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Macroeconomic policy questions: commodities

World commodity trends and prospects

Report of the Secretary-General**

Summary

The present report provides an overview of world commodity trends and prospects, as requested in General Assembly resolution 57/236 of 20 December 2002. Commodity prices increased considerably in 2003 and the first half of 2004, particularly for minerals, while prices of agricultural products rose more slowly. The general economic recovery and rapidly increasing demand in Asia, particularly China, were the main reasons for the price rises. The report also reviews recent developments in negotiations in the World Trade Organization, particularly on agriculture, and their possible effects on prospects for developing country commodity exports. It is expected that rapid growth in developing countries in Asia, particularly China and India, will continue to bring a new dynamic element to international commodity markets. The combination of these two processes — a more level playing field for agricultural trade and dynamic markets — may result in the opening of a “window of opportunity” for developing countries to increase their earnings from commodity exports. For this to occur, however, negotiations on trade in agricultural products need to meet the ambitious objectives of the Doha Work Programme. But neither increasing demand nor improved market access can guarantee that developing countries will make major progress in increasing commodity exports or in reducing poverty. Efforts are required on the part of these countries themselves to overcome supply-side constraints and market entry barriers, and to that end assistance from the international community will be necessary. As requested by the General Assembly in resolution 58/204 of 23 December 2003, the present report addresses progress in the implementation of that resolution, along with other intergovernmental initiatives relevant to commodities. In this context, the

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** The present report was submitted on this date in order to take into account the decision adopted by the General Council of the World Trade Organization on 1 August 2004.

launching of an international task force on commodities at UNCTAD XI is particularly significant. At the national level, developing country Governments have to provide an enabling environment and the private sector has to take steps to improve competitiveness. At the international level, apart from reforming the international trading system in a manner favourable to developing countries, developed countries and enterprises need to remove obstacles to market entry and mobilize assistance from the international community.

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I. Introduction

1. The present report was prepared pursuant to General Assembly resolution 57/236 of 20 December 2002, in which the Assembly requested the Secretary-General of the United Nations Conference on Trade and Development (UNCTAD) to report to the Assembly at its fifty-ninth session on world commodity trends and prospects, and resolution 58/204 of 23 December 2003, in which the Assembly requested the Secretary-General to submit to the Assembly at its fifty-ninth session a report on the implementation of that resolution.

II. Trends in the world commodity economy

A. Recent developments in international commodity markets

2. After a prolonged period of falling commodity prices, from 1995 to 2002, when the UNCTAD combined commodity price index fell by 31 per cent,¹ most commodity markets experienced higher prices in 2003 and the first half of 2004. This was due to the general, albeit uneven, recovery of the world economy and to fast increasing commodity demand in Asia, especially China. The UNCTAD combined price index rose by 12 per cent over the course of 2003 and by 6 per cent during the first half of 2004. However, if the depreciation of the United States dollar is taken into account, the price improvements were less impressive — the index in terms of special drawing rights (SDRs) increased by 2.5 per cent in 2003. In the first half of 2004, however, the increase in the SDR index was equivalent to that of the dollar index.²

3. Developments differed between commodity groups. Industrial raw materials experienced good demand conditions and the UNCTAD price index for minerals, ores and metals rose by more than 28 per cent during 2003 and by almost 15 per cent during the first half of 2004. The index for agricultural raw materials rose by 27 per cent in 2003, but fell by almost 6 per cent during the first six months of 2004.

4. The economic upturn in major developed economies in the second half of 2003 influenced raw materials prices, although the fast growth of Asian, particularly Chinese, demand was probably a more important factor behind the price increase. At a certain point, Asian demand for investment goods became large enough to lead to significant reductions in metal stocks and this event coincided with signs of an upturn in the growth rates of major industrial economies. Consequently, around October 2003, prices of almost all metals started rising rapidly. In view of low stock levels for most metals and the likelihood that industrial production will increase substantially in 2004, prices of these commodities are likely to remain at historically high levels in 2004 and at least early 2005.

5. Food prices, on the other hand, were generally flat in 2003, with the combined price index for all food products rising by 1 per cent, but recovered in 2004, increasing by 6 per cent during the first half of the year. Weaker prices for food

¹ All changes in price indices are expressed in current United States dollars.

² For a more detailed review of recent developments in commodity markets and some comments on prospects, see the *World Economic and Social Survey, 2004*, to be issued as a United Nations publication (Sales No. E.04.II.C.1).

products were partly a consequence of the unevenness of world economic recovery, with economic growth being too slow to lead to significant demand increases, partly the result of continued supply overhangs. In 2003, the only group of food products experiencing positive price developments was vegetable oilseeds and oils (prices rose by 17.5 per cent), where the underlying reason was mainly increased Chinese demand. Food price improvements in 2004, although significant, should be judged against the background of the prolonged period of very low prices. In June 2004, the price index for all food remained at a level almost 20 per cent below the average for 1995. Developing countries exporting agricultural commodities are therefore still faced with low prices and, because of price increases for manufactures and oil, their terms of trade have generally declined over the past two years. While the economic upturn is having a positive influence on food prices, the outcome depends also on supply-side factors, including stock levels, which vary from one product to another, and weather.

6. Probably, the most important recent trend has been the extraordinary development of oil prices, which began a rapid rise in 2003, continuing in 2004. A significant part of the price increase can be explained by the economic recovery and the increasing demand from countries such as the United States and China, as well as some newly industrialized countries. There is also concern about the adequacy of oil production capacity in the medium term and about reserves in the long term. However, overreactions and speculative positions in view of potential supply disruptions in countries such as Iraq and Saudi Arabia, as well as concern about developments in the Russian Federation and Venezuela, also played a part. These high prices are hurting the economic growth of oil importers, and particularly developing countries, the economies of which are more energy-intensive than those of developed countries and which tend to spend a large part of their export revenue on oil imports. Particularly hard-hit are least developed countries, as well as landlocked countries, which are confronted with major increases in transport costs. According to International Monetary Fund (IMF) estimates, a sustained US\$ 10 per barrel increase would, after one year, reduce gross domestic product (GDP) in highly indebted poor developing countries by 1.6 per cent (and within this group, for countries in sub-Saharan Africa, the figure would be 3 per cent).³ Persistently high oil prices could also slow down the rate of growth in large oil importing developing countries such as China and India and reduce their capacity to be growth nodes in the world economy.

B. Potential for expansion of demand and trade in commodities

1. Changes in the international trading system⁴

7. On 1 August 2004, the WTO General Council agreed on the framework for continued negotiations under the Doha round. The framework agreement for agriculture aims to guide the remaining negotiations towards the objectives set under the 2001 Doha Ministerial Declaration, i.e. substantial improvements in

³ IMF estimates based on its Multimod model, quoted in International Energy Agency, "Analysis of the impact of high oil prices on the global economy" (IEA (2004) 2), May 2004.

⁴ For a more detailed treatment of the issues arising particularly in the context of ongoing WTO negotiations, see the Secretary-General's report on international trade and development (A/59/305).

market access, phasing out of export subsidies and substantial reduction in trade-distorting domestic support. The text also tries to balance the interests of all WTO member countries, thereby leaving considerable room for negotiation with respect to the actual modalities to achieve the Doha objectives, such as the rates of reductions of tariffs and domestic support, the implementation period, and the exact elements of special and differential treatment. Market access will be improved by applying a tiered approach for tariff reductions so that deeper cuts are made on the highest tariffs, but countries may select a number of sensitive products to be excluded from ambitious cuts. Export subsidies, including certain types of export credits and activities of State exporting enterprises, will be eliminated, although the end date, the pace and the exact measures for elimination remain to be defined. Domestic support is the most controversial part of the framework agreement. Whether the remaining negotiations achieve massive reductions in trade distorting domestic support critically depends on the choice of the reduction formula (the amber box) and the revision of the criteria of the blue box and the green box. Should the criteria be set too broad, countries with a high level of trade-distorting support would be able to maintain some of them by shifting them to the blue box or to the green box to avoid abrupt cuts in their farm subsidies. The agreement, which reflects some of the recommendations made by the group of eminent persons on commodity issues convened by the Secretary-General of UNCTAD at the request of the General Assembly (see TD/B/50/11, paras. 6-7), is to be welcomed.

8. Cotton had been the subject of an initiative on the part of several African countries. The WTO General Council decided to deal with it as part of the agriculture negotiations, but it would be “addressed ambitiously, expeditiously and specifically” under a newly established subcommittee on cotton. The negotiations will encompass all trade-distorting policies affecting the sector, including import tariffs, trade-distorting domestic support subsidies and export subsidization. Commitments to achieve the fullest liberalization of trade in tropical agricultural products will also be addressed. Finally, negotiations on market access for non-agricultural products will have implications for exports of processed products from developing countries.

9. Two ongoing cases under the World Trade Organization (WTO) dispute settlement process may have wider implications: United States — Subsidies on upland cotton (complaint by Brazil) and European Union — Export subsidies on sugar (complaint by Brazil, Thailand and Australia). In both cases interim panel rulings, as reported in the press,⁵ recognized that the subsidies in question were not consistent with United States and European Union (EU) obligations under the WTO. If the rulings were upheld, a precedent would be set, which could have implications not only for cotton and sugar but also for other commodities and could significantly improve prospects for some developing country exporters of agricultural products.

10. Many countries have entered regional trade agreements or bilateral trade agreements, partly because of the slow rate of progress in WTO negotiations. There are indications to suggest that the setback of the Cancún Conference has given this process a boost. As of 1 March 2004, almost all WTO members participated in or

⁵ *Financial Times*, 18 June and 4 August 2004.

were actively negotiating regional trade agreements.⁶ Regional trade agreements exclusively among developing countries account for about 30 to 40 per cent of all active regional trade agreements. The EU is one of the most active in this area, not only at the level of Europe and the Mediterranean basin, but also through numerous interregional agreements. The United States has concluded many agreements covering the Americas and African countries. It should be noted that regional trade agreements, especially the North-South ones (as seen, for instance, in the cases of EU-Mercosur and Free Trade Area of the Americas (FTAA) negotiations), are typically limited in their coverage of agricultural trade.

11. The “Everything but arms” initiative of the European Union has important implications for developing countries’ commodity exports. It grants least developed countries quota free and duty free access to the EU market on a non-reciprocal basis for all products except arms and three sensitive products, namely fresh bananas, rice and sugar, which go through gradual liberalization until 2009. A Danish survey⁷ estimates that the EU “Everything but arms” initiative can generate around US\$ 280 million of welfare gains for the least developed countries, although a great deal of the gains is associated with the three sensitive products. With the coming reform of the Common Agricultural Policy of the EU and the liberalization expected to result from the WTO negotiations, the least developed countries preferences will erode and, according to the Danish survey, the result may be a net loss of welfare, especially for Sub-Saharan Africa. At the same time, some African, Caribbean and Pacific (ACP) countries, which benefit from preferential access to the EU market, may face potential losses as a result of the “Everything but arms” initiative. A recent report prepared by UNCTAD staff⁸ based on a computable general equilibrium simulation model shows moderate welfare and trade gains from the initiative. The largest gains are recorded for sub-Saharan Africa and the EU sugar market is the single most important source of change. The effects on the EU itself are minimal, as increased market access for least developed countries comes mostly at the expense of other preference-receiving countries, although the changes are modest.

12. The United States African Growth and Opportunity Act provides Sub-Saharan African countries with the possibility to export duty-free and quota-free products to the United States. Agricultural products account for less than 2 per cent of United States imports under the African Growth and Opportunity Act scheme. Except in a few cases, agricultural products face many constraints: stringent standards, especially regarding pests and diseases for fresh products, and a lack of information

⁶ “Bilateralism and regionalism in the aftermath of Cancún: re-establishing the primacy of multilateralism”, synthesis note based on regional papers prepared by the Economic Commission for Africa (ECA), the Economic Commission for Europe (ECE), the Economic Commission for Latin America and the Caribbean (ECLAC), the Economic and Social Commission for Asia and the Pacific (ESCAP) and the Economic and Social Commission for Western Asia (ESCWA).

⁷ According to a survey by the Danish International Development Agency (DANIDA), the “Everything but arms” initiative without EU agricultural reform will improve Sub-Saharan Africa welfare by US\$ 281.7 million, while with an EU reform it will be a loss of US\$ 379.5 million. Wusheng Yu and Trine Jensen, “Trade preferences, WTO negotiations, and the LDCs: the case of the “Everything but arms” initiative, Working paper, Danish Research Institute of Food Economics, April 2003.

⁸ L. Cernat and others, “The EU’s Everything but arms initiative and the least-developed countries”, United Nations University and World Institute for Development Economics Research Discussion Paper No. 2003/47, June 2003.

regarding these standards. A lack of national institutions able to carry out the necessary analyses has obliged exporters in many cases to contract laboratories at the destination in order to certify shipments. The African Growth and Opportunity Act is considerably more important for energy related products (essentially oil), which account for 80 per cent of United States imports under the scheme, and for textiles and apparels, which account for less than 10 per cent.

13. The new round of negotiations on the Agreement on the Global System of Trade Preferences among Developing Countries (GSTP) launched during UNCTAD XI in São Paulo, Brazil, may bring new opportunities for expanding South-South trade, particularly in agricultural commodities. Trade in these commodities, when not covered by regional trade agreements, is often constrained by high tariffs. It is hoped that the vision of President Lula of Brazil of a “new geography of trade of the South” will be helped by successful GSTP negotiations. All members of the Group of 77 and China have been invited to accede to the Agreement. Trade among GSTP members is estimated to have been close to \$2 trillion in 2000 or about 55 per cent of the international trade of all developing countries.

14. According to a survey undertaken by UNCTAD, almost all South-South trade agreements have increased trade among their respective members, but also with non-members.⁹ Thus, the dynamic effects of regional trade agreements in the form of increased growth and import capacity increase trade to the benefit also of countries that are not members. Since about half of developing country commodity exports go to other developing countries, large benefits could accrue from extended coverage of commodities in regional trade agreements, particularly since experience shows that such agreements have spurred the integration of supply chains on a regional or subregional basis.

15. Improving market access is one part of the problem of expanding the trade of developing countries. Tariffs and other barriers need to be addressed in international trade negotiations. These include sanitary and phytosanitary measures, technical barriers, restrictive rules of origin and intellectual property protection (especially geographic indicators), which arise from measures under the multilateral trade agreements, although they are often set unilaterally by Governments. Many other important aspects, however, go beyond the mandate of the WTO and addressing them requires action in other international forums.

2. Increasing Asian demand for commodities

16. Developed countries account for two thirds of world non-fuel commodity imports. They are likely to remain a dominating influence for many years to come and they have a crucial role in establishing conditions in international commodity markets that are favourable to developing countries.

17. On the other hand, rapid economic growth in developing Asian countries, particularly China, has been one of the major dynamic elements for international commodity markets in recent years and forms part of the “new trade geography of the South”. Together with improved export opportunities that could result from changes in the international trading system, increased demand for commodities in these countries could considerably boost world demand for commodities. A

⁹ *Assessing South-South Regional Integration: Same Issues, Many Metrics* (United Nations publication, Sales No. 02.II.D.11).

“window of opportunity” could thus open up over the next several years, making possible substantially improved export earnings for developing countries.

18. In order to assess the likelihood of this “window of opportunity” actually opening, it is first useful to review briefly past developments concerning Asia’s role in international commodity markets. The growth of total merchandise imports by Asian countries¹⁰ was badly hurt by the crisis of 1997 and grew at an annual rate of only 1.2 per cent from 1995 to 2002. During the same period, their commodity imports increased significantly faster, at an annual rate of 2.4 per cent. Import growth in the region’s two most populous countries, China and India, which were relatively little affected by the 1997 crisis, was considerably faster, spurred on by high economic growth, and their commodity imports expanded at respectively 11.5 and 9.5 per cent per year on average. If fuel imports are excluded, the rates of increase are still respectable, at 8 and 7.5 per cent. Commodities have accounted for a constant (in the case of China) or increasing (in the case of India and the rest of Asia) portion of imports. Moreover, the share of Asian commodity imports coming from other developing countries has increased steadily. In China, agricultural imports from developing countries outside Asia increased by a total of 30 per cent from 1995 to 2002 and mineral imports from these countries (including fuels) almost tripled over the same period. Since this was a period when commodity prices decreased dramatically, the growth in volume terms was higher.

19. India’s share of world consumption of major commodities is still relatively modest, but China’s rapid industrialization has led to it becoming a major market for most raw materials (see table 1). China is also a major producer of several commodities, but in many cases, demand growth has outstripped the capacity of the domestic industry to increase production. Accordingly, Chinese exports, particularly to the Asian region, are increasingly replaced by exports from other parts of the world, including developing countries.

Table 1
China’s share of consumption of selected industrial raw materials

Material	Share of world consumption (percentage)	
	1999	2003
Cotton ^a	23.9	31.1
Copper	10.6	19.0
Iron ore	23.2	30.8
Lead	8.4	15.6
Zinc	14.1	19.8

^a Data for 1999/2000 and 2003/2004 harvest years.

Sources: International Copper Study Group, *Copper Bulletin*, August 2004; International Cotton Advisory Committee, *Cotton: World Statistics*, September 2003; International Lead and Zinc Study Group, *Lead and Zinc Statistics*, vol. 44, No. 2, February 2004; UNCTAD, *The Iron Ore Market 2003-2005*, Geneva, May 2004.

¹⁰ For the purposes of the present discussion, “Asia” includes developing countries in Asia except those in West Asia and Central Asia.

20. China's share of world consumption of food products is also increasing fast. Its major agricultural commodity imports are cereals (mostly wheat and barley); vegetable oils and oilseeds (particularly soybean, soybean oil and palm oil); fish and seafood and animal feed. Other growth sectors include horticultural products such as cut flowers and fruits and vegetables, as would be expected at the present level of income.

21. What are the implications of continued rapid growth in China and India for world commodity demand? In order to answer this question, two important facts need to be kept in mind. First, China and India have a combined population of 2.3 billion people, about 37 per cent of the world's population. Thus, a US\$ 100 increase in the per capita income of these two countries (10 per cent for China and 20 per cent for India) represents US\$ 230 billion in additional demand. Second, both countries are at a stage of industrialization (with China somewhat ahead of India) where per capita commodity consumption tends to increase rapidly and they are likely to remain at this stage for the next several years. The need for major investments in infrastructure in both countries, particularly in India, will lead to rising demand for construction materials and other industrial raw materials. Lifestyle changes, including in dietary patterns, brought on by rising income and urbanization, will change the composition of demand for food products. As just mentioned, this is already reflected in the composition of China's agricultural imports, and also in India's, although to a smaller extent. Since both countries have made great progress in reducing poverty, this last factor is of major importance because, other things being equal, rising incomes for the poorer segments of the population tend to have a large impact on food consumption. Imports of non-traditional products such as coffee and cocoa are also increasing and this development is important for other developing countries.

22. Some of the increased demand for commodities will be met from domestic production. However, in spite of rapidly expanding production of most minerals and metals, China's exports (where the country has a surplus over domestic consumption) have been falling for some years, and imports have been growing. Future investments are unlikely to reverse this trend, given both geological factors and signs of increasing scarcity of energy in China. In the case of India, major mining companies are showing great interest in exploration and investment in the country, and India's mineral and metals production may increase substantially in the future. Its domestic needs are also expected to increase, however, and this may offset the growth in production. With respect to agricultural goods, productivity improvements in both countries would be expected to lead to increasing agricultural production. However, in both China and India shortages of arable land may be a constraint on production increases. The amount of land devoted to rice production in China has declined over the past six years and the rice harvest is expected to fall to a 12-year low of 126 million tonnes in the current crop year.¹¹ Within a decade, China may have to import up to 50 million tonnes of grain per year.¹² Moreover, self-sufficiency is unlikely to be a viable option in a globalizing world, where food products will be available at lower prices from other countries and where the international trading system would complicate efforts to replicate the bad example of developed countries in the area of agricultural protectionism.

¹¹ "SOUTH-EAST ASIA: China spurs commodities demand", Oxford Analytica, Daily Brief, 13 August 2004, www.oxweb.com.

¹² Oxford Analytica, 13 April 2004, www.oxweb.com.

23. Accordingly, China and India can be expected to need increasing commodity imports for several years ahead. For reasons of geographical proximity, Asian countries could be expected to be major beneficiaries and Chinese demand has already led to improved markets for its neighbours. For instance, Thailand expects rice exports for this year to increase by one million tonnes to nearly 8 million tonnes because of strong Chinese demand, earning revenues of 2.4 billion dollars compared to 1.85 billion dollars last year.¹³ Over the long term, increasing Chinese demand for vegetable oils, particularly palm oil, will benefit Malaysia, which accounts for 50 per cent of global production and 65 per cent of exports, and Indonesia. China is set to overtake India this year as the world's leading importer of vegetable oils and is expected to buy up to 5.5 million tonnes of palm and soybean oil, up from 4.2 million tonnes in 2003.¹⁴ Accelerating demand for rubber from China's automobile industry has created a boom for neighbouring producers. Leading international tyre manufacturers are moving production to China, further benefiting regional rubber suppliers such as Thailand, whose rubber export earnings leapt by 60 per cent in 2004 to 2.8 billion dollars, making rubber that country's fastest-growing export.¹⁴ However, other developing regions are also beginning to see major increases in their commodity exports to China. African countries experienced a 10 per cent annual increase in agricultural exports to China from 1995 to 2002 and Latin American countries saw exports increase at an annual rate of over 4 per cent, albeit in both cases from relatively low initial levels. For minerals (including fuels), the increases were 12 and 19 per cent respectively.

24. In conclusion, Chinese and Indian demand growth will provide a major dynamic stimulus to international commodity markets over the next several years and, since commodity markets are global, the additional demand arising from Asian growth will benefit a wide range of countries and not only affect the immediate neighbourhood. Although problems of oversupply of individual commodities will continue to affect export earnings and producers' incomes, the general trend should be positive.

III. Converting opportunities for increased commodity exports into development and poverty reduction

25. As can be seen from the preceding discussion, a "window of opportunity" for developing countries to increase their earnings from commodity exports may be opening as a result of trade liberalization and increases in commodity demand in Asia, particularly China and India. It should be emphasized that the two processes are complementary. Developing countries would benefit much less from increased Asian demand for commodities if developed countries were to use the expected demand increase as an excuse for taking a complacent view of the need for reductions in agricultural tariffs or support to domestic producers or, worse if they were to decide to exploit the market growth for their own exclusive benefit by continuing export subsidies and high levels of domestic support. On the other hand, a prolonged period of growing demand and improved price stability could make it easier for developed countries to overcome domestic resistance to reduced support,

¹³ Vietnam News Agency, 24 March 2004, www.vnnet.vn.

¹⁴ Oxford Analytica, 3 April 2004, www.oxweb.com.

thereby facilitating the transition to a more level playing field in world agricultural trade.

26. However, neither increasing demand, nor improved market access, singly or in combination, can guarantee that developing countries will make major progress in increasing commodity exports or in reducing poverty. Efforts are required on the part of these countries themselves and assistance from the international community will be necessary. The rest of this chapter discusses first, the links between commodity production and trade and poverty, and second, how to improve the competitiveness of developing country commodity producers by removing supply-side obstacles and facilitating market entry.

A. Links between poverty and commodity production and trade

27. The importance of the relationship between commodity production and both the incidence of poverty and the potential to reduce it is illustrated by the basic fact that more than two billion people in the world are employed in commodity production and that the majority of them are poor. While production and exports of commodities have provided a platform for industrialization and economic growth in some countries, in many others dependence on a few commodities for export revenues has trapped economies and people in a vicious circle of falling incomes. Neither dependence on commodity exports nor poverty among rural farming populations is limited to the poorest countries, but the situation of the least developed countries provides a stark illustration of the problems.¹⁵ The incidence of one dollar a day poverty in the period 1997-1999 was 82 per cent among mineral exporting least developed countries and 63 per cent among least developed countries with predominantly agricultural exports, while for services exporters it was 43 per cent and for manufactures exporters 25 per cent.¹⁶ Thus, in a number of least developed countries commodity exports have failed to provide a way out of poverty.

28. The mechanisms behind this failure are different in countries depending on mineral commodities and in those exporting agricultural products. As a rather sweeping generalization, it may be said that in agricultural economies the commodity producers are poor, while in mineral economies it is those left out of commodity production who experience poverty.

29. In agricultural economies, declining real prices and slow demand growth has led to stagnant or falling incomes in the agricultural sector. With little surplus available for investment, either in the sector itself or in the public sector (which is responsible for providing necessary services such as infrastructure), productivity growth has remained low. While access to developed countries' markets has improved through various preferential schemes, it has proved difficult under these circumstances for least developed country producers to achieve successful market entry, to participate in international value chains and to increase retained value added. Thus, the lack of diversification reinforces dependence on a few products with declining real prices and aggravates poverty. Competition from developed

¹⁵ Of the 49 least developed countries, commodities are the major source of export earnings in 31, of which four are oil exporters, seven predominantly mineral exporters and 20 predominantly agricultural exporters the *Least Developed Countries Report, 2004; Linking International Trade with Poverty Reduction* (United Nations publication, Sales No. E.04.II.D.27), p.124).

¹⁶ UNCTAD, op. cit. chart 19, p. 132.

country producers, helped by subsidies, is a major contributing factor since it poses a formidable challenge, not only in developed country markets but also in developing country markets, including those of the least developed countries themselves. The potential for significant increases in commodity demand and for a more level playing field in international agricultural trade described in the previous chapter offers an opportunity for developing countries dependent on agricultural exports to break out of the vicious circle of declining incomes and lack of diversification. Depending on the strategies chosen, this could lead to advances in the fight against poverty.

30. In mineral economies, the incidence of poverty results from both structural distortions brought on by the influx of mineral revenues and failings in the distribution of such revenues. In many mineral economies, “Dutch disease”¹⁷-type phenomena have resulted in reduced competitiveness for non-mining export goods, including agricultural products, and high domestic inflation. These problems can be dealt with through the “sterilization” of excess foreign exchange, for instance by holding funds offshore, and by channelling revenue to investment in human and physical capital, thus providing the basis for more broadly based development. In practice, however, competition for control over resource rents has often predominated. In some cases this has led to excessive growth of the central government machinery, corruption, increased military expenditure and, sometimes, armed conflict. Expected increases in demand offer opportunities for raising export incomes, since market access does not pose a problem. However, the conditions for reducing poverty in mineral economies are not directly affected by higher export incomes. The solutions have to be looked for in the area of national development strategies, supported by assistance from the international community.

31. The *Least Developed Countries Report, 2004* argues that an export-led growth strategy in its pure form is unlikely to lead to a virtuous trade-poverty relationship in the least developed countries. Most of the population in these countries live at or below income levels that are sufficient to meet only their basic needs, and export-led growth generally means exclusionary growth with benefits concentrated in enclaves. The report identifies four possible strategies relevant to commodity dependent countries in which export growth is an important component but in which there is balance between domestic demand and export expansion in the process of economic growth:¹⁸

- A balanced growth strategy based on agricultural productivity growth and export-accelerated industrialization
- An agricultural-development-led-industrialization strategy — which includes infrastructure investment and technological progress in agriculture, together with forward linkages into processing activities with an export component
- Development and diversification through management of mineral revenues
- Development of natural-resource-based production clusters

¹⁷ The term “Dutch disease”, which was coined following the problems caused by increasing natural gas exports in the Netherlands in the 1970s, refers to the effects of a real exchange rate appreciation brought on by a sudden influx of export earnings. These effects include reduced competitiveness in non-boom tradables sectors and increasing domestic inflation resulting from excess demand directed towards the non-tradables sector.

¹⁸ UNCTAD, op. cit., pp. 282-283.

B. Improving competitiveness and achieving market entry

32. It is recognized that substantial progress in international trade negotiations on agriculture is necessary to eliminate the bias against developing country producers. However, even if a more level playing field in agricultural trade results from the ongoing trade negotiations, this would not automatically lead to substantively increasing exports from developing countries. The realization of the potential development gains arising from growing international commodity demand and from changes in the international trading system depends on the ability of developing countries to improve their competitiveness, through eliminating supply-side obstacles and meeting market-entry conditions, so that they can respond to new opportunities.

33. Common supply-side obstacles include deficiencies in infrastructure and extension services and lack of access to credit, technology and market information. In some cases, institutions such as marketing boards earlier provided important services to producers. However, many of these institutions have been abolished and the private sector has not filled the gap. Low productivity is another important problem in the agriculture of many developing countries, especially in Africa. For example, maize yields are 1.6 tonnes per hectare in Africa compared to 3.8 tonnes per hectare in Asia,¹⁹ and the gap is not narrowing.

34. On the demand side, commodity markets are undergoing rapid change, with closed commodity chains rapidly replacing wholesale or spot markets. Highly concentrated agro-food processing, supermarkets, retailers and food service industries are narrowing their supply base and demanding increasingly stringent levels of quality and compliance with safety standards. With the increasing dominance of international distribution networks even in developing countries, these exigencies must be met also when supplying domestic markets. Only a small group of producers and exporters in developing countries has the capitalization, infrastructure, technical expertise and market information to meet requirements. And even for this highly capitalized group, it is difficult to prevent bargaining power from being eroded as downstream agribusiness becomes ever more concentrated. Small producers without the financial and technical means to adjust to new standards have been increasingly marginalized.

35. An example of the significance of private sector standards is provided by the EUREPGAP certification, a private initiative by European retailers aimed at certifying production as safe and sustainable. A normative document details the procedures to follow in order to receive EUREPGAP certification. The certification is in place for fruit and vegetables, flowers and ornamental plants, other farm products, aquaculture products and (soon) green coffee. Accredited organizations control and deliver the EUREPGAP certification, which provides the possibility to market to the retailers that are part of the scheme.²⁰ There are obvious advantages to having an industry-wide standard replace the different standards used earlier by several retailers which required multiple certification. However, small producers, particularly in developing countries, perceive the initiative as problematic. Producers in developed countries benefit from help to comply with the

¹⁹ Jeffrey Sachs and Pedro A. Sanchez, «Une révolution verte pour l'Afrique», *Le Monde*, 11 August 2004.

²⁰ For more detail on the EUREPGAP initiative, consult the web site <http://www.eurep.org>.

requirements, while this is generally not the case in developing countries. Large transnational companies can easily comply with the standards, but this is obviously much more difficult for small farmers in developing countries. For instance, bananas from plantations owned by Chiquita are certified EUREPGAP, while bananas from ACP countries, including Caribbean island States, are not. A second version of EUREPGAP standards has been implemented since January 2004 and will be the only one applicable from 1 January 2005.

36. In order to deal with both supply-side obstacles and difficulties of market entry, specific policies and assistance are needed. Capacity-building to tackle transaction costs and overcome institutional weaknesses obstructing trade, both in the public and private sectors, is important and would call for significantly stepped-up funding for technical assistance from developed countries and multilateral financial institutions. Developing countries, for their part, would also need to commit themselves to creating supportive conditions for trade and investment as part of their national development strategies. Such conditions include stable macroeconomic and sectoral policies, improved institutional frameworks, better access to seasonal finance and improved infrastructure. It is also important that developing country Governments take actions supporting producers' and exporters' efforts to meet market requirements. Such actions include support to product quality improvement, including the provision of testing services, and to improvements in logistics; elimination of unnecessary regulations; and upgrading of agricultural extension services.

IV. Implementation of General Assembly resolution 58/204 and some other intergovernmental initiatives

37. As has been argued in the present report, the coming years may see an unprecedented opportunity for developing countries to increase exports of commodities, particularly to other developing countries, as a result of favourable market conditions over the medium term, both for raw materials and for food commodities. As has also been noted, the support of the international community, especially developed countries, will be necessary for developing countries to be able to exploit this "window of opportunity" to the fullest extent and convert increased export income into reduction of poverty. This support should include a dramatically more level playing field for international trade in agricultural commodities, to be achieved through the successful conclusion of negotiations on agriculture and other relevant areas, such as market access for non-agricultural products in the WTO. Regional trade agreements and renewed negotiations on the expansion of GSTP can also provide a significant impetus, in particular to trade among developing countries. For least developed countries, in particular, increased financial and technical assistance will also be necessary to allow their commodity producers to achieve successful integration into international supply chains, eliminate supply-side obstacles to increased commodity exports and distribute the gains from rising export revenues to the poorest segments of the population, particularly small-scale farmers, many of whom are women. Progress in this area will make a significant contribution to meeting the Millennium Development Goals established by the General Assembly.

38. UNCTAD will continue to devote efforts to contribute to the identification, design and implementation of new policy approaches to commodity-related development problems. In addition to the Millennium Goals, several recent decisions by the General Assembly, related to commodities, are important in this respect and are guiding the work of UNCTAD.

39. At its fifty-seventh session, in resolution 57/236 of 20 December 2002, the General Assembly called upon the Secretary-General of UNCTAD to designate independent eminent persons to examine and report on commodity issues for consideration by the General Assembly at its fifty-eighth session. The designated eminent persons met on 22 and 23 September 2003 in Geneva. On the basis of their discussions, they agreed upon a set of recommendations,²¹ among which they attached the highest priority to the following:

- Enhanced, equitable and predictable market access for commodities of key importance to developing countries
- Addressing the problems of oversupply of many commodities
- Making compensatory financing schemes user-friendly and operational
- Strengthening capacity and institutions
- Pursuing the possibilities for the creation of a new international diversification fund

40. At its fifty-eighth session, the General Assembly, in resolution 58/204 of 23 December 2003, took note of the report of the Meeting of Eminent Persons on Commodity Issues. With respect to the recommendations, it urged Governments and invited international financial institutions to continue to assess the effectiveness, including the operationalization and user-friendliness, of the systems for compensatory financing of export-earnings shortfalls. The Assembly also requested the Secretary-General to undertake further open and transparent discussions with all relevant stakeholders on enhancing the impact of the set of existing instruments to support commodity-dependent developing countries in their efforts to diversify their exports. It called upon UNCTAD and invited other relevant bodies and organs of the United Nations system, as well as other relevant international organizations, to strengthen coherently their capacity-building and technical cooperation activities in this area. Finally, the Assembly requested the Secretary-General to submit to it at its fifty-ninth session a report on the implementation of the resolution. Paragraphs 41 to 45 below constitute this report.

41. In spite of severe resource constraints, UNCTAD has endeavoured to take into account the recommendations of the eminent persons in its work and has also strived to meet the requests made by the General Assembly in resolution 58/204. At the eleventh United Nations Conference on Trade and Development (UNCTAD XI), held in São Paulo, Brazil, from 13 to 18 June 2004, member Governments gave UNCTAD an ambitious mandate on commodities that will facilitate this task. Existing responsibilities, which were in some cases reformulated, were reconfirmed, including:

²¹ The recommendations of the eminent persons are contained in their report (A/58/401, chap. II).

- Monitoring developments in commodity markets
- Assisting developing countries in formulating strategies and policies to respond to the challenges of commodity markets, including oversupply
- Addressing links between international commodity trade and national development, particularly poverty reduction
- Analysing and promoting exchange of experiences with factors, policy issues and responses influencing the competitiveness of the commodity sector so as to contribute to diversification, adding value and more effective participation in the supply chain
- Analysing and supporting the development of appropriate and effective mechanisms and capacity to respond to commodity price fluctuations and to mitigate earnings shortfalls, in particular by improving the capacity to apply modern commodity price risk management and financial instruments (TD/410, para. 100)

42. In addition to the above-mentioned responsibilities, UNCTAD was also requested to help build effective partnerships among relevant stakeholders aiming at viable solutions and sustainable approaches to commodity problems, including by fostering public-private cooperation in commodity chains with a view to ensuring, inter alia through market-based principles, a more equitable distribution of revenues and benefits along the supply chain, and to supporting diversification (TD/410, para. 100). To this end, the establishment of an International Task Force on Commodities was announced at UNCTAD XI. As explained in the annex to document TD/410, the Task Force will function in an informal and flexible manner, with partners cooperating in a spirit of cooperative endeavour. Partners will include member States, international organizations, commodity-specific bodies, the private sector, non-governmental organizations and the academic community. The Task Force could play a crucial role in ensuring networking and synergies between the activities of different bodies and different actors, inter alia to avoid duplication and ensure coherence, and in generating ideas for technical cooperation, building upon technical cooperation projects so that their impact is enhanced and identifying technical cooperation projects that fall outside the purview of existing organizations, in particular multi-stakeholder projects. The Task Force is expected to contribute constructively to finding ways to exploit the “window of opportunity” for commodity dependent developing countries to increase the role of the commodity sector in economic growth and development. Accordingly, the Task Force will play a crucial role in responding to both the recommendations of the eminent persons and the requests of the General Assembly. Financial support for the Task Force from Governments, international financial institutions and other international organizations is crucial for its success and should be encouraged.

43. Other developments and initiatives in the area of commodities are also related to the recommendations of the eminent persons. With respect to the effectiveness of the systems for compensatory financing of export-earnings shortfalls referred to by the Assembly, some progress has been made. The failure to revive an effective system for compensatory financing of export-earnings shortfalls under the IMF, as well as the inadequacy of the FLEX (which replaced the former STABEX instrument) scheme set-up under the EU-ACP Cotonou Agreement has been a serious concern. After discussion with various stakeholders, the European Commission decided in February 2004 to reshape the FLEX export-income

compensation instrument by simplifying the criteria for benefiting from the scheme (e.g., considering the elimination of the eligibility requirements regarding an increase in the public deficit, proposing that a preferential 2 per cent (of export revenues) trigger threshold be applied to least developed countries and landlocked and island States, as well as examining the special case of African cotton producing countries). Further work will be needed to assess the impact of such approaches and to review past and potential new schemes, including those using new financial instruments and commodity-risk insurance schemes, as well as those based on indicators allowing a quicker response.

44. A significant initiative related to commodities and some aspects of the recommendations of the eminent persons, which was launched in April 2004, is the EU Action Plan on Agricultural Commodity Chains, Dependence and Poverty, in which UNCTAD has been designated as one of the partner organizations.²² The implementation of this initiative has not yet started, but UNCTAD expects to participate fully in areas of its competence once the preparations for implementing it are completed.

45. In conclusion, with respect to the implementation of resolution 58/204, some initiatives have been taken, but it will take some time for them to have a significant impact on the situation of commodity dependent developing countries.

46. It should also be mentioned that activities of the United Nations Conference on Trade and Development in the commodities area are closely related to the implementation of the Monterrey Consensus of the International Conference on Financing for Development²³ (see TD/B/51/5). They are particularly relevant to removing supply-side constraints, diversifying export capacity and strengthening institutional development and enhancing overall productivity and competitiveness as referred to in paragraph 36 of the Monterrey Consensus, and to mitigating the consequences of depressed export revenues of countries that still depend heavily on commodity exports, empowering developing country commodity producers to insure themselves against risk and supporting export diversification programmes in those countries, as called for in paragraph 37. Although all of the activities in the area of commodities are relevant in this connection, some merit special mention. The reports prepared for several meetings of experts and of the Commission on International Trade in Goods and Services, and Commodities have focused on the constraints and opportunities for more effective participation by developing country producers in international commodity value chains.²⁴ A differentiation has been

²² For the text of the Action Plan, see Communication from the Commission to the Council and the European Parliament, "Agricultural commodity chains, dependence and poverty — a proposal for an EU Action Plan", Brussels, 12.02.2004, COM(2004)89 final.

²³ *Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002* (United Nations publication, Sales No. E.02.II.A.7), chap. I, resolution I, annex.

²⁴ "Market access, market entry and competitiveness", TD/B/COM.1/65 of 19 December 2003; "Report of the Expert Meeting on Market Entry Conditions Affecting Competitiveness and Exports of Goods and Services of Developing Countries: Large Distribution Networks, taking into account Special Needs of LDCs", TD/B/COM.1/66 of 19 January 2004; "Export diversification, market access and competitiveness", TD/B/COM.1/54 of 26 November 2002; "Report of the Expert Meeting on the Diversification of Production and Exports in Commodity Dependent Developing Countries, including Single Commodity Exporters, for Industrialization and Development, taking into account the Special Needs of LDCs", TD/B/COM.1/50 of 19 April 2002.

made between market access conditions that are subject to international trading rules and market entry conditions that emanate from market structures. The removal of supply-side constraints and improving competitiveness through upgrading business practices and meeting quality requirements, the identification of opportunities and the role of Governments in enabling the private sector in these areas have been covered. UNCTAD has also been implementing a project on “Capacity-building for diversification and commodity based development” financed from the Development Account of the United Nations. Several regional and national workshops have been organized. Information on this activity, including a large number of reports, can be found at <http://www.unctad.org/infocomm/Diversification/index.htm>. Another project financed by the Common Fund for Commodities on “Improvement of sustainability of cotton production in West Africa” aims to improve the competitiveness and sustainable development of the cotton sector in countries of that region. Regarding the consequences of depressed export earnings, UNCTAD has continued to work on improving institutional and operational capacity in the management of commodity price risks. Its work on innovative mechanisms for the financing of commodity production and trade is also relevant in this respect.

V. Conclusions

47. In the past several decades, commodities have not played the role of an engine of growth. The prospects may be improving with the expected demand increase resulting from rapid growth, especially in developing countries. This opens a “window of opportunity” for increasing commodity exports from developing countries. In order for the benefits of this opportunity to be equitably shared so that they reach the poorest countries and the poorest population segments of developing countries, national and international policies and actions are required.

48. At the national level, productivity needs to be improved, particularly in least developed countries and African countries. Measures to this effect include improved extension services, enhanced and more rational use of inputs and the adoption of better yielding varieties and better farming practices. Improvements in the quality of products and quality control are necessary in order to meet market exigencies and increase returns to production. Governments have an important role to play in this respect, both by providing support to producers, processors and traders and by establishing an enabling environment. For this to be effective, the private sector has to adopt modern business practices necessary for participation in international value chains. The design and implementation of innovative financing mechanisms would help in attracting resources to agriculture. In mineral dependent countries, the management of mineral revenues and the establishment of stronger links between mining and other parts of the economy are particularly important for contributing to the structural transformation to more broadly based and diversified economies.

49. At the international level, it is necessary for the international trading system to be reformed in a way that offers substantially improved opportunities to developing country agricultural exporters and provides the policy space for implementing the necessary measures in this respect. Financial and technical assistance is needed to support the efforts of developing countries to participate more effectively in international commodity trade. In this context, it deserves to be noted that the Organization for Economic Cooperation and Development (OECD) Development

Assistance Committee (DAC) flows to agriculture, which comprised 11.7 per cent of the total in 1981-1982, declined to 5.6 per cent in 2001-2002,²⁵ and there is no indication that they have rebounded. Finally, international support to mitigate the consequences of price instability calls for user-friendly and operational approaches to schemes intended to address earnings shortfalls.

²⁵ Statistical Annex of the 2003 Development Co-operation Report, 12 January 2004, <http://oecd.org/dataoecd/52/11/1893159.xls>.