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# Conspiracy of silence: old and new directions on commodities

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*There is, on this subject of commodities, a sort of conspiracy of silence. There are no simple solutions. Many of the remedies introduced in the past - especially the major commodity agreements - have failed and we do not want to repeat these experiences. Yet there is no justification for the current indifference.<sup>2</sup>*

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<sup>2</sup> Speech by President Jacques Chirac to the 22nd summit of the heads of state of Africa and France, Paris, February 2003

## Executive Summary

This paper explores five main approaches to the commodities issue:

1. **'Mainstream'**: includes both macro level issues such as WTO agriculture negotiations, compensation and aid schemes, as well as micro strategies such as diversification; market-based price risk management
2. **'Sustainable commodities'**: improved environmental management; fair trade; organics; corporate social responsibility
3. **'National coordination'**: state marketing boards; producer organisations; increased attention to quality and product differentiation
4. **'International coordination'**: supply management; harmonisation of standards
5. **'Market Power'**: national and international competition law; increased monitoring and transparency

**The Problem:** The 'commodity problem' is often described as a combination of declining terms of trade and price volatility. More recently, Market Power in commodity supply chains has been widely discussed, since it is held to be driving down prices, especially those received by farmers.

There is some evidence that this traditional commodities story may be changing, following a distinct breakpoint in the mid-1980s. Prior to that time, prices fluctuated widely while the overall trend declined steeply. Since then, however, both the fluctuations and the trend have flattened out considerably. Moreover, since 2001, prices have recovered sharply since the low points of the 1990s, driven partly by booming demand in China. However, price bubbles and booms are invariably accompanied by predictions that this time, things are different, and the good times will never end. History suggests circumspection is in order.

These problems face all countries that produce commodities, but are more serious for agricultural commodity-dependent developing countries (ACDDCs) that are more dependent on agricultural commodity exports and specialise in producing one or a few crops. Over time, more successful developing countries have diversified either into more dynamic sectors within commodities, or out of agriculture altogether. But in the Least Developed Countries (LDCs), dependence on these products for agricultural export earnings actually increased from 59% to 72% over the last 40 years. The ACDDC category can thus be seen as a residual group of those countries that have failed to find an exit from commodity dependence through conventional policy prescriptions.

Such dependence is exacerbated by the difficulties LDCs and others face in capturing a larger slice of the value added on their commodities. Price volatility also leads to uncertainty of foreign exchange earnings, which in turn undermines debt sustainability. Out of 42 Heavily Indebted Poor Countries (HIPC), 37 rely on primary commodities for more than half of their merchandise export earnings.

In many ACDDCs the producers and workers directly affected by agricultural commodity exports are among the poorest of the population. Cocoa, for example, provides livelihoods for 14 million rural workers on big plantations and for a further 2.5 million small producers. Coffee provides income for 25 million producers.

Intensification in commodity production can lead to increased soil erosion and exhaustion, reduced biodiversity, increased pollution and can divert scarce water supplies. At a global level, there are concerns over the use of fossil fuels (e.g. in fertilisers) and the impact on climate change of intensive soil use.

### ***Mainstream Approaches***

Within the mainstream paradigm, commodity dependence is seen as a problem, especially when countries are seen as uncompetitive. The solution generally lies in diversification, either horizontally into other products, preferably non-agricultural, or vertically into higher value-added links in the supply chain. Short-term improvements in productivity and quality are seen as ways to fund diversification.

The nature of the debate varies greatly between so-called 'competing commodities', produced in both developed and developing countries (e.g. cotton, sugar, rice) and non-competing, or tropical commodities such as coffee and cocoa.

For competing commodities, the crucible of discussion is the Doha round of WTO negotiations and to a lesser extent in regional trade negotiations. Here, issues such as northern subsidies, and market access for commodities in both North and South are seen as central to improving the lot of ACDDCs.

Within mainstream organizations such as the World Bank and the more economically liberal northern governments, the generally accepted view is that through a combination of subsidies and restrictions on market access, government intervention in the North has disrupted the natural order of economic development. Whereas developed countries should largely move out of agriculture into manufacturing and services, allowing poor countries to benefit from their comparative advantage in natural resources, the opposite has in fact occurred. Subsidies also come under attack for their environmental impact.

The issue of preference regimes and their erosion by multilateral liberalisation is becoming increasingly important. Within the WTO, northern negotiators are concerned that preference erosion is turning a group of ACP countries into blockers who stand to gain more from defending their preference margins by preventing further multilateral liberalization, than from a successful conclusion to the Doha round. Such fears are driving renewed interest in increasing financial flows to preference-receiving ACDDCs to compensate them for preference erosion.

Compared to the WTO debates on competing commodities, the mainstream policy discussion on tropical commodities is remarkably threadbare, mainly consisting of condemnations of past remedies such as supply management, exhortations to diversify, and largely unsuccessful attempts to harness market-based mechanisms in order to smooth price volatility.

### **Sustainable Commodities**

Environmental and Development NGOs and others trying to influence the social and environmental impact of commodity production have largely focussed on progressive versions of process and production methods (PPMs). Although schemes such as the fairtrade mark remain small (currently turning over \$500mn per annum) in terms of

world trade, they are growing fast. Fairtrade and other approaches channel a premium to poor producers and good environmental practices from socially conscious consumers, through a variety of labelling schemes.

In recent years, a number of corporate-driven schemes have followed suit, introducing social and environmental schemes that both hold out the possibility of influencing much greater volumes of production, and the threat of significantly watering down the standards involved. Moreover, concerns have been raised about the potential for both niche and mainstream labelling schemes on small scale producers, for example as large supermarkets move into organics and demand levels of scale and traceability that exclude small farmers.

### **National Coordination: the state and producer organizations**

The structural adjustment programmes (SAPs) of the 1980s and 90s dismembered many state-led coordination and support structures in developing countries, through the abolition of state marketing boards, cut-backs in sources of finance and sharp reductions in technical assistance programmes.

The records of marketing boards were mixed. In the late 1970s and early 1980s, governments often used them to tax agriculture and suppress food prices for higher priority urban populations. If administered prices were too low, farmers were cheated, while excessive prices created financial difficulties for the marketing board. In addition, they provided little incentive for quality improvements and suffered from inefficiency and rent-seeking behaviour, including corruption.

Nevertheless, some argue that crop marketing boards played a vital role in the development of the agricultural export sectors in several African countries and the policy of dismantling them has been widely criticised. Apart from their role in stabilising prices, they were important for providing ancillary services, such as extension and rural infrastructure, including input provision, product distribution services and credit. Following their abolition, small scale farmers were left atomized and weakened, easy prey for more powerful sections of the value chain such as traders and retailers.

Much of the current debate revolves around a revived role for the state. A closer examination of the role of producer organisations in improving the outcomes for small farmers and poor farm labourers could also produce new policy ideas, especially in post-liberalisation situations where the role of the state is likely to remain constrained.

Whether a return to state marketing boards is either desirable or feasible is a moot point. The challenge is how to ensure that the state does not replicate past mistakes, but equips poor producers to engage with the market on more beneficial terms. National supply management may have a future for some countries and sectors. Elsewhere interventions that scale-up the competitiveness and bargaining power of smallholders at national level in producing countries may be more effective.

### **International coordination and supply management**

Ever since the demise of the International Commodity Agreements (ICAs), one of the most polarised debates around the commodities issues has been that of supply management at an international level. For some, it is, if not a magic bullet, an

essential first step in any attempt to address the commodity crisis. For others, it is both a political impossibility and a distraction from more important issues, such as Market Power or producer organization.

A number of reasons have been advanced as to why this generation of commodity agreements failed. Some believe that the breakdown reflects the difficulties involved in trying to limit production at a time when productivity increases are expanding supply. Lack of enforcement mechanisms and the free-rider problem have also been suggested. In the case of competing commodities, such as sugar, the impact of developed country farm policies played an important role in undermining the agreement.

What is clear, however, is that whatever their flaws, ICAs achieved some beneficial impacts on price levels and volatility. In coffee, the agreement succeeded in stabilising prices and persistently raised them by 24-30% over what would otherwise have been market clearing levels. For that reason, interest in international supply management has revived in recent years. Critics, however, see demanding the return of ICAs as a policy dead end, doomed to fail because consumer countries would refuse to sign up, while at a national level, structural adjustment programmes have destroyed the market coordination mechanisms needed to enforce ICAs.

### **Market Power**

Agricultural products are linked to final consumers through so-called global value chains. As with all agricultural producers, ACDDCs are capturing less and less of the value of their markets relative to traders, processors, wholesalers and retailers. In addition, the destruction of marketing boards has further reduced the capacity of farmers to raise their share in value chain rents by removing a useful intermediary that could improve farmers' bargaining power with large corporate buyers, while the international markets for agricultural commodities have become much more concentrated.

Concentration has created two different forms of value chain. In buyer-driven chains, such as those in horticulture or specialty coffees, retailers dominate, and demand a combination of high quality, standards and product differentiation. In contrast, trader-dominated supply chains prevail in bulk commodities, where the main impact of corporate concentration is to drive down producer prices.

Value chains have shifted the balance of power against small-scale farmers. Larger farmers with deep enough pockets, low enough costs and the right kind of technology to meet rapidly changing requirements in volumes, standards and new product development stand to benefit. Moreover, concentration is not just a developed country issue. Supermarkets are spreading rapidly in developing countries. Consequently, small farmers producing for the domestic market increasingly face the same barriers to entry as those trying to export.

A number of measures have been proposed that would contribute to reducing market concentration. These include strengthening national and international competition law. At an international level, many NGOs and developing countries feel the WTO is an inappropriate home for rules on competition. National competition law could address some of these issues, but only if it shifts from its current focus on consumer

welfare and retail prices (i.e. monopoly/oligopoly) to one on producers and farmgate prices (monopsony/oligopsony).

Improved monitoring and transparency offers a less ambitious approach, for example by reviving the defunct UN Centre on Transnational Corporations in a monitoring role. Current WTO rules require governments to complete questionnaires about any state trading enterprises operating in their country. That approach could be expanded to include market-dominant companies.

### **Conclusion**

There are inevitably overlaps between these approaches, but they offer a useful point of entry to discussing possible measures to address the 'commodity question'. If judged useful, the next stage of refinement would be to run the comparative analysis used in this paper for the main sub-categories of commodities (e.g. cereals, tropical commodities and perishables). For advocates seeking to increase the international attention devoted to this issue, one way forward may be to clarify which elements of the non-mainstream agenda go with the grain of the mainstream approaches, and which go against it. The latter are more likely to prosper in the international arena. Some thoughts on this are contained in table 4.

## **Introduction**

This paper briefly summarizes the main aspects of the crisis affecting agricultural commodities, both those that compete with northern agriculture (e.g. sugar, corn) and the non-competing commodities such as coffee and tea, also known as tropical commodities.

It then goes on to examine and compare the main approaches taken both within the mainstream policy community, and among a wider range of thinkers and advocates. It identifies five main currents within such approaches:

1. '**Mainstream**': includes both macro level issues such as WTO agriculture negotiations; compensation and aid schemes and micro strategies such as diversification; market-based price risk management
2. '**Sustainable commodities**': improved environmental management; fair trade; organics; corporate social responsibility
3. '**National coordination**': state marketing boards; producer organisations; increased attention to quality and product differentiation
4. '**International coordination**': supply management; harmonisation of standards
5. '**Market Power**': national and international competition law; increased monitoring and transparency

A final section compares the impact and feasibility of these approaches, and discusses the degree of complementarity between them. This paper draws on an earlier paper for the UK Department for International Development, co-written by the author with Ian Gillson, Steve Wiggins and Nilah Pandian (Gillson, Green et al, 2004).

## Part I: the problem

The 'commodity problem' is often described as a combination of declining terms of trade (commodity prices rising less rapidly than those of manufactures) and price volatility. Producers therefore face the dual problem of low returns and high risks (Page and Hewitt, 2001). More recently, a third element has been widely discussed, namely corporate concentration in commodity supply chains, which is held both to be driving down prices in general, and further reducing the share of export prices going to farmers (Gibbon, 2004).

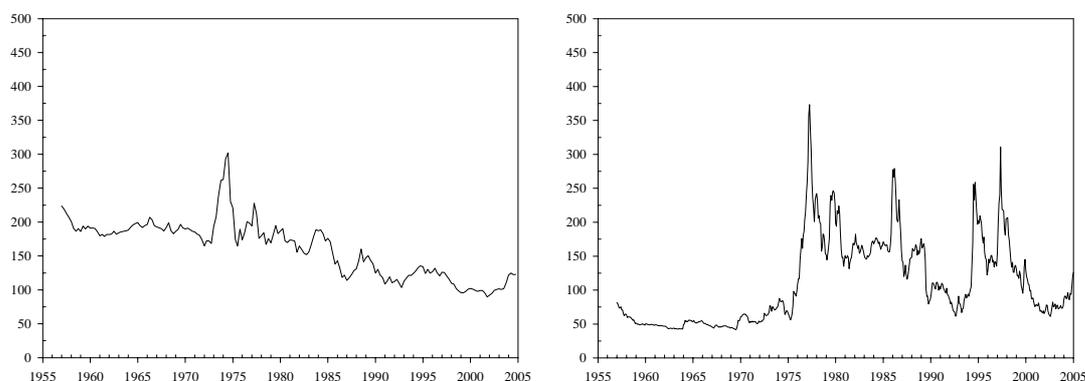
### *Long-term decline in prices*

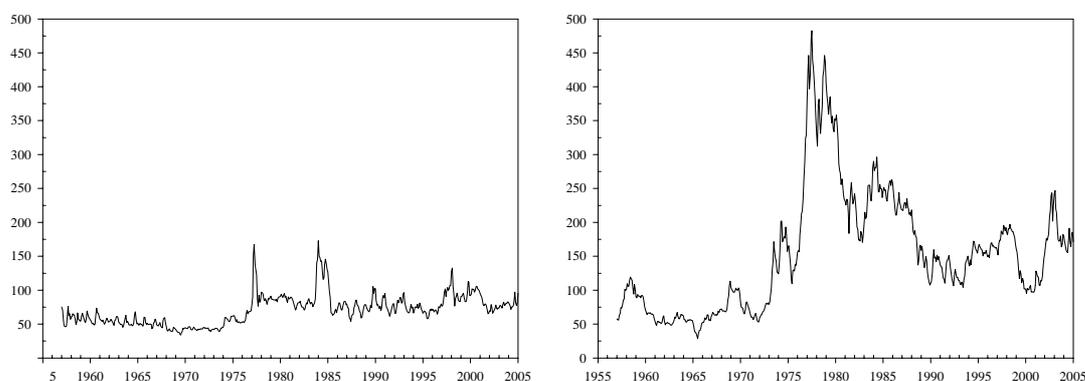
Analytical work (e.g. Prebisch, 1950; Singer, 1950) concluded that in the long run, the price of primary commodities declines relative to manufactures. This hypothesis has been repeatedly tested and found valid (e.g. Spraos, 1983; Bloch and Sapsford, 2000). Over the past four decades, real prices for agricultural commodities declined by about 2% per year. If prices for the ten most important (in terms of export values) agricultural commodities exported by developing countries had risen in line with inflation since 1980, these exporters would have received around US\$112 billion more in 2002 than they actually did. This is more than twice the total amount of aid distributed worldwide (FAO, 2004).

Theoretical analysis suggests that agricultural commodity prices fall relative to others because of relatively inelastic demand and because of the lack of differentiation among producers, which means that the markets are competitive. Moreover, the decline in agricultural commodity prices is likely to continue. On the supply side, technological improvements, increased competition, reduced protection of markets and devaluation of some national currencies (e.g. CFA franc) of many agricultural commodity-producing countries (following structural adjustment programmes) have all contributed to significant increases in production. On the demand side, the development of synthetic substitutes, which further displace agricultural commodities as intermediate inputs and consumption items, and slower population growth will act to depress demand growth.

Prices vary between different commodities. The UN notes 'the two groups for which the developing countries account for the largest shares in world exports, namely tropical beverages and vegetable oilseeds and oils, show the highest rates of decline in prices' (UN, 2000). However, whereas the relative growth of global demand for traditional agricultural commodities (such as coffee) has weakened, that for some agricultural products has been on the increase. These new dynamic products include fruits, vegetables, fish, and dairy products. The different demand growth for different products reflects, in part, changing consumer habits (UN, 2002).

**Figure 1: Cycles in real prices of selected primary commodities, 1957-2005 (2000=100)**





Source: IMF, International Financial Statistics (2005).

### ***Price volatility***

In addition to their long-term decline, the prices of many agricultural commodities show a high degree of volatility, caused by time lags between production decisions and delivery to the market; delayed and inappropriate responses by producers to price signals; inelastic supply and natural shocks. The characteristic behaviour of commodity price cycles is one of ‘flat bottoms punctuated by occasional sharp peaks’ (Gilbert, 1999), i.e. periods of low prices endure for longer than price spikes. This trend is illustrated in Figure 1.

### ***Is the commodity crisis permanent?***

There is some evidence that the traditional picture of commodities as a developmental blind alley may be changing. Firstly, there appears to be a distinct breakpoint in the mid-1980s. Prior to that time, prices fluctuated widely while the overall trend declined steeply. Since then, however, both the fluctuations and the trend have flattened out considerably. This change is explained in part by a slowdown in the formerly rapid growth of prices for manufactured goods (due to the growing importance of developing countries into manufacturing industry, pushing down prices) (FAO, 2004). For some authors, this has changed the logic of development, strengthening the case for looking for progress within commodities, rather than the traditional option of exit into manufacturing or services (Kaplinsky, 2003). However, this finding is disputed by UNCTAD, which does not see any evidence of a significant breakpoint.<sup>3</sup>

Moreover, since 2001, prices have recovered sharply since the low points of the 1990s, driven partly by booming demand in China and other rapidly-growing developing countries. Opinions differed over whether this is just another price spike or part of an extended ‘super cycle’ – an extended period of high prices that defies the normal rules of boom and bust (Financial Times 2005). Moreover, the recovery has

<sup>3</sup> Mehmet Arda, personal communication, June 2005

been much stronger in some commodities than others. Compared to 2000 prices, for example, cereals showed a relatively uniform 20-30% increase by 2004, whereas the picture in tropical commodities varied from a 70% increase for palm oil and cocoa, to a price fall in sugar, coffee and tea (though all three were rising from troughs in the early 2000s) (see appendix 1).

It should be remembered, however, that price bubbles and booms are invariably accompanied by predictions that this time, things are different, and the good times will never end. History suggests circumspection is in order. One cause for caution is the looming impact of nanotechnology, which lead to a new generation of products that substitute for traditional commodities such as cotton or oil (ETC 2004). Climate change on the other hand, is likely to reduce commodity yields and so raise prices.

### ***The impact of agricultural commodity price decline and volatility on developing countries***

These problems face all countries that produce commodities, but are more serious for agricultural commodity-dependent developing countries (ACDDCs). ACDDCs are defined as being those countries that are more dependent on agricultural commodity exports and specialise in producing one or a few commodities (Dehn, 2000).

Over time, more successful developing countries have diversified either into more dynamic sectors within commodities, or out of agriculture altogether. The better equipped developing countries have moved into more dynamic areas, either within agriculture or beyond, leaving the LDCs behind. Non-LDC developing countries reduced their reliance on tropical beverages and raw materials in their total agricultural exports from more than 55% in the early 1960s to around 30% in 1999–2001. But in the LDCs, dependence on these products for agricultural export earnings actually increased from 59% to 72% during the same period (FAO 2004).

Such dependence is exacerbated by the difficulties LDCs and others face in capturing a larger slice of the value added on their commodities. A combination of poor infrastructure, distance from markets, lack of technology, tariff escalation and their relative powerlessness in buyer-driven global value chains means few poor countries have managed to process their own raw commodities, instead exporting their products at low prices to be turned into high value goods in the developed countries.

For many governments, uncertainty of foreign exchange earnings combined with lack of access to credit that could smooth fluctuations in income makes long-term planning of spending difficult. Debt sustainability then becomes a major issue. Sharp falls in prices can threaten the ability of Heavily Indebted Poor Countries (HIPCs) to exit from unsustainable debt. Out of 42 HIPCs, 37 rely on primary commodities for more than half of their merchandise export earnings (FAO 2004). If prices fall after the required level of debt relief has been pledged, this level will be insufficient by the time the country completes the process (DTI, 2004).

### ***The extent of agricultural commodity dependence***

The effects of long-term declines and volatility in agricultural commodity prices are greater when a country remains particularly dependent on agricultural commodity exports. This is principally a problem of small developing countries that have found it difficult to diversify due to political, economic or entrepreneurial obstacles. The

ACDDC category is thus partly a residual group of those countries that have failed to find an exit from commodity dependence through conventional policy prescriptions. Many of these countries are Least Developed and/or among the EU's associated countries in Africa, the Caribbean and the Pacific (ACP). Almost all of the countries in sub-Saharan Africa rely on primary commodities (including non-agricultural) for over half of their exports, with some countries relying particularly on one, two or three commodities (see appendix 2).

### ***Social and Environmental Impact***

The failure to tackle the link between agricultural commodity dependence and extreme poverty has been dubbed as a 'conspiracy of silence' by President Chirac, and described as the 'major sin of omission' in current international efforts to reduce poverty (UNCTAD 2004a). Although implementing such strategies may not require large financial resources from governments, they would require sufficient technical capacity and political will, something that has been an impediment in the past. UNCTAD (2003b) has called for increased donor support to build such capacity.

In many ACDDCs the producers and workers directly affected by agricultural commodity exports are among the poorest of the population. Cocoa, for example, provides livelihoods for 14 million rural workers on big plantations and for a further 2.5 million small producers. Coffee provides income for 25 million producers. Price falls or fluctuations put exceptional strains on efforts to reduce poverty.

In some commodities such as bananas, palm oil and tea, NGOs claim that the downward pressure on prices has triggered a 'race to the bottom' in wages and working conditions on plantations, including casualisation of labour, the use of child labour, increased workloads, reduced benefits such as health provision, schooling and housing. International trade unions such as the IUF point out that 40% of the global agricultural workforce are waged labourers, and yet their fate is largely ignored in the commodity debate.<sup>4</sup>

However, according to Gibbon (2004), smallholders are the worst hit by a combination of low and volatile prices, and changes implemented since the 1980s under a swathe of structural adjustment programmes.

Large-estate commodity production has fared much better than smallholder production since the advent of structural adjustment, partly because estates alone now enjoy economies of scale and partly because of the evaporation of many of the sources of competitive advantage that smallholders once enjoyed – such as conventions of quality that rewarded land husbandry based on hand-cultivation and mixed cropping, as well as ability to exercise detailed control over labour. At the same time, countries with smallholder-based systems, because they are poorer and less economically diversified, have been much more exposed to the commodity crisis than ones where large estates play the leading role.

When discussing the social impact of the commodity crisis and different responses, the relative importance of consumers and producers is hotly disputed. Some advocates

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<sup>4</sup> Sue Longley, IUF, personal communication, June 2005

of higher prices ignore consumer impact altogether, while the more extreme proponents of liberalization seem equally casual about the impact on producers. In reality, many of the rural poor are net consumers, forced to buy food for part or all of the year, often combining subsistence production with other forms of income generation, including labour on larger farms. Rising or falling prices therefore have complex impacts on family livelihoods, compounded by issues such as seasonal price variations – farmers are often forced to sell cheap at harvest time, and then buy dear when their own food supplies run out. A nuanced and comprehensive livelihoods approach is essential in trying to unravel the link between commodity prices and wellbeing.

SAPs have thus had the reverse effect to that intended, which was to increase producer incomes by raising the share of export prices going to farmers, thereby encouraging them to invest and upgrade their production. Instead, as competition in the sector has grown, many countries have in fact witnessed a process of downgrading in quality, and progressive marginalisation of producers within supply chains increasingly dominated by large, usually transnational, corporations.

A number of authors also raise concerns about the environmental impact of some commodity sectors. Intensification in commodity production can lead to increased soil erosion and exhaustion, reduced biodiversity, increased pollution (e.g. through the excessive use of pesticides) and can divert scarce water supplies. At a global level, there are concerns over the use of fossil fuels (e.g. in fertilisers) and the impact on climate change of intensive soil use (Clay, 2004b).

## **2: Mainstream Approaches**

This section reviews what can be categorised as ‘mainstream’ views on problems and solutions to commodity dependence. These currently hold sway in influential institutions such as the World Bank, bilateral donor agencies such as DFID and more broadly among the ‘policy and decision-making community’ of politicians, civil servants, consultants and academics. Categorizing any set of views as ‘mainstream’ is necessarily both a simplification and a caricature: views within these circles are not monolithic; differences and debates are vigorous and the boundary between ‘mainstream’ and ‘alternative’ is both porous and blurred. In particular, what counts as mainstream in Europe is often seen as dangerously radical in Washington, (and occasionally vice versa).

Within the mainstream paradigm, commodity dependence is seen as a problem, especially when countries are seen as uncompetitive. The solution generally lies in diversification, either horizontally into other products, preferably non-agricultural, or vertically into higher value-added links in the supply chain. Short-term improvements in productivity and quality are seen as ways to fund diversification.

The first section deals with macro solutions, including the role of international trade rules, northern subsidy regimes and commodity-linked aid flows. The second section goes more ‘micro’, exploring mainstream thinking at sectoral and firm level within developing countries.

## **Macro Approaches**

The nature of the debate varies greatly between so-called 'competing commodities', produced in both developed and developing countries (e.g. cotton, sugar, rice) and non-competing, or tropical commodities such as coffee and cocoa.

For competing commodities, the crucible of discussion is the Doha round of WTO negotiations and to a lesser extent in regional trade negotiations such as the EU's Economic Partnership Agreements or the Free Trade Area of the Americas. Here, issues such as northern subsidies, and market access for commodities in both North and South are seen as central to improving the lot of ACDDCs.

Within competing and to a lesser extent, non-competing commodities, the issue of preference regimes and their erosion by multilateral liberalisation is becoming increasingly important. An exporting country experiences preference erosion when an importing country removes tariff preferences, expands the number of exporting countries eligible to benefit from preferential access to its market or reduces its most-favoured nation (MFN) tariff to third-country exporters without maintaining margins of preference (by reducing preferential tariffs). The highest margins of preferences, and therefore the highest income transfers, are for sugar, bananas and clothing, which are often dominant in the export structures of those countries predicted to lose the most from preference erosion.

While there have been some attempts to raise the issue of tropical commodities within the Doha round, these have not to date met with much success, mainly because average tariffs are low on these commodities and they receive very little / no domestic support / export subsidy. Instead, The mainstream debate on tropicals largely revolves around financing diversification and improvements in productivity.

### ***COMPETING COMMODITIES***

The generally accepted view is that through a combination of subsidies and restrictions on market access, government intervention in the North has disrupted the natural order of economic development. Whereas developed countries should largely move out of agriculture into manufacturing and services, allowing poor countries to benefit from their comparative advantage in natural resources, the opposite has in fact occurred. Over the course of the past 40 years, the net flow of agricultural commodities between developed and developing countries has reversed direction. In the early 1960s, developing countries had an overall agricultural trade surplus of almost US\$7 billion per year. By the end of the 1980s, however, this surplus had disappeared. During most of the 1990s and early 2000s, developing countries were net importers of agricultural products. FAO has projected that this agricultural trade deficit is likely to widen markedly. The change has been even more pronounced for the LDCs (FAO 2004).

#### ***Northern Subsidies***

The most trenchant view of the reasons for this apparent anomaly comes from Kevin Watkins (2004):

Rules in the WTO perpetuate a system under which the distribution of opportunity in agricultural trade is shaped not by comparative advantage, but

by comparative access to subsidies – an area in which rich countries have an unrivalled advantage... The Uruguay Round Agreement on Agriculture (AoA) provided a multilateral façade for what was a bilateral arrangement designed to accommodate, rather than constrain, EU and US subsidies.

The anti-subsidy argument points out that the WTO Agreement on Agriculture (AoA) treats developed and developing countries in a discriminatory manner. Developed countries tend to use subsidies to support their agricultural sector, while cash-strapped developing countries tend to use tariffs to support their farmers by keeping prices high on the domestic market. Koning (2004) calls tariffs the ‘poor man’s instrument of support’. Thanks to the so-called Blair House agreement between the EU and US, which paved the way to a final deal in the Uruguay Round, the AoA places no upper limit on subsidies, but (except for LDCs) does constrain the use of tariffs.

The Blair House agreement introduced a crucial distinction between ‘trade distorting’ and ‘non-trade distorting’ subsidies. Trade distorting subsidies, such as payments per head or per bushel, were to be reduced, but non-trade distorting subsidies, such as payments that were *decoupled* from production, were not.

While payments per bushel are clearly likely to affect farmers’ production decisions more than subsidies for encouraging songbirds or hedgerow retention, arguments remain over the impact of payments that fall between these two extremes, especially in the ‘subsidy superpowers’ of the EU and US.

Watkins concludes that the distinction is ‘unworkable and unwarranted’. The World Bank (2005) largely agrees, pointing out that from 1986-8 to 2000-02, domestic subsidies in the OECD rose by 60%, even as they shifted to less distorting forms of payments. Quantity thus undermined the change in quality towards less distorting forms of subsidy. According to the Bank, the effects of decoupling on production ‘have been modest. In many cases overproduction has continued.’ The Bank argues that the continued coexistence of coupled and decoupled programmes means that incentives to overproduce remain. In the four decoupling cases it examined, all either left some coupled support programs in place or added new ones.

Subsidies also come under attack for their environmental impact. Clay (2004a) argues that globally, subsidy regimes result in more environmental impacts than any other single set of policies. Producers whose production or exports are subsidized or whose markets are protected have an unfair advantage over those who do not receive similar support. If they are encouraged to overproduce this in itself will have an adverse environmental impact. In agriculture, environmental impacts are associated with changes in the volume of production of agricultural products, implying use of a greater or smaller land area for production under existing technology, switches away from or to particular crops that have different environmental effects associated with them (for example cotton’s high use of water), and changes in technology, that is, the mix of land, labour and other inputs such as fertilisers and pesticides utilised in production – rather than or as well as increasing (decreasing) the area of land under production, the existing area may be used more (less) intensively. To compete, producers who are not subsidized often cut corners to reduce their costs of production and remain competitive.

However, others (both mainstream and beyond) believe subsidies do not merit their prime suspect status. Unsurprisingly, the EU and US claim that their forms of decoupled payments are indeed non or minimally trade-distorting and a great improvement on the past. On the progressive end of the spectrum, some authors argue that subsidies are a symptom of over-production, not a cause. The real culprit, they believe, is the abandonment of supply management schemes in the North. The answer is thus a return to supply management, not an attack on subsidies (Ray et al, 2003).

The WTO Agreement on Agriculture draws a distinction between domestic subsidies and what it terms ‘export competition’ measures, including direct export subsidies. The Doha round is bringing considerable pressure to bear on countries that use export subsidies to dump surplus production. The case against export subsidies is broadly accepted (with some exceptions in the French Ministry of Agriculture). The EU is responsible for 90% of global export subsidies, and after years of resistance, agreed in the August 2004 framework agreement to negotiate an end date for such subsidies, which member states agree to be anywhere from 2010 (UK) to 2015-17 (France). In any case, export subsidies are in decline, falling globally from \$7.5bn in 1995 to \$3bn in 2001 (FAO 2005).

More disagreement exists over attempts within the WTO to discipline other forms of export competition, which critics claim are little more than disguised subsidies. These include officially supported export credits, whose value rose from \$5.5bn in 1995 to \$27.8bn in 1998 (the last date for which data are available) (FAO 2005).<sup>5</sup> Oxfam (2005b) has devised an ‘export support equivalent’ that combines direct subsidies with the portion of other transfers such as export credits destined for exports. It arrives at figures of \$5.2bn per annum for the EU, and \$6.6bn for the US.

### ***Market Access***

Within the mainstream paradigm, there is general agreement that the central ‘trade liberalisation leads to growth leads to poverty reduction’ proposition holds true, and that both developed and developing countries would benefit from lowering their tariffs. Indeed, due to higher average tariffs in developing countries, the World Bank’s models predict that global liberalization would actually benefit developing countries more (see Table 1).

**Table 1. Gains from Removing All Trade Barriers in Agriculture and Food Globally, Post-Uruguay Round, 2005 (in 1997 US\$ Billions)**

<b>Liberalizing Region</b>	<b>Benefiting Region</b>	<b>with Fixed Productivity</b>	<b>With Endogenous Productivity</b>
<i>High income</i>	<b>High income</b>	<b>73</b>	<b>144</b>
	<b>Low income</b>	<b>31</b>	<b>99</b>
	<b>Total</b>	<b>104</b>	<b>243</b>
<i>Low income and middle income</i>	<b>High income</b>	<b>23</b>	<b>53</b>

<sup>5</sup> For excellent summaries of the evidence on export competition and other aspects of the WTO negotiations on agriculture, see FAO Trade Policy Technical Notes, [http://www.fao.org/trade/policy\\_en.asp](http://www.fao.org/trade/policy_en.asp)

<b>Low income</b>	<b>114</b>	<b>294</b>
<b>Total</b>	<b>137</b>	<b>347</b>

*All countries*

<b>High income</b>	<b>106</b>	<b>196</b>
<b>Low income</b>	<b>142</b>	<b>390</b>
<b>Total</b>	<b>248</b>	<b>586</b>

**Source:** Global Agricultural Trade and Developing Countries, M Ataman Aksoy and John C Beghin, eds, World Bank, 2005

While there is broad agreement on the developmental benefits of northern market access (e.g. reduction in tariff peaks on particular developing country exports, or escalating tariffs on processed goods, which deter higher value added production in poor countries), there is much more disagreement on the appropriate tariff regimes in developing countries. Orthodox economists tend to stress the benefits of liberalization, and the growing importance of South-South agricultural trade, while others raise concerns over the distributional impact of southern liberalization, as it increases pressures on smallholder agriculture and paves the way for expansion of labour extensive agribusiness in developing countries. Some NGOs also criticize liberalization at early stages of development on infant industry grounds, arguing that tariff protection is often necessary in the initial stages, and is generally withdrawn as a country develops (Oxfam 2005a).

**Preferences**

The thorny issue of preferential access to developed country markets for certain categories of developing countries is becoming increasingly prominent in the WTO and other fora. The subject applies both to competing commodities such as sugar (cane v beet), and non-competing commodities such as bananas.<sup>6</sup> In both categories, preferences can advantage one group of ACDDCs over another (in the banana case, ACP countries over Latin America), causing tensions between developing countries that are easily exploited by northern trade negotiators.

Commodity protocols for bananas<sup>7</sup>, beef/veal, rum<sup>8</sup>, and sugar attached to the Cotonou Agreement (and before it under the Lomé agreements) extend quota access

<sup>6</sup> Although, technically, the EU produces almost 20 percent of its total banana consumption in the Canary Islands (Spain); in the French Overseas Departments of Martinique and Guadeloupe; in Madeira and the Azores (Portugal); and, very small quantities in Crete (Greece). The rest is imported from the ACP countries and from Latin America.

<sup>7</sup> Quotas are still in place but will be going soon. On 27 October 2004 the EU proposed a single duty on third-country imports of bananas of €230/tonne that will replace the current quota system from 2006.

<sup>8</sup> The Rum Protocol, which existed between 1975 and 2001 as part of the successive Lomé agreements, is almost irrelevant now. Under it, Caribbean ACP countries received quota-restricted duty-free access to the EU market for their aged brown rums and bulk white rum exports. Quantitative restrictions were to protect French interests for their rum produced in Martinique, Guadeloupe and Réunion. In November 1996, at the Singapore WTO Ministerial, the EU agreed to liberalise its market for white spirits including gin, vodka and rum in return for better access to the US technology market. In accordance with the MFN principle these concessions had to be extended to all exporters including imports of rum from Brazil, Panama, Mexico and Venezuela. Under the agreement, four of the six tariff lines for rum were reduced to zero by 2003. Low tariffs continue to apply on the two remaining tariff lines (providing small preferences for ACP rum exports) but these will be phased out by 2010. Losses to the Caribbean ACP rum producers due to preference erosion have been estimated to be US\$260

to the highly protected (high price) European market for those products from traditional exporting countries of the ACP group. For many ACP states, these generated substantial foreign exchange revenue and employment. In some cases preferences also encouraged export diversification by providing tariff exemption for most other ACP exports. Examples include Mauritius (from sugar to clothing and services) and Zimbabwe (from tobacco to textiles, clothing and horticulture). In general, however, preferences (especially for protocol beneficiaries) are criticised for having stifled diversification, by making commodity-dependence profitable.

The structure of preferences is under assault from reforms such as the EU's drive to move from preferences to 'economic partnership agreements' with its former colonies in the ACP, WTO rulings on bananas and sugar, CAP reform, and more generally from the issue of preference erosion. As developed country tariff barriers come down, the margin afforded by preferential access also falls, in many cases to levels where it can no longer enable uncompetitive producers to compete against other, more competitive, developing countries. Within the WTO, northern negotiators are increasingly concerned that preference erosion is turning a group of ACP countries into blockers who stand to gain more from defending their preference margins by preventing further multilateral liberalization, than by other benefits from a successful conclusion to the round, such as increased market access or technical assistance.

Such fears are driving renewed interest in increasing financial flows to preference-receiving ACDDCs to compensate them for preference erosion. In April 2004, the IMF approved the Trade Integration Mechanism (TIM) designed to mitigate concerns that implementation of WTO agreements might give rise to temporary balance of payments shortfalls. The TIM provides enhanced access to existing IMF facilities based on estimated preference erosion losses. Its first disbursements were made to Bangladesh in 2004. The IMF estimates that additional demand for PRGF resources from a successful completion of the Doha Round could be in the order of SDR500-600 million. Although the World Bank is concerned about HIPC countries facing falling commodity export incomes, it has been less convinced that there is a need for special measures to compensate for preference erosion on developmental grounds, arguing that the most preference-dependent countries are not the poorest and that losses could be compensated through diversification, trade facilitation and more liberal rules of origin.

While the TIM is a loan, albeit on concessional terms, staff at the World Bank and DFID are developing other ideas around the general theme of 'aid for trade', involving increased aid flows channelled through an expanded version of the Integrated Framework for Trade-Related Technical Assistance to least-developed countries.<sup>9</sup> These proposals are likely to feed into the G8 meeting in Gleneagles in July 2005.

### ***South-South trade***

UNCTAD (2005) points out that South- South trade has increased faster than South-North trade in almost all commodity groups and all regions in recent years. It believes that increased demand for commodities in developing countries, particularly Asia,

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million per year, although these have been partially offset by the removal of quota restrictions under the Cotonou Agreement.

<sup>9</sup> See <http://www.integratedframework.org/>

could considerably boost world demand both for raw materials and food products. A “window of opportunity” could thus open up over the next few years, allowing developing countries to substantially improve export earnings from commodities, including from South-South trade.

For this to materialize, financial services such as trade credits for South-South trade need to be strengthened. In North-South trade, a range of financial services has sprung up, whereas there are very few similar services for South-South trade.

Clay (2004a) agrees that South-South trade is a boom area, but is pessimistic about its poverty-reducing potential. In South-South trade, there is far more concern about price than any other single factor. What may be developing globally is a trade system where volume and value are important in developing countries, and quality and uniqueness are major determinants in developed countries. Small scale farmers will be torn between trying to climb the standards mountain to access better prices in customized northern markets, or stay with rock bottom prices but expanding volumes in the South.

### ***TROPICAL COMMODITIES***

Compared to the WTO debates on competing commodities, the mainstream policy discussion on tropical commodities is remarkably threadbare, mainly consisting of condemnations of past remedies such as supply management, exhortations to diversify, largely unsuccessful attempts to harness market-based mechanisms in order to smooth price volatility, and increased financial flows to compensate for falling prices and fund diversification efforts.

#### ***Compensation schemes for exporters***

Both the IMF (through the Compensatory and Contingency Financing Facility) and the EU (with STABEX, FLEX, SYSMIN and COMPEX) have operated schemes that have made financial transfers to national governments in compensation for falls in export earnings. Most of these schemes are now essentially defunct.

The EU-ACP STABEX arrangement was established in 1975 under the first Lomé Agreement and continued through until the recent Cotonou Agreement. In the form in which it operated in the 1990s, the instrument had serious drawbacks. First, transfers had to be used by the recipient government to support the commodity sector that had suffered the price falls, even if this aggravated the commodity dependence problem. Secondly, the EU placed ever-greater restrictions on the use of transfers, which had to be spent according to provisions negotiated with each recipient country, so transfers frequently remained unspent for long periods of time. Thirdly, time delays built into the system for assessing and making transfers and approving expenditures, coupled with the cyclical nature of international prices for commodities, meant that support often arrived just as commodity prices were rebounding, exacerbating rather than mitigating the impact of price instability.

With the entry into force of the EU-ACP Cotonou Agreement, a new instrument was established to compensate countries for sudden falls in export earnings: the FLEX. FLEX allows ACP governments to use the finance for a wider range of purposes, e.g. in order to safeguard macroeconomic and sectoral reforms. It provides support to countries that have registered a 10% loss in exports earnings (2% in the case of LDCs)

and a 10% worsening of the programmed public deficit. Initial experiences with the FLEX have shown that several countries that experienced significant losses in export earnings were not eligible for compensation, due to the stringent eligibility criteria (European Commission, 2004). The special clause applied to LDCs has therefore been extended to landlocked countries and island states, lowering the eligibility threshold to a 2% loss in export earnings. The benchmark on the worsening in the programmed public deficit has also been reduced to 2%. Had the proposed criteria been applied from 2000–02, ACP countries would have received €255 million through the FLEX system, six times more than the amount actually disbursed.

### ***Voluntary commodity funds***

A number of proposals have been made (often for the coffee sector) for introducing voluntary commodity levies to fund demand, efficiency and livelihoods-enhancing measures in the agricultural sector.

UNCTAD and Oxfam have both proposed an ‘international diversification fund’ (UNCTAD 2004b, Oxfam 2004). The Walter Zwald proposal (for the International Coffee Organisation) was for importers to pay a voluntary levy of US\$20/tonne into a coffee fund which would raise only an estimated US\$84 million per year (Zwald, 2001). The fund would be used for promotional activities aimed at expanding demand and for a range of production-related activities, including support for sustainable livelihoods.<sup>10</sup> In return for their contribution, roasters would be permitted to use the fund’s logo on their packaging, which would yield publicity benefits in terms of increased sales.

There are a number of problems with these proposals as they currently stand. In particular, there is no guarantee that participating enterprises will not pass the cost of the levy on to consumers in the form of higher prices (reducing demand and therefore lowering producer prices) or that the levy will not be passed back directly in the form of lower producer prices.

A further idea that has arisen in the context of the reform of the EU sugar regime is that a compensation fund for the impact of European sugar policies on developing countries could be financed by a small tax on European sugar consumption. A levy of €25/tonne (representing 3 percent of the current price) would raise €400 million. Processors would pay the levy and pass it on to consumers. This would also ease health concerns over the impact of a sudden fall in sugar prices, following a shift to a more liberalised regime.

The increasing ingenuity and attention being paid to aid and compensation schemes for ACDDCs is intended to wean them off preferences and commodity dependence and in the process, reduce obstacles to multilateral trade liberalization. Rarely is the question asked, ‘is lack of money really the problem?’ In any one country, some products will always retain *comparative* advantage. However, it may be that small and vulnerable economies, such as island or landlocked countries, may simply have no competitive advantage in anything, compared to larger countries enjoying economies

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<sup>10</sup> The proposal was subsequently revised by the ICO in that the fund would be administered by the ICO, and a minimum of 80% would be spent to provide assistance to coffee workers with primary healthcare and basic education for their children (ICO, 2001).

of scale and lower transport costs. In such circumstances, the only way to regain competitiveness is through a drastic fall in wages, often through a massive devaluation that in turn risks inflation or serious hardship for those dependent on imported food and other products. In parts of the Caribbean, this dilemma has been solved through mass migration.

### ***Incorporating price and volume risk into debt sustainability calculations***

Volatile and falling agricultural commodity prices can aggravate the ratio of debt to exports, yet commodity price risks have so far not been sufficiently considered in design of debt relief schemes such as the HIPC initiative. A substantial drop in the prices of key export commodities explains the deterioration in the net present value of debt-to-export ratios relative to ratios projected at decision point for 2001 of 15 HIPCs, of which 13 were African (IMF and World Bank, 2002a). Uganda found itself in an unsustainable debt situation at completion point, due to steep declines in the price of coffee (IMF and World Bank, 2002b) and completion point debt relief for Burkina Faso had to be topped up by US\$129 million because of the decline in the price of its main export, cotton (UNCTAD, 2003a).

In addition, there remains concern about the low priority being accorded to the agricultural sector in the Poverty Reduction Strategy Papers (PRSPs) drawn up as part of the debt relief process, and the consequent impact on levels of investment, e.g. in rural infrastructure.

One proposal from a number of economists has been to modulate debt service obligations to the rise and fall of commodity prices (Guillaumont 2005).

### ***Is there a place for tropical commodities in the WTO?***

Part IV of GATT 1994 provides a comprehensive legal basis for dealing with the tropical commodity crisis in the WTO. Article VI recognises ACDDC dependence, and the importance of expanding and stabilising their export earnings. Article VIII further obliges Members to develop a joint action plan to achieve the objectives of Part IV, including 'measures designed to stabilise and improve conditions of world markets in these products including measures designed to attain stable, equitable and remunerative prices for exports of such products'. To date, this has not happened.

Oxfam has in the past called for a Trade and Commodities working group at the WTO, which would address these issues in a comprehensive manner. Currently, however, there is little prospect of such a group appearing. Instead, some aspects of the commodities issue have been dealt with piecemeal, while others have been sidelined. The most determined drive for a comprehensive approach to the issue has come from a group of East African countries (Kenya, Uganda and Tanzania), in two submissions to the Committee on Trade and Development in May 2003 (WT/COMTD/W/113) and 2004 (WT/COMTD/W/130). In the Working Group on Trade, Debt and Finance (WGTDF), the ACP has made a two-page submission (WT/WGTDF/W/30) arguing for the establishment of a regular Committee on trade, debt and finance with a remit that includes, among other things, reviewing WTO provisions relevant to commodity issues. The submission specifically calls for rethinking "international commodity policy" and addressing the problem of commodity price instability.

The most recent submission was to the Agriculture negotiations in June 2005. Uganda presented a proposal co-sponsored by Cote d'Ivoire, Kenya, Rwanda, Tanzania and Zimbabwe on the crisis African countries face because of the decline in commodity prices. Among the proposals was the creation of a price stabilization fund, possibly under UNCTAD. These constitute the most coherent developing country position to date on tropical commodities in the WTO, touching on issues such as supply management, the impact of structural adjustment and market concentration.

At a WTO-wide level, the commodity crisis was recognised in the draft text for the Cancun ministerial, which instructed the Committee on Trade and Development to work on 'the dependence of many developing countries on a few commodities and the problems created by long term and sharp fluctuations in prices of these commodities'. That agreement fell with the collapse of the ministerial (although this paragraph was never disputed). The subsequent August 2004 Framework Agreement gave much less comprehensive recognition to the issue, merely including commodities in a list of 'other development issues' to be 'taken into consideration, as appropriate, in the course of the agriculture and NAMA<sup>11</sup> negotiations'.

### **Micro approaches**

In recent decades, mainstream thinking has become disenchanted with issues such as raising productivity through increased investment in infrastructure, Research and Development (R&D) and technical assistance. Overproduction and falling prices have raised doubts about the purpose of raising productivity even faster - average yields for the major agricultural export commodities increased by almost one-third over the past two decades (FAO, 2004). Instead, most donors have moved towards encouraging exit from commodity dependence, either through encouraging developing countries to diversify within agriculture, or (increasingly) to move out of agriculture and explore other options in manufacturing and services. The global aid budget devoted to agriculture has fallen sharply as a result. The global volume of assistance to agriculture decreased from US\$ 6.2 billion to US\$ 2.3 billion between 1980 and 2002.<sup>12</sup>

### ***Reducing dependence on agricultural commodities***

In the long run, diversifying into other activities is seen as the best way to reduce dependence on agricultural commodities and the associated vulnerability to negative price declines. There are three diversification routes available to ACDDCs: horizontal diversification into alternative crops; vertical diversification into agricultural products and processes that capture a higher proportion of the value chain; and, diversification into non-agricultural activities that exploit comparative advantage (such as manufactures and services). Of these, diversification into new areas of economic activity is generally seen as the only solution in the long run and should, therefore, be a long-term objective of development strategies.

#### Horizontal diversification

Diversification into other internationally-traded agricultural commodities has a principal disadvantage: with few exceptions, the prices of all agricultural commodities appear to be in long-term decline, so the problem of declining terms of trade will

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<sup>11</sup> Non-agricultural market access, covering tariffs on industrial goods, forestry products and fisheries

<sup>12</sup> Official development assistance to agriculture, DFID, 2004

remain. In order to reduce exposure to risk, countries need to diversify into several different agricultural commodities. For a small country, even if agro-ecological constraints can be overcome (e.g. limited internal market, climate changes, vulnerability to natural disasters), this may imply quantities that are too small for efficient production, transport or marketing (Page and Hewitt, 2001). Alternatively, for countries that are heavily dependent on one or two agricultural commodities for the bulk of their export earnings, but also produce and export several other commodities (although in lesser quantities), 'diversification' could mean increasing production of these minor exports, rather than necessarily finding new commodities. For smallholders in developing countries, existing patterns of diversification for food crops are typically well-established and may be so entrenched that they constitute a barrier to further diversification into new cash crops (Gibbon, 2003). A further problem is that of 'adding-up'. Agricultural commodity prices could become further depressed if all countries diversify into the same products simultaneously – prawns and pineapple became notorious examples in the 1980s (Page, 1990).

A further possibility is to diversify into crops for the domestic market. Agricultural-based growth is perhaps the best way to reduce poverty, but a number of countries have achieved this kind of take-off by producing cereals for the domestic market, rather than by export-led growth (Green and Morrison, 2004). The general strategy of openness and state withdrawal may well be appropriate for middle income developing countries, while for some Least Developed Countries import substitution at a national or regional level may be a better way forward.

#### Vertical diversification

Higher value-added agricultural exports offer good prospects for long-term growth due to their relatively high income elasticities (Gibbon, 2003). However, there are a number of problems and difficulties associated with this approach. High transaction costs (associated with storing and processing) are perhaps the most important impediment (Delgado and Siamwalla, 1997). Other major obstacles to the development of modern processing capabilities in developing countries are poor infrastructure; the lack of investment; and, the high marketing costs and constantly-rising product standards faced in penetrating retail outlets in developed countries.

These kinds of 'exit barriers' have meant that in many of the poorest countries the recent trend has been *away* from vertical diversification, not towards it: among LDCs, processed primary commodities fell from 24.5% of commodity-sector exports in 1981-83 to 11.1% in 1997-99 (Lines, 2004).

#### Diversification into new activities

The main benefits of diversification away from agricultural commodities (and primary commodities in general) are reduced risk and more stable export revenues. A number of developing countries have succeeded in diversifying away from agricultural commodities into new areas such as manufacturing and services. For manufactures, this has mainly been the case in Asia (e.g. Malaysia, Indonesia) and Latin America (e.g. Brazil). For services, the Caribbean has shown some success in diversifying into tourism and financial services. This has occurred as a result of the promotion of long-term economic transformation, often involving an enhanced role for the state, for example in industrial policy. High investment and savings were significant in

developing supply capacity, while public investment in infrastructure and education, as well as foreign direct investment, played key roles (Page and Hewitt, 2001).

Nevertheless, diversification into manufactured products and services (destined for the world market or to substitute for current imports) presents its own challenges. The significant investment associated with tree crops (e.g. cocoa and coffee) makes producers reluctant to destroy these in order to move into other sectors. Already-established players in other developing countries provide fierce competition. Banking systems and capital markets in many ACDDCs, particularly in sub-Saharan Africa, are underdeveloped, making it difficult for new producers to raise the necessary capital to move into new sectors.

Based on the changed trends in international terms of trade for commodities since the breakpoint in the mid-1980s, Kaplinsky (2003) questions whether diversification out of commodities into manufacturing remains the best option. He believes instead, that a new quality and product-enhancing approach towards commodity sectors holds the possibility of rising terms of trade for at least some producers, with a more stable price regime. This is discussed in section XX on national coordination.

### ***Market-based price risk management***

As donors have given up on supply management for agricultural commodities, they have increasingly switched their attention to the use of market-based risk management instruments such as futures, options and swaps. These are intended to enable producers, whether farmers' organisations or governments, to limit the risks arising from price volatility by transferring some of the risk to financial providers, in exchange for a fee.

In 1999, the World Bank, with the assistance of UNCTAD, convened an International Task Force (ITF) to assist developing countries in piloting these approaches. The ITF consists of international institutions, producers' and consumers' groups, commodity exchanges, commodity trading firms and private sector entities from the commodities sectors.

Although the use of derivative instruments is not widespread in ACDDCs some African countries, such as Côte d'Ivoire and Ghana, have sold forward their cocoa exports, and some West African countries their cotton exports (UNCTAD, 2003a). Several reasons have been put forward for the narrow use of these instruments in developing countries: limited know-how and awareness of the alternative instruments available; regulatory and institutional barriers; and creditworthiness problems that make it difficult for developing countries to access financial markets. In addition, the coffee market is rather atypical of most commodity markets, in that it is traded on major futures markets, whereas many commodities are traded only by private contracts between buyers and producers, greatly complicating the use of derivatives. Finally, derivatives are unsuitable for addressing long-term instability (for agricultural commodities, coverage is generally restricted to a few months) and they cannot maintain higher prices for sellers.

While it may be premature to start writing price risk management 's obituary, six years on, the ITF has yet to produce significant breakthroughs. According to delegates at the Annual Meeting of the ITF in Rome in May 2004, pilots and research continued

to show bottlenecks and constraints rather than workable solutions: the minimum size of commercially viable transactions (put at US\$50,000 in premia per client by one finance house, with an initial setup cost to opening an account of US\$5-30,000) was proving extremely hard to generate. Finally, security concerns were placing increasing legislative demands (e.g. the European Investment Directive) on financial houses to 'know your client', which was both time-consuming and required levels of data that were sometimes unavailable in ACDDCs. Microinsurance, along the lines of microcredit, seemed to offer little hope, given its much higher demands in terms of data, proof of loss and danger of moral hazard. In the face of this disappointing record, the ITF and others' attention has increasingly moved to large-scale risk management such as weather insurance, but this does not, of course, address the price volatility issue.

### **Conclusion**

Mainstream discussions on competing commodities appear far more vigorous and hopeful than those on non-competing tropical commodities. In regional and global trade negotiations, robust solutions do battle with the realpolitik of equally robust vested interests. In tropical commodities, however, the debate resembles little more than a dispirited counsel of despair. Resigned to falling prices and increasing marginalization, policy makers and opinion formers can only advocate aid, managed decline (e.g. by smoothing prices) and exit for an increasingly trapped residual group of poor countries that have so far failed to find the way out of commodity dependence. Yet donors have few ideas, confining themselves to repudiating past remedies and stressing the need for an 'enabling environment' for private sector investment. One author likened such 'let them diversify' exhortations to Marie Antoinette's 'let them eat cake' advice to the starving French peasantry.

On the other hand, there will always be an incentive for governments to exaggerate the difficulties in order to retain the rents from preferences. Despite their protestations, some countries, for example in the Caribbean, have succeeded in partially diversifying into services such as tourism or finance. However, the social costs of such diversification have been high – unemployed sugar and banana workers do not easily become tourist guides or bank clerks.

Even the current silver lining of the price boom has its cloud attached. There is a risk that the gathering momentum behind revisiting the commodity crisis will dissipate, potentially putting off the debate for another decade.

### 3. Sustainable Commodities

Environmental and Development NGOs and others trying to influence the social and environmental impact of commodity production have largely focussed on progressive versions of process and production methods (PPMs). These have provided a means of channelling a premium to poor producers and good environmental practices from socially conscious consumers, through a variety of labelling schemes. In recent years, a number of corporate-driven schemes have followed suit, introducing social and environmental schemes that both hold out the possibility of influencing much greater volumes of production, and the threat of significantly watering down the standards involved. Moreover, concerns have been raised about the potential for both niche and mainstream labelling schemes on small scale producers.

#### *Environmental Impact*

Table 2 summarises the main environmental impacts of a range of commodities. These are in addition to the wider impact of industrial agriculture in areas such as climate change (use of fossil fuel-based inputs and carbon release from soil depletion) and loss of biodiversity through monocropping.

**Table 2 Environmental Impact of Commodity Production**

Commodity	Deforestation though clearance for planting	Excessive use of Pesticides	Water	Other
Cocoa	Yes	Yes	-	Clearings open way for illegal timber and wildlife exploitation
Coffee	Sometimes (eg Ivory Coast)	-	Processing pollutes local supplies	-
Cotton	-	Uses 25% of global insecticides and 10% of pesticides	73% of cotton production is on irrigated land – e.g. disappearance of Aral Sea	Loss of soil fertility
Oil Palm	Yes	-	-	Air pollution from clearance fires; soil loss; soil fertility
Soy	Yes, esp in Brazil and Argentina	-	-	Rapid spread of GM Round up Ready Soya Bean (RRSB) increases farmer dependence on chemical herbicide and

				Monsanto; soil erosion
Sugar	No	No	The third thirstiest of commodities – needs 1,500-3,000 litres per kg of sugar cane	Water pollution from processing run-off
Tea	-	Yes	Yes	Soil fertility

Source: Based on Better Management Practices and Agribusiness Commodities, IIED, Rabobank and ProForest, January 2004

A number of ‘known unknowns’ in the coming decades are likely to strengthen sustainability arguments. In particular, if oil prices remain high, or rise even further in response to supply constraints, prices of industrial inputs such as fertilizers and pesticides will rise, increasing the incentives to switch to low-input agriculture, although rising prices will also increase the attraction of substitution by synthetic products.

The standard environmentalist solution to such issues is to advocate the use of better management practices (BMPs). BMPs involve maintaining and building soils, maintaining the natural ecosystem functions on farms, working with nature and not against it to produce products, reducing total input use and using inputs more efficiently, and reducing waste or creating marketable by-products from materials that were previously considered waste (Clay 2004b).

Clay (2004a) sees some conflict between social and environmental objectives in this area. He points out that few BMPs (or at least the systems for proving compliance with BMPs) are appropriate for small-scale farmers attempting to produce on more marginal lands and at scales that are often not competitive, while evidence suggests that the most environmental impacts per hectare of production of commodities come from small-scale producers who cannot afford better land and/or better practices. Clay sees crop selection as offering some room for progress:

Some crops lend themselves to poverty strategies (e.g. perennial crops in the tropics that are labor intensive and don’t lend themselves to mechanization such as coffee, cocoa, fruit crops, palm oil, or rubber; annual, horticultural crops that are labor intensive, e.g. fruits and vegetables; or organic or other more labor intensive crops where labor is substituted for other inputs). In general, perennial crops tend to have fewer environmental impacts, tend to be less easily mechanized, and tend to longer investment periods that discourage larger, more capital sensitive investors. For all those reasons they tend to be ideal for long-term poverty reduction strategies.

### ***GMOs: problem or solution?***

Clay also considers the controversial issue of genetically modified organisms (GMOs). Following introduction of GMOs such as Bt cotton and more recently Bt wheat, pesticide application per hectare has fallen, but overall more herbicide is being used as more marginal lands are brought into production. Moreover, there are initial signs of growing pesticide resistance. This raises the spectre of a heavier application

treadmill, as increasing amounts of pesticide are required to kill increasingly resistant bugs – a bonanza for the pesticide companies that eliminates most of the benefits for farmers and pollutes the environment. Research in China Bt cotton production suggested that the best path to minimising pesticide use and maximising producer income lay in a combination of GM and integrated pest management (IPM) (Clay 2004b).

GMOs can also facilitate soil conservation via the use of no-till cultivation practices where existing crop is killed with herbicides and a new crop is sown through the dead vegetation.

### ***Niche markets – Fair Trade and organic agricultural commodities***

Fair Trade organisations have created a parallel marketing chain that allows consumers to pay a premium that directly supports agricultural producers. This constitutes a different approach to marketing, in that buyers are informed and concerned about the nature of production, not only about the quality and other characteristics of the product (Page, 2003). Proponents of Fair Trade argue that paying producers a ‘living’ price, above the cost of production, is the only sustainable long-term strategy for consuming countries. They also point to the positive impact of the community projects funded by such schemes.

Fair Trade commodities represent a small share of world trade in commodities. Global sales are estimated at \$500 million per annum (International Herald Tribune, 7 May 2005). Westlake (2002), for example, estimates that Fair Trade coffee (the most important fair-traded commodity) only accounts for 1.0–1.5% of total global trade in coffee. However, year on year growth far exceeds that of trade as a whole, with global fairtrade-labelled produce sales rising 42% in the year 2002-03. Coverage is patchy with Switzerland, Netherlands and the UK some of the most advanced. In the UK, fairtrade has a market share of 19% in the roast and ground coffee market (Fairtrade Foundation, 10 December 2004).

According to calculations for coffee by Daviron and Ponte (2005), Fair Trade purchasing returns between 12-21% of the retail price to the producer cooperatives. Even the higher end of this spectrum is only what farmers achieved in the mainstream market in the 1970s and 1980s under the International Coffee Agreement.

The emergence of organic commodities, which also compete with Fair Trade products, has allowed some other areas of production to be marketed at a price premium. The emergence of organic coffees, in particular, is frequently cited as a major reason for the consumption of coffee in the US not falling, despite health concerns.<sup>13</sup> An increase in organically produced commodities represents a potentially attractive means of assisting poor producers, since the poorest farmers are the least able to acquire chemical fertilisers and sprays.

However, in practice the processing and marketing of these commodities is more difficult and complex than for those traditionally produced. In particular, the system requires that the commodity be traceable from its source through the value chain. This

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<sup>13</sup> In the US the market for organic and speciality coffees has been growing annually at around 30% since 1999 and today accounts for 17% of coffee imports by value and for 40% of coffee retail sales (Ponte, 2002).

requires comprehensive inspection and certification, which is much easier for large farms in developed countries than for scattered smallholders in developing countries (Wheeler, 2001). The price premia obtainable from producing organic commodities may therefore not cover the additional marketing, certification and inspection costs and would yield lower returns than investing similar resources in efficiency or quality-enhancing measures at the national level. Moreover, as organics have increased their market share, the large supermarkets have moved in, squeezing down profit margins and squeezing out small producers. Vorley (2004) concludes that 'organic and high-welfare production is not a refuge for smaller scale producers in modern agrifood systems.'

Clay (2004a) is also sceptical on the environmental impact of organics. Organic production can produce as much soil erosion as conventional agriculture and more than no-till agriculture. Organic agriculture has no water standards and uses water less efficiently than well managed conventional farms. Finally, the natural chemicals used in organic agriculture (e.g. copper, sulphur, nicotine, and rotenone) can be far more toxic to the environment and biodiversity than many synthetic chemicals used in conventional agriculture.

### **Corporate Social Responsibility (CSR)**

The growth of the fairtrade market and growing public concern over the social and environmental impacts of commodity production have prompted responses from mainstream traders, processors and retailers. In coffee, roasters, roaster/retailers and roaster/coffee house chains have devised alternative sustainability standards, aimed more or less explicitly at deflecting more radical initiatives. Amongst the best known of these is Starbuck's proprietary 'Coffee and Farmer Equity Programme' (CAFEP), along with initiatives from Nestlé, and the Common Code for the Coffee Community (CCCC).

Gibbon (2004) and others are sceptical of these second generation initiatives, arguing that they water down standards on fair trade, confuse consumers by blurring the boundaries between fair trade and non-fair trade products, load the costs of compliance onto producers while giving little back in the shape of price premia, are skewed heavily toward estate production, with little attention to smallholders, and more generally add to standards proliferation.

Daviron and Ponte (2005) suggest that the best way to deal with this proliferation of standards, is to set up 'multiple certifications' which group together 'high bar' standards such as fairtrade and organic, in contrast to 'low bar' industry-driven standards such as the CCCC. However, introducing such an intermediate tier of labelling is likely to confuse consumers even more!

### ***Conclusion***

Environmentally sustainable, fair trade and organic commodities face a number of challenges in the years ahead. Firstly, they must reconcile the tensions between social and environmental goals through some degree of standards harmonization; secondly they have to deal with the problems of success, whether through corporates launching watered down versions of fairtrade marks that confuse consumers, or scaling up organic production, driving down margins and squeezing out small producers. Thirdly they will have to deal with the underlying issue that introducing new standards tends

to place extra burdens on small producers and favour large-scale agriculture.

#### **4. National Coordination: the state and producer organizations**

The structural adjustment programmes (SAPs) of the 1980s and 90s dismembered many state-led coordination and support structures in developing countries, through the abolition of state marketing boards, cut-backs in sources of finance and sharp reductions in technical assistance programmes. Small scale farmers were left atomized and weakened, easy prey for more powerful sections of the value chain such as traders and retailers, who in some cases moved into the vacuum left by the retreat of the state. In others, the private sector failed to fill the vacuum and production collapsed. But governments have intervened in agricultural markets since at least the time of the Pharaohs in ancient Egypt (Murphy 2004) and much of the current debate revolves around a revived role for the state. A parallel and linked discussion considers other ways to achieve the levels of producer coordination that were undermined by SAPs, such as the promotion of independent producer organization or contract farming relationships between small producers and buyers.

##### State Marketing Boards

Often producing a narrow range of agricultural commodities on which they depend for foreign exchange and government revenues, and enjoying only limited shipping outlets for sale on to international markets, ACDDCs have traditionally relied on national stockpiles to regulate and manage the supply of the commodity for export. These were until recently run by state-owned market boards, or *caisses de stabilisation*, which served the additional purpose of collecting output from small and large producers across the country, notably in the cases of tree crops/tropical beverages, e.g. West African cocoa and coffee. The national stockpile was therefore part of a much larger exercise (UNCTAD, 2003a). For marketing boards, the government would normally set an annual price at which it would purchase the commodity through intermediaries (cooperatives or licensed traders), who were given a fixed margin. *Caisse de stabilisation* systems differed in that although they controlled export contracts they did not handle, export or acquire physical ownership of the commodity in question: primary processing, marketing and exporting were performed by cooperatives, private traders or state enterprises. Marketing boards and *caisses de stabilisation* had the advantage that farmers knew the price they would receive at harvest. By aggregating the output of a large number of small producers, they also strengthened their bargaining power relative to buyers.

The records of marketing boards have been mixed. In the late 1970s and early 1980s, they struggled to determine the right level of support prices. In several instances, the value of administered prices was not sufficiently and regularly adjusted to reflect inflation in the domestic economy, exchange rate movements, or the medium-term trend in world prices. Often governments used marketing boards to tax agriculture and suppress food prices for higher priority urban populations. If administered prices were too low, farmers were cheated, while excessive prices created financial difficulties for the marketing board. In addition, they provided little incentive for quality improvements and suffered from inefficiency and rent-seeking behaviour, including corruption.

Nevertheless, some argue that crop marketing boards played a vital role in the development of the agricultural export sectors in several African countries and the policy of dismantling them as part of structural adjustment programmes has been widely criticised (see, for example, UNCTAD, 1998a; WTO, 2003). Apart from their

role in stabilising prices, they were important for providing ancillary services, such as extension and rural infrastructure, including input provision, product distribution services and credit (UNCTAD, 1998b).

State marketing boards also played a role in building globally recognised national quality standards. These territorial reputations were built on local specificities of climate, soil etc., but state bodies ensured consistency in sorting, grading and description, and applied sanctions when these standards were violated. National reputations established in this way attracted premia for growers of higher quality products (Gibbon, 2003).

FAO (2004) summarizes the positive and negative impacts of the retreat of the state, pointing out that while it did indeed lead to the predicted increase in the proportion of sale price reaching the farmers, it led to a number of problems, including a sharp fall in the overall price which largely wiped out this benefit:

Cocoa farmers in Ghana, for example, received only 6% of the export price of cocoa in the early 1980s. Now they get more than 40%. Elimination of what amounted to confiscatory taxation on agriculture has restored incentives for farmers to increase investment and production. In many cases, however, the abolition of marketing boards has left an institutional vacuum. Farmers often relied upon the boards for credit, fertilizer and other inputs, and for access to extension and training. Now that the boards are gone, in many cases neither government nor the private sector has taken on these roles. Smallholders in many developing countries have been confronted by loss of access to credit and soaring prices for inputs. Poor market infrastructure and information channels leave them vulnerable to price volatility and exploitation by trading companies that have often stepped in to replace the state monopoly with a private one. At the same time, public expenditures in agriculture have dwindled. In many countries, both yields and quality of commodities have fallen since the marketing boards were abolished.

### ***Producer organisations***

A closer examination of the role of producer organisations in improving the outcomes for small farmers and poor farm labourers could also produce new policy ideas, especially in post-liberalisation situations where the role of the state remains constrained. At least five types of producer organisation can be identified (Gibbon 2003): large estates, small estates, large modern cooperatives, small cooperatives and contract farming and outgrower schemes. Scale and organisational model affect the benefits that accrue to farmers. For example the FNC, the Colombian national coffee growers' federation, claims 500,000 members with an average of 2 ha of coffee each. FNC operates an extension service with over 800 staff, as well as its own agricultural colleges and a research and development centre. It runs a price stabilisation scheme and has diversified downstream into freeze-drying and own label sales. Cooperatives in Africa on the other hand, have often failed to grapple successfully with the market and high demands on quality and reliability.

In cotton, post liberalisation structures fall into three groups: geographical monopolies (Ghana, Mozambique), systems with numerous players (Tanzania, Uganda) and

oligopolies (Zimbabwe, Zambia). Gibbon (2003) concludes that the last category produces the best outcomes, by combining the positive benefits of competition with a scale that can deliver price stabilisation and other benefits and that 'rebuilding local-level economies of scale is becoming a strategic issue in the wake of increasing buyer-drivenness on a global plane on the one hand, and the fragmentation that has frequently followed market liberalisation on the other.'

### **State or Producer? Putting Humpty together again**

Whether a return to state marketing boards is either desirable or feasible is a moot point. Responding to the challenges of small or Least Developed ACDDCs may require an enhanced role for the state, in contrast to the generally deregulatory and market-based approaches of the 1980s and 90s. Here, the challenge is how to ensure that the state does not replicate past mistakes, but equips poor producers to engage with the market on more beneficial terms. Rather than get involved too directly in production, successful Latin American initiatives in the 1980s/90s focused on providing services such as acting as an information point for new entrants and new buyers. Governments in Asia and Mauritius were more active, ensuring a broad level of cooperation between the state and the private sector.

General state support to enhance and diversify assets, and to increase productivity and value-added through the development of agro-processing is uncontroversial and likely to form a growing part of mainstream approaches, such as the 2004 EU Action Plan for Commodities. Measures include access to finance, rural credit facilities to non-farm activities, provision of extension services, and training. Improving social infrastructure, health and education, or physical infrastructure that can enable new economic sectors to emerge - transport and communications - will also enhance productivity.

In conjunction with international schemes, national supply management approaches have also been encouraged. UNCTAD (2003b) cites the example of Malaysia's levy on palm oil production, imposed in times of high prices and then used in periods of low prices to subsidise the use of palm oil in a non-traditional way, namely, for electricity generation. In West Africa studies by the French Government (Gergely, 2004) have concluded that the remaining *caisses de stabilisation* offer a more effective means to protect small cotton producers from price volatility than the more fashionable market-based risk management approaches. The researchers propose the creation of national 'stabilisation fund mechanisms', building on embryonic structures in Cameroun and Burkina Faso. The stabilisation funds, which could be either private or publicly run, but in either case require a single nation-wide purchasing organisation to be viable, would be akin to collective self-insurance, taking a share of any surplus in good years and redistributing it to farmers and ginners in bad years. A regional fund, capitalised by donors, would underwrite national stabilisation funds against exhaustion.

If donors are to revisit the issue of state marketing boards, they need to consider the increasing pressures on state trading enterprises within the WTO. Although these are largely targeted at developed country state trading enterprises, such as the Canadian Wheat Board, any move towards rules that inadvertently prevent a new generation of

more effective state interventions in ACDDCs would have negative consequences for the poor.

Gibbon (2004) agrees that new ways of regulating and balancing market power must be found, but concludes that the best place to look is not in a return to state regulation, but in interventions that scale-up the competitiveness and bargaining power of smallholders at national level in producing countries. These need to be accompanied by measures to rebalance power in global supply chains, discussed in the next section. Murphy (2002) foresees strong opposition from national and international traders who benefit from low prices in the post-SAP world.

Lines (2004) argues for a pragmatic combination of state and producer-led approaches:

Efforts should be supported to find effective replacements for some of the functions of former marketing boards. This means fostering organisations that assist farmers with market intelligence, the development of cooperatives, extension advice, access to credit and physical inputs, and schemes to make the most of premium market niches. They should be farmer-based where possible, government-run where not.

### **From coffee to wine: the possibilities of quality-based commodity production**

In several sectors, the demise of state regulation has had a severe impact on quality control. Absent the state, a collective action problem arises in which rogue farmers can damage national quality reputations. Specialty retailers and traders are overcoming the problem by establishing vertical links to estates, bypassing small producers (Daviron and Ponte, 2005). Several agencies and authors have therefore looked at the issue of quality, particularly in the case of coffee.

In 2002, the International Coffee Organisation agreed a Coffee Quality Improvement Program (CQP). This required members to withdraw low quality production from the market and implement quality improvement programmes. However, the means of enforcing compliance was never clear, and the programme was made voluntary as a condition for the US rejoining the organization in 2004, reducing it to little more than just another labelling scheme (Daviron and Ponte 2005).

Optimists are undaunted and advocate a ‘wine makeover’ for coffee, with coffee houses playing the same role as the 1980s wine bars in countries like the UK in educating the palate of new generations of coffee drinkers. The key lies in cultivating consumers, rather than coffee and this should be done within mainstream markets, not as a new niche exercise (Daviron and Ponte, 2005). Kaplinsky (2003) holds up Jamaican Blue Mountain Coffee as an example of such ‘winification’, as well as the Specialty Coffee Association of Costa Rica, formed in 1999 to pursue product and process upgrading and selling directly to roasters and retailers.

Daviron and Ponte (2005) suggest that developing countries need to turn the tables on intellectual property rights by using geographical indications to promote their own coffee to consumers, thereby increasing their bargaining power in the value chain. ‘Selling territory, a story, symbols and exoticism’ could even include promoting coffee tourism, in the manner of US or European vineyard tours.

However, this may all be bad news for smallholders, if international traders turn to tighter forms of vertical integration. In the case of specialty coffees this typically takes the form of buying from estates, which can be considered insulated from the generally prevailing market chaos and enjoy economies of scale in meeting new quality conventions. In the case of cotton, where potentially large producers are often absent, this typically takes the form of outgrower schemes. According to Gibbon (2004)

These twin trends both pose the issue of keeping smallholders 'in the system', but in different ways. In the case of cotton, where economies of scale in meeting the prevailing quality requirements are low, smallholders will be kept in the system provided that outgrowers and other buyers can find ways of competing that do not lead to side-selling by producers - and which at the same time provide the latter with incentives to increase acreages and improve yields and quality. The alternative here is decline of national reputation and national marginalisation in the global market. In the case of coffee, smallholders will only *get back into* the system if ways can be found that reduce their costs of quality conformity.

### **Conclusion**

Where state coordination mechanisms have avoided dismemberment, as in West Africa, there are strong arguments for retaining them. Elsewhere, efforts may be better spent finding other solutions to the underlying problem of producer fragmentation. It is hard to argue on political or developmental grounds against a focus on producer organization, supported by the state in an enabling role. The hard question is, can it work? How can producer organizations become a significant counterweight in an ever-more unbalanced supply chain? How can producer organizations counter the many pressures that are steadily squeezing small-scale producers out of all but the most sluggish backwaters of international trade?

Where producer organization can be made to work, it could also offer a path to a better, more accountable role of the state as producers lobby for supply management schemes, extension services and other state support.

## **5. International coordination and supply management**

Ever since the demise of the International Commodity Agreements (ICAs), one of the most polarised debates around the commodities issues has been that of supply management at an international level. For some, it is, if not a magic bullet, an essential first step in any attempt to address the commodity crisis. For others, it is both a political impossibility and a distraction from more important issues, such as corporate concentration or producer organization.

### ***Supply management***

John Maynard Keynes included a commodity control organisation in his grand design for the Bretton Woods institutions (Keynes, 1943). However, the US opposed any restriction of free trade (Henningson, 1981). The General Agreement on Tariffs and Trade (GATT, 1947) allowed commodity agreements in some circumstances, specifying in article XXXVIII that contracting parties shall:

‘where appropriate, take action, including action through international arrangements, to provide improved and acceptable conditions of access to world markets for primary products of particular interest to less-developed contracting parties and 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 for exports of such products’

Measures taken in compliance with a commodity agreement are also explicitly allowed as legitimate exceptions to normal MFN treatment under Article XX, subject to agreement by all contracting parties.

The 1970s saw a brief period of ‘commodity power’ (1973–79), which put control of supply in the hands of developing country exporters. Collective action was taken first for phosphates and then, in 1973–74, for crude petroleum. In the case of these particular (non-agricultural) commodities, this strategy worked. Stocking costs for non-perishable standard products were relatively modest. These were supplied by developing countries and enjoyed strong international demand, concentrated in developed countries. The strategy also worked because the commodities themselves were not easily or cheaply substitutable. The formation of supplier cartels or quasi-cartels seemed to show that concerted producer supply-regulation could raise international prices.

International momentum built up in the 1970s for an international Integrated Programme for Commodities (IPC), which had managed buffer stocks as its key element. UNCTAD took the lead in promoting the IPC, which had as an explicit objective raising the price of commodities.

International Commodity Agreements (ICAs), by contrast with OPEC, played by GATT rules and incorporated both consumers and producers. Those that were negotiated under the auspices of UNCTAD in the 1970s were designed ostensibly to prevent unexpected price fluctuations through price controls and subsidies. However such international efforts to replicate OPEC for agricultural and other primary commodities met with less success and eventually collapsed, often after the withdrawal of consuming countries. The ICAs no longer maintain physical buffer

stocks. Many of them have reduced their activities to those of mere study groups, some with new purposes, such as providing data and research and promoting sustainability (UNCTAD, 2003b).

The Common Fund for Commodities (CFC) was initially envisaged as an instrument to fund buffer stocks of core commodities that were to form part of the IPC.<sup>14</sup> The Agreement establishing the CFC was signed in 1980 but only became operational in 1989. By then, the world had changed. National, as well as international, markets had been liberalised. In response, the commodity agreements that were to serve as the foundation for the buffer stocks had dropped the objective of market stabilisation. Consequently, there was no longer a role for the main 'first account' of the Fund (CFC, 2002) and it was left with other supporting activities to be financed through its 'second account' – undertaking technical assistance pilot projects in developing countries (focusing on individual commodities) and multi-country projects examining market chain strategies.

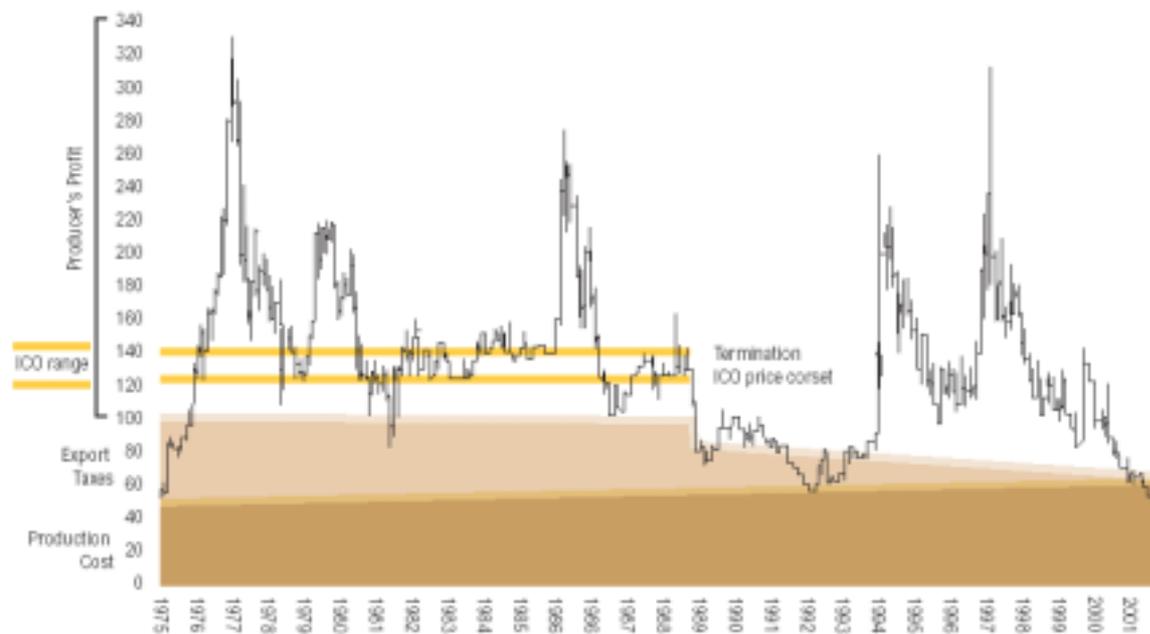
A number of reasons have been advanced as to why this generation of commodity agreements failed. Some believe that the breakdown reflects the difficulties involved in attempting to influence prices via output management, in an environment of supply expansion brought about by productivity increases (Reinhart and Wickham, 1994). Others propose that it is difficult, if not impossible, to agree on price ranges (Gilbert, 1996) or to determine accurately the correct long-term price trend. Lack of enforcement mechanisms and the free-rider problem (Cashin *et al.*, 1999) have also been suggested. The ICAs' failure to curb supply has also been cited, while in the case of competing commodities, such as sugar, the impact of developed country farm policies played an important role in undermining the agreement (Koning, 2004). The World Bank (2005) also blames supply controls for bringing new entrants into the coffee market – a problem potentially afflicting any successful attempt to raise or stabilise prices. On the other hand, it has been argued that many of these challenges would have been surmountable had there been sufficient political will and financial resources (Rangarajan, 1993; Robbins, 2003).

After OPEC, the best known and most discussed ICA is that for coffee. Oxfam views the International Coffee Agreement, which lasted from 1975-89, as a 'golden era of good and stable prices.' (Oxfam, 2002). The Agreement regulated exports and imports within price bands, but the economic clause in the agreement was abandoned in 1989. Until 1989, governments in both producing and consuming countries sought to agree to pre-determined supply levels by setting export quotas for producing countries. The aim was to keep the price of coffee relatively high and stable, within a price band ranging from US\$1.20 - US\$1.40 per pound. The agreement succeeded in stabilising prices and persistently raised them by 24-30% over what would otherwise have been market clearing levels (Palm and Vogelvang, 1991; Hermann *et al.* 1993). As Figure 2 illustrates, from 1975-89, though prices fluctuated significantly, they remained relatively high and rarely fell below the price floor. In the six years following the collapse of the ICAs for coffee and cocoa, international prices for these products fell between 60 and 65% (Gibbon & Ponte 2005).

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<sup>14</sup> Cocoa, coffee, sugar, rubber, wheat/coarse grains, jute, tropical timber, copper, cotton, lead/zinc, nickel, olive oil, and tin.

**Figure 2: Monthly New York coffee futures<sup>15</sup>**



Source: Oxfam (2002)

In recent years, an increasing number of commentators have returned to the issue of international supply management. Lines (2004) and Robbins (2003) advocate moving away from buffer stocks and export controls towards controlling production. This would deal with a problem identified by Gibbon (2004):

the question arises of whether export restraints would any longer have much impact on the market price for coffee. In the absence of state marketing boards who can undertake or support finance of producer country stocks, large private producers in supplying countries have taken to hedging their own stocks in futures and options markets. This means that the effect of the existence of this coffee will be transferred to the market in price terms, even if the stocks themselves are physically withheld.

Koning and Robbins (2005) propose a further refinement by allowing production quotas to be traded on a secondary market. This would solve two problems – how to enable new entrants to enter the market, and how to provide incentives for higher cost producers to exit. Koning et al (2004) also believes a key weakness of the first generations of ICAs is that they were commodity-specific, and so precluded any chance of trade-offs between commodities. He argues for restoring UNCTAD's role as 'an obvious forum to house such a multi-commodity approach coupled with one or more funding mechanisms'.

But other authors see demanding the return of ICAs as a policy dead end, doomed to fail. Firstly, consumer countries would be unlikely to sign up to them, since their support for the first generation ICAs sprang from Cold War geopolitics and the need

<sup>15</sup> Monthly, nominal spot prices. Real prices (taking inflation into account) would show an even sharper long-term decline.

to win over third world governments: only hydrocarbons are now seen as strategic. Secondly, at a national level, structural adjustment programmes have destroyed the market coordination mechanisms to sign up and enforce ICAs. The pressures for circumvention and free riding within any agreement are so great that very strong institutions are a precondition for success. Only if these mechanisms are restored (a big 'if'), will any international initiatives be able to function.

Both problems are clearly visible in relation to the succession of recent attempts in the coffee sector to re-launch looser or more indirect forms of international agreement. The 'Association of Coffee Producing Countries', formed in 1990, introduced a voluntary quota-based programme that foundered in the face of Brazilian over-production, while the ICO Coffee Quality-Improvement Programme (CQP), was shelved in return for the US re-joining the organisation, as discussed on page XX.

ICAs are likely to be more practicable for some commodities than others, notably where a small number of producers dominate the market, and when political alliances between producers are strong. Examples in tropical commodities could include nutmeg (Indonesia and Grenada) and rubber, but there are also arguments for ICAs that bring together northern and southern producers in crops such as soya or cotton. Crops produced by large number of countries with few political links, such as coffee, seem much less convincing candidates for a reworked ICA.

#### **Other aspects of international coordination:**

##### ***Boosting demand***

Apart from the attempts to boost quality and geographical identities described in the previous sections, FAO (2004) advocates generic promotion campaigns in consumer countries, pointing to the long-running UK campaign promoting bananas as a source of energy, which contributed to a threefold increase in consumption, making them the most popular fresh fruit in the country.

##### ***Standards***

The World Bank (2005) has led the way in drawing attention to the proliferation of international quality and health standards, and their potentially exclusionary impact on small-scale farmers. New standards are being developed and introduced by governments (for example in animal health) and by the private sector (for example supermarkets in horticulture). While standards have some economic benefits, for example in facilitating trade by reducing transactions costs associated with imperfect information regarding product quality and safety, the Bank and others are concerned that they are making it increasingly difficult for small farmers to break into higher value production chains in areas such as horticulture.

While resisting such standards is unlikely to win much political mileage in consumer countries, other approaches include harmonization of the different standards demanded for the same product by different importing countries, and establishing, where appropriate, equivalence between developing and developed country standards that reduce the imposition of new, sometimes inappropriate standards, and disruption they can cause.<sup>16</sup> Donors have also set up a trust fund to support developing country

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<sup>16</sup> See for example the now legendary case of Mauritanian camel cheese, where EU health rules required would-be Mauritanian exporters to use automatic milking equipment – which does not exist in camel-size models, [http://www.geocities.com/madhukar\\_shukla/mauritaniancheese.html](http://www.geocities.com/madhukar_shukla/mauritaniancheese.html)

participation in international standard setting at the Codex Alimentarius Commission, created in 1962 by the FAO and the WHO. This sets food standards to protect the health of consumers and to ensure fair practices in the food trade. At a national level, training in standards compliance is one of the areas of technical assistance that is frequently offered by the World Bank and other donors.

### **Conclusion**

International Supply Management has several attractions for development advocates and campaigners: it has been tried and found (to some extent) to work; it is relatively simple to explain; it requires action by northern governments, which are easier to lobby than either private companies or developing country governments. However the ideological and political obstacles are great, and the danger is that ICAs will become like the Tobin Tax – a magnet for campaigners who see them as a ‘magic bullet’ that can solve the commodity crisis, stifling interest in other approaches that may be more piecemeal, but more feasible. It is important to keep the full menu of measures in mind, when discussing the commodity crisis.

Moreover, there is currently little obvious appetite for a return to ICAs even among producer countries, let alone consumers. A pilot in a small, unthreatening commodity such as nutmeg might help refine the proposals, and generate a demonstration effect for the sceptics.

## 6. Market Power

### *Market concentration and the value chain*

Agricultural products are linked to final consumers through so-called global value chains. A value chain describes the full range of activities that are required to bring about a final product from the growth of a primary commodity, through the intermediary phases of production (transformation and producer service inputs), delivery to final consumers and final disposal after use (Kaplinsky, 2000).

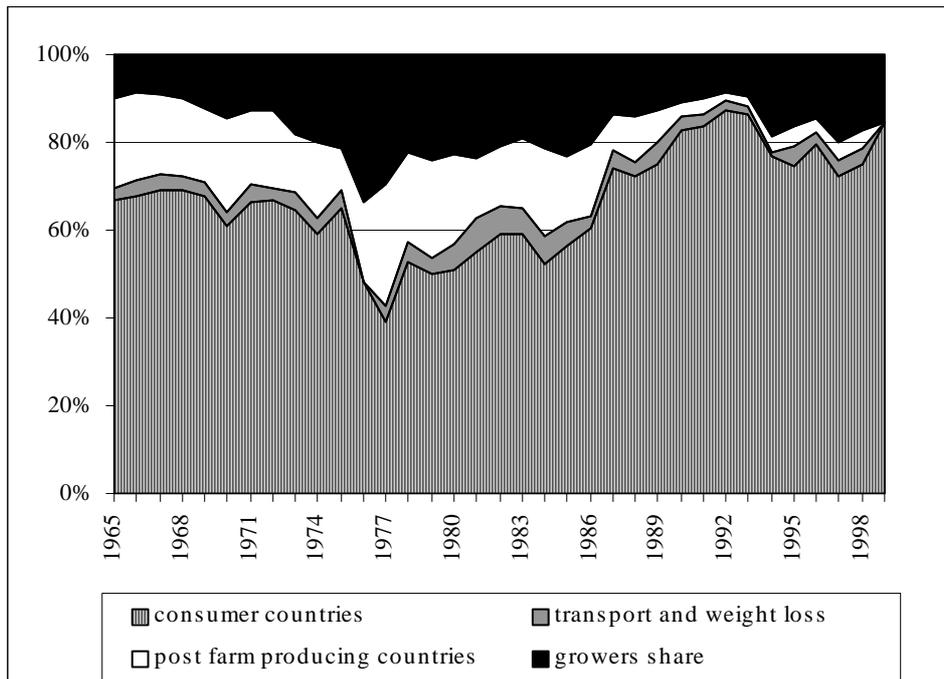
As with all agricultural producers, ACDDCs are capturing less and less of the value of their markets relative to traders, processors, wholesalers and retailers. This is not just a developing country phenomenon. In the US in 1900, a farmer received about 70% of every dollar spent on food. Today it is about 3-4% (Clay 2004b). The increasing importance of technology in areas such as seeds or processing has helped drive such concentration, with the help of the rising barriers to technology transfer represented by intellectual property rights legislation.

In addition, two closely related changes have occurred in the market structure for most agricultural commodities. First, in producer countries, farming is highly fragmented, and the destruction of marketing boards has further reduced the capacity of farmers to raise their share in value chain rents by removing a useful intermediary that could improve farmers' bargaining power with large corporate buyers (UN, 2000). Secondly, the international markets for agricultural commodities have become much more concentrated. Perhaps in response to declining profit margins (UNCTAD, 1999), large trading companies dealing in many commodities have replaced smaller and specialised companies, while the total share of all trading companies has fallen relative to direct purchases by processors or final sellers.

In cocoa, the number of trading houses in London shrank from 30 in 1980 to around ten in 1999. Similarly, the six largest chocolate manufacturers account for 50% of world sales. A handful of vertically integrated companies now dominate the production, distribution and international trade of both oilseeds and oils. Just three global companies control 80% of the soybean crushing market in Europe and more than 70% in the United States. Grain trading, storage, processing and milling is also dominated by a few big companies. Three or four companies control 60% of the terminal grainhandling facilities, 61% of the flour milling, 81% of the maize exports and 49% of the ethanol production in the United States (FAO 2004).

Concentration and the removal of the buffer layer of traders tend to weaken producers' market power, although the removal of the middle level may increase the share of the final price accruing to producers. The growing role of integrated companies also leads to more direct control of what is produced (technical and quality standards). The interaction of these two trends has meant that some of the services formerly provided by governments, e.g. finance and stockholding, are now provided by foreign companies, decreasing the share of commodity income remaining in the producing country.

For coffee, figure 3 shows how relative income within the value chain has changed over the years. Consumer countries achieved their peak slice of the overall cake under the ICA in the late 1970s, but since then have steadily lost ground.



**Figure 3. The inter-country distribution of income: % share of final retail price.**  
Source: Kaplinsky, 2003

In the early 1990s earnings by coffee producing countries (exports f.o.b) were some US\$10-12 billion and the value of retail sales of coffee, largely in industrialised countries, about US\$30 billion. Now the value of retail sales exceeds US\$70 billion but coffee producing countries only receive US\$5.5 billion (Osorio, Executive Director of ICO, 2002). The asymmetrical character of power in the coffee value chain helps explain the increasingly unequal distribution of total incomes. At the importing end of the chain, importers, roasters and retailers compete with each other for a share of the rents but combine to ensure that few of these accrue to producer countries (Fitter and Kaplinsky, 2001). Real profits in the agricultural commodity chain are made by those who control critical points along the chain, own established brands, or have access to shelf space in supermarkets (UN, 2002).

Concentration has created two different forms of value chain. In buyer-driven chains, such as those in horticulture or specialty coffees, retailers dominate, and demand a combination of high quality, standards and product differentiation. To obtain these, many have established direct supply linkages with producers. In contrast, trader-dominated supply chains prevail in bulk commodities, where the main impact of corporate concentration is to drive down producer prices (Vorley, 2004).

### **Distributional Implications**

Not only has corporate concentration diminished the slice of final retail value accruing to developing country producers, it has shifted the balance of power against small-scale farmers.

Vertical coordination and concentration creates 'insiders' and 'outsiders'. The suppliers who have deep enough pockets, low enough costs and the right kind of technology to meet rapidly changing requirements in volumes, standards and new product development can benefit as 'insiders'. Their environmental and social performance credentials may also be higher than average because they have the capital and economies of scale to invest in such practices.

Vorley (2004) cites the example of dairy in Brazil, where before the 1990s, most of the main processing firms were central cooperatives. Deregulation of the dairy market between 1989 and 1993 saw almost all of these cooperatives sold to multinationals. Nestlé, Parmalat and Fleischmann Royal control around 60% of the Brazilian dairy market. The top three dairy processing companies in Brazil – Nestlé, Parmalat and Brazilian-owned Vigor – had 53% of the market in 1996. By 2000, eight of the 10 largest food companies in Brazil were multinationals, with Nestlé the biggest. As a result of higher price competition, dairy companies have consolidated their supply bases to reduce transaction costs. The number of farmers delivering milk to the top 12 companies, for example, decreased by 35% between 1997 and 2000, and the average size of those farm suppliers has increased by 55%. Nestlé alone shed 26,000 farmers from its supply list in the same period – a drop of 75%.

Concentration does not only apply to consumer country traders and retailers. Supermarkets have also spread rapidly in developing countries. In Latin America, for example, supermarkets increased their share of food retailing from less than 20% in 1990 to 60% in 2000. Worldwide, the top 30 supermarket chains now control almost one-third of grocery sales (FAO 2004). Consequently, small farmers producing for the domestic market increasingly face the same barriers to entry in terms of standards as those trying to export.

The majority of smaller and family-scale enterprises (the 'outsiders') are thus left as residual suppliers to low-priced bulk commodity or wholesale markets. In terms of poverty impact, the negative impact of corporate concentration in driving out small producers is perhaps clearer than its impact on producer prices in developing countries, although the evidence is stronger in developed country agriculture (Vorley 2004).

### ***Proposals to reduce the adverse impact of market concentration***

A number of measures have been proposed that would contribute to reducing market concentration and thereby would increase competition in these segments of the marketing chain.

National and international competition law is one obvious way to deal with oligopsonies and oligopolies. In their communication to the WTO (2003), Tanzania, Uganda and Kenya requested that the WTO examine steps to deal with anti-competitive behaviour of large foreign firms and to improve the bargaining position of small producers *vis-à-vis* these firms. If core principles on competition such as non-discrimination and transparency and an undertaking to outlaw hard-core cartels can be established then this could be relevant to agricultural commodity markets.

Unfortunately, this proposal fell victim to the broader argument on 'new issues' in the WTO. Many developing countries see the WTO as an inappropriate forum for such a competition agreement, arguing that the agenda there is more likely to be driven by transnational corporations' desire for improved market access than by a concern to improve development outcomes. As a result, competition was dropped from the Doha agenda in the August 2004 Framework Agreement.

However, there are some other options within the WTO system, notably in the General Agreement on Trade in Services (GATS). Article VIII of the GATS calls on members to ensure that their monopoly suppliers of services in the relevant market do not act in a manner inconsistent with the Members' MFN obligations. Unfortunately, the anti-competitive behaviour of oligopolist/oligopsonist retailers is largely outside of the domain of Article VIII since in most cases the global retailers do not have government involvement to thank for their market power. Another model is that adopted within the WTO agreement on basic telecommunications services, which came into force in 1998, signed by 69 countries (now risen to 75). This agreement includes a negotiated set of pro-competitive regulatory principles contained in a reference paper. Asfaha (2005) sees the reference paper on telecommunications as the only tool under the WTO that sets precedents for extending trade rules and disciplines to private anti-competitive practices by national firms.

The reference paper deals with six regulatory principles including competitive safeguards, interconnection, universal service, licensing, allocation and use of scarce resource and creation of independent regulator. The reference paper was adopted in full or in part by 61 signatories to the basic telecommunications agreement as additional commitments in application of article XVIII of GATS<sup>(5)</sup>. Once adopted, the principles of the reference paper become binding commitments and enforceable through dispute settlement under WTO (Guermazi, 2005).

Some authors and NGOs believe a pro-development competition agreement is more likely to be achieved elsewhere in the UN system, such as UNCTAD or an entirely new UN body.

Vorley (2004) points out that national competition law could address some of these issues. For example the Brazilian anti-trust agency CADE recently blocked Nestle's acquisition of Garoto, a local chocolate manufacturer, on grounds of concern over Nestle's 58% market share. However, a more general extension of national competition law to would require a shift from its current focus on consumer welfare and retail prices (i.e. monopoly/oligopoly) to one on producers and farmgate prices (monopsony/oligopsony). One model might be the regulation of public utilities. For example, governments could require market-dominant buyers to source a certain proportion of their products from small producers, or provide an agreed level of extension services or credit.

Gibbon (2004) dismisses competition law as a practical solution because of the difficulties in determining what constitutes oligopolistic behaviour. For example, the EU bases its competition law on the actions of firms, whereas in commodity markets, firms behave in a less obvious way, benefiting from their market power rather than plotting behind closed doors. Other problems arise over remedies – how could

developing countries enforce competition law, since they cannot easily impose fines, or exert sufficient power to ban mergers.

Improved monitoring and transparency is an altogether less ambitious approach than setting up an international competition authority. Vorley (2004) calls for the restoration of the defunct UN Centre on Transnational Corporations in a monitoring role. Current WTO rules require governments to complete questionnaires about any state trading enterprises operating in their country. That approach could be expanded to include any company, public or private, with more than a given percentage of the import or export market. Such improved transparency would help in checking restrictive business practices at an international level. In June 2004, for example, delegates from 70 countries attending a 'World Farmers' Congress' organised by the International Federation of Agricultural Producers adopted resolutions to collect and publicise concentration information and demand that government anti-trust agencies provide economic impact statements of proposed mergers and joint ventures. IFAP (2004) supports introducing a pre-established level of concentration that triggers a presumption of a violation of anti-trust law. Vorley also points to the potential for consumer transparency in the case of double pricing, piloted in 1999 in France, when, with the support of farmers and distributors, the French Agriculture Ministry imposed a temporary double price labelling system for a number of fruits and vegetables. Every retailer was obliged to display the price the grower received for their product in addition to the retail price for fruits, tomatoes and cucumbers, as well as imported produce.

### ***Conclusion***

Since the demise of supply management, corporate concentration has been the most significant change in the global commodity trade and is only likely to grow in importance and extent, despite efforts to promote developing country processing and trading capacity.

This raises two main questions for policy makers. To what extent does corporate concentration change the debate on dealing with the commodity crisis, making some remedies more difficult, and others more practical? Secondly, what combination of carrots and sticks, and hard and soft law, are required to moderate excessive market power and ameliorate its negative impacts on producers? While maximalist positions such as a binding international competition agreement are likely to prove elusive, the issue may also be amenable to 'soft law' approaches such as transparency and reporting requirements. Here the last decade of corporate campaigning has armed NGOs and unions with useful experience in influencing the social and environmental practices of powerful northern companies.

## **7. Conclusion: Comparing the Approaches and Next Steps**

Dependence on commodities is rarely chosen. ACDDCs are largely a residual category of countries that have so far been unable to escape from the sinking ship. Saying to them ‘you shouldn’t start from here’ and exhorting them to diversify is therefore not helpful, unless accompanied by the means (both intellectual and financial) to do so. In order to escape, ACDDCs have only aid and their commodity exports to count on. Making the best of this particular bad lot is a challenge, but it can be done – witness the numerous examples of countries that have made the transition to a more sustainable development path. Commodity dependence is not a death sentence.

Developing countries and their supporters need to consider the pros and cons of the different approaches described in this paper. They vary in their ambition, social and environmental impact, and in their political and technical feasibility. Table 3 summarizes these qualities. Moreover, the approaches are not entirely de-linked. Some reinforce and complement each other, while others may even undermine each other. The synergies (whether positive, negative or zero) between the approaches are briefly discussed in table 4.

The commodity crisis is not over. Even the current silver lining of the price boom in some commodities has a cloud attached. There is a risk that the gathering momentum beyond revisiting the commodity crisis will dissipate, potentially putting off the debate for another decade. This paper has explored the strengths and weaknesses of five current approaches to the commodity issue, highlighting in particular the impact on poverty and sustainability.

### **Mainstream**

Mainstream discussions on competing commodities appear far more vigorous and hopeful than those on non-competing tropical commodities. In regional and global trade negotiations, robust solutions do battle with the realpolitik of equally robust vested interests. In tropical commodities, however, the debate resembles little more than a dispirited counsel of despair. Resigned to falling prices and increasing marginalization, policy makers and opinion formers can only advocate aid, managed decline (e.g. by smoothing prices) and exit for an increasingly trapped residual group of poor countries that have so far failed to find the way out of commodity dependence. Yet donors have few ideas, confining themselves to repudiating past remedies and stressing the need for an ‘enabling environment’ for private sector investment. One author likened such ‘let them diversify’ exhortations to Marie Antoinette’s ‘let them eat cake’ advice to the starving French peasantry.

### **Sustainable Commodities**

Environmental and Development NGOs and others trying to influence the social and environmental impact of commodity production have largely focussed on progressive versions of process and production methods (PPMs). These have provided a means of channelling a premium to poor producers and good environmental practices from socially conscious consumers, through a variety of labelling schemes. In recent years, a number of corporate-driven schemes have followed suit, introducing social and environmental schemes that both hold out the possibility of influencing much greater volumes of production, and the threat of significantly watering down the standards

involved. Moreover, concerns have been raised about the potential for both niche and mainstream labelling schemes on small scale producers.

### **National Coordination**

The role of the state, for example via the state marketing boards that in many countries have been dismantled as part of structural adjustment programmes, has earned increasing attention in recent years. Where state coordination mechanisms have avoided dismemberment, as in West Africa, there are strong arguments for retaining them. Elsewhere, efforts may be better spent finding other solutions to the underlying problem of producer fragmentation. It is hard to argue on political or developmental grounds against a focus on producer organization, supported by the state in an enabling role. The hard question is, can it work? How can producer organizations become a significant counterweight in an ever-more unbalanced supply chain? How can producer organizations counter the many pressures that are steadily squeezing small-scale producers out of all but the most sluggish backwaters of international trade?

One particular solution for the hard-hit coffee sector may lie in pursuing a 'wine makeover', with coffee houses playing the same role as the 1980s wine bars in countries like the UK in educating the palate of new generations of coffee drinkers, enabling coffee producers to improve price premia based on geographical origins and quality.

### **International Coordination**

International Supply Management has several attractions for development advocates and campaigners: it has been tried and found (to some extent) to work; it is relatively simple to explain; it requires action by northern governments, which are easier to lobby than either private companies or developing country governments. However the ideological and political obstacles are great, and the danger is that ICAs will become like the Tobin Tax – a magnet for campaigners who see them as a 'magic bullet' that can solve the commodity crisis, smothering interest in other approaches that may be more piecemeal, but more feasible. It is important to keep the full menu of measures in mind, when discussing the commodity crisis.

### **Market Power**

Since the demise of supply management, corporate concentration has been the most significant change in the global commodity trade and is only likely to grow in importance and extent, despite efforts to promote developing country processing and trading capacity.

This raises two main questions for policy makers. To what extent does corporate concentration change the debate on dealing with the commodity crisis, making some remedies more difficult, and others more practical? Secondly, what combination of carrots and sticks, and hard and soft law, are required to control concentration and ameliorate its negative impacts on producers? While maximalist positions such as a binding international competition agreement are likely to prove elusive, the issue may also be amenable to 'soft law' approaches such as transparency and reporting requirements. Here the last decade of corporate campaigning has armed NGOs and unions with useful experience in influencing the social and environmental practices of powerful northern companies.

### **What is to be done?**

Faced with this array of options, each with differing levels of ambition and political and practical feasibility, development advocates face difficult, if familiar, choices. Should they pursue a radical, perhaps long-term solution, such as international supply management, which goes against the ideological grain of major institutions and runs the risk of total failure? Or do they allow themselves to be bought off with piecemeal reforms such as CSR, or support for niche markets, which may only offer limited benefits? How much room for reform is there within a globalised, liberalized marketplace, for example through strengthened competition law, or support for producer organizations? A common understanding of the different approaches, and of the trade-offs involved in choosing one or other as an advocacy and campaign issue, is essential to building an informed and effective coalition to end the conspiracy of silence on commodities.

### **Next Steps**

This paper reviews the existing literature and adds some initial observations on the strengths, weaknesses and synergies of the main approaches. These were discussed at a conference in Barcelona in June 2005, and some of the comments and suggestions have been incorporated. One overall suggestion remains as a proposal for taking the discussion forward, and that is to unbundled 'commodities' into four or five clusters and run the kind of analysis and comparison contained in this paper separately for each of them. Possible candidates for such clusters could include kinds of crop (tropical beverages, cereals, perishables), or kinds of market structure (buyer driven v trader driven; small number of producer countries v large number of producer countries). Using the comparative approach adopted in this paper, drilling down further via these commodity groups would then produce a clearer picture of what approaches are best suited to different kinds of commodities.

**Table 3: The Main Commodities Approaches Compared**

Paradigm	Proposed Solution	Poverty Impact	Environmental Impact	Who needs to agree/ accept?	Political Feasibility	Technical Feasibility	Comments
Mainstream macro	WTO: cut subsidies; open markets	Limited. Large farms main beneficiaries in most crops with notable exceptions in cotton and sugar	Good in North. Could be negative in South (spread of industrial ag)	OECD governments (trade and ag ministries), DC governments for southern liberalization	Low in North, due to strong agribiz lobby	High	More important for competing commodities than tropicals. Supply response and competition from synthetic substitutes may mean benefits are short-lived
	Compensation and aid schemes	Depends on DC governments, and on developed country governments making timely disbursements and on the conditions they attach	Depends on DC governments	OECD governments (finance ministries). Some developing country governments hostile towards compensation for preference erosion in bananas and sugar (want to maintain the rents associated with	High	High	What exit routes for remaining ACDDCs exist - is shortage of \$ really the problem?

				preferences).			
Mainstream micro	Diversification: horizontal, vertical or out of ag	High in long term, but in short term depends on labour intensity of new activities	Depends on nature of new production, eg more chemical intensive ag	DC governments, producers, supply chains	Easy to say	v hard to do!	Remaining ACDDCs are a residual category of those countries that have so far failed to diversify, so bound to be hard.
	Market-based Price risk management	Low, since mechanisms largely inaccessible to SS Ag plus cd lead to increased overall production	Neutral	Financial Providers; Farmers	High	Low	6 years into World Bank programme, v little to show for it. Triumph of ideology over pragmatism.
Sustainable commodities	Environmental Better Management Practices	Cd be negative, if excludes SS Ag, or positive, by reducing input costs	Positive	Producers; supply chains; consumers	Market driven, so feasible if incentives are there	High	Role of GMOs likely to surface in debate
	Fair Trade	Positive but limited in scale	Could be negative, since SS Ag less amenable to	Consumers (rest, eg supermarkets, will follow, if price premium	Market driven, so feasible if incentives are there	High, but need good traceability system	Market share + threat of dilution from CSR initiatives

			BMPs	sufficient)			are main challenges
	Organics	Cd be negative, if excludes SS Ag, or positive, by reducing input costs	Cd be negative, depending on what replaces chemical inputs	Consumers (rest will follow, if price premium sufficient)	Market driven, so feasible if incentives are there	High	Not clear who benefits from organics apart from health conscious consumers and retailers
	Corporate Social Responsibility	Depends if broader reach is undermined by weaker standards, plus exclusion issue	Depends whether broader reach is undermined by weaker standards	Can be corporate driven eg reputation risk management, or consumers	Market driven, so feasible if incentives are there	High	Doubts over whether CSR is driven by desire for real impact, or reputation management
National coordination	Defend/revive state marketing boards	High, <i>if</i> previous problems such as low farmer prices, corruption etc can be overcome	High, since provides channel for disseminating BMPs	DC governments and (preferably) donors	Low. High level of donor hostility and scepticism on practicality.	Low. Hard to restore state coordination once privatisation has taken place and value chains have been consolidated.	Best option may be to defend remaining marketing boards, but look for other options elsewhere.
	Producer organisation	High	Neutral, unless POs used as channel for disseminating	Producers; DC governments; buyers	High, at least for limited degree of coordination	High, at least for limited degree of coordination	Spans huge range from basic technical assistance to

			BMPs		around extensions services, credit	around extensions services, credit	real shift in producer power within GVCs
	Quality and differentiation based on geographical indicators	High, if does not exclude SS farmers	Neutral	Consumers; Producer; DC governments	High	Depends on commodity – coffee and tea most promising	Only relevant to a few commodities like coffee that can be ‘winified’
International coordination	Supply Management/ ICAs	High	Neutral	Producer and consumer countries, if want GATT legality	Low. Consumer countries unlikely to support	Low. Intractable problems with free riders, new entrants, substitution	Magic bullet or massive distraction? Depends who you ask.....
	Standards: harmonisation, equivalence, DC voice in setting	Cd reduce exclusionary impact of standards	Neutral	Consumer and producer governments	Limited, if seen as watering down health standards	Possible, given political will	Sensible step, given inexorable proliferation
Market Power	International competition law	High, if leads to higher producer prices	Neutral	Consumer and producer governments	Low. US unilateralism + corporate resistance	Low. Hard to prove, plus hard to impose penalties on international firms.	Unlikely in short or medium term
	National competition law	High, if leads to higher producer prices	Neutral	Producer governments, northern	Medium. Corporates may abandon	Low. Wd DC governments have enough	Coordinated approach between DCs eg

				companies	marginal countries, but would stay with profitable ones	trained lawyers or be strong enough to ban mergers, impose penalties on TNCs etc?	via UNCTAD would reduce danger of corporate backlash
	Increased corporate monitoring, transparency	Unclear	Neutral	Northern companies, possibly pushed by northern governments via reporting requirements	Medium. Corporate resistance, but transparency = motherhood and apple pie.	High	Relatively easy win, but how much impact would it have?

Table 4. Summary of interactions and complementarities between approaches to the commodity problem

Paradigm	Sustainable Commodities	National Coordination	International Coordination	Market Power
<p><b>Mainstream macro:</b> WTO rules on market access and subsidies Compensation for preference erosion Diversification Price Risk management (PRM)</p>	<p>WTO may be barrier to Soc/Env Process and Production Methods; With WTO waiver, pref schemes cd be extended to soc/env issues (as proposed for bananas). Compensation and diversification schemes cd be linked to BMPs. PRM largely irrelevant to small producers.</p>	<p>Ideological gulf on role of state, but mainstream more likely to accept strengthened producer organization WTO cd restrict operation of state marketing boards but strengthen protection of geographical indicators; Compensation schemes cd fund technical assistance, credit etc for producer organizations. Differentiation via geographical indicators cd be part of differentiation strategy; Producer organisations and marketing boards cd have scale to use PRM</p>	<p>Ideological gulf on role of state. WTO legitimises but restricts ICAs by insisting they include consumer countries. World Bank or other donors cd play a role in harmonising standards. Compensation schemes cd fund work on standards compliance</p>	<p>Orthodox economists amenable to ‘market failure’ arguments on competition law. WTO could require transparency on corporate concentration, similar to that on state enterprises.</p>
<p><b>Sustainable Commodities:</b> Better</p>		<p>Complementary: marketing boards and producer organizations</p>	<p>Sustainability Standards may need to be harmonized to reduce burden on SS Ag;</p>	<p>Contradictory: buyer-driven chains more susceptible to NGO/consumer pressure for</p>

Management Practices (BMPs) Fairtrade Organics		provide channel for spread of BMPs, technical assistance. Fair trade encourages producer organization.	International supply management rules cd require BMPs	improved sustainability, but outside niche products, large corporations squeeze prices and exclude small farmers more.
<b>National Coordination:</b> State marketing boards Strengthened producer organizations 'Winification' of coffee			Restoration of national supply management an essential precondition to any international agreements. Producer mobilization in developed countries (e.g. Holland) has often been catalyst for creation of national supply management schemes.	Complementary. Producer organizations wd be able to take advantage of curbs on corporate power in supply chains. Corporate concentration itself reduces the number of actors required to participate in any attempt at national supply management
<b>International Coordination:</b> New generation of international commodity agreements (ICAs) Greater coordination of standard setting				Corporate concentration likely to pose serious obstacle to introduction of international supply management, unless corporates can be won round on sustainability arguments.

**Appendix 1: Real export prices of primary commodities, 1994-2004 (2000=100)**

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Non-fuel commodities	115.52	125.73	123.83	120.20	102.77	95.71	100.00	95.86	96.67	103.53	122.97
Food	118.96	126.38	136.76	124.62	110.94	98.27	100.00	102.10	103.45	109.50	125.32
Wheat	131.38	155.22	181.70	140.05	110.61	98.29	100.00	111.23	130.28	128.19	137.61
Maize	122.17	139.94	186.49	132.82	115.19	102.35	100.00	101.58	112.60	119.23	126.71
Rice	132.29	157.49	165.97	148.49	149.94	122.23	100.00	84.79	94.17	97.92	120.66
Barley	94.06	134.67	154.94	125.90	110.12	98.32	100.00	121.63	141.09	135.58	128.17
Coconut oil	133.45	146.90	168.02	144.89	143.10	165.73	100.00	68.65	90.62	100.88	147.10
Groundnut oil	143.54	139.09	125.95	141.83	127.53	110.42	100.00	94.30	96.57	175.55	162.74
Linseed oil	129.38	164.63	141.68	143.03	177.20	128.33	100.00	95.71	130.25	169.81	218.52
Olive oil	105.66	150.99	200.17	142.16	108.29	122.49	100.00	89.50	97.33	127.40	155.39
Palm oil	167.44	205.87	178.89	187.80	230.08	144.47	100.00	91.29	136.61	157.15	166.47
Soybean oil	171.41	166.20	154.70	149.47	159.89	111.54	100.00	98.63	116.50	142.21	167.83
Sunflower oil	190.74	166.54	147.73	146.81	175.37	122.97	100.00	114.97	159.71	171.36	193.61
Beef	120.54	98.53	92.23	95.88	89.19	94.70	100.00	109.97	108.67	102.22	129.75
Lamb	111.35	100.36	128.88	133.17	102.79	102.65	100.00	115.42	129.41	141.61	146.89
Swine meat	95.14	105.92	155.99	122.89	76.94	74.90	100.00	103.62	79.71	90.07	119.77
Poultry	92.99	93.33	104.81	102.59	106.23	100.87	100.00	107.03	106.11	111.37	127.38
Fish	137.47	131.00	112.80	102.20	102.01	97.92	100.00	79.33	80.61	82.10	91.7
Shrimp	85.74	88.62	86.03	96.80	93.16	95.71	100.00	100.57	68.96	75.31	73.24
Sugar	149.87	164.35	147.97	141.12	110.39	77.55	100.00	101.89	77.19	85.70	93.39
Bananas	104.15	105.41	111.20	123.75	116.56	88.55	100.00	138.46	124.95	88.85	124.29
Oranges	113.25	146.32	135.37	126.36	121.80	120.65	100.00	163.95	155.43	188.06	235.28
Beverages	153.38	154.20	131.41	172.24	149.55	117.76	100.00	83.87	97.73	102.51	105.6
Coffee	174.65	175.68	141.39	217.55	155.68	119.55	100.00	72.80	70.98	75.31	94.17
Cocoa beans	154.41	158.48	161.00	179.08	185.42	125.57	100.00	120.41	196.82	193.94	171.56
Tea	73.88	66.16	71.40	95.60	96.15	93.65	100.00	79.85	72.22	78.32	79.86
Agricultural raw materials	119.72	123.72	119.18	113.52	94.59	95.77	100.00	95.06	96.73	100.35	106.41
Timber	130.01	117.97	119.72	110.41	88.19	98.82	100.00	88.08	87.19	92.66	103.44
Cotton	135.01	166.48	136.40	134.18	110.98	89.98	100.00	81.29	78.35	107.45	105.01
Wool	101.61	105.69	88.83	103.59	75.36	84.42	100.00	84.99	87.85	95.71	97.24
Rubber	168.54	236.59	209.87	152.35	108.04	95.16	100.00	86.09	114.54	162.14	195.3
Hides and skins	108.21	109.87	108.85	110.01	95.60	89.94	100.00	105.46	100.65	85.14	83.67
Metals	100.93	122.08	108.26	109.55	90.14	89.13	100.00	90.20	87.73	98.20	133.98
Copper	127.06	161.59	126.39	125.39	91.14	86.66	100.00	87.08	85.99	98.06	157.81

Aluminium	95.11	116.34	97.12	103.08	87.50	87.66	100.00	93.25	87.08	92.35	110.77
Iron ore	91.94	98.58	104.20	104.72	107.68	95.83	100.00	103.91	101.88	109.46	131.64
Tin	100.44	114.01	113.30	103.76	101.85	99.18	100.00	82.59	74.71	89.95	156.02
Nickel	73.37	95.28	86.95	80.24	53.57	69.55	100.00	69.17	78.60	111.58	160.14
Zinc	88.52	91.43	90.89	116.6	90.83	95.40	100.00	78.64	69.07	73.42	92.94
Lead	120.82	138.56	170.45	137.19	116.02	110.48	100.00	104.89	99.58	113.22	194.19
Uranium	113.71	140.80	188.34	146.03	125.38	120.89	100.00	104.04	118.62	135.63	217.81
Energy	58.78	63.97	74.45	70.38	49.21	64.07	100.00	88.53	88.03	102.76	134.55
Natural gas	44.45	39.57	62.43	57.11	48.47	52.49	100.00	91.91	78.02	127.57	137.16
Crude petroleum	56.49	60.93	72.16	68.24	46.31	63.68	100.00	86.18	88.37	102.33	133.74
Coal	123.05	149.99	145.04	133.71	111.36	98.63	100.00	123.10	103.09	105.67	208.38

*Source: IMF, International Financial Statistics (2005).*

**Appendix 2: Countries dependent on primary commodities for export earnings  
(Annual average export data, US dollars, 1995–2000)**

	>50% of export earnings	20–49% of export earnings	10–19% of export earnings
Countries in Africa			
Crude petroleum	<i>Angola</i> (92%) <i>Congo</i> (57%) <i>Gabon</i> <sup>a</sup> (70%) <i>Nigeria</i> (96%) <i>Libya</i> (61%) <i>Equatorial Guinea</i> (91%)	<i>Cameroon</i> <sup>a</sup> (37%) <i>Algeria</i> <sup>a</sup> (41%)	<i>Egypt</i> (13%)
Natural gas		<i>Algeria</i> <sup>a</sup> (37%)	
Bauxite		<i>Guinea</i> (36%)	
Iron ore		<i>Mauritania</i> <sup>a</sup> (37%)	
Copper	<i>ZAMBIA</i> (52%)		
Cobalt			<i>Congo, Dem Rep</i> <sup>a</sup> (14%)
Gold		<i>Ghana</i> <sup>a</sup> (25%) <i>MALI</i> <sup>a</sup> (30%)	
Diamonds	<i>Congo, Dem Rep</i> <sup>a</sup> (71%) <i>BOTSWANA</i> (91%)	<i>CENTRAL AFRICAN REPUBLIC</i> <sup>a</sup> (30%) <i>Namibia</i> <sup>a</sup> (38%) <i>Sierra Leone</i> <sup>a</sup> (41%) <i>South Africa</i> (22%)	
Uranium	<i>NIGER</i> <sup>a</sup> (59%)		
Timber		<i>Cameroon</i> <sup>a</sup> (20%)	<i>Gabon</i> <sup>a</sup> (12%) <i>Ghana</i> <sup>a</sup> (13%)
Cotton		<i>BURKINA FASO</i> (41%) <i>CHAD</i> <sup>a</sup> (37%) <i>Benin</i> (34%) <i>MALI</i> <sup>a</sup> (34%)	<i>Togo</i> (17%) <i>CENTRAL AFRICAN REPUBLIC</i> <sup>a</sup> (12%) <i>Tanzania</i> <sup>a</sup> (11%)
Tobacco	<i>MALAWI</i> (59%)	<i>ZIMBABWE</i> (29%)	
Coffee	<i>BURUNDI</i> <sup>a</sup> (76%) <i>ETHIOPIA</i> (62%) <i>UGANDA</i> (83%)	<i>RWANDA</i> <sup>a</sup> (48%)	<i>Madagascar</i> <sup>a</sup> (15%) <i>Kenya</i> <sup>a</sup> (13%) <i>Tanzania</i> <sup>a</sup> (16%) <i>Congo, Dem Rep</i> <sup>a</sup> (11%) <i>CENTRAL AFRICAN REPUBLIC</i> <sup>a</sup> (11%)
Cocoa		<i>Sao Tome and Principe</i> <sup>a</sup> (48%) <i>Côte d'Ivoire</i>	

		(28%) Ghana <sup>a</sup> (27%)	
Tea		Kenya <sup>a</sup> (24%) RWANDA <sup>a</sup> (21%)	BURUNDI <sup>a</sup> (12%)
Vanilla		Comoros (35%)	
Sugar	Gambia <sup>a</sup> (87%)	Mauritius (23%) Djibouti <sup>a</sup> (45%)	SWAZILAND <sup>a</sup> (18%)
Cashew nuts	Guinea Bissau (83%)		
Livestock	Somalia (55%)		CHAD <sup>a</sup> (18%) MALI <sup>a</sup> (18%) Sudan (14%) NIGER <sup>a</sup> (14%) Namibia <sup>a</sup> (12%) Djibouti <sup>a</sup> (17%)
Fish	Seychelles (59%)	Mozambique (32%) Sao Tome and Principe <sup>a</sup> (30%) Madagascar <sup>a</sup> (30%) Senegal (30%) Sierra Leone <sup>a</sup> (25%)	Namibia <sup>a</sup> (19%) Cape Verde (19%) Gambia <sup>a</sup> (15%) Mauritania <sup>a</sup> (14%) Morocco (11%)
Countries in Latin America			
Crude petroleum	Venezuela (53%)	Colombia <sup>a</sup> (24%) Ecuador <sup>a</sup> (31%)	
Copper		Chile <sup>a</sup> (26%)	Peru <sup>a</sup> (12%)
Cotton			Paraguay (12%)
Coffee		El Salvador (30%) Honduras (24%) Nicaragua <sup>a</sup> (22%)	Colombia <sup>a</sup> (15%)
Sugar		Cuba (36%) Belize <sup>a</sup> (29%)	
Bananas		Ecuador <sup>a</sup> (21%) Panama <sup>a</sup> (23%)	Belize <sup>a</sup> (16%) Costa Rica (13%)
Livestock			Uruguay (18%) Nicaragua <sup>a</sup> (10%)

	>50% of export earnings	20–49% of export earnings	10–19% of export earnings
Fish		French Guiana (31%) Panama <sup>a</sup> (25%) Ecuador <sup>a</sup> (20%)	Peru <sup>a</sup> (16%) Nicaragua <sup>a</sup> (15%) Belize <sup>a</sup> (14%) Chile <sup>a</sup> (11%)
Rice			Guyana <sup>a</sup> (16%) Suriname (10%)
Bauxite			Guyana <sup>a</sup> (16%)

Sugar	<b>St Kitts and Nevis</b> (52%)	<u>Guyana</u> <sup>a</sup> (25%)	Guatemala (10%)
Gold		<u>Guyana</u> <sup>a</sup> (24%)	Peru <sup>a</sup> (13%)
Countries in the Caribbean			
Crude petroleum			<b>Trinidad and Tobago</b> (14%)
Coffee			<i>Haiti</i> (11%)
Sugar			Dominican Republic (14%) <b>Barbados</b> (11%)
Bananas	<b>St Lucia</b> (55%)	<b>St Vincent and Grenadines</b> <sup>a</sup> (42%) <b>Dominica</b> (32%)	<b>Grenada</b> (11%)
Rice			<b>St Vincent and the Grenadines</b> <sup>a</sup> (13%)
Countries in Asia			
Crude petroleum	Iran (82%) Kuwait (62%) Oman (76%) Qatar <sup>a</sup> (53%) Saudi Arabia (71%) Syria (60%) <u>Yemen</u> (91%) United Arab Emirates (61%)	Brunei Darussalam <sup>a</sup> (36%) <b>Bahrain</b> (20%) Azerbaijan (44%) Kazakhstan (31%) <u>Vietnam</u> (22%)	Indonesia (10%)
Cotton		Uzbekistan (36%)	TAJIKSTAN (17%) Turkmenistan <sup>a</sup> (15%)
Natural Gas		Qatar <sup>a</sup> (26%) Turkmenistan <sup>a</sup> (34%) Brunei Darussalam <sup>a</sup> (48%)	
Timber		<u>Myanmar</u> <sup>a</sup> (30%)	
Fish			<u>Myanmar</u> <sup>a</sup> (14%)
Tea			<b>Sri Lanka</b> (13%)
Countries in the Pacific			
Crude petroleum		<b>Papua New Guinea</b> (25%)	
Timber	<b>Solomon Islands</b> <sup>a</sup> (67%)		
Sugar		<b>Fiji</b> (27%)	
Coconut Oil			<b>Samoa</b> <sup>a</sup> (13%)
Vanilla			<b>Tonga</b> <sup>a</sup> (11%)
Copra		<b>Kiribati</b> <sup>a</sup> (35%) <b>Vanuatu</b> (42%)	<b>Samoa</b> <sup>a</sup> (11%)
Fish		<b>Kiribati</b> <sup>a</sup> (46%)	<b>Solomon Islands</b> <sup>a</sup>

		<b><i>Tuvalu</i></b> (42%) <b><i>Samoa</i></b> <sup>a</sup> (42%) <b><i>Tonga</i></b> <sup>a</sup> (20%)	(15%)
<sup>a</sup> Country dependent on more than one commodity			
Typeface		Meaning	
<b>Bold</b>		Island	
CAPITALS		Land-locked	
<i>Italics</i>		Least Developed	
<u>Underline</u>		HIPC	

Source: Adapted from Page and Hewitt (2001) and updated using UNCTAD (2003c).

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