

By Gun Eriksson Skoog

Reformed Cocoa Market Benefits Liberian Farmers

But watch out for new forms of market power and elite capture

The business environment for smallholder cocoa farmers in Liberia has improved.

Game-changing efforts by the government have increased competition among cocoa buyers and led to higher producer prices. Farmers are also encouraged by new investors to improve the quality of cocoa, for which they earn more. In addition, farmers organisations have strengthened their bargaining power.

However, policy-makers must be alert to a possible backlash if competition is not ensured, and from elite capture of farmers' organisations.

Non-inclusive economic growth is a problem in much of sub-Saharan Africa, particularly in agriculture, on which most of the population still depends for its livelihood. To be beneficial to smallholder farmers, however, market participation depends on the conditions for participation, specific institutional arrangements and power relationships within the market and the broader institutional environment.

In Liberia, cocoa is a typical smallholder export crop, but with a poorly developed domestic market since before the war and limited profitability for smallholders. Recently, the post-war Liberian cocoa market has experienced dynamic change, change that may represent a possible break with the past.



Photo: Aune/Waaf/Panos

Cooperatives and increased competition have strengthened the bargaining power of the farmers. However, policy-makers must be alert to possible elite capture.

The number of large cocoa buyers and middlemen has increased nationally and locally, boosting competition for cocoa produced by smallholders. The official Liberian export market, once a near monopoly, now involves several exporters. Competition between exporters for Liberian cocoa has increased, as well as between buyers at local level in different parts of the country.

Moreover, large companies investing in lasting relationships with farmers and their organisations have now emerged. They promote farmer value addition, increased productivity and output by pro-

viding inputs and services on credit and offering high cocoa prices in exchange for secure contractual access to good quality cocoa. As a result, the Liberian cocoa market has become more complex and diversified, combining traditional spot markets with integrated value chains.

Farmer organisations have re-entered as market actors, with cocoa farmers increasingly organised in cooperatives and associations. These bulk and sell cocoa in larger volumes, facilitating market access and strengthening the farmers' market position.

These changes in the structure of the Liberian cocoa market have shifted power relationships within it. Small-

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holder bargaining power has been strengthened.

Changing the rules of the game

Several institutional changes have contributed to the structural changes in the market, and yet other rules emerged in the process. In 2009, the government initiated regulatory reforms. Deregulation eliminated exclusive buying rights (monopsony) and reduced the market power of cocoa buyers in national and local markets. New buyers could now enter, enhancing competition in the market, strengthening farmers' bargaining power and placing upward pressure on cocoa prices.

At the same time, a cocoa quality-grading system, compatible with international standards, was introduced. This increased international prices for Liberian cocoa, and stimulated productive investment by new buyers and smallholders. A related reform is the official reference-price system, to which the new buyers subscribe, and which establishes a

norm that rewards higher-quality cocoa with higher prices. These reforms have prompted farmers to add value to their cocoa by processing higher quality.

In parallel, the very establishment and entry of farmer cooperatives altered the rules for how cocoa transactions are organised and coordinated within the value chain, by linking many smallholder farmers and large buyers with one another and facilitating trade between them.

Cooperatives also serve as a channel for inputs, services and credit from buyers in integrated value chains to farmers. To these ends, cooperatives established internal rules for their own interactions with farmers as regards decision-making and power-sharing, pricing, payments and services, notably a warehouse-receipt system that facilitates the bulking and selling of large volumes of cocoa.

Similarly, integrated value chains

introduced new rules, notably in terms of contracts between farmers/cooperatives and buyers. Contracts allow for the longer-term exchange of cocoa and integrated services, sometimes for 20 plus years. Like cooperatives, integrated

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value chains have introduced rules to coordinate transactions between buyers and sellers in the cocoa market. Together, they have also altered the rules for competition, in particular among buyers,

with whom for farmers' cocoa, in what ways and on which terms.

More inclusive market

These institutional changes have contributed to increased participation by, and benefits for, smallholder farmers in the post-war Liberian cocoa market. The prices farmers receive have increased considerably, particularly for high-quality cocoa. Data from late 2013, based on

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The market for cocoa in Liberia has undergone substantial change, but adapting farming takes time. Some smallholder farmers still wait for incomes to rise, especially those who recently started farming. It takes time before the newly planted cocoa trees can be harvested.

interviews with market actors and observers, suggest prices have increased 3-4 times in seven years, and almost doubled as a share of the official recommended/reference price. By late 2013, the average reported price for Grade 1 cocoa was higher than the reference price. This means smallholder cocoa farmers have seen a considerable increase in their share of the world-market price over time, in relation to buyers and exporters. Average reported prices for cocoa increased from 22 per cent of the world-market price at the end of 2006, to as much as 49 per cent for Grade 1 cocoa in late 2013 – a remarkable increase.

Farmer access to output markets has increased through more and new channels for selling cocoa. And opportunities to invest in farms to raise returns have improved through increased access to a host of integrated services; inputs (improved seeds/seedlings, fertiliser and pesticides); extension services and training; and financial services, notably input credit but also consumer credit. This enables farmers to more actively participate in the cocoa market, although some inputs are expensive, possibly due to high transaction costs and the monopoly power of input providers.

Consequently, smallholder freedom of choice has increased. Farmers have more alternatives and choices: they can sell to middlemen, a cooperative and/or the buyer of an integrated value chain, or to a combination of them. There are signs that farmers make strategic choices.

Farmers interviewed are highly responsive to the improved price incentives and new market opportunities. They participate more actively by investing in their cocoa business. They add value to their cocoa by processing higher quality, which helps to explain the higher prices received. To increase productivity and output they adopt improved farming practices, apply fertiliser and pesticides, replace their old cocoa trees and expand their farms. Farmer engagement in cooperatives and integrated value chains is another indication of more active participation, as is increased cooperative activity and cocoa supply. Official data on total cocoa production show considerable increases, and total official exports increased

Recommendations for Liberia

- 1** Safeguard the achievements to date, continue and expand the process to ensure institutional and structural change throughout the Liberian cocoa market to benefit all smallholder farmers, including in remote areas. Immediately mitigate the risks regarding the market power of cocoa buyers and elite capture of farmer organisations, which may threaten the progress already made.
- 2** Promote local and national competition between cocoa buyers, in particular between integrated value chains, which are also input suppliers. It is the government's role to ensure this, by eliminating formal rules or informal powers that enable monopsony buying power, and by facilitating entry of new buyers. Donors must ensure they do not hamper competition through the projects they fund – with civil society as a watchdog.
- 3** Encourage smallholder farmers to organise into effective cocoa-trading cooperatives and the democratic development of cooperatives, with leaders held to account by members. The main responsibility rests with farmers and cooperative leaders. Donor-funded projects and local and international NGOs can support these initiatives and serve as watchdogs – with the government as a guardian.
- 4** Create conditions for the development of markets for inputs and services for smallholders, such as improved cocoa seeds/seedlings and financial services. This responsibility rests with government, but donors and NGOs can facilitate the process and should avoid crowding out emerging private initiatives through unsustainable handouts.
- 5** Promote further coordination within the cocoa value chain, by facilitating the entry of new investors, not least domestic ones; alternative business models for integrated value chains; out-grower schemes for larger farms; relationships with input-providers and farmer organisations; and seeking to include middlemen and traditional buyers. Government is responsible for an enabling environment, private actors for developing business models, while innovative donor-funded projects and cocoa-sector stakeholder groups may serve as facilitators and brokers.
- 6** Ensure that all Liberian cocoa is processed into high-quality cocoa, and that cocoa is rewarded accordingly throughout the value chain. This requires collaboration among market actors, perhaps through cocoa-sector stakeholder groups and business organisations, and government is central in enforcing the standard.

several-fold during the post-war period. In short, in recent years the Liberian cocoa market has become more inclusive.

Cocoa sector in transition

So far, the returns to cocoa-market participation present a somewhat mixed picture in terms of incomes earned and physical output, at least for the farmers interviewed. Some reported growing productivity, production and incomes, but several farmers who had recently started to grow cocoa have not realised incomes yet. Others have old and dying cocoa trees with poor and declining yields, while the new trees planted have yet to yield.

These findings suggest that the smallholder cocoa sector is in transition. Whereas the cocoa market has undergone substantial recent change, smallholder cocoa farming has only begun to adapt. Once this process gains momentum, farmers may see more consistent growth in their financial returns. Their investments have certainly increased their chances, and most farmers interviewed express belief in the future of cocoa.

Major causal mechanisms

New rules of the game have been introduced by government, farmers themselves and the private business sector. They have contributed to a more inclusive market through four major mechanisms:

1) By rewarding high-quality cocoa, the new government quality-grading and reference-price systems, applied within integrated value chains and by cooperatives, have led to value addition of cocoa and higher prices for farmers.

2) By increasing coordination of trans-

actions of cocoa and inputs/services, cooperatives and integrated value chains have facilitated, and reduced the costs of, exchange between smallholders and buyers. Efficiency ought to have increased and hence the financial returns to be shared within the value chain.

3) By strengthening smallholder bargaining power, increased competition from deregulation and countervailing market power of cooperatives have made it possible for farmers to reap a larger share of returns – reflected in a higher share of the world-market price.

4) By supplying integrated inputs, services and credit, for which markets remain largely non-existent, integrated value chains have made it possible for smallholder farmers to make productive investments in their cocoa farms.

A caution

However, one cannot take for granted the continuance of these developments. First, large buyers and exporters retain significant market power, and there is the risk that new buyer monopsony power may emerge in integrated value chains in certain localities. Second, farmers report that some cooperatives do not represent farmer interests well. There is a risk of ‘elite capture’ of re-established and new farmer organisations, if their leadership is not held to account by members. In addition, the severely underdeveloped input, service and credit markets for smallholder cocoa farmers imply a risk of undue market power by a few suppliers and monopoly prices.

If market power and elite capture are reinforced over time, developments so far may be jeopardised, especially smallholder

bargaining power, and the benefits smallholders have experienced in recent years.

Besides, while beneficial participation in the cocoa market by smallholder farmers has increased, one cannot say that change has taken place across the board. A process has been initiated, but more is needed for a truly inclusive cocoa market.



This Policy Brief is based on the preliminary research findings of Dr Gun Eriksson Skoog, Senior Research and Policy Analyst at the Nordic Africa Institute.

The research is based on primary data collected in October-November 2013 and on secondary sources. Semi-structured interviews were held with more than 100 smallholder farmers, cooperatives, buyers, exporters and input providers and external market observers. The interviews took place at the national level and in Lofa, Nimba and Gbarpolu counties.

Dr Eriksson Skoog has a background in development cooperation, including a three-year attachment to Sida in Liberia.

General recommendations for inclusive market growth

- 1 Undertake institutional changes that promote farmers' value addition, increase coordination within the agricultural value chain, strengthen smallholder bargaining power and ensure the supply of inputs and services, not least credit.
- 2 Promote coordination of transactions through farmer cooperatives and developing integrated value chains, to reduce transaction costs and increase efficiency.
- 3 Strengthen farmers' bargaining power by ensuring competition in the output market, as well as in input and service markets, and by encouraging their organisation, while ensuring that cooperatives are not captured by the elite.
- 4 Encourage integrated value chains based on contractual relationships, while preventing monopsony and monopoly power, to increase farmer access to output markets and to inputs and services in the absence of functioning markets for these.