MINISTRY OF AGRICULTURE, ANIMAL INDUSTRY AND FISHERIES; VEGETABLE OIL DEVELOPMENT PROJECT PHASE 2

PRICING OF OIL PALM FRESH FRUIT BUNCHES (FFBS) IN KALANGALA

1.0 INTRODUCTION

The Government of Uganda (GOU), with support from the International Fund for Agricultural Development (IFAD), is implementing the Vegetable Oil Development Project (VODP), under the Ministry of Agriculture, Animal Industry and Fisheries (MAAIF). As part of the project, Oil Palm development is being undertaken in Kalangala, under a nucleus estate Out grower/ smallholder scheme model. The nucleus estate has set up two mills for processing of oil palm fresh fruit bunches (ffb) from smallholder farmers/ outgrowers and the nucleus estate.

IFAD, together with the World Bank, supported GOU in designing and appraising VODP. Due to environmental concerns and economies of scale, it was recommended one investor would invest in the nucleus estate and palm oil mill in a given area. This would enable the investor to set up a big efficient palm oil mill with high environmental standards and also being in one place, it would be easier to supervise in terms of environmental protection. This however, would lead to a monopoly situation.

As part of the design of the project, IFAD, World Bank and GOU recommended that a pricing mechanism be incorporated as part of the project to ensure that the smallholder farmers receive a fair and equitable price for their produce. Given that there is only one buyer for the farmers' ffbs, there was need to ensure that the farmers are protected from the effects of monopoly.

GOU signed an agreement with - BIDCO Oil Refineries Limited on 4th April 2003, for oil palm development in the country. As part of the agreement, Government, ensured that the pricing mechanism developed during the design process, with support from IFAD and the World Bank, is incorporated (Article 19). This was to ensure that the farmers get a fair price for their oil palm fresh fruit bunches, since there would only one buyer for the ffbs. The pricing mechanism is composed of a pricing formula and a pricing committee.

Article 19 of the agreement between Gou and BIDCO refers to the pricing formula for ffbs to be supplied by smallholders to the palm oil mill at the factory gate, and the establishment of a pricing committee which may from time to time monitor or verify that the pricing formula in the agreement is adhered to. The tripartite agreement signed on 28th April 2006 between GOU, Oil Palm Uganda Limited (OPUL) and the registered Trustees of Kalangala Oil Palm Growers Trust (KOPGT) lays out the composition of the pricing committee and gives further details on the pricing mechanism in Article 9.

2.0 DETAILS OF THE PRICING MECHANISM

The pricing mechanism adopted a pricing formula applied in Malaysia in cases where farmers supply to one mill. It is meant to protect the farmers and ensure fair prices. The mechanism ensures that it is not the private investor that determines the price, but rather, the formula. The pricing mechanism is composed of a pricing formula and a pricing committee.

2.1 Oil Palm Fresh Fruit Pricing Formula Applied for Payment by OPUL to KOPGT

The Oil palm ffb pricing formula is premised on the international crude palm price. The farmer in Kalangala is paid an import parity price (CIF Jinja), which is the cost that Bidco would incur if they purchased crude palm oil from the international market- Malaysia. All costs associated with crude palm oil import are included in the formula. The pricing formula is based on the Malaysian Ministry of Primary Industry and is widely applied in Malaysia to ensure fair pricing for farmers that supply to one mill. While one mill/nucleus estate is important for economies of scale and ensuring big mills of high environment standards, it presents itself with a monopoly buyer situation, hence the need for a fair way of determining prices.

The pricing formula as laid out in the project design document, the agreement between GOU and Bidco and the tripartite agreement between GOU, Smallholder farmers through KOPGT and Bidco/OPUL, Article 9, is as follows;

FFB price = (H/J) x K where

- **FFB** price is the factory gate price per metric ton of fresh fruit bunches (ffb) of a standard quality.
- **H** is the price of **CPO** ex mill
- **K** is the oil extraction rate per metric tonne of oil palm fresh fruit bunches
- **J** is a milling constant fixed at 1.2

The calculation starts with the average world price of the CPO in Malaysia for the previous month **(H).** The cost of transport, insurance and freight (CIF) from Malaysia to Jinja is added to this price, in order to obtain the import parity price per metric ton of CPO at the refinery in Jinja. From this price, the cost of transporting the CPO from Bugala Island to Jinja is deducted to obtain the ex-mill price of CPO (H).

The agreed milling constant (J) of 1.2 is applied to cover the milling costs (operating, repairs, maintenance and depreciation) associated with extracting one metric ton of CPO at the mill on Bugala Island.

The oil extraction rate (K) Reflects the amount of oil recovered/extracted per tonne of oil palm ffbs expressed in percentage terms.

This mechanism means that the prices that farmers receive are directly determined by world prices and will fluctuate, depending on the international prices of crude palm oil. The company (OPUL) has the option of importing crude palm from Malaysia and Indonesia and all the costs involved are incorporated in the formula. Details of price calculation for March 2019 are shown in Annex 1.

2.2 Oil Palm Pricing Committee

Purpose: The members of the pricing committee are expected to apply the pricing formula to determine the prices for oil palm ffbs supplied by farmers to the palm oil mill, and meet from time to time to assess the application of the formula in price determination.

Membership: The pricing committee is made up of representatives of:

1. MAAIF (Chair)
2. Trustees of Kalangala Oil Palm Growers Trust
3. Kalangala District Local Government (KDLG),
4. OPUL / BIDCO and KOPGT (representing farmers).
5. Ministry of Finance, Planning and Economic Development
6. Ministry of Trade and Industry
7. Coopted members as the Committee may agree upon from time to time.

Meetings are chaired by MAAIF and KOPGT acts as Secretary. Members of the committee serve for a period of three years (renewable) and adopt their own rules of procedure.

The National level pricing committee was constituted and worked for its term. The term has expired and another committee is being constituted.

However, when the national level committee was applying the formula to determine prices, the oil palm farmers complained that they did not feel adequately represented. This necessitated the formation of a Kalangala based pricing subcommittee that is currently in place and meets every month to set prices for oil palm ffbs.

The Subcommittee membership is as follows:

1. Kalangala District Local Government represented by the District Commercial Officer (DCO) as Chairperson,
2. OPUL/ BIDCO,
3. MAAIF/ VODP representative
4. Seven (7) Block representatives representing the farmers (Sesse Oil Palm Growers Cooperative - SOPGCO) leadership).
5. KOPGT Secretariat as the Secretary.
6. Any other members of the SOPGCO Board.

The subcommittee sits monthly to set the price of the coming month and thereafter communicate to farmers. The terms of reference of the committee are as follows;

i) Determine the price for ffb, using the pricing formula

ii) Communicate the price to the farmers

iii) Handle any other issues related to oil palm production including agronomy and fertilizer use.

2.3 Sources of Information Applied in the Formula and other relevant information

I. **International Price for Crude Palm oil (CPO):** The average monthly international price for crude palm oil form the Malaysian Palm Oil Board is applied. This is available on the internet. The CPO price for the previous month is used.

The transportation, handling and insurance costs from Malaysia to Jinja are added to the crude palm oil price in Malaysia to get the cost CIF Jinja. The cost of transport of CPO from Bugala Island to Jinja is deducted. This is to ensure that the farmer gets the price that BIDCO would pay for importation of crude palm oil from Malaysia.

II. **The Constant** varies between 1 and 1.25, in practice. It was agreed and included in the tripartite agreement that the constant would stand at 1.2

III. **The Oil Extraction rate (OER) ranges** between 15% to 24% depending on the age of the palms. The older the palms, the higher the OER. Negotiations resulted in a 23% OER for farmers. This is a good OER given that 50% of the farmers' plantations are still young and planting is still on going. The OER in Kalangala is higher than the OER in Malaysia which is about 19 to 20%. This information is available on the internet.

IV. **Exchange rates:** Exchange rates for the USD Dollar is the average rate for the previous month, and it is got from Bank of Uganda.

V. **Communication of prices:** The price agreed by the committee is published the next day following the meeting so that it is available at the beginning for the month to farmers.

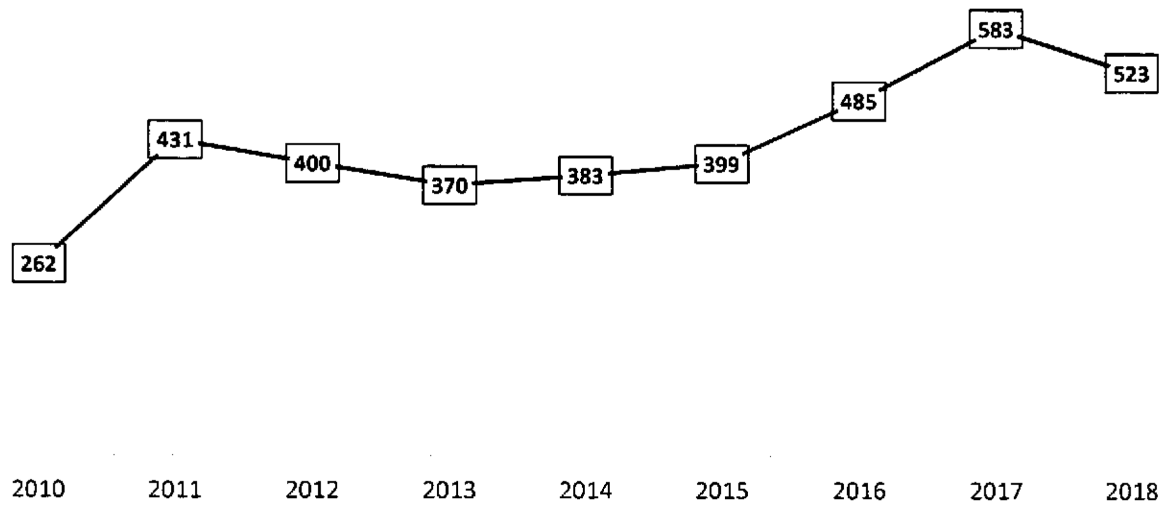
VI. **Payment periods:** Payment for farmers' ffbs is monthly. The ffbs are supplied and at the end of the month, paid for, before the 10th of the following month.

2.4 Price Fluctuations

Prices for ffbs fluctuate a lot because they are tagged to the international crude palm oil price which fluctuates frequently. The down ward trend of ffb prices has been occasioned by the downward trend of palm oil on the international market. Annex 2 shows the prices of ffbs in Kalangala since 2010 when harvesting started. The graph below shows the average price for ffbs over the years since onset of harvesting. Annex 3 gives the international crude palm prices over the last two years and show a significant down ward trend. The prices have fallen by about 20% on average.

GRAPH SHOWING THE OIL PALM FFB PRICE TRENDS IN KALANGALA

Graph 1: Trends of the oil palm fresh fruit bunch average yearly prices in Kalangala



2.5 KOGPT Shareholding in OPUL on behalf of the smallholder farmers.

KOPGT holds a 10% shareholding in Oil Palm Uganda Limited (OPUL), on behalf of the oil palm smallholder. KOPGT recently earned UGX 3.9 billion as dividends from their shares in OPUL.

3.0 INTERNATIONAL OIL PALM PRICES HAVE BEEN DECLINING SINCE 2017

The CPO, have been declining since 2017 at the international market. This has been explained by the following;

a. There has been increase in production of palm oil by Malaysia and Indonesia hence increasing supply and affecting prices.
b. trade agreements between the U.S. and China have affected the market for palm oil, given that China is a very big market for palm oil . China committed to buy an additional 10 million tons of U.S. soybeans for meal to support its livestock industry, and soy oil as a by-product and hence reducing the need to import palm oil. Palm oil prices are affected by movements in soy oil, as they compete for a share in the global vegetable oil market.
c. The demand for palm oil by India has been reducing and yet India has been one of the major importers of palm oil

The crude palm oil prices has reduced by about 20% in the last two years (2017-2018). Please refer to Annex 3.

4.0 CONCLUSION AND WAY FORWARD.

- The Government negotiated appropriate pricing arrangements for FFB for farmers, and the implementation of these to ensure equitable share of the benefits from the production of CPO between the mill and the smallholders.

- Oil Palm, like other agricultural products, suffers from fluctuating prices.

- Farmers remain price takers and forces of demand and supply determine the prices to be paid for the products.

- The mill will only pay the price that is the same as the one it can pay to import crude palm oil into the country, otherwise it does not make business sense.

- **The way forward is for farmers to improve their yields by ensuring timely and adequate application of fertilizers and improving agronomic practice for their plantations.**

MINISTER-MAAIF

Annex 1: Showing ffb Price Workings for March 2019

DESCRIPTION	**BASIS**	**COSTING**
FOB Value(USD)		530.29
Freight (USD)	$55 PER MT	55
C&F to MSA Price(USD)		585.29
Marine Insurance	1.20%	7.02
CIF MSA Price(USD)		592.32
COSTS INVOVLED AT MOMBASA		
Port Wharfage Per Ton	$2.20	2.20
Clearing Agency Fees For Warehousing Entry / per Invoice	$300	0.67
Ex Warehousing Entry Per Truck	$30	1.07
Trade Levy per Ton	**$0.12**	**0.12**
Transit Insurance from MSA to Jinja (CIF)	0.30%	1.78
Storage Charges At MSA Per Month	$3.25	3.25
Storage period(month)	1	
ITS/SGS Survey fees per month	$0.26	0.26
Cost At Mombasa(USD)		9.35
TRANSIT COST TO JINJA		
Transport charges From MSA to Jinja	$100per TM	100
Border Clearance Cost per Truck(UGX per truck of 28MT)	32	1.14
COST TO JINJA (USD)		**702.81**
Exchange rate and price in UGX	**3,696.75**	**2,598,111**
LANDED COST AT BUL JINJA/TON CPO		**2,598,111**
Extraction Rate (OER)	23%	
Milling Constant (J)	1.2	
Transport Cost From Kalangala to Jinja		72000
Insurance CPO to Jinja	3,013	3,013
KOPGT Management fees	0%	
CPO Price Ex POM, Kalangala		2,523,098
prices of FFB/MT Delivered at POM(UGX)		**483,594**
Prices of FFB/Kg Delivered at POM (UGX)		**484**

Annex 2: Trends of Monthly Oil Palm Fresh Fruit Bunch Prices in Kalangala

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
January	215	407	391	340	397	359	398	598	525	440
February	215	431	401	369	381	373	405	617	535	469
March	227	434	397	378	396	379	462	595	564	484
April	247	410	443	371	431	382	478	565	565	
May	246	398	466	358	407	401	512	550	566	
June	248	466	422	365	398	402	490	562	557	
July	252	428	386	370	390	434	476	537	550	
August	256	436	393	357	393	437	459	528	512	
September	280	468	408	377	355	391	507	593	497	
October	285	465	393	371	334	406	542	623	494	
November	328	422	349	379	346	436	525	613	479	
December	348	411	348	403	373	392	565	612	433	
Average monthly price	**262**	**431**	**400**	**370**	**383**	**399**	**485**	**583**	**523**	**464**

Annex 3: Showing Price Variations Between 2017 And 2018 In Malaysian Currency.

MONTHLY AVERAGE PRICES

CPO Local Prices					
	Malaysian Ringgit	**Dollars**	**Malaysian Ringgit**	**Dollars**	
Months	**2018**	**2018**	**2017**	**2017**	**Variance%**
Jan	2,487	612	3,275	806	-24%
Feb	2,488	612	3,237	796	-23.10%
Mar	2,427	597	2,958	728	-18%
Apr	2,418	595	2,754	677	-12.20%
May	2,396	589	2,804	690	-14.60%
June	2,324	572	2,686	661	-13.50%
Jul	2,215	545	2,630	647	-16%
Aug	2,184	537	2,633	648	-17.10%
Sep	2,178	536	2,781	684	-21.70%
Oct	2,082	512	2,736	673	-24%
Nov	1,831	450	2,689	662	-32%
Dec	1,795	442	2,407	592	-25.40%
***Jan-Dec Average**	**2,235**	**550**	**2,783**	685	**-20%**

Source: Malaysian Palm oil Board