CHAPTER 6
COMMODITIES

The problems facing primary commodities (agricultural primary commodities and mineral commodities, but not fuel) are closely related to those afflicting agriculture, because about 80 per cent of commodity exports—for developing countries and for the world—are agricultural. Despite progress in diversifying exports and broadening national economic structures, most developing countries—86 of 144 for which data are available—still depend on commodities for more than half their export earnings. This number has remained virtually constant for the past ten years. Moreover, for many countries a large share of export income comes from only one commodity or just a few. For 55 countries, three commodities together account for more than half of export earnings.

A BRIEF HISTORY

In April 1942, during preparations for the Bretton Woods conference in New Hampshire, John Maynard Keynes ([1942] 1974) presented a memorandum to the Allies proposing an international institution for regulating world commodity markets as one of three major international institutions needed to regulate the world economy after World War II. His proposal outlined a series of commodity agreements and organizations for major commodities (tin, wool, wheat, maize, sugar, coffee, cotton and rubber), operating in an integrated manner under a general council for commodity organizations and relying primarily on buffer stocks.

Negotiations over international commodity arrangements were not new. Even before World War II such arrangements had been concluded for sugar, wheat, tea, natural rubber and tin, aimed at stabilizing prices or defending floor prices. But between 1945 and 1964 price-stabilizing international commodity arrangements were concluded for only three of these five commodities (wheat, sugar and tin) and for coffee. The commodity issue became one of the major concerns leading to the establishment of the United Nations Conference on Trade and Development (UNCTAD) in 1964.

Following the 1973 oil price increase by the Organization of Petroleum Exporting Countries (OPEC) and the 1974 call of the United Nations General

Assembly (1974, p. 6) for 'an integrated programme for . . . commodities of export interest to developing countries', negotiations under the auspices of UNCTAD led to the creation in June 1980 of the Common Fund for Commodities, a central financing mechanism. They also resulted in the conclusion of three new international commodity arrangements, for jute, natural rubber and tropical timber. Of these, only that for rubber included economic clauses for market intervention. The others, along with international study groups on nickel and copper, aimed at increasing market transparency through the publication of statistics and through research and development (R&D) and other development projects financed by the Common Fund for Commodities. After the collapse of the International Tin Agreement in 1985, successive renegotiations of the other international commodity arrangements resulted in a progressive abandonment of economic clauses aimed at price stabilization.

Since the 1970s there have been several major developments in global commodity markets:

- The structures of world commodity markets have altered significantly, both on the demand side (through mergers and acquisitions) and on the supply side (through the abolition of marketing boards). While concentration has often been helpful to market management and mergers and acquisitions can play a useful role, the changed market structures make reaching agreement on international commodity arrangements that would increase prices even more difficult than in the 1970s.
- Developing countries, particularly African and least developed countries and those in the African, Caribbean and Pacific (ACP) group, have suffered more from losses of market share in world commodity exports (excluding fuels) than from price declines for their commodities. Between 1970–72 and 1998–99 Africa's share in world commodity exports declined from 8.6 per cent to 2.6 per cent, that of ACP countries from 8.4 per cent to 2.4 per cent and that of the least developed countries from 4.7 per cent to 1.0 per cent. If these three groups of countries (which overlap to a large extent) had been able to maintain their 1970–72 market shares, their average annual export earnings in 1998–99 would have been far higher: US$41 billion higher for Africa, US$45 billion higher for the ACP countries and US$28 billion higher for the least developed countries. These losses are due in part to a loss in competitiveness and in part to the protectionism (through higher trade barriers and export subsidies) of industrial countries. Developing countries today account for only around 26–29 per cent of world commodity exports.
- Meanwhile, 14 of the 15 countries of the European Union (all except Denmark) have increased their market share in world commodity exports. So have China and some of the newly industrialized countries in Southeast Asia and Latin America, such as Indonesia, Thailand, and Mexico. For agricultural exports alone, the European Union's share rose from 28.1 per cent to 42.7 per cent between 1970 and 2000, that of China from 2.4 per cent to 4.3 per cent, that of Thailand from 0.9 per cent to 1.8 per cent and that of Mexico from 1.3 per cent to 1.9 per cent.[1]

- The share of developing countries in world exports of tropical products that are produced exclusively in these countries has fallen, as industrial countries import raw commodities and blend and pack them (or just pack and brand them without blending) for re-export at a much higher value. (For example, the share of developing countries in world coffee exports declined from 93 per cent to 75 per cent between 1970–72 and 1998–99.)
- Traditional commodity exports of developing countries have lost importance, overtaken by new, dynamic commodity sectors. Between 1970–72 and 1998–99 the value of world coffee exports increased by more than 4.4 times (from US$3.2 billion to US$14.2 billion) and that of tea by 4.3 (from US$0.7 billion to US$3.0 billion). Meanwhile, the value of world vegetable exports expanded by almost 14 times (from US$2.1 billion to US$29.2 billion), cut flowers by 22 (from US$0.2 billion to US$4.4 billion) and poultry by 41.5 (from US$0.2 billion to US$8.3 billion). Coffee, which used to be the foremost commodity export earner for developing countries, now ranks only fifth—behind fish, vegetable oils, fruits and wood.
- The prices of several major export commodities of developing countries have collapsed since the mid-1990s, leading to massive losses in foreign exchange earnings.
- Newly industrialized developing countries have become the most dynamic importers of commodities, underlining the importance of direct South-South trade in commodities.

The situation today

Given the history of international commodity arrangements and other developments since the 1970s, trade in most commodities, unlike other agricultural and industrial products, continues to take place outside the framework of the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO). Yet many if not most commodities are subject to tariff peaks and escalation, especially in industrial countries. In addition, numerous anti-dumping actions and the resurgence of voluntary export restraints are nullifying the potential benefits of liberalization in the minerals and metals sector.

The collapse in the prices of several major commodities of export interest to developing countries since the mid-1990s has fuelled calls for supply management schemes by producer associations of developing countries (along the lines of the OPEC model) aimed at raising the prices of developing country commodity exports from their dismally low levels. The fall in export prices and revenues has had dramatic consequences for human development, transmitted through lower employment, wages, incomes, livelihood security and social well-being (boxes 6.1 and 6.2). In developing countries typical export crops such as tea, coffee, cotton and sugar are often harvested by casual, unprotected and unregistered day labourers, many of whom in some countries are women.

BOX 6.1 THE CASE OF COFFEE

In 2001 the composite indicator price for coffee was 44.62 cents a pound, a 30-year low and 68 per cent lower than the average of 138.04 cents in 1995. For developing country exporters, the drop in price represents an annual loss of export earnings estimated at US$7 billion. The real (inflation-adjusted) price of coffee beans has fallen to just 25 per cent of its level in 1960, so that the money farmers make from coffee can buy only a quarter of what it could 40 years ago (see figure).

The impact on export prices, revenues, employment and wages

The coffee sector in several Latin American and Caribbean countries has entered an unprecedented crisis, with repercussions for economic performance, balance of payments, employment and income. Hardest hit are Colombia, Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua. In 2001 alone Central American countries lost US$713 million in coffee revenues (compared with their average export earnings of the late 1980s), equal to 1.2 per cent of the region's GDP for that year. In the same year about 170,000 jobs were lost in coffee farming, and US$140 million in wages. The unemployment and lower wages in the coffee sector affected some 1.6 million people in the poorest population groups.

In El Salvador coffee export earnings collapsed from US$311 million in 2000 to US$130 million in 2001 and to an estimated US$100 million in 2002. Direct jobs provided by coffee growers in the country are expected to decline from 150,000 in 1997 to 80,000 in 2002. In Guatemala the harvest labour force for the 2001/02 crop has been halved from 500,000 to 250,000. In Colombia, where coffee production accounts for 2 per cent of GDP and more than 500,000 families depend on coffee production for their livelihood, the downturn in the coffee industry in 2001 led to the loss of 257,000 jobs, of which 181,000 were in the coffee sector.

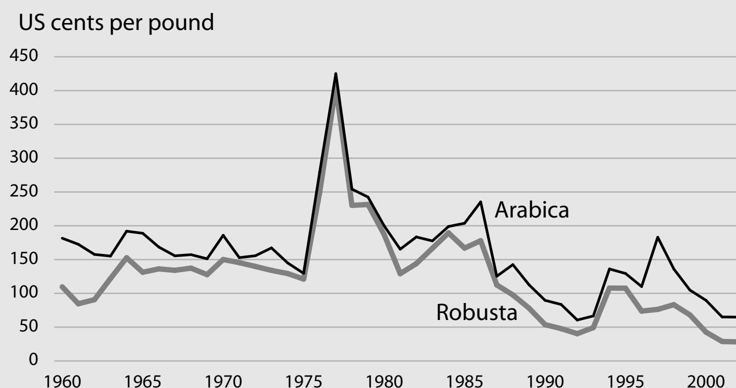
The same story is echoed in parts of sub-Saharan Africa. Ethiopia's export revenues from coffee fell 42 per cent, from US$257 million to US$149 million, between 1999–2000 and 2000–01. In Uganda, where roughly a quarter of the population depends on coffee in some way, coffee exports for the eight-month period before June 2002 remained at almost the same volume as in the year before while earnings dropped by almost 30 per cent. In the southern Indian state of Karnataka, which produces a large share of India's coffee, the number of plantation workers has fallen 20 per cent over the past two years.

Countries highly dependent on coffee export earnings are doubly disadvantaged. While the price of their exports tends to decline over time, the prices of their imports, often manufactured goods, do not fall or fall more slowly. Oxfam International reports that a coffee farmer in producer countries would have to sell more than twice as many coffee beans today as in 1980 to buy a Swiss army knife. A similar situation arises for debt and debt service, which are fixed in US dollars. For Uganda, for example, the falling value of coffee exports has negated the benefits of its debt relief under the heavily indebted poor countries (HIPC) initiative.

The impact on farmers' incomes and livelihoods

In stark contrast with the booming coffee industry in industrial consuming countries and the exceptional windfall profits of their coffee roasters and processors, coffee farmers in developing countries are going through their worst crisis ever. More than 125 million people depend on coffee for their livelihood, a large share of them in least developed countries. The recent collapse in coffee prices has hit rural economies worldwide, even in countries (such as Brazil and Vietnam) where production costs are low. In Brazil low returns led to reduced spending by farmers and rising unemployment. In Vietnam, one of the lowest-cost producers

Real price of coffee, 1960–2000



Note: The price deflator is the manufactures unit value index for the G-5 countries (G-7 minus Canada and Italy) in constant 1990 US dollars.
Source: Oxfam International, 2002, based on World Bank data.

in the world, research in Dak Lak province suggests that the price farmers were receiving at the beginning of 2002 covered as little as 60 per cent of their production costs.

Indebted farmers who depend primarily on coffee for income, including for food purchases, have been forced to sell their farms to pay back their debts. Many have had to move to cities or join the illegal flow of emigrant workers to industrial countries. Others have had to switch to alternative crops—including proscribed drugs, as in Colombia, parts of Asia and much of Central America. In Bolivia, Colombia and Peru, where the conditions required for growing coffee are similar to those for growing coca—the raw material for cocaine—farmers are replacing coffee with coca. This brings its own set of problems—assaults, rape, prostitution and gang warfare.

The impact on families

The World Food Programme reported in March 2002 that the coffee crisis, combined with the effects of a drought, had left 30,000 Hondurans suffering from hunger, with hundreds of children so malnourished that they needed to be hospitalized. It also reported that farmers were selling their assets and cutting down on food. In Vietnam's Dak Lak province farmers dependent solely on coffee are now categorized as 'pre-starvation'. In January 2002 the European Union and the US Agency for International Development warned of increased poverty and food security problems among coffee farmers in Ethiopia.

Mohammed Ali Indris, a 36-year-old Ethiopian coffee farmer interviewed in March 2002, gave a graphic sense of how the price collapse had affected his family. The head of a household of 12, including the children of his deceased brother, he estimated that he will earn only US$60 from the combined sale of coffee and corn in 2002, down from around US$360 five years earlier.

> 'Five to seven years ago, I was producing seven sacks of red cherry [unprocessed coffee] and this was enough to buy clothes, medicines, services and to solve so many problems. But now even if I sell four times as much, it is impossible to cover all my expenses. I had to sell my oxen to repay the loan I previously took out to

(Box continues on next page.)

> buy fertilizers and improved seed for corn, or face prison. . . . Earlier we could cover expenses, now we can't. . . . Three of the children can't go to school because I can't afford the uniform. We have stopped buying teff and edible oil. We are eating mainly corn. The children's skin is getting dry and they are showing signs of malnutrition'.

Hunger is particularly acute in households that have decided to devote a larger share of their land to coffee than to subsistence crops. Wherever coffee serves as a cash crop for subsistence farmers (such as in many African and some Asian countries), substantially less cash income is available for spending on food, medicine and education. Families that depend on money generated by coffee are withdrawing their children, particularly girls, from school. The price crisis also affects women directly since the male household head often goes to work elsewhere, for at least part of the year, leaving the women and children to work the land. The workload of women has also increased in families used to contracting casual labour to help with the coffee harvest. Women have to shoulder the extra workload now that such families can no longer afford casual labour.

Source: Megzari, 2002; Oxfam International, 2002; Fonseca, 2002; Osorio, 2002.

Box 6.2 The case of cotton

The global labour force directly involved in cotton production at the farm level probably exceeds 100 million, although at least twice that many people living in rural households benefit from cotton cultivation. In addition to direct farm employment, cotton production also provides employment in cotton ginning, transport and marketing. Many least developed countries depend heavily on cotton production and exports. But unlike coffee, which is produced exclusively in developing countries, cotton is also produced in industrial countries.

Much of the overproduction of cotton and the resulting collapse of its prices is due to production and export subsidies, mainly in industrial countries. (In 2001 the average US dollar price per pound of cotton was around 52 per cent lower than the 1995 average price.) The International Cotton Advisory Committee estimates that abolishing such subsidies would increase the world price by almost 75 per cent. This would provide more than US$1.2 billion in additional income a year to African cotton producers, most of whom live in least developed countries.

The decline in export earnings and government revenue in developing countries affects the investment in and availability of public goods, including health care, agricultural extension services and maintenance of feeder roads. And the gains in market share by industrial country cotton exporters, thanks to higher production and export subsidies, have led to significant losses in rural employment and income in some developing countries—particularly least developed countries—contributing to the spread of poverty.

While cotton farmers in industrial countries are shielded by subsidies from the negative effects of a price collapse and may even expand their market shares and revenues, cotton growers in developing countries have to bear direct effects through a loss of cash income and indirect effects through a loss of export earnings and government revenue. The decline in cash incomes has curtailed their access to basic foods, to medicines, to education for their children, to communications and to production inputs, further reducing their productive capacity and future incomes.

Source: Megzari, 2002; Fortucci, 2002.

BOX 6.3 THE CASE OF SHEA BUTTER

Shea butter is produced from shea nuts, which grow on a tree native to several African countries. Burkino Faso, with 1 million such trees, produces 25 per cent of the world's shea nuts. These are consumed locally and exported to Europe and Japan for the production of shea butter, used in chocolate, margarine, cosmetics and pharmaceuticals.

During colonial times shea butter intended for export to Europe was produced and handled much the same as other export commodities. Nuts were gathered and sold in the community, with low returns to the growers and those who prepared the nuts for export, most of whom were women. Shea processing facilities were set up by colonial enterprises in Bobo Dioulasso, where initial purification and packaging were done for easy transport to the world market.

At independence this chain was broken and replaced by unregulated intermediary services at the national level. Attempts to regulate the commodity and establish a national council for price stabilization in Burkina Faso failed, and access to financing to support the export of shea nuts and butter became difficult. But two markets grew steadily:

- The cosmetics industry, where the natural virtues of shea butter surpass those of alternatives in the production of hair lotions and healing and moisturizing creams. The shift from margarine making to beauty products has led to a demand for higher-quality shea butter.
- The chocolate industry, especially after the European Union adopted shea butter as a possible substitute for cocoa butter.

The growth in these markets has allowed women to increase their earnings by producing shea butter locally and thus adding value to the commodity.

The collapse of several major export commodities, including cocoa, opened new space for 'dynamic commodity sectors' such as shea butter and other vegetable oils. To take advantage of the new markets, however, shea producers needed to be able to negotiate a good price for their products. The gains from greater production of high-quality shea butter had to outweigh those from agriculture and subsistence farming, which women still considered their main source of livelihood.

Funding from several sources—the government of Luxembourg, the United Nations Fund for International Partnerships and the United Nations Development Fund for Women—supported the organization of women producers into a consortium enabling them to access larger markets and negotiate better prices. As members and later co-chairs of the national council of shea producers, the consortium was able to set a common basic price that was three times the price in 1998. They then negotiated directly with European companies, most notably with L'Occitane, the French cosmetics enterprise, which supplies Delta Airlines with shea butter–based products for use as in-flight cosmetics. In January 2000, under its first contract with the consortium, L'Occitane purchased some 60 tonnes of high-quality shea butter at twice the local market price.

Adding value to the raw commodity through local processing is a step towards greater competitiveness in the world market. But these gains remain modest in today's global trading environment, where the negotiating power of commodity producers is continually eroded and a broad array of cheaper substitutes are allowed.

Source: UNIFEM, 2000; Zaoude, 2002.

Proposals for the future

On the international backburner for too long, the commodity issue requires urgent attention in multilateral trade negotiations. The international community should give the issue serious consideration in post-Doha negotiations at the WTO. It should also give serious encouragement to developing country producer groups that wish to build South-South coalitions on specific commodities so as to increase their bargaining power in the international market. Small island developing states and a group of single commodity exporters have recently made specific proposals in the WTO in the context of the ongoing negotiations on agriculture. Three dimensions of commodity diversification should be promoted: horizontal (new dynamic products), vertical (adding value) and geographical (new market outlets). The production and export of shea butter by women in Burkina Faso illustrate what is possible when this is done (box 6.3).

Supply side

There is a need to address the supply constraints of developing countries and, in particular, to strengthen their capacity to process commodities, adding value before exporting them. Special consideration should be given to product differentiation, or 'decommoditization', of the export commodities of developing countries so as to allow them to capture the premiums on products with special qualities (such as gourmet coffees and high-quality teas).

Wherever feasible, the international community should encourage international schemes aimed at voluntary supply management with a view to achieving a better balance between supply and demand. Such schemes would avoid the waste of investment, depletion of non-renewable natural resources and excessive price volatility. These schemes should also assist high-cost commodity producers in overcoming exit barriers.

Market access

As proposed in chapter 5, the multilateral trading system needs to rationalize tariff structures and subsidies in agriculture and allow developing countries to support their own markets. There is an urgent need to reduce tariff peaks and eliminate tariff escalation, especially in industrial country markets.

Financing

The international and regional financial institutions and bilateral donors should take into account the escalating effects of financing projects aimed at increasing the production of a commodity in one developing country. Such projects can affect the commodity's price and the corresponding export earnings for other developing countries—and have even contributed to the collapse of prices. Gains achieved by commodity diversification in one country should not be more than offset by losses in all other producing and exporting countries.

The highest priority should be given to resource allocations that enhance the R&D abilities and competitiveness of developing countries and the capacity of their small farmers and producers to supply and market new commodities with dynamic market prospects and the potential for significant local value added, including organic products. To support this, all OECD countries should join the Common Fund for Commodities, and this institution should be given adequate resources to reach a critical mass in its operations.

Also warranting the highest priority is establishing effective compensatory financing schemes to help bridge shortfalls in export earnings. Market-based risk management instruments have proved ineffective over periods longer than a year or so, especially for least developed countries, whose needs are the most acute. Official development assistance can play an anticyclical role in this regard, at least in the short term.

Effective support should be provided to developing country farmers and other commodity producers to empower them to access appropriate multilateral commodity risk management mechanisms or new, alternative schemes combining traditional finite insurance (such as against natural catastrophes) with new risk management instruments. And because women, who make up the bulk of small farmers, have traditionally had restricted access to credit, these risk management schemes need to be tailored to women in particular.

Note

1. Computations by UNCTAD based on the Food and Agriculture Organization's FAOSTAT database. In the European Union, for example, France increased its market share of agricultural exports from 5.7 per cent to 8.1 per cent between 1970 and 2000, while Germany expanded its share from 2.6 per cent to 5.9 per cent, and the United Kingdom its share from 2.7 per cent to 4.1 per cent.

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