The Commodities Challenge

Towards an EU Action Plan

A submission by Oxfam to the
European Commission
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Summary

The collapse of agricultural commodity prices is one of the biggest causes of world poverty today. Yet so far there has been little serious attempt to address the roots of the crisis.

Until 20 years ago the trade in commodities was always regarded as a basic development issue. Since then, international prices of tropical agricultural products have fallen by between 50 and 86 per cent. The greatest fall was in coffee, which has the largest market of them all. Yet over that period, trade in commodities was largely ignored in the most influential circles.

A change in mood can now be detected, and the European Union is to be congratulated for being one of the first to take this issue on. European ministers in December 2003 promised an EU action plan on commodities and offered to support commodity initiatives brought by African countries at the World Trade Organisation.

So it is a disappointment that there is no reference to commodities in DG-Trade's work programme for 2004. The EU needs to back up its ministers' words with actions which will help resolve the crisis facing poor commodity-dependent countries.

Underlying the crisis are three fundamental issues: a long-term decline in prices; inherent price volatility; and high degrees of market concentration. In many markets, the poorest farmers find themselves trapped by all three of these adverse trends at once.

The EU's Action Plan needs to tackle all three issues in order to provide long-term solutions to the present crisis. It should also assist rural development efforts in commodity-dependent poor countries, to enable them to diversify their economies and overcome this dependency once and for all.

Among Oxfam's specific suggestions for EU action are:

- Assist the proper functioning of the commodity markets by pursuing measures which will end situations of chronic oversupply. The EU has substantial instruments available in its aid and trade development strategy, and should support new initiatives such as the ICO quality scheme. Participation of small producers and unions in policy-making structures are a key element.
- Push urgently for changes in WTO rules to end agricultural export dumping, and to provide developing countries with sufficient flexibility to protect their domestic agricultural sectors in line with their food security and national development needs.
- Explicitly support a West African proposal for an end to trade-distorting production subsidies and export subsidies on cotton, and compensate affected exporting countries for loss of revenue until such subsidies are entirely removed.
- Support the search for the best available mechanisms to correct the market failures which lie at the heart of the commodities crisis. This should include a review of appropriate supply management methods, to be carried out by the WTO and specialist bodies such as UNCTAD and the Common Fund for Commodities.
- Work with the IMF and UNCTAD to design a common system of compensatory finance for reverses in commodity export prices. The system should be easy to use, quick-disbursing, based on automatic rules without policy conditions, and pass funds through to the actual producers.
- Support reforms of the debt relief system for poor countries to ensure it provides greater relief when a country's commodity export prices fall seriously short.
- The EU or Member States should deal with excessive market concentrations in the processing and retailing of agricultural commodities.
- Assist local organisations that help poor farmers with market intelligence, co-operative development, extension advice, access to credit and physical inputs, and marketing. The bodies aided should be farmer-based wherever possible, government-run where not.
- Support proposals for an International Diversification Fund to help commodity-dependent countries to develop their way out of such dependency in the long term.

The mid-term review of the Cotonou Agreement's financing, due in 2004, will provide an ideal opportunity to reallocate resources for these purposes, to the benefit of needy countries in the African, Caribbean and Pacific regions.

Given the critical importance of addressing the commodities' challenge for poverty reduction, the EU's initiative on commodities is both essential and welcome. However, wider action is needed by the international community, and the EU now has the opportunity to work with African governments to champion the international debate on commodities and encourage other countries to join forces in tackling the crisis.

Commodities in crisis: the new policy challenge

'The sharp decline in prices of … commodities has created a crisis situation in most of [the] commodity exporting countries, as there is [a] close relationship between world market prices and poverty levels.'

'Non Paper' on commodity prices, WTO, May 2003[1]

'It is apparent that the problem of agricultural commodity dependency is primarily a problem which afflicts ACP countries.'

Agritrade, December 2003[2]

The collapse of commodity prices is one of the biggest causes of world poverty today. The impact of this crisis has been reported by many people, including Oxfam. Yet despite several international initiatives, there has been little serious attempt yet to grasp the roots of the crisis.

In 2002, Oxfam described the predicaments of two coffee farmers. Tatu Museyni lived with her children in the village of Kishimundu in Tanzania. Since 1998, the price she received for beans from her 30 coffee bushes had fallen from US$1 per pound to just 30 cents per pound. She said:

> *The price of coffee is destroying me. It is destroying this whole community. I cannot even afford to feed and clothe my children… Now I cannot pay for the school fees and books. Sometimes they are chased out of school because they cannot pay.*

In Chiapas province in Mexico, coffee prices fell by more than two-thirds between 1998 and 2000. One farmer there told Oxfam in 2000:

> *Right now the trader pays us 40 cents [US$] per pound... The coffee plot is not worthwhile. It cannot support a household. That is why people are selling off their plots. It is sad to see, because so much work has been invested. If people don't sell, men are abandoning their fields and going to the north. There is no work here for poor people.*[3]

According to a recent study, the international prices of 12 major tropical agricultural products fell from 1980 to 2002 by between 50 per cent and 86 per cent, after general inflation is taken into account. The greatest fall was in coffee, which has the largest market and is produced in more than 70 developing countries. The 2002 coffee price, adjusted for inflation, was just 14.2 per cent of that of 1980.[4] The study calculated that developing countries would have earned $243bn more in 2002 if the real prices of 10 of those products[5] had remained as high as in 1980. That is almost five times the world's annual aid budget.

This mirrors a general economic crisis in the poorest countries. While the richest nations prosper, people in most of the poorest are worse off than they were in the 1980s or, in many cases, the 1970s.[6] The role of declining export prices is made clear by the U.N. Conference on Trade and Development (UNCTAD):

> *When principal petroleum and manufactured goods exporters are excluded, the terms of trade of developing countries have declined by more than 20 per cent since 1980. For African countries, which comprise the most commodity-dependent group, the decline is more than 25 per cent.*[7]

In other words, over the past 20 years the prices of Africa's exports have fallen by more than one-quarter in relation to its import prices: a change in the ratio from 100:100 to less than 75:100. As a result, African countries must increase exports by *more than one-third* if they want to earn 100 again, and so pay for the same amount of imports as before.

The situation faced by commodity-dependent developing countries (CDDCs) can be illustrated by the most severe case among them, a small least developed country in Africa which depends on coffee for 75 per cent of its exports and on tea and sugar for another 14 per cent.[8] This country's gross domestic product per person in 2001 was just $99, representing a one-third decline in living standards over 10 years.[9] Life expectancy at birth is now estimated at 41 years, some three years less than in the early 1970s. The nature of its agricultural specialisation means the country has to rely on imports for food, and two-thirds of the people are undernourished.

Back in 1980 the trade in commodities was regarded as a basic development issue. Yet during the subsequent years, when prices collapsed, this ceased to be the case in the most influential circles. The reform of commodities trade lay at the heart of attempts in the 1970s to create a 'New International Economic Order' more favourable to developing countries. But throughout the 1980s and 1990s the issue was widely ignored as foreign debts and market-oriented reforms took centre-stage. The Millennium Development Goals adopted in 2000 do not even mention commodities or related issues.

Given the gravity of the current crisis, a change in mood can now be detected, and numerous international initiatives have been launched. So far they have yielded few significant proposals for policy change, but the European Commission is to be congratulated for being one of the first to take the issue on.

This submission from Oxfam examines the recent developments on commodities at the World Trade Organisation (WTO), then examines the European Commission's analysis of the commodities crisis, making recommendations for EU action.

Commodities policy and the WTO

Two important initiatives on commodities were made by African countries at the WTO in 2003. At the end of the year the European Union gave these initiatives its verbal support. This was very welcome. **It is therefore a disappointment that there is no reference to commodities in DG-Trade's work programme for 2004.**[10] **The EU needs to back up its words with actions to resolve the crisis facing poor commodity-dependent countries.**

Two groups of African countries succeeded separately in getting commodities issues into the draft declaration for the WTO's ministerial meeting at Cancún, Mexico in September 2003. **These represented an important breakthrough as proposals on subjects of specific concern to poor developing countries, pushed through the WTO's machinery by those countries themselves.**

The first of them, Para. 25, took note of a proposal by Burkina Faso, Benin, Chad and Mali on poverty reduction and the cotton sector.[11] Actions on it were to be decided at the Cancún meeting.

Para. 26 of the draft declaration was headed 'Commodity Issues' and wanted to take into account 'the dependence of many developing countries on a few commodities and the problems created by long-term declines and sharp fluctuations in the prices of these commodities.' It would instruct the WTO to work on this issue in co-operation with other organisations. The paragraph also recognised that various trade-related aspects of this issue 'could' be addressed in the ongoing negotiations, particularly under the topics of agriculture and non-agricultural market access.[12] The draft Para. 26 arose from an initiative launched by Kenya, Uganda and Tanzania with a so-called 'Non Paper' on commodities, tabled at the WTO in May 2003.

This Non Paper analysed the commodities crisis and its impact on developing countries, ending with an 'illustrative list of elements' for discussion at the WTO, in two parts:

A. Elements requiring priority action in the Doha Round: tariffs (including tariff escalations), both domestic and export subsidies to agriculture, assistance for technology transfer, and rules on export taxes and export restrictions.
B. Elements requiring review and further examination before they are included in the WTO's work programme.[13]

The 'B' section in the WTO Non Paper's illustrative list recommends the review of:

- international commodity agreements, with a view to regulating structural oversupply, including systems of supply management by producing countries;
- the impact of the liberalisation of internal trade in producer countries;
- the functioning of compensatory finance for commodity-related export losses, specifically the IMF's facility and the EU's scheme under the Cotonou Agreement;
- market-based risk management; and
- steps to improve small farmers' competitive position vis-à-vis large foreign firms.

All of these elements deal with structural change in trading arrangements. So far, discussions on the Non Paper have taken place within the WTO's Committee on Trade & Development, but this committee does not have the right powers to follow it up in the longer term. Certain aspects of the question already need to be pursued in other WTO working groups such as those on Trade & Finance and Transfer of Technology. There is also a discussion in Geneva on whether these negotiations should be led by another working group, perhaps reviving one on Trade in Primary Commodities which existed in previous trade rounds, or subsuming it with other development topics in the Working Group on Implementation Issues.

In December 2003 the EU's General Affairs Council approved a Commission paper on reviving the stalled WTO talks, which promised:

> *The Commission is committed to providing input for an EU perspective on commodities and will produce an EU action plan no later than January 2004. Within the WTO, the EU should support such commodity initiatives aiming at raising the profile of the issue as proposed by preparatory texts to the Cancun conference.'*[14]

Besides the two African initiatives, this endorsed another two actions pursued by DG-Development during the course of the year: an analytical working paper[15] and a High-Level Consultation to generate ideas for a commodities action plan.

So what is the EU committed to do at the WTO? Its endorsement of the African initiatives will boost its authority further, even though the Cancún talks ended prematurely and the draft declaration was never approved. But 'raising the profile' of an issue should mean a real commitment to discussing and resolving it, to the satisfaction of all concerned. On cotton, the working paper endorsed by the Council states that the Commission will use ideas on cotton 'as an illustration of how the wider commodities issue could be dealt with.' The paper proposed:

- *an explicit commitment to grant duty free and quota free market access for cotton exports from least developed countries, as the EU already provides through the "Everything But Arms" initiative;*
- *substantial reductions of the most trade-distorting forms of domestic support; and*
- *elimination of export subsidies within a stated timeframe.*[16]

At the same time, the EU would support measures for modernisation and restructuring in cotton-producing LDCs such as the four West African countries.

However, the EU's proposal on export subsidies is disingenuous since, although the EU exports 295,000 tonnes per year, its annual €600m of cotton subsidies do not include any actual export subsidies. It might even be damaging to developing countries since, if the proposal for a limited list of export subsidies is approved at the WTO, it could mean *keeping* export subsidies on a basic foodstuff which the EU does export to developing countries, such as wheat or dairy products. However, the EU's *production* subsidies on cotton are the highest in the world at 160 per cent of the world price: and it is subsidies of that sort which are estimated to depress world cotton prices by around 20 per cent.[17]

Oxfam urges the EU to declare its explicit support for the West African proposal, which demands an end to trade-distorting production subsidies and export subsidies on cotton, and compensation for loss of revenue until the subsidies are entirely removed.

Towards an EU Action Plan

The European Commission's working paper examines the markets for five tropical agricultural products: bananas, cocoa, coffee, cotton and sugar. Oxfam has recently published papers on three of these: coffee, cotton and sugar. The biggest report, *Mugged*, recommended actions to restore the coffee market from its current state of collapse. These comprised a Coffee Rescue Plan – a series of immediate measures to reduce supply and help prices to recover in the short term, in preparation for more far-reaching actions under a Commodity Management Initiative. This would improve commodity prices and provide alternative livelihoods for tropical farmers in the long term.[18] Any action plan from a leading international institution such as the EU needs to be at least as ambitious.

The Commission's recommendations arise from a set of five 'key challenges' which face agricultural commodity markets:

1. long-term declining price trends;
2. short-term price volatility;
3. international market concentration and integration;
4. market reforms in producing countries; and
5. over-dependence on traditional primary commodities.[19]

The five challenges can be grouped together as follows.

- **Challenges 1-3** concern fundamental issues of price and market structure. The paper rightly identifies three of these: the decline in commodity prices in the long term; sharp volatility around the trend line in the meantime; and high degrees of market concentration at certain points in the supply chain, which have generally reduced the share of final value accruing to farmers. **The depth of the crisis is measured by the extent to which farmers are trapped by all three of these adverse trends at once.**

  However, the implications run deeper than the EU's working paper allows. On p. 14 the paper describes the markets as 'imperfect,' but what we actually see is a multi-layered case of market *failure*, since inherent features of these markets can prevent demand, supply and price signals from interacting with any degree of efficiency. For example, prices of tree crops such as coffee, cocoa and rubber tend to be volatile not just in the short term but over the years of the business cycle, because it takes several years for supply to expand or contract in response to price changes.

The point was made recently by a senior official of the World Bank. Kevin Cleaver, the Bank's Director of Agriculture and Rural Development, observed a wide consensus that a free-market solution to the coffee market's problems would be too expensive socially. The main problems lay in oversupply and the distribution of value, he said. He also commented that the Bank was not ideologically opposed to supply controls. However, the solutions he proposed lay in rural development and market-based interventions, such as quality schemes, support for co-operatives and local processing.[20]

Yet non-market solutions, and various forms of market intervention, have been tried in the past. We will discuss below the technical and political difficulties which they have met, but it must not be forgotten that several of them enjoyed considerable success over a number of years. There is a long tradition of supply management on these and other agricultural markets. Given the depth of the crisis even in completely liberalised markets like coffee, it is well past time to abandon the presumption that only the market can provide solutions to economic problems. **Oxfam urges the EU to support the WTO, UNCTAD and other bodies in the search for appropriate mechanisms to put right the market failures that lie at the heart of the world commodities crisis.**

- **Challenge 4** concerns reforms to be carried out by commodity-exporting developing countries themselves. This is of great importance; but as these reforms can apply to any of the issues addressed in the other four challenges, it is rather different in nature to them.
- While Challenges 1-3 concern the functioning of commodity markets themselves, **Challenge 5** is about their context and the extent to which poor countries' economic options should be limited to commodities production and sale. As such, it necessarily ranges more widely to include issues of development policy and strategy.

Challenges 1-3 and Challenge 5 therefore complement each other, and it is important to address them simultaneously. This was reflected in the mandate given to a meeting of Eminent Persons called by UNCTAD in September 2003: 'to examine and report on commodity issues, including the volatility in commodity prices and declining terms of trade and the impact these have on the development efforts of commodity-dependent developing countries.'[21]

The rest of this paper examines these challenges in turn, and discusses actions which the EU might take up as part of its Action Plan for commodities. Some of the headings have been modified in an effort to improve specification of the five categories. Those items which would come under Challenge 4 are discussed under whichever of the other challenges they also apply to, for the reason just given. A comparable discussion may also be found in the report of the UNCTAD Eminent Persons Meeting, and it is recommended as further reading.[22]

Challenge 1

Market structures: declining prices, oversupply and deteriorating terms of trade

The commodities problem has been known to economists since at least John Maynard Keynes' time. In 1946 he wrote:

> *Proper economic prices should be fixed not at the lowest possible level, but at the level sufficient to provide producers with proper nutritional and other standards in the conditions in which they live … and it is in the interests of all producers alike that the price of a commodity should not be depressed below this level, and consumers are not entitled to expect that it should.*[23]

But it is just such a relentless decline in prices which turns this from a problem into a crisis for commodity-dependent countries. Oxfam identifies four policies to address the decline. It could also be addressed by methods of supply management, discussed under Challenge 2 below.

- The declining trend in prices and terms of trade is a long-term problem, while oversupply is a short-term one. Responses are needed to both. **A chronic oversupply indicates that markets are not operating effectively to increase demand or reduce supplies in response to falling prices. The proper functioning of the market needs to be assisted by the selection and use of appropriate measures to support this essential function**. These will differ from market to market: examples are the destruction of stocks, and the redefinition of technical standards to rule certain produce out (such as the International Coffee Organisation's Resolution no. 407 of 2002, on coffee quality). Such measures can be carried out by producer countries either individually or collectively, or by agreement between producer and consumer countries together. [24] Support for them is especially important where requested by aid-recipient countries themselves. For example, in November 2003 the Inter-African Coffee Organisation called on the EU and other donors to support the promotion of domestic consumption of coffee in its member countries, in the framework of poverty alleviation.[25].
- **Develop new end-uses or new markets** for a commodity-based product. A danger here is that of displacing the problem by reducing demand for other products which served those markets previously. However, in many cases it can yield results, and it should be investigated and, where appropriate, supported with technical assistance by the EU and other donors
- The problem of low agricultural prices is exacerbated where one group of farmers – usually in rich countries – benefits from subsidies and so can sell their produce for less than it costs to produce. Small farmers in the developing world lose out where subsidised exports compete unfairly with their produce on local markets, in some cases forcing them out of the market. Export dumping drives down world prices, reducing income for vulnerable households and cutting foreign exchange for poor countries. We have seen that the world cotton price is 20 per cent lower as a result of such subsidy-induced dumping. Similar calculations are available for sugar, wheat and other big markets.

  This process has serious consequences, and not only on other farmers who produce the same crop without subsidies. For example, subsidies for one export crop (e.g. wheat) can reduce local demand and therefore prices for other crops on which poor farmers depend (e.g. cassava in West Africa). Alternatively, where prices for an important crop like coffee have collapsed, its farmers cannot diversify into other crops if those crops' prices are themselves forced down by rich-country subsidies.

  Changing WTO rules to end agricultural export dumping is an essential part of the solution to low commodity prices and oversupply. Similarly, WTO rules must provide developing countries sufficient flexibility to protect and promote their domestic agricultural sectors in line with their food security and national development needs.
- Opening the ICO's 40th anniversary meeting in Cartagena in September 2003, the President of Colombia called for **guaranteed minimum prices** for coffee farmers, to be financed by producer and consumer governments jointly. With the Presidents of Brazil and Honduras, he also persuaded the ICO to start talks with the coffee multinationals to seek ways to address the price crisis. This was especially encouraging in the light of Brazil's participation. The Brazilian government, representing very competitive

producers who already dominate the coffee market, apparently does not want low prices to wreck the chances of other producers. This deserves a reciprocal response from the EU, which represents an even larger share of world coffee consumption than Brazil does of production.[26]

Challenge 2

Market structures: price volatility

There are two forms of price volatility on commodity markets: **short-term fluctuations during the crop year**, resulting from changes in the weather or forecasts of the supply and demand balance; and **medium-term disturbances over the course of the business cycle**. The latter can have many causes, but a frequent one is the time-lag found in many markets between price changes and resulting adaptations of supply or demand. As long as those adaptations do not occur, the market will remain out of balance, with prices excessively high or excessively low. The unpredicted price changes over the medium term can be much larger than over the short term, and cause greater damage to investment possibilities and livelihoods.

The difference between these two forms of volatility is widely overlooked in the current debate, which has tended to discuss only the short-term variety. The Commission's working paper itself is an example of this. There are important policy implications here, since the two kinds of volatility require quite different measures in response.

- Medium-term volatility has traditionally been eased by measures to take supplies off the market when prices are low and return them when prices are high. Different mechanisms have applied to different markets. Some of these are controlled by corporations, for example that on the diamond market. Until their system broke down in the 1980s, the major aluminium producers also used similar methods to keep aluminium prices stable – and gain a competitive advantage over less stable, exchange-priced metals such as copper.[27] Producer countries can co-operate in a similar way, as with OPEC in the oil market.

  Alternatively, market interventions can be made in co-operation between the producer and consumer sides of the market under international commodity agreements, such as that for tin from the 1950s to the mid-1980s and the economic clauses of the International Coffee Agreement from 1964 to 1989. The Commission's working paper notes that 'the 1983 [Coffee] Agreement was largely successful in maintaining prices within the agreed range of 120-140 US cents/lb.'[28] Yet the coffee market has entered its worst ever crisis since those economic clauses were abandoned.

  It is largely a matter of rhetoric whether supply management of these sorts is described as market-friendly, non-market or a matter of market intervention. It would be conventional to call producer companies' actions the former, and intergovernmental actions the latter. But when set against the practical impact of enabling markets to find a necessary and timely balance of supply, demand and price, such distinctions can seem sterile.

  Where international commodity agreements are concerned there are technical difficulties in identifying the price ranges to be defended (in effect by international treaty), the moments to intervene on the market and the size of the national quotas or international buffer stock required. There are also political problems in ensuring the cohesion of all parties; these tend to be stronger where the market's participants are more numerous or more diverse, as in the case of coffee (although the strong Latin American element in that market helps to provide cohesion). Several markets might well benefit from such agreements, but Oxfam does not see them as a universal panacea. What is needed is a pragmatic search, looking for what will serve each market best.

Yet whatever the difficulties may be, we consider that they are no longer adequate reasons to dismiss supply management on commodity markets out of hand. Where the working paper states that 'the conditions are not in place that would allow such schemes to be successful,'[29] it refers in large part to political conditions; and they in turn depend on political will. But we have already described the new initiatives taken on the coffee market by Brazil, Colombia and Honduras, while Viet Nam has moved to reduce its *robusta* production and improve the quality of its coffee crops. This deserves a response on the consumer side. **If the EU wishes to be taken seriously in not just 'raising the profile' of the commodities crisis but seeking to *resolve* it, it should push for a full review of appropriate supply management methods for those markets, to be overseen by the WTO in close co-operation with specialist bodies such as UNCTAD and the Common Fund for Commodities (CFC).**

- **Support for producer countries to undertake supply management without consumers' involvement is also welcome and needs to be maintained.** In some cases producers can co-operate effectively to align supply with demand over the long term. It is generally accepted that this is permitted under current WTO rules and it deserves continued international support in Geneva, including from the EU.

- Financial measures to compensate producers for adverse movements in commodities earnings have a history of nearly 30 years. Such **compensatory finance** could in principle be used to combat declining prices as well as price volatility; however, over a long period this is expensive, so compensatory finance is more often seen as a mechanism to counter the effects of price volatility, providing relief when prices fall dramatically. Any long-term decline in price can be seen as a problem for development, amenable to measures under Challenge 5 below.

  The most famous schemes of this sort are the International Monetary Fund's Compensatory Finance Facility and the EU's Stabex programme under the former Lomé agreements with African, Caribbean and Pacific countries. Many CDDCs are in the ACP group. The EU has long been held up as an example of using practical aid measures to address poor countries' trade difficulties, and rightly so. However, it is widely considered that FLEX (the successor of Stabex under the Cotonou Agreement) is failing. This is due to its lack of an automatic link between adverse changes on specific export markets and financial relief, and the relatively high level of harm that has to be demonstrated before relief will be considered. To give it a better chance, FLEX's access criteria should be eased, the threshold for eligible economic damage should be lowered, and it should be extended to other EU regional programmes besides Cotonou and the ACP. It should support domestic compensation schemes for farmers, such as those used in the coffee sector in Brazil and Colombia.

  UNCTAD's Eminent Persons Meeting called on the Commission and the IMF to work with UNCTAD to **design a common system that is easy to use, based on known, automatic rules without policy conditions, and passed through to actual producers and consumers**.[30] It should also be **quick-disbursing**. Oxfam warmly encourages the Commission to **respond positively and quickly to this invitation**.

- A related issue lies in **debt relief for shortfalls in commodity earnings**. Of the 54 CDDCs identified in the Commission's working paper, 25 are highly indebted poor countries (HIPC), which are subject to special debt relief by international agreement. Yet commodity price shortfalls can make it more difficult to meet debt repayment schedules, without any fault on the part of the borrower. It would be a common financial reflex, but quite against the ethics of the HIPC programme, to punish a debtor country if this increased any repayment delays. Debt relief under both HIPC and other systems (such as the Paris and London Clubs) should be made to provide more, not less, relief in cases of commodity shortfalls.

- Oxfam applauds the EU's support (for example, in the Cotonou Agreement) for efforts to **extend access to price-risk insurance** via commodity futures markets to groups of producers in developing countries. However, this can only succeed if it is done slowly and carefully over a period of years, and it can and should be both simpler and cheaper for the final user than the mechanism currently being promoted by the World Bank group. The Commission should use its influence as a donor to that programme to encourage a change in the terms.

  Given the nature of futures trading, such insurance can only apply to short-term price volatility, as the promoters of that scheme willingly admit. Medium-term volatility needs to be countered by other forms of action, as discussed above.

Challenge 3

Market structures: value chains and market power

The Commission's working paper argues that 'there is, as yet, no substantive evidence of abuse of market power or of other anti-competitive practices' in agricultural commodity markets.[31] Be that as it may, there is plenty of evidence of grave consequences arising from imbalances in market power between small farmers and highly concentrated commercial or industrial sectors purchasing their produce. This arises from the competitive process itself and does not require any deliberate abuse of market power or anti-competitive practices.

On the coffee market, each farmer has on average fewer than 15 bags of 60 kgs to sell each year. Since a wave of international mergers in the 1990s, the biggest international roaster companies have bought about *15 million* bags each per year. Meanwhile, the international price of 'green' (unroasted) robusta coffee fell by 86 per cent between January 1986 and October 2001. Yet over the same period UK retail prices for coffee *increased* by nearly one-third.[32]

It is hard to avoid seeing a direct connection between these two sets of facts: market power downstream in association with rising final prices and, upstream, a collapse in raw material prices. According to the International Trade Centre, 'Competition … has shrunk to a point where in 2000 it is estimated that five leading green coffee trading companies accounted for over 40% of the total volume of green coffee imports worldwide.'[33] There is a similar degree of worldwide concentration in coffee roasting. Meanwhile, national coffee markets tend to be even more highly concentrated. In 11 EU countries listed by the ITC, the national market shares of the top five coffee roasters in 2000 varied from a minimum of 72 per cent in Austria up to 97 per cent in Finland.[34] Thus, in the United Kingdom Nestlé has 51 per cent of the consumer market, while in the Netherlands Douwe Egberts (a subsidiary of the US food conglomerate, Sara Lee) has 69 per cent, and in Sweden Kraft (owned by the US-based tobacco multinational, Altria) enjoys a 53 per cent share.[35] Kraft has approximately one-third of the EU's market overall.

Corporate mergers have led to increasingly concentrated international markets for many commodities. And it is not only declining prices overall but the farmer's declining share of those prices which has led to crisis. This is the third issue of market structure that needs to be addressed. Caused largely by the free operation of market mechanisms themselves, it is unlikely to be amenable to purely market-based solutions. Oxfam proposes four avenues to go down in the search for solutions.

- Traditionally since the 19th century, this sort of problem has been addressed by **competition policy**: legal measures that prevent concentrations of market power, or break them up when they have occurred. On global markets that policy should have a global basis. This is markedly different from the sort of competition policy which has been proposed for the WTO (and repeatedly rejected by the majority of its members, most recently at Cancún in September and then in Geneva in December 2003). At present there is little sign of a political basis for competition policy of this sort, but in the meantime the EU or its Member States could deal with excessive European or national concentrations in the processing and retailing of commodities.
- Market-based reforms pursued under structural adjustment in the 1980s and 1990s led to the abolition of many developing countries' commodity marketing boards. Although sometimes corrupt or inefficient, these boards provided information and facilities such as credit and extension services to farmers, and mobilised the country's market power in selling the crop for export. In their place there is generally an institutional vacuum, leaving small farmers at the mercy of private traders.

  The EU should **support efforts to find domestic replacements for these former institutions** – farmer-based where possible, government-run where not. Drawing on its long experience in the area of aid and trade policies, the EU can play a crucial role in funding organisations assisting farmers with market intelligence, the development of co-operatives, extension advice, access to credit and physical inputs, and schemes to make the most of premium market niches.
- A critical aspect of this institutional vacuum lies in the **lack of market information available to farmers**. The supply of such information is one of the best ways to boost small farmers' bargaining power, and the search for innovative ways to do so should be supported – in addition to those just advocated in the previous paragraph.
- Active support should be found to persuade the major companies to pursue policies of **corporate social responsibility**, and draft and observe **codes of conduct** on labour conditions, technology transfer, and social and ecological standards.

Challenge 5

Supply capacity, diversification and the path of development

We have chosen a broader title for this challenge, which is called 'Over-dependence on traditional primary commodities' in the working paper. Our aim is to spell out all that the reduction of this dependence entails. It leads into broad issues of development strategy for the strengthening and deepening of national economies. This is another measure of the profound importance of the commodities problem for development in general.

Matrix of actions recommended for the EU's support

		Market failures: Challenge 1 — Oversupply, declining prices, terms of trade	Challenge 2 — Price volatility	Challenge 3 — Value chains and market power	Challenge 5 — Supply capacity, diversification and development
Global respons-ibilities:	Structural change	• Supply management review • Measures to reduce supply • Develop new end-uses or new markets • Floor prices for traded commodities	• Supply management review	• Market concentration and competition policies • Institutional vacuum in producer countries from loss of marketing boards	• EU's subsidies and trade barriers • Subsidies and trade barriers at the WTO negotiations • Codes of conduct on labour conditions, technology transfer, environmental standards
	Aid policies	• Support producer co-operation	• Increased, non-conditional, fast-disbursing compensatory finance: ➔ EU and IMF to work up a flexible, easy-to-use scheme ➔ debt relief for commodity shortfalls	• Institutional vacuum from loss of marketing boards • Market information for farmers	• Commodity strategies in PRSPs • International Diversification Fund • Capacity-building for: ➔ quality incentives ➔ research ➔ credit, risk management, warehouse receipts ➔ marketing • Stronger financing for Common Fund for Commodities
Challenge 4 Developing countries' own actions		• Co-operation on supply reductions	• Producer country co-operation • Farmers' own stabilisation fund	• Institutional vacuum from loss of marketing boards • Market information for farmers	• Develop South-South trade and regional markets for commodities

- The first requirement is to encourage developing countries to establish **overall strategies for trade and their specific commodity sectors in particular**, and include those strategies in overarching policy documents such as Poverty Reduction Strategy Papers (PRSPs). They should include the role of fiscal management and revenue utilisation. Strong donor co-ordination is recommended: it should be performed in the field and discussed with each government, as happens for example in health and education policy.

  Oxfam is warmly encouraged by signs that the EU is ready to support such approaches, including the preparation of restructuring programmes in countries affected by the commodities crisis. **The mid-term review of the Cotonou Agreement's financing in 2004 will provide an ideal opportunity to reallocate resources** where this is requested and appears necessary.

- **Capacity-building** is required to enable countries to develop commodity strategies, and to strengthen their supply capacity. Relevant issues include: rural development; quality incentives; investment in research; credit, risk management and warehouse receipts; and local producers' financial and marketing capacity.

- Much of the response to the commodities crisis from Northern governments and donors has emphasised **horizontal diversification** out of declining commodities into other forms of produce or production, and **vertical diversification** by such means as downstream processing. While, as we have seen, this does not deal with the core of the commodities problem, it is a necessary part of development and is certainly part of the answer to that problem. It is, however, difficult to achieve; the most effective forms of agricultural diversification are chosen by the farmers themselves in the light of local circumstances and their own knowledge and skills.

  It is worth noting that in many of the poorest countries the recent trend has been away from vertical diversification, not towards it: among LDCs, processed commodities fell from 21 per cent to just eight per cent of exports between the early 1980s and the late 1990s.[36]

  Oxfam is pleased that in view of all these complexities, the Commission sees diversification in CDDCs as part of the broader issue of rural development. We are happy to encourage the EU to continue financing efforts along these lines. We urge support for UNCTAD's proposal for an **International Diversification Fund** to be set up, possibly under the auspices of the CFC.[37]

- **The finances of the CFC itself need to be strengthened** to enable it to provide continued, extensive support for all these necessary processes. The EU and its Member States are encouraged to play a full part in this.

Oxfam's matrix of actions

The range of major recommendations and their relationship with the five policy challenges is best shown in tabular form, as in the matrix on the previous page. This paper has argued that the humanitarian and development problems found in the commodities crisis arise from the very nature of commodity markets. Only measures dealing with those economic structures can provide real and lasting solutions. Those proposed measures are marked on the matrix in 'Oxfam green.'

While Challenges 1-3 and 5 are faced by the global community as a whole – including the EU and its Member States – Challenge 4 concerns reforms to be carried out by commodity-exporting developing countries themselves. These reforms can apply to any of the issues addressed in the other four challenges. The matrix therefore shows Challenges 1-3 and 5 as columns while Challenge 4 is a row which intersects all of them.

Tom Lines was commissioned by Oxfam and has produced the principal analysis for this submission.

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Notes

[1] WTO, 'Non Paper' on commodity prices, para. 2.5.
[2] Available on the Technical Centre for Agricultural and Rural Cooperation's website at http://agritrade.cta.int/news0312.htm.
[3] Taken from Oxfam International, *Rigged Rules and Double Standards*, pp. 155-57.
[4] Robbins, *Stolen Fruit*, p. 9. The products are: copra, coconut oil, palm oil, sugar, cocoa, coffee, tea, pepper, groundnuts, jute, cotton and rubber. The Federal Reserve Bank of Minneapolis is cited as the source.
[5] Omitting coconut oil and pepper. Ibid., p. 11, citing the U.N. Food & Agriculture Organisation and Public Ledger.
[6] The U.N. Development Programme has published the highest annual value for each country's GDP per capita between 1975 and 2001. In 25 of the 30 countries with the highest human development, that figure was achieved in 2001; in the other five, it was in 2000. But in only seven of the 30 least highly developed was GDP per capita at its peak in 2001, while in 11 of them it occurred before 1980. See UNDP, *Human Development Report 2003*, Table 12, pp. 278-81.
[7] UNCTAD, 'Report of the Meeting of Eminent Persons on Commodity Issues,' chap. II, para. 32. The 15 Eminent Persons included Mr Pierre Defraigne, Deputy Director-General of Trade at the European Commission, and Ms Sylvia Borren, Executive Director of Novib Oxfam (a Dutch affiliate to Oxfam International).
[8] European Commission, 'Agricultural Commodity Trade, Dependence and Poverty,' Annex 2, p. 42. The country is Burundi.
[9] UNDP, op. cit. Recalculated on a purchasing power parity (PPP) basis, Burundi's GDP per capita fell by 33.3 per cent from $1,034 in 1991 to $690 in 2001 (Table 12, p. 281). All the remaining data in this paragraph are taken from the same source.
[10] European Commission, 'DG Trade Work Programme for 2004.'
[11] Benin and Chad also support a WTO complaint made by Brazil against the USA's annual $3.9bn of domestic subsidies to its cotton farmers. The Africans argue that these subsidies harm their own farmers by lowering world prices and capturing third-country cotton markets for the USA.
[12] WTO, 'Preparations for the Fifth Session of the Ministerial.'
[13] WTO, 'Non Paper,' op. cit., pp. 9-10.
[14] European Commission, 'Reviving the DDA Negotiations – the EU Perspective,' p. 8.
[15] European Commission, 'Agricultural Commodity Trade, Dependence and Poverty.'
[16] European Commission, 'Reviving the DDA Negotiations,' p. 8.
[17] UK Department for International Development, 'Potential Assistance to African Cotton Producers: Where to Focus?,' which cites the International Cotton Association.
[18] Oxfam International, *Mugged: Poverty in your Coffee Cup*, p. 49.
[19] European Commission, 'Agricultural Commodity Trade, Dependence and Poverty,' Executive Summary, p. iv.
[20] The remarks were made at a round table on coffee organised jointly by the World Bank and the International Coffee Organisation in London in May 2003.
[21] UNCTAD, op. cit., p. 2.
[22] Ibid.
[23] Keynes, 'The International Control of Raw Material Prices' (1946), included in *The Collected Writings of John Maynard Keynes*, Vol. XXVII (1980).
[24] Their success is, of course, dependent on the commitment of all countries involved. A particular concern at present is about the USA making its rejoining of the ICO conditional on amending

Resolution no. 407 so that the USA can continue to import poor quality coffee. This threatens to undermine the ICO's coffee quality initiative.
[25] See 'The Abidjan Declaration on the Coffee Crisis,' which could be found on the web at www.ico.org/ed/iaco.htm in early January 2004.
[26] According to the ICO, the EU's 15 Member States account for 46 per cent of the world's coffee imports while in the 2002/03 crop year Brazil accounted for 41 per cent of world output. See the statistical data on www.ico.org.
[27] See Lines, 'Restructuring of the Aluminium Industry: Implications for Developing Countries,' p. 250.
[28] European Commission, 'Agricultural Commodity Trade, Dependence and Poverty,' Box 4, p. 22.
[29] Ibid., Executive Summary, p. iv.
[30] UNCTAD, op. cit., pp. 4-5 and 10.
[31] European Commission, 'Agricultural Commodity Trade, Dependence and Poverty,' p. 33.
[32] As expressed in US dollars, from 170.17 cents per pound to 23.24c/lb and from $9.17 per pound to $11.92/lb respectively. These are raw price data, unadjusted for inflation (ICO data).
[33] International Trade Centre, *Coffee: An Exporter's Guide*, p. 29.
[34] Ibid., Fig. 7, p. 30.
[35] Figures from Calfat and Flôres, 'Government Actions to Support Coffee Producers.'
[36] European Commission, 'Agricultural Commodity Trade, Dependence and Poverty,' p. 17.
[37] See UNCTAD, op. cit., paras 27-29, p. 9.

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