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INFORMATION

DEVELOPMENT AID

THE WORLD MARKET FOR COCOA

Instability, speculation and international misunderstanding

44/73

In the last few weeks of 1972, an international agreement was at last worked out for cocoa. The effort and negotiation which went into its preparation had continued, on and off, for more than fifteen years.

Cocoa has a respectable history. It first came to Europe four centuries ago, in the days of the Emperor Charles V. It is a native of the American continent, but nowadays the main production is in Africa. In the world of today it is entirely a product of the developing countries. For some years Ghana, Nigeria, the Ivory Coast, Cameroon and Togo, have been exporting between them more than a million tons of cocoa a year, and in Latin-America the big producer is Brazil, while New Guinea is making its first diffident advance into the market.

For most of the producing countries, cocoa is one of the pillars of the national economy. It accounts for more than half the exports from Ghana; and in Nigeria the cocoa bean is second only to oil as an export product and accounts for 16 % of the total.

These countries of the developing world thus have the monopoly of the product for which the industrial world has so strong a taste; but they have never succeeded in securing control of the price. There is no point in asking the cost of a pound of cocoa, unless you specify the date; for within ten years the price has ranged between 12.2 cents (US) per pound and a peak of 48.7 cents. These prices, of course, relate to exactly the same product, of the same so-called "merchant" quality.

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Careful cultivation

This does not make things easy for the cocoa planter, despite the work of official organisations for stabilising prices in Africa -- marketing boards and stabilisation funds -- none of which can tell in advance how much the trees will yield that year. This of course is partly the fault of nature; for cocoa is a very sensitive plant. The soil has to be neither too dry nor too moist, but just right; and sometimes it calls for careful irrigation. It is very sensitive to the weather; and too much sunshine may be as disastrous as too little. The trees are not difficult to grow; but the planter must be at hand to deal with parasites and plant-sicknesses, and the products he uses for this unfortunately do not follow the same market trends as cocoa itself. When it comes to picking, too, great care is needed; for the fruit must be cut one by one at the moment of ripeness, with the same strict care as a bunch of dessert grapes. The pod, or "cabosse", is shaped like a small rugby football; and the next job is to open it and extract the bean. After this the beans are piled up for fermentation and there is quite a difference between well fermented beans and others; and then they are spread out for drying and lose a lot of their moisture -- but not all of it of course.

To calculate the cost price of such an operation is beyond the scope of the common computer; and remembering that all this time the price is still an unknown factor, it is impossible to say what will be the profit. This is why the cocoa palm, especially in Africa, is for the most part a family crop, and the hours of labour do not have to be calculated.

In english-speaking Africa the cocoa then comes into the hands of centrally-organised Boards, and in the countries of former French Africa, it is taken over by private companies. The cropping period runs from September to December and is followed by a secondary cropping in the spring.

The grinders

In the consuming countries the cocoa is then processed on an industrial basis. Only a small proportion of the beans is processed locally in the producing countries; and the main part goes to the grinding mills in the consuming countries, where the beans yield up the cocoa butter and the powder. The biggest consumption is of course in the United States, which takes

25 % of world production. Next comes Federal Germany, which takes 12 % of the world market supply; but this is only part of the consumption of the Nine-nation European Community, which buys 43 % of the total. It will be understood from what follows how considerable a part this high consumption has enabled the Community to play in the negotiations for the international agreement.

The importers do not all buy the cocoa entirely for their own consumption. The Netherlands, for example, consume less than 3 kg of chocolate per head per annum; but they buy nearly as great a tonnage of cocoa beans as Federal Germany, which means that the Dutch mills process three times as much cocoa as the Dutch consume themselves. The rest of the product of these chocolate industries is sold for export. The Netherlands rank as one of the big world importers; but the consumption per head is much the same as it is in Federal Germany. The Belgians are bigger consumers, taking 6.8 kg per head (which compares with 6.2 kg for the British), but their imports are only about a sixth of their Dutch neighbours. France and Italy come right at the bottom of the consumption scale, taking respectively, only 1.4 kg and 0.6 kg per head.

The european consumer, whether he be a big chocolate eater or a small one, is always familiar with the names of the great trade marks, under which the products are sold in his own country. Some of these trade marks, indeed, belong to big multi-national companies; and this is a reminder that the industrial processing of cocoa into chocolate confectionery is not a mere family craft, as is the growing of it in equatorial Africa. The techniques which come into play are often of an advanced kind.

A good deal of capital has been invested in the processing industry; and security of jobs is an important factor with the work-people. The industry is no better able to cope with wide fluctuations in the prices of its raw material, than are the Africans and Latin-Americans who produce it. The only difference is that the industrialists the "users" of the cocoa are economically stronger and better able to defend themselves. To them, too, "speculation" is a helpful factor.

Playing the cocoa market

When it comes to currencies or the price of land, speculation has a bad press. From another standpoint, however, serious and impartial economists realise that it plays a valuable rôle in keeping prices steady.

For commodities, such as cocoa, this operates through the forward market, and it is not easy to make allowance for the part played by brokers and traders in these markets, and the speculators who are not professional operators. In the picking season there is plenty of cocoa available in the market; and this is when the grinders, the professional users of cocoa, buy as much of it as their financial resources permit, and their storage space accommodate. Only if they are exceptionally lucky, can they do the whole of their year's buying in one operation. It is at this point that the forward market operators come into the picture. They take a very careful view of the market prospect, assembling all the available information, and prepare their estimates of the probable yield from the current crop, the prospects for the secondary crop in the spring, the volume of stock carried over and still available and the supplies the users will want.

In the picking season the fact that there is plenty of cocoa in the market might be expected to send the price down; but if the market operator, after all his investigations, comes to the conclusion that it will become scarce later, he will decide to buy. He thus helps to put the price up when it might be falling; and his sales when supplies are running short, will prevent the price from soaring to levels at which the processing industry would grow discouraged and start looking for substitute products.

Conversely, if the operator expects the crop to be bigger than the market will require, he sells forward (i.e. for future delivery); but he will only buy the supplies to cover his contract when the crop begins to come forward. In this way he sells forward when prices are high and comes in as a buyer at a time when abundant supplies would otherwise be pushing prices down. If the operation is successful -- which is not always the case -- it enables the user to take advantage of the future fall in price before it happens. Moreover the market operator, by his cover purchases in the season of abundance, will be contributing to check the fall in prices which, when supplies are excessive, does so much damage to the growers.

The system, of course, is valuable only insofar as the forecasts by the market operators are good. If they are wrong, or influenced by rumour (which may well have market interests behind it), they may worsen the instability of prices; and it is always in periods of instability and uncertainty that speculation is most rampant.

In practice the supply of cocoa is very apt to vary, and the demand is comparatively rigid. It thus has to be acknowledged that the international cocoa market ranks among those where prices are most volatile and where, therefore, speculators are most active. This is a basic fact on which the critic must put his own interpretation.

Wide price fluctuations

A glance at the recent history of the world market for cocoa, gives an indication of how irregular the prices are apt to be.

In 1965, production had risen to a record level of over 1.5 million tons; and this brought the price down to only 17 cents per pound. In the few subsequent years demand went ahead of supply and prices kept steady around 40 cents.

Both in 1969-70 and in 1970-71, however, the market was again beset by over-supply and there were further price collapses. The average in 1970 -- a year when speculators were squeezed through the collapse of a finance company -- was 33 cents per pound; and in 1971 the price again fell by a full third.

The gaps between production and consumption, which occasioned these price movements, were of the order of 60,000 or 80,000 tons out of a total of about 1.4 million tons. It often takes only a slight imbalance to upset the market. An example occurred around the end of 1972, when, according to the trade press, the Soviet Union succeeded in bringing off an advantageous deal, as a result of a fall in the market which followed their announcement that they were reducing the scale of their buying.

In 1971, when cocoa prices were at their most depressed, a number of oil-producing countries were successfully forcing on their customers a substantial rise in the price of their product. This was a success for the "aristocracy of the under-developed world"; and the advocates of price stabilisation for tropical products took heart at the result. When President Pompidou, and his Finance Minister M. Giscard d'Estaing, went to Africa, they announced their intention of making a fresh start with work on organising the world market for cocoa.

The International Cocoa Agreement

Months had still to pass,however,before the agreement was reached in October 1972,and eventually signed on January 15,1973. Federal Germany,so important as a consumer, was inclined for some time to hold back; but in the end the country joined with the group of consuming countries,which were impatiently awaiting its agreement. The risk was,that without Germany's 12 % of the world market, the agreement might not muster the support of 70 % of world consumption required for its operation.

Since the United States (25 % of consumption) had already decided to keep out, the full participation of the whole European Community was indispensable. Federal Germany,in agreeing to join forces with its EEC partners, and thus to make the agreement effective, was making a political gesture,moved by considerations of the importance attaching to its attitude. The agreement was signed not only by the individual countries,but also by the European Community.

The agreement is based on annual export quotas which are to be fixed each year with a view to the prevailing price levels. The minimum price is fixed at 23 cents per pound and the maximum at 32 cents. It is worth noting that, at the moment when these limits were being fixed,the market was fluctuating around 32-33 cents. Moreover, the current forecasts for 1972-73 suggested that production would fall short of probable consumption,by about 88,000 tons. Remembering the price collapse which,only a few years earlier,had resulted from a surplus of 60,000 tons,the current condition pointed to another price boom. From this standpoint it looked as though the agreement would not be doing the consumers too badly; but,of course, it is an illusion to think a maximum price can be defended without there being cocoa in stock.

As a contribution to price stabilisation,in a more orderly manner than through the simple reaction of market forces and speculation, the Geneva Agreement provides for setting up a buffer stock. This is not to exceed 250,000 tons,and it is to be financed by a contribution of 1 cent per pound. Here again,however, it looked as though there might be difficulties ahead; for how could it be possible to build up a buffer stock in a market in which production is apparently less than enough to cover demand ?

Nevertheless, this is not an occasion for pessimism. The International Cocoa Agreement,despite its complexities and its imperfections, was regarded by the under-developed countries as a test of the goodwill towards them of the richer countries. It was for this reason that the European Community threw in all its weight to make the agreement valid,despite the abstention of the United States. The countries which signed it on January 15, represent approximately 70 % of the consumer markets,which should permit of its coming into force for the cocoa season 1973-74 beginning October 1,1973.

The European Community had already given financial help,through the resources of the European Development Fund,to the national cocoa price stabilisation Fund in one of the associated African countries-- Cameroon. In the International Cocoa Agreement it is fulfilling its ambition to contribute to setting up steady international markets for basic products,so that the developing countries can be sure of adequate revenue from their exports.

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