Overseas Development Institute

Background Note

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Marketing reforms in Ghana's cocoa sector

Partial liberalisation, partial benefits?

Ghana is the second largest global producer of cocoa – being responsible for nearly a fifth of the world's supply – and it remains the only cocoa producing country in the world without a fully liberalised marketing system. In the early 1990s, the Ghanaian government opted for a gradual introduction of reforms, which have so far included only the liberalisation of internal marketing, privatisation of input distribution (for example, chemicals) and reform of extension services.

Thus, Ghana's state-owned Marketing Board (Cocobod) still controls external marketing. The Quality Control Division, a subsidiary of Cocobod, is responsible for the final quality checks of cocoa beans. Ghana produces good quality cocoa, for which it receives a premium on the world market. Through a system of forward sales, Cocobod still manages to prefinance cocoa production, and price stabilisation has remained intact.

The Ghanaian economy is heavily dependent on cocoa exports so the government is loath to relinquish control; private buyers rely on government licences to operate; and global buyers are guaranteed a good-quality product.

But cocoa farmers might not be benefiting as much as other stakeholders from the partial liberalisation. Intensive fieldwork undertaken with the Amsterdam institute for Metropolitan and International Development Studies (AMIDSt) in Ghana has shed some light on this issue, and the findings suggest that farmers are not benefiting fully from the system, and those benefits they do see are not equitably distributed. Not only that, farmers are being exposed to new risks — such as rises in production costs and in costs of living — as a result of the reforms.

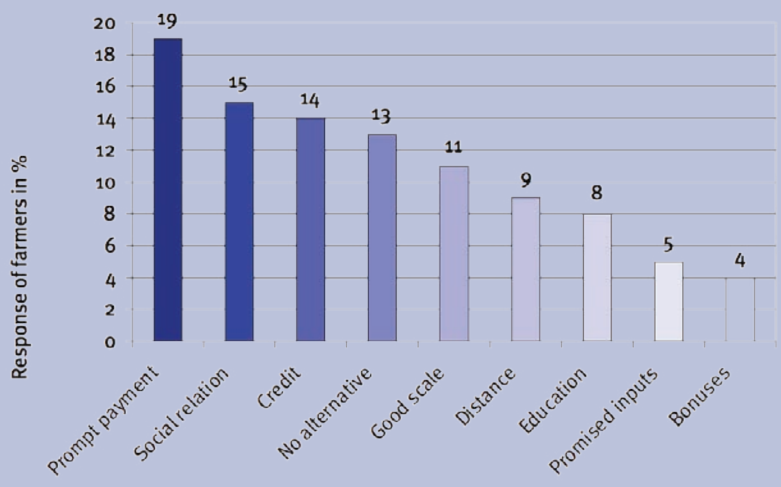
Cocoa sacks being collected at a one of the local buying companies in Ghana

Bringing competition to the internal market

The liberalisation of internal marketing started in 1992 with the introduction of private Licensed Buying Companies (LBCs) as competitors to the state-owned monopoly in buying cocoa from farmers (Box 1). The objective was to improve the operational and financial performance of Ghana's marketing system, to enable higher and competitive producer prices. The export taxes and net marketing margins reduced gradually. The share farmers received from the net Free on Board (FoB) price (the producer-price) increased from 56% in 1998-99 to 70% in 2006-07, equalling around US $995/tonne.

Despite the introduction of competition (LBCs cannot compete on price: all buyers pay the floor price, although some have introduced

Figure 1: Farmers' main reasons for LBC selection in Ghana in 2002/03 (n=173)



Source: Author, based on fieldwork in 2003

small bonuses), LBCs have found ways to ensure that farmers sell to them preferentially:

- Prompt payment;
- Asking farmers' community representatives to help select their purchasing clerks;
- Social involvement with farmers' communities, by attending funerals, for example; and
- The provision of services, subsidised input or credit.

In 2003, the top reason farmers cited for selecting LBCs was prompt payment, and this was followed by the farmer having a social relationship with the purchasing clerk and the provision of credit (Fig. 1). In 2005, social relationship was the main reason for choosing an LBC, followed by prompt payment and trust.

The liberalised system has (some) benefits for farmers. They are usually paid on time; if an LBC is unable to pay promptly, farmers always have the option of selling their cocoa to another buyer. However, research shows farmers do not benefit equitably from the liberalisation of internal marketing. For example, despite the promises made to them, only a small number received any services or bonuses from LBCs. The ones who did were mainly farm-owners and farmers living in the Western and Central region (where competition between LBCs is intense). Farmers in communities in Ashanti and Brong Ahafo have a limited choice of LBC. Private buying companies can choose where they open their buying-depots, while the former state-owned buying company is still obliged to operate in every cocoa growing district.

Surprisingly, the introduction of competition did not result in farmers negotiating with local buyers in selling their produce collectively or negotiating for extra services as a group. This could be because they prefer selling to someone from their social network, or they are not yet familiar with negotiating options available to them in the new marketing system. Moreover, cocoa farmers lack the organisation to support their negotiating power; a major legacy of the former state-run marketing system.

Obstructing external marketing

After introducing competition in the internal marketing of cocoa, the government decided to allow qualified LBCs to export part of their cocoa purchases from October 2000. Officially, LBCs are allowed to export 30% of their domestic purchases, if they meet the conditions set by the Ghanaian Ministry of Finance. The idea behind the gradual pace of the reforms was that this transition period would allow LBCs to become familiar and acquire the necessary skills for effective external marketing. The transition period was to have ended in 2003, with a final decision on whether to proceed or not with full liberalisation of the external market.

But the process has stalled. No formal decision on full liberalisation has been taken, and there is a sense that the current status quo of partial liberalisation is the desirable 'end-stage' of the reforms. Government officials argue that the current system works and that LBCs are unwilling or not yet ready to enter into direct exporting — the LBCs themselves generally contest this view.

Interviews with local buyers identify institutional constraints that some LBCs face. Despite the fact that the foreign-owned LBCs meet the requirements for exporting, and other LBCs have indicated they could meet the requirements by joining forces, Cocobod seems to obstruct their involvement in external marketing. This is illustrated by one comment made by an LBC representative:

'The way I look at it, we have three [LBCs] in a group, we could have a trading company to do the export for us, if we are allowed to export. But because Cocobod is not letting go, nobody is pushing it.'

LBCs do not officially complain about these practices, as the relationship between local buyers and Cocobod is hierarchical and buyers depend on Cocobod for their licence to operate. Smaller LBCs also benefit from the current system, as they can take advantage of the marketing expertise and ability to borrow offshore when financing local purchases of the Cocoa Marketing Company, a subsidiary of Cocobod. Also, for global buyers of cocoa, the partially liberalised system in Ghana is beneficial, as they are guaranteed consistent supplies of high-quality cocoa.

For Ghana, cocoa is an important source of income and foreign-exchange earnings. Consequently, the government has a stake in retaining control over cocoa exports. It is also in the interest of Cocobod to remain the sole exporter of cocoa, for which it receives an extra margin. In 2006-07, this margin was around 45% of the Net FoB price. A part of this margin is reinvested in the cocoa economy, through the payment of farmer bonuses, scholarships and housing for cocoa farmers, research, provision of pesticides and fertiliser, discounts on light-crop cocoa beans used for local processing and the improvement of cocoa roads. So far it is not possible to get insight into the exact composition making up Cocobod's margin. What is clear from our research is that farmers do not equally benefit from these reinvestments. For example, the government complemented farmers' income by paying bonuses at the end of the cocoa season. In the more remote Brong Ahafo region farmers had more difficulty obtaining bonuses, as did sharecroppers and farmers who fulfilled no special position in the cocoa community. Also, only 6% of the respondents had benefited fully from the 'mass-spraying programme' (Fig. 2). The provision of 'free' spraying of insecticides and fungicides was organised through the Cocoa National Disease and Pest Control Committee (CODAPEC), set-up by Cocobod. Not everyone benefited equally from the mass-spraying programme. Location of the farm mattered, as well as farmers' social networks.

Risks for farmers

Due to the reliability of the marketing system, Ghana's cocoa sector has a good reputation for fulfilling its contracts and providing good-quality products. However, the risks involved for farmers could be outweighing some of the benefits.

For example, the production of premium quality cocoa benefits farmers, but also entails a cost (as it requires adequate fermentation and drying techniques). In the 2004-05 cocoa season, there were serious problems with quality, as beans became infected with a disease that turns the beans purple and results in less flavoursome and more acidic cocoa liquor. Experts believe that because some LBCs, which are responsible for the first quality check of cocoa, did not encourage farmers to continue their traditional good farming practices, a high percentage of inferior beans were delivered to the market, affecting Ghana's reputation.

In response, Cocobod declared all bags of cocoa with more than 25% purple beans as sub-standard, and paid the LBCs only half of what they were due. The LBCs had already paid farmers and were unable to recover their costs. Most LBCs temporarily stopped buying cocoa, with knock-on effects on other economic activities in cocoa-growing areas. This also affected the livelihood of many farmers as they were not able to sell or store their cocoa and lost their main source of income.

Another development that has made farmers more vulnerable is the increase in production costs, due to privatisation of the distribution of inputs, and the rise in the costs of living (e.g. transport). It is not clear whether the increase in producer-price offsets the increase in costs. Some suggest the increase in production costs has led to 'self-exploitation' among farmers — i.e. farmers working longer hours, recruiting family members who would not normally be involved in the business, and increasing labour exchange groups.

Future changes?

LBCs are locked into a system with few incentives for high performance, and little financial scope for establishing strong relations with farmers, while LBCs are given more responsibilities without being able to generate increasing returns.

Although liberalisation has sparked the revival of farmers' organisations in other cocoa-producing countries and led to the establishment of more direct (trade) relations between global buyers and organised suppliers, this has not happened in Ghana. Consequently, farmers lack any collective strength and remain vulnerable during the transition process. This is especially the case for farmers living in more remote regions, sharecroppers, and farmers

Box 1: LBCs in Ghana today

In Ghana, around 25 LBCs are operational; the nine largest buyers own around 95% of the market. Two of them, Armajaro and Olam, have parent companies in the UK and Indonesia respectively. One LBC is also a farmer's union, the Kuapa Kokoo Union (KKU), and is officially owned by the farmers. KKU is supported by the British non-governmental organisation Twin Trading and sells around 3% of its cocoa beans as Fair Trade cocoa.

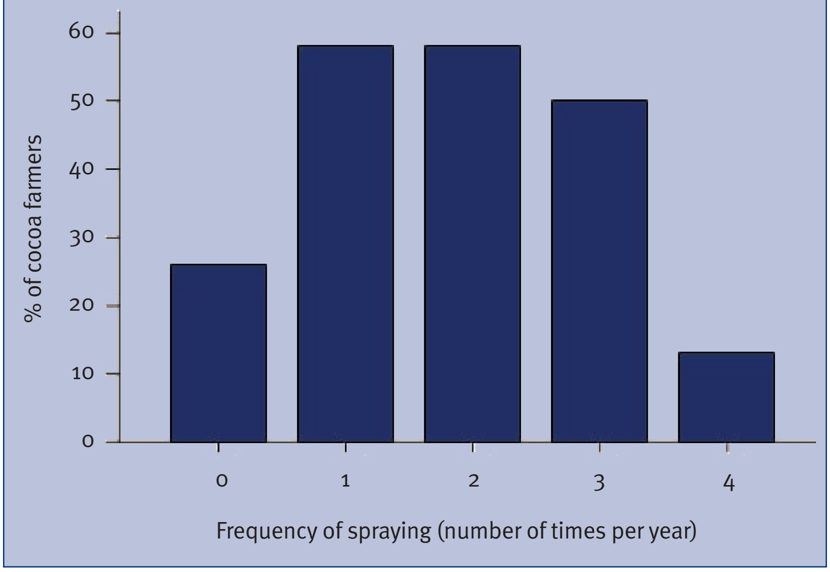
Most LBCs are Ghanaian, organised in a buyers' association but working independently. That said, the majority of the shares of three LBCs – Cocoa Merchants, Transroyal and Fedco – are owned by the same shareholder, transport company Global Haulage. The Produce Buying Company (PBC) buys most of the cocoa. PBC was previously government-owned, and it was the only buyer operational before liberalisation. It has now been partly privatised, and its shares are traded on the stock market, with the Cocobod being the company's major shareholder.

LBCs receive a fixed yearly 'buyers margin' set by the government. In 2002-03 this margin was set at 9% of the 'free on board' price. The margin was reduced in 2005, limiting the LBCs' incentives and ability to invest in long-term relationships with farmers. LBCs have two strategies for persuading farmers to commit to them:

- Investing in local purchasers of cocoa and making sure the purchasing clerk is capable, trustworthy and motivated to serve farmers' needs; and
- Investing directly in maintaining durable social relations with farmers and providing them with prompt payment, bonuses, gifts, rewards, inputs, credit and training.

Source: In-depth interviews with LBCs and purchasing clerks in Ghana in 2003 and 2005.

Figure 2: Frequency of mass spraying in 2003/04 (N = 205)



holding no notable position in the community.

Although partial liberalisation could be a viable alternative model, changing preferences of international buyers, or pressure from World Bank and international donors may provide the impetus for further reforms. If partial liberalisation remains in place, its long-term success depends also on the ability and willingness of the Ghanaian government to re-invest the income generated from exporting cocoa effectively back into the farmer communities and strategically for the long-term future of the industry. Either scenario will require an increase in the bargaining power of LBCs and farmers in relation to the state.

This background note was prepared by Anna Laven (a.c.laven@uva.nl), for an ODI/International Food Policy Research Institute workshop: 'Production, markets and the future of smallholders: The role of cocoa in Ghana', held on 19 November 2007 in Accra, Ghana. To find out more, and read the other papers prepared for this workshop, visit: http://www.odi.org.uk/plag/events/07_ghana_cocoa.htm

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