INSTITUTE OF CURRENT WORLD AFFAIRS

BSQ-28

c/o Tourist Mail
U.S. Embassy
01 BP 1712
Abidjan, Ivory Coast
March 15, 1981

The Cost of Cocoa

Mr. Peter Bird Martin
Institute of Current World Affairs
Wheelock House
4 West Wheelock Street
Hanover, New Hampshire 03755

Dear Peter,

"The West is making the bed for communism in the Third World. By persisting in not buying raw materials at a fair price, it is forcing the peoples of the Third World into poverty, misery and revolt."

So said President Felix Houphouet-Boigny of the Ivory Coast, as quoted recently by the French-language weekly Jeune Afrique. The president was engaging in a bit of dramatic hyperbole, no doubt trying to get Western leaders to take notice of demands from the developing countries for a more equitable marketing system for their primary products. Communism offers no ready alternative, and no army of disgruntled peasants seems about to topple any government in Africa. However, the West's insistence on a free market for basic commodities, which entails sharp and unpredictable rises and falls in prices, works against Western interests as well as the Third World's, contributing to the current debility of the world economy.

Proponents of the free market say price instability is an inevitable consequence of the law of supply and demand. If the law of gravity may be simply described as what goes up must come down, the law of supply and demand implies that, in the economic world, prices must go up and down, up and down, up and down, forever. It may not make life as comfortable as the law of gravity does, but it's the best way of apportioning materials and labor to meet people's needs and wants, according to its advocates.

Like most laws, that of supply and demand works to the benefit of some people and the disadvantage of others. Critics of the present commodity marketing system say it mostly benefits speculators, especially those in U.S. markets. Because speculators earn their livings not by supplying a demand for a good but by taking advantage of fluctuations in its price, extreme price changes work in their interest. Their influence can make such havoc with the market that Cameroonian economist Jean Assoumou, in his book L'Economie du Cacao, maintains: "Speculation plays such a role that one could say it would suffice to purge it from the system to assure the stability of cocoa prices."

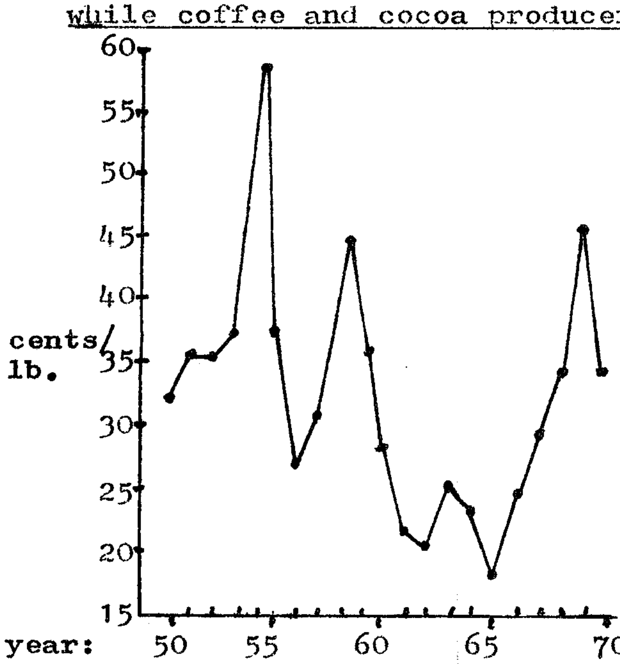
Speculators usually don't deal in tangible goods. For

Bowden Quinn is an Overseas Journalism Fellow of the Institute studying colonial influences on West African nations. His current interests are the economies of Ghana and the Ivory Coast.

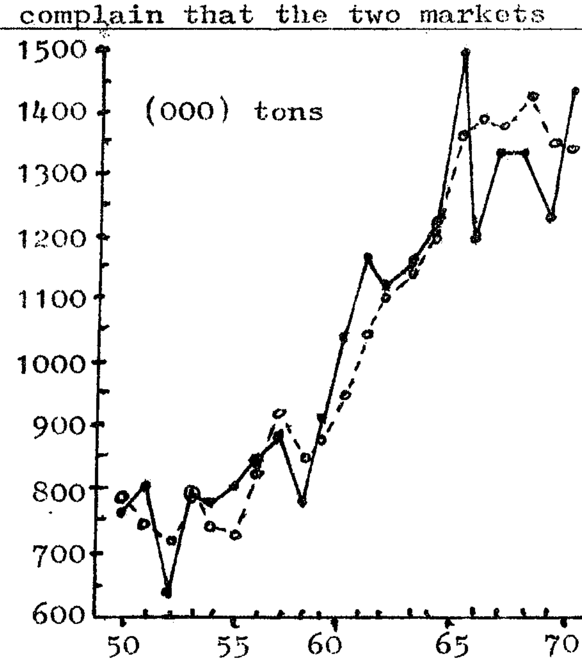
cocoa and other commodities, they trade futures, which are a means of gambling on what the prices will be up to eighteen months before goods are ready for the market. If a speculator thinks the price of cocoa will go up, he buys cocoa futures. His purchase encourages that upward trend. When he thinks prices will fall, he sells his futures, which may contribute to the accuracy of his prognosis. The array of possible markets for speculative investment puts cocoa in competition with goods to which it has no other connection. Today, a speculator may think the cocoa market looks good; tomorrow, he may like the looks of gold or pork bellies, treasury bonds or Swiss francs, corporate stocks or any one of the other myriad items that make the tiny numbers that fill pages in the middle of newspapers.

None of this has anything to do with the cocoa farmer, except that the price he receives for his crop is affected by the futures market. To a large extent, what speculators think about what's happening in a commodity market is more important than what is happening. A good example is the rise of coffee prices in the mid-Seventies. When traders learned of a severe frost affecting the crop in Brazil, the leading producer, they bid coffee prices up from £450 ($990 at current exchange rates) a ton on the London market in May, 1975, to £4,200 ($9,240) a ton in March, 1977. Coffee production for 1975-76 fell by only 25 percent. The market slumped to just over £1,200 ($2,640) a ton by December, 1978.

Overall, coffee producers benefited from the exaggerated response of the market to the Brazil frost, but financial planning is difficult under such circumstances. The price of cocoa has followed a similar, though less extreme, pattern starting from the same price of £450 a ton in 1975. Today, while coffee and cocoa producers complain that the two markets



Price in cents per pound for Ghana "fair fermented" cocoa on New York market



Consumption (--) and production (—) for growing seasons ending in year marked. In long tons except for consumption after 1960, which is in metric tons.

are depressed, the prices are still about twice as high as six years ago. The producing countries would prefer a reliable future of gradual price increases, however, to the unpredictable gains of the present.

The above graphs show the fluctuations of the cocoa market between 1950 and 1970. The one on the right depicts the levels of production and consumption. It shows the trend has been parallel growth. The gap between supply and demand was minor, and varied from a supply surplus to deficit in a fairly regular pattern. The graph on the right shows price movements over the same period. Its peaks and valleys make a much more jagged line, and seem to have little relation to the pattern of supply and demand on the right.

Here are the figures for the difference between production and consumption, in thousands of long tons, for seven growing seasons. A plus figure signifies surplus production, a minus figure indicates an excess of demand: 1951/52, -75; 52/53, 0; 53/54, +44; 54/55, +79; 55/56, +18; 56/57, -12; 57/58, -76. For the same period, prices went like this on the New York market, in cents per pound; 1952, 35.4; 1953, 37.1; 1954, 57.8; 1955, 37.5; 1956, 27.3; 1957, 30.6; 1958, 44.3.

From 1953 to 1954, the price jumped by more than 20 cents, after a year in which supply and demand were even. The price dropped just as quickly the next year, and in 1956 fell well below the level of four years before. While producers were adjusting to that market shift, the buyers were already pushing the price up again. Thus, while the balancing scales of supply and demand rose and fell, the price rollercoaster shot up and down and up again.

Commodity-producing countries have tried to regulate the market through agreements among themselves or with consuming countries. Coffee and cocoa producers have gone both routes; neither has worked well. Last year, South American coffee producers tried to beat the speculators at their own game by buying up coffee futures to keep prices high. The group's purchases didn't succeed in stopping the decline in prices, and the effort was abandoned after a few months and a substantial loss of money. Cocoa producers formed an alliance in 1962 to keep prices up by withholding supplies from the market. The alliance fell apart under the pressure of a bumper crop in 1964. The alliance was perhaps unfortunate to have formed just at a period when supplies exceeded demand for a few years.

In the Seventies, both coffee and cocoa producers reached agreements with consuming countries in an attempt to stabilize prices. The accords set high and low price limits that would trigger export manipulation by international organizations. When the market price goes below the lower limit, producer supplies are directed to a buffer stock. The cessation of exports is supposed to tighten the market and boost prices, while producing countries are still assured of sales through the stock formation. If the price goes above the upper limit, the control organizations begin to sell the buffer stock until prices go down. When the price is between the agreed limits, the market acts freely.

One problem with the accords is that the price limits were set so far apart that only extreme variations in supply can trigger the corrective measures, and in those cases the control action has little effect on the market. Stocking also causes problems. Cocoa doesn't keep well, so manufacturers can usually wait until producers are forced to put their supplies on the market. Coffee can be stored for a long time. In glut periods, manufacturers build up their stocks. These coffee reserves have upon occasion almost equaled two years' consumption, giving manufacturers a lot of time to wait for prices to come down.

Currently, both coffee and cocoa are below the lower price limits of the accords. The coffee accord is still in effect, but has had little effect on the price. A new cocoa accord is under discussion. The Ivory Coast, the world's leading cocoa producer, refuses to join unless the price limits are raised. The United States, the top consumer, refuses to agree to lifting the prices.

The developing countries would like to see a more general commodity agreement, with prices linked to the rising costs of manufactured goods from the industrialized countries. They have little bargaining strength, however. Except for oil, the Third World's commodities are either non-essential to the West, as in the case of cocoa and coffee, or the West has access to adequate supplies, its own or those of protected states like South Africa.

Who are the winners and losers of the cocoa market? Farmers are usually hurt only indirectly. In the Ivory Coast, as in most cocoa-producing countries, they are protected by a government agency that guarantees them sales at a fixed, remunerative price. In the Ivory Coast, the government raises the price about every two years, no matter what the market is doing. The loss of revenues from cocoa sales has forced the government to cut its budget and slow its development projects, which hurts the farmer as well as other citizens.

The Western consumer, on the other hand, gets hurt more directly. Market prices fluctuate greatly, but the cost of the finished product rarely goes down. Americans have seen the size of their chocolate bars shrink while their price has risen. Cocoa prices haven't been responsible for this. Cocoa accounts for only about 20 percent of the cost of a chocolate bar. When cocoa prices have gone up, manufacturers have often reduced the amount of cocoa in their chocolate, replacing it with cheaper substitutes. Rises in sugar prices have had some effect on the cost of a Hershey, but it is largely the manufacturing and labor costs that account for the vanishing chocolate bar.

Coffee presents much the same story. Perhaps in the long run, consumers, thinner and less fidgety as they cut down on cocoa and coffee consumption in response to higher prices, do benefit from the present system, but then the manufacturers are hurt. One candy company is even reported to have increased the size of its chocolate bars without raising the price to try to increase sales. The only people who seem to profit from the free market for commodities are the lucky speculators.

Regards,

Bowden

Bowden Quinn

Received in Hanover 3/24/81