March 2008
No. 14

SOUTH CENTRE

Policy Brief

From Declarations to Actions on Commodities: Marking the Turning Point at UNCTAD XII

I. Introduction

We live in an era of paradox. It is characterized by unprecedented global economic prosperity in some parts of the world and by widespread economic and social deprivation in other parts. The prosperity is primarily due to global economic integration driven by new international trade and investment relations and advances in technologies which render distance less relevant as barrier. On aggregate, the world is several folds richer today than it was a century ago. Yet, shockingly, this period of prosperity has simply bypassed millions of poor people, who are too poor to take advantage of it; and too vulnerable to deal with the risks that globalization imposes.

About 2.1 billion people in developing countries live on less than $2 a day.[1] Most of them live in rural areas and depend on agriculture for their livelihoods.[2] Therefore, broad-based improvements in agriculture productivity, conducive and fair trading opportunity for agriculture, and enabling and supportive policies and institutions at local, regional and international levels are fundamental for development. As the World Bank in its latest Development Report observed, agriculture is imperative to meeting the Millennium Development Goal and other development targets.

Poverty is a complex but not inexorable challenge. The prosperity that the world has enjoyed

Executive Summary

With the multilateral trade negotiations at an impasse, with the rising concern on climate change and energy insecurity, rising international food prices which disproportionately affect the poor, the time is ripe for all concerned on development to start taking concrete actions to address the plight of the commodity crisis. The time is high for translating pledges and action plans on commodities into concrete actions. Given UNCTAD's historical role, there is no better framework other than UNCTAD XII for gathering the steam for this.

Table of Contents:

in the last century has created the resources and the means to end poverty.[3] However, the political will has yet to come. Therefore, if UNCTAD XII is to make a difference on development, it should focus to solicit the political will from the international community such that it delivers on the promises made time and again. UNCTAD XII should not become yet another conference for brainstorming and a stage for making promises, action plans and declarations. With the multilateral trade negotiations at an impasse, with the rising concern on climate change and energy insecurity, rising international food prices which disproportionately affect the poor, the time is ripe for all concerned with development to start taking concrete actions to address the plight of the commodity crisis. Given UNCTAD's historical role, there is no better framework other than UNCTAD XII for gathering the steam for this.

II. The Commodities Problem

The commodities problem has been widely debated at policy and scholarly circles. The challenges that agricultural commodity producers and farm workers face and the mechanisms that created them are indeed well understood and vastly documented. Of course, new challenges have arisen due to changes in technology, market structure, institutions and policies. Yet the crux of the commodities problem has two facets: (i) falling long-term prices, both in absolute terms and as share of income in commodity value-chains. In the past few years, commodity prices on aggregate have increased. However, this is not the case for all commodities. In addition, the rise in oil and gas prices has led to further deterioration of the terms of trade of many agriculture exporting developing countries; (ii) pervasive commodity price volatility, hence rural household income volatility.

"… Poverty is a complex but not inexorable challenge. The prosperity that the world has enjoyed in the last century has created the resources and the means to end poverty. However, the political will has yet to come. …"

Among the factors that cause the long-term price decline, in particularly farm-gate prices, include: (i) oversupply of commodities; (ii) increased supply in developed countries mainly due to subsidies; (iii) increased buyer power and (iv) the dismantlement of commodity boards. Similarly the volatility of commodity prices is due to several factors. But, it is mostly due to the demand inelasticity of commodity prices, i.e. commodity demands are less sensitive to changes in price. As a result, changes in supply due to such factors as weather or overproduction or change in demand (hence relative change in supply) result in a disproportionate change in commodity prices. This makes commodity prices notoriously volatile.

III. Past Actions: What Have We Learned?

The policy gaps related to the commodities problem include sins of commission (i.e. due to actions) and sins of omission (i.e. due to inactions). Dismantling of institutions such as commodity boards and international commodity stabilization bodies in developing countries, subsidies and market access barriers in the industrial countries constitute crucial sins of commission. The reluctance to put institutions and regulatory mechanisms to regulate market concentration in commodity markets is perhaps the biggest sin of omission. Presumably, former president Jacques Chirac of France has in mind both these sins when he referred the oblivious attitude towards the commodities problem as the "conspiracy of silence".

During the last two decades, several schemes, primarily market-based risk-hedging instruments, have been championed as the means for mitigating the commodities problem. It has been argued that market-based risk hedging instruments enable commodity producers to enjoy the benefit of free trade by transferring risks to those who are willing and able to bear them. Several neo-classical models have been used to demonstrate how this is possible. However, although these schemes may play a positive role in assisting small and poor producers to mitigate the vagaries of commodity prices, their concrete contribution should not be exaggerated. The institutional and structural constraints of developing countries provide serious limitations to the use of market-based risk hedging instruments by the poor in rural areas in these countries. These instruments should be seen as part only of a comprehensive set of measures to address the issue of price volatility and its consequences for producers in commodity-dependent developing countries.

IV. Delivering on Promises

The solutions to the commodities problem, hence to poverty, are not out of the reach of the international community. There are no easy solutions; there are no easy short-cuts. Yet, with right domestic institutions, and macroeconomic and investment policies; with reforms to create supportive international trading and financial systems; with sufficient financial support from donor countries and organizations, the commodities problems are solvable and the Millennium Development Goals are reachable. Financial, institutional or expertise constraint although important are not the major hindrances for achieving these. In fact, year after year, donor countries and agencies, one after the other, have pledged to mobilize sufficient resources to address development problems. However, the political will and machinery that is required to transform promises into actions have been the major missing element and hindrance.

The following are some of the key issues that should be considered at UNCTAD XII for addressing the commodities problem.

IV.1. Create a fair, balanced and inclusive multilateral trading regime.

In Doha, ministers of WTO members agreed to address the marginalization of least-developed countries in international trade. The importance of delivering on the promises made in Doha has been highlighted in several declarations and actions plans. But, progress in Doha has been slow. In the meantime, the imbalances on world trade persist.

The problem of developing countries is not less integration per se. The structure of their integration which is characterized by heavy dependence on a few primary commodities is the main problem. Increasing integration through enhanced market access is thus only part of the solution; change in the trade structure is also needed. This requires diversification through value-addition. The role of industrial policy for value-addition thus cannot be overemphasized. So policy space for industrialization, including for the development of national and regional markets and industrial clusters, plays crucial role for commodity dependent developing countries in the long term. In this light, deeper industrial tariff cuts by developing countries in exchange for agriculture market access and reduction of farm subsidies is akin to snatching developing countries' long-term development prospects.

IV.2. Create Export Diversification funds and meet the promised ODA target.

Economic diversification is the long-term solution to the commodities plight. In this respect, the UNCTAD Meeting of the Eminent Persons on Commodity Issues in 2003 proposed the establishment of a Diversification Fund. Recently, the Brasilia meeting on "Global Initiative on Commodities"[5] proposed that international organizations establish export diversification funds arguing that new policies to effectively mobilise capital necessary for financing diversification programmes should be promulgated.

Financing diversification should be a pivotal part of financing development. In the Monterrey Summit on Financing for Development which took place in March 2002 in Mexico, Member countries of the United Nations reached a consensus to increase Official Development Assistance (ODA) to support social and economic development, in particular in countries with least capacity to attract private capital. Developed countries has made a commitment to contribute 0.7 per cent of gross national product (GNP) as ODA to developing countries and 0.15 to 0.20 per cent of GNP to least developed countries as reconfirmed at the Third United Nations Conference on Least Developed Countries held in Brussels in May 2001. However, to date, only a handful of developed countries have met the target while many of them still are reluctant to even maintain their current contribution.

It was in this context that the initiative towards the diversification of African economies was initiated by the United Nations (the Secretary-General's Expert Group on African Commodity Problems) in 2004 and further elaborated with a study conducted by the Food and Agriculture Organization of the United Nations (FAO) and presented to the General Assembly.[6] Based on this report, resolution A/48/214 on the implementation of the "UN New Agenda for the Development of Africa" was negotiated, including a call for the international community to support the establishment of the Fund with resources of $50-75 million for an initial period of three to four years. The fund, however, has never come to see the light of the day.

"… The problem of developing countries is not less integration per se. The structure of their integration which is characterized by heavy dependence on a few primary commodities is the main problem. Increasing integration through enhanced market access is thus only part of the solution; change in the trade structure is also needed.…"

Recently, pledges have been made at the WTO to increase Aid for Trade to, *inter alia*, assist developing countries increase their supply side capacity and trade infrastructure. Several discussions at various forums, including at the recent Global Review on Aid for Trade, on how to mobilize resources for implementing the aid for trade agenda have been undertaken. Yet, there is no clarity yet, for instance, about the extent that aid for trade would prioritize on production and export capacity. In addition, resources for expanding the Aid for Trade agenda may come from existing ODA, implying significant reshuffling of development aid. This makes questionable the contribution of the Aid for Trade agenda for sustainable development.

In spite of several declarations and action plans pledging to increase international resource mobilization to support export diversification in commodity dependent developing countries, sadly, ODA has been declining significantly over the last few years. No genuine political commitment has materialised to provide support to the establishment of an international export diversification fund. Yet, developing countries has attached significant importance to the issue. For example, Ambassador Munir Akram, in his capacity as Chairman of the G-77, highlighted in his message to the participants at the Brasilia meeting on "Global Initiative on Commodities" the importance of export diversification fund.[7] Such fund is critical for enhancing economic transformation in commodity-dependent developing countries. UNCTAD XII should thus gather the steam for concrete actions for transforming pledges for the establishment of a diversification fund into reality.

IV.3. Create an effective international compensatory mechanism

The role of international compensatory mechanisms as means for addressing export earning revenue instability for commodity exporting countries, especially the poorest among them, cannot be overemphasised. Unfortunately, the laissez-faire paradigm that has dominated development thinking during the last three decades has dropped compensatory finance mechanisms out of fashion. This has happened even when revenue-smoothing became a critical challenge for development as a result of risks that globalization has brought and all forms of interventionary price stabilization mechanisms were dismantled during the last two decades. During this period, long-term commodity prices have been secularly declining. Even the recent improvement in commodity prices has not brought the price for agricultural commodities close enough to their 1970s levels. In addition, despite the recent increase in commodity prices, most commodity exporting countries' terms of trade have either deteriorated or have not been significantly improved, particularly for those countries that oil and foodstuffs commodities account for significant share of their import basket. In addition, commodity price volatilities still continue to be critical problems.

A number of empirical studies indicated that shocks for most commodities last for over a year.[8] This shows that rapid, unexpected, and often large movements in commodity prices are important feature of commodity markets. It therefore implies that mitigation of the short-term and medium-term shocks should be an immediate area of concern for policy makers. In this respect, the need to reintroduce compensatory financing mechanism at, for example, the IMF in order to smooth the effects of a temporary, exogenously-caused shortfall in merchandise export receipts should be considered. In so doing, lessons learned from previous schemes, particularly in terms of accessibility of the mechanism, must be explicitly taken into account.

It is also vital to reinvigorate the EU FLEX[9] mechanism, which is the existing EU system of compensatory finance for ACP countries. Stringent eligibility criteria and bureaucratic delay in reimbursing funds have made the EU FLEX mechanism, as has been the case in the past with the COMPEX[10] system, a non-efficient, cumbersome and pro-cyclical, rather than countercyclical, mechanism. In this regard, important lessons must be learned from past mistakes in the design and operation of compensatory financing mechanisms.

The appeal and opportunity of globalization will remain blurry to the poor unless the international community injects some means of safety-net to protect the poor. The safety-nets need to be complemented by mechanisms and institutions that enable the poor to benefits from the systems. Compensatory mechanism should thus be seen as an international initiative that can provide the poor with critical means of safety and security so that they too will have the opportunity and the drive to seize the opportunities that globalization brings.

In this respect, UNCTAD XII should mark a starting point to the rebirth of new mechanisms of compensatory finance preferably at a multilateral level. Already, the EU in its *Action Plan on Agricultural Commodity Chains, Dependence and Poverty* which was adopted in 2004 has made a gesture to improve the FLEX. Among the suggested improvements are relaxation of the eligibility of access required and extending the system to include non-ACP landlocked and small-island states. Indeed, the EU action plan in general and the plan to improve the FLEX in particular, although not implemented, could be referred to in order to take the issue of compensatory finance at UNCTAD XII a step further. The conference should envisage implementable concrete actions for new initiatives and strengthening of existing systems of compensatory financing mechanism. In addition a mechanism that links commodity exporting countries' debt service obligations with prevailing conditions in commodity markets should be envisaged.

IV. 4. Create a forum for consultation on market concentration on commodities

Changes in market structures have been observed in many commodity value-chains. This is particularly the case for foodstuffs such as fruits and vegetables and tropical commodities such as coffee and cocoa. Increasingly, commodity markets are becoming oligopsonic in structure – a market with a few buyers and many sellers. The most noticeable trends are the dominance of processors and retailers. Another noticeable trend is the increasing vertical integration and consolidation among multinational processors and retailers.

The buyer-power that a handful of vertically integrated processors and retailers enjoy has enabled them to reap immense profit. For commodity exporters, the market concentration has negatively affected their ability to maintain existing markets and penetrate new ones. It is also one of the major reasons for the little share of producers' earnings in final value of commodities. This is clear from the large gap between farm-gate prices that commodity producers receive and retail prices that consumers pay. In addition, the buyer-power that few vertically-integrated processors and retailers enjoy is the main cause for the asymmetry in price pass-through, i.e. the transfer of changes in retail prices to farm-gate prices and vice-versa.[11]

This new emerging challenge for developing countries requires organizations such as UNCTAD to adjust their research agenda such that they provide timely and relevant research and policy advice to emerging development challenges. The change in the research agendas should gear towards providing in-depth understanding of the dynamics and trends of market concentration in commodity markets and its effect on developing countries.

The agenda should, among others, consider impacts of market concentration on developing countries' foreign exchange earnings and their ability to take advantage of market access opportunities. It should also gear to identify effective solutions through the use of international regulatory mechanisms. UNCTAD with its historical role on commodity issues is best situated to play a leading role in this regard. However, it cannot do so without the mandate and sufficient political and intellectual space.

UNCTAD should also become an effective platform where the issues of market concentration will be thoroughly discussed and analysed. In this regard, the UNCTAD Consultative Task Force on Commodities should be implemented with a mandate and resource that would enable it to become a vital consultative mechanism on market concentration and other emerging challenges that commodity exporting countries face. The establishment of the Consultative Task Force was already discussed at UNCTAD XI; but no specific action has been taken. UNCTAD XII should thus undertake a concrete action to establish the Consultative Task Force with sufficient resources and a clear mandate.

> *"… UNCTAD XII should mark a turning point by mobilizing the political will from Members to tackle the commodities problems. UNCTAD XII should not become yet another stage for brainstorming, promise-making and declarations. It should rather provide the impulse for translating promises and declarations into concrete actions …"*

IV.5. Objectively re-examine the role of government vis-à-vis market forces in commodity markets

There is also a need to undertake concrete actions to strengthen UNCTAD's research and policy analysis. UNCTAD should be given a clear and unambiguous mandate to objectively re-examine the role of government in commodity markets. It is clear that the advent of neoliberal ideas in development policies during the last quarter of the last century has denied government intervention any credence. As a result, commodity markets were left to the vagary of market forces. The result has been catastrophic for development.

It is now recognized that both government and markets need each other for their respective better functioning. The development policy debates have now, by and large, passed the point of 'either-or' insofar as the roles of government and market are concerned. Even the major international organizations that have vehemently championed neo-liberalism have now changed their attitude towards governments. The recognition that markets by themselves are incapable of laying down strong foundations for development is the reason for the change of moods.

Therefore, UNCTAD should adjust the focus of its research and policy agenda to reflect the proper balance that government and market forces need to play in commodity markets. In this regard, as a key first step, UNCTAD should objectively re-examine the role of specific intervention mechanisms in a primarily market-driven economic structure. UNCTAD should also be tasked to provide technical and logistical assistance to commodity exporting developing countries if they desire to establish producers' only commodity agreements, as stipulated by the African Group proposal on commodities to the WTO.[12]

V. Conclusion

In this regard, a number of pledges in the form of declarations and action plans have been put forth by industrial countries and multilateral agencies to alleviate poverty in developing counties. However, most of these pledges have remained unimplemented and forgotten. On issues such as ODA, despite the promise to increase such flows to developing countries, in reality ODA has decreased. This while the prosperity enjoyed by the world in the last century has created the resources and the means to address poverty. What is missing is the political will. UNCTAD XII should mark a turning point by mobilizing the political will from Members to tackle the commodities problems. UNCTAD XII should not become yet another stage for brainstorming, promise-making and declarations. It should rather provide the impulse for translating promises and declarations into concrete actions.

End Notes

1. World Bank. 2007. "World Development Report 2008", Washington D.C.
2. Ibid.
3. Sachs, J. 2005. *The End of Poverty: Economic Possibilities for Our Time*, New York: Penguin.
4. For a detail analysis, see South Centre. 2004. "Commodity market stabilisation and commodity risk management: could the demise of the former justify the latter?" Analytical note, SC/TADP/AN/COM/1.
5. This conference, which took place on 7-11 May 2007, was jointly organized by the Common Fund for Commodities, the UNCTAD, the ACP Secretariat and the UNDP and was hosted by the Brazilian Ministry of Agriculture, Livestock and Food Supply. Among its key objectives were: raising awareness about the commodities problem; re-launching the commodities agenda from a poverty reduction and development perspective; and identifying a global strategy for commodities and a coherent approach to capacity building.
6. United Nations, 2004, "United Nations New Agenda for the Development of Africa in the 1990s", 94th Plenary Meeting of the General Assembly, A/RES/49/142.
7. See, http://www.g77.org/statement/getstatement.php?id=070507.
8. For example, see Cashin, P., H. Liang and C. McDermott. 1999. 'How persistent are shocks to world commodity prices?', IMF Working Paper. Washington, DC: IMF; Cashin, P., McDermott, C., and Pattillo, C. 2004. "Terms of trade shocks in Africa: are they short-lived or long-lived?" *Journal of Development Economics*, Vol. 73 (2): 727-744; and DFID, 2004, "Rethinking tropical agricultural commodities", http://dfid-agriculture-consultation.nri.org/summaries/wp10.pdf.
9. FLEX is a system, under the Cotonou Agreement, for stabilization of sudden export earnings fall. FLEX has substituted the old system, COMPEX.
10. COMPEX is a system for revenue loss compensation for non-ACP LDCs.
11. This indicates that higher retails prices only slightly pass to produces in the form of higher farm-gate prices (and often with long time-lags) while substantial share of fall in retail prices pass to producers in the form of low farm-gate prices (often with less time-lags). Similarly, declines in farm-gate prices are seldom passed to consumers in the form of lower retail prices whereas high farm-gate prices are usually passed to consumers in the form of high retail prices.
12. The African Group proposal on Commodities (TN/AG/GEN/18, dated 7 June 2006) was submitted to the WTO Committee on Agriculture, Special Session. It stipulates to find rules-based solution to, among other things, the trade-related problems of commodities such as tariff escalations and non-tariff barriers that have undermined value-addition; and calls for clarification of certain WTO provisions with a view to allowing producers' only commodity agreement.

Chemin du Champ d'Anier 17
PO Box 228, 1211 Geneva 19
Switzerland

Telephone: (4122) 791 8050
Fax: (4122) 798 8531
E-mail: south@southcentre.org

Contact us in the web:

http://www.southcentre.org

SOUTH CENTRE

In August 1995, the South Centre was established as a permanent inter-Governmental organization of developing countries. In pursuing its objectives of promoting South solidarity, South-South cooperation, and coordinated participation by developing countries in international forums, the South Centre has full intellectual independence. It prepares, publishes and distributes information, strategic analyses and recommendations on international economic, social and political matters of concern to the South.

The South Centre enjoys support and cooperation from the governments of the countries of the South and is in regular working contact with the Non-Aligned Movement and the Group of 77. The Centre's studies and position papers are prepared by drawing on the technical and intellectual capacities existing within South governments and institutions and among individuals of the South. Through working group sessions and wide consultations which involve experts from different parts of the South, and sometimes from the North, common problems of the South are studied and experience and knowledge are shared.

Other Publications in this Series

- Who Should Bear the TRIPS Enforcement Cost?
  South Centre Policy Brief 12—January 2008
- Mandatory Disclosure of the Source and Origin of Biological Resources and Associated Traditional Knowledge under the TRIPS Agreement
  South Centre Policy Brief 11—October 2007
- Why Inclusion of Services in the EPAs is Problematic: Legal and Development Implications
  South Centre Policy Brief 10—September 2007
- The Threat of Technological Protection Measures to a Development-Oriented Information Society
  South Centre Policy Brief 9—August 2007
- The Proposed WIPO treaty on the protection of Broadcasting and Cablecasting Organizations
  South Centre Policy Brief 8—June 2007
- The Development Dimension of the Agriculture Negotiations
  South Centre Policy Brief 7—May 2007
- Development and Intellectual Property under the EPA Negotiations
  South Centre Policy Brief 6—March 2007
- Increasing LDC Participation in services through Special Priority Market Access in the WTO
  South Centre Policy Brief 5—September 2006
- State of Play of the GATS Negotiations: Are Developing Countries Benefiting
  South Centre Policy Brief 4—November 2005
- Benchmarking and other approaches for liberalization in GATS: What does his mean for Developing Countries?
  South Centre Policy Brief 3—November 2005
- Aid for Trade
  South Centre Policy Brief 2—November 2005
- Policy Space for the Development of the South
  South Centre Policy Brief 1—November 2005