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Making the white gold, gold again: reducing market asymmetries and increasing competition in Mozambique's cotton market

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Main message

Current policies have not been able to ensure stable price incentives to cotton farmers during the last decade. Producers are currently penalized by the international price volatility and the strong depreciation of the national currency against the US dollar. To reduce market distortions and increase profitability and competitiveness of the Mozambican cotton sector, we recommend to:

- Shield the farmers against volatility in international markets by introducing hedging mechanisms, as well as against exchange rate risks, which, in turn, can lead to reduced production costs;
- Create mechanisms to increase farmers' bargaining power;
- Ensure more balanced benefits for farmers and ginners by improving the current price policy;
- Improve the quality of agricultural extension services to increase quantity and quality of cotton production.

Introduction

Cotton is an historical crop being produced in Mozambique. It is reported that between the colonial years 1765 and 1779, the government of the time defined cotton production as compulsory for local farmers (IAM, 2014). Today, two and half centuries later, the sector remains largely regulated with the state playing a key role to protect the interests of numerous stakeholders and contributing to a stable value chain, in particular through the Mozambican Cotton Institute (IAM). Currently cotton (cottonseed and lint) is ranked among the top-five cash crops cultivated in Mozambique, representing around 10 percent of the total agricultural exports (INE, 2015; FAOSTAT, 2016).

Cotton yields have trended upward recently, after dropping sensibly in the 2012/13 season (Figure 1), but remain well below other countries in Africa (Estur, 2015). Cultivated area and number of farmers growing cotton, however, have declined substantially since 2012 (Figure 2) and are much lower than a decade ago, despite the increasing trend in the minimum nominal producer price set by the Government (Figure 3), as

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well as the provision of inputs, subsidized credit and extension in support to cotton farmers mainly by the ginning companies.

Low production of raw cotton in Mozambique is one of the reasons the ginning industry is not operating at full capacity (Minor, 2004; USITC, 2009), making the country a net exporter of cotton lint (mainly to China, Mauritius, Bangladesh and Indonesia) and a net importer of textiles. At regional level, Mozambique cotton exports account for only 2 percent of the aggregate African cotton exports (Bettencourt, 2015). Informal trade also represents an issue for the industry, impacting negatively on ginning companies' sales and profitability. Furthermore, updated regulations impose taxes on cotton traders ranging from 2.5 to 3.5 percent of the cotton lint FOB price, with small traders paying the highest tax (GoM, 2015).

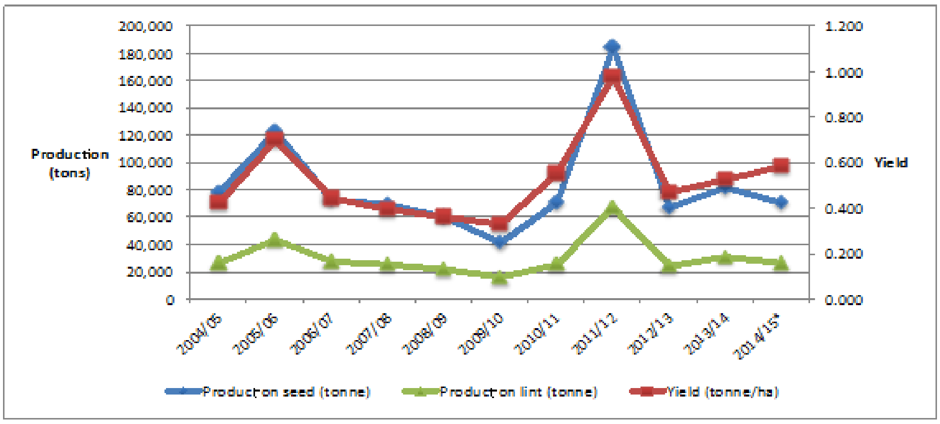

Figure 1: Yield and production (cotton 2004/5 to 2014/15)
Source: Data from IAM

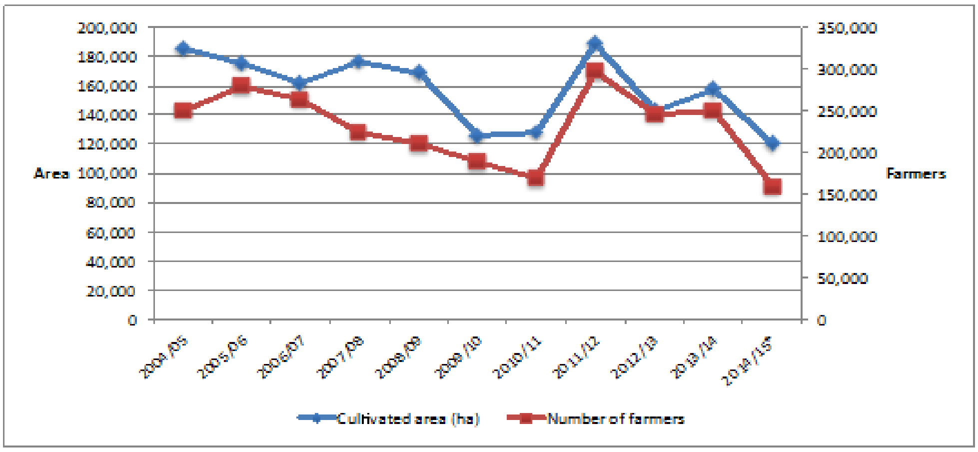

Figure 2: Production area and number of farmers (cotton 2004/5 to 2014/15)
Source: Data from IAM

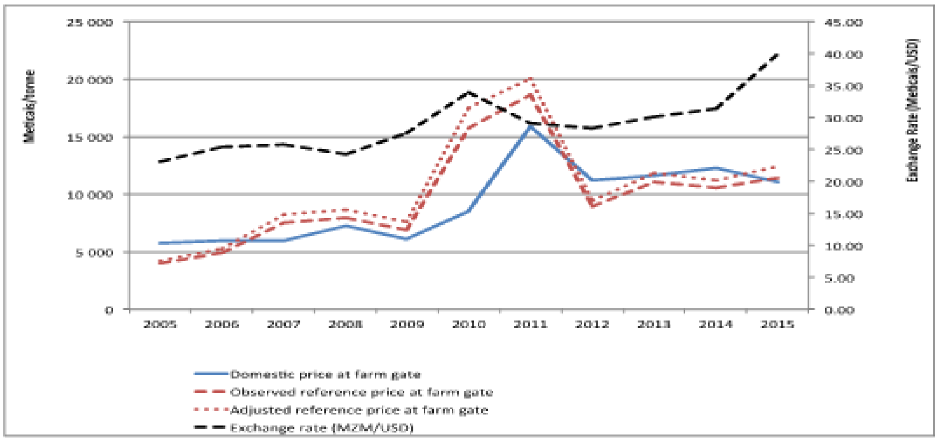

Figure 3: Farm gate prices vs benchmark prices
Source: FAO (2016)

Key Issues

High price volatility and price risks lessen incentives for cotton production

According to the FAO (2016) analysis, the policy and market environment have created an inconsistent incentives structure for the cotton sector during the last decade. In many years (2007-2011 and 2015) farmers were penalized, as they received prices lower than the price that would have prevailed in absence of policy and market distortions (Figure 3). Indeed, the current price setting mechanism allows ginners to benefit significantly from rising lint prices or depreciating national currency to the detriment of the farmers (Estur, 2015).

Overall, nominal producer prices for seed cotton in Mozambique are the lowest in Sub Saharan Africa, although the sector shows better ginning outturn compared to other countries, such as Tanzania (Estur, 2015). Smallholder farmers lack information and bargaining power to negotiate better prices. Furthermore, the minimum price policy has proved not to be effective in hindering the high price volatility and exchange rates fluctuations and smoothing the price risk that affect all the stakeholders of the value chain. This instability and uncertainty have a negative impact on cotton production and - as consequence - on costs for ginners and export revenues.

Lack of local competitiveness and low quality undermine domestic profitability and international competitiveness

Roughly 97 percent of the cotton production comes from family farms, which sell their production to the concessionary company within their region (IAM, 2014); and the total national exports only account for near 2 percent of the aggregate African cotton exports (Bettencourt, 2015). Currently, it is the government – through IAM – that sets the minimum domestic price for raw cotton. The prevailing monopsony regime usually does not allow farmers to renegotiate effectively with the concessionary firms for better prices. Nonetheless, by increasing farmers' bargaining power to countervail regional monopsony along with farmers' access to market information, it is likely that farmers would benefit, yielding high farm gate prices. As a result, farmers could respond to such incentives by increasing the levels of production.

Apart from the relatively low yields and production levels for raw cotton compared to other African countries such as Mali and Burkina Faso (MAFAP, 2013) for instance, lint quality has also been an issue in Mozambique. Some of the reasons for the low quality have been associated with low levels of inputs used (e.g. fertilizers), poor cropping techniques and post-harvest management (Bettencourt, 2015).

Recommendations

Currently, there are very few price incentives for farmers to increase the quantity and quality of cotton. Therefore, only a small fragment of cotton farmers are not from the family sector. Pricing mechanism, along with limited competiveness and production techniques need to be considered to improve quality and overall performance of the cotton sector. For instance, the current pricing formula in use by IAM penalizes farmers for quality aspects, as the quality differential of cotton lint is articulated to reduce the minimum price rather than to increase it. In addition, volume of cotton traded by each producer is not accounted in the pricing policy. However, by adding premium price for the volume of cotton traded to the pricing policy, it could raise farmers' motivations to take some advantage from the synergies of working as farmers' associations as well as to increase the outputs from their production. Furthermore, it may also represent an additional incentive for improving crop management practices in order to get the best value for quality as well. As a result, overall quality and volume of cotton traded would increase. This, however, needs to be combined with farmers' access to improved inputs (e.g. fertilizers), technologies as well as extension services. If extension agents are better trained to assist farmers, gains in the form of improved yields (and hence production) as well as quality for cotton lint can be achieved. As a result, farmers would benefit from increased prices; and the economy at large would be better off from increased volume and value of exports.

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