SUSTAINABLE COCOA INITIATIVE

European Commission | #CocoaTalks

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COCOA TALKS

EU VIRTUAL MULTI-STAKEHOLDER ROUNDTABLES ON SUSTAINABLE COCOA

SUBJECT: SUMMARY REPORT ON MEETING 1 ON THE LIVING INCOME DIFFERENTIAL.

On the 09th of February 2021, the European Commission hosted Meeting 1 of the "Cocoa Talks", its multi-stakeholder roundtables on sustainable cocoa, on the topic of the Living Income Differential (LID). The objective of this meeting was to:

- explore the potential benefits, challenges and impacts of the LID initiative and its implementation in Ghana and Cote d'Ivoire.

Two-hundred and forty-nine (249) people attended the meeting, which lasted for three-and-a-half hours.

Ms. Carla MONTESI, Director, Green Deal and Digital Agenda, Directorate-General for International Partnerships (DG INTPA), European Commission provided the opening statement. She introduced the Living Income Differential, a joint initiative by Côte d'Ivoire and Ghana that aims to increase the income of cocoa farmers in both countries. She stated that the LID is a first step in the right direction towards sustainable cocoa production, noting that price and sustainability are like two sides of the same coin. Producing more sustainable goods has a cost, and the price premium of $400 on exports of cocoa from Ghana and Côte d'Ivoire can begin to cover that cost. She commended the European industry for engaging with producing countries on this issue and for paying the LID on the cocoa they source from Ghana and Côte d'Ivoire. However, she urged producing countries to work together with the European Union to deliver on the other side of the bargain, by effectively tackling deforestation and child labour in cocoa supply chains. She reminded of the European Commission's rapid action in approving a first development cooperation package of €25 million for the cocoa sector in Ghana and Côte d'Ivoire, under the outgoing Multi-Financial Framework. She encouraged the producing countries to perpetuate a LID that is resilient to future market developments, economically sustainable over the long-term and WTO compliant, but also to reinforce the LID by investing in the diversification of farmers' revenues and in infrastructure, such as schools, hospitals and roads. Above all, she insisted on the European Commission's appreciation of the LID initiative as a starting point that helps deliver on all three pillars of sustainability: economic, social and environmental.

Hon. Ibrahima KONE, Director General of the Conseil Café-Cacao of Côte d'Ivoire, thanked the Commission for the opportunity to discuss the topic of cocoa with its main trade partner, the European Union. He acknowledged that the cocoa sector in Côte d'Ivoire faces several challenges, including child labour and deforestation. He reassured the audience that Côte d'Ivoire wishes to meet consumer expectations regarding these issues, but insisted that farmers' revenues must be the starting point. Cocoa farmers must be considered as entrepreneurs; the price of cocoa must be greater than the cost of production. This is the logic that has led

Côte d'Ivoire and Ghana to calculate a 'floor price', expressed as percentage of the FOB/CIF price, which allows farmers to make a profit. He called on the European Union to help producing countries consolidate the Living Income Differential, which serves as a guarantee that farmers will continue to produce cocoa in the future, noting that the chocolate industry has (with a few exceptions) supported the initiative. Insofar as deforestation is concerned, he informed the audience that Côte d'Ivoire has completed a census of farmers, finding that 15% of farmers produce within protected forests. He expressed the government's ambition to ensure that all farms have been subject to a geo-satellite mapping process and to implement tracking systems to ensure that beans can be traced back to their origins. Insofar as child labour is concerned, he noted that Côte d'Ivoire and Ghana are major destination countries for migration from the broader West African region, highlighting the fact that numerous migrants (including children) make their way across the countries' border to work on cocoa plantations. Efforts are nevertheless being made in both countries to ensure children are not put to work on cocoa farms. He concluded by reiterating his request to support the Living Income Differential, reassuring the audience that the entirety of the USD 400 premium is transferred to the farmer, free of taxes.

Hon. Joseph AIDOO, Chief Executive of Ghana Cocobod, noted that, over the past two decades, innumerable discussions have been held over the question of price and living income. Different solutions to the problem of farmer poverty have been proposed including certification and corporate sustainability programmes. However, these initiatives reach less than 10% of farmers in Ghana, and only transfer about 20 cents on the dollar to farmers themselves. Mr Aidoo acknowledged consumer concerns around deforestation and child labour, which are genuine and germane, but drew the link with farmers' revenues: if farmers are poorly paid, they are more likely to employ child labour and to use more land. This is the context in which Ghana and Côte d'Ivoire joined forces to launch the LID, to ensure that farmers get a reasonable return on their labour. The LID is universal, it is transferred directly to the farmers, and improves real income from cocoa. When prices fall below $2,200 per tonne, farmers struggle to produce on a sustainable basis and may switch to other crops (rubber, palm oil) or lease their land to illegal miners. The LID has allowed Ghana and Côte d'Ivoire to counter this trend by increasing farm-gate prices by 28% and 21% above the previous year's farm-gate price, respectively, despite unfavourable market conditions.

Mr Aidoo reminded the audience that the LID was introduced following extensive consultations with all stakeholders, including trading houses, buyers, chocolate manufacturing companies. He recalled statements from the European Union and the World Cocoa Foundation in support of the LID. In this context, he deplored the fact that some chocolate brands have refused to buy cocoa from traders in Côte d'Ivoire and Ghana, choosing instead to take physical delivery of beans from the international futures market. He called on the European Union to protect the gains that have been made as a result of the LID and recognised that, in return, European stakeholders will expect more responsible production practices, the elimination of child labour, and an end to production within forest reserves.

Dr. Tancrède VOITURIEZ, senior economist at CIRAD, set the scene for the debate on the LID. He noted that, despite numerous attempts to raise farmer's incomes and sustainable production practices in the cocoa sector, including myriad voluntary sustainability standards and corporate initiatives, the sector is still not sustainable. 'Living income' is one key element of the sustainability framework, but there is a "chicken-and-egg" problem associated with it: do farmers' incomes have to increase in order for them to deliver on sustainability, or is sustainability a precondition for price increases? The LID addressed this problem, by taking price and farmers' livelihoods as a starting point.

Dr. Voituriez further detailed the "three storylines" that underpin the LID: the need to improve farmers' livelihoods by raising the cocoa export price to at least USD 2600 FOB; the desire to rebalance power dynamics in cocoa value chains by shifting "price-making" power from the futures market in London to the major producers of cocoa; the need to respond to consumer preferences, including the expectation of a living income for farmers. The LID responds to these narratives through its double nature as a price premium and a "gentleman's agreement" (in the making), since it aims at connecting price increases to progress on child labour and deforestation. Dr. Voituriez confirmed that the LID is a premium on exports that is effectively passed on to farmers through higher farm-gate price during the crop year. However, he specified that the environmental and social services that are expected in return for the LID are not directly enforced through the LID and require explicit and targeted policy initiatives. In this sense, he explained, the LID premium is similar to an instalment for staged sustainability delivery.

In the third and fourth sections of his presentation, Dr. Voituriez focussed on the intended and unintended consequences of the LID. Citing Waarts et al. (2019) he noted that an increase in commodity income is not sufficient to pull all farmers above the poverty line or above the living income threshold, though it can help farmers to boost household expenditures or invest in their plantations. On the other end of the supply chain, evidence suggests that consumers could afford to "absorb" the LID premium, though questions remain about the capacity of the market to absorb possible increases in supply. The expert also outlined some unintended consequences of the LID. On the one hand, there is an immediate consequence that is already being observed, as buyers shift away from Ghana and Côte d'Ivoire and search for other sources of cocoa. This effect seems to be subdued in the short term, due to the limited supplies of quality cocoa available in other countries and the "reputation risk" that companies incur when seeking to avoid the LID. However, the effect could become more serious in the long run, as new suppliers emerge and sell without the LID. Connected to this phenomenon is the possibility of increased deforestation, as farmers in Côte d'Ivoire, Ghana and / or other producing countries expand surfaces in response to higher prices. These risks could be mitigated through the enforcement of the "gentleman's agreement" at the producing-country level and / or through EU legislation. Lastly, Dr. Voituriez mentioned another unintended consequence, a short-term mismatch between the "spot price" of cocoa and the price of cocoa futures, which caused problems for traders seeking to hedge against price fluctuations. This problem can be resolved if traders / grinders are able to pass on the LID to chocolate companies and other buyers.

In his conclusion, Dr. Voituriez explored ways to improve the resilience of the LID to world price changes. For example, producing countries could behave more like traders, to take advantage of price increases and sell forward to a greater extent than they do now. The second strategy could be to create buffer stocks of semi-finished products (cocoa butter, powder) to cope with a fall in price. Furthermore, producing countries could begin preparing for expected supply/demand dynamics, by for example, developing supply management systems. Lastly, he reflected on the possible advantages of enlarging the dialogue on prices to other producing countries and other non-chocolate-related businesses (such as the cosmetic and pharmaceutical industries).

Panel Discussion:

Mr. Friedel Huetz-Adams, a senior researcher at the Südwind Institute, began by calling attention to the Universal Declaration of Human Rights, which establishes a right "to just and favourable remuneration" for workers. He noted that the price of cocoa is a major determinant of farmers' income, and that a long-term decrease in international prices, combined with extreme price volatility, have seriously compromised farmers' livelihoods over the years. He acknowledged other determinants of farm income (e.g. infrastructure) but insisted that price remains an essential part of the solution. Lastly, he criticized approaches that focus on productivity, noting that they tend to ignore the consequences of over-production and over-supply, demonstrating through case studies that more productive farms are not necessarily more profitable. He contrasted this with the LID itself, which generated an immediate boost to farmers' net income.

Mr. Aldo Cristiano, President of CAOBISCO, the European chocolate, biscuits and confectionery association, acknowledged that cocoa price is a critical driver of farmers' incomes and endorsed producing governments' goal to ensure that farmers receive better remuneration for their crop and increased returns on their investments. He expressed the industry's support for the LID and noted that the member companies of his organization are independently and voluntarily incorporating the LID into their procurement plans for the season and sourcing cocoa in line with their normal schedule. In addition to this, he highlighted industry initiatives to improve farmers' incomes that go 'beyond' the LID, such as voluntary premiums paid for certified cocoa (on top of official prices) as well as individual company sustainability programmesIn this context, he insisted that price initiatives cannot be introduced in isolation, but must be part of a broader 'package' or a 'smart mix of measures'. He called for greater professionalization of farmers, through higher yields, higher productivity, and greater diversification of crops / revenue streams. He emphasized the need for a better enabling environment in cocoa origin countries. He urged governments to introduce sector-wide traceability systems and enhance transparency. Furthermore, he encouraged them to improve coordination between national production policies and targets, as well as supply management measures, consistent with global demand projections. Unless these precautions are taken, he warned, the LID could stimulate production, resulting in excess stocks, structural oversupply, a decline in quality, further conversion of forest land, and the use of child labour.

Ms. Yuca WAARTS, Senior Researcher at Wageningen University & Research, repeated the call for a holistic strategy towards a living income for cocoa farmers. She noted that cocoa support systems must be tailored to individual farmers, due to massive differences between them; those with large farms and low yields, for example, need different support from those with smaller farms and higher yields. She noted that the poorest farmers are often those with the smallest farms and the lowest yields, and that off-farm revenue streams are often necessary to achieve a living income. To conclude, she agreed with the other speakers that price increases are extremely important, but must be accompanied by other support measures, including some form of supply management.

Mr. Michel ARRION, Executive Director, International Cocoa Organization (ICCO), expressed his intention to draw a link between the bilateral talks between the EU and the two major producing countries, Côte d'Ivoire and Ghana, and ongoing discussions at the multilateral level within the ICCO. He noted the consistency between the present discussion on the LID and the ICCO Strategic Plan of Action (April 2019), which states that "the overarching objective of the ICCO is: to improve significantly the living income of cocoa farmers by adopting a policy mix of increased farmgate prices, strongly coupled with agriculture intensification, supply management, diversification, contract farming and environmental services". He insisted that "increased farm-gate prices" are a starting point, to be complemented by other measures as necessary. Mr. Arrion then called on ICCO members to discuss the living income at the ICCO Council in spring 2021, urging members to agree on a mechanism to effectively manage the supply-demand equation, as a means influencing international prices. He applauded Côte d'Ivoire and Ghana for coordinating 65% of global production through the joint initiative, but expressed an ambition to increase that figure to 95% by inviting other producing countries to join the discussion. On the demand side, he encouraged the industry and producing countries to reach long-term agreements, with reciprocal commitments on quantities, prices and tax rates, and to promote greater consumption of cocoa in emerging markets such as India, China and South-East Asia.

<u>Question and Answer Session:</u>

The Q&A session began with some requests for clarification for Dr. Voituriez. One participant asked "**what percentage of the LID is paid to the farmers and who retains the difference?**" Dr. Voituriez, responded that – to his knowledge – the LID is almost entirely transferred to the farmer, allowing for a few minor adjustments along the value chain. Another set of questions pertained to the idea of supply management. Participants asked **how supply management measures could work in practice** and whether he had considered **the failure to introduce buffer stocks in the cocoa sector in the 1990s**. Dr. Voituriez responded that premise of this question is already a good sign: it is no longer taboo to discuss whether supply management measures are needed or not. Instead, the conversation is now becoming practical: what works and what does not work? He outlined three possible supply management measures and discussed the advantages and disadvantages associated with each of them.

The moderator then took a question from the floor for the European Commission: **What can the EU do to ensure that the LID gets paid every year and that the LID is gradually raised to deliver a living income for farmers?** Mr. Regis Meritan from the Directorate-General for International Partnership clarified that the European Commission does not have a role in enforcing the LID. Instead, all stakeholders are currently in agreement on the need for a living income, and for the elimination of child labour and deforestation in cocoa supply chains, this is encouraging to make progress. He acknowledged that the market will have the final word, but expressed his conviction that, if all stakeholders agree on the need for a higher price for sustainable cocoa, it is possible to agree on a *win-win* arrangement and to change the game.

A series of questions were addressed to the other panellists. In response to questions on **the reaction of other producing countries to the Living Income Differential**, Mr. Michel Arrion informed the audience that the issue had not been discussed within the framework of the ICCO. In response to questions on a possible **supply reaction to the LID** and the potential for a consequence **decrease in international prices**, Mr. Arrion observed that the solution would lie in the implementation of some form of supply management mechanism. In response to a question on **the industry commitment to the LID** and the possibility that buyers might **begin to shift away from Côte d'Ivoire and Ghana** in their sourcing decisions, Mr. Aldo Cristiano responded that the industry remains committed to paying the LID. He also expressed his **strong belief that companies will continue to buy from Côte d'Ivoire and Ghana** and will not make radical changes to their sourcing patterns. Lastly, he agreed with other panellists that **there is a need for better supply management**. In response to questions on **child labour** and the impact of the LID and accompanying measures on achieving the **Sustainable Development Goals**, Mr. Friedel Huetz-Adams explained that there is a **non-linear relationship** between prices changes and farmers' production decisions: a fall in prices can also cause farmers to produce more, and often in a less sustainable way (using child labour). He explained that he has never argued against the need for complementary measures to tackle deforestation and child labour but insisted that the LID is a necessary precondition, precisely because it can generate the funds necessary for investment in those accompanying measures.

Conclusion

In conclusion, **Hon. Joseph AIDOO, Chief Executive of Ghana Cocobod,** agreed that there is a need for complementary measures such as diversification, in addition to the LID, and presented several government's initiatives that address both deforestation and child labour issue but noted that these complementary measures require funding. Farmers need the LID in order to make the required investments and sustain the cocoa sector into the future. **Hon. Ibrahima KONE, Director General of the Conseil Café-Cacao of Côte d'Ivoire**, agreed with his colleague from Ghana and called on all stakeholders to make the LID a success. He promised a meeting in future to review the LID and improve it, together with all stakeholders and partners. The **European Commission** closed the meeting by thanking the representatives from Ghana and Côte d'Ivoire for their participation and looking forward to the subsequent roundtable meetings on the sustainability of the cocoa sector.