is to be released in the fall. The deadline for submitting feedback is June 30th, 2017, to antonie@voicenetwork.eu.

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