UNCTAD XI: Challenging the Commodity Crisis

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Introduction
To the consternation of the U.S. government and the joy of much of the rest of the world, Brazil recently won a case at the World Trade Organization (WTO) against U.S. subsidies on upland cotton. The WTO ruled that the U.S. violated its obligations under the Agreement on Agriculture by exceeding its spending limits for cotton. The U.S. will almost certainly appeal the ruling, but no one expects the finding to be overturned. After 50 years of waivers and carefully worded exemptions for agriculture, rich countries may have lost their power to set agricultural policies without regard for the rest of the world.

In international negotiations of all kinds—whether at the WTO or regional trade talks, the United Nations Economic and Social Council or the Human Rights Commission—the domestic agriculture programs in the world’s richest countries have been under heavy attack. Leaders such as Kofi Annan at the United Nations, James Wolfensohn at the World Bank and Rubens Ricupero at UN Conference on Trade and Development (UNCTAD) have all made much the same speech: tremendous resources for development await if the U.S. and European Union can be persuaded to eliminate their agricultural subsidies. By eliminating subsidies, these leaders claim, production in the North will slow, the dumping of agricultural commodities at prices below the cost of production will stop, and developing country farmers will gain access to large and lucrative markets.

Might this WTO decision steer the Agreement on Agriculture, to date a considerable disappointment to developing countries, towards a solution to rural poverty? No. Unfortunately, this ruling on upland cotton subsidies will prove most important as a symbol: rich country spending on agriculture is not unassailable.

The symbol is important, of course. David has defeated Goliath. The legitimacy of the multilateral trading system depends on its ability to protect countries that are too small to defend their trade rights on their own.

But the data shows that even if governments succeed in eliminating all subsidies to U.S. agriculture, world markets will not make the dramatic recovery predicted by such authorities as the World Bank: agricultural dumping and low prices will continue at damaging levels.

UNCTAD XI and commodities: As governments prepare to meet in São Paulo for the eleventh session of the UN Conference on Trade and Development, they face an important opportunity to tackle the problems that plague commodity markets. Since the first session of the conference in 1964, UNCTAD members have grappled with commodity issues, with developing countries’ dependence on commodities and with the economic challenges this dependence creates. It is time to end the debate and take action. One of UNCTAD’s proposals is the establishment of a High Level Panel on Commodities, housed at UNCTAD, to bring together governments, academics, the private sector and civil society organizations to brainstorm, analyze and promote workable solutions to commodity problems. Such a commission is much needed.

Agricultural commodities underpin developing countries’ economies—they determine whether those economies produce enough jobs, food and growth to keep people out of poverty. The balance of historical evidence shows that agricultural development is an essential component for sustained poverty alleviation. Coupled with equitable land distribution, a strong farm sector provides the basis for a strong rural sector, with sufficient capital for investment and livelihoods created for the many services that support agricultural production. For tens of millions of people in developing countries, a healthy agricultural sector is essential to their survival. Agriculture has also proven to be a powerful engine for industrial development through the links it has to the broader economy.

The world economy has changed enormously in the 40 years since UNCTAD’s first session. New technologies have transformed communications and transportation. Governments have agreed to successive rounds of tariff cuts and have created the World Trade Organization as a permanent home for multilateral trade negotiations. Multilateral trade rules now set parameters for domestic policy on agricultural support programs, intellectual property rights and investment measures - areas previously in the domestic policy domain.

Despite the changes, however, some things are painfully familiar. Only a tiny handful of countries have “graduated” from developing to developed country status (including South Korea, Mexico, the Czech and Slovak Republics). At the same time, the vast majority of developing countries remain at a significant disadvantage against their developed country counterparts. Dependence on commodity trade is one of the familiar elements of their relative poverty: a dependence that has proved a constant handicap in the effort to raise people’s standard of living. A few countries in Asia have successfully moved from primary commodity dependence to more diversified economies, but they are few. Sub-Saharan Africa in particular remains heavily dependent on commodities, and yet has seen its contribution to world trade, manufactured exports and primary commodity exports all decline in the last 20 years. Seventeen of the 20
most important non-fuel exports from Africa are either primary commodities or partially processed commodities.¹

WTO Member States are working hard in Geneva to conclude negotiations launched in 2001 in Doha. Agriculture is yet again the sticking point, widely said to be the most important issue on the negotiating table. Several African countries, among the poorest in the world, have attempted to raise commodity issues in the WTO agricultural negotiations—both as a general problem and very specifically in the context of cotton, proposing an initiative that would compensate them for economic losses due to subsidies in the North. Yet the WTO, despite its founding commitment to development, equity and employment, does not really have the mandate or capacity to address the complicated roles that commodities play in global and national economies. UN Member States, on the other hand, created UNCTAD with precisely this role in view.

Commodity issues have gradually been downgraded on the UNCTAD agenda over the past 20 years, despite their continued urgent importance to many developing countries' welfare. Prevailing economic theories dismissed attempts to manage commodity production and trade, particularly internationally: the efforts were judged ill considered and destined to fail. During the 1980s, a number of commodity agreements fell apart because major consuming countries refused to cooperate or because producers could not agree how to limit production. Politically, too, the mood shifted: efforts to address the debt crisis were stifled by a firm, ideological commitment to deregulated markets. Domestically and internationally, policies moved away from supporting a strong governmental role in managing the economy.

This trend was more muted with regard to agriculture. Indeed, it is ironic that domestic policies to manage agriculture have persisted in the North, while the same governments have blocked international efforts to manage the commodity trade. Today the debate on commodities has resurfaced with a vengeance. Economists and policymakers are revisiting the problems and dilemmas with new analysis, acutely conscious that the world community has failed developing countries by not effectively tackling the problems that plague the commodity sector. If managing agricultural commodity production had proven difficult, then looking to the market to solve the problems has been just as disappointing. As UNCTAD’s recent report on commodity issues in Africa says:

…there is a need for a clear recognition of the fact that markets have not provided, and are unlikely to provide, the necessary solutions to instability and secular decline in commodity prices.

— UNCTAD, 2004, p. 55²

What’s the problem?
The Members recognize that the conditions under which some primary commodities are produced, exchanged and consumed are such that international trade in these commodities may be affected by special difficulties such as the tendency towards persistent disequilibrium between production and consumption, the accumulation of burdensome stocks and pronounced fluctuations in prices. These special

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difficulties may have serious adverse effects on the interests of producers and consumers, as well as widespread repercussions jeopardizing the general policy of economic expansion. The Members recognize that such difficulties may, at times, necessitate special treatment of the international trade in such commodities through inter-governmental agreement.  


Markets fail for many reasons. The challenge for policymakers is to determine the best solutions for real situations rather than rely on theoretical models whose assumptions are not robust. As Adam Smith pointed out, business is always going to be tempted to try to circumvent the market to increase its profits. In addition to the tendency of capital to concentrate in a diminishing number of hands, there are specific problems that plague commodity markets that lessen the capacity of an unregulated market to ensure the most desirable outcome. In fact, governments have intervened in agricultural markets since at least the time of the Pharaohs in ancient Egypt. Some of the reasons for market failures are reviewed here.

- Price volatility. Commodity prices are more volatile than the prices of manufactured goods. Supply shocks, often weather-related, require buffer stocks to be smoothed over. Crop failures induce sharp price spikes, which in turn can trigger new investment to increase production which comes on to the market just as harvests are back to normal, thereby creating over-supply and triggering a price fall. The significant time lag required to adjust supply to demand creates constant disequilibrium in unregulated commodity markets. By and large, the price falls are longer and more pronounced than the spikes. Speculation in commodity futures markets exacerbates this pattern. The market encourages short-term speculation, which undermines attempts to create long-term stability in commodity markets. A number of commodity exchanges only handle a small amount of overall production, which exacerbates the volatility of reference prices.

- Long-term price decline. Due to chronic structural over-supply, long-term prices for commodities are on a persistent downward trend. The over-supply in many temperate commodities, such as cotton, groundnuts, sugar and wheat, can be attributed in part to significant increases in output in developed countries since 1980. Developed countries often combined high levels of government payments with uncontrolled output, which generated unusable surpluses. For example, the 1985 Farm Bill in the United States changed cotton policy. Before, surplus stocks were held off the market until prices recovered. After, price support was given to farmers without production controls. There was an immediate and significant impact on world markets: cotton prices dropped precipitously.

- Other causes of production increases. The “Green Revolution” and other agricultural technologies have increased production dramatically. Donors have invested heavily to increase developing country commodity export production and have encouraged the emergence of new producers: Viet Nam, for example, is now a significant exporter of coffee. Brazil, one of the world’s largest agricultural exporters, is steadily bringing new land into production and investing heavily to overcome transport infrastructure bottlenecks.

- The failure of international co-operation. A number of international commodity agreements broke down in the 1980s, removing one of the possible avenues for multilateral discussion and resolution of the problem of over-supply. Developing country debt severely restricted

**PRICE INDICES OF SELECTED AFRICAN COMMODITY EXPORTS, 1980–2002**

(1980 = 100)

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Source: UNCTAD secretariat estimates based on UNCTAD Commodity Price Bulletin

Note: Annual price indices deflated by unit value indices of manufactured exports of developed economies.
the ability of these governments to shape the multilateral debate from the early 1980s forward, while developed country governments objected to commodity management on principle. Between 1997 and 2001, commodities lost more than half their purchasing power against manufactured goods. Over half the countries most affected by this decline in the value of commodity exports are in sub-Saharan Africa, many of them among the most indebted, poorest countries in the world. Declining terms of trade have had a real and measurable negative effect on poor countries’ ability to generate employment, attract investment and produce the economic growth they desperately need.

**Price and agricultural markets.** Price is the all-important signal in a market-based economy. In theory, price indicates relative supply and demand—the less there is of something, the more it will cost, while the more someone wants something that is comparatively scarce, the higher its price. Eventually, price rises above where demand exists, or drops below a level where further production makes sense. Between the two, there are points of equilibrium that “tell” producers and consumers how much something is worth. The system is brilliant in its simplicity and understandably attractive as a way to manage economic relations, especially when compared to the very imperfect, and often corrupt, attempts of governments to dictate where the market should go. When applied to the world of agricultural commodity production and trade, however, the theory loses some of its luster. The time lags between price increases and the capacity to bring new production onto the market is slow for most agricultural products. At the same time, consumption of staple foods is curtailed by the limits on how much people can eat, even at low prices. The unpredictable nature of crop yields year-to-year makes stock holding of staple crops vital, not just to keep food on the market at affordable prices, but to prevent famine. The UN Food and Agriculture Organization estimates that there should be adequate food to feed the world for a minimum of three months to protect global food security. Consumers depend on daily access to crops that are harvested once or twice a year.

**Market power.** Markets are also failing under the pressure of oligopoly power. The companies that process and ship agricultural commodities are growing in size as they decrease in number. Empirical evidence shows a growing disconnect between prices paid by consumers and prices received by producers. One of the factors highlighted by Oxfam and others in the scandal of the global coffee crisis is that record low prices for producers have come at a time when consumption has been expanding. The result? Enormous profits for the four companies that control about 40 percent of global coffee trade, while the countries that depend on coffee have seen significant increases in poverty and severely diminished capacity to service their external debt. The International Coffee Organization says that in the early 1990s, coffee-producing countries earned US$10-12 billion, about a third of the value of final retail sales. Today, retail sales have more than doubled, to US$70 billion, but the revenue to coffee-producing countries has dropped in half, to some US$5.5 billion. The market power of processors and retailers allows them both to realize significant profits and to pass on low prices to consumers. In turn, this increases their market share and limits the scope for new entrants to the market. Horizontal and vertical integration in the commodity value chain has also lessened the usefulness of more traditional market-based tools, such as auctions and futures markets, which only encourage competition if many small buyers are present. If a country attempts to redress market power in favor of producers by setting a price floor for commodities then international trade today make it easier than ever for processing companies to import cheaper raw commodities rather than pay the domestic price.

Commodity problems are not just about market failures. A number of commodities are fundamentally linked to governments’ obligation to respect, protect and promote the universal human right to food. In turn, this requires that someone, somewhere, manage physical stocks of staple foods. Public storage programs are a common means of controlling volatile food prices. However, storing grain is expensive—a fact reflected in the grain companies’ practice of managing their supplies virtually whenever possible, in the form of contracts for purchase

### Cost of Food Imports in U.S. Billions

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<th>Year/Forecast</th>
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*Low-income food deficit country

**Estimate

***Forecast

Source: United Nations Food and Agriculture Organization
and delivery rather than in physical stocks. Many of the largest producer countries have reduced their holdings because they are expensive to maintain. Moreover, international trade rules discourage public stockholding because it counts against domestic support reduction commitments unless it is held at prevailing world market prices. As a result, between 1991 and 1999 the European Commission's spending on storage fell from 18.3 percent to 4 percent of total Common Agricultural Policy costs. At the same time, structural adjustment programs have forced developing countries to sell their public stocks and to rely instead on world markets. As the recent famine in Zambia and nearby countries showed, when drought struck it left countries dependent on food aid rather than able to feed themselves from their own reserves.

Excessive stockholding is a problem. Indeed, a number of International Commodity Agreements have been negotiated so as to reduce excess stocks. However, the elimination of all public stocks is unacceptable from a public policy perspective if the commodity is a basic food item. Governments cannot always afford to buy food on the world market. In fact, the cost of food imports to developing countries has been steadily increasing over the past decade, despite the volatile but overall downward trend in commodity prices. FAO says developing country food purchases have increasingly had to come from commercial sources because public stocks have been diminishing. Moreover, food companies can take advantage of the fact that food is not an optional item in the budget to actually raise prices during times of scarcity. When supplies are low, those with more money get the food and those with less go hungry.

Governments have a long history of seeking to protect producers and consumers against large fluctuations in food prices. In the interests of a well-fed, and therefore quiescent, population as well as a productive, and therefore profitable, agricultural sector, governments have experimented with supply management through land set-aside programs, import and export controls, production quotas, and price floors. Many developing countries opted for state marketing boards: agencies that were responsible for outreach and extension, purchasing, domestic distribution, exports, and, in many cases, setting farmgate prices. All of these instruments have costs, some more than others. But as they have been eliminated under contemporary liberalization policies, many countries have learned that these tools offered important services the open market has not been able to replicate.

International commodity agreements are an extension of such interventions, aimed at restoring order to the international level. As with the domestic policy lessons, so governments are encouraged to look again at the costs and benefits of a more coordinated international approach to commodity markets with a view to improving their performance for the tens of millions of people that rely on commodity markets for their livelihood.

Why create an international commodity agreement?:
International commodity agreements (ICAs) have a range of objectives. Two are overriding: stabilizing prices—smoothing the inevitable short-term fluctuations that plague commodity markets—and countering long-term downward price trends that have steadily eroded the purchasing power of commodity exports on world markets. A number of the commodity agreements in place during the 1960s and 1970s sought to stabilize export earnings for producer countries, including the agreements for coffee, cocoa, rubber, sugar and tin.

Again today, many governments and producers are looking for a way to address the long-term decline in the value of commodities. The drop in agricultural export earnings has intensified the economic crisis in developing countries, crippling their ability to service their external debt, while reducing employment, depressing wages, and inhibiting their capacity to buy inputs needed for production and for investment in essential human services.

In the developed world, countries have chosen to protect their agriculture without tackling the market power of the firms that dominate trade and processing of commodities. They have also moved away from instruments intended to control production. Instead, developed country governments now rely on direct income transfers to producers, compensating for some of their lost income in a market that does not pay cost-of-production prices. These responses are supported by the provisions of the Agreement on Agriculture, which discourages supply management tools by subjecting the kinds of expenditure they entail to reduction commitments and by forcing down tariffs, which are an essential component of domestic supply management programs. The result has worsened the global commodity crisis by encouraging oversupply and dumping level prices.

ICAs offer a way to mediate a multilateral discussion on the problem with the promise of a fairer deal for producers and a more reliable supply of higher quality commodities for consumers, in part by tempering the power of oligopoly business. The overall result would be a fairer distribution of the profits in the commodity value chain.

There is a newly invigorated debate in academic circles over whether the many failures of ICAs were the result of
political rather than economic factors. A number of agreements have successfully managed to overcome temporary stock-overhangs that were depressing prices, such as tin in the late 1980s. Some have managed to control production, or to limit the production that reaches the market, so as to raise prices for all producers—petrol is one obvious example, and rubber is another. Successful long-term management of a commodity to counter long-term downward price trends is less common. The international coffee agreement managed until 1989 with export quotas, but then fell apart when consumer countries left the agreement and producers could not agree on a new allocation of quotas.

Economists Niek Koning, Muriel Calo and Roel Jongeneel argue that one of the reasons many international commodity agreements failed is because the 1947 UN Havana Conference locked in a set of principles to govern all agreements, rather than allowing a more adaptive process to identify an approach best suited to a given commodity. Under the Havana approach, ICAs were limited to a five-year period, although new negotiations could extend them for a further five years. The assumption was that the agreements would be temporary fixes rather than a permanent way to frame commodity trade. The Havana framework also encouraged a commodity-by-commodity approach, which precluded the possibility of trade-offs through simultaneous negotiations on several commodity agreements. This multi-commodity approach would take advantage of producers of some commodities being consumers of others. It is counterintuitive to force all commodities into a single framework, when some are produced by two or three countries, and others are produced by dozens, and when commodities differ greatly in how easily they can be stored, shipped, or substituted.

An international commodity agreement need not solve every problem facing a commodity sector to succeed. To work, ICAs must be complemented by national policies and by complementary international interventions. For example, a compensatory financing mechanism, improved by the experience we have to date with the International Monetary Fund’s and European Union’s efforts, could provide an effective tool to counter the immediate impact of a commodity price slump while other, longer-term measures are considered and implemented. A recent meeting of Eminent Persons at UNCTAD proposed a diversification fund to strengthen the private sector and producer associations in developing countries. The group also proposed that the diversification fund be used to encourage investments, for example by providing seed capital for new projects.

To succeed, the group proposed the fund be disbursed when triggers agreed in advance are set off rather than waiting for after the fact analysis on a case-by-case basis. That is, if a producer country is not responsible for the price decline and is suffering from its impact, it should automatically receive compensation. The group also made the point that any funds have to be given in such a way that payments actually reached those hurt in the recipient country (whether producer or consumer or both).

**Time to act**

In effect, the developed countries have found it worthwhile to politically protect a mere 3 to 4 per cent (more or less) of their working population from the adverse impact of volatile and generally declining real commodity prices, but have argued against deploying similar instruments to protect about 70 to 80 per cent of much poorer developing countries’ population whose sole livelihood is agriculture.


Some experts, and many transnational agribusinesses, advocate that governments get out of regulating agricultural markets. Citing the failures of the extensive, expensive domestic agricultural policies of most OECD members, their demand is: “Liberalize this!” However, other advocates point to the experience of tropical commodity markets where dramatic liberalization has taken place. There, deregulation has led to severe over-production, worse price falls than those experienced during the Great Depression, and the disappearance of traditional brokerage firms as a small number of processors and retailers have emerged to dominate global commodity markets.

It’s time to get the regulations right. Producers, whether in the United States, Uruguay, Uzbekistan or Uganda, are all hurt by over-supply and consequent low prices. Each country’s producers call the others’ advantages unfair, but when farmers get to meet and discuss issues, they come to a surprisingly consistent description of the problem they face: weak and disparate farmers facing chronic over-supply and unequal bargaining power in the face of oligopsonistic buyers. Of course there are real and important differences among farmers North and South, but there are also important similarities. In describing the problem as one of a few, rich, developed country farmers against millions of poorer developing country farmers, the real holders of power in the value chain—transnational processing and retailing companies—get conveniently overlooked.
UNCTAD offers a number of important institutional advantages as countries revisit the merits of managing commodity supplies at the international level.

1. UNCTAD membership includes every UN member state—now over 190.

2. UNCTAD has been the pre-eminent forum for debate, analysis and policy-formulation with regard to commodity issues in the context of development. This context is critically important: ICAs are desirable if they are effective as a tool for realizing certain fundamental objectives, including the protection of the universal human right to food and the promotion of a more equitable distribution of global wealth. Governments gave UNCTAD the mandate to look at this wider context, and, as a UN body, UNCTAD can leverage other resources in the UN system.

3. ICAs may work better when negotiated over a number of commodities simultaneously, rather than on a commodity-by-commodity basis - thus providing incentives for a larger group of countries to engage. This idea, elaborated by Koning et al, includes the suggestion of funding diversification through export taxes, which would raise commodity prices to the level agreed in the ICA. UNCTAD provides an obvious forum to house such a multi-commodity approach coupled with one or more funding mechanisms.

Governments have starved UNCTAD of the resources it needs to fulfill its mandate - but this phase must end. It is time to fund commodity work adequately. UNCTAD's work should be revitalized and funded with a view to renewing the commitment made when the Integrated Programme for Commodities was first launched:

1. Stabilize commodity export earnings at adequate levels;
2. Create conditions for effective planning of production and investment in producer countries; and,
3. Enhance the capacity of producer countries to diversify their economies and to move towards creating higher value processed commodities.

UNCTAD is proposing that governments agree to create a High Level Panel on Commodities, housed at UNCTAD, which would bring together governments, academics, the private sector and civil society organizations to brainstorm, analyze and promote workable solutions to commodity problems. The idea deserves support.

In the search for trade and agriculture policies to promote development, this High Level Panel on Commodities should include in its recommendations to governments:

1. Ensuring that UNCTAD is adequately funded to dedicate staff to an examination of all aspects of the commodity problem.
2. Renewing UNCTAD's mandate to monitor the market presence of transnational corporations (TNCs) in commodity markets. Until the mid-1980s, UNCTAD could report which companies had what share of different markets at the global level. This information is vital to understand multilateral needs for competition rules, to understand how policy interventions will play out in practice, and to make a realistic appraisal of whether producers and consumers need to organize their side of the market for a given commodity, in order to counter the market power of TNCs in their sector. This type of transparency is required under WTO rules for State Trading Enterprises, but such national monopolies are dwarfed by the size of their private sector competitors. Functioning markets require transparency, an element lacking in today’s commodity trade.
3. Studying the impacts of dismantling State Trading Enterprises to determine how best to replace the vital services these organizations have provided to agricultural producers, rural communities and commodity-dependent economies.
4. Improving the methodology used to calculate margins of dumping for agricultural commodities. IATP estimates that the five principal commodity exports from the US are dumped at prices considerably below their cost of production. UNCTAD should be funded to review the dumping methodology, to develop ways of fairly applying the analysis in multiple countries, and to offer a menu of measures which countries can implement to keep dumped commodities off world markets.

6 The depreciation in the U.S. dollar may have slowed or reversed this trend in the last year or two.