FINANCIAL IMPLICATIONS OF LIBERALISING COCOA MARKETING

1. Background

The Ghana Government has since 1984 implemented various reforms in the cocoa industry aimed at reducing waste in the Ghana Cocoa Board (Cocobod) system and passing on savings in the form of higher producer prices to cocoa farmers. Under the Agricultural Sector Adjustment Program, the Government implemented additional reforms also aimed at creating a competitive domestic cocoa marketing system to further reduce marketing costs and consequently improve producer incentives and thereby increase output and exports. During the 1993/94 light crop season, private buyers were licensed to compete with the Produce Buying Company, a subsidiary of Cocobod in buying cocoa from farmers.

Under the reforms, the Licensed Buying Companies (LBCs) were expected to:

- raise funds from the domestic financial markets to purchase cocoa from farmers; and
- transport purchased cocoa to designated points for the Cocoa Marketing Company (CMC) to take over for reimbursement.

It turned out that the LBCs were unable to raise enough funds for their operations due to their inability to put up adequate collateral for their funding requirements. To circumvent this problem, Cocobod decided to give LBCs seed fund which was redeemed with cocoa purchased from farmers. Thus the internal marketing of cocoa has been liberalized since then while the external marketing remained the preserve of CMC.

La Cote d’ Ivoire (which produces about 40% of world Cocoa) fully liberalized its external marketing system from October 1996. It was therefore necessary that Ghana designed its own external trade liberalization option so as to counteract its neighbours’ efforts, before it losses its competitive edge.

A number of options were considered for liberalizing the external marketing of Ghana’s cocoa. Eventually, the Government settled on allowing LBCs to export 30 per cent of their purchases with the remaining 70 per cent handled by CMC. This option was on pilot basis to determine whether complete liberalization of the external market would be in
Ghana’s interest. The LBCs that were permitted to export 30% of their purchases during the 2001/2002 main crop season all decided to channel their exports though CMC since they did not have the required capacity to undertake the exercise.

This paper looks at the financial implications of the complete liberalization of the external marketing of cocoa. A review of experience of other cocoa producing countries in West Africa is in section 2, followed by implications of liberalization on quality of cocoa to be exported in section 3. Trade financing issues are taken in section 4 while section 5 deals with the producer price. Fiscal and balance of payments impact are considered in sections 6 and 7, whilst in section 8, a review of legislation and regulations that need to be revised in the light of liberalizing the cocoa sector are discussed. Expected benefits from liberalization and conclusions are given in sections 10 and 11 respectively.

2. Review of Experiences of Other Countries

We now review case studies of some West African countries which have liberalized their cocoa sectors. An overview of the findings regarding best practice in these particular cases are presented for Cameroon, Cote d’voire, and Nigeria.

2.1 Cameroon

Cameroon currently produces about 4 per cent of the world’s cocoa. Production has been fairly stable, falling below 100,000 tonnes only twice since 1977/78, while never rising above 133,000 tonnes.

Liberalisation in Cameroon was implemented in stages beginning in 1991\(^1\). Under the initial reforms, exporters were permitted to export directly and licensing requirements for domestic traders were removed. However, all marketing margins were still maintained to ensure the intra-seasonal stabilisation of grower prices. A formal stabilisation fund was established and the Office National du Café et du Cacao (ONCC) was established to regulate the system.

However, the system came under increasing pressure: the stabilisation fund went bankrupt and the ONCC’s operating costs increased. In 1994/95, the marketing system was further liberalised and the stabilisation fund were abandoned.

\(^1\) Liberalisation of external marketing of cocoa in Ghana, LMC International and School of Administration, University of Ghana, Legon, May 2000.
At present, the system is fully free market determined. Although there are exporter criteria in place, these are rarely adhered to and exporters are free to conduct business with little interference from the state. Despite the loose requirements for an export licence, in practice the exporters provide a bank guarantee to the grading companies such as SGS and SAGA in order to ensure the fluid movement of cocoa through the stages of storage, grading, and loading onto the ship. The grading companies take the process through to the loading stage on behalf of the exporter and claim the fees back from the exporter at a later stage. Export contracts are not required to be registered.

Prior to liberalisation, quality controls were enforced by the State both up-country and at the port. Following liberalisation, up-country checks were stopped and the ONCC retained responsibility for quality control at the port (and certification). In 1997/98, the ONCC’s responsibility for quality control was removed and three private sector firms were given the responsibility of issuing quality certificates prior to export. Additional four companies were licensed to issue quality certificates in November 1998. It is for the exporters and international buyers to decide which company to use for quality control.

Following liberalisation, the number of licensed exporters increased from around 60 to over 300. The internal market initially became chaotic and speculative: inexperienced operators entered the market with modest amounts of capital and for limited periods bought any grades of products offered to them. Both exporters and internal buyers lost money only to
be replaced by other inexperienced buyers, with the result that export contract default levels were high. By 1997/98 the number of active exporters had declined to around 50, but 10 companies account for over 70 per cent of exports. Four of the five largest exporters are foreign owned, although two of these companies were exporters prior to liberalisation. The increased competition and lower taxation resulted in an increase in grower prices as a proportion of the export price.

At first, quality deteriorated at both the farm and export levels. The increased competition has meant that farmers have effectively had a guaranteed buyer for their crop whatever the quality, and so attention to quality has fallen. More recently, exporters have taken action to grade and dry beans before export, and the reputation of Cameroon beans has recovered.

Trade finance has been a major problem for Cameroonian exporters. Following liberalisation the private sector have established a system of warehouse warrants in Douala, the capital, whereby exporters could store the cocoa in registered warehouses and be issued a certificate according to the amount in storage which would act as collateral for financing. This scheme continues to be the basis of crop finance in Cameroon; however, when an attempt was made to expand the scheme to allow for stocks held in warehouses up-country, a number of problems were highlighted, as warrants were issued against stocks that has not yet been delivered to the warehouses. The case of an up-country warehouse warrant scheme in Cameroon illustrates how the system can quickly become undermined. While the example of warehouse warrants in Cameroon should not deter its use elsewhere, it offers a valuable lesson as to the importance of proper policing of the system. At present, exporters who are subsidiaries of the multinationals are primarily financed from overseas, while the more established local exporters (who existed before liberalisation) use a combination of their own funds, local finance, international finance and pre-finance from overseas buyers.

### 2.2 Cote d’Ivoire

Ivorian cocoa production has risen from 227,400 tonnes in 1975/76 to 1.2 million tonnes in 2002/03. As a result, Cote d’Ivoire has become the largest producer of cocoa in the world with 43 per cent share (See Chart 1). The high levels of new plantings between 1975 and 1985 were a key factor in this expansion, particularly as much of these plantings were of a higher yielding hybrid variety.
Liberalisation of the external marketing of the cocoa sector occurred in October 1999. Prior to liberalisation, physical exports were handled by the private sector, while the Caisse de Stabilisation (Caistab) arranged export contracts and issued export permits to the private sector. Without an export permit, an exporter was not permitted to export. The Caistab also made its own direct sales whereby it arranged export contracts and then instructed private exporters to ship on its behalf. The Caistab was responsible for quality control and made checks both up-country and at the port.

In 1999 the cocoa sector was fully liberalised, with only an indicative producer price and export price being issued by the New Caistab. In June 1999, quality control was liberalised and is now the responsibility of two private companies, SGS and Cornelder (who have since merged).

In the early stages of liberalization, the low international price at the time placed severe strain on farmers who were receiving farmgate prices which were more than 50 per cent lower than the period before liberalisation. Farmers actively protested against the system and low prices and threatened to burn cocoa. This caused delays in the export of the crop. Farmers demanded for Government intervention, although intervention in producer pricing was not within the mandate of the New Caistab. Nevertheless, serious efforts were made to create a scheme, involving the forward selling of sizeable quantities of cocoa, to re-establish a system of stabilised indicative producer prices.

The new Caistab is currently renovating and building new warehouses up-country. This new infrastructure is to allow for the establishment of a physical commodities exchange and, given that the stocks would have to be graded and certified, there should be no barrier to the development of a warehouse warrant scheme.

The Ivorian case study highlights the issues of concern already raised by the Ghana with regard to the strains which liberalisation can place on a sector which has previously relied on a stable system of pricing and marketing.

Regarding export licensing criteria, the Ivoirian approach is typical in requiring that a company be registered locally and show evidence of financial viability. It has been criticised that the criterion of presenting a bond guarantee of FCFA 200 million (almost US$400,000) has forced many of the smaller companies out of business and has in fact encouraged the development of the larger groups which are often in partnership with overseas companies. The criteria do not require that a
company be an established exporter, i.e., proving a certain level of trading volumes in previous years. Furthermore the criteria do not include any proof of access to storage facilities.

2.3 Nigeria

Nigeria accounts for 7 per cent of the world’s cocoa supply. Despite the importance of cocoa to Nigeria’s agricultural sector and rural incomes, it contributes little to the country’s foreign exchange earnings, which are predominantly provided by oil. The decline in cocoa production from a peak of 300,000 tonnes in 1970/71 to 130,000 tonnes lately was due to a variety of factors: an ageing stock, low producer prices prior to liberalization in 1986, black pod disease and smuggling.

Until liberalisation, the Nigerian Cocoa Board (NCB) had very similar responsibilities to the Cocobod. It set the producer price, controlled quality at farm level, provided extension, controlled the internal buying through agents and was the monopoly buyer and exporter of cocoa. In 1986 the Government of Nigeria, as part of a general move towards liberalising pricing systems and the marketing of commodities, disbanded the NCB and completely deregulated the internal and external marketing of cocoa. The licensing of internal buyers and exporters was abolished and quality control procedures abandoned.

These changes took place almost overnight with no effective alternatives put in their place. One of the objectives of liberalisation was to make farmers more responsive to world prices which, given their previously low incomes, was expected to result in a rise in earnings and an increase in output. It was assumed that a rise in exports would enable the Government of Nigeria to earn more foreign exchange through taxes and would give a badly needed boost to the economy.

Liberalisation initially boosted production and exports but the quality of cocoa delivered to end users plummeted and became notoriously unreliable. Large numbers of new traders entered the sector, and these traders, most of whom had little knowledge of cocoa, competed with processors to obtain cocoa directly from the farmers. Cocoa was purchased at high prices with little regard to quality, and much was exported before it was fully fermented and dried.

As the quality of Nigerian cocoa declined, so did the premium that Nigerian cocoa fetched on the export market. The problem originated at both the farm level and the port level. At the producer level, farmers,
confronted with numerous new traders offering considerably higher sums for their cocoa, realised that most of these operators had no concept of what they were buying, and consequently often sold them anything, even most unfermented beans, simply because many fly-by-night exporters wanted to take delivery as quickly as possible. Many exporters mixed the higher quality cocoa with the poorer grades and shipped the resulting uneven blend. Clearly, there was no effective quality control.

Many, but by no means all, of the middlemen, known as licensed buying agents (LBAs), are now more familiar with the quality concerns than they were at the time of liberalisation. This is due, in part to the realisation that poor shipments will go unsold, especially in the face current surplus stocks on the world market, and also because they appear able to negotiate a better price for deliveries of higher quality cocoa. Consequently, many LBAs grade the cocoa which they purchase from the farms even before it goes to state and federal officials for inspection. However, no exporter would rely solely on the grading done by LBAs or the state and Federal authorities, and this is a major factor why international firms have established operations in Nigeria.

The growers’ share of the F.O.B export price has risen substantially since liberalisation. It has been estimated that Nigerian farmers currently receive more than 80 per cent of the F.O.B. export price. This is boosted to a certain extent by the lack of an export tax.

Liberalisation led to the removal of restrictions on who could engage in cocoa trading or exporting in Nigeria. Currently, the only requirement is that in order to export commodities, a company must register with the Nigeria Export Promotion Council in order to obtain an export licence. In practice, anyone with the capital to undertake such a business can obtain this licence. Currently there are around 15 major cocoa exporters operating in Nigeria, and fewer small companies. Two major international cocoa trading and processing companies dominated the cocoa sector following liberalisation, namely ED & F Man and Cargill. However, in 1999, Cargill closed its up-country purchasing operations; bean purchases are now made solely through its Lagos office on a cash against documents basis from shippers. Forward selling of the crop ended with liberalisation and cocoa was sold on a spot basis. This situation continues today, with many sales only concluded once the shipment has been inspected in a Western European or North American port warehouse.

The cultivation of relationships between buyers and the more reliable exporters has squeezed some of the smaller and less reputable traders out of business. Many of the remaining exporters of significance are now
either agents of trade houses or are joint ventures between foreign nationals or expatriates and Nigerian counterparts. The major foreign companies appear to acquire cocoa in three possible ways, namely, though local trading companies, having their own buying operation and by purchasing cocoa brought to their own port warehouse operations after the appropriate quality checks.

3. Quality

International experience has shown that liberalisation has often led to a situation where the increased competition among buyers has meant that farmers have effectively had a guaranteed buyer for their crop, whatever the quality. In addition, in those cases where buyers advance seasonal credit to farmers in return for a commitment to receive the crop after the harvest, it becomes very difficult for a trader to refuse whatever is offered by the grower. Thus, farmers frequently pay less attention to quality than they did under a tightly regulated system, where the penalties for poor quality production may be severe.

3.1 Cocoa Quality Standards in Ghana

In Ghana, grading, quality checks and fumigation are currently in the hands of the Quality Control Division (QCD) of the Cocobod. In the past there were five quality inspections before beans were exported, but the number has now been reduced to three: inspections at the up-country store, at the take-over point (Kaase, Takoradi or Tema) from the LBCs to the CMC, and at the point of export (in the ports of Takoradi and Tema). In each of these locations there are QCD personnel who check the cocoa’s quality, and in the buying stations the QCD places seals on the bags. The seals remain on the bags until they reach their final destination.

It should be noted that sealed cocoa, originally of Grade I or Grade II\(^2\), which had subsequently been downgraded at the time of delivery to the

\(^2\) The Ghana Cocoa Board has four grades for its cocoa beans. These are defined as follows:

- Grade I: Cocoa which is thoroughly dry, free from foreign matter, smoky beans and any evidence of adulteration, and which contains not more than 3% by count of mouldy beans, not more than 3% by count of slaty beans, and not more than 3% by count of all other defects;
- Grade II: Cocoa which is thoroughly dry, free from foreign matter, smoky beans and any evidence of adulteration, and which contains not more than 4% by count of mouldy beans, not more than 8% by count of slaty beans, and not more than 6% by count of all other defects;
- Sub-Standard: Cocoa which fails to reach grade II will be regarded as sub-
CMC (within the allotted time period of four months from the end of the month of sealing), will receive only half of the official producer price for the beans plus the transportation costs. However, the LBCs have the option of sorting and re-conditioning the beans to bring them up to Grade I or II and avoiding the penalty. In such cases, the beans are almost invariably used by domestic processors.

Ghana’s cocoa exports are described as “good fermented” cocoa, with anything else known as sub-grade. The contractual terms of this cocoa are the same as those from other West African origins, in that they specify not more than 5 per cent mouldy, 5 per cent slaty and 5 per cent other defects. As might be expected for cocoa that has previously passed the QCD 3 per cent quality checks, Ghana’s export quality always exceeds the contract specifications. Recognition of, and confidence in, this situation amongst buyers, leads them to undertake less thorough checks of deliveries than they do for most other origins, so avoiding costs. At present, buyers’ confidence in Ghana cocoa ensures that it realises a premium price. Clearly any erosion in the confidence that Ghana will consistently outperform its contractual obligations will lead to a reduction in the premium.

Small beans have become, and are likely to remain, a problem for Ghana cocoa. In part, it is a result of widening cultivation of hybrid trees, which tend to have smaller beans in their earlier years. Light crop beans are typically on the small side, and in recent months, when Ghanaian prices have been above those in Cote d’Ivoire, there is evidence that Ivorian light crop production has been smuggled into Ghana and blended with domestic supplies.

On the technical side, small beans have similar flavour characteristics to larger main crop beans, but have a lower fat content, which is primarily related to their higher shell ratio, but is also a reflection of a slightly lower percentage of bean fact content. Also small beans tend to result in uneven roasting. Nevertheless, rejections are only a very small proportion of the total crop, and most rejected beans are actually sold to local processors.

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standard. Any cocoa which contains a high proportion of defective beans and which, in the opinion of the Executive Director or any officer acting on his behalf, cannot be reconditioned to either Grade I or Grade II should be double sealed and stencilled "XS"; and

- Waste: Anything below sub-standard
Ghana is able to maintain a high export quality of cocoa because of the established practices of the farmers, who are very quality conscious. Indeed it has been argued that 80 per cent of the quality is dependent on the correct growing, drying and fermentation methods adopted by farmers. The Ghanaian farmer, unlike his Ivorian counterpart, takes great care and pride in the preparation of his cocoa; this includes sorting out the good and bad beans on a mat, with most of the rubbish being thrown away. In other countries this rubbish would find a market, in that it would be blended with better quality output.

The farmer delivers the cocoa to a buying station, where quality is checked, initially by the LBC’s purchasing clerk, and is then bagged, graded and sealed with a unique seal by a representative of the QCD before the cocoa leaves the buying station. Thus the farmer is penalised immediately if the cocoa is not up to standard. In almost all other origins, quality control occurs much further along the marketing chain and therefore any penalties are incurred much later. Fixed buying points are an important factor underpinning the maintenance of quality.

With the liberalisation of internal marketing, purchasing clerks of LBCs have been known to move from village to village in search of cocoa to buy. This led to the buying of wet cocoa in some cases. Moreover, this practise led to theft of cocoa from drying mats thus causing financial losses to some farmers.

Furthermore, these purchasing clerks used hanging scales instead of the prescribed platform scales thus they were able to cheat farmers by adjusting these scales. It must be said that these practices of the purchasing clerks were against Cocobod rules governing cocoa purchases but in the face of competition, purchasing clerks devised various means to stay on top of the competition.

3.2 Quality Under Internal Liberalisation in Ghana

Conflicting views have been expressed as regards the trends in quality since the internal liberalisation of cocoa marketing in 1993. A minority has argued that quality has definitely declined; a more scientific study by a major chocolate manufacturer suggests that there has been no evidence of a decline in quality. Others have suggested that climatic factors, combined with the increasing use of hybrids and some changes to drying methods, have altered the characteristics of some output.
Currently, in Ghana, the LBCs can only move cocoa once it has been inspected and received a certificate/seal from QCD. This does result in delays, but while it is bad for turnover, it is beneficial for quality.

In 1997 it was found that pressure from the LBCs to obtain cocoa from the farmer was leading to the sale of some cocoa with a high moisture content. This encouraged the development of mould which is one of the most important quality defects of cocoa, and one for which buyers will discount heavily. Currently QCD field inspectors do not have verifiable means of measuring moisture content, which is, however, checked at the take-over points where more sophisticated equipment is available. There has been some consequent rejection of individual parcels and the resultant need by the LBCs to re-condition cocoa, thus incurring further costs and disputes. The provision of additional equipment (moisture meters and scales) could help to overcome such problems, and the decision to concentrate the QCD’s grading operations in the district centres will make this easier and less costly to implement.

Another major constraint identified in 1997, particularly by the LBCs, was the speed of response by the QCD inspectors to the request for grading. When the internal buying was a monopoly of the PBC, this was much less of a constraint, but now, it is a bigger concern, since the more rapidly the cocoa is graded at the Society level, the lower are the financing costs faced by the LBC, and the more rapid its turnover of its funds.

In practice, the QCD grading is done in strict rotation, based on the order in which requests are received by the QCD office. On average, a QCD grader is expected to grade 200 to 240 bags per day when he is at the location, although this does not include travel time. In order to speed up the grading procedure some LBCs have been assisting QCD staff with transport to the Societies and/or making payments in addition to the fixed fees, and both of these practices may compromise the independence and integrity of the QCD graders. This is another respect in which the rationalisation of QCD facilities in district centres will ease the situation.

### 3.3 Quality Trends Following Librelisation in Cote D’Ivoire

In Cote d’Ivoire, the partial liberalisation of the cocoa sector in the 1990s was among the cases of a decline in quality. This was related to greater practical difficulties in enforcing contract fulfilment and failures by some sellers to provide the buyers with the quality that was contracted for. The increased uncertainty associated with delivery from little known sellers at
origin and the heightened risk of failure to meet a contract’s specifications both give rise to the payment of a discount.

- An equally important factor has been the intrinsic decline in the quality of Ivorian beans. This has arisen, in part, because of the lack of quality control procedures throughout the production and marketing chain.

In Cote d’Ivoire, prior to complete liberalisation in 1999, poor cocoa quality was also partly due to the Caistab’s refusal to permit the payment of quality premiums to farmers. Traders paid farmers the fixed price for cocoa, almost irrespective of quality. The drying, cleaning, sorting, blending in large silos, grading and re-bagging of beans were all undertaken by exporters, mainly at the ports of Abidjan and San Pedro, often some weeks after the cocoa was purchased from the farmer.

The system in Cote d’Ivoire has been very successful in shifting large volumes of cocoa quickly. However, the example illustrates that intense internal competition can damage cocoa quality unless there is a reliable up-country inspection system in place.

### 3.4 The Premium for Ghana Cocoa

Ghana cocoa consistently commands higher prices than other bulk cocoa on the world market\(^3\). In the spot physical market in Europe, price differentials reflect users’ valuation of the intrinsic features of the cocoa from different origins. In Diagram below, there is no doubting the premium value attributed to Ghanaian beans, as a result of their

\(^3\) The price premium reflects a number of factors:

- **Higher fat content**: Ghana cocoa has a higher fat content than other major origins, resulting in a higher butter yield.

- **Lower levels of defects**: Ghana cocoa has a lower level of mouldy and slaty beans than other origins.

- **Preferred flavour**: as a result of better fermentation practices and the lower level of defective beans, Ghana cocoa produces liquor with a flavour preferred by some end-users.

- **Shipping weight basis**: the CMC sells cocoa on a shipping weight basis.

- **Contract performance**: the CMC has the reputation of fulfilling contracts with buyers (or of alerting them to problems well in advance)

**Consistency and reliability**: the above factors combine to produce confidence among buyers in Ghana cocoa as a commodity and the CMC as a counterparty. An important indication of this confidence is the relative low level of testing (of quality and weights) of Ghana cocoa shipments conducted by many buyers. Which itself represents a cost saving.
consistently high quality and reliable supply. Nigerian cocoa beans prices were very close to similarity of Cote d’voire from 1992/93 to 1996/97, which is not surprising, given the similarity in the market’s perception of the quality of their beans, but a divergence has emerged in the past two years.

Cameroon has been the worst sufferer from a downgrading of its beans’ reputation. Whereas Cameroon cocoa beans once stood second only to Ghana in their valuation, they have been at the bottom of the ranking among the four origins since 1996/97, although the Cameroon discount has shrunk since then (See Chart 2).

![Chart 2: Differential relative to the average London price (LLIFFE), 1992/93 - 1998/99](chart2.png)

Improvements in processing technology have threatened the quality premium, not necessarily its size, but the number of users prepared to pay for it. During the past decade, the major end-users of cocoa have intensified their efforts to substitute different origins and qualities. Several factors account for these efforts, including their concerns about the availability of certain West African origins (particularly the dramatic fall in Ghanaian production in the early 1980s, the debacle after Nigeria liberalisation in 1986 and the Cote d’voire’s refusal to sell cocoa in the late 1980s) and until recently, the rapid increase in availability of lower priced Malaysian and Indonesian production.

These structural changes led to a substantial growth in the use of Asian cocoa butter, which is harder than West African butters. While many end-
users wish to continue to use Ghana cocoa, most are unwilling to pay too high a premium. If the premium is too high, particularly in relation to Ivorian and Nigerian cocoa, then alternative origins will be substituted. Ghana cocoa is of most value to confectionery companies, who have a preference for the flavour of Ghana liquor. Meanwhile, cocoa processors are willing to pay a special premium for Ghana cocoa, since they are mainly interested in the butter content, and all the butter can be deodorised.

4. Trade Finance

4.1 Current Marketing Arrangements

Cocobod has had the principal responsibility for funding the internal marketing of cocoa since 1993. The Board obtains offshore funding through syndication of local and external banks. The Board changed from the use of domestic cocoa-bill finance to offshore borrowing due to the high funding requirement for cocoa purchases which was beyond the capacity of local banks and the relatively low cost (interest rate) of borrowing offshore (See Chart 3). Cocobod’s lending rate is lower than the rates charged by local banks.

Currently, LBCs are granted a Seed Fund for the purchase of cocoa from farmers. The Seed Fund is repaid with cocoa beans purchased from farmers. Access to the Seed Fund is contingent upon the submission of
bankers’ guarantees by the LBCs. The Seed Fund is the only source of financing available to the LBCs for cocoa purchasing. Commercial banks are prevented, by law, from making loans to companies to facilitate cocoa purchasing regardless of whether or not the LBC is able to offer asset security. With liberalisation, it should be possible for this restriction to be removed so that commercial bank could extend loans to LBCs that are able to satisfy the collateral requirements. It is envisaged that the Seed Fund will continue to be allocated according to the share of internal purchases made by each LBC.

When the cocoa sector is fully liberalized, financing for LBCs would be entirely dependent upon their credibility as assessed by local and offshore banks. This would undoubtedly accelerate the rate at which foreign companies could become involved in cocoa trading. There is therefore the need to allow for a transitional period whereby the LBCs have an opportunity to improve their skills and international standing, whilst sheltered in a stabilised environment.

4.2 Options for Trade Finance

Due to the large amounts of funds required to purchase cocoa, most LBCs are not in a position to secure adequate bank facilities independently. In order to meet the funding requirements of the cocoa sector after the liberalisation of the external marketing, the following sources of financing will have to be considered:

4.3 Cocobod

Over the years Cocobod, has earned the reputation and clout, which has enabled it to raise funds overseas. These funds which have relatively much lower interest rates than can be obtained locally should still be used by the Board to pre-finance cocoa purchases through the LBCs.

With the liberalisation of export marketing, the average costs of finance for Ghana’s cocoa exporting sector will increase (and its access to finance will decrease). The CMC enjoys two clear advantages over the LBCs in its dealings with commercial banks:

- first, because it is fully under Government control, it is seen as having the full support of the Government in its financial dealings, which tends to raise the status of borrowings by the CMC to the level of sovereign debt; and

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4 The Banking Law (PNDCL 225) prohibits banks from lending more than 25 per cent of their networth to one customer.
• second, since the CMC has a good track record of undertaking forward sales of cocoa and securing syndicated loans using the forward sales as collateral, it is viewed as a known quantity in the financial market.

In contrast, bank lending to the LBCs is seen as leaving them exposed to the full risk of lending to private sector companies, each of which will have to be judged on the quality of their collateral and financial history.

Accordingly, it is important that the benefits of the reputation built up by the CMC over a number of years are not lost to the domestic sector. This is especially true in view of the likelihood that international trading houses will enter the Ghana market soon after export liberalisation, and that they will have the advantage of higher credit ratings and significantly lower borrowing costs than domestic exporting companies.

There are various possible sources of future loans for the cocoa sector, including loans from local and international banks, loans against sales contracts and inventories, and advances from foreign buyers.

4.4 Syndication

To deal with the percentage of equity restrictions imposed on lending by the Banking Law, PNDCL 225, syndication or consortium financing could be a way out. Furthermore, due to the huge sums involved in the purchase of cocoa from farmers it is not possible or prudent for local financial institutions to go it alone in supporting the purchases. The pooling of resources of two or more financial institutions, through syndication should be utilized. The introduction of the Interbank Foreign Exchange Market (IFEM) presents an opportunity for the banking system in Ghana to pool resources together for the purpose of funding LBCs operations. The Bank of Ghana could sell part of its foreign exchange holdings on the market for this purpose.

4.5 Offshore funding for LBCs

An LBC can avail itself of financing from abroad as Cocobod does. An LBC may form an alliance with other companies who have the necessary clout. In this regard, Cocobod (CMC) could continue to play a leading role as mentioned above.

Exporters may be able to finance operations through loans from international banks, with future sales of cocoa used as collateral. These
loans, which are typically organised on a syndicated basis, are used by the Cocobod to finance the Seed Fund, which provides credit to LBCs for the purchase of beans on the domestic market. The two most practical mechanisms for securing international finance are the transfer to the lender of either

- A contract with the importer; or
- Legal title to stocks, in the form of warehouse receipts. Such financing is attractive to exporters as it enables them to secure access to a proportion of foreign exchange earnings before shipments are made.

4.6 Advances from Foreign Buyers

Foreign buyers of cocoa may provide local companies with so-called pre-financing loans to finance their crop purchasing and export operations. This financing can take number of forms, including unsecured and secured payments and the establishment of in-country operations, at which the foreign company takes ownership of the tonnages in question.

The LBCs could also team up with foreign commodity houses to raise funds from the international financial markets. In this case, the foreign partners would be expected to bring in foreign exchange for the internal marketing operations of their Ghanaian counterparts. This would lead to an increase in foreign direct investment (FDI) in the cocoa sector. The investment code caters for repatriation of earnings and dividends and these should be applied to the FDI in the cocoa sector.

Moreover, Ghanaian banks could also take loans in foreign currency from their corresponding banks or parent banks (for the foreign owned ones) for on lending to LBCs. Some of the provisions of the Banking Law (PNDCL 225) may have to be relaxed to enable banks lend to LBCs.

4.7 Warehouse warrants

Warehouse warrants schemes should be a very valuable element of trade finance in the cocoa sector. If effective control over cocoa stocks could be guaranteed, these stocks could be used as a basis for securing ready, low risk and therefore low interest financing. This will however depend on availability of warehouses that are spacious and secure enough as to attract financial institutions to accept the risk pertaining to related
contracts. Where LBCs have their own warehouses, it should be possible for the banks to use inventories in these warehouses as secure collateral.

The foreign exchange laws still require cocoa and gold proceeds to be channeled through BOG. This arrangement should be maintained in the new dispensation but it would be necessary to agree on retention of proceeds as currently applies to gold mining companies should foreign commodity houses team up with LBCs in their operations.

As the liberalization of external marketing of cocoa and the operations of LBCs operations become efficient, they could pass on some of the benefits to cocoa farmers in the form of higher producer price.

5.  **Producer Pricing**

The objectives of Ghana’s cocoa producer pricing framework are:

- improving upon farmers real returns from cocoa to ensure the provision of adequate incentives cocoa yield and output;
- maximising Ghana’s foreign exchange earnings revenue for Government; and
- providing adequate returns to other stakeholders.

Since the 1998/99 Cocoa Season, the producer pricing approach shifted from the cost-plus approach to a system of guaranteeing a percentage of FOB price\(^5\). The latter approach provides a direct link between the Ghana producer price and the world market price. If the external marketing of cocoa be liberalized, then producer price should continue to be linked to the price of cocoa on international market.

To ensure that cocoa farmers are not disadvantaged, Government through Cocobod should set a floor producer price as a guide to LBCs. In fixing this floor price, all factors that could impact on the international price of cocoa should be factored into the pricing mechanism. Thus the prospects for increased producer prices under a liberalized external market of cocoa appear brighter.

In addition to setting a floor producer price, the use of Akuafo cheques needs to be reviewed. Akuafo cheques were introduced into the internal marketing system to safeguard the interest of cocoa farmers against purchasing clerks who sometimes cheat the farmers. In addition, the

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\(^5\) Ghana Cocoa Sector Development strategy pg 79, Ministry of Finance, April 1999.
Cheques were introduced to ensure that cocoa funds were not misapplied by purchasing clerks and depot managers of LBCs. Due to the lack of banking facilities or the inadequate facilities in most cocoa growing areas, purchasing clerks have again devised means of paying farmers cash for produce purchased from them. Cocoa farmers have been known to have queued for longer periods at bank branches with some sleeping at these branches to cash their Akuafo cheques. In some cases these purchasing clerk have discounted the value of cocoa purchased from farmers when they pay cash. Thus in all these cases, farmers incomes are reduced to the detriment of the cocoa industry.

In the past, some cocoa farmers were also able to cheat LBCs by collecting inputs from the LBCs with the promise to repay with the cocoa. The farmers turn round to sell their cocoa to other LBCs for cash instead of using the Akuafo cheque system.

As shown in Chart 4, eight LBCs led by the Produce Buying Company Limited (PBC) have currently exceeded the 10,000 tonnes purchases mark and have qualified to export cocoa. With time, it is expected that more LBCs would qualify to export cocoa and this could increase the level of competition among LBCs. The increased competition would give the farmer the opportunity of choosing from the number of LBCs available in the locality. This could lead to farmers being paid a fair price for their produce.

6. Fiscal Impact
Cocoa duty payments to Government are currently determined as residual after all other costs (farmers, buyers’ margin, haulage cost, Cocobod operational cost etc), have been taken into account. Under the current external marketing arrangements, the bulk of cocoa duty in any year is paid after the external facility has been repaid (ie after August). The delayed payment of cocoa duty amounts to an implicit subsidy from Government to Cocobod.

In a liberalized external market, Government would be entitled to cocoa duty paid by the LBCs at the point of export. This could improve Government’s cashflow. Alternatively, the LBCs could be made to pay cocoa duty out of their profits at the end of the year as it is currently done for the corporate sector. This would have the effect of delaying cocoa duty payments to Government and depending upon the efficiency/profitability of the LBC, could reduce the level of payment. Cocoa duty payments to Government stagnated below ₴50.0 billion until 1994 when it shot up to about ₴150.0 billion. Since then cocoa duty payments generally have been on the increase (See Chart 5).

![Chart 5: Cocoa Duty & Tax Revenue (1983 - 2002)](chart.png)

The internal marketing of cocoa was liberalized in 1994. The Cocobod also started using the external facility for cocoa purchases at the beginning of the 1993/94 cocoa year. One possible explanation for the jump in cocoa duty payments in 1994 was the reduction in financing cost arising out of the new mode of trade finance. Before then, Cocobod financed crop purchases with proceeds from the floatation of cocoa bills.
In terms of its contribution to tax revenue of the Government, the ratio of cocoa duty to tax revenue has been on the decline since 1983. Again there was some recovery in 1994 and thereafter apparently for the same reason given earlier on. Since 1998, the ratio has reversed to the declining trend.

7. Balance of Payments Impact

The liberalization of the external marketing of cocoa could impact positively on Ghana’s trade balance and eventually, the balance of payments (BOP). Liberalizing the external marketing of cocoa will encourage FDI in the cocoa sector in that foreign firms that invest in the sector would be in control of any cocoa beans purchased. They could then decide to ship the raw beans or process for shipment.

Currently, there is a price dispute between the West African Milling Company (WAMCO) based at Takoradi and the Ghana Government over cocoa beans supplied to the former. The argument is that there is no advantage to foreign firms for setting up a cocoa processing company in Ghana if cocoa beans supplied to these processors are priced at near world market levels. This was the basis of the price dispute.

Under the current marketing arrangements, Cocobod takes over cocoa purchased by LBCs for export by CMC. Consequently, cocoa processing companies in Ghana obtain their cocoa beans supplies from Cocobod at the average monthly export price of Ghana cocoa beans less a discount.
With the liberalization, cocoa processing companies could set up subsidiaries to purchase cocoa from farmers for processing. This would enable Ghana to add value to its cocoa and thereby increase the value of exports. If these processing companies are set up in Export Processing Zones (EPZ) then they would enjoy tax relief for some period which could impact negatively on Government revenue in the short term. Thus liberalizing the external marketing of cocoa could be an incentive for setting up cocoa processing companies in the country and thus add value to Ghana’s exports.

Under the current marketing arrangements, Cocobod arranges for a short term loan for cocoa purchases. This loan is collateralized with cocoa contracts and repaid in six equal installments. This implies Cocobod is not able to take advantage of any improvements in the price of the commodity since Cocobod has to satisfy the collateral requirements for any loan drawdown. If funds for cocoa purchases come in the form of FDI, then there could be an improvement in the BOP as Cocobod can take advantage of any favourable price movements. In addition there would not be any loan repayments.

Proceeds from cocoa beans export have been in the range US$242.0 million and US$541.0 million since 1983. Similarly, proceeds from export of cocoa products has also been in the range US$25.0 million to US$79.0 million during the same period. The two together have been constrained to hover around the US$500.0 million mark throughout the period 1983 to 2002 (See Chart 7).

The importance of cocoa as a major foreign exchange earner has been on the decline since 1984 when about 68.0 per cent of total export receipts
came from cocoa beans and products (Cocoa). Currently, the ratio is around 22.0 per cent (See Chart 8).

The foregoing is a reflection of the improvements in the diversification of Ghana’s exports commodities. Currently, gold exports have overtaken cocoa as the number one foreign exchange earner while non-traditional exports have also increased. These developments explain the decline in the ratio of cocoa proceeds to total export proceeds.

![Chart 8: Cocoa Receipts as Percentage of Total Export Receipts (1983 - 2002)]

**8. Legislation and Regulations**

For many years all aspects of the cocoa industry have been in the hands of Cocobod and its subsidiaries/divisions. The question of controlling its activities, through the monitoring of operations, issuing of directives, etc. has accordingly not been an issue, even if it was widely believed that Cocobod and its subsidiaries/divisions could improve its operational/structural inefficiencies.

With the decision to liberalise the external marketing of cocoa, however, the situation is bound to change. Managing the export operations of over 20 LBCs would in the circumstances call for a re-examination of the existing legislation on the export of cocoa, with the view to suggesting changes, where necessary. This would ensure that the companies licensed to export cocoa operate within a legal framework which, while not unduly constraining their export functions, will nevertheless protect
the interest of other stakeholders including the farmers, Cocobod and ultimately the nation.

8.1 Maintaining Ghana’s Cocoa Premium Quality

To strengthen the hand of the Quality Control Division, consideration should be given to the QCD to effect forfeiture when pre-shipment inspection and grading has established a clear case of adulteration.

The quality of cocoa for export is adequately protected under the provisions of the Cocoa Industry (Regulation) Consolidation) Decree, 1968 (NLCD 278) and the Cocoa Industry Regulations, 1968 (LI 598). For example, paragraph 1 of NLCD 278 provides that:

- “No person shall buy or sell or expose for sale or tender in satisfaction of any claim or demand or shall export any cocoa which is not thoroughly dry or which contains any foreign matter.

Regulations 23 (1) also provides that:

- “Any person who exports or attempts to export or despatches or transports for the purpose of export any adulterated cocoa, shall be guilty of an offence.

Again, there is ample provision against the export of cocoa which has not been inspected graded and sealed by an Inspector (paragraph 3 of NLCD 278). The Decree and Regulations in that paragraph make adequate provision for the mode of inspection and grading, as well as for the making of cocoa sacks.

8.2 Pricing and Repatriation of Proceeds

The Exchange Control Act, 1961 (Act 71) makes adequate provision for payment for exports. Section 10 of the Act provides as follows:

Except in such circumstances as may be prescribed, no person shall export goods of any description unless:

- payment for the goods has been made in the prescribed manner to a Ghana resident, or is to be made not later than six months after the date of exportation; and

- the amount of the payment that has been made is such as to represent a return for the goods which is in all the circumstances satisfactory in the interest of Ghana.
To allow Cocobod or a Committee of its subsidiaries/divisions to determine a floor price for the licensed exporters is to detract from the whole concept of export trade liberalisation. However, the Government has relied heavily, not only on revenue, but also on foreign exchange earnings from cocoa over the years, permitting the LBCs to sell at any price at all, without scrutiny, would place Government revenue in jeopardy.

Besides, if in the interest of farmers, the practice of fixing a uniform producer price is to be continued, then Government, acting through Cocobod, should fix a minimum export price, at least during the transition.

Since the whole concept of fixing a minimum price to guide a large body of cocoa exporters is a new one, it has to be provided for explicitly in the draft regulations/guidelines. Even though there is a general provision in the Exchange Control Act for payment for export, the prompt repatriation of proceeds should be accorded a prominent place in the regulations for cocoa export. It is for this reason that the question of the financial viability of licensed companies should not be overlooked.

8.3 Off-Shore Borrowing

Since the 1993/94 crop year, Cocobod has been raising off-shore loans from a consortium of banks to finance local cocoa purchases. This has become necessary because of the steady increase in the producer price of cocoa. In the 2003/04 cocoa year alone, as much as US$640 million had been projected for crop purchases. Even if the limitation on the local Banks as to their exposure in relation to the financing of cocoa purchases were to be removed by the Bank of Ghana it is not likely that they would be able to accommodate Cocobod’s request for the equivalent in cedis of US$640 million.

In all cases where Cocobod has negotiated off-shore loans, it has had to pledge all cocoa sale contracts entered into by Cocoa Marketing Company as collateral security against repayment. Being a parastatal, by virtue of the Ghana Cocoa Board Law, all the loans have been taken with the approval of the Minister of Finance.

As a consequence of the licensing of LBCs to export cocoa, it is envisaged that LBCs will have to assume, in part at least, the responsibility of raising loans to finance the purchasing of cocoa. Indeed, as and when the LBCs’ export quota increases with time it should be expected that their responsibility for raising financing will rise correspondingly.
8.4 Penalties and their Enforcement

It needs to be stressed, however, that the success of the whole idea of the liberalised exportation of cocoa, whether partial or complete, will depend on the imposition of appropriate sanctions for breaches pertaining to all aspects of the export trade, and the readiness to enforce those sanctions.

By appropriate sanctions is meant sanctions that are enough of a deterrent to induce compliance, and yet not so oppressive as to discourage people from wanting to have anything to do with the scheme at all. It is important also that a mechanism be put in place to enforce compliance.

8.5 Ownership of Cocoa

The effect of section 4 (1) of Ghana Cocoa Board Law (PNDC L.81) is that all cocoa in Ghana, whether purchased by Cocobod’s own subsidiary or by a licensed buying company, is to be sold to Cocobod.

This means that, as of now, property in cocoa purchased in Ghana resides in Cocobod. In a liberalised regime, however, that situation will appear untenable, for a couple of reasons.

First, if LBCs are to be able to raise loans, especially off-shore, as indeed they are bound to do, they may have to be able to pledge the cocoa they have purchased as collateral security. This, however, cannot be done if all cocoa must be sold to Cocobod.

Second, if the LBCs should be able to enter into sale contracts on their own, they should be able to assure their prospective buyers that they (LBCs) have the title to pass to them. This is very crucial, especially since they are unknown companies seeking to enter the international market for the very first time. Yet they cannot pass title if property in the cocoa resides in somebody else. Hence there is the need to amend the relevant sections of PNDC Law 81 to enable the LBCs to own and have the right to the cocoa they purchase.

9. Expected Benefits From Cocoa Sector Liberalisation

In countries where cocoa liberalisation has occurred, the reforms initially led to a proliferation in the number of exporters and to increased (and often unsustainable) levels of competition. The new private exporters were from a variety of backgrounds, including subsidiaries of multinational cocoa traders; joint ventures between local and international trading
firms; co-operatives; or wholesalers or traders of other commodities. As liberalisation has proceeded there has been a tendency towards growing export market concentration, with only the most efficient companies surviving.

In almost all cases, the increase in the number of exporters following liberalisation and the removal of internal buying regulations have led to a rapid increase in the number of buyers and to increased internal competition.

One of the most important benefits of liberalisation is that the increased competition has led to a reduction in marketing costs and to a higher proportion of the export price being received by growers. The chart below illustrates average grower prices (as proportion of export unit values) for the years 1995/96-1997/98 compared to the levels in 1998/99. For the 1995/96-1997/98 average, the countries where growers received a higher proportion of the export price are those with free market system. In 1998/99, the values in Ghana and Cote d'Ivoire were high because both producer prices were fixed before the beginning of the crop year and, thus, before the fall in the world price which subsequently occurred.

In Ghana, the producer price was relatively low in the mid-1990s due to high taxation. In recent years, lower levels of taxation have allowed growers to receive a larger share of the world price. In 1997/98, growers received a higher proportion of the world price as buyers became concerned over possible supply interruptions during Ivorian liberalisation.
Ivorian grower prices fell in the mid-1990s due to high taxation, as was the case in Ghana. With the approach of liberalisation in Cote d’Ivoire, however, grower prices began to improve as a proportion of world prices.

The Nigerian liberalisation occurred earlier, in 1986, and it is evident from Chart 9 that the period immediately after liberalisation, which coincided with a time of considerable speculation about the value of the Naira, was one in which producers enjoyed an unsustainably high proportion of the world price.

In the spot physical market in Europe, price differentials reflect users’ valuation of the intrinsic features of the cocoa from different origins. In chart 2, there is no doubting the premium value attributed to Ghanaian beans, as a result of their consistently high quality and reliable supply. Nigerian beans prices were very close to those of Cote d’Ivoire from 1992/93 to 1996/97, which was not surprising, given the similarity in the market’s perception of the quality of their beans, but a divergence has emerged in the subsequent two years. Cameroon has been the worst sufferer from a downgrading of its beans’ reputation. Whereas Cameroon beans once stood second only to Ghana in their valuation, they have been at the bottom of the rankings among the four origins listed in the diagram since 1996/97, although the Cameroon discount has shrunk since then.

10. Conclusion

The liberalization of the external marketing of cocoa poses a number of challenges but have potential benefits for the Ghanaian economy. The challenges are in the form of teething problems to get the LBCs to be able to source funds for cocoa purchases and the Ghanaian banking system to be able to raise the financing requirements.

The benefits include higher prospects for FDI flows into the country, higher producer prices to farmers, improvement in export revenues and cocoa duty payments to the Government. The attainment of these benefits would depend on Ghana’s ability to monitor the operations of LBCs and cocoa processing companies in terms of payment of producer price to farmers, quality of beans/products exported and repatriation of proceeds into Ghana.

The speed at which the liberalization process is carried out is very important. To ensure that any systemic problems are dealt with in a manner that will not disrupt the operations of the cocoa sector, a phased liberalization over a five-year period (at most) is recommended. This would mean Cocobod will continue to perform its current functions over
the period until full liberalization is achieved. Afterwards, Cocobod will continue to monitor the sector to ensure compliance with any rules and regulations that would be put in place.

Alternatively, LBCs/processing companies that will be able to source funds on their own for purchases should be allowed to export their purchases from the onset, subject to any rules and regulations that may be in place. In the event, Cocobod should be able to raise funds for purchasing the remainder of the projected crop. To ensure that there is enough funds for purchases, each LBCs/processing company opting to use its own funds must be committed to any amount projected for it.

RESEARCH DEPARTMENT
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