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# Securing higher prices for cocoa

## Price mechanisms in international trade

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# Contents

# Executive summary

The purpose of this paper is to examine whether the sustainable production of cocoa can be supported by increasing the price of cocoa on world markets, through a variety of national or international policy measures, and whether these policy measures would align with or breach global trade rules. The paper reviews four approaches: producer-country measures, consumer-country measures, bilateral partnership agreements and international commodity agreements.

Raising the price of cocoa can increase farmers' incomes, enabling them to enjoy higher standards of living as well as to invest in more sustainable forms of production, including eliminating deforestation, protecting biodiversity, reducing the use of chemicals and maximising carbon storage in soils. Higher prices of cocoa may also deliver greater revenue to producer-country governments, helping them to invest in the enabling conditions necessary to support sustainable production, including improvements in standards of governance and law enforcement, the provision of basic services, infrastructure, and support for farmers and better protection for forests and forest communities. All these steps should also help to reduce the incidence of child labour.

There are, however, drawbacks to raising the prices of cocoa on world markets. First, any sustained rise in the farmgate price for cocoa also raises the incentives to farmers to increase production, risking eventual over-supply and a possible subsequent price crash. Possible solutions include limiting supply, for example by capping production or setting minimum standards, for example to ensure that cocoa is produced without deforestation or the use of child labour. An alternative solution is for producer-country governments to withhold some of their supply, putting cocoa beans in storage until the world price has risen again; but this is costly, and cocoa beans cannot be stored indefinitely (though it may be easier to store processed cocoa products for longer).

Second, higher cocoa prices may lead to reduced consumer demand, though the price of cocoa is only a small proportion of the retail price of chocolate products, so the impact should be limited. It may also be possible to minimise the impacts by producer countries aiming to produce higher quality products, where volumes of sales are lower but value added is higher, and where consumer markets are less sensitive to price increases.

Third, countries raising the price of their cocoa risk losing global market share, as companies sourcing the cocoa switch their buying to other producer countries. While in the short term major new alternative sources of supply are not likely to be available, in the longer term they could grow relatively rapidly. This could be countered by encouraging other producer countries to adopt similar measures to raise their prices.

**International trading rules**

Any measures taken by countries to alter the price of products in international trade, or to discriminate in trade between products based on their countries of origin or the ways in which the products are produced (rather than their inherent characteristics) raises potential questions of compatibility with the trade disciplines of the World Trade Organisation (WTO).

These require countries to apply trade measures – for example, import or export duties – without discriminating between other countries; not to raise import duties above the maximum rates (the 'bound' rates) they have committed to; and to reduce subsidies and other measures that may affect trade. Bilateral and regional trade agreements may place additional restrictions, for example on raising export duties.

**Producer-country measures**

Those producer countries which operate an effective monopoly over their cocoa exports – such as Côte d'Ivoire and Ghana – are able to increase the export price above world market prices, as these two governments have done recently through applying the 'Living Income Differential'. While initially this has had a positive effect in raising the farmgate price for cocoa, more recently it has run into problems of over-supply caused by falling demand as a result of the coronavirus pandemic, and of traders switching sourcing to other countries; in the longer run it could face the problem of over-supply caused by increased production in response to the higher price.

In principle, countries not operating a monopoly over cocoa exports could apply export duties to achieve the same effect. However, the Economic Partnership Agreement (EPA) between the EU and West African states includes the obligation not to introduce any new duties or taxes on exports. Even ignoring this latter problem, it is highly unlikely that either of these options could be successful in the long term unless they are accompanied by controls on supply – which, given weaknesses in regulation and governance, and likely resistance from cocoa farmers, would be challenging to implement.

**Consumer-country measures**

An alternative approach is for consumer countries to apply import duties to the import of cocoa beans and to recycle the revenue generated to the producer countries. However, both the UK and EU have committed to bound tariff rates of zero on cocoa beans, so this would place them in breach of their commitments under the WTO – though cocoa exporters would be unlikely to initiate a dispute if they were receiving the revenue. Raising the price of imported cocoa beans would also mean that cocoa processors and chocolate manufacturers in the EU/UK would face a loss of competitiveness against their counterparts elsewhere, and could lose market share to imports of finished products from other countries. For all these reasons, this is a highly unlikely option.

Both of these problems could be avoided by applying a consumption tax to cocoa and chocolate products, whether produced domestically or imported. However, raising the price of cocoa through either of these measures is not likely to be popular with consumers (and for the EU, a consumption tax would have to be agreed by all 27 member states) – though if the increase was badged as a 'living income tax', explicitly designed to support poor cocoa farmers, public acceptance might be higher, and in reality the level of the tax is likely to be quite low. However, the same aim could be achieved more simply through development aid funded through general taxation.

**Bilateral partnership agreements**

Bilateral agreements between the EU or the UK and cocoa-producing countries – possibly modelled on the Voluntary Partnership Agreements (VPAs) negotiated between the EU and timber-exporting developing countries under the Forest Law Enforcement, Governance and Trade (FLEGT) initiative – have been suggested as a mechanism to improve the sustainability of cocoa production on the ground, in exchange for capacity-building support and, possibly, improved market access.

While it seems unlikely that a commitment to pay higher prices – that *companies* would need to enter into – could be included in an agreement between *governments*, it may be possible to conceive of incentives that would give cocoa from partner countries a higher market share in the EU/UK. More positively, a partnership agreement could help to put in place some of the critical elements needed for the comprehensive reform of the cocoa sector, including agreed standards for sustainable cocoa production, improved governance and law enforcement – including a multi-stakeholder deliberative process for setting the sustainability standard, policy-making and implementation – and a national traceability system for cocoa. This offers a chance for wider and longer-lasting improvements in cocoa production than higher prices by themselves are likely to deliver. Implementation of the agreement could be supported by EU/UK due diligence legislation for cocoa which would give preferential access to cocoa licensed as produced to the agreed standard from the partner countries.

**International commodity agreements**

A possible solution to the problem of cocoa buyers switching to other sources of supply in response to some countries raising their cocoa price, and to the problem of higher farmgate prices creating an incentive for farmers to increase production, could be to establish an international commodity agreement covering all (or, at least, most) producers. The parties to the agreement would jointly fix production or export volumes and thereby manipulate the global market.

The experience of the international commodity agreements, including the International Cocoa Agreement, negotiated in the 1960s and 1970s, however, is not encouraging. To maintain high prices, either production or export volumes must be controlled, which is likely to be challenging – though if the kind of outcomes of the bilateral approach discussed above can be realised, these may help. There would always be an incentive for some producer countries to stay outside the agreement, to benefit from efforts of cocoa buyers to avoid paying higher export prices; if their number can be minimised, such an agreement would have a higher chance of success.

**Conclusions**

Most of these options do not look likely to achieve their ends in anything other than the short term. This should not come as a surprise. Using trade measures to achieve domestic policy objectives is rarely a first-best option; there is a high risk of them triggering consequential changes with negative impacts.

A sustainable long-term strategy for raising cocoa farmer incomes, protecting forests and reducing the incidence of child labour is likely to need a wide range of interventions: investments in improving productivity, increasing technical support to farmers, improved access to finance, restricting levels of production by supporting diversification into alternative crops or, possibly, alternative livelihoods, better provision of social security, health and education, and improvements in governance and law enforcement, including traceability schemes, and forest protection. All of these can be supported through development assistance and better regulation of the companies sourcing the cocoa, for example through imposing due diligence obligations. If these measures can be delivered – and of course there are significant challenges in doing so – the kind of trade interventions discussed in this paper would not be necessary. And if there are failures to deliver all or some of them, it is not obvious that trade mechanisms by themselves can compensate.

The most hopeful measure examined here is the option of bilateral partnership agreements, which could help to create these enabling conditions supporting the transition to a wholly sustainable cocoa sector. The current debates within the EU on the feasibility of such agreements for cocoa should accordingly be encouraged.

# 1 Introduction and background

The purpose of this paper is to examine whether the sustainable production of cocoa can be supported by increasing the price cocoa can command on world markets, through a variety of national or international policy measures, and whether these policy measures would align with or breach global trade rules. The paper reviews four broad approaches: producer-country measures, consumer-country measures, bilateral partnership agreements and international commodity agreements. The paper focuses mainly on Côte d'Ivoire and Ghana as the main global producers of cocoa beans; in 2019 these two countries together accounted for about two-thirds of world production.

## 1.1 Cocoa prices, poverty and sustainability

The challenges of achieving the sustainable production of cocoa are well known. In countries where the vast majority of cocoa producers are smallholder farmers – including Côte d'Ivoire and Ghana – poverty is the underlying factor, helping in turn to drive deforestation and the use of child labour. In 2018 Fairtrade International calculated that on average, cocoa farmer households earned only 37 per cent of the minimum living income in rural Côte d'Ivoire: US$0.78 per day compared to an estimated minimum living income level of $2.51 per day.[1]

Low income hinders the sustainable production of cocoa, which requires greater resources than most cocoa farmers can at present afford. Most cocoa farms are very small: farmers in West Africa typically work plots of a few hectares, often growing cocoa alongside food crops. A farm of 2–4 hectares typically produces 300–400 kg of cocoa beans per hectare per year, perhaps half of its potential output. This is due mainly to poor farming methods and a lack of access to inputs, technology, finance and credit and extension services. While cocoa provides the family's main cash income, in general this is too low to allow farmers to generate enough capital to invest in improvements in productivity, including improving depleted soil fertility and replacing ageing or diseased cocoa trees, or in more sustainable practices.[2] In turn this helps to drive deforestation, since it is usually cheaper to expand production through increasing the total planted area, often by encroaching into the forest, rather than through improving productivity. And the cocoa poverty trap, coupled with failures of governance and law enforcement, has also led to the widespread use of child labour.

In general, the share in the value of the final product that reaches farmers is small and shrinking. A recent study of the value chain of chocolate produced from West African cocoa and sold in France suggested that farmers received between 7 and 11 per cent of the total value of the product.[3] This is a fall from up to 50 per cent in the 1970s and 16 per cent in the 1980s.[4]

One objective of raising the price of cocoa could therefore be to increase farmers' incomes, enabling them to enjoy higher standards of living as well as to invest in more sustainable forms of production, including eliminating deforestation, protecting biodiversity, reducing the use of chemicals and maximising carbon storage in soils. Higher cocoa prices may also deliver greater revenue to producer-country governments, helping them to invest in the enabling conditions necessary to support sustainable production, including improvements in standards of governance and law enforcement, the provision of basic services, infrastructure, and support for farmers and better protection for forests and forest communities.

[1] Ivorian Center for Socio Economic Research (CIRES), *Living Income Report: Rural Côte d'Ivoire Cocoa-growing areas* (ISEAL Alliance, Sustainable Food Lab and GIZ, 2018).
[2] *Fairtrade and Cocoa: Commodity Briefing* (Fairtrade Foundation, April 2016).
[3] *Comparative Study on the Distribution of Value in European Chocolate Chains* (FAO and BASIC, 2020).
[4] *Fairtrade and Cocoa*.

While cocoa is the main focus of this paper, the discussion is also relevant to other forest risk commodities, and some are mentioned where appropriate. Coffee, for example, which is also primarily farmed by smallholders, has seen similar developments. While in the 1970s, producers retained an average of 20 per cent of the retail price of coffee, after over-supply caused prices to crash to historic lows in the period 1994–2004, coffee growers' share fell to just 1–6 per cent of the retail price in Europe and North America; by 2012 it had recovered somewhat, but only to 7–10 per cent.[5] This helps to highlight the typical boom–bust nature of many agricultural commodities, and the sharp price swings which are typical of their global markets. The production of other commodities, such as palm oil, soy or beef, may be less characterised by poverty, but face their own challenges of deforestation, environmental harm, disputes over land ownership and access and, sometimes, forced labour.

## 1.2 Options for raising prices

While several approaches are available to tackle the problems of unsustainable cocoa production, raising the price of the cocoa produced is one option. This increases the returns to farmers from farming a smaller area, and increases their ability to invest in improvements in productivity, thus reducing the need to expand their farms at the expense of the surrounding forest. It may also help to meet the costs of sustainability verification, for example through certification systems, which in turn allows the farmers to access markets which put in place minimum standards of legality or sustainability. Higher farmer incomes also reduce the need for child labour, as more income is available to employ adult workers.

Chapters 3–6 of this paper examine six policy options for raising cocoa farmers' incomes through increasing the price their cocoa commands on world markets:

3. Producer-country measures: export price regimes (Section 3.1) and export duties and taxes (Section 3.2).
4. Consumer-country measures: import duties and taxes (Section 4.1) and consumption taxes (Section 4.2).
5. Bilateral partnership agreements between producer and consumer countries.
6. An international commodity agreement for cocoa.

While the producer-country options can be undertaken by producer countries unilaterally, they are likely to be more effective if taken in concert with other producer countries and, possibly, consumer countries too. The consumer-country options require cooperation between consumer and producer countries, as does the option of bilateral agreements. The final option, of an international commodity agreement, assumes a wider buy-in from producer and, possibly, consumer countries. In most cases, therefore, these options may be pursued through some form of international agreement.

This paper assumes that the most likely consumer countries, or blocs, to try to reach such agreements are the EU and the UK. These countries' governments have displayed the most consistent interest in adopting regulations and other measures designed to reduce the impact of their citizens' consumption on forests overseas. On the producer side, most of the focus is on the main producer countries, Côte d'Ivoire and Ghana, but the analysis is relevant to other producers too.

All of these options have the potential to interact with the international trade rules set by the World Trade Organisation (WTO). Chapter 2 therefore provides a brief introduction to the relevant aspects of the WTO agreements. After discussing the options in Chapter 3–6, Chapter 7 offers brief conclusions.

[5] *Fairtrade and Coffee: Commodity Briefing* (Fairtrade Foundation, May 2012).

## 1.3 The challenge: negative consequences

There are three main drawbacks to raising the price of cocoa on world markets: over-production leading to an eventual price crash; falling consumer demand; and traders shifting their purchasing to other countries.

Any sustained rise in the farmgate price for cocoa will also raise the incentives to farmers to increase production, through taking on more labour (either adults or children), expanding the area of their farms (potentially increasing deforestation), or replacing other crops with cocoa. Clearly, this risks eventual over-supply and a possible subsequent price crash.

One possible solution is to limit supply through regulation, for example by placing caps on annual production, or possibly on the area of farms or the number of farmers (though efforts to increase productivity without expanding area – in some ways a positive outcome – could still lead to production rising), or by encouraging farmers to diversify into other crops. Other possibilities include setting minimum standards, possibly through national legislation, for example to ensure that the cocoa is produced without deforestation or the use of child labour, which should reduce total production volumes.

An alternative solution is for producer-country governments to accept the reality of over-production and to withhold some of their supply from export, putting cocoa in storage to avoid the world price falling. Cocoa beans cannot be stored indefinitely – in cool, dry conditions, they should remain fresh for six months to a year, but no longer – but it may be possible to store processed cocoa products, such as cocoa mass, cocoa butter or cocoa powder, for longer. However, storage, particularly in tropical countries, is costly, and if it is processed products that are to be stored, processing facilities must also be available; in Côte d'Ivoire and Ghana these are limited, though investment in processing is increasing in both countries. In addition, the government must bear the cost of paying the farmers without generating the export revenue. An alternative to storage could be for the government to buy up any production above the agreed annual cap and destroy it, thus limiting the volume entering export markets and helping to keep world market prices high; but if the farmgate price is the same, there is no incentive for the farmer to reduce production.

The second concern is that if prices rise globally as a result of the sustained application of higher export prices, consumers might respond by purchasing less. Retail prices of chocolate products, and consumers' responses to price rises or falls (the price elasticity of demand) are affected by a very wide range of factors, including the price of other ingredients (sugar, milk, flavourings, etc.), the type and quality of the products, health concerns (which can be positive as well as negative for chocolate), consumer tastes and fashions, and perceptions of the products' links with issues such as child labour or deforestation, or of the absence of such links for products certified by schemes such as Fairtrade or Rainforest Alliance. In addition, manufacturers may respond to higher cocoa prices by substituting ingredients (for example, using more palm oil-based cocoa butter equivalent) or reducing the size of portions, or other solutions.

A full exploration of these issues goes beyond the remit of this paper, but studies tend to suggest that demand for chocolate is relatively price-elastic, particularly for low-quality low-price products. So higher export prices may reduce sales, and therefore the demand for imports of cocoa beans overall, which means that the net impact on producers may be negative. The price of cocoa is only a small proportion of the retail price of chocolate products, however, so the impact should be limited. It may also be possible to minimise the impacts by aiming to produce higher quality products, where volumes of sales are lower but value added is higher, and where consumer markets are less sensitive to price increases.

The final concern is the prospect of losing global market share, as companies sourcing the cocoa switch their buying to other producer countries not raising the price of their cocoa beans. Companies' ability to do this may be constrained by several factors, including their investment in production facilities in the original producer countries, the length of their supply contracts, the extent to which the commodities are bought and sold on international exchanges or direct from the source, and, most obviously, the availability of alternative sources of supply.

For this last issue, the main producer countries at least start from a strong position, since the production of cocoa is highly concentrated: in 2019 Côte d'Ivoire and Ghana together accounted for 63 per cent of global production.[6] (The same is true of several other forest risk commodities, including palm oil (Indonesia and Malaysia together accounted for 85 per cent of global production in 2017), coffee (Brazil and Viet Nam 46 per cent) and rubber (Thailand and Indonesia 58 per cent).[7])

In the short term, therefore, major new alternative sources of supply are not likely to be available, and a period of several years would be needed to invest in developing new sources. In the longer term, however, alternative major sources could grow relatively rapidly. In Cameroon, for example, production of cocoa beans rose by more than 30 per cent in the five years to 2019.[8] So the fear of a loss of global market share following farmgate or export price rises is a real one. This could be countered by encouraging other producer countries to adopt similar measures to raise their prices, possibly through international agreement. These options are considered further in Chapters 3 and 6.

# 2 International trading rules

Any measures taken by countries to alter the price of products in international trade, or to discriminate in trade between products based on their countries of origin or the ways in which the products are produced (rather than their inherent characteristics) raises potential questions of compatibility with the trade disciplines of the World Trade Organisation (WTO).

The WTO was founded in 1995, at the conclusion of the Uruguay Round of trade negotiations, the eighth such round between parties to the General Agreement on Tariffs and Trade (GATT), an international treaty originally agreed in 1947. The primary aim of these trade rounds was to remove barriers to trade, in the form of tariffs – import and export duties charged by governments on trade in goods – and non-tariff barriers such as quotas or administrative requirements. As a result of these efforts, industrialised countries' tariffs on manufactured goods have fallen from about 50 per cent in 1948 to an average of less than 4 per cent today, though tariffs remain rather higher on agricultural goods, and developing countries' tariffs tend to be higher across the board.

This reduction in trade barriers has underpinned a substantial expansion in world trade. The volume of global exports of merchandise (primary commodities and manufactured products), for example, grew from US$58 billion in 1948 to US$19 trillion in 2019, in real terms a 30-fold increase.[9] Trade is now a more significant component of national economies than it used to be: in 1948 the value of exports as a proportion of world GDP was 7 per cent; in 2014, it was 24 per cent.[10]

The Uruguay Round, building on earlier trade rounds, led to a significant volume (22,500 pages) of individual countries' commitments to cut import duties on specific categories of goods and services, in some cases to zero. There was also a major increase in the number of 'bound' tariffs: the maximum rates of duty that countries commit to. If they raise tariffs above their bound level, they can be liable to

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[6] ICCO, 2019.
[7] *The Urgency of Action to Tackle Tropical Deforestation* (IDH, February 2020).
[8] Antonie C. Fountain and Friedel Hütz-Adams, *2020 Cocoa Barometer* (Cocoa Barometer Consortium, 2020).
[9] WTO Data at https://data.wto.org.
[10] Esteban Ortiz-Ospina and Diana Beltekian, 'Trade and Globalisation' (OurWorldInData.org, 2018); https://ourworldindata.org/trade-and-globalization#trade-has-changed-the-world-economy.

compensate other countries affected by the increase. In practice, in many cases applied tariff rates are even lower than the bound rates.

Further cuts in tariffs, and more tariff bindings, have followed since the conclusion of the Uruguay Round, but progress has been much slower, largely because there is now less scope for further cuts. Since tariffs are now so low, particularly on manufactured products, trade negotiations have increasingly attempted to deal with other factors affecting trade in goods, such as product standards imposed for reasons of health and safety or environmental quality, and also with trade in services. Since modifying or harmonising these kind of standards affects domestic regulatory frameworks and policies far more than reductions in tariffs, this has also helped to make further progress with trade liberalisation slower and more controversial, as wider and wider areas of national policy are affected, or potentially affected, by international trade rules – as recent debates over hormone-treated beef, or chlorine-washed chicken, illustrate.

The successive trade rounds also led to agreements to reduce government subsidies to industries, or entire sectors, since these can obviously also affect international trade. The most difficult topic to tackle has been agriculture, where issues of food security, rural livelihoods, environmental protection and the inherent instability of agricultural product markets have led almost all governments to intervene extensively. The WTO Agreement on Agriculture that emerged from the Uruguay Round aimed to reduce trade-distorting subsidies while permitting other forms of farm support that do not affect trade, or affect it only minimally (though these are difficult distinctions to draw, and in practice many measures that have been classified as falling into the latter category have still affected trade). The agreement was accompanied by commitments to reduce tariff and non-tariff barriers to trade in agricultural products and to cut export subsidies. The implementation and further development of this package – there have been agreements on further commitments, including a 2015 decision to abolish all export subsidies – has remained one of the most controversial areas of trade negotiations.

The Uruguay Round also led to the creation of the WTO as a permanent rules-based body. The WTO oversees the implementation of the GATT and the range of additional agreements that came into place alongside it, together with a quasi-judicial system of dispute resolution which requires consensus among WTO members to overturn any decision – taken together, a much more powerful and far-reaching system of trade rules than existed under the GATT alone.

The WTO agreements lay down general rules for governments to follow in liberalising international trade. They cannot possibly deal with every specific traded product or service, so they set out broad principles which must be interpreted and applied in particular dispute cases where one WTO member believes that another is failing to comply with them. (It should be noted that WTO rules apply only to governments and public policy, not to private enterprises and their purchasing and sourcing policies.)

As well as the general aim of removing barriers to trade, the WTO system is based around opposition to discrimination in trade. Its core principles include GATT Articles I ('most favoured nation' treatment) and III ('national treatment'): WTO members are not permitted to discriminate between traded 'like products' produced by other WTO members, or between domestic and international 'like products'. GATT Article XI ('elimination of quantitative restrictions') forbids any restrictions other than duties, taxes or other charges on imports from and exports to other WTO members.

Essentially the same principles are built into the other WTO agreements that have developed alongside the GATT. These either cover specific sectors such as agriculture, textiles or services, or aim to impose trade disciplines on non-tariff barriers such as intellectual property, technical barriers to trade or sanitary and phytosanitary (health and plant health) standards. It was always recognised, however, that some circumstances justified exceptions to this general approach, permitting governments to apply unilateral trade restrictions in particular circumstances; these are set out in GATT Article XX, and similar provisions are included in other WTO agreements.

The bodies that carry out the interpretation of these rules in trade disputes are the dispute panels (generally composed of trade experts), which issue an initial set of findings, and the WTO Appellate Body (mostly international lawyers), to which dissatisfied parties can appeal. Since their decisions can only be overturned if all WTO members (other than those involved in the dispute) agree – which has never happened – this system is a powerful means of resolving conflicts and ensuring that trade rules are interpreted and applied consistently around the world. If the loser in any given case does not modify its policy accordingly, the winner is entitled to take trade-restrictive measures (e.g. apply tariffs) against it to the estimated value of the trade lost because of its action.

The WTO's dispute settlement system, however, is currently in disarray. Since 2011, the United States has systematically blocked the appointment of new members to the Appellate Body and the reappointment of existing members, citing a range of objections to the way in which the system has worked. As a result, by the end of 2019, only one member of the Appellate Body remained, instead of the standing roster of seven supposed to be in place. Since the minimum number required to hear appeals is three, the Appellate Body has now ceased to function.[11]

In response, in 2020 a number of WTO members, including the EU, established the Multiparty Interim Appeal Arbitration Arrangement, designed to replace the WTO's dispute settlement system on a contingency basis (the WTO agreements allow members to resort to arbitration as an alternative means of dispute settlement). By August 2020 the EU and 22 other WTO members were participating in the Arrangement, and the mechanism is expected to be in effect as long as the Appellate Body remains dysfunctional.[12]

As progress with further trade liberalisation through the WTO has become more difficult, bilateral and regional trade agreements – often referred to as 'free trade agreements' – have become more common; by February 2021, 339 were in force.[13] These reciprocal preferential trade agreements between two or more partners aiming to reduce tariffs and other trade barriers constitute one of the allowed exemptions from the WTO's core principle of non-discrimination between trading partners, though they are subject to a number of requirements for notification and transparency. Such agreements may range wider than just trading arrangements, covering, for example, provisions to liberalise investment or to provide development assistance, such as the EU's array of Economic Partnership Agreements (EPAs) with developing countries.

Both the international trade rules overseen by the WTO and the requirements of bilateral or regional trade agreements may constrain the ability of countries to affect trade in cocoa, for example by limiting their use of export or import duties. The relevant issues are discussed in each of the following chapters.

[11] Aditya Rathore and Ashutosh Bajpai, 'The WTO Appellate Body Crisis: How We Got Here and What Lies Ahead?', JURIST – Student Commentary, 14 April 2020, https://www.jurist.org/commentary/2020/04/rathore-bajpai-wto-appellate-body-crisis/.
[12] European Commission, 'The WTO multi-party interim appeal arrangement gets operational', 2 August 2020; https://trade.ec.europa.eu/doclib/press/index.cfm?id=2176.
[13] WTO, 'Regional trade agreements', https://www.wto.org/english/tratop_e/region_e/region_e.htm.

# 3 Producer-country measures

This chapter discusses two options that could be taken by producer countries to raise the prices of the cocoa they produce and export. Depending on the producer countries' priorities, the higher income this generates could be used to alleviate poverty amongst smallholder cocoa farmers, or to meet other objectives, such as meeting the costs of farming with higher environmental standards, increasing productivity or establishing legality or sustainability assurance systems – or all these aims.

## 3.1 Export price regimes

The first option envisages producer-country governments raising the price of their cocoa exports above the market price to meet the objectives outlined above. Self-evidently, this requires the governments to possess a real or effective monopoly, or near-monopoly, on the export of cocoa beans. This is indeed the case in both Côte d'Ivoire and Ghana, where government marketing boards – respectively, the Conseil du Café-Cacao (Coffee and Cocoa Council, CCC) and the Ghana Cocoa Board (Cocobod) – fix guaranteed farmgate prices for cocoa, with the aim of supporting local farmers and furthering the development of the domestic cocoa sector. In Côte d'Ivoire, private companies purchase a license from the CCC to export a specific volume of cocoa at a pre-agreed reference price, ahead of the main crop season (October – March); the exporters then purchase their cocoa directly from farmers' cooperatives or intermediaries who are counterparts to the export contracts registered at the CCC. In Ghana, Cocobod has a monopoly on sales of cocoa beans and a quasi-monopoly on their purchase; a small number of licensed buying companies are authorised to purchase cocoa beans from cocoa-growing communities. In both countries the minimum farmgate price is set by the government as a proportion of the export price.[14]

Until 2019 the export prices were effectively what the global market was prepared to pay, but in June 2019 the two governments announced their intention to start charging a premium called the 'Living Income Differential': an additional fee of US$400 per tonne of cocoa on top of the market price for forward sales for the 2020/21 main crop, aiming to achieve a target total price of US$2,600 per tonne.[15] The governments committed to passing at least 70 per cent of the total to farmers, for a guaranteed fixed price of US$1,820 a tonne – about US$675 higher than the price that Ivorian farmers received during the 2018–19 harvest, and about the same price level they had received prior to the 2016 cocoa price crash, when prices collapsed by almost 40 per cent.[16] Farmgate prices announced in October 2020 were in fact slightly higher, at US$1,837 per tonne in Ghana and $1,840 in Côte d'Ivoire.[17] If global prices were to rise above US$2,900, proceeds from the Living Income Differential were to be placed in a stabilisation fund that would be used to ensure farmers were still paid the target farmgate price if market prices fell in the future.[18]

In Côte d'Ivoire the Living Income Differential appeared as an additional cost item on the pre-agreed contract between exporters and local sellers of cocoa beans registered by the CCC. Accordingly, the

[14] Tancrède Voituriez, 'Framing the Living Income Differential's Contribution to Sustainable Cocoa', presentation at European Commission's 'Cocoa Talks' session on the Living Income Differential, 9 February 2021.
[15] This is the 'Free On Board' (FOB) price, a term frequently used in shipping where the price quoted by the seller included the cost of delivering goods to the nearest port.
[16] 'VOICE Network welcomes historic move to raise cocoa prices, questions remain on implementation', (VOICE Network, September 2019), https://www.voicenetwork.eu/wp-content/uploads/2019/09/190905-VOICE-Position-on-West-African-Cocoa-Floor-Price.pdf.
[17] *2020 Cocoa Barometer.*
[18] 'Ivory Coast, Ghana strike first cocoa deals with living income premium', Reuters, 13 September 2019; https://www.reuters.com/article/cocoa-west-africa-pricepremium-idUSL5N2644FR.

proceeds did not flow to the CCC, but to the farmers directly; the higher export price allowed the CCC to set a higher farmgate price. In Ghana, Cocobod charged the Living Income Differential on exports and transferred the revenue to farmers through the higher farmgate price.[19]

While cocoa and chocolate companies either did not publicly oppose the move, or openly supported it – despite concerns about a roughly 20 per cent increase in their costs, and the possibility of eventual over-supply – in practice they proved reluctant to enter into forward contracts for the 2020/21 crop. After the two governments raised the pressure by announcing a review of, and possible halt to, cocoa buyers' sustainability programmes – which are important for consumer confidence in these companies' products – the industry fell into line and accepted the higher price.[20]

In November 2020, however, the CCC and Cocobod accused Hershey and Mars of trying to undermine the scheme and threatened again to suspend company programmes.[21] In December the governments went ahead and cancelled Hershey's programmes after the company bought a quantity of cocoa beans on the New York futures market, although the company denied that this was an attempt to avoid paying the Living Income Differential.[22] A few days later the suspension was lifted after Hershey's acknowledged the importance of the Living Income Differential and committed to paying it.[23]

This move took place against a background of falling consumer demand in the wake of the coronavirus pandemic, thanks to lower sales of chocolate at outlets such as restaurants, hotels and airports (somewhat offset by increased consumption at home, but this is more likely to be of cheaper products).[24] By December, Côte d'Ivoire's main crop sales had fallen by 15 per cent, and 90–95 per cent of contracts for the 2021 mid-crop remained unsold.[25] In January 2021, members of three farmers' organisations began an 'indefinite peaceful strike' in protest at being paid less than the agreed farmgate price.[26] In March the Ivorian government cut the farmgate price by 25 per cent against a backlog of unsold cocoa beans from the harvest from October 2020 to March 2021, and urged farmers to curb production to boost prices.[27]

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[19] Voituriez, 'Framing the Living Income Differential's Contribution to Sustainable Cocoa'.
[20] 'A lesson in the high politics of cocoa' (Living Income Community of Practice, November 2019), https://www.living-income.com/single-post/2019/11/12/a-lesson-in-the-high-politics-of-cocoa-how-a-united-front-by-exporting-countries-result.
[21] 'Mars, Hershey's accused of avoiding fair pay for cocoa farmers', Agence France Press, 1 December 2020; https://www.rappler.com/business/mars-hersheys-accused-avoiding-fair-pay-cocoa-farmers.
[22] Anthony Myers, 'Ghana and Cote d'Ivoire cancel Hershey's sustainability programmes as row over "cheap cocoa beans" intensifies', ConfectioneryNews.com, 1 December 2020; https://www.confectionerynews.com/Article/2020/12/01/Ghana-and-Cote-d-Ivoire-cancel-Hershey-s-sustainability-programmes-as-row-over-cheap-cocoa-beans-intensifies
[23] Anthony Myers, 'Cote d'Ivoire lifts ban on Hershey sustainability programmes after company commits to LID', ConfectioneryNews.com, 7 December 2020; https://www.confectionerynews.com/Article/2020/12/07/Cote-d-Ivoire-lifts-ban-on-Hershey-sustainability-programmes-after-company-commits-to-LID.
[24] Jonathan Kingsman, 'Cocoa economics', 24 January 2021; http://commodityconversations.com/wordpress2/2021/01/24/cocoa-economics/.
[25] Anthony Myers, 'Cote d'Ivoire's cocoa exports plummet as COVID and LID disrupt market', ConfectioneryNews.com, 4 December 2020; https://www.confectionerynews.com/Article/2020/12/04/Cote-d-Ivoire-s-cocoa-exports-plummet-as-COVID-and-LID-disrupt-market
[26] Leanne de Bassompierre, 'Ivory Coast Cocoa Farmers Strike as Unsold Beans Pile Up', Bloomberg News, 18 January 2021; https://www.bnnbloomberg.ca/ivory-coast-cocoa-farmers-strike-as-unsold-beans-pile-up-1.1550204.
[27] Leanne de Bassompierre, 'Ivory Coast Cuts Farmers' Pay by 25% for Smaller Harvest', Bloomberg News, 31 March 2021, https://www.bloomberg.com/news/articles/2021-03-31/ivory-coast-cuts-farmers-pay-by-25-for-smaller-harvest; Anthony Myers, 'European-governments and legislators urged to help cocoa farmers as prices continue to fall in West Africa', ConfectioneryNews.com, 12 April 2021; https://www.confectionerynews.com/Article/2021/04/12/European-governments-and-legislators-urged-to-help-cocoa-farmers-as-prices-continue-to-fall-in-West-Africa

This demonstrates the concern over the impact of higher prices pushing up production and leading to a subsequent price crash (as discussed in Chapter 1), though in this case over-supply was caused by a fall in demand rather than a rise in production, which would take several years to work its way through. To maintain high prices, either production or export volumes must be controlled. In fact, in 2019 Côte d'Ivoire announced plans to cap production at 2 million tonnes, but given weaknesses in regulation and governance, and likely resistance from cocoa farmers, it is not at all clear how this could work in practice, and it has not done so to date.[28]

The other main concern discussed in Chapter 1 is of cocoa buyers switching their sourcing to other countries not applying the Living Income Differential or a similar price mechanism. In December 2020, this was exactly what appeared to be happening, with buyers reportedly switching to alternative sources such as Ecuador, Brazil, Nigeria and Cameroon.[29] Figures from European and US futures markets reported in February 2021 showed sharp drops in the share of cocoa from Côte d'Ivoire and significant increases from Nigeria and Ecuador, as well as a fall in total volumes, and the next set of figures, in March, confirmed that 'grinders prefer to source their cocoa from non-LID origins'.[30]

A possible solution to this problem is for other cocoa producer countries to adopt the same approach; and, indeed, in 2019 there were reports of discussions between Cameroon and Nigeria – the other main West African producer countries – with the aim of following suit.[31] Peru was also apparently expressing interest. Nigeria, however, faces the barrier that, thanks to liberalisation in the 1980s, the government does not exert control over cocoa export prices. And even if agreement can be reached, there will always be an incentive to break the agreement, lower the price and gain market share.

The compatibility of the measure with WTO trading rules is unlikely to be an issue, though in fact it is not entirely clear, in two respects. First, the Living Income Differential could possibly be considered a means of support for the agricultural sector under the WTO Agreement on Agriculture. As discussed in Chapter 2, the Agreement specifies two broad categories of domestic support: support with no, or minimal, distortive effect on trade ('Green Box' measures), which are permitted, and trade-distorting support ('Amber Box' measures), which should be reduced or eliminated.[32] Direct payments to producers are included as a Green Box measure, but only if they are not linked in any way to production – which, clearly, the guaranteed farmgate price is, with or without the Living Income Differential.

As a market price support measure, the guaranteed farmgate price should therefore be subject to reduction commitments. Under the de minimis provisions of the Agreement there is no requirement to reduce such trade-distorting domestic support in any year in which the aggregate value of the product-specific support does not exceed 10 per cent (for developing countries) of the total value of production of the agricultural product in question. Price support is generally measured as the gap between the applied administered price and a specified fixed external reference price (the world market price). The element of the Living Income Differential passed on to farmers almost certainly does exceed 10 per cent of the total farmgate price, so arguably both countries should aim to reduce it. However, as discussed above, if the Living Income Differential distorts trade, it is likely to be mainly to the detriment of the exporting countries themselves (assuming a loss of market share), so it seems unlikely in practice that any other WTO member would initiate a trade dispute over the issue. (Furthermore, neither government appears to consider the Living Income Differential as a domestic support measure under the WTO Agreement on

[28] 'Ivory Coast caps cocoa production at 2 mln tonnes to buoy prices', Reuters, 1 October 2019, https://uk.reuters.com/article/ozabs-us-cocoa-ivorycoast-idAFKBN1WG437-OZABS.
[29] Myers, 'Cote d'Ivoire's cocoa exports plummet as COVID and LID disrupt market'.
[30] International Cocoa Organisation, *Cocoa Market Report*, February 2021 and March 2021.
[31] Anthony Myers, 'Nigeria and Cameroon to discuss joint plan for cocoa premium price', ConfectioneryNews.com, 16 October 2019; https://www.confectionerynews.com/Article/2019/10/16/Nigeria-and-Cameroon-to-discuss-joint-plan-for-cocoa-premium-price.
[32] For more details, see https://www.wto.org/english/tratop_e/agric_e/ag_intro03_domestic_e.htm.

Agriculture; while such measures must be notified to the WTO Committee on Agriculture, neither government has done so.)

Second, Article XVII of the GATT deals with state trading enterprises, which it defines as: 'governmental and non-governmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports'. The article, together with a subsequent 'WTO Understanding on the Interpretation of Article XVII', states that such enterprises are to act in accordance with the general WTO principles of non-discrimination, and that commercial considerations only are to guide their decisions on imports and exports. It also requires members to notify their state trading enterprises to the WTO annually.

Although the CCC and Cocobod would both appear to fit the definition of state trading enterprises, neither has been notified by their governments to the WTO.[33] In general, as the WTO secretariat has commented, these obligations have historically been only poorly observed.[34] The main aims of the WTO provisions are to improve transparency and to avoid discrimination, e.g. by state monopolies protecting domestic production at the expense of imports, neither of which are at issue here. So while there may be question marks over whether the two bodies should be registered as state trading enterprises, and whether the application of the Living Income Differential is consistent with the obligation to make sales 'solely in accordance with commercial considerations', this seems unlikely to cause any problems in reality; as above, no other WTO member is likely to initiate a trade dispute over the issue.

Finally, if the scheme is to guarantee higher incomes for cocoa farmers, there must be some mechanism to ensure that the higher price, or a portion of it, is actually passed on to the farmers. While concerns have been raised about the lack of transparency of the CCC's and Cocobod's procedures in this respect, farmgate prices did genuinely rise in 2020 in response to the Living Income Differential; and in any case the mechanism used by the CCC should result in an automatic transfer. Conversely, if the export price is cut, the farmgate price will also fall, as happened in March 2021.

## 3.2 Export duties and taxes

In countries without centralised control of export prices, the use of export taxes or duties to raise the price of cocoa exports could achieve the same end as the Living Income Differential. As with that mechanism, procedures would need to be in place to ensure that the revenue collected, or at least some of it, is passed through to cocoa farmers or is used for other sustainability objectives such as eliminating deforestation or the use of child labour. Cocoa buyers would have to be prepared to pay the duty, rather than attempt to offload it on to the exporter by offering a lower underlying price.

With one exception, WTO rules do not prevent WTO member countries applying export duties, as long as they are non-discriminatory, i.e. they are applied to all exports regardless of destination. Indeed, some cocoa exporters, such as Nigeria, already apply export duty – at a relatively low rate – to cocoa exports. (The exception is for some of the countries acceding to the WTO after its establishment in 1995, including, notably, China and Russia, which, under the terms of their accession are bound by strict obligations on export duties – but neither Côte d'Ivoire nor Ghana fit into the category of acceding members, as both were parties to the GATT long before the WTO came into existence.)

[33] The only submissions to the Working Party on State Trading Enterprises by Ghana, in 2001 (G/STR/N/7/GHA) and 2004 (G/STR/N/10/GHA), both stated that Ghana maintained no such bodies; the only submission by Cote d'Ivoire, in 1996 (G/STR/N/1/CIV), claimed only the Societe Ivoirienne de Raffinage, an oil refinery.
[34] See WTO, 'State trading enterprises', at https://www.wto.org/english/tratop_e/statra_e/statra_e.htm.

Other trade agreements, however, may place restrictions on export duties. In February 2014 negotiations for an Economic Partnership Agreement (EPA) were concluded between the EU and the 16 West African countries and their two regional organisations, the Economic Community of West African States (ECOWAS) and the West African Economic and Monetary Union (UEMOA). The aims of the agreement for the West African countries are to increase exports to the EU, stimulate investment, contribute to developing productive capacity and employment and support structural reforms; and for the EU, to open up new business opportunities and increase legal certainty for European investors in the region. The agreement has not yet entered into force, however, and pending this, 'stepping stone' EPAs have been agreed with Côte d'Ivoire and Ghana; they entered into provisional application on 3 September 2016 and 15 December 2016 respectively. As well as the general aims of the West Africa EPA, they include specific commitments on trade in goods, including product standards and trade facilitation.

The ECOWAS EPA contains the provision that: 'No new duties or taxes on exports or charges with equivalent effect shall be introduced, nor shall those currently applied in trade between the Parties be increased from the date of entry into force of this Agreement.'[35] Although some temporary exceptions are allowed, this would clearly rule out the application of export duties to cocoa, meaning that countries without centralised control of export prices would not be able to use this route.

Ignoring those limitations, the potential impact of export duties or taxes, both positive and negative, are very similar to those of the export price regimes discussed above. If the revenue is not passed on to the farmer in the same way as the Living Income Differential raises the cocoa farmgate price, one additional impact may be to encourage the development of processing facilities in the countries of origin, since buying cocoa beans on the domestic market (free of export duties) would be cheaper than exporting the beans for processing abroad – unless the producer country also applies export duties to processed cocoa products.

In fact export duties have often been used in this way to support the development of processing of agricultural commodities, with accompanying gains in value added and employment. Malaysia, for example, has adopted a fairly consistent export-oriented policy for processed palm oil since the 1960s: while processed palm oil was exempt from export duties, crude palm oil faced 10–30 per cent export duties, depending on the price.[36] Thus processing of palm oil in Malaysia was encouraged, and the country's share of world exports of processed palm oil increased sharply.

## 3.3 Conclusions

For countries where the government exercises monopoly control over the export of cocoa beans, raising the price, through mechanisms such as the Living Income Differential, is a possible way to generate more income from cocoa production, to be used either to raise cocoa farmers' incomes or for other sustainability objectives. However, since raising farmers' incomes creates an incentive to produce more cocoa, leading to over-supply and a probable price crash, it is highly unlikely that this option can be successful in the long term unless it is accompanied by controls on supply (and, as recent experiences have shown, the 'long term' may be very short). The measure also faces the challenge of cocoa buyers switching their sourcing to other countries, though this could be avoided if other countries also raise their prices (see further in Chapter 6).

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[35] *Economic Partnership Agreement between the West African States, the Economic Community of West African States (ECOWAS) and the West African Economic and Monetary Union (UEMOA), of the One Part, and the European Union and its Member States, of the Other Part*, Article 13(1).

[36] Duncan Brack, *Controlling Imports of Palm Oil: Interaction with WTO Rules* (Global Canopy Programme, May 2013).

While there are some theoretical question marks over the WTO compatibility of such a measure, in reality it seems unlikely that this would lead to a WTO dispute.

For countries without government monopoly control over export prices, in theory export duties could be used in the same way to raise cocoa prices, but the terms of the West Africa EPA with the EU prevent this, at least for West African countries.

# 4 Consumer-country measures

This chapter discusses two options that could be taken by consumer countries to raise revenue from trade in cocoa so as to be able to reward producer countries for exporting them.

## 4.1 Import duties and taxes

Instead of export duties being applied to raise the price of exports of cocoa beans, this option envisages the EU or the UK (or other consumer countries) imposing import duties on imports of cocoa and transferring the revenue generated to the producers, to support higher incomes for cocoa farmers or other sustainability aims. Since, under WTO non-discrimination rules, import duties must be imposed on all imports of cocoa regardless of their origin (unless they are covered by a free trade agreement), this approach avoids the problem of diverting demand for cocoa from Côte d'Ivoire and Ghana, as a result of higher prices, to other countries. This measure could be carried out unilaterally, but the assumption is that the EU or UK would enter into an agreement with the producer countries to implement the measure.

Although the mechanism is different from those considered in Chapter 3, in theory the end result is the same – consumers pay higher prices for the cocoa products they consume, and cocoa farmers benefit from higher prices for the cocoa beans they produce. There are, however, some practical problems.

First, how is the revenue raised from the import duties to be transferred to the cocoa farmers? Although in theory this could be done, the number of actors in the chain – the UK or EU member state governments collecting the revenue, the agencies transferring it to the producer countries, the bodies in the producer countries receiving the revenue and, finally, the bodies transferring it to the farmers – is larger compared to the options in Chapter 3, which adds complexity and overhead costs and increases the likelihood that the proportion that finally reaches the farmers is lower.

Second, increasing import duties on cocoa beans would place the UK or EU in breach of their WTO bound tariff rates (see Chapter 2) on cocoa beans, which in both cases are zero.[37] If one WTO member raises applied tariffs above their bound level, other WTO members can take the country to dispute settlement, and request compensation in the form of higher tariffs of their own. In practice, the countries affected – cocoa exporters – would be unlikely to initiate a dispute if they were in any case receiving compensation for lost exports in the form of the revenue raised from the import duties. Whether this would be enough to make good the possible lost exports would depend mainly on the consumer response to higher prices, as discussed in Chapter 1. It would also require the EU/UK to recycle the revenue to all cocoa-exporting countries, though; the EU/UK would not be able to target its support on

[37] EU tariff rates available at https://www.wto.org/english/tratop_e/tariffs_e/tariff_data_e.htm. This WTO database does not yet contain UK tariff rates, but these are set out in the goods schedule submitted by the UK to the WTO for certification, available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/762822/UKs_Goods_Schedule_at_the_WTO.pdf.

the poorest countries, though since Côte d'Ivoire and Ghana export larger volumes of cocoa to the EU and UK than other countries, they would receive the lion's share of the revenue.

Third, raising the price of imported cocoa beans would mean that cocoa processors and chocolate manufacturers in the EU or UK would face a loss of competitiveness against their counterparts elsewhere, and could suffer a loss of market share to imports of finished products from other countries (e.g. from Switzerland) – unless import duties were applied to all cocoa and chocolate products, not just cocoa beans. Under either scenario, consumer prices would rise, with potential impacts on consumer demand, as discussed in Chapter 1.

In theory these challenges may be surmountable, but the likelihood of any country adopting this measure is very close to zero. It runs directly against the trend of trade liberalisation – reducing barriers to trade – that has dominated government policy in almost all countries since the 1940s. And although there may be good reasons in some cases for erecting some barriers to trade – for example to discriminate between products on the basis of the way in which they have been produced (sustainably or unsustainably, for example), in this case the purpose is to deliver financial support to cocoa farmers, which could be achieved more simply through development aid funded through general taxation rather than through the more complex route of raising import duties and recycling the proceeds to the producers.

For other commodities where bound tariff rates are not zero, there may be the additional possibility of varying import duties between products on the basis of the way in which they are produced. While there is an extensive literature on the WTO-compatibility of discrimination between 'like products' on the basis of their 'processes and production methods', most observers have concluded that such measures could be designed to be WTO-compatible. (There are question marks over applying this treatment to some vegetable oils, e.g. palm or soybean oil, and not to others, since they are largely substitutable for one another.) However, this option still suffers from running counter to the general trend of government trade policy, and also from the fact that developing countries tend to see such measures as protectionism by developed countries imposing their environmental standards (assumed to be higher and more costly) on poorer countries' exports.[38]

## 4.2 Consumption taxes

This option envisages the UK or EU member states (or other consumer countries) applying a consumption tax to cocoa and chocolate products; the tax would be levied on all such products sold within the UK/EU, whether produced domestically or imported. As in the option above, the revenue would be used to support cocoa farmers' incomes or other policy outcomes in producer countries; and as in that option, there would need to be a robust and transparent mechanism to ensure the revenue reached the farmers or relevant agencies.

This is almost identical to levying import duties on all imports of cocoa and chocolate products. However, it avoids the problem of a loss of competitiveness of UK/EU-based processors and manufacturers, or the possibility of processing and manufacturing moving to countries elsewhere, since all chocolate products, not just cocoa, are affected. Its impacts on consumer demand are similar to those discussed in Chapter 1, though the precise pattern of changes in consumption could be different. Assuming the tax is imposed on an ad valorem basis, i.e. a percentage of the price (perhaps through a higher rate of VAT, though there are EU-level-agreed constraints on VAT rate changes; these do not now apply to the UK), then luxury products would increase in price even more than basic products, possibly reversing the lower

[38] For a summary of the arguments, see Duncan Brack, *WTO Compatibility with EU Action on Deforestation* (Fern, March 2015).

price elasticity of demand that luxury products exhibit as a result of the higher costs of their ingredients (see Chapter 1).

For the EU, unlike import duties, which are decided at EU level, taxation policy is a topic of member state competence, so all 27 member states would need to agree to impose it. This outcome does not seems very likely; raising prices to consumers – and electors – is never a popular move, and, as above, in this case the same aim could be achieved simply through using development aid funded through general taxation. If the increase was badged as a 'living income tax', explicitly designed to support poor cocoa farmers, however, public acceptance might be higher, and in reality the level of the tax is likely to be quite low; but the political barriers are still real.

It is also likely that exporting countries, or at least those not receiving any compensatory revenue, would object. Consumption taxes are not import duties, and therefore there is no suggestion that the UK or EU would be breaching their bound tariff rates. In fact, since the beginning of the Uruguay Round many countries have effectively replaced import duties with consumption taxes (mainly developing countries, which rely more on tariffs as a source of government revenue than industrialised countries).[39] Nevertheless, it is conceivable that producer countries suffering a loss of exports as a result of the tax, and not compensated by a revenue transfer, could launch a WTO dispute on the basis of discriminatory treatment by the UK or EU between cocoa-exporting countries.

On three occasions between 2012 and 2016 the French parliament discussed proposals to levy a special surtax on palm oil destined for human consumption; it was swiftly nicknamed the 'Nutella tax' after the presence of palm oil as an ingredient (at almost 20 per cent) in the popular sweetened hazelnut cocoa spread.[40] The justification was initially on health grounds, and also on the fact that palm oil was taxed more lightly than other vegetable oils; the impact of oil palm cultivation on deforestation became more important in the later proposals. Unsurprisingly, palm oil producers, including Malaysia and Côte d'Ivoire, as well as French consumer groups and industry, protested strongly; the earlier proposals were abandoned, and the later proposal, in 2016, reduced in scale.

## 4.3 Conclusions

In theory, either of these options – using import duties or consumption taxes – to raise revenue to transfer to producer countries could work, but both face challenges of implementation. Raising import duties would break UK and EU commitments to their WTO bound tariff rates, and runs counter to the general direction of all countries' trade policies. Applying a consumption tax to chocolate seems more feasible, but is likely to be unpopular with consumers and industry (and with those producer countries not receiving compensation), though this could be offset by identifying its purpose specifically as to support poor cocoa farmers. And in either case the same aim could be achieved by using development aid, raised through general taxation; though in a period of constrained government budgets, additional sources of revenue would always be welcome.

[39] Thiess Buettner and Boryana Madzharova, *WTO Membership and the Shift to Consumption Taxes* (CESifo Working Paper No. 6052, Center for Economic Studies and Ifo Institute, July 2016).
[40] Alain Rival and Patrice Levang, *Palms of Controversies: Oil palm and development challenges* (CIFOR, 2013); 'France set to slash "arrogant Nutella tax" after protests', The Local, 18 March 2016, https://www.thelocal.fr/20160318/france-moves-to-slash-nutella-tax-after-protests;

# 5 Bilateral partnership agreements

Bilateral agreements between the EU or the UK and cocoa-producing countries have been suggested as a mechanism to improve the sustainability of cocoa production on the ground, in exchange for capacity-building support and, possibly, improved market access.

Such partnership agreements, possibly modelled on the Voluntary Partnership Agreements (VPAs) negotiated between the EU and timber-exporting developing countries under the Forest Law Enforcement, Governance and Trade (FLEGT) initiative, have been called for by NGOs and industry alike.[41] In some FLEGT partner countries, including Ghana, the VPAs have proved effective in improving standards of governance and law enforcement and in reducing levels of illegal logging. They do not include commitments on prices or incomes, however, partly because poverty is less of an issue in the timber sector. So could a VPA-type bilateral agreement on cocoa contain such provisions, perhaps guaranteeing the payment of the Living Income Differential or similar measure?

Such a provision was called for in September 2020 in a report issued by a coalition of NGOs from consumer and producer countries: ‘As part of this bilateral partnership agreement, the private sector should agree to pay a higher price for cocoa every year going forward, with governments then responsible for ensuring a significant portion goes towards farmers’.[42] The idea is, in principle, attractive, managing to deliver a guaranteed reward to producer countries for improving their standards of governance and law enforcement and the sustainability of cocoa production. One weakness of the FLEGT approach is that the timber VPAs have been less successful than was initially hoped in delivering higher prices or greater market share for verified legal timber products. Only one partner country, Indonesia, has so far succeeded in establishing a full timber legality and export licensing regime; while Indonesian timber products do appear to have gained some market share in the EU, the improvement is small and limited to some products and some countries.[43] The inclusion of the commitment to pay higher prices for cocoa in a bilateral agreement for cocoa could provide a means to avoid this problem.

The report does not suggest, however, how these commitments that *companies* would need to enter into could be included in what is otherwise an agreement between *governments* – or, if they are, what incentives, if any, could be offered to the companies, or how such provisions could be enforced. Competition rules limit the ability of governments to provide direct support to companies agreeing to pay a higher export price. Possible options that might be worth exploring could include favourable treatment in public procurement contracts (under EU procurement rules the treatment would have to be focused on the cocoa, not the company, but it may be possible to favour cocoa produced to the standard specified in the partnership agreement and subject to the Living Income Differential); or an EU or UK label identifying cocoa products for which the higher price has been paid, together with public information campaigns supporting its purchase. However, public purchasing does not account for a large proportion of cocoa or chocolate sales, and introducing a new label risks confusion with existing labels and certification schemes, such as organic, Fairtrade and Rainforest Alliance.

Similar question marks are raised over the report’s linked suggestions for the private sector to commit to adopting purchasing and contracting practices that could contribute to a living income, ‘such as long-

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[41] See, for example, Duncan Brack, *Towards Sustainable Cocoa Supply Chains: Regulatory options for the EU* (Fern, Fairtrade, Tropenbos, July 2019); *Joint position paper on the EU’s policy and regulatory approach to cocoa* (Barry Callebaut, Fairtrade, Mars, Mondelez, Rainforest Alliance, VOICE Network, December 2019); *Key elements for an agreement between the EU and cocoa-producing countries, to ensure sustainability in the cocoa sector* (Fern and 12 other NGOs, September 2020).
[42] *Key elements for an agreement between the EU and cocoa-producing countries*, p. 11.
[43] Rupert Oliver, ‘FLEGT VPA Independent Market Monitoring (IMM)’, presentation to Forest Governance Markets and Climate forum, London, March 2020.

term contracts, direct contracts with farmers, and potentially some form of security in case of a bad growing season' – though these would, clearly, be desirable outcomes.[44] It is likely that these issues will be raised in the European Commission's Multi-Stakeholder Dialogue 'Cocoa Talks' process which started in September 2020.

Even without formal inclusion in the agreement, political support from the EU, or UK, for the Living Income Differential could be helpful. Due to the challenges outlined above in Chapter 1, continued government commitment to it in Côte d'Ivoire and Ghana is not guaranteed, and support from external governments may make a difference.

## 5.1 Conclusions

For the reasons discussed above, it seems unlikely that any kind of measure relating directly to higher prices could be included in a bilateral agreement for cocoa. But a VPA-style bilateral agreement could help to put in place some of the critical elements needed for the comprehensive reform of the cocoa sector, including agreed standards for sustainable cocoa production, improved governance and law enforcement – including a multi-stakeholder deliberative process for setting the sustainability standard, policy-making and implementation – and a national traceability system for cocoa. This offers a chance for wider and longer-lasting improvements in cocoa production than higher prices by themselves are likely to be able to deliver. Implementation of the agreement could be supported by EU/UK due diligence legislation for cocoa (and other forest risk commodities) which could give preferential access to cocoa licensed as produced to the agreed standard from the partner countries, in the same way as the EU Timber Regulation operates with respect to the timber VPAs.

# 6 International commodity agreements

As discussed above in Chapter 1, the risk of some producer countries and not others raising their export prices risks cocoa buyers switching to other sources of supply. Raising farmgate prices for cocoa farmers also creates an incentive for them to increase production, with accompanying additional pressure on forests. One possible solution to both of these problems is to establish an international commodity agreement covering all (or, at least, most) producers; the parties to the agreement would jointly fix production or export volumes and thereby manipulate the global market. Where producer countries also fix the export price, through marketing boards or similar bodies, establishing the right price level could also be subject to negotiations.

## 6.1 Background

Several international commodity agreements between producer and consumer countries were established in the post-war period, though some were devoted only to information collection and dissemination, market promotion, and research and development. Six agreements had explicitly interventionist objectives, aiming to stabilise prices, avoid excessive swings in commodity markets and ensure that producers were adequately rewarded; they covered wheat, sugar, tin, rubber, coffee and cocoa itself.[45]

[44] *Key elements for an agreement between the EU and cocoa-producing countries*, p. 11.
[45] Christopher Gilbert, *International Commodity Control: Retrospect and Prospect* (World Bank, 1995); Niek Koning, Muriel Calo and Roel Jongeneel, *Fair trade in tropical crops is possible: International commodity agreements*

Supplies of the commodities were managed through export controls and the maintenance of buffer stocks to absorb excess production; controlling the level of production was generally viewed to be more difficult and was only occasionally attempted. Most of these agreements did help to provide some price stability, and in some cases higher prices; price levels above the recommended prices were achieved for most of the lives of the coffee and rubber agreements, and for around half the life of the cocoa and sugar ones.

However, they faced a series of challenges. They tended to freeze patterns of production and exports amongst their membership, deterring innovation and preventing low-cost producer members from expanding market share at the expense of their higher-cost rivals (unless they ignored their commitments). There were significant costs involved in maintaining the buffer stocks needed to stabilise prices. And it was not always clear that the higher price levels benefited farmers directly; sometimes the money was appropriated by supply chain intermediaries or by the governments involved. On top of this, since the agreements only included countries which were significant producers at the time the agreements were negotiated, potential new producers, and producers which were too small initially to be included in the scheme, were able to export without restriction. Total volumes of world commodity exports increased by 40 per cent during the 1980s, despite the export quota and buffer stock schemes in the agreements.[46]

The combination of these factors led to increasing pressure on the agreements, reinforced by the growing view among their industrialised-country participants that price stabilisation was at best a diversion of funds from more pressing development objectives and at worst an attempt to impose a socialist-style planned economy model; this accompanied the general rise in support for the deregulatory approach of the ‘Washington consensus’. In the case of sugar, developed-country producers helped to undermine the agreement by refusing to constrain exports (the EU) or by introducing import quotas (US). All of the agreements eventually abandoned their attempts at market manipulation in the 1980s and 1990s, and reverted to the non-interventionist model of information, promotion and research. Production subsequently expanded significantly and prices fell.

The only exception to this general failure of international commodity agreements is the Organisation of the Petroleum-Exporting Countries (OPEC), founded in 1960. This is different from the agreements discussed above, since it includes only producer countries, not consumer countries; it is a producer cartel, currently controlling over 40 per cent of the global oil market. Another major difference is that production of oil can be controlled much more easily than the production of agricultural commodities, simply through pausing extraction at the oil wells.

Since the 1980s OPEC has set production targets for its member nations, with knock-on effects on global oil prices and member nations’ own revenues. The status of oil as a strategic resource on which many elements of economic activity depend also helps to explain OPEC’s continued existence, though the growth of oil production in non-OPEC members such as the US, Norway and Brazil, together with higher standards of energy efficiency, has limited its impact and has ensured that the 1973 energy crisis, caused by an embargo on oil exports by the Arab members of OPEC in protest at Western support for Israel in the Yom Kippur War, is highly unlikely to recur.

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*revisited* (Wageningen UR North-South Centre, 2004); Thomas Lines (ed.), *Agricultural Commodities, Trade and Sustainable Development* (IIED, 2005); Niek Koning and Roel Jongeneel, ‘Food sovereignty and export crops: Could ECOWAS create an OPEC for sustainable cocoa?’ (paper prepared for the Forum on Food Sovereignty, Niamey, September 2006; Christopher Gilbert, *International Agreements for Commodity Price Stabilisation: An Assessment* (OECD, 2011).

[46] A. Maizels,‘Economic dependence on commodities’ (paper given to UNCTAD X High-level Round Table on ‘Trade & Development: Directions for the 21st Century’, Bangkok, 2000).

In the face of falling prices for agricultural commodities, and falling incomes for farmers, some developing countries, and NGOs, continued to make the case for reviving the market-interventionist model of international commodity agreements, though without success. In recent years, more attention has been paid to the wider problems of commodity production, such as its environmental impacts. Some interest has been shown in particular amongst coffee producers in attempting to negotiate a more modern kind of international agreement designed to improve standards of production and rewards for producers without at the same time stimulating output and creating over-supply; until the end of the 1980s the International Coffee Agreement was more successful than most other commodity agreements in maintaining higher prices.[47]

## 6.2 Conclusions: an international commodity agreement for cocoa?

The first International Cocoa Agreement was negotiated in 1973, overseen by the International Cocoa Organisation (ICCO). Unlike most of the other commodity agreements, the US declined to join it, which contributed to a chronic shortage of funding. The coverage of the agreement was also limited – Côte d'Ivoire was not initially a member – and after two decades of maintaining buffer stocks, the system was abandoned in the 1990s. An attempt was then made to limit production, but that too proved ineffective.

The introduction of the Living Income Differential by the governments of Côte d'Ivoire and Ghana has on several occasions been referred to as an 'OPEC for cocoa' or 'COPEC'.[48] As noted in Chapter 3, other countries, including Cameroon and Nigeria, have reportedly expressed interest in emulating the imposition of a higher export price. The four countries together account for almost 75 per cent of world production.

In theory, cocoa could be a good candidate for an OPEC-style producer cartel.[49] As discussed in Chapter 1, there is only a small number of major producers, and climatic requirements act as a barrier to entry – cocoa grows only in the tropics, limiting the number of countries that could emerge as new producers outside the cartel. There are no good substitutes for cocoa, and cocoa beans are non-perishable in the near to medium term, though not the longer term – though it may be possible to store processed cocoa products for longer.

However, a cocoa cartel would face the same problems as the international commodity agreements discussed above. To maintain high prices, either production or export volumes, or both, must be controlled. As noted in Chapter 3, in 2019 Côte d'Ivoire announced plans to cap production at 2 million tonnes, but it is not clear how this could work in practice; unlike oil, the production of cocoa (and other agricultural commodities) is very difficult to regulate at short notice.[50] The call, in March 2021, by the managing director of the CCC to cocoa farmers to: 'listen to us and stop planting cocoa. They are bringing the price down by flooding the market' suggests that in practice the government has no mechanism to control production.[51]

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[47] See, for example, Alan Murray and Katherine Dunn, 'The Coffee Industry Considers Its Own OPEC: CEO Daily' (*Fortune*, 10 July 2019); Sandra Boga, 'Coffee exporters discuss "coffee OPEC", global fund' (IEG Vu Agribusiness, 11 July 2019).
[48] See, e.g., Charlotte Gifford, 'Sweet nothings: what West Africa's COPEC plan means for cocoa farmers', World Finance, 10 April 2020; https://www.worldfinance.com/markets/sweet-nothings-what-west-africas-copec-plan-means-for-cocoa-farmers; Baudelaire Mieu, 'Ghana and Côte d'Ivoire taste success in raising price of cocoa', theafricareport, 8 September 2020, https://www.theafricareport.com/40945/ghana-and-cote-divoire-taste-success-in-raising-price-of-cocoa/.
[49] Gifford, 'Sweet nothings'.
[50] 'Ivory Coast caps cocoa production at 2 mln tonnes to buoy prices', Reuters, 1 October 2019, https://uk.reuters.com/article/ozabs-us-cocoa-ivorycoast-idAFKBN1WG437-OZABS.
[51] de Bassompierre, 'Ivory Coast Cuts Farmers' Pay by 25% for Smaller Harvest'.

If production cannot be controlled, export volumes must be, which requires the maintenance of buffer stocks; after the introduction of the Living Income Differential, both governments were reportedly planning to construct more storage facilities.[52] However, as noted above, this is expensive, and likely to become more so as production volumes expand in response to higher prices and as, possibly, demand falls in response to higher consumer prices or other factors. The cost of maintaining buffer stocks could be mitigated if consumer countries join the agreement and contribute funding; but the failure of the earlier agreements makes this unlikely. Finally, there will always be an incentive for some producer countries to stay outside the cartel, to benefit from the efforts of cocoa buyers to avoid paying cartel-controlled export prices.

In 2006 a detailed proposal for a new international cocoa agreement was put forward by Niek Koning and Roel Jongeneel.[53] It featured the following steps:

1. The establishment of a new producers' organisation with agreement on national production quotas (based on recent production volumes), a formula to allow the transfer of some quota rights from high-cost countries to low-cost countries in the future, the target price and the minimum share of the farmgate price in export prices. Over a transition period, member countries are to reduce production to their quota level. (Consumer countries are also welcome to join the agreement, but its operation must not depend on them.)
2. In order to implement the fall in production, member governments define forest areas where no cultivation is allowed, and old cocoa-growing areas where cocoa trees are to be replaced by other crops ('diversification zones').
3. All member countries impose an export tax; the revenue is transferred to agreement's secretariat to allow it to buy up cocoa beans to maintain buffer stocks and destroy low-quality cocoa (or use it for animal feed) to reduce volumes. World prices, and therefore farmgate prices, rise.
4. The secretariat intervenes in international markets to disrupt purchases from free-rider producers outside the agreement; buyers in consumer countries are also encouraged not to buy from free-riders.
5. Part of the export tax revenue is refunded to governments to enable them to support diversification out of cocoa; after the transition period, cocoa production in diversification zones is banned. Part is used to support farmer organisations to improve productivity and quality and surrounding infrastructure.
6. As national production falls and world prices rise, the need for buffer stocks and market intervention falls; a greater proportion of export earnings can be invested in rural development. Similarly, a higher proportion of the export tax revenue is directed to farmer organisations (on an area rather than a production basis) and used to improve standards.
7. Over time, the price band that is maintained by the arrangement is adjusted to the production costs in the participating countries, with some transfer from high-cost to low-cost producers in line with an agreed formula (to avoid repeated negotiations). Countries that lose quota receive some compensation, and national quotas are gradually expanded, in aggregate, in line with the increase in world demand for cocoa (estimated at about 2 per cent per year).

[52] Mieu, 'Ghana and Côte d'Ivoire taste success in raising price of cocoa'.
[53] Koning and Jongeneel, 'Food sovereignty and export crops: Could ECOWAS create an OPEC for sustainable cocoa?'.

This outline helps to illustrate the formidable challenges faced by any attempt to negotiate a new international commodity agreement aimed at manipulating the global market for cocoa. It underlines in particular the critical need to control both supply and export volumes – steps which it is not clear that producer-country governments are either willing or able to take. If these challenges can be met, however, and if the number of free-rider producers outside the agreement can be minimised, this is a plausible outline of such an agreement.

# 7 Conclusions

It should be clear from the preceding discussion that most of the options discussed in Chapters 3–6, and particularly in Chapters 3 and 4, do not look particularly likely to achieve their ends in anything other than the short term. This should not come as a surprise. Using trade measures to achieve domestic policy objectives is rarely a first-best option; there is a high risk of them triggering consequential changes that are likely to have negative impacts.

Trade measures can certainly be a *second*-best option, correcting for an absence of or failures in domestic regulation. For example, trade measures – bans on trade in specified products – have been used to enforce compliance with multilateral environmental agreements such as the Convention on International Trade in Endangered Species (CITES) or the Montreal Protocol on ozone-depleting substances. If all parties to these agreements were to comply with the commitments they had themselves entered into, these trade measures would not be necessary, but sometimes they do not because of a lack of political will or capacity or a deliberate desire to evade their obligations.

To choose another example, if forest-rich developing countries had better systems of governance and law enforcement in place, they would not suffer from the extensive problems of illegal logging that many of them do. But recognising that they sometimes do not, adopting trade-related instruments such as those implemented under the FLEGT VPAs, or the Lacey Act in the US, can help to deny access to consumer markets to the proceeds of illegal logging. And trade measures might sometimes be necessary to compensate for a failure by some countries to incorporate environmental externalities into their domestic regulatory frameworks; hence the current debates over the feasibility of border carbon adjustments in the EU and elsewhere.

For most of the options discussed in this paper, it seems unlikely that trade measures are even a second-best option. A sustainable long-term strategy for raising cocoa farmer incomes, protecting forests and reducing the incidence of child labour is likely to need a wide range of interventions: investments in improving productivity, increasing technical support to farmers, improved access to finance, restricting levels of production by supporting diversification into alternative crops or, possibly, alternative livelihoods (in practice the development process has always involved a reduction in the size of the agricultural workforce), better provision of social security, health and education, and improvements in governance and law enforcement, including traceability schemes, and forest protection. All of these can be supported through development assistance and better regulation of the companies sourcing the cocoa, for example through imposing due diligence obligations. If these measures can be delivered – and of course there are significant challenges in doing so – the kind of trade interventions discussed in this paper would not be necessary. And if there are failures to deliver all or some of them, it is not obvious that trade mechanisms by themselves can usefully compensate.

The main exception to this is the kind of partnership agreement discussed in Chapter 5, which could help to create these enabling conditions supporting the transition to a wholly sustainable cocoa sector. The experience of the FLEGT VPAs has shown how, while these agreements are challenging to design and implement, they can contribute to reforms of governance, transparency and law enforcement with positive long-term impacts.

There may possibly be a role for trade measures aimed at improving export and farmgate prices within the context of this kind of partnership agreement focused on a wider range of enabling factors. If these kind of agreements do contribute to building a genuinely sustainable cocoa sector, this could make it easier in turn to establish the kind of international cocoa agreement discussed in Chapter 6, which could in turn lead to higher cocoa prices on world markets.

The current debates within the EU on the feasibility of such partnership agreements for cocoa should accordingly be encouraged, particularly with respect to the possible participation of cocoa and chocolate companies within them. Where possible, such approaches should also be explored for other commodities and other countries. Of all the options explored in this paper, this offers the most hopeful way forward.

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