

GHANA

Strategy Support Program



Price Setting in the Cocoa Sector

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INTRODUCTION

The Ghanaian cocoa sector is considered a successful case of agricultural development in Africa. Sector reforms in the 1990s resulted in increased production that reached 1 million tons, making Ghana the second largest cocoa producer in the world. The Ghana Cocoa Board (COCOBOD) has played an important role in maintaining quality, thus earning Ghana a reputation for high quality and commanding a premium price in the global market. Through various public programs, the sector has been able to achieve some growth in productivity, and the institutional structure has been able to pass on a significant share of export prices to producers.

TO LIBERALIZE OR NOT TO LIBERALIZE

Higher producer prices are usually obtained through liberalization or introduction of competition, but the Ghana cocoa sector withstood pressure, most notably from the International Monetary Fund and the World Bank, to fully liberalize. Instead, the government initiated a stakeholder-led process to determine producer prices and re-introduced the use of licensed buying companies (LBCs) to procure cocoa from producers at or above the recommended prices. Prices are set by the Producer Price Review Committee (PPRC), an independent body that includes representatives of farmers, COCOBOD, LBCs and haulers. PPRC decides on the producer prices and shares of other stakeholders based on the recommendations of a technical committee similar in composition to the PPRC committee that also has representatives from the Institute of Statistical, Social, and Economic Research of the University of Ghana, and from the Bank of Ghana. Along with the establishment of the PPRC, several operations formerly controlled by COCOBOD were trimmed down, but quality control and the centralized export marketing system were left under COCOBOD's control. Although the cocoa sector was only partially liberalized, COCOBOD still managed to pass on a significant share of export prices to farmers, a key objective of the liberalization of commodity markets in Africa.

The partial liberalization probably did little to reduce marketing costs. This is understandable given that the margins of

buyers are determined administratively rather than through competition. Though the share of marketing costs in sector revenues is declining, costs per ton of performing marketing functions in both nominal and constant terms are increasing, although there should be significant economies of scale in some operations, including that of COCOBOD. The margins per ton paid to LBCs have been increasing in real terms over the last few years. Cost increases are particularly noticeable in the case of haulage, the rates for which are set by PPRC.

PRICES AND POLITICS

The government has successfully increased and maintained producer shares that have reached as much as 70 percent of export prices. To do this, the government set for itself targets to increase producer share by reducing both taxes and COCOBOD expenditures. The government may have done this initially in response to pressure from multilateral organizations to liberalize the sector but it is also likely that the government sees increased production of a major export crop as a key component of Ghana's economic growth strategy. Consequently, the democratic processes in the country help to keep the producer prices high. Not surprisingly, the manifestos of the two key political parties, the National Democratic Congress (NDC) and the New Patriotic Party (NPP) have made specific promises regarding cocoa prices. Both parties also contend that maintaining high producer prices is the most effective way to combat cocoa smuggling.

FAIR PLAY FOR FARMERS

In practice, the government has increased producer shares to some extent by reducing the rate of taxation from nearly a third of the export prices to one twentieth over the past 15 years. The government may have reduced tax rates to meet a political commitment, but fulfilling this obligation was made easier by a decreased dependence on cocoa taxes for revenue and rising revenues from the sector that have compensated for declining rates. New sources such as the petroleum taxes have reduced the share of cocoa taxes in government revenues.

Producer shares of export prices would have been even higher in recent years had industry costs not increased dramatically. The costs of services provided by COCOBOD are double the

levels recommended by PPRC and large surpluses left with COCOBOD appear to have encouraged over-the-budget spending on industry costs. This withholding of revenues to cover industry costs is tantamount to taxation, except that the expenditures are ring-fenced to benefit only the cocoa producers. Who among the producers is benefiting and whether the goods and services are provided cost effectively are issues of concern. Few industry cost expenditures are public goods—cocoa research and efforts to reduce the worst forms of child labor are examples. Less than about 7 percent of the funds go into research and welfare programs such as farmer housing and scholarships. The rest (93 percent) goes into supporting increased production and productivity in the short and long term. The total expenditure on behalf of farmers in 2011 amounted to more than 450 Ghana cedis (US\$ 220) per hectare. While some public goods need to be funded, it is important to consider whether some of the objectives would be more effectively met by giving producers 20–25 percent higher prices, at least in the longer run.

Although well intentioned, there are inherent problems in public delivery of services. Even if public provision of many of the services can be justified, it would be useful to consider alternative ways of provision. This study did not examine the benefits from major programs such as the Cocoa Diseases and Pest Control Program (CODAPEC) and High-Tech, but the unit costs of the services provided suggest the need to consider other options and considerable room for improving cost effectiveness.

PROBLEMS TO CONSIDER

COCOBOD's management of all aspects of these programs, including the transport of inputs, results in considerable inefficiencies. For example, LBCs complain that fertilizers are not received on time, and producers complain of not receiving the sprays they are entitled to. It is worth considering the option of giving farmers vouchers or resources to buy chemicals and organize spraying regimes themselves as and when the private sector can develop adequately. The board should consider experimenting with various options rather than waiting for a consensus. COCOBOD implements a massive program to benefit cocoa producers with-

out adequate information. It should urgently develop and make use of information on producers and their farms if it wishes to remain in the business of delivering services that benefit individuals.

Apart from political pressure to maintain the producer share, the current pricing system lacks a mechanism to encourage efficiency among marketing agents, particularly because pricing is administered in the spirit of sharing FOB price. The LBCs are reluctant to compete with each other because their profit margins are too small to generate sufficient savings to pay producers higher-than-declared prices. Improving the efficiency of parastatals will require considerable political will due to the fact that their inefficiencies add costs to the only private agents in the system (LBCs). Inefficiencies within the operations of both COCOBOD and its subsidiaries cause considerable delays in certification and transport of cocoa from depots to ports as well as in the payment for cocoa delivered by LBCs. These delays impose substantial financial costs on LBCs. Improving infrastructure and streamlining the operations of COCOBOD and its subsidiaries offer an opportunity to reduce marketing costs. However, it is not clear what will motivate them to reduce the operational deficiencies that have persisted for years despite healthy growth in the sector. The kind of political will that led to the initial reforms appears necessary to streamline the operations of the organizations in the absence of further reforms to introduce competition.

OPPORTUNITIES

Opportunities exist to bring in private companies to reduce costs and create rent-seeking opportunities. One option to introduce elements of competition in the sector is to pass on additional functions to LBCs and have them compete to deliver cocoa at the lowest cost to COCOBOD. The additional functions could be secondary evacuation of cocoa from depots to ports, the price of which is now set administratively, and certification of cocoa at LBC depots, which could be done by private agents if certification were to be opened to them.

Note: The term 'ton' in this brief refers to metric tonne.

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