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Introduction

Commodities have been through turbulent times in recent years with prices reaching a nadir in 2002, although they have since then bounced back with strong demand from China for all types of commodities, fuel and non-fuel. But how long shall this mini-boom last? Does it mean that at long last, what has become known as the "commodities problematic" is behind us?

UNCTAD's analysis of real commodity prices of 14 products of export interest to Africa between 1960 and 2000 suggests that 12 (bananas, copra, coconut oil, copper, cotton, coffee, cocoa, fish-meal, gold, sugar, tea and white pepper) suffer from high price volatility. The standard deviation

of deviations of prices from the trend is more than 10 per cent for each of these commodities. In addition, the real prices of nine commodities (copra, coconut oil, cotton, coffee, cocoa, gold, tea, sugar and white pepper) depict declining trends.

This presentation briefly examines different approaches to solving the commodity problem in the past, and argues that there might still be a role for commodity agreements (or some reincarnation of these) based on the lessons of the past three or four decades.

Commodity price stabilization – brief historical background

The case for commodity price stabilization in order to assure "remunerative" returns to producers is not new. Two distinctive trends can be identified – first, with respect to producers in the "North", and second, with regards to producers in the "South".

Interventionist and protectionist measures in agriculture in many developed countries have a long history. First, competition in grains, dairy products and meat from the newly settled areas of North America and Oceania, and associated revolution in transportation and refrigeration during the last quarter of the nineteenth century, elicited different responses from European countries. A number of these countries reacted to this competition by intensifying intervention in, and protection for, their agricultural, and especially grain, sectors. This was to sow the seeds of what decades later became the basis for the EU's CAP. The second protectionist wave took place during the depressed interwar period, when agricultural intervention and economic nationalism were adopted or intensified by both importers and exporters. The third wave of agricultural protectionism associated with the post-World War II era is derived from four main sources: (i) the post-war reconstruction and concomitant balance of payments difficulties experienced by western European countries; (ii) the deepening involvement of governments in alleviating disadvantages associated with income and opportunities for people, sectors and regions; (iii) notions of distributive justice for the agricultural sector, which was unable to capture the benefits, but obliged to bear most of the costs, of rapidly advancing technology; (iv) and the process of forming regional economic groupings. The Japanese protectionist agricultural stance was a manifestation of the system "administrative guidance" under which the country slowly and selectively liberalized its trade and participated in the world trading system.

Indeed, in developing countries (including Africa), the case for international commodity agreements, or how to guarantee some form of remunerative price for farmers could be justified on almost all of these grounds. Nevertheless, limited room for manoeuvre fiscally has implied that African commodity producers have had to rely on their trade partners at the international level to design responses to problems faced by their own producers. As discussed below, though domestic responses via the establishment of Marketing Boards did have some limited impact, these have had to be dismantled under the BWIs-inspired structural adjustment programmes of the 1980s and 1990s.

International stabilization efforts

The impact of price fluctuations and real price declines on the agricultural and commodity sector of low-income, countries, has been much more acute. This is because commodity production and exports constitute the major source of livelihoods of millions of poor farmers. However, unlike the developed countries, it is almost impossible, due to fiscal constraints, for the governments of these countries to provide any support to their farmers. This has propelled the issue into the international arena.

The first serious consideration of the problem of commodity dependence in the post World War II period was the negotiations leading to the 1948 agreement on the Havana Charter (which was not ratified by member States). Nevertheless, the approach enunciated in the Charter was to influence international commodity negotiations in the following decades. This approach was underscored by three guiding principles:

- (i) Intervention in commodity markets by intergovernmental action should be an exception (dealing with severe market disruption) rather than the norm in commodity trade;
- (ii) Both producers and consumers should be a party to such agreements; and,
- (iii) Equality of representation of producer and consumers should be reflected in individual commodity councils or organizations (UNCTAD, 1977).

The search for solutions to commodity problems at the international level was subsequently shifted to the Economic and Social Council of the United Nations (ECOSOC) which established an Interim Co-ordinating Committee for International Commodity Agreements (ICCICA) with responsibility for:

- (i) Convening commodity study groups;
- (ii) Recommending the convening of conferences to negotiate commodity agreements; and,
- (iii) Coordinating the activities of study groups and councils administering commodity agreements.

Over the next decade or so, attempts by the international development community to develop a viable international commodity policy were carried out within the framework of UNCTAD which led to the proposals for an Integrated Programme for Commodities (IPC) in August 1974. After intensive debates, the IPC was approved at UNCTAD IV in 1976; and subsequently negotiations were launched on a basket of commodities. At the time, the idea was to negotiate the establishment of commodity agreements with economic clauses that

could, through their own resources as well as resources borrowed from a common financing facility to be established for this purpose, should be able to finance buffer stocks in order to reduce price fluctuations, and stabilize prices at levels remunerative to producers. Negotiations with respect to such a facility were soon initiated, which later led to the establishment of the Common Fund for Commodities (CFC).

Following the global recession during the 1980s and the subsequent decline of commodity prices as a whole, intervention in markets (at least in favour of developing countries) was no longer deemed acceptable, nor, feasible. This period coincided with the breakdown of multilateralism in international economic relations and the ascendancy of market-oriented strategies under the "Washington Consensus", which advocated the free play of market forces (via price liberalization and deregulation) as the most efficient means of allocation of resources and welfare gains. The concept of international commodity price stabilization thus suffered a major setback.

Why have commodity agreements failed to function, or simply proved impossible to negotiate.

Specifically, the "failure" of commodity agreements has been explained by three schools of thoughts. The first postulates that the breakdown of these agreements reflects the difficulties entailed in attempts to influence prices via output management, or other means. This is particularly so in a context of supply expansion underscored by productivity increases and recently by new producers as is the case of coffee by Vietnam. The second underscores the

difficulties of agreeing to price ranges that would be “equitable” to producers or the difficulty of determining accurately a long-term price trend around which to stabilize prices. And finally, the problems in coordinating the interests of different parties to the (commodity) agreement, as well as the lack, or weaknesses, of enforcement mechanisms and the problem of free riding have been advanced .

On the other hand, it has been argued that these challenges, as serious as they may be, were not insurmountable had there been sufficient political will, backed by adequate financial resources, to make these agreements work . The US had neither supported nor joined CFC, and EU member States would like to reduce the scope for its operations. Some donors have transferred the first account holdings into the second account fund supporting more commodity projects. For example, while a commodity such as petroleum shares many of these difficulties (albeit of a slightly different nature) OPEC through cooperation among its members (and with some non-members) has been able to maintain a certain measure of price stability in the market, despite the fact that prices have fallen in real terms. De Beers has also been able to stabilise the price of diamonds at a fairly high level.

This lack of political support is further illustrated by the fact in the history of ICAs only one agreement had collapsed – that is the Tin Agreement in 1985, ironically after a successful operation of more than 20 years! On the other hand, all the others had lapsed: sugar because of adverse market conditions rendering any attempt at stabilization impractical; cocoa, because of a lack of sufficient support (funds) for the stabilization

authority for effective intervention, and lack of support from the USA and largest producer, the Cote d'Ivoire, which was not a party to the first three agreements; and while there was effective intervention in the coffee market (raising prices and reducing variability), there were problems over division of benefits between countries, and the effects of high prices did not reach farmers. The agreement for natural rubber was trudging on account of the fact that intervention was at a low level – that it gave little enthusiasm for producers and little resentment to consumers .

It is therefore doubtful if these agreements actually "failed", because of the different reasons for which they malfunctioned. A major reason for this is the lack of full support, first, from the major players (the USA and the EU) who would not want to be seen as supporting international actions perceived to be inimical to their domestic private sector interests; and second, in a few cases, from major producers. Also, the holistic approach advocated by UNCTAD to resolving the commodities issue, under its IPC, was never implemented. It could thus be contended that with the necessary political will and support from the international community, and commitment from the producers themselves to the collective good or welfare, such agreements properly implemented would have some chances of attaining their objectives, if the target prices reflect medium- to long-term market trends.

Compensatory financing mechanisms

The best-known examples of compensatory finance are: (i) Contingency and Compensatory Financing Facility (CCFF) of the IMF

(1988), preceded by the Compensatory Financing Facility (CFF), which commenced in 1963; and (ii) the European Union's Stabilization of Export Earnings (STABEX).

The objective of the *CCFF* was to smooth the effects of a temporary, exogenously caused shortfall in merchandise export receipts below the medium-term trend in a particular country. Schemes like these are predicated on the assumption that temporary shortfalls in export earnings will be self-reversing. It is, however, difficult to distinguish between temporary and permanent shocks, as even those considered temporary might turn out to be of a long-term duration.

Marketing Boards

The experience of these Boards varied, but some did perform better than others. In addition, these Boards performed ancillary services such as the supply of insecticides, fumigation services, agricultural extension, provision of rural roads, schools, etc. And their experience cannot be detached from the low development-poverty spiral in which these economies were or are trapped. While some of these Boards were indeed afflicted by a few problems, including corruption, their *reform* would have been better than outright scrapping. The post-adjustment experiences have been mixed, but the evidence to date reveals that on the whole:

- (i) Real producer prices have reflected the declining pattern of world market commodity prices (UNCTAD, 2002).
- (ii) Domestic terms of trade have turned more against farmers in those countries that have liberalized; shift from public to private marketing agents has not increased the proportion of

export prices passed on to producers (Ibid.).

- (iii) Farmers have suffered negative consequences because key production and marketing costs have risen rapidly, prices of fertilizers and transport costs have soared, and lower wages have not helped as hired labour accounts for less than 20 per cent of the total labour force (UNCTAD, 1998).
- (iv) In the case of cocoa: "...market liberalization measures do not appear to have been a resounding success" even considering their limited stated goals. Most significantly, following market liberalization, producer prices displayed greater volatility in Cameroon, Côte d'Ivoire and Nigeria (countries that dismantled their marketing boards) than in Ghana.

Market-based risk management approaches

These are market-based mechanisms, such as forward, futures and option contracts as well as swaps, for managing commodity price risks. Technically, these mechanisms permit producer countries to limit the risks arising from unanticipated price movements by passing them over to investors in other countries. While such instruments have been in use for more than a century mainly in the developed countries, it is only in the past two or three decades that they have become popular as instruments for hedging commodity risk.

Why have these instruments not been used much in developing countries/Africa?

There are a variety of reasons for the restricted use of these instruments in developing countries including:

- (i) Unfamiliarity with their advantages, and of the costs and benefits of alternative contracts available;
- (ii) Some government policies militate against their use;
- (iii) Two-year limited horizon of futures and options markets, which render them unsuitable for exports of those commodities with longer gestation periods;
- (iv) The difficulty of locating an appropriate hedging tool for specific export commodities;
- (v) Low credit worthiness - difficult for developing countries to access other financial markets – for example, for non-standard contracts and longer dated instruments.
- (vi) Shallowness of the financial sector and the limited number of (unsophisticated) financial products on offer also discourage the use of such instruments in Africa.

It is doubtful if the futures markets are suitable for addressing problems of price variability as they are for the reduction of uncertainty in revenue flows: commodity futures prices are only slightly less volatile than cash prices. Thus the futures markets are certainly not the correct instruments for addressing the issue of long-term decline in commodity terms of trade for commodity-dependent countries, as they are best suited to managing risks resulting from short-term price movements. They are more suitable for dealing with variability in revenue flows. And in view of their clear limitations in economies with underdeveloped financial markets, their widespread use for commodity risk management in Africa would depend on technical assistance in

building the required institutional infrastructure, experience and expertise, all of which would take time. Indeed, the dangers in the use of such instruments in African countries, with weak corporate and political governance, is clearly illustrated by the experience of Ashanti Goldfields Company Ltd. (AGC) that lost about \$250m-\$280m through “over-hedging” (collars) in September and October 1999 (for details, see Gilbert, 2001). This was one of the major reasons why AGC was an object of hostile bids during 2002, which eventually led to its take over by Anglo Gold in 2004.

Which way forward?

Domestic Policies

There is very limited room for manoeuvre for most African countries to address the declining terms of trade afflicting its commodity producers primarily because they are price takers. On the other hand, with prudent macroeconomic management including a stable macroeconomic framework underscored by sound exchange rate, fiscal and monetary policies, the impact of these shocks to the economy and producers could be minimised.

Developing institutional capacities via *research* into high-value added products; *quality improvement* (e.g. reducing the moisture content, and proportion of broken beans in the case of cocoa); and more effective extension services, could help in improving the value of their exports; just as and vertical and horizontal diversification (possibly facilitated by a Diversification Fund) into new market dynamic and temperate products with higher income elasticity of demand could also provide a cushion against terms of trade decline. Provision of public goods, for

example, infrastructure, could also address market imperfections and increase margins, while the withdrawal of productive capacity by high cost producing countries, and withdrawal of low quality stocks could address the problem of over supply to some extent. Considering the institutional hiatus created by the dismantling of produce Marketing Boards, there is the need for some institutional innovation to assume some of the critical functions performed by these Boards, in particular as research has shown that the private sector in African countries has failed to take over these functions. The concept of "warehouse receipt system", which is being promoted in Zambia could offer a valuable starting point for discussions regarding a new "public" institution to replace the erstwhile Marketing Boards.

Certainly the reduction and finally the elimination of subsidies and other production support in OECD countries will also go a long way in reducing world supplies for those products, such as cotton, where surplus production is at the heart of dressed prices.

International Policies

The need for a **compensatory financing mechanism** cannot be over-emphasised, but the design and operation of such a facility must be informed by the lessons learnt from the collapse of STABEX, CCFE and the weaknesses of CFC. Thus, any new compensatory financing mechanism must be quick disbursing; counter-cyclical; highly concessional (preferably on a grant basis), and with limited conditionality.

It should be completely unimaginable to resuscitate the idea of commodity agreements in some other garb. A starting point could be for producers to

come together to strengthen their own market positions and bargaining power *vis à vis* the trans-national corporations so dominant in the commodity trade at present. Producers could also take advantage of the new developments in commodity trade and markets based on tailored supply chains if they undertake to meet the interests of consumers, in particular by guaranteeing quality, origin, traceability, and the environmental and social conditions of production, among other qualities. If all producers share this common interest and a vision for collective action as a means of guaranteeing some minimum price levels, this should forestall or at least reduce the risk of "free riding". Second, the price level should also be set at a "realistic level" if it is to be defensible and effective. That is, the target prices should not be completely detached from the medium- to long-term market (price) trend, which would necessitate periodic adjustments, preferably based on an automatic formula to limit political interference

The new multilateral trading system (MTS) defined by the World Trade Organization (WTO) restricts trade policy measures to only those that are consonant with WTO Agreements. Thus any debate on commodity agreements in whatever reincarnation would have to accommodate the sticking issue of WTO compatibility of any mechanism it might engender. Indeed, GATT Article XX (h) does not prevent the adoption or enforcement of any measures by contracting parties "undertaken in pursuance of obligations under any intergovernmental commodity agreement which conforms to criteria submitted to the CONTRACTING PARTIES and not disapproved by them or which is itself so submitted and not so disapproved". This

notwithstanding, "...such measures should not be applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries ..., or a disguised restriction on international trade..." However, as cautioned by Greenfield, any such agreements must meet certain conditions set out in the Havana Charter or otherwise be consonant with WTO disciplines (Greenfield, 2003).

In addition, it would appear that Article XXXVI of GATT (Part IV on Trade and Development) is a bit more explicit on providing some leeway for commodity price stabilization within the WTO framework, when it states in section four that:

"... Given the continued dependence of many less-developed contracting parties on the exportation of a limited range of primary products, there is the need to...wherever appropriate to devise measures designed to stabilize and improve conditions of world markets in these products, including Measures designed to attain stable, equitable and remunerative prices ... to provide them with expanding resources for their economic development"

This provision is further strengthened by GATT Article XXXVIII (2a), which provides for "joint action" "...through international arrangements. and to devise measures to attain stable equitable, and remunerative prices for exports of such products"; and GATT Article (2f) under which contracting parties could "establish such institutional arrangements as may be necessary to further the objectives set forth in Article XXXVI..."

In effect, measures designed and agreed among the less developed countries to influence the supply of their primary commodity exports in order to "attain stable, equitable and remunerative prices" that meet the conditions enunciated in these GATT

Articles could possibly not fall foul of the WTO disciplines. If it proves difficult for any such measures to win legitimacy under these Articles, producer countries could seek derogation from the relevant WTO disciplines to permit them to implement these. Also, it should be possible to explore other avenues for legitimising any apparent WTO non-compatible arrangements in favour of commodity producers, for example, as part of the "collective preferences" suggested by the EU trade Commissioner as an intellectual basis for accommodating non-trade-concerns in the WTO framework.

Conclusions

Admittedly, the current multilateral trade environment defined by the WTO and the dominant neo liberal development ideology are hostile to **International Commodity Agreements (ICAs)**. Indeed, even if the international trade law experts agree on conditions under which it would be legal under these GATT Articles to introduce certain measures that offer some protection against the long run declining trend in prices suffered by poor farmers in developing countries, political opposition to these within the WTO by developed country members may still block the implementation of these. However, this should not necessarily preclude a study of the feasibility for supply management schemes; and working out a financing mechanism to rationalize and diversify supply. It will be difficult winning the argument for revisiting ICAs, but we need to remind ourselves that the persistence of the commodity problem in the last three decades suggests that markets have not, and cannot be expected to solve the problem. Therefore, in terms of meeting the concerns of commodity

producers (addressing declining terms of trade and price variability) there is a clear case of “market failure”. Second, there are contradictions between OECD domestic agricultural support and international level agricultural support for Africa, which are not likely to be addressed effectively in the foreseeable future considering the proposals put forward so far during the on-going discussions within the Doha framework. Third, the need to tackle in more systemic manner the linkage between commodity dependence, poverty and debt relief cannot be gainsaid in the light of evidence produced by recent research (see for example, IMF and World Bank, 2002a and 2002b, UNCTAD 2003).

Dr. Samuel Gayi, from Ghana, is with UNCTAD Secretariat, wrote this article in his personal capacity for the Conference on Agriculture and Commodities held in Geneva in November.

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Chandrakant Patel

A number of commodity-specific initiatives, including proposals before the current session of the UN General Assembly, at UNCTAD Conference in Sao Paulo (to establish a Task Force involving the civil society, Governments, producers, consumers and international organizations to examine all issues relating to the sector) and the report of a Group of Eminent Persons on the crisis in the commodity economy would appear to suggest that the malign neglect that has defined the treatment of the commodity question under the Washington Consensus may be finally ending. The much-deserved attention

given to the plight of cotton producers in Africa and the subsequent introduction of the issue in the Doha Work Programme re-enforces the view that the commodity issue may well begin to get policy-makers attention that the size and importance of the sector warrants.

At the same time, the recent upsurge in prices of minerals in particular, on account of the steep rises in imports by major Asian importers notably, China and India, has led some to argue that the period of steep declines in commodity prices may be over. If, as projected, these economies continue to grow at rates above global averages, their demand will exert upward pressures on prices for the next several decades. Even if such an assertion turned out to be true, it is clear that the positive effects will be concentrated on minerals and not on beverages or related agricultural commodities. In this connection, it should be noted that a well-documented characteristic of commodity price cycles is that they are asymmetric. Over the past 50 years or so, boom cycles have been shorter than slump ones: the IMF isolates an average of 37 months for booms and 63 for slumps. It has also been observed that the duration of slumps exceeds that of booms by nearly a year; and that the magnitude of price falls in slumps is slightly larger than that of price rebounds in subsequent booms, with the rate of change of prices in booms being typically faster than the rate of change of prices in slumps. A common feature of booms and busts in the minerals sector in particular is the long gestation period between investment and output; an increase in investment, in response to an upsurge in demand, often leads to an excess productive capacity with a significant time lag. The newly installed capacity inevitably results,

over time, in price contraction. Conceivably, the international commodity economy may be in the midst of such a cycle.

At a recent Conference on Agriculture and Commodities in Geneva organized, among others, by SEATINI, IATP and OXFAM, many of the issues on the commodity agenda were discussed and strategies to continue to keep the issue alive on global agenda were examined. In the current issue of the Bulletin, Samuel Gayi (an extended version of his paper is available upon request to the editor or the author) outlines the contours of a new generation of commodity agreements. These include, for example, the need for future agreements to take into account heterogeneity of markets, producers, products and consumers; the need to address the problem of 'free riders' (i.e. producers outside the agreement securing benefits of higher prices resulting from the agreement); the need to recognize the much greater concentration of markets, and the role that multinational corporations now play in the value chain; the tendency for steep changes in technology leading to productivity improvements resulting in continuing pressures on prices ; the observed long-term tendency for a reduction in the use of raw materials per unit of final output etc. Moreover, the disappearance of state actors -- like state export enterprises and state marketing boards -- which were once the key counterparts in government-to-government agreements, , suggests that the next generation of commodity arrangements will need to pay increased attention to the role and

influence of multinational marketing and distribution entities in the global commodity markets.

The foregoing suggests that arriving at commodity agreements--even assuming that the major players in this sector- were to completely reverse their long-standing opposition to such agreements and support supply management initiatives-- will be a very difficult challenge.

In the wider context of the WTO's Agreement on Agriculture and the expectation of its reform, Professor Darryl Ray examines question of the likely consequences of a reduction in subsidies for US farmers. He observes the historical tendency towards sustained rises in output on account of research, technology and acreage-expansion driven productivity growth. The conclusion he reaches is a sobering one, namely the likely continuation of overproduction and exports, irrespective of the levels of subsidies provided to the farm sector. Whilst supporting international supply management policies as a possible response, a view equally relevant with respect to primary commodities, the long-term challenge for policy-makers and farmers in Africa and elsewhere must be to diversify away from agriculture and primary commodities to activities that embody increased value.

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