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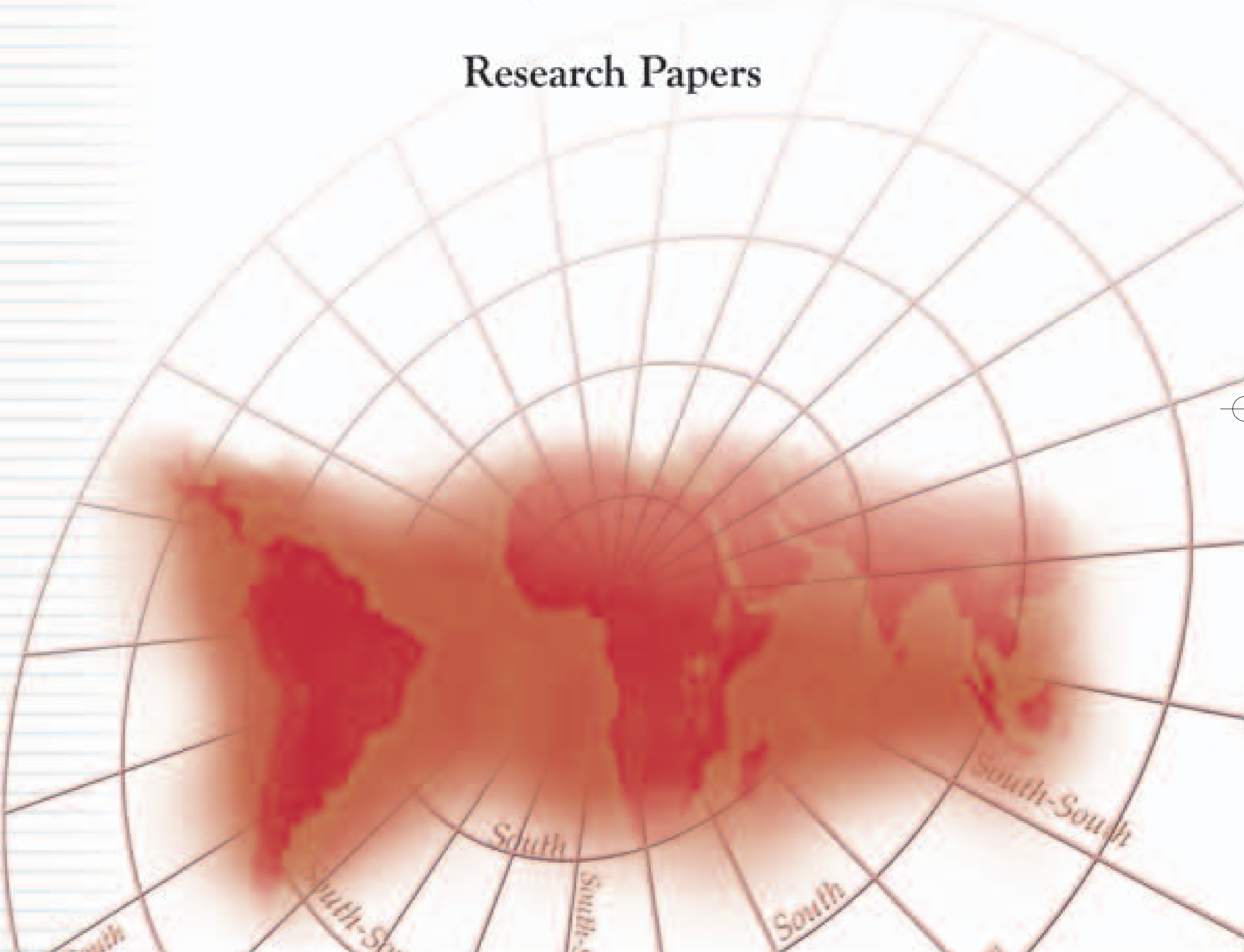

Supply-Side Measures for Raising Low Farm-gate Prices of Tropical Beverage Commodities

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SUPPLY-SIDE MEASURES FOR RAISING LOW FARM-GATE PRICES OF TROPICAL BEVERAGE COMMODITIES

This working paper was written by

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SOUTH CENTRE

NOVEMBER 2005

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ACRONYMS

CAP	common agricultural policy (EU)
GATT	General Agreement on Tariffs and Trade
GPS	global positioning system
ICAs	International Commodity Agreements
NAMA	Non-Agricultural Market Access
NGO	Non-Governmental Organizations
SAPs	Structural Adjustment Programmes
S&DT	Special and Differential Treatment

Organizations

CFC	Common Fund for Commodities
FAO	Food and Agricultural Organization
ICO	International Coffee Organization
ICCO	International Cocoa Organization
IFAD	International Fund for Agricultural Development
ILO	International Labour Organization
IMF	International Monetary Fund
UNDP	United Nations Development Programme
WTO	World Trade Organization

EXECUTIVE SUMMARY

This paper is concerned with the crisis affecting the markets of coffee, cocoa and tea, the conditions under which these three beverage crops are produced and traded, and the welfare of the men and women who produce them.

There is a common misconception that the only major reason why the agricultural sectors of developing countries have failed to thrive is that they lack access to the main consuming markets. In the case of these three crops, no tariff barriers have been raised to impede their access into these markets. As with many other agricultural commodities, the markets of these products are in crisis due to overproduction.

The international community has, until recently, failed to give serious consideration to the negative impact of changes in international trade rules, aid conditionality and agricultural development policy on the economies of many of the poorest, agriculture-dependent countries of the world. The most serious consequence of this omission has been the collapse of prices received by farmers in developing countries for the commodities they produce. In the case of coffee and cocoa, the world market price has fallen to less than a quarter of its value in 1980 and the price of tea has more than halved during that period. Falling agricultural commodity prices have been identified as the main cause of increasing poverty levels in rural communities – the bulk of the population of developing countries.

The price collapse has been felt particularly sharply by the small-scale producers of coffee, cocoa and tea and by those who work in the plantations that grow these three beverage crops. Farmers dependent on the sale of these commodities have had to reduce expenditure on the education of their children, on purchasing health care and medicines and on improving their farms. Plantation workers have had their wages cut and their working conditions made harsher. Such impoverishment is likely to have serious long-term consequences.

The countries that depend on these products for export revenue have also suffered as falling commodity prices have reduced income for investment, cut tax receipts and increased the debt burden.

The root cause of the problem has been systemic overproduction of these crops causing supply to outstrip demand.

In the past, the international community recognized the natural tendency, within the relationship between trading nations, for the economies of countries dependent on agriculture to fall behind those of manufacturing countries unless measures are taken to stabilize tropical agricultural commodity markets.

International Commodity Agreements (ICAs) were established for coffee and cocoa in the late 1960s and early 1970s but, due to a combination of producing-country disagreements and the withdrawal of support by consuming countries, the supply-control function of the ICAs was disbanded in the late 1980s. From that date, the general trend in coffee and cocoa prices has been downward.

However, the prices of coffee and cocoa are not the only commodity prices to have fallen. The prices of tea and of almost 200 other agricultural commodities exported by developing countries have also dropped. This has happened in an environment which is very different to that which pertained during the era of ICAs. In the words of the World Bank, developing countries have been obliged to "put exporters first". As part of aid conditionality and through Structural Adjustment Programmes, national development policies have encouraged increased production of exportable commodities, leading to overproduction and falling prices. As a result of this raft of policy changes most government-controlled marketing boards were dismantled. Such boards had had the function of bargaining with exporting companies but since their demise each farmer is obliged to make their own sales arrangements with buyers. This atomization of producers has considerably weakened the bargaining position of producing countries in these transactions.

In addition, throughout this period, through a process of acquisitions and mergers, the number of international trading companies in these commodities has been greatly reduced. Today a handful of companies dominates the entire trading process of beverage crops. This fact has affected the companies that process, brand and retail beverage crops. As a result, although the retail prices of these products in consuming countries have increased enormously, and the giant companies involved have boosted their profit margins, the share of the revenue accruing to farmers is now only a tiny fraction, typically half of one percent, of the retail price.

These problems have not gone unnoticed by those international agencies charged with the task of lifting rural communities in developing countries out of poverty. They have devised a plethora of strategies ostensibly designed to address the problem. These range from helping farmers to produce bigger yields, advising farmers how to use risk control measures offered by the futures markets, helping them to sell into niche markets such as organic or Fair Trade, improving quality, encouraging them to diversify into other crops, showing them how to cut costs, etc., but all these strategies have proved to be woefully inadequate or counter-productive.

The most obvious way to improve the welfare of smallholders and farm workers in developing countries is for them to gain a larger share of the total revenue available to the markets of the products they produce. In the case of beverage crops, this means that farm-gate prices would need to be improved.

It has become clear that market power along the commercial chain from farm to supermarket, has been heavily skewed in favour of the larger companies operating in the chain. For this reason this paper explores the possibility of reversing this bias and concludes that this should be done by introducing supply-side measures that would reduce production and measures that would ensure that purchasers of these products compete more aggressively with each other for the producers' output. In other words the twin market failure affecting these commodities must be corrected: namely overproduction and the systemic inequality of market power between buyer and producer.

The world's economic environment has changed considerably since neo-liberalism began to dominate all other schools of economic thinking.

International trade negotiations under the various rounds of the General Agreement on Tariffs and Trade (GATT) specifically identified key tropical commodities for special consideration. GATT's successor organization, the World Trade Organization (WTO), devotes a great deal of its time and resources to discussing agricultural issues but the emphasis of these discussions is on the need to encourage further liberalization of agricultural markets. The Common Fund for Commodities (CFC), which was established to administrate supply-side measures in order to balance supply and demand in tropical commodity markets, now has no apparatus to do so. At present, none of the international institutions concerned with agricultural trade or development have the mandate, or the inclination, to advocate measures to solve the price crisis in tropical agricultural goods.

It should be borne in mind that neither ICAs nor marketing boards were established with the primary objective of lifting farm-gate prices. ICAs were designed to stabilize prices and marketing boards were instruments used by governments to manage and control their agricultural industries, and, in some cases, to generate tax revenue.

Even if international agreement could be reached, the re-establishment of the previous design of supply-side measures used to manage these markets would not necessarily assist small-scale farmers or plantation workers. A new generation of measures needs to be designed with the specific purpose of ending overproduction and raising farm-gate prices. The weaknesses in previous designs could be avoided and mechanisms could be put in place to increase the bargaining power of smallholders and farm workers.

There are two major obstacles confronting those who might wish to tackle the commodities crisis in this way, however.

Firstly, it would be technically very difficult to adapt or create all the various institutional mechanisms needed to negotiate agreements in international forums, design detailed plans for the implementation of such measures, allocate production or export quotas and enforce competition-enhancing measures in all the producing countries.

Secondly, and more importantly, those wishing to instigate such action will need to overcome political opposition to any such scheme. Despite the scale of damage that has been done by the changes in economic policy which have allowed the prices of tropical commodities to fall so far, those institutions that implemented these policies are extremely reluctant to find fault with them. The powerful governments that support these institutions have a vested interest in keeping the cost of their imports down and the large corporations that influence the policies of these governments have a strong interest in keeping down the cost of their raw materials.

This paper attempts to describe the impact of the crisis in beverage crop markets and to offer some suggestions for how the institutional space might be widened to allow these obstacles to be overcome in order to restore an equitable balance between the market power of producers and consumers.

I. INTRODUCTION

This year has seen how governments and individuals can respond with immense energy and generosity to relieve the suffering of people caught up in natural disasters. The man-made crisis affecting the markets of tropical commodities is every bit as devastating as any of these disasters, yet not only is there very little being done to address the problem but very few people are even aware of it.

This paper is concerned with the relationship between the conditions under which three beverage crops, coffee, cocoa and tea, are produced and traded, and the welfare of the men and women who produce these commodities. An examination of this topic, however, reveals several important misconceptions in current development thinking that extend beyond the limits of the beverage crop industry. Such an examination may also offer some guidance on what kind of measures need to be taken to significantly strengthen the economic prospects of the hundreds of millions of people who make their living from the land in developing countries

The central features of the markets of these three beverage commodities have been the very significant fall in their market price over the last twenty-five years and the fact that the producers of these products, smallholders and plantation workers, are receiving a smaller and smaller share of their eventual retail price.

In the case of coffee and cocoa, the world market price has fallen to less than one quarter of its value in 1980 and the price of tea has more than halved during that period. The World Bank's monthly index of beverage crop prices (which averages prices for coffee, cocoa and tea) declined by 71% between 1997 and 2001. Although prices, in dollar terms, have increased a little since then, the value of the dollar itself has decreased by a third against other major currencies since that time.

Table 1
Commodity price changes since 1980 taking inflation into account
(Prices in US Dollars per metric ton)[1]

Commodity	1980 prices	1980 prices adjusted for inflation	2005 prices	2005 prices as percentage of adjusted 1980 prices
Cocoa	2832	6712	1506	22.4
Coffee	3989	9454	2248	23.7
Tea	1863	4415	1970	44.6

(Goods bought for $1 in 1980 would cost $2.37 in 2005 = Federal Reserve Bank of Minneapolis)
Price data – The Public Ledger

[1]The value of the US$ has fallen by 30 % against the Euro in the last three years. For those countries purchasing imported goods in Euros, therefore, the price fall has been greater by this factor.

At the same time, through a process of mergers and takeovers, there has occurred a marked reduction in the number of large, multinational trading companies, processors and retail chains involved in these industries which has reduced competition between these firms and left the producer in an increasingly weak bargaining position. This means that small-scale farmers are not only suffering from the drastic fall in the international market value of their crops but are, in many cases, also receiving a smaller share of that low price for the sales they make to their local trader – the so called farm-gate price.

Some 200 million people are directly dependent on the production of these three commodities in some 70 developing countries. The catastrophic collapse of the value of their crops has been the major cause of increased poverty levels among small-scale farmers and the reason why farm workers now receive lower wages for increased workloads. Given the large size of the populations directly involved in agro-commodity production in low-income countries, the large proportion of these populations falling below the poverty line, and the large multiplier effects of changes in income from these sources, it is clear that the price trends described have very substantial poverty impacts (Gibbon, 2005)

Some of these producing countries are almost completely dependent on beverage crops for export revenue and the fall in prices has had very serious consequences in terms of its negative impact on their balances of payments, government expenditure and increased indebtedness.

Of course, the price of any commodity falls if supply exceeds demand. And, in the case of these three commodities, although demand has increased, supply has increased at a faster rate.

Since producers have not deliberately set out to ruin the industries on which their livelihood depends, it is of the utmost importance to discover the cause of this phenomenon before deciding what measures need to be put in place to rectify the problem.

The cause of the price crisis affecting beverage crops is not unique to these commodities. Developing countries export over two hundred different agricultural products, including vegetable oils, spices, industrial raw materials, nuts and natural medicines, fibres and food additives. The market prices of almost all these products have fallen significantly. So widespread is the crisis that some commentators have described it as not only the world's most important trade issue but also the world's most important development problem.

As with all the other tropical commodities, the overproduction and consequent price collapse of coffee, cocoa and tea has been caused by the effects of a fundamental change in the measures used to balance the interests of industrialized countries and the countries that are dependent upon supplying them with cash crops.

Until the late 1980's there was an international consensus about the need to intervene in these markets which are so vital to so many developing countries. The root cause of this current market failure has been the reversal of that consensus. Developing countries have been pressured into adopting export-led economic strategies leading to overproduction, fierce competition between exporters and the consequent collapse of prices.

The effects of these strategies have not, of course, gone unnoticed. Increasing poverty among rural communities and the fall in export revenue have stimulated a number of agricultural development agencies to devise market-orientated strategies designed to address the problem but they have proved to be inadequate and even counter-productive.

The economic and political landscape of the world has changed significantly over the last twenty years and it is unlikely that the problems facing beverage crop producers could be solved merely by making another 180-degree turn in trade and development strategies. A new generation of measures needs to be considered. Here it is proposed that such measures should address the supply-side of the markets of these commodities. In other words, rather than relying on market stimulation, quality improvement and other non-interventionist strategies, steps need to be taken to give more control of the flow of production and trade of these commodities to the people and countries that produce them.

Although it may seem obvious, even to a lay person, that steps should be taken to control supplies if a glut of production is causing such distress, the current orthodox thinking in agricultural development has, as yet, set itself against such measures.

This paper attempts to trace the origins of the crisis, its cause and possible solutions. The technical difficulties associated with such solutions are considerable but well within the capacity of the producing countries and international development agencies to solve. Novel and effective solutions to this crisis face a more formidable set of obstacles, however, in the form of the lack of political and institutional means or "policy space" in which producing countries can debate their problem and have their case heard and redressed.

For this reason, this paper offers some suggestions on how this policy-space might be filled, how part of the existing institutional framework might be used for this purpose and how this space might be widened by informing policymakers of the true nature and dimensions of the crisis and its possible consequences.

II. BACKGROUND

II.1. Production and Trading

II.1.1. Production

Coffee and cocoa can only be grown successfully in tropical regions of the world and although most tea is grown in the tropics it can also be grown in some sub-tropical climates including as far north as Turkey.

About 7 million tons of coffee are produced each year and 5.8 million tons are exported from the country of origin. The equivalent figures for cocoa are 2.8 and 2.4 million tons and for tea 3 and 1.5 million tons.

The three beverage crops are grown both by smallholders and on larger farms and on plantations utilizing employed labour. Approximately 75% of the world's coffee is grown by smallholders – most plantation coffee is grown in Latin America. The equivalent figure for cocoa is 85%. The overall percentage of tea grown by smallholders is only about 7% but this varies widely from 4% in India to 60% in Kenya.

Each of these crops needs a degree of processing before they reach the supermarket shelf.

The fruit of the coffee tree must be turned into 'green' beans. This is a fairly simple process usually carried in the production area. This can be done on a small scale but the trend is towards larger processing plants. Most blending, roasting and processing into 'instant', soluble coffee is carried out in consuming countries.

Cocoa beans are produced in a similar simple process. Almost all cocoa is used in chocolate manufacturing. (Its classification as a beverage crop comes from the days when most cocoa was consumed as drinking chocolate.) Again, almost all chocolate is produced in consuming countries.

Smallholders in the tea industry simply pick leaves from tea bushes to sell on to either a large tea plantation or to a processing company where they are dried and graded. Most tea plantations, or estates as they are called, both pick and process the leaf. Although this loose-leaf tea can be used to make the drink, most tea is consumed in industrialized countries as tea bags, most of which are, again, made in consuming countries.

II.1.2. Trading

The system of trading of these commodities varies according to the countries in which they are grown, and the size of the producer.

Typically, for coffee and cocoa, the smallholders either sell their raw product to a local processor or carry out the first stages of processing themselves – often collectively. The beans are purchased from the farmer either by a local small-scale trader for onward sale to a larger trader or they are purchased by the agent of a large-scale trader. Larger-scale producers might sell directly to a multinational trading company. Small-scale tea producers usually sell their crop to a large local estate or to a processing company.

A proportion of all these products is consumed in the country of origin but most are exported in their semi-processed form, mainly to wealthy industrialized countries. Exporting is mainly carried out by large, international trading companies, some of which are vertically integrated – that is to say, they may own or control plantations, storage facilities, transport systems, processing plant and marketing companies. In the case of coffee and cocoa, the benchmark international price is arrived at by trading on commodity futures markets in London and New York. The benchmark price for tea is arrived at by trading in several auctions located in the main producing areas.

Most of the world's outputs of these three commodities are blended, e.g. one variety or origin of coffee is mixed with another to arrive at a product with the desired taste. The product is then fully processed and packed for sale by a specialist company or branch of a multinational. Such companies may have been responsible for branding, advertising and marketing the product to retail outlets. Equally, this marketing exercise may have been carried out by separate companies who contract out the processing operation to the specialist company.

At present, the retail price of the product is now only slightly related to the price received by the smallholder or the wages received by plantation workers. Retail prices have climbed in line with general inflation over the last 25 years while the farm-gate price has plummeted and farm wages and conditions have significantly deteriorated. A smallholder will typically receive only about half of one per cent of the retail price.

Before looking at the cause of this apparent iniquity associated with changes in trade rules and economic strategies, it needs to be understood that there are many layers of costs between the farm gate and the supermarket shelf.

The product has to be packed and transported to a port by the small-scale trader, who also needs a profit margin. Exporting requires a certain amount of quality testing, certification and bureaucracy associated with shipping and payment. The product then needs to be insured and shipped to the destination port where it is unloaded and transported to the processing plant. Once processed, the goods have to be packed and labelled and transported to a distribution warehouse before being taken to the retail outlet for sale. The final product also needs to be branded, marketed and advertised. Each of the intermediaries and service-providers in this chain take a profit margin.

In the case of coffee, the cost of getting the beans to the processing plant is about ten times the price paid to the farmer. Once the coffee has been processed and placed on the supermarket shelf, its sales price is about 200 times the price paid to the farmer. In other words, nearly all the money paid by the consumer goes to private companies based in or near the consuming country.

Of course, if the product could be processed, packed, labelled and branded in the country of origin a very much larger fraction of the retail price would accrue in that country. The fact that this very rarely happens is a topic that will be discussed later in this paper.

II.2. The Problems and Root Causes

II.2.1. The Problems

(a) Oversupply

It has long been recognized that the terms of trade between countries that depend on the export primary commodities and those that export mainly manufactured goods and services will always be in favour of the latter. The hypothesis put forward by Raul Prebisch and Hans Singer in the 1950s, which gave rigorous intellectual support to this notion, has now become universally accepted even by the conservative economists of the World Bank and the International Monetary Fund.

The implication of this phenomenon is that, if countries fail to diversify away from primary commodity-based economies, they will fall further and further behind their industrialized counterparts. Such an event was once considered to be politically and economically destabilizing for the world as a whole and measures were put in place to ameliorate the problem.

GATT waivers to allow market control measures in certain tropical commodities were agreed in the mid 1950s. International Commodity Agreements (ICAs) were established between the major producers and consumers of a number of key commodities which included coffee and cocoa.[2] In addition, individual producing countries exercised control over their exports through state-controlled marketing boards, which not only set domestic prices for farmers of the commodity in question, but were also responsible for negotiating sales contracts with international trading companies for the export of these goods.

These supply-side measures ensured that the international prices of the commodities covered by the agreements stayed within narrow, pre-agreed price bands which were acceptable both to producing and consuming countries. In the case of coffee and cocoa, these price levels were, in real terms, considerably higher than today's levels.

Although the effect of these measures was positive, in that they ensured an acceptable income for the producing country, they did not provide an ideal solution to the problems faced by farmers and farm workers.

The design of the ICAs depended on allocating export quotas to producing countries and, in periods of unforeseen oversupply, surplus stocks were financed mainly by consuming countries. These features weakened the effect of the agreements. Producing countries regularly argued between themselves over export quotas and, since consuming countries were mainly responsible for financing and storing any surplus stocks, they had the power to alter the agreements at any time. When they withdrew their support for any price-correcting mechanisms contained in the agreements, prices began their fall to today's low levels.

The practical demise of the ICAs meant that, although farmers received only a fraction of the eventual retail price of the product, the value of that fraction fell to much lower levels.

State-controlled marketing boards had many faults but they fulfilled a vital role for the producing country. They acted as an intermediary between the farmer and the international trading companies who purchased the commodity in question. The boards employed experienced sales managers and could bargain from a position of strength because they controlled sales from the entire nation. The other ancillary roles of the boards – provision of inputs such as fertilisers and pesticides on credit, also directly benefited farmers. The fact that they bought from the farmers at a fixed price for each season also meant that farmers did not have to worry about fluctuating prices.

Unfortunately, many governments used the boards as a tax-raising instrument. Although the boards may have made sales at the true market price, they paid the farmers far less. In addition, many boards became over-bureaucratic and even corrupt. Nevertheless, when most marketing boards were swept away, in aid conditionality deals of structural adjustment programmes, farmers were required to do their own marketing individually, which has put them in a very weak bargaining position.

[2] An international agreement to limit tea production was established after overproduction had caused a price collapse in the 1920s but the agreement was finally abandoned in 1934 after wide-scale non-compliance with the agreement even among signatory countries.

The 1980s saw the beginning of another change affecting all tropical agricultural commodities. As part of the conditions for receiving aid, loans and grants from the Bretton Woods institutions, developing countries were obliged to adopt a raft of economic policies under Structural Adjustment Programmes (SAPs). These neo-liberal measures reversed the previous consensus which prioritized the stabilization of commodity markets and an understanding that countries would be allowed to protect vulnerable producers from foreign competition.

The stated aim of SAPs was to make local industries more globally competitive. This was to be achieved by exposing them to international competition and reducing any burden placed upon them by government. In addition, growth was to be achieved by increasing exports of those products in which the country was deemed to have a competitive advantage. In the words of the World Bank, governments were to "put exporters first". Since the only products that were exported from these countries were agricultural commodities, this was the category of items in which exports were to be boosted. This was achieved by offering tax incentives and grants to exporters, by concentrating farm assistance to producers of export crops and by lowering exchange rates against those of other currencies. The resulting increase in world supplies has been a key factor in the price collapse of coffee, cocoa and tea.[3]

(b) Market concentration

Throughout this period another aspect of the markets for these commodities is rapidly changing. The number of multinational companies trading in these commodities has fallen dramatically. As with many other industries, the more successful trading companies have put less successful companies out of business and, in addition, companies have merged with each other to increase economies of scale and pool their market intelligence and resources. This phenomenon has been repeated in the processing and retail links of the market chain.

In the case of coffee, the market is dominated by two sets of key players – traders and roasters. Just three international traders, Neumann, Volcafe and Cargill, control about one third of the market share and the top six traders control half of it (Oxfam 2003, Ponte 2001). Just two coffee-roasting companies, Nestlé and Philip Morris produce half the world's roasted and instant coffee.

In 1980 there were more than 30 large-scale traders in cocoa in London alone. Today just four companies, Archer Daniel Midland, Barry Callebaut, Cargill, and Hosta, account for 40% of global cocoa processing. Around nine companies account for 70% of total capacity.

Table 2

Product	**1980 prices**	**2005 prices**	**2005 prices as percentage of 1980 prices**
Jar of instant coffee (200g)	£2	£4.44	+ 222 %
Chocolate bar (Kit Kat)	13p	35p	+ 269 %
Box of tea bags (80)	52p	£1.37	+ 263 %

UK Supermarket prices (J.Sainsbury)

[3] India, the world's largest tea producer, still exercises some control over domestic production. The Tea Board of India can, and does, force states to stop harvesting tea if it considers that overproduction is harming the market in any particular season. Such unilateral action has not resulted in controlling the tea price, however, and Indian tea producers are facing increased competition from Sri Lankan growers.

This market concentration, as it is called, has had two main effects on suppliers. Firstly, there is less competition between buyers of their products. In some cases whole regions are reliant on a single trading company. Since competition laws are unenforceable in many poor countries which, anyway lack the resources to mount investigations, it is impossible to say whether these companies collude with each other to keep prices from suppliers down. Similarly, the reduction in the number of processors has reduced competition in this sector too. The increased profits of both trading and processing companies over the period of the price collapse of tropical commodities appears to demonstrate that market concentration has benefited these companies.

Giant supermarket chains now represent an even stronger player than traders and processors in these markets. In some consuming countries three or four of these chains represent up to 80% of the retail outlets for beverage commodities. They have the power to force down the price of their supplies yet they too are able to post significant increases in their profits.

Even though retail prices of beverage commodities have increased, the supermarkets, processors and traders have demanded cheaper and cheaper sources of supply forcing farmers and plantation owners alike to sell at lower prices.

II.2.2. Root causes of the problem

Even a superficial examination of the crisis in the beverage crop industries points to two main market failures.

- Overproduction of these commodities, to a point where supply and demand are out of balance, which means that farmers produce more and more for a diminishing return – technically known as a *fallacy of composition*.

- Reduced competition and a gross imbalance of market information between buyer and seller means that farmers retain a smaller and smaller share of the value of the product.

Both these failures have occurred as protection for these industries has been withdrawn to comply with the new economic orthodoxy of the market liberalization.

The secondary effects of this loss of protection have been:

- Smallholders produce more in order to maintain income.

- A systemic oversupply of beverage commodities.

- A move towards larger farms using less labour.

- The adoption of more efficient farming techniques – which, out of this context, might once have been seen as a positive, workload-reducing development.

- The cutting of costs by plantation owners – meaning a cut in the pay and conditions of employment.

- Producers receive a lower proportion of the market price.

- Consuming countries obtain plentiful and cheap supplies of these products.

All the international development agencies are fully aware of the devastation caused by the collapse of beverage crop prices but none, so far, have considered applying any supply-side measures which would return prices to equitable level by once more balancing supply with demand.

The way that these agencies are responding to the crisis will be covered in more detail in the next section of this paper but the main strategy has been to encourage individual groups of farmers to adopt techniques which increase yields which have, in turn, added to global oversupply. These agencies have also encouraged lower-cost producers to sell at a loss until high-cost producers are driven out of the market.

Another strategy has been to encourage farmers to diversify into other crops. Increased production of these items has caused their prices to fall also.

Otherwise, great emphasis has been put on the need to stimulate demand by product promotion, niche marketing and organic production. In addition, these agencies have recommended measures which make internal markets more efficient, often involving a reduction in government bureaucracy and tax rates.

Very few institutional mechanisms have been put in place to ensure competition between trading companies, nor to provide farm credit, which is rarely available in the poorest countries, nor to ensure that farmers strengthen their bargaining position. Even those negative consequences of market liberalization, that orthodox economists recognize as needing solutions, have been largely ignored. Funding for the provision of market information for typical small-scale farmers is paltry and although the low economies of scale associated with traditional farming is recognized as an impediment for farmers, very little effort has been made to assist farmers to market their goods collectively.

Institutional constraints

One of the characteristics of developing countries is their lack of institutional resources.

Although laws may have been put on the statute books to outlaw collusion and other forms of anti-competitive behaviour among traders, many countries do not have the mechanisms to enforce them.

Most deals in these commodities are cash transactions. Most small-scale farmers are not familiar with sales or purchase contracts and, even if contracts were more widely used, the legal systems of many of these countries lack the resources to enforce them.

Products can be rejected by larger traders on quality grounds but suppliers have no access to impartial testing laboratories to dispute the rejection. Buyers often need to be able to trace the origin of a particular parcel of a commodity back to the farm it came from if, say, some serious quality problem occurs, but in circumstances where such a parcel could be a mixture of product from a hundred farms, this task is made almost impossible.

Farmers, who usually have no access to communications equipment, often do not know the latest market price for their crops in the nearest town, let alone prices on the New York commodities markets. Postal services and the distribution of literature are far too slow and unreliable to be suitable for disseminating market information even if it could be collected. In fact, the advent of modern electronic communications systems, which can only be afforded by comparatively rich traders, has widened the information gap between buyers and sellers.

More importantly perhaps, the skills and experience base within the population of these countries is very low. Very few individuals understand how to put business plans together to attract investment. They cannot respond to requirements to change the product to suit changing patterns of demand. Often, they even lack the skills to persuade their fellow farmers to join with them to sort, grade, pack and market their goods.

Many government agencies in these countries are weak. Even if governments agreed to tackle the problem of oversupply, many lack the skills and resources to control production and exports. In any event, most developing countries are dependent on aid and cannot afford to adopt policies designed to protect their agricultural sectors for fear of losing their share of the aid budget.

It is, however, on the international stage that the absence of an appropriate institutional apparatus most seriously impedes progress in finding a solution to the commodities crisis.

Most forums for debate are heavily influenced by the interests of consuming countries. Even collectively, poor producing countries appear to lack the resources to commission the necessary studies needed to find a remedy for their problems.

II.3. The Impact of the Problem

II.3.1.Farmers in today's market environment

Almost all producers of the three beverage crops work tiny plots of land using only family members as their work force and can only produce a few hundred kilos of the commodity each season. Very often, the beverage crop is grown only to raise cash while the rest of the farmer's land is used to grow food crops or graze a few head of livestock.

Private sector traders have taken over the function of the marketing boards but the local markets for these crops have not evolved to the level of sophistication, transparency and competitiveness of equivalent markets in industrialized countries.

The lack of transport, roads, communication systems, packing materials, credit and fixed market places often means that farmers are isolated from the main centres of trade and know little about up-to-date market prices. The quantity of the harvest in any area may be very small and the farms may be difficult to access. This often means the amount of business available only justifies the attention of a single trader and, without competition from other traders, farmers must sell at almost any price the trader offers. Indeed, reports of collusion among traders are commonplace.

Small-scale local traders may not be able to weigh, sort, pack or transport the commodity very far and must sell the products they have bought from the farmer to a larger-scale trader. There maybe as many as five transactions between the farmer and the exporter and each trader in the chain must reserve a profit margin for himself. Multiple handling costs and wastage add to the difference between the price paid to the farmer and the price paid by the exporter.

Although marketing boards did not serve the farmer well, they at least raised revenue for the country and eliminated the need for farmers to spend time bargaining one-sidedly with traders.

Since the dismantling of ICAs, the market price of these crops has become very volatile and since multinational traders have a far superior knowledge of price movements than farmers or intermediary traders, they can buy during a period of low prices and refrain from buying when prices are high. Where once marketing boards extended credit to farmers in the form of inputs, the private sector now remains the only source of credit that farmers can depend on to tide them over between harvests. Farming is an inherently risky business, however, and private banks have no inclination to lend money to farmers with little or no collateral. Some traders are prepared to pre-pay for beverage crops but often at usurious rates of interest.

Low prices are the farmers' main problem. Many can no longer buy medicines for their family, send their children to school or purchase inputs to improve their farms. If they have the space on their farm, they may try to increase output but this only adds to the global oversupply problem which lowers prices further. Many international trading companies are now complaining that the quality of the product, especially coffee, is falling. This, perhaps, should come as no surprise given that farmers can no longer afford to improve their crop and the marketing boards, that once regulated quality, no longer exist.

Plantation and farm workers are, if anything, worse off than typical smallholders producing these crops. They usually have no access to land to farm for themselves and, even if they have the skills to do other work, there are few other jobs available in alternative industries. They often depend entirely on the plantation owners not only for their wages but also for housing and the education of their children.

Numerous reports have been written documenting the exploitation and increasingly harsh conditions suffered by workers in all three of these industries. Many workers who refuse to work under the more onerous conditions imposed by plantation owners have been summarily dismissed, to be replaced by cheaper, casual labour. Children are widely employed in all three industries. In 2002, the World Bank reported that some 600,000 Central American coffee workers had recently lost their jobs. Twelve-hour workdays are common.

Plantation workers have had to pay for their children's education, housing and even clean water, when once it was part of their income package. Many of Malawi's tea estates no longer offer agreed payments to workers who are ill. (Line Eldring 2003). Where workers are unionized, union officials have often been victimized and agreements with workers have been reneged upon causing considerable labour unrest. Increased incidences of malnutrition, higher workloads and wages falling to below legal minimum levels, have also been reported. (Oxfam 2002, Anannya Bhattacharjee 2004)

II.3.2. The impact on producing countries

The collapse of commodity prices causes the obverse of an economic multiplier effect. As farmers and farm workers have less money to spend, local businesses lose trade or shut down. As businesses close, less tax is generated. The consequent fall in government spending causes more jobs losses and if these spending cuts affect health, education and welfare provision, then the loss of human resources means that the country slips even further behind the rest of the world in terms of its future prospects.

The crisis is also causing severe cultural and environmental problems. As incomes fall in the countryside, more rural people move to already overcrowded cities to try to find work. These are often younger and healthier members of the community which changes the demographic and, often, ethnic profile in different areas of the country and, in turn, causes a breakdown of cultural integrity and traditional family obligations, which once acted as a social safety net.

The displacement of such large numbers of people is also seen as one factor in the spread of HIV/AIDS. In contrast to historic examples of urbanization, such as after the Enclosure Acts in Britain, most poor countries have no alternative industries in which people can find employment.

Rural and urban poverty and unemployment have been seen as a major cause of internal strife and conflict as witnessed in Zimbabwe, the Sudan and Rwanda.

As prices fall farmers try to use more fragile, marginal land to increase their production, which leads to environmental degradation. In addition, many farmers are being displaced from their locations by larger farming interests. Many such farms attain any increased efficiency by importing machinery, which adds to the burden on the countries' balance of payments. The agro-chemicals and other modern farming techniques, used by such farms can also damage the environment.

It should also be noted that beverage crop prices are notated in US dollars and over the last few years the US dollar has lost a third of its value against other currencies. The quadrupling of oil prices, the main imported item for most developing countries, has added to the tremendous economic burden of these countries.

III. SUPPLY-SIDE POLICY OPTIONS

So what measures could be taken to address the crisis in beverage crop markets? Indeed, can anything be done?

In order to answer these questions, we should first look at the strategies being used at the moment to assist farmers and farm workers suffering from the effects of low farm-gate prices. We should then examine in more detail the objectives of any additional measures required. Since any such action is regarded as controversial, we should look at those arguments put forward in opposition to such action. Only then can we decide if other new measures are desirable and feasible. On the assumption that this is the case, we can start to offer some suggestions for what measures are needed, how opposition to them could be overcome and how they could be implemented.

III.1. The limitations of existing strategies to increase farmers' incomes

There are many thousands of organizations working on behalf of farmers and farm workers in developing countries. These range from giant institutions like the United Nations Food and Agriculture Organization (FAO), down to local agricultural extension services and trades unions. They are all charged with the task of improving the welfare of the producers in areas such as policy advice to governments, provision of training, market analysis and crop research. They have adopted several main strategies to try to achieve their objectives.

III.1.1. Reducing barriers to trade

It is a commonly-held belief that if all barriers to trade in agricultural commodities were lifted – and this refers to trade barriers erected by wealthy countries – the agricultural problems of developing countries would disappear and farmers in these countries would be far better off. Indeed, great emphasis has been placed on the need to reduce such trade barriers by orthodox economists and the Bretton Woods institutions, in the WTO and other trade negotiations.

In fact, very few products grown in the tropical regions of the world, where almost all developing countries are located, can also be grown in wealthy temperate countries. The major exceptions are cotton, rice, sugar (beet and cane) and tobacco.

No major importing industrialized country produces coffee, cocoa or tea. This means that there are no import tariffs applied to the three beverage crops by major importing countries. A trading impediment does exist in the form of escalating tariffs, however, where higher import duties are levied on processed beverage crop products from developing countries such as chocolate, soluble coffee, etc. With the advent of the European Union's (EU's) "Everything but Arms" initiative and similar initiatives, however, least developed countries are exempt from paying import duty even on these processed products.

In other words, the lifting of any trade barriers on other agricultural products may help sugar, cotton, rice and tobacco producers in some developing countries but it would give no benefits to producers of beverage crops.

III.1.2. Alternative market niches

(a) Fair trade

Another strategy which has been recommended to increase farmers' income has been for them to develop specialist markets.

The most directly relevant of these has been the Fair Trade market. Here the idea is to harness the genuine concern of some consumers for the plight of rural communities in developing countries by offering them brands of products, which distinguish themselves from other brands by claiming that the primary products from which they have been made have been bought from the producers at prices that are significantly higher than prevailing market prices.

On the face of it, this is an excellent idea and Fair Trade organizations are able to recount many examples where the lives of individual groups of farmers have been transformed with the additional cash they have received for their goods.

There are several limitations, however, on the usefulness of this strategy. Firstly, after 20 years of marketing Fair Trade products, this market niche still only represents a tiny proportion of trade in the products, less than one per cent in the case of beverage crops, and figures show that the market for these products has peaked. (Oxford Policy Management 2000)

It is also possible that governments and international development agencies may abrogate responsibility for taking action to tackle the commodities crisis by suggesting that the solution lies in the hands of the consuming public.

(b) Organic products

Another recommendation has been for developing countries to respond to the opportunities represented by the growing market for organic products. Consumers in the Western world are prepared to pay up to 50% more for products free from synthetic chemicals because, firstly, in the case of edible products, they think that such chemicals will damage their health and secondly, even in case of inedible commodities, like cotton, they are concerned about damage to the environment caused by these chemicals. The market is very small, about one per cent of consumption, compared to the overall market for conventional products but it is growing.

In fact, many farmed products from the developing world are organic simply because the farmers cannot afford to pay for artificial fertilizers or chemical pesticides. Organic beverage crops can be, and are being, produced which can be sold at a premium price. Unfortunately, consumers of organic products are not prepared to take the word of the farmer or trader that the product is truly organic and they insist on certification by independent organizations. The cost of obtaining such certification, even for small quantities, is about US$ 1,000 – far beyond the means of a typical small-scale farmer in a developing country.

(c) Other niche markets

There are a number of other niche markets for beverage crops, mostly based on quality or on a distinctive taste.

Some of the larger trading and processing companies have complained recently that the quality of the beverage crops they buy is falling. This, perhaps, should come as no surprise given that the producers are being paid such low prices. The quality of all three products can be improved using a number of techniques and higher quality crops command higher prices. These quality-enhancing techniques, however, usually require a great deal of extra labour and, sometimes, extra investment. There is, therefore, no great incentive for the farmer to improve quality.

Niche markets are, by definition, small. Some fortunate producers may be able to produce a distinctive product because it is grown at a particular altitude or on some unusual soil or, merely because some entrepreneur has used a clever branding campaign. This strategy cannot, however, be described as anything like a useful response to the market crisis in beverage crops.

(d) Price risk management

Concerned with another price related phenomenon which makes life difficult for producers – namely price volatility – the World Bank and UNCTAD pioneered an initiative which gave access for tropical farmers to the futures markets where the price of various commodities are fixed. The futures markets offer a range of sophisticated mechanisms for ensuring that producers never receive less than the current market price – a kind of insurance system. All the very large producers and traders of those few products which are traded on futures markets regularly use these facilities.

The World Bank and the UNCTAD schemes revolve around the provision of training producers on how to use these mechanisms and in funding part of the brokerage costs. Since a minimum transaction is about US$ 30,000 for coffee and cocoa, only very large producers can take advantage of the scheme and, in any event, these techniques cannot do anything about restoring higher absolute prices. Tea is not traded on any futures market.

(e) Horizontal diversification

This strategy has been used extensively over recent years and involves encouraging farmers to grow an alternative cash-crop to augment their income. Farmers in Vietnam have been encouraged to grow coffee. Coffee farmers in Uganda have been persuaded to grow vanilla. Tea producers in Kenya have been helped to grow chilli peppers, and so on.

This strategy is known a horizontal diversification and it is usually recommended following the fall in the world price of the main commodity produced by a group of farmers. The agricultural development agency working with those farmers then looks for a commodity with what appears to be a stronger market. Of course, the increased supply of this alternative crop immediately reduces its market price and in this way the market crisis spreads from one commodity to another.

(f) Increasing productivity and output

The most common type of assistance offered to farmers takes the form of increasing productivity and output.

Over the last decade, for instance, the French and German government-controlled development agencies have funded programmes to help Vietnam, once a minor coffee producing country, to become the world's second largest exporter. The Common Fund for Commodities (CFC), a UN-linked organization working with the International Coffee Organization (ICO), is spending millions to increase coffee production in many countries.

Field workers employed by agricultural development agencies spend a great deal of their time assisting the local farmers to use more productive varieties and varieties that are less prone to disease and training them to grow more of a product on a given area of land. Such assistance is given in good faith and may help the local group to increase their overall income but, of course, the resulting increase in production only exacerbates the global glut of the product.

A tiny proportion of the world's producers do benefit from selling at higher prices to Fair Trade and organic outlets but, it can be seen that none of the above strategies can address the crisis in beverage crop markets adequately. Indeed, some of them contribute to the crisis.

III.2. The role of supply-side measures in increasing low farm-gate prices

III.2.1. Objectives

Since current strategies are failing to increase the income farmers and farm workers receive, we need to consider what kind of additional or alternative measures could be put in place to achieve this objective and what, exactly, would they be designed to achieve.

The very simplest rule in economics is that prices rise when demand exceeds supply and fall when supply exceeds demand. A low price is supposed to stimulate demand and reduce supplies whereas a high price is supposed to reduce demand and increase production. In this way the market is supposed to "self-correct" until supply and demand are balanced at a price level that offers a small profit to the producer but does not stifle demand.

As we have seen, however, these assumptions are not valid in the case of beverage crops.

Producers have to go on producing, and even increasing output, when prices fall - just to maintain their income. Since the cost of the "raw material" (in this case coffee and cocoa beans and the leaves of the tea bush) represents only about half of one percent of the retail price of the product, the raw material price can change enormously without any noticeable impact on demand. For this reason these markets are described as "inelastic".

With this point in mind, we can proceed by asking how supply-side measures might be used to increase farm-gate prices.

Clearly, in the case of beverage crops, over the last two decades supply has outstripped demand causing their market prices and farm-gate prices to fall. In examining the role of supply-side measures, however, we have to look at two main objectives:

(a) Objective 1

The first objective must be to stabilize market prices at a higher level. This could be done either by increasing demand, or cutting supply. Low raw material prices cannot and have not stimulated demand nor have the massive promotion and advertising campaigns of the beverage industry. In fact, a major objective of coffee companies has been to persuade people to drink coffee rather than tea and vice versa. So we are left with the remaining option – to control supplies. In the past, this was achieved with ICAs in conjunction with state-controlled marketing boards.

(b) Objective 2

The second objective must be to make sure that an increase in the market price is reflected in higher farm-gate prices. To achieve this aim it will be necessary for the buyers of the products to compete more vigorously for the farmers' crops. Competition would be stimulated if oversupply could be eliminated but the increased concentration of the number of traders, processors and retailers means that such an outcome can no longer be guaranteed. In the past, mechanisms were not put in place to maximise farm-gate prices although, in the era of the ICAs, farm-gate prices were generally higher because market prices were higher.

It seems clear that the market, as presently regulated, will not achieve either of these objectives. If, therefore, something is to be done about the failure of the market to distribute the proceeds of these industries appropriately, new or additional rules or other measures would have to be put in place.

Before looking in more detail at the possible nature of such measures, we should recognize that significant changes have occurred in the political and economic landscape since the late 1980s. Some observers believe that the trend towards a globalized market-place and the liberalization of trade now makes it impossible to intervene even in cases as serious as this. Some economists have ideological objections to any change of direction in the march towards a fully globalized economy. In the next two sections we will examine the possible obstacles in the path of establishing measures designed to lift farm-gate prices

III.2.2. The prospect for solutions

(a) Obstacles and counter-arguments

Some significant changes have occurred in these markets since the demise of International Commodity Agreements in coffee and cocoa in the late 1980s.

- Firstly, of course, the International Commodity Agreements have essentially been eviscerated.

  Consuming countries were never particularly enthusiastic about them (indeed the United States was not even a participant in the cocoa agreement but still managed to modify the agreement in its favour) and when the recent great sea-change in economic thinking began to be reflected in the development policies of the wealthiest nations, the ICA's had little chance of survival in their existing form. Since these countries could make the greatest contributions to financing surplus stocks in periods of overproduction, they were in a powerful position to influence renegotiations of the agreements. Throughout the lifetime of the agreements, producing countries had argued with consuming countries and with each other over quota shares, stock and finance contributions and the floor and ceiling price. Continued quibbling became a contributing factor for the decision of the consuming countries to act. The end came when consuming countries withdrew their support for the so-called economic clauses of the agreements – that is to say, those clauses concerned with the function of stabilizing prices.

- Secondly, after 25 years of efforts to liberalize the economies of developing countries, through Structural Adjustment Programmes and other means, developing countries no longer have the centralized institutional mechanisms, such as marketing boards and agricultural extension, which were once used to organize the flow of inputs, outputs, credit, research, market information and training. In most developing countries, it is expected that all these services will be carried out in the private sector.

- Thirdly, through the GATT and WTO rulings and the conditionality attached to World Bank, IMF and other multilateral and bilateral agreements, the entire global economy has become more liberalized. Most currencies are convertible with others, tariff barriers have fallen somewhat and countries are prevented from taking unilateral action to protect some aspect of their trade, industry or to alter their internal economic policies.

- Fourthly, while the power of individual producers has atomized, market power has become massively more concentrated towards the retail end of the commercial chain.

All these factors would seem to suggest that any attempt to establish mechanisms to regulate beverage crop markets would be very difficult.

On the other hand, other changes that have occurred over this time period may have provided better opportunities for bringing in such measures.

- First, and foremost, the dimensions of the commodities crisis represent a significant spur to even the lowest-cost producers to find some way out of their horrendous predicament.

- Secondly, some by-products of the crisis, such as the surge in narcotic drug production, emigration, disease and conflict, are all issues that the governments of even the wealthiest countries are becoming increasingly alarmed about. This may mean that these countries might be won round to the idea of addressing the issue seriously.

- Thirdly, there is a significant shift in public thinking towards a more sceptical view of the globalization process, including its impact on the environment, the growth in power of unelected and unaccountable transnational corporations and the fact that that economic liberalization has signally failed to reduce levels of poverty in developing countries.

- Fourthly, the exponential evolution of computer capacity, global positioning systems (GPS), electronic communication systems and other advance technologies, offer the prospect of organizing complicated tasks, such as the administration of supply-side measures, more easily than in the 1980s.

Although it is clear that much of the institutional apparatus, which was once used to bring some order to beverage crop commodity markets, has disappeared, the incentive to reintroduce a new generation of measures to help farmers is greater than ever. Can an institutional framework be constructed to assist in this task? We will return to this question later.

(b) Two sides of the argument

The dispute between those who oppose supply-side measures and those who support them could be described as ideological but both camps claim to offer the best solution. What we need to know, however, is which argument is most likely to serve farmers' interests by raising farm-gate prices.

The opponents' main arguments are:

(1) That if supply-side mechanisms were established to support the price of beverage crops, producers and producing countries would deepen their dependency on an inherently weak industry.

(2) That, without intervention, prices will eventually reach some kind of equilibrium once inefficient producers are driven out of business by low prices.

(3) That any future arrangement for controlling prices through the management of supplies is doomed to failure because some producing countries will take advantage of others by not joining the agreement and continuing to sell all they can produce – so called "free-rider" activity.

(4) That individual producers will smuggle more than their allocated share of production out of their countries.

(5) That the process of allocating quotas will quickly become corrupt, by officials seeking and receiving bribes in exchange for higher quota allocations.

(6) That the level of bureaucracy involved in managing these markets will be too costly and complicated.

(7) Some objectors have suggested that, under current WTO rules, the imposition of trade restrictions or the use of export taxes, which might constitute an element of such measures, are not legally permissible.

Let us look more closely at each of these opposing arguments.

(1) Farmers are already dependent on these crops for their livelihood. Many farmers would dearly love to find another source of income but they lack the skills to work elsewhere, even if jobs were available. One Indian farmer interviewed by Action Aid for their 2005 report "*Tea Break: A crisis brewing in India*" explained that "We can't pull out of tea; it was such a huge investment." If prices for their beverage crops were higher, however, many farmers could be expected to find it easier to pay for education and training and to save enough to invest in some other business. Higher local incomes would help to secure customers for such businesses.

(2) It is true that some producers are going out of business but they are not necessarily the least efficient producers. Even large, efficient farms may have to pay dividends to shareholders but, with prices so low, this may now be impossible and they may well go out of business. Inefficient smallholders, however, may be so desperate to earn at least something from their crops that they continue to produce even on starvation wages.

It is simple to say that inefficient producers will be driven out of business but what this means is that large numbers of the poorest people in the world will be denied any opportunity to earn a cash income from their labour.

Criticisms 3, 4, 5 and 6

All these problems have been encountered on all other supply management arrangements, including De Beers diamond cartel, but it has not significantly impaired their ability to maintain agreed prices.

(7) No one seems quite sure whether the De Beers diamond cartel could or should be outlawed. Certainly, if all De Beers stock of gem diamonds were to be sold, the price of diamonds would fall to the price of glass and several diamond-producing countries would be reduced to penury. The EU's Common Agricultural Policy (CAP) is a form of supply management but it has been granted a waiver under WTO rules. Some clauses in GATT which remain part of international trade law specifically allow producing countries to intervene to maintain equitable commodity prices. In any event, if some legal impediment can be found to prevent any such action, it could be repealed.

For instance, Article XX(h) of the GATT agreement refers back to the Havana Charter which states that commodity agreements should involve both consuming and producing countries. Clearly, such an impediment would limit the policy space for producing countries to act. Consuming countries proved to be unreliable partners in previous ICAs and there is no guarantee that they would be more reliable in the future. Such an impediment appears to contravene the rules of GATT 1994 which allow action to stabilize prices. Whatever the precise legal position is on this question, producing countries have a right to demand the correction of any rules that allow market failure in their vital industries.

It should be said also that many of those arguing against supply-side intervention have some vested interest in maintaining the *status quo*. The United States is a major consumer of these products and has a long history of opposing such agreements. As the major shareholders in the World Bank and IMF, the largest consuming countries have significant influence over these institutions' policies. Individual trading companies also have a vested interest in ensuring a plentiful and cheap supply of these products. A spokesperson for Sara Lee, a company with US$ 20 billion sales revenue in 180 countries and owner of five top coffee brands, said "Sara Lee is uneasy about price support. The market needs to equilibrate on supply and demand. We believe that the best solution (is)…to be found in the improvement of coffee quality at the local level." (Oxfam 2002)

More importantly perhaps, the arguments put forward by opponents of the introduction of supply-side strategies do not even attempt to address the problem of low farm-gate prices.

III.2.3 Can the obstacles in the path of new measures be surmounted?

When earthquakes or floods devastate some area of the world, emergency services are marshalled immediately to rescue survivors, supply food and drinking water and build shelters. Specialist teams fly in from other countries at a moment's notice to find people buried in rubble and appeals are launched to raise money for the victims. Nobody asks whether such assistance violates any economic policies.

It may be that swirling floods and rescue teams braving collapsing buildings make better television pictures than hundreds of thousands of children slowly dying for want of medicines, but the crises in the beverage crop markets are every bit as devastating and considerably more widespread than the worst of these disasters.

Some economists seem to assume that the problem of the collapse of commodity prices and its solution is, somehow, beyond any human agency. The market, they believe, is some natural force akin to gravity. They ignore the fact, perhaps, that no market, especially in agriculture, could begin to work unless it is regulated and that this regulation determines how the market works and in whose favour.

At a recent meeting in Barcelona, Niek Koning and I submitted a paper entitled "Supply management for supporting the prices of tropical export crops". Another participant suggested that the paper be retitled "Where there is a will, there is a way". This, I believe, neatly sums up the arguments about addressing the beverage crop crisis. Most participants at that meeting agreed that, although there would be considerable technical difficulties in constructing measures to address the problem, the most formidable obstacles are, in essence, political.

What objectors really have to bear in mind is the cost of doing nothing, in terms of poverty and aid-dependency, in increased resentment, conflict, emigration and supply of narcotic drugs.

Since, at least in this paper, we are interested in what might be done, we will now look at our options in more detail.

Correcting market failure

As outlined above, the measures needed to address low farm-gate prices for beverage crops are really the measures needed to tackle the two forms of market failure in these industries – overproduction and lack of competition.

(a) Oversupply

Overproduction is a common feature of many industries. When demand falls for, let us say, automobiles, some car manufacturers will suffer losses. Companies in this situation will do their best to cut costs but they are constrained in most countries from cutting wages too far by labour laws, trades unions, minimum wage legislation and so forth. If cost-cutting and efficiency measures are not sufficient to stem the company's losses, the management of the company will close loss-making factories. In most industrialized countries, workers who have lost their jobs will receive a lump sum redundancy payment and government money will be made available for retraining workers. In any event, other jobs are available in similar industries.

The effect of the management's action to close the car factory is to reduce supplies. This type of action is not considered to be "market intervention", but rather the opposite. It is seen as part of the normal way markets work in modern times.

Let us now compare this example with the example of say, small-scale coffee growers in Uganda.

These smallholders know nothing of profit and loss accounts or balance sheets. Their costs are measured by the sweat of their brow. They are in no position to "close their factory down" – in this case cut their coffee trees down – because their sales of coffee beans represent their only source of cash. They know no other way of earning an income. They are unlikely to be educated beyond primary level and many are illiterate. Unemployment is so high they have no realistic hope of gaining employment elsewhere. Private-sector retraining might be available but only at costs way beyond the farmers' means. They must continue to grow coffee no matter how low the price falls.

In the hypothetical case described above of the car industry, measures to maintain the welfare of workers are built into the "market" decision to close the factory. Coffee growers face starvation and lack even the means to maintain their farms, so this is also a case of overproduction and, therefore, market failure. In this case, however, there are now no in-built measures to defend the producers' welfare.

If coffee, cocoa and tea overproduction is to be tackled, supplies to the market must be cut. Simply allowing the price of these products to fall to lower and lower levels might simply mean that more and more is produced to maintain income levels.

(b) Market concentration

The second form of market failure – reduced market competition – also clearly needs to be tackled if farm-gate prices are to rise. Economists refer to this market phenomenon affecting so many beverage crop producers as oligopsony – a market situation in which the demand for a commodity is represented by a small number of purchasers.

We know that farmers are getting a smaller and smaller share of the eventual retail price for their product – typically now just half of one percent. But how much of this problem is due to lack of competition between the buyers of the product? Since the outside world is not party to the private deals of trading companies it is almost impossible to answer this question.

Oligopsony, in itself, does not necessarily mean that suppliers are put at a disadvantage in the market place but, in reality, the diminution in the number of competing buyers, has weakened the bargaining power of producers considerably. With only a few operational traders in any location the opportunity for trader collusion increases and traders may even divide a market between them so that only one buyer may be available in some producing areas.

Higher up the market chain the number of global players in these markets has also shrunk considerably. Since most of these large trading companies operate internationally, they are not constrained by competition law, in the same way that companies operating only in one country are constrained. In the report of a study on coffee, Daviron and Ponté conclude that both roasters and coffee houses possess the power to inflate their mark-ups. Gross mark-ups by retailers are in the range of 20-25 % and mark-ups by coffee houses are in the range of 70-80%. (Daviron, B. and Ponte, S. 2005)

Many of these firms operate as private companies or are either based in tax-haven countries like Switzerland or may use such countries as trading conduits. In such cases the company need not make its accounts public and there are numerous reports of such companies indulging in transfer pricing abuse. This means that they may under-invoice their purchases, say, from a developing country in order to lower their profits artificially in that country to avoid tax. They will then reimburse the local trader from whom they have made the purchase outside the country of origin. This practice not only robs the producing country of its tax entitlement but also encourages local traders to pay low prices to farmers.

At the end of the market chain the trend towards fewer, but larger chains of supermarkets, is also affecting the way that proceeds of the sales of beverage crops are shared out. Every supplier of these products must make sales to every major supermarket chain in modern, industrialized countries because each chain may represent as much as 20 % of the entire market. These chains have so much market power that they can force suppliers to cut their margins to the bone. In fact, as this trend of concentration in the retail trade has occurred, the international trading companies have begun to lose market power to the supermarkets.

The size of these chains is truly massive. British consumers now carry out 12 % of their total retail expenditure in a single supermarket chain, Tesco. This store does not just sell foodstuffs. Customers can buy clothes, televisions, cosmetics, medicines, insurance policies and furniture from the same company. Tesco made a profit of over two billion pounds sterling in 2005. Walmart, the largest United States supermarket chain, has posted annual profits of US$ 7 billion and both companies have seen double-digit growth in annual profits over recent years.

Profitable as these companies are, they use every ounce of their market weight to keep the cost of supplies down and, in the case of coffee, cocoa and tea, this pressure is passed all the way down the market chain to the their humble suppliers in Africa, Asia and the Caribbean.

Two forms of market failure, then, have occurred in the beverage crop industry. They are, in some respects, connected because if these products were not in plentiful supply, purchasers would be forced to compete more fiercely with each other to obtain them. Any measures designed to increase the income farmers receive from selling these products must, therefore, address both these market failures.

Clearly, a reduction in global production of these products would be bound to increase world market prices and an increase in the number of companies competing to purchase the output of farms and plantations in developing countries would boost farm-gate prices. But what kind of supply-side measures need to be put in place to achieve these ends without decreasing, even in the short term, the already small income of typical producers?

In the next section we will examine the issue of overproduction and the possible supply-side measures that could be used to overcome the problem.

III.3. Supply management – towards a new model

If our first objective is to raise prices by ending overproduction, supplies of beverage commodities entering the market must be controlled. We cannot expect individual producers to cut production without being sure that all producers are doing the same thing. And that goes for individual farmers and individual producing countries. Just as with the De Beers diamond cartel, all major producing countries have to participate otherwise the scheme will not work.

The international consensus which supported the previous era of supply-side measures used to stabilize prices has gone. Even at that time several of the wealthiest countries were not enthusiastic about the idea and proved to be unreliable partners in the agreements. If producing countries are to reintroduce some form of control over their own exports, they need either (a) to do it for themselves or, (b) to gain more influence over the process of international policy-making in this area.

Such measures should not include those elements of the previous generation of ICAs that proved to be weaknesses in their design. (It should be noted here that the recent generation of ICAs did not include an agreement on tea.)

- The most notable weakness proved to be that they relied too heavily on the cooperation of consuming countries.

There is no doubt that such cooperation would represent a tremendous advantage if it could be relied upon. Consuming countries could enforce a ban on imports and help to provide the necessary skills and resources to negotiate and establish supply management measures. On the other hand, the governments of wealthy countries are extremely concerned about even tiny inflationary factors and higher farm-gate prices might be considered one of these. In this sense, the interests of producers and consuming countries are diametrically opposed and, if history is anything to go by, consuming countries will try to water down and even emasculate such agreements.

- A second inherent weakness of the ICAs was that control was exercised over exports of commodities and not supply.

This meant that individual producers and unscrupulous traders had a strong incentive to cheat the system by smuggling supplies out of the country where they could be sold to consuming countries who were not signatories to the agreement. It also meant that large volumes of unsold stock could build up in times of overproduction which had to be bought from the producers and stored in warehouses at the cost of participating countries.

Alfred Maizels, of Oxford University and a notable expert on supply management has explained the merit of controlling supply rather than exports. He says:

> *"A production reduction scheme does have an advantage over export quota, however, insofar as it is based on a uniform percentage cut in current, or recent, levels of production. Since this would leave the relative production levels of various producing countries unchanged it should not give rise to major disputes about market shares – a common difficulty in negotiation on export quotas."*

- A third weakness was that only governments were parties to these agreements.

Under the terms of the agreements, each government allocated internal quotas, or stamps as they were called, to producers and potential exporters which gave them licence to export the commodity but not to exceed that quota. Some governments irresponsibly used that power to favour some sections of society rather than others. This feature of the arrangement also offered considerable opportunities for corrupt practices. It is likely that any new set of arrangements would be strengthened by the inclusion of civil society groups, such as farmers and trade associations, as participants in local arrangements to control supply. Peer pressure would be a useful tool in the effort to ensure that quotas were allocated fairly.

In addition, if parties to the agreements included representations from producers' organizations, more pressure would be applied to ensure that the problem of low farm-gate prices was being properly addressed.

- A fourth weakness, and one that was a major cause of frustration in ICAs, was that low-cost countries found it very difficult to have their export quota allocation increased. Clearly, it is against the interest of all producers for some countries, no matter how efficient, to ruin the purpose of the agreement by being allowed to sell more but, nevertheless, without some form of flexibility, there is a danger of encouraging inefficiency.

A former Secretary-General of UNCTAD, who could be described as one of the architects of ICAs, has acknowledged some of these weaknesses. In his book, *Taming Commodity Markets*, Gamani Corea, wrote in 1992:

> *"But the effectiveness of such (new export control) measures is likely to be limited without parallel actions that are aimed directly at supplies – that are aimed, in other words, at correcting the persistent tendency for supplies to be excessive even in conditions of improving demand."*

Commenting on the different interests of producing and consuming countries, he says:

> *"Supply management by producers, whatever the instruments used, may prove to be a necessity in the light of the prospects for commodity prices over the next decade."*

Several models of designs for supply management arrangements have been proposed.

In his book, *Rise and demise of commodity agreements*, Marcelo Raffaelli concluded, in 1995, that the old ICA model needed strengthening rather than being completely redesigned.

Among his suggestions for any new agreements are that they should:

- Defend a "realistic" floor and ceiling price range and that this range should be periodically reviewed to reflect any changes in exchange rates, inflation, consumption patterns and costs.
- Provide sufficient resources to absorb enough stock to defend the floor price - such resources to be provided by all parties to the agreement.
- Have a means to enforce a production policy that could reduce to a minimum today's demented (sic) policies of both exporting and importing countries.

Although these comments were made after ICAs ceased to function as a price-stabilizing mechanism, circumstances have changed more significantly in the intervening period. So, not only should the design of any new measures take account of the weaknesses in ICAs, they should also reflect these changes.

Niek Koning, of Wageningen University, and I have recently put forward a model for such a new arrangement which contains several novel features and which we feel could work effectively in today's world and could be applied to coffee, cocoa and tea. One of these features attempts to tackle the problem of low-cost producers wishing to increase their quota allocation. The model outlined below addresses this problem by suggesting that a market be opened for quota rights. Those producers or producing countries that believe that they can produce a product more efficiently in the long term can pay an upfront cost for gaining an extra quota through an international and national market in quota rights.

Other features of the model are designed to keep the problems of "free-riding", smuggling and corruption to a minimum.

The bare bones of the design are as follows:

- First, farmers' associations, producer-country governments, and civil society organizations form an international coalition to create support for the arrangement among other stakeholders. This coalition agrees on the sustainability and quality norms that are to be achieved by the arrangement. It also asks the major trading and processing companies to cooperate with the scheme and applies legitimate pressure to persuade them if needed.

- When sufficient support has been created, producer-country governments, in consultation with other stakeholders, specify the range of sustainable world market prices for the commodity, and establish an intergovernmental secretariat to manage the arrangement.

- Following this, producer countries impose a uniform export tax that raises the world market price to the desired level. The revenue is transferred to the intergovernmental secretariat. The secretariat establishes its own trading company, and uses this company to buy existing stocks, plus as much of the current production as would raise world market prices sufficiently to allow a moderate improvement in farmer earnings in spite of the tax. Preferably low-quality products are purchased from the market. Apart from a buffer stock, all purchases are destroyed or denatured to induce expectations of price rises, thereby stimulating private stockholding and moderating the size of the intervention required. The trading company also acts as a broker and trade agent for the member countries on a voluntary basis, and engages in profitable transactions that increase the price discount and the price volatility in the free-rider segment of the international market for the crop.

- Meanwhile, quota certificates are allocated to individual producers on the base of their current production. The allocation occurs through national governments assisted by farmers' associations or other local institutions that are trusted by producers. Inter-professional arbitration committees settle any conflicts. Complaints departments supervised by the intergovernmental secretariat handle any complaints about abuse or corruption. The intergovernmental secretariat refunds the costs that national institutions make for administering the allocation process, but only after it has found that the allocation has been done in an orderly way.

- During the subsequent few years, the intergovernmental secretariat uses the tax revenue to buy quota rights from producers to achieve a stepwise reduction of production (by equal percentages per country). In addition, a country may choose to buy additional quota rights from its producers and sell these to other countries that can thereby limit their reduction obligations. Meanwhile, the intergovernmental secretariat continues to buy sufficient parts of the current production to raise prices further and to allow a gradual increase in producer earnings. (Koning et al. (2004) present a model that illustrates how this could work in the case of coffee.) Gilbert & Zant (2001) and Koning et al. (2004) provide examples for coffee that show that these operations may be profitable.

- When the intergovernmental secretariat starts to buy quota rights from producers, a system with tags and personal identification numbers is introduced to control the flows of the crop and payments within each country.

- When production capacity has been reduced sufficiently to move prices within the pre-established price band, the export tax is reduced so that farm-gate prices come closer to world market levels. The secretariat limits its intervention in the product markets to the management of a buffer stock for short-term price stabilization. Farmers are now allowed to buy and sell quotas in national quota exchanges (with decentralized sales-counters to maximise access) that are managed by the international secretariat. Meanwhile, the size of individual production quotas is adjusted periodically to keep prices within the price band. The band itself is adjusted so that the weighted average of national quota prices remains at a fixed level. (Increased quota prices are taken as an indication of decreased production costs).

- The intergovernmental secretariat uses the remaining export tax revenue to purchase part of the quotas that are sold at the national quota exchanges. It distributes these quotas for free reallocation to farmers according to criteria that have been decided by the national government. (Again, inter-professional committees and complaints departments settle conflicts and deal with complaints). In addition, the secretariat transfers part of the quotas that it purchases in countries where quota prices are low (indicating high marginal costs) to countries where they are high (indicating comparatively efficient producers).

The volume of quota purchases in a country and the part that is transferred to low-cost countries are calculated using a formula that is agreed upon in advance by the participating governments. This formula specifies (i) an average percentage of the global quota turnover that will be purchased by the secretariat; and (ii) a rule that couples quota price differentials to yearly percentage reductions or increases in national quota volumes. (Besides, countries may still choose to buy additional quotas from their producers and sell these to other countries.)

- Apart from these sales and purchases of quotas, farmers and, at the international level, countries, may rent quotas on a strictly seasonal basis to cushion fluctuations in production. We believe that this could be a robust and transparent arrangement. It is self-financing and not dependent on the cooperation of importing countries. The arbitration and complaints committees, and the audit of the allocation process before administration costs are refunded, guarantee fairness to farmers. Although the national quota exchanges encourage efficient reallocation of quotas within countries, the free reallocation of part of the traded quotas prevents the protective effect of the arrangement from leaking away through these markets. The sovereignty of national governments is respected because they structure this free reallocation and the regional reallocation of all traded quotas within their own territories.

Meanwhile, the automatic redistribution from high-cost countries to low-cost countries reduces incentives to free ride for government. The transactions by the secretariat's trading company further decrease these incentives by raising the market discount on free-rider products. On the other hand, no government is compelled to do something against its will, since the price band, average recycling of traded quotas and formula for redistribution between countries are established beforehand by joint decision. Governments can be mutually assured that the principles will be fairly applied, since the implementation is left to a supranational organization (the intergovernmental secretariat). Incentives for misuse are limited and minimized.

Export taxes are used only for financing the scheme, they are controlled by the intergovernmental secretariat, and they decrease progressively after the first years. Apart from these taxes, the improvement in world market prices benefits producers. The quota purchases by the intergovernmental secretariat will ensure that the national quota exchanges become the effective markets for quotas, which makes it difficult to bribe farmers to bid up quota prices or withhold quotas to improve a country's position in the international quota redistribution. Moreover, this redistribution is controlled by the intergovernmental secretariat, which has the authority to punish misuse.

Niek Koning and I insist that this design for a new generation of supply-management measures is only one of many possibilities. The model could be much simplified if solidarity among all producing countries and producers could be assured and if parallel measures to stamp out corruption were put in place. Further refinements to tackle, for instance, different grades and qualities might also need to be included.

There is no doubt that this model would require significant resources both for it to be established and to operate. Nevertheless, these resources would pale into insignificance beside the increased income that could be generated from such a scheme and would be no more than those used by the ICAs or, for that matter, resources used to run programmes with similar aims in wealthy countries such as the EU's Set-aside scheme.

III.4. Complementary Supply-side Measures

III.4.1. Empowering developing countries to control their markets

Designing a model for measures that could raise market prices for beverage commodities is one thing – bringing them into operation is quite another.

For producing countries to act, they would first need a forum to discuss and negotiate such arrangements which was, ideally, uninhibited and not influenced by the interests of consuming countries and the large corporations in the industry. This would not be true of the Bretton Woods institutions, UN organizations nor the International Coffee Organization (ICO), the International Cocoa Organization (ICCO) or the Tea Association. It maybe that some existing institutions could provide suitable forums for such activities, perhaps based on continental geographical areas but, if not, the establishment of new forums may be necessary for this special purpose.

Producing countries would also need to be prepared to exercise their sovereign rights over the control of the production and trade of the products they produce and their right to impose export taxes.

When UNCTAD organized the previous generation of ICAs, Gamani Corea, the Secretary-General at the time, employed only 25 professionals to carry out background research, to design models for all the agreements, organize negotiations, and bring them into operation. This may imply that the bureaucracy required to organize a new generation of agreements covering beverage crops does not need to be very large. It is important to stress, however, that producing countries would need to take the initiative here and not rely on some outside organization to provide the necessary initiative and resources.

Stakeholders in these commodities in producing countries would also need to organize themselves in a different way to carry out the local functions of any such agreement. Individual producers in these countries often lack institutional structures and need to establish democratically-run farmers' associations and to encourage collective marketing of their products. Such organizations would act as an alternative to government-imposed institutions and would help to prevent corrupt practices by officials. Also, the power of plantation workers could be enhanced through linkages with multinational workers' organizations and the enforcement of the obligations established by International Labour Organization.

III.4.2. Strengthening competition

The second objective for measures designed to lift farm-gate prices is to ensure that buyers actively compete for the output of farms and tea estates.

It is in the nature of the free market system that, without outside constraints, successful companies in a particular sector of industry will absorb the business of less successful companies in the sector. This is because larger companies enjoy economies of scale and when very few companies dominate an industry the "cost of entry" becomes too high for a smaller, new company to compete. That is to say, that a large company will have established its brands, expertise, business contacts, etc., and the cost of reproducing these is usually so high that other potential competitors are discouraged from entering the industry.

Throughout the history of free enterprise, governments have been concerned about this natural trend and have set up systems to curb its excesses. Perhaps the most famous of these measures were the anti-trust laws in the United States which were used successfully in 1892 to break up John D. Rockefeller's Standard Oil of Ohio, the largest oil company in the world at that time. Now, almost all countries have some form of anti-competition laws or mergers and acquisition regulatory bodies which can decide whether a merger or acquisition within the country's borders can go ahead or not. Many countries, however, fully understand that, if they are to compete successfully in the modern world, they need large companies and so many industries are getting more and more concentrated.

Large, modern corporations are now less constrained by national legislations as their activities span the globe and they might have trading centres in many countries including tax havens with highly secretive disclosure laws.

Clearly, there needs to be a strengthening of international law to ensure that company concentration in any particular industry does not represent a threat to the interests of the global community.

Peter Gibbon recommends, as a first step, that researchers should develop economic criteria for identifying the exercise of monopsony power or on exploring what types of legal reasoning could serve as a basis for action in relation to it (Gibbon 2005).

Under aid conditionality agreements, developing countries are obliged to make public all the dealings and accounts of parastatal (government-controlled) companies, including any remaining marketing boards, as part of the drive for good governance. The large private corporations that purchase the country's goods for export, however, are under no such constraints even though they may conduct far more of the country's business than any parastatal.

There is no doubt that corruption is endemic in many developing countries but for everyone taking a bribe, there must be someone offering a bribe. Many accounts have been reported of large corporations offering bribes for favours to officials. In this environment the incentive for companies to influence government officials or members of the judiciary not to invoke anti-competition law must be very high. There have also been very many accounts of transfer-pricing abuse by large corporations in the commodities industries. Such abuse involves under-invoicing exports to reduce a company's tax liability.

It seems reasonable, therefore, that the governments of countries that suspect a lack of competition between traders, especially those companies trading through tax-haven countries, should insist on the same degree of transparency for these companies as is demanded from them in the case of parastatals. This would act as an important deterrent in preventing anti-competitive practices.

Producing countries also need assistance to enforce their anti-competition laws for internal instances of collusion among commodity traders.

As mentioned in the section above concerning supply-management measures, the bargaining power of farmers would be much improved if they joined together in farmers' associations to market their goods. Every effort should be made to assist farmers in this task.

If all these measures were taken in a different market climate where overproduction of beverage crops was eliminated, it would go a long way to ensuring that producers received their fair share of the retail value of the commodities they produce. We will discuss the problems of building the institutional apparatus for doing this later in this paper.

However successful these measures may be, they will only go part of the way to ensuring that the rural populations of beverage crop-producing countries capture a much bigger share of the huge amount of money within the beverage commodity industry. To make a real impact they will need to add value to their products.

III.4.3. Promoting vertical diversification through active industrial policy and competitiveness

We have discussed the phenomenon of horizontal diversification before. This simply means that producers switch, or partially switch, from growing a product with a weak market to growing a new product with a stronger market. We have also seen that this usually results, as in the case of vanilla, in seriously damaging the market of the new product.

Vertical diversification is the description of the process of adding value to a primary product. In the case of beverage crops, this implies making chocolate and chocolate products out of cocoa beans, making roast and ground and soluble "instant" coffee from coffee beans and packing tea in tea bags. It might also mean the packaging, labelling, branding and advertising of these products. At present almost all this work is carried out in consuming countries.

We know that, as the farm-gate price of these commodities has been falling, the retail price has been increasing at about the general inflation rate. As these two prices have drifted further and further apart we can see two main things. Firstly, that the amount of money in the trade has grown and, secondly, that if farmers could capture some of this increased revenue from further up the commercial chain, they would be a lot better off. So, what could be done to help make this happen?

In the first place it should be understood that the processing plant, inputs and skills needed to perform these tasks is very costly. Such investment can only realistically come from the private sector – without forgetting that the private sector also includes farmers and farmers' groups.

Farmers in developing countries might well be able to process their product further but since they now earn so little for their raw material, they are unable to save enough money to pay for the necessary machinery and other capital equipment involved. But, given that the cost of labour in producing countries is much lower, why do the large processing companies not base their factories in the country that produces the raw material?

One reason has been the imposition by consuming countries of escalating tariffs – whereby higher tariffs are applied as the product receives more processing, as discussed above. But these tariffs are eroding opportunities, especially for least developed countries.

Another reason is the difficulty of recruiting skilled staff to run processing plants. Here I speak with some personal experience. I was a director of three different international commodity trading companies and I was involved in making decisions of this kind. I quickly discovered that, since this type of processing is almost exclusively carried out in consuming countries, skilled technicians and managers needed to be recruited from wealthy countries. These skilled people, especially those with young families, want to live in countries which are clean and safe and those which have good and accessible schools and hospitals and recreational facilities such as golf clubs and theatres. Almost by definition, poor countries have few, if any, of these facilities. The cost of inducing employees to live in producing countries is, therefore, prohibitively high.

There are several other reasons including poor access to clean water and packing materials, poor transport and banking systems and, more importantly, no local market for the processed product because local people are too poor to buy it.

This is, perhaps, one of the most important benefits of introducing measures to increase the market and farm-gate prices of beverage commodities. Almost all economists agree that in order to escape from the consequences described in Prebisch's hypothesis, commodity-dependent countries need to expand non-agricultural industries and services. The most obvious way of doing this is to process their own raw materials into higher value goods.

If beverage crop prices could be increased by the measures outlined above, the governments of producing countries would need to find ways of encouraging farmers' groups to use their extra income to invest in processing plant. The country's businesses will also benefit greatly from the extra spending power of farmers and farm workers. Such existing businesses might include shops, transport companies, suppliers of farm inputs and repairers of farm machinery. These companies could also be encouraged by governments offering the necessary incentives to invest in coffee, cocoa and tea processing.

Governments could help in other ways. They could, for instance, invest in the kind of facilities mentioned above, which would attract skilled expatriate workers to train local people in processing skills. In addition, governments could cut any tariffs and other trade barriers on the type of equipment needed for beverage-crop processing. They could also provide the necessary testing laboratories and product-control systems needed for ensuring food safety in exported processed products.

If such industrial policies were adopted in tandem with farm-gate price-enhancing measures, the prospects of eradicating poverty, putting the country's economy on a sustainable footing, creating employment and building a proper skills base, would be much brighter.

Aid agencies could also play their part by training farmers' groups to add value to their crops, rather than to grow ever larger quantities of those commodities.

III.4.4. Addressing institutional vacuums

The extremely serious dimensions of the commodities crisis demand effective and urgent attention. The process of defining the complicated aspects of the problem, designing measures to tackle it, bringing interested parties together, negotiating agreements and implementing the agreed strategies takes a considerable length of time and requires the appropriate institutional "space" for it to take place.

Although the seriousness of the crisis has been quite apparent for many years, almost nothing has been done to address it. A series of promises that strategies, such as increased market access, risk management and horizontal diversification would solve the problem have come to nothing and have served only to delay effective remedial action.

This has been allowed to happen mainly because those that devise these strategies do not suffer from the consequences of the crisis, yet they have the greatest influence over the decision-making processes and the institutional framework that carries them out.

In order to address the crisis, producers must, therefore, increase their influence over the existing institutional framework.

The institutional mechanisms required for this task need to function in concert both at the international and national levels. The former, for establishing and implementing international measures; and the latter for organizing production and supplies in the country of origin. So let us first look at the appropriate, existing institutions.

(a) International institutions

Those agencies that could be expected to provide developing countries with institutional capacity on agricultural and trade matters at the global level have not engaged in any action to address the root causes of the commodities crisis.

Several relevant organizations are in the United Nations "family" including the World Bank, the International Monetary Fund (IMF), the United Nations Development Programme (UNDP), the Food and Agriculture Organization of the United Nations (FAO), the United Nations Conference on Trade and Development (UNCTAD), the Common Fund for Commodities (CFC) and the International Fund for Agricultural Development (IFAD) – whose mission statement is "enabling the rural poor to overcome poverty".

Of these only UNCTAD has organized an open-minded dialogue between interested parties. The request from these parties for further examination of the possible merits of bolder measures to address the crisis has led UNCTAD to set up a "Commodities Task Force". At the time of writing this paper, however, there is no information available as to the amount of funding that has been made available or pledged to enable the Task Force to function.

Three other organizations work specifically for the interests of the beverage crop industries – the International Coffee Organization (ICO), the International Cocoa Organization (ICCO) and the Tea Association. All these organizations depend on funding from member states (or companies, in the case of the Tea Association) to carry out not only their core duties but also any research projects, organize meetings outside their schedules or conduct individual development projects. Almost all such contributions come from wealthy consuming countries that benefit from the availability of cheap agricultural raw materials. None of these organizations are calling for measures to reduce supply in order to boost prices.

At the World Trade Organization (WTO) decisions have to be made by consensus and the issue of agriculture has represented the major stumbling block for any progress at successive Ministerial meetings.

The arguments at the WTO around the issue of agriculture are many and varied and include the following relevant items:

- Tariff barriers erected to protect the agricultural sectors of the very same wealthy countries that preach free trade to developing countries.
- Tariff escalation – when consuming countries apply higher and higher tariffs to agricultural products as their degree of processing increases.
- Dumping – the practice of selling cheap, highly subsidized agricultural products on the markets of developing countries, thus undermining the livelihoods of local farmers.
- Loss of Lomé and similar trading concessions.
- The application of strict quality standards on imports from developing countries.
- The nature of Special and Differential Treatment for developing countries.

If all the grievances associated with these issues were settled, however, it would do very little to solve the crisis in beverage crop markets. There are almost no tariff barriers applied to raw coffee, cocoa and tea, neither are these products dumped onto producing countries' markets, nor did any Lomé protocol apply to any of them. Since the "Everything but Arms" initiative by the EU and similar measures taken by other consuming countries, the Least Developed Countries do not suffer from tariff escalation.

Unfortunately, a common misunderstanding is that if these issues were settled, the agricultural sectors of developing countries would thrive. This results from two main but widely-held misconceptions surrounding the issue of international trade rules for agricultural products.

The first of these is that trade liberalization will strengthen agricultural productivity in any developing country and thus allow it to diversify away from agriculture into manufacturing and service industries.

An examination of the historical role of agriculture in the establishment of successful, diversified economies demonstrates that the opposite is true. The "Asian Tiger" economies protected agriculture and used the industry as a base for diversification. Agricultural productivity was stifled in the United Kingdom between 1880 and 1930 when it adopted free trade policies.

The second major misconception concerns the degree of benefit that developing countries would gain from the dismantling of the measures used to protect the agricultural sectors of industrialized countries. There are only three major tropical crops that are seriously affected by the trade barriers erected by the major consuming blocks – these are cotton, rice and sugar. Tropical countries would not be the main beneficiary if these barriers were eliminated – Australia, Argentina and Canada would be the countries most likely to replace consuming countries' production.

In the case of beverage crops, therefore, the current international institutional apparatus offers very few opportunities for producing countries to exercise the necessary influence to seek a solution to the price crisis.

The most promising development appears to be the recognition by UNCTAD that new and different strategies must be adopted to address the problem. If producing countries consider UNCTAD a suitable vehicle to take this idea forward, they must be prepared to provide it with the necessary resources to do so. UNCTAD was, after all, the institution used to carry out a similar function with ICAs and it has the most relevant expertise in this field.

The second encouraging development has been the initiative from a group of African missions to the WTO who have, since 2002, submitted a number of proposals to the relevant WTO committees voicing their concerns about the commodities crisis. They have put forward, for consideration, measures to address the problem including supply management and measures to ensure a proper level of competition among the traders of these products.

(b) National institutions

Much evidence has been accumulated to show that many marketing boards in producing countries failed, in some respects, to serve the interests of farmers. Some were used as a tax-raising mechanism, purchasing goods from the producers at below market prices and selling them at the true market prices. Many became moribund due to high levels of inefficiency and bureaucracy and some became vehicles for corruption – others were extremely slow at paying farmers for their goods.

In theory, though, marketing boards could be very useful in the effort to increase farm-gate prices. The most important of these functions would be for them to act as an intermediary between the farmer and the exporter to protect the interests of farmers in sales negotiations. Trading companies have so much market power that they can easily play one farmer off against another, so that each farmer has to lower his price in order to make a sale. Once one desperate farmer sells at a low price, others have little choice but to do likewise. For example, if all the cocoa farmers in a country are represented by a single negotiator, their market power is greatly increased.

Other important functions of many marketing boards included the provision of credit (often in the form of inputs, such as farm chemicals, plant stock and tools) as well as quality control. At present farmers find it extremely hard to get credit and one reason that many have to sell at such low prices is that they owe money to the traders they sell to. The absence of any national institution with the function of controlling the quality of the product has caused quality standards, and hence the value of the product, to fall.

The dismantling of marketing boards has also had the effect of increasing the cost of farmers' inputs. These inputs were once supplied by marketing boards – albeit, often inefficiently. Peter Gibbon explains that: "Inputs in many of these countries are no longer purchased and distributed in bulk, and public subsidies have been removed from their local prices." (Gibbon, 2005).

If farm-gate prices are to be increased, it would seem sensible, therefore, for national governments, in conjunction with producers' organizations, to reconstruct institutions that are able to carry out these functions of marketing boards for the beverage crops they produce.

If and when an international mechanism is set up to control output, each producing country that is a signatory to the agreement will also need to establish mechanisms to explain to farmers and traders the reasons for managing output and to convince them of the merits of the measures. They will also need mechanisms for allocating production quotas, monitoring exports and controlling smuggling and other forms of cheating. In many countries farmers do not totally trust their government agencies. They are, however, much more likely to trust other farmers and are much more likely to abide by their obligations under the agreement, if these functions are carried out with the full participation of farmers' associations.

As mentioned above, most tea is produced by large estates employing wage labour, although most coffee and cocoa is produced by smallholders. However, some of these crops are also grown on large farms and plantations, especially in Latin America.

The rapid deterioration, over the last decade or so, in the welfare of plantation workers is due only partly to the fall in commodity prices. Clearly, if plantations were making more income for their owners, workers would be in a stronger position to demand higher pay and better working conditions. The problem is that, as prices have fallen, owners have often ignored their obligations to their workforce and, sometimes, reneged on their agreements with trades unions. They can, justifiably in some cases, explain to their governments that they would go out of business completely if they had to pay their workers more.

All the major producing countries of beverage commodities have signed up to the International Labour Organization's rules on workers rights. In many documented cases, however, some of these governments ignore their ILO obligations and, it seems, that the ILO has very few powers to enforce its rules. The fate of farm workers, therefore, is very much in the hands of their governments. In any international effort to improve the lot of both smallholders and farm workers it will be necessary to create a "level playing-field" among producing countries. A country that enforces ILO rules should not be penalized by another that ignores the rules. All the countries party to such agreements should, therefore, bring pressure to bear on members that ignore the plight of their farm workers.

III.4.5. Widening policy space

As the obligations of developing countries increase, under the various bilateral and multilateral agreements they sign up to, the institutional space available for them to take independent action to support their vital industries has been shrinking.

In the latest WTO negotiations this policy space is threatened even further as developed countries aggressively demand access to developing country markets for non-agricultural products as a *quid pro quo* for reducing tariffs on agricultural imports. Referring to current developments at the WTO's Non-Agricultural Market Access (NAMA) talks, Martin Khor of Third World Network states: "The onslaught (by industrial countries), if successful, will dramatically narrow the existing policy space that developing countries still have to apply tariffs to shield their infant and nascent industries from the full force of global competition."

This is, of course, a very serious issue for those countries who wish to provide incentives and protection for investment in the processing of agricultural products in order to escape from dependency on the production of agricultural raw materials which continue to fall in value and who wish to gain some of the revenue to be made from adding value to their primary products.

In his paper, *Expanding national policy space for development: Why the multilateral trading system must change*, Robert Hamway traces the changes that have occurred in the balance between national sovereignty and international obligations over the last few decades. He offers many examples, including those concerned with agricultural policy, where developing countries have lost the right to implement policies to protect vital industries because such action would contravene commitments they have made in international agreements.

He says that "The narrowing set of national policy options permissible under a growing array of international agreements is increasingly referred to in international debates as a major constraint on national policy space".

He attributes much of this loss of sovereignty to changes which have occurred following the emergence of the WTO from the embers of GATT. Within GATT, developing countries were given wide discretion in interpreting their options for policies designed to protect their important industries. The exemptions under which developing countries are entitled to reduced obligations to open their economies are known as Special and Differential Treatment (S&DT). But this is now a vague notion under the WTO and the WTO's disputes settlement mechanisms have the power to penalize any country that is judged by its actions to have financially damaged another party.

Hamway quotes Corrales-Leal, et al: "Most developing countries are demanding that S&DT assumes an integral role in all WTO agreements, similar to the one it has in GATT 1947, by substantially upgrading it to restore much of the national policy space for development that has been lost during the conclusion of the Uruguay Round and establishment of the WTO."

The requirement to make S&DT more precise is, in fact, an agreed objective in the Doha Declaration of 2001 which relates to the requirement to "make positive efforts to ensure that developing countries secure a share in the growth of world trade commensurate with the needs of their economic development."

It is possible, therefore, that efforts to define S&DT as offering a wider space for domestic policy options will, coincidentally, offer the necessary institutional space for establishing the supply-side and competition-enhancing measures needed to address the price crisis affecting beverage and other agricultural crops.

We can see, however, that, both at the international and national levels, a great deal of work needs to be done to influence existing institutions but in the present situation there is not a complete institutional vacuum. Much progress could be made by the producing countries themselves, especially at the national level. They could begin by helping farmers to understand the cause of the price collapse and its possible remedies. Farmers naturally copy other farmers, if they see their neighbour adopting a new technique or methodology which helps them to earn more from their farm. Farmers do not need a great deal of help to act collectively if it is made clear that it is in their interests to do so. Collective marketing is a good way to empower farmers in the market place.

Agricultural extension services could concentrate more on helping farmers to add value to their crop using simple methods, rather than to grow more of their products. Government and development agencies could help with this task.

At the international level the commodities issue is receiving far more attention than it did three years ago. Several conferences have been arranged to discuss the issue, an on-line discussion group of experts and policy advisors in this field has been established, many NGOs and pressure groups have taken up the issue and academics are conducting research and advocating action.

This new interest in the subject is starting to find its way onto the agenda of some of the most important international development institutions but progress is very slow. It is unlikely that this pace will change without pressure being applied by individual governments and from the wider public.

III.4.6. Influencing international institutions

Perhaps the most important form of pressure would be a display of common purpose among producing countries. At present these countries seem unsure how to tackle the problem. Understandably, they do not wish to antagonize those countries and agencies that hold the purse strings on aid budgets, nor do they wish to adopt new and untried measures. All producing countries, however, are seriously concerned about the crisis and are calling for some sort of remedy. In order to ensure that this problem is addressed effectively, however, they will need to exercise more influence over the relevant international decision-making processes. Some steps which could be taken to increase their influence are outlined below:

- An obvious first step for these countries to take would be to bring their best, independent experts on this issue together, in a meeting with world experts from every side of the debate. Studies could be commissioned to measure the likely impact on the market of the beverage crop in question, on the economy and rural community of each country and on the likely response of transnational companies in the industry and of consuming country governments.

This exercise would go a long way to clearly define the options available to producers.

- At the same time, much needs to be done to inform the general public about the disaster. Jacques Chirac, the President of France, has said that there was "a conspiracy of silence" on commodities. Developing countries need to use the mass media to break this silence.

- There are also some extremely powerful arguments in favour of raising tropical commodity prices in the interests of consuming countries.

What use is a poverty-stricken developing world to large corporations? These firms want to sell all manner of goods and services but most tropical countries offer very few sales opportunities in their present state of economic development.

The flow of narcotic drugs into wealthy countries is now so great that some areas of these countries are suffering crime-waves of tsunami proportions. Tropical farmers do not want to take the risk of growing these illegal drugs but, if it becomes a choice between starving while growing coffee or surviving while growing coca leaves, they will choose to survive.

Mass emigration is now a common feature of the modern world. Many wealthy countries are bringing in draconian measures to curb the inflow of immigrants but they would be better off tackling the cause of emigration – poverty and a lack of prospects, especially in the rural communities of developing countries.

There is a direct link between conflict and poverty and a direct link between poverty and the commodities crisis. In his book *"Collapse"*, Jared Diamond identifies one of the triggers for the mass slaughter in Rwanda in the 1990s as being the poverty caused by the collapse of the coffee price. The resentment engendered by the lack of concern by Western countries about these horrific events can easily result in attacks on Western people and interests.

Producing countries will have to emphasize these arguments if they are to influence powerful governments to address the commodities problem.

- Third world farmers also have many allies in developed countries. The enthusiasm for campaigns such as Make Poverty History and Live 8 has shown that a large section of the public is becoming increasingly concerned about the lack of development progress. Many pressure groups, NGOs, think tanks, academic institutions and church organizations are putting pres-

> sure on their governments to act more effectively. Even some Northern farmers' groups are realizing that they have a common cause with farmers in the tropical regions of the world. They too are suffering, though to nothing near the same extent, from falling prices for their crops and reductions in farm subsidies and they are beginning to talk about controlling supplies as a means of raising prices. Producing countries should strengthen their contacts with all these groups to help build an alliance with the aim of addressing the crisis.

Clearly, producing country governments should continue to make vigorous representations through the WTO, UNCTAD and all other relevant multinational institutions, but they are unlikely to get a much more positive response without pressure being applied on the individual governments represented at these bodies. It is, therefore, of the utmost importance that producing countries become more sophisticated in the use of the mass media and contacts with sympathetic organizations around the world to inform the world about this problem and about their inability to receive a sympathetic hearing from the official institutions which, in theory, have an obligation to do something about it.

IV. CONCLUSION

Developing countries should be congratulated for their efforts over the last few years in bringing the subject of agriculture to a central position in the international debate on development.

Agriculture has proved to be the most contentious issue in WTO Ministerial Meetings and will continue to be so unless the legitimate grievances of developing countries are properly addressed. Lack of market access is a serious problem for producers of cotton, rice and sugar. The dumping of cheap, subsidized agricultural goods on the markets of developing countries is undermining local producers. The imposition of escalating tariffs by wealthy countries on processed agricultural products is stifling the prospect of adding value to such products in the country of origin.

For producers of beverage crops and most other tropical commodities, however, the major problems are overproduction and low farm-gate prices.

Producers of these commodities need now to concentrate on designing and implementing measures that address market failure in these industries and restoring equitable incomes to those who produce them. The measures needed to address the crisis in the markets of these commodities are different from those presently on the WTO negotiating table.

Since such action will require a great deal of independence from parties whose interests are to preserve the *status quo*, the greatest immediate need will be to widen the institutional space available to developing countries for nurturing their vital industries. It may also be necessary, as the Oxford Policy Management group recommends, to go further: "There is a need for a new institution that would tackle the problems of commodity trade and its impact on development targets." Certainly, developing countries need to defend and widen what remaining institutional space they have in negotiations on non-agricultural market access (NAMA) and Special and Differential Treatment.

Another priority would be to instigate the necessary studies to define the crisis in beverage crop markets and to design appropriate and detailed measures for dealing with it.

Over the last few years this issue has attracted the attention of many academics in relevant fields who have now produced a body of work which, when coordinated, would go some way to answering these questions. UNCTAD's Task Force for Commodities theoretically has the mandate to investigate any proposals that could lead to an alleviation of the commodities crisis and beverage crops have been identified many times as candidates for special attention. The Task Force needs to be supported by member countries, however, if it is to carry out this work.

As indicated above, producers' organizations and producer countries need to explain their predicament to a wider, global audience and to form alliances with sympathetic organizations all over the world and, especially in other producing countries. The Canadian government has a long record of support for its farmers and is now defending its supply management measures in the current round of negotiations. Canada is ideally placed to support proposals from developing countries for similar action. By building such relationships, further pressure can be applied to governments, and through them, to the international institutions that should be recommending and implementing new forms of action to solve the beverage crop crisis.

It should be understood, however, that the best likely outcome of such persuasion will be to allow producing countries to act autonomously in this matter. In other words, they should not have to seek permission from non-producers to exercise control over the production and supply of commodities grown in the soil of producing countries. It should always be borne in mind that coffee, cocoa and tea are commodities that the rest of the world cannot or will not do without. When producers of beverage commodities are, theoretically at least, in such a strong market position they should, like any actor in any market receive the highest possible price provided that they do not damage the long-term market. The increased power of giant corporations, due to market concentration, must be matched by increasing the market power of producing countries acting in unison.

In his very detailed account of the establishment of ICAs, Gamani Corea, former Secretary-General of UNCTAD, devotes several chapters to the difficulties he encountered, both before and after the agreements were signed, caused by quibbling between producing countries over quotas and quality standards, etc. With prices so low for beverage crops, even the lowest-cost producer now has a massive incentive to show solidarity with all other producers in the task of implementing measures to raise farm-gate prices.

This effort will ultimately require the attention of lawyers, diplomats, trade experts and experts from customs and excise and the Ministries of Trade, Finance and Agriculture in the capital cities of producing countries. But at this stage of the debate, the emphasis should be on the dissemination of information and political persuasion. Sophia Murphy puts the case clearly: “We cannot eradicate poverty with fair, multilateral trade rules alone. But if we can persuade governments that trade rules must form part of a broader package to support development – we will be well on our way.”

At the time of writing, almost the entire debate on agriculture at the WTO is bogged down with interpretations of the minutiae of offers to cut subsidies and tariffs, to transfer farm support from one coloured box to another, or to interpret the meaning of the July package. Whether or not this Hong Kong meeting can resolve these issues, the crisis in beverage crop markets is not going to go away. It is time to start the process of finding effective solutions.

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