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## **Integrating commodity policies into development and poverty reduction strategies: success stories, transparency and accountability**

Note by the UNCTAD secretariat

### *Executive summary*

A large number of developing countries are dependent on commodities for their well-being and for development resources. In many cases, particularly in low-income countries, the commodity sector is the only base a country has from which to kick-start its economic development. However, commodity markets tend to be volatile and have been subject to secular declines in real prices, which pose challenges for both macroeconomic and microeconomic management. This note examines strategies pursued by developing countries to adapt to these challenges and ensure commodity-based development, including poverty reduction. It discusses the historical context for the development of commodity policies in developing countries, and the policies of integrating agricultural commodity policies into national, regional and international development. It also examines issues involved in improving transparency and accountability of the commodity sector – in particular the minerals and gas and energy subsectors – at the various levels.

## Introduction

1. Most primary commodity-dependent developing countries have historically been vulnerable to the vagaries of the market. National commodity policies in these countries have thus been responses to what has been described as the “commodity problematique” – how to respond to two main problems that exacerbate the macroeconomic management of these economies. The first is volatility in world commodity prices – very often sharp volatility in the short term with significant year-to-year variability – arising mainly from fluctuations in demand and lags in supply response. The second is the secular decline in real commodity prices (which has been the norm until the recent price boom) and its associated terms-of-trade losses.

2. The commodity problematique has often entailed heavy costs for most primary commodity-dependent developing countries in terms of loss of incomes, reduced investment and increased indebtedness and poverty, all of which translate into lower levels of development. These effects are more pronounced in countries that are dependent on the exports of a small number of commodities. Macroeconomic management in most commodity-dependent developing countries has been focused in several instances on containing the adverse impact of the “boom-and-bust” cycles in commodity markets, especially for agricultural commodities. However, the need to stabilize commodity prices and to assure returns that are considered “remunerative” to producers has been a concern of both developing and developed countries. Historically, two distinctive trends have emerged, one with respect to producers in the developed countries and the other with regard to those in the “South”.

3. Whereas Organization for Economic Cooperation and Development (OECD) countries have been providing income stabilization support and protection of livelihood for their farming populations (which represent on average 3 to 4 per cent of their workforce) equivalent to some \$1 billion a day, developing countries, because of fiscal constraints, have not been able to do so. Instead, they have looked to the international community for solutions to their commodity dependence and associated problems. This is especially the case with Africa, where agriculture employs around 70 per cent of the workforce, a great majority of whom live on less than \$1 per day.

4. This paper examines the different mechanisms that have been developed to address the challenges associated with commodity dependence in order to ensure commodity-based development. Chapter I sketches out the historical context for the development of commodity policies in developing countries. Policies for integrating agricultural commodity policies into national, regional and international development and poverty strategies are discussed in chapters II, III and IV. Some issues for discussion have been identified at the end of each chapter. Chapter V discusses how to improve transparency and accountability of the commodity sector, in particular the minerals and gas and energy subsectors at the national, regional and international levels.

### I. Commodity policy: a historical perspective

5. The need to stabilize commodity markets has been a concern of economists since the 1940s. This concern manifested itself in the development of international commodity agreements (ICAs) to stabilize prices, ensure reasonable and stable incomes for producers and correct adverse situations resulting from oversupply of commodities. The frustrations of commodity-exporting countries with the operation of the ICAs eventually culminated in the shift of commodity issues to the United Nations Economic and Social Council, and finally to UNCTAD (see below).

6. At the time of independence, the production and marketing of agricultural commodities in the South were for the most part inherited from the colonial production and marketing systems where the State played a key role. Production units (e.g. estates)

were privately owned and the Government, through parastatal bodies, organized marketing both domestically and internationally, and provided various types of support to production.

7. The global economic crisis following the two oil crises of 1973–1974 and 1979–1980 hit hard many commodity-dependent developing countries, in particular those in sub-Saharan Africa. The external environment deteriorated drastically and reduced the demand and prices for many agricultural commodity exports, with the global recession associated with the latter crisis lasting until 1982. Some Asian developing countries with a strong manufacturing base chose to restrict the increase in their debt levels by expanding export volume via a variety of export promotion measures and industrial policies. On the other hand, many other developing countries did not adjust in this way, either because their economies were not sufficiently diversified, or because they deliberately chose not to. Most sub-Saharan African countries resorted to external borrowing to finance fiscal and external imbalances on the assumption – which turned out to be wrong – that the recession would be short-lived, and that prices of non-fuel commodities would quickly recover. For African commodity-dependent countries, this was not only the genesis of their debt crisis, but also the end to the relatively strong economic growth that some of them had enjoyed since independence. The region's annual gross domestic product (GDP) growth rate plunged from 4.3 per cent in 1971–1975 to 1.1 per cent in 1981–1985.<sup>1</sup>

8. Within a context of worsening economic performance, further financial assistance from the international financial institutions was predicated on the implementation of a policy package of market-oriented reforms, which generically came to be identified as structural adjustment programmes (SAPs), from the early 1980s. In line with the diagnosis of the crisis by the international financial institutions (IFIs), the reform package focused on national policy reforms at the macro and sectoral levels.

## **II. Agricultural commodity policies in national development strategies**

9. SAPs not only marked the beginning of macroeconomic reforms, but also the implementation of agricultural sector policy and institutional reforms. The main features of the agricultural reforms were:

- (a) The elimination of:
  - (i) State monopolies on agricultural marketing in specified inputs and outputs;
  - (ii) Price controls on foods, although sometimes pricing reforms were ambiguous;
  - (iii) Pan-territorial pricing and support prices for farmers;
  - (iv) Subsidies on agricultural inputs;
- (b) Privatization or closure of:
  - (i) State agricultural banks, or the reduction of their lending activities in tandem with the elimination of credit subsidies and restructuring of loan portfolios; and
  - (ii) State-owned agro-processing and storage facilities and of State agricultural marketing boards and trading corporations.

10. The outcomes of these reforms have been mixed. There is a general consensus that they did remove the policy-induced distortions that had hitherto held back improvements in productivity and output in the agricultural sector in much of the developing world.

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<sup>1</sup> UNCTAD (2008a). *Economic Development in Africa: Export Performance Following Trade Liberalization: Some Patterns and Policy Perspectives*. E.08.II.D.22. Geneva.

However, the reforms – particularly in Africa – failed to address the structural constraints (social and institutional) that were critical to engendering a positive supply response. These constraints still thwart Africa’s agricultural potential, even in a context of improved macroeconomic fundamentals, as evidenced by the impact of the recent high food prices on most countries in the region.

11. A review of the literature on the performance of agriculture in most developing countries suggests that the role of the State or the Government has been critical in formulating and implementing specific policies to promote the sector. Historically, these Governments implemented price stabilization schemes with mixed results. In the last three decades or so, in particular as part of macroeconomic reforms discussed earlier, most commodity-dependent developing countries have designed and experimented with other types of strategies. These include domestic stabilization schemes, supply management, diversification and market-based risk management strategies.

### **A. Domestic stabilization schemes**

12. Domestic price stabilization measures to address commodity problems have been tried in many developing countries. Crop marketing boards and *caisses de stabilization*, which in many cases had existed since colonial times, mediated between the world markets and producers in many commodity-exporting countries.

13. The record of these boards was mixed, and in the late 1970s and early 1980s some were beset with problems, including corruption. These problems notwithstanding, crop marketing boards did play a vital role in the development of the agricultural export sector in several countries. Nevertheless, these institutions were dismantled in many countries within the context of SAPs, thereby exposing commodity producers to the vagaries of world commodity markets. While the post-adjustment experiences have also been mixed, on the whole, real producer prices have reflected the declining pattern of real-world commodity market prices. Farmers have also suffered negative consequences because production and marketing costs have risen, fertilizer prices and transport costs have soared and net incomes have declined. Consequently, small producers have been less able to protect themselves from falling commodity prices.

### **B. Supply management**

14. Supply management is any concerted action or mechanism by producers which controls the supply of a commodity relative to its demand, in order to influence its price. Such a mechanism usually entails taking supplies off a market, or putting them back on it, in order to influence price movements. This policy has been adopted by several commodity-dependent developing countries at different points in time with varying levels of success.

15. In May 2005, a new Government in Ecuador, the largest banana exporter, signed a decree to regulate the volume of bananas leaving the country.<sup>2</sup> Two months later, Malaysia and Indonesia announced a bilateral plan to cooperate on palm oil, rubber, cocoa, timber and other products to ensure price stability and eliminate the undercutting of their positions by others.

16. Sometimes, supply management is mediated through commodity cartels such as the Organization of the Petroleum Exporting Countries (OPEC) or ICAs between producer and consumer countries. These cartels (or producers operating through ICAs) have intervened on markets by withholding stocks or capacity to allow prices to go up. While OPEC has

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<sup>2</sup> BananaLink (2005). Banana Trade News Bulletin No. 33. BananaLink, Norfolk, United Kingdom: 2.

been quite successful at managing oil prices, ICAs have had mixed outcomes for a variety of reasons.<sup>3</sup>

17. This mechanism has also been deployed by private corporations to maximize their profits. An example of this is De Beers Company's control of diamond distribution. Aluminium and nickel transnational corporations (TNCs) also used this mechanism to control prices up to the 1980s. The aluminium system was extremely successful (and arguably beneficial for consumers) for the first 90 years in which that metal was traded.

18. On any large international market, supplies are likely to be under effective control at some point along the supply chain. Just-in-time inventory processes on integrated supply chains have also made it possible to control the quantities supplied in a more sophisticated manner than before.

### C. Diversification

19. Diversification of the economic structure in itself is not an entirely new concept or strategy, but it has in the past decade or so taken on greater resonance, probably in response to the "failure" of price stabilization schemes at the national and international levels. In its original formulations, the objective of diversification strategies was to reduce a country's dependence on limited and volatile income streams by engaging in activities (e.g. processing) that add value to an existing basket of commodities by moving up the value chain. In recent years, the term has been used to encompass producing new crops with unrelated price movements – that is, horizontal diversification into income-elastic, high-value agricultural commodities such as horticultural products (e.g. fruits and cut flowers) and fishery products.

20. Côte d'Ivoire diversified its agricultural sector because of huge State investments during the 1960s, which were later complemented by a "crops diversification" policy, which introduced new crops and transferred others from one region to another to improve quality and productivity. Although the strategy was initially considered to be successful, the gains of diversification appear to have been eroded, inter alia, because of political instability. To date, cocoa still represents 80 percent of the country's total commodity exports.

21. Other countries – such as Ethiopia, Ghana, Kenya, Uganda and Zambia – have diversified into non-traditional exports, including horticultural products, although some of them are at present marginal players in such markets. In Kenya, private sector-led efforts within the framework of the country's Private Sector Development Strategy were critical to the emergence of the horticultural sector as an alternative to traditional exports of coffee and tea.

22. The most successful African diversification case is, however, Mauritius, which utilized savings from its sugar industry to diversify into the production and export of textiles and garments. The sugar industry provided start-up capital as well as the technical and managerial expertise to develop export-processing zone enterprises involved in manufacturing (see box 1).

#### **Box 1. Successful diversification in Mauritius**

Mauritius has been highly successful in the overall management of its economy, with GDP averaging close to 6 per cent and a 250-fold increase in export earnings over the 30 years up to the late 1990s. In 1964, the Government of Mauritius implemented an import substitution scheme, but by the early 1970s this was supplanted by an export processing zone, which provided a range of incentives. These included low import taxes on raw materials and equipment, overseas marketing support, low corporate

<sup>3</sup> UNCTAD (2003). *Economic Development in Africa: Trade Performance and Commodities Dependence*. E.03.II.D.34. Geneva: Chapter 2.

taxes and generous tax holidays, and preferential loan schemes, for both domestic and foreign investors. Foreign firms appear to have followed domestic firms in the clothing sector, but they have no doubt played a crucially strategic role as a source of production and marketing techniques. In the other key growth sector, tourism, there has been more reliance on domestic firms and restrictions on foreign ownership. Key to Mauritius's success was its successful management of sizeable economic rents (and the translation of these rents into productive investment and jobs) in the early 1970s, when its sugar exports enjoyed privileged access to European markets, which later expanded under the Lomé Convention, at a time of rising prices. This provided a surplus for Mauritian entrepreneurs to invest in clothing exports, which in turn benefited from favourable market access to Northern markets through the Lomé Convention and the Multi-Fibre Arrangement (MFA). Combined with a diversification strategy that focused on consolidating and modernizing the traditional sectors and creating new areas of growth, Mauritius has been able to reduce its dependence on sugar. However, the Government is not unaware of the dangers of heavy reliance on just two export items (sugar and clothing still account for three quarters of export earnings), particularly in the aftermath of the end to the MFA. As such, in recent years, it has developed plans to turn the island into an offshore financial services centre.

*Source: UNCTAD (2005). Economic Development in Africa: Rethinking the Role of Foreign Direct Investment. E.05.II.D.12. Geneva.*

23. In Asia, countries with very different initial levels of development conditions have been able – through a variety of heterodox policies, including a strong role for the State, but also free market policies – to diversify successfully into new agricultural products, including processed products and manufactures. Malaysia (box 2) and Thailand have captured world markets in electronic products, while they have remained significant exporters of agricultural products through productivity and efficiency enhancement in the agricultural sector.

#### **Box 2. Malaysia: the role of the State in diversification**

Malaysia's success in developing export-led agribusiness is underscored by broad development planning and sector-specific intervention in identifying and assisting promising commodity sectors carry out science-based development and diffusion of products in demand by international markets. Government diversification efforts dating back to the 1960s include (a) identifying commodities with a high economic potential (e.g. palm oil); (b) developing new land for palm oil and cocoa, and infrastructure; (c) establishing support institutions with a view to increasing farm income and food security; (d) provision of support through research and regulatory and marketing institutions; and (e) creating a dedicated development authority for land management, including the enactment of land tenure laws.

Malaysia's competitive position in global agribusiness also owes much to the organized marketing and quality assurance of its exports to meet buyers' requests, as well as to good infrastructure, efficient logistics (modern transport/handling and bulking and shipping facilities) and competitive freight costs. In terms of diversification, its palm oil industry offers a diverse variety of products, by-products and downstream products. Within the palm oil value chain, up to 100 products made up a total export value exceeding \$6 billion in 2006. Currently, new high-value crops are being experimented with for similar development, including bio-fuel crops.

Other policy instruments that have been deployed – in particular developing the palm oil sector, revolve around investment incentives and tax measures.

*Sources:* (a) Tawang Ariffin (2008). Successful Agricultural Commodity Development and Diversification Strategies – the Case of Malaysia. UNCTAD Secretary-General's, High-Level Multi-Stakeholder Dialogue on Commodities in the context of UNCTAD XII. January 2008. Mimeo. Geneva.

(b) Petronas – [http://www.petronas.com.my/internet/corp/centralrep2.nsf/frameset\\_map\\_corp?OpenFrameset](http://www.petronas.com.my/internet/corp/centralrep2.nsf/frameset_map_corp?OpenFrameset).

24. Viet Nam, through an eclectic set of policies which culminated in the gradual liberalization process of the external marketing system, has become the second-largest world producer and exporter of coffee and rice. In recent years, it has moved up the value chain by adding value, through joint ventures with domestic and foreign organizations, to some of its agricultural products, including coffee. Some of the most successful cases of diversification in Latin America are Argentina, Brazil and Chile, which produce and export a bewildering combination of primary and processed agricultural commodities and manufactures (box 3).

**Box 3. Diversification in Chile: agricultural high-value product innovation from a mining base**

The Chilean economic boom and high degree of diversification owe much to market-friendly and sound macroeconomic policies that created the environment for attracting investment in mining. Another important aspect of this success story is an innovation strategy to harness high-value agricultural products – such as wine, fisheries, and fruits and vegetables – offered by Chile’s unique ecosystem.

Following adoption of free-market policies in the mid-1970s, Chile experienced an economic boom starting from the late 1980s to the early 1990s. In 1974, the Foreign Investment Statute assured (a) equal legal treatment between national and foreign investors; (b) access to all sectors of the economy; and (c) minimum intervention by the authorities in investor activities. The statute also offered attractive fiscal incentives.

The Government established several institutions, including State-owned enterprises and professional associations, that worked together with government agencies to design and oversee development strategies for the mining sector. Chile maintained macroeconomic stability in the face of variations in mineral export revenues and an investment boom in mining. It achieved high growth rates and was able to diversify to the point of exporting to 177 countries up to 3,800 products, including high-value agro-food products such as wine, fruits and vegetables. The key to Chile’s success in converting mining exports into development lies in two main factors: (a) a long-term development strategy based on an open economy and free trade; and (b) a prudent fiscal and monetary policy which did not lead to real exchange rate appreciation as a result of mineral windfalls. Chile, however, implemented moderate State intervention between 1982 and 1991, the “*neo-liberalismo pragmático*”, based on privatization, increased tariff protection and export subsidies.

In 1990, the Government introduced policies based on technological upgrading, innovation and international competitiveness, which had a significant impact on the agricultural sector. These new policies were supported by the signing of preferential trade agreements and the creation of export promoting. With State financial support, a National Innovation System (NIS) was conceived as a network of institutions with knowledge linkages between universities, enterprises and State institutions helping to develop and disseminate new technologies across agricultural industries. The 1982–1983 recession pushed the Government to shift the policy regime towards market-based allocation of research and development resources. In the 1990s, many projects were developed to foster collaboration between the private sector and public research institutions, including university–industry linkages.

To maintain the performance of the agro-business industry and to promote research activities for technological, managerial innovation and training, the Government started work on the formation of clusters and linkages between industry, the public sector and research institutions. It is also promoting policies to better coordinate the NIS and producer associations, which play an important role in the coordination of common strategies in international markets and facilitating networks for technology transfers.

The fisheries sector also benefited from the attention of NIS. The sector has boomed on the back of a favourable exchange rate policy, the lifting of non-tariff barriers and liberal credit, which allowed accessible financing for entrepreneurs.

*Sources:* (a) Katz J and Spence R (2008). Chile: Universities and the National Innovation System. Facultad de Economía y Negocios, Santiago de Chile.

(b) Giuliani E (2003). Evidence from a Chilean wine cluster. Study paper for EADI workshop on Clusters and Global Value Chains in the North and the Third World. October. University of Sussex, United Kingdom.

(c) Lagos G (1997). Developing National Mining Policies in Chile: 1974–1996. Catholic University of Chile, Santiago de Chile.

(d) UNCTAD (2008). Mining and Economic Development. Mimeo. Geneva.

#### **D. Market-based risk management**

25. Since the 1990s – against the background of the limited progress made by both domestic and international price stabilization schemes to address the commodity problems of developing countries – attention has focused on the use of market-based mechanisms for managing commodity price risks. These are instruments to offset exposure to price risk through financial markets or other institutions. The relevant derivatives contracts are usually traded on international commodity exchanges in major financial centres (e.g. London and New York). Technically, these mechanisms permit producers, or Governments of producing countries, to limit the risks arising from unanticipated price movements by passing them on to investors (speculators).

26. However, the use of these market-based instruments is not widespread in low-income developing countries because of the sophistication, size and cost in using them. Accordingly, interest is now focusing on the establishment of commodity exchanges in developing countries that can offer hedging opportunities adapted to the needs of domestic producers and traders. However, not all developing countries – especially low-income commodity-dependent countries – have the necessary critical mass of professional traders/exporters and large commodity producers required to operate an exchange with viable and effective hedging possibilities. In any case, while futures markets may help to address problems related to price variability, they can not address the issue of long-term declines in commodity prices and negative terms of trade trends for commodity-dependent countries.

27. Over the past decade, there has been political interest from developing countries – e.g. as expressed at the African Union Conference of Trade ministers in 2005 – for the use of some of these mechanisms, such as commodity exchanges. A limited number of developing countries have institutional sophistication, market and professional characteristics required to operate viable commodity exchanges. Malaysia and Brazil have succeeded in establishing commodity exchanges through private sector initiatives, capitalizing on the size of their domestic market, or their market share in a commodity in which they have a leadership role, and with some government regulatory oversight.

28. A few low-income commodity-dependent African countries have also established (or are contemplating establishing) commodity exchanges. For example, the Ethiopia Commodity Exchange started trading operations in coffee in April 2008. It has since launched trading operations with contracts for other commodities such as maize, wheat, processed and unprocessed haricot beans and sesame.

#### **E. Budgetary management measures**

29. Some Governments have implemented budgetary management measures to smooth government expenditure over time via stabilization funds and investment rules, as part of overall national revenue management processes. Malaysia, for example, used resources from its successful energy sector to set up several sovereign wealth funds controlled by the Government through the Ministry of Finance.

30. The key to Botswana's success is a resource-based development strategy, within the framework of which the private sector and the Government have clearly defined roles, with the Government being a shareholder and a regulator. In its position as a regulator, the Government ensured a careful investment of mineral revenues in productive sectors and long-term development programmes, such as modernizing agriculture and developing human capital.

31. Issues for discussion include:

- (a) Should it be the role of the State to provide core public goods and an enabling environment in which all stakeholders (public and private) could function optimally?
- (b) What type of environment facilitates improvements in productivity?
- (c) How can the State improve the marketing and distribution systems?

### III. Regional level policies

32. While there have been many initiatives at the national and international levels to address the commodity problematique, there have been very few commodity-specific policies at the regional level. This is surprising, because the trend towards the proliferation of regional trade agreements (RTAs), which began just before the conclusion of the Uruguay Round of trade negotiations (amidst doubts about multilateralism), had barely subsided. However, the coverage of agricultural commodities in these RTAs is not usually as comprehensive as the coverage of industrial goods. This may be due to the traditionally protected status of agriculture, which was outside the purview of multilateral trade disciplines until the launch of the Uruguay Round. Thus, although there is some evidence that preferential trade arrangements, with some exceptions, tend to expand agricultural trade and improve agricultural income, until recently few RTAs have had comprehensive trade rules covering the sector.

33. Even where agricultural products are accorded preferential treatment in RTAs, this is limited and subject to the exclusion of some products considered sensitive. In the first stage of liberalization in the Association of South-East Asian Nations (ASEAN) Free Trade Area, for example, all unprocessed agricultural products were excluded from tariff liberalization. The trade liberalization in the Southern Common Market of Latin America (Mercosur) also excluded many products of "sensitive industries", including some agricultural products. Despite the long history of RTAs in Africa, it is generally accepted that RTAs have been ineffective in promoting trade and foreign direct investment (FDI) because of a variety of reasons. These include relatively high external trade barriers, low resource complementarity between member countries, small market size, poor transport facilities and high trading costs. Very often, overlapping memberships, which result in competing and sometimes conflicting programmes of liberalization, have meant that such programmes are not fully implemented.

34. To date, the China-ASEAN FTA's Early Harvest Programme (2004-2006) constitutes one of the most successful examples of successful trade liberalization in the agricultural sector within the context of RTAs. This agreement covers over 500 products, including 188 vegetables and fruits from Thailand and China, which have enjoyed zero tariffs since October 2003.

35. In Africa, despite this lack of attention by RTAs to commodity trade, there are a number of technical regional organizations whose role is to foster regional cooperation for the sustainable management and exploitation of resources – such as water basins and forests – including safeguarding the ecosystems. There has not been systematic coordination of policies between RTAs and these technical regional organizations with a

bearing on natural resources management for agricultural production and natural resources exploitation.

36. Issue for discussion include:

- (a) What accounts for the competitiveness of agricultural trade in RTAs in other regions, including the developed world?
- (b) What are some of the constraints and obstacles to developing regional policies to promote efficient and competitive agriculture in commodity-dependent developing countries?

## **IV. International policies**

### **A. Stabilization efforts**

37. The search for solutions to commodity problems at the international level was first given serious consideration in the post-World War II period, in the negotiations leading to the 1948 agreement on the Havana Charter (not ratified by member States). In the 1950s, consideration of commodity issues shifted to the Economic and Social Council of the United Nations. The continued downward trend in the terms of trade for commodity-exporting countries, combined with instability in commodity prices and revenues, led to the commodity issue being placed high on the agenda of the first UNCTAD conference in 1964. After that, attempts to develop a viable international commodity policy were carried out within the framework of UNCTAD, leading to the adoption in 1976 of an Integrated Programme for Commodities (IPC) at UNCTAD IV in Nairobi. The idea was to negotiate commodity agreements that would – through their own resources, as well as resources borrowed from a common financing facility to be established for this purpose – be able to finance buffer stocks to reduce price fluctuations and stabilize prices at levels remunerative to producers. However, despite intensive negotiations spanning several years, the only new commodity agreement that was negotiated within the context of the IPC in UNCTAD was the International Rubber Agreement. The agreement establishing the Common Fund for Commodities (CFC) was adopted in 1981 – but entered into force only in 1989.

38. With the advent of a global recession in the 1980s, some existing commodity agreements (such as that for sugar) were discontinued under the pressure of depressed prices, while economic clauses in agreements such as those for coffee and cocoa were removed. With the ascendancy of market-oriented strategies in the 1980s, intervention in markets was no longer deemed acceptable. Instead, the free play of market forces via price liberalization and deregulation was held up as promising the most efficient allocation of resources and welfare gains for developing countries suffering balance of payments difficulties and debt overhang in the 1980s.

### **B. Compensatory financing mechanisms**

39. Compensatory financing facilities, first introduced in the International Monetary Fund (IMF), have also been used in efforts to buffer (at the macro and micro levels) commodity-exporting developing countries and producers against the worst effects of commodity price and income volatility. The best known are (a) the Contingency and Compensatory Financing Facility of the IMF (1988), preceded by the Compensatory Financing Facility, which commenced in 1963; and (b) the various EU–African, Caribbean and Pacific Group of States schemes under successive Lomé Conventions and the Cotonou Agreement. Although these instruments have had significant resources, they have suffered from problems associated with their design and operation. This affects eligibility and the number of countries having access, the proportion of export shortfall compensated and the speed of disbursement which have limited their intended countercyclical effects.

## C. The World Trade Organization and the Doha Work Programme

40. Agriculture is one of five new areas of trade on which negotiations were held during the Uruguay Round (the eighth round of trade negotiations of the General Agreement on Tariffs and Trade). While these negotiations resulted in the World Trade Organization (WTO) Agreement on Agriculture, further negotiations were planned to be held at WTO within the framework of the built-in agenda in order to fully integrate agriculture into multilateral trade disciplines. The full liberalization of agricultural trade is expected to increase the benefits derived from it by commodity producers.

### Doha Work Programme

41. The Doha Work Programme (DWP) has the long-term objective of establishing a fair and market-oriented trading system, including correcting and preventing restrictions and distortions in world agricultural markets. The comprehensive negotiations envisaged within the framework of this work programme aim at, inter alia, “substantial improvements in market access; reductions of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support”. No doubt some progress was made in the agricultural negotiations with the three concrete decisions taken on agriculture during the Hong Kong (China) WTO Ministerial Meeting in 2005. However, some observers have pointed out that these amount to no more than marginal gains for developing countries, particularly because the ministerial declaration does not call the elimination of domestic subsidies in major developed countries.

42. Negotiations that have been ongoing since the 2005 ministerial meeting appeared to be making some progress towards meeting several demands of commodity-dependent developing country WTO members. In the revised draft modalities published recently,<sup>4</sup> a series of measures has been proposed to (a) address tariff escalation (higher tariffs on processed products); (b) eliminate non-tariff measures that affect trade in commodities; and (c) clarify the conditions under which members could take joint action, including through intergovernmental commodity agreements. This is reflected particularly in paragraphs 91, 93 and 95 of the revised draft modalities.

43. These draft revised provisions also include (a) the provision of technical assistance for, inter alia, the improvement of world markets for commodities, and adoption and implementation of intergovernmental commodity agreements; and (b) the monitoring of the financial resources required by international trade and other organizations for providing technical assistance in accordance with the relevant provisions through the mechanism established by WTO for administering Aid for Trade.

44. Issues for discussion include:

- (a) How can one address effectively the issues that negatively affect the competitiveness of developing country agriculture, such as export and domestic subsidies of developed countries, “unfair” or non-transparent use of standards (health, safety and technical), tariffs – including peak tariffs and tariff escalation – and non-tariff measures?
- (b) Are competition rules necessary to promote the entry of domestic investors into global value chains and enhance their participation in the higher levels of the value chain?

<sup>4</sup> WTO (2008). Revised draft modalities for agriculture, Committee on Agriculture. Special Session, 6 December. Geneva.

## **V. Transparency and accountability in managing natural resource revenues**

### **A. Definition and context**

45. The exploitation of natural resources can generate large revenue streams, which could be used to foster growth and reduce poverty. At the same time, the magnitude of resource revenue flows to host Governments, their sudden accrual, as well as their negotiated nature, present risks for corruption or mismanagement. Against this background, the rationale behind the flurry of recent transparency initiatives is that increased knowledge of how much revenues Government gets from extractive industries will empower citizens to hold Governments accountable for the management of these revenues for national development. Such empowerment of citizens is essential for the monitoring of the management of (non-renewable) resources and its impact on local communities in producing areas. Improved transparency also helps Governments to identify and remedy lapses in corporate payments to the Government and to negotiate more mutually satisfactory, transparent and equitable contractual terms for the exploitation of their natural resources.

46. Transparency issues in business arise in relation to the transfer of technology, restrictive business practices and transactions between related parties, commonly referred to as “transfer pricing”. Transfer pricing is considered a critical issue as it may lead to income being diverted from tax authorities by corporations. This poses a serious problem in mineral-dependent developing countries where TNCs are predominant and local partners may not have the capacity, or resources, to identify the profit-shifting effect of transfer pricing manipulations. At the meso level, transparency and accountability issues arise particularly with regard to information asymmetry and opaque price discovery mechanisms, as well as a lack of transparency and accountability in standard-setting processes. At a very general level, transparency applies to multilateral trading and financial systems.

47. These issues became critical with deregulation of the mining sector, which also started in the 1980s, in the context of SAPs. The emphases of these reforms were on the commercialization and privatization of State-owned mining enterprises, capacity-building, private sector development, and attraction of FDI. The main rationale underlying mining reforms was to shift Government objectives in the mining sector towards generating tax revenues. The main decision criteria were to attain a stable legal and fiscal framework, which included a mining code, contractual stability, a guaranteed fiscal regime, profit repatriation and access to foreign exchange. In return, Governments were expected to receive a “fair” slice of increased rents generated in the sector. However, the reforms have raised some concerns, as in some cases they have led to the development of enclave economies, with little technological, employment or other spillovers, and contractual agreements that allegedly handed over excessive mineral rents to TNCs to the detriment of host countries. They have also been criticized for the lack of value addition and for environmental degradation.

### **B. Examination of success stories and consideration of ways forward**

48. A number of new initiatives and standards of transparency and accountability in the commodity sector have led to the strengthening of revenue and resource management in developing countries. These apply at the national, regional and international levels, although a clear distinction between the different levels is hard to make, as domestic measures may apply extraterritorially, with a virtually global impact. Some international initiatives take an in-country approach and translate into best practices at the domestic level. Besides, some of the most prominent international initiatives involve corporations

directly, along with States and civil society organizations, moving beyond the traditional international (i.e. intergovernmental) system.

49. The initiatives reviewed in this section raise some major challenges. First, transparency, like accountability, is no longer a local matter but a transnational phenomenon that requires concerted and coherent actions of all the stakeholders, at all levels, and across jurisdictions (host and home countries). In the regulation of business, in particular, there is a perceivable misalignment between the territorial capacity of host Governments and the transnational dimension of corporate conglomerates. Second, meaningful engagement by all key stakeholders is critical to translate the efforts addressing transparency and accountability into systemic interventions. A third issue is the rule of engagement of actors from emerging economies, which are fast becoming important operators globally in the commodity sector. Global industry associations (e.g. the International Council on Mining and Metals) may play an important role in levelling the playing field and overcoming collective action problems. Multilateral discussions at the governmental level remain critical in shaping a common conceptual and policy framework within which action could be taken.

## C. Domestic measures

### 1. Host State practices: reliance on domestic political processes vs. country-specific implementation of international initiatives

50. A range of countries (including Botswana, Malaysia and Chile) with high standards of governance in the extractive sector have built on domestic political processes to manage, relatively successfully, large, volatile and exhaustible revenue flows. In Botswana, for example – where diamonds account for about a third of GDP, three fourths of exports and over half of government revenues – tax legislation has been simple and transparent. Significant shares of mining revenues were saved over many years to sterilize their liquidity impact. The country's revenue management strategy is more centred on effective medium- and long-term priorities, coupled with strong institutional arrangements, rather than on transparency alone.

51. Other countries have endorsed a broadly consistent approach to transparency, but with some notable variations that reflect sector- and country-specific circumstances and sensitivities. Nigeria is one of the first signatories to the Extractive Industry Transparency Initiative (EITI)<sup>5</sup> and the first to give statutory backing to its implementation (so as to partially insulate the process from domestic political pressures). Through an international competitive tender, Nigeria commissioned an external, independent audit of the financial flows between the federation and the oil and gas companies for the years 1999–2004. Audited results have been made publicly available through the Nigerian EITI website in a disaggregated form. The audits identified several weaknesses related to the oil and gas sector governance, and a remedial action plan was put in place.

52. In Azerbaijan, revenue disclosure has been institutionalized with corporate payments to the Government and government revenues from the extractive industry being independently audited, reconciled and made public on an aggregated basis. A few Governments are moving in the direction of disclosure of mining development agreements and, in the case of the oil and gas industries, production sharing agreements. In Timor-Leste, bids received and final contract awards are disclosed publicly through the website. Overall, the Government has adopted a legal framework for petroleum production, taxation and revenue management that is considered international best practice. These three approaches to disclosure (disaggregated disclosure, aggregated disclosure and contract transparency) are among a wide range of initiatives that implement the EITI standard at the

<sup>5</sup> EITI is a country-led and owned initiative supported at the international level by Group of Eight (G8) Governments, IFIs, business (extractive companies and institutional investors with exposure to the sector) and civil society.

country level and foster transparency in a traditionally secretive sector (the extractive one). Major drawbacks in some cases include a technically complex and costly implementation process.

## **2. Home country measures: capturing the transnational dimension of transparency and accountability**

53. In some circumstances, host States may lack the institutional capacity to enforce laws and regulations (including disclosure requirements) against TNCs operating in their territory, or they may feel constrained from doing so by having to compete internationally for investment. One alternative is for the home country to impose and monitor more stringent requirements on internationally-operating companies domiciled in its jurisdiction. Also, stock market listing requirements have attracted particular attention as a mechanism through which home States (here intended as the countries where companies are raising capital) can fold revenue transparency into standard global practice. However, securities law disclosure obligations (which supersede confidentiality clauses in home countries) provide an effective policy tool only in commodity sectors where many major players are publicly listed (e.g. oil).<sup>6</sup> In these sectors, it is permitted to extend the reach of disclosure requirements, including disclosure of payments to foreign Governments, to issuers from countries that do not have similar requirements. Linking access to project finance with resource revenue transparency (i.e. by requiring financiers, risk insurers and export guarantors to only engage with companies that disclose payments) is another approach to transparency and accountability that has attracted some interest. These unilateral moves denote good practices, to the extent that they build on a common conceptual and policy agenda framed at the multilateral level so as to accommodate concerns regarding sovereignty, laws and contracts.

54. Corruption/money laundering is perhaps one of the areas where concerted action by host and home countries is most needed, given the transnational dimension of the phenomenon. Specific legislative actions have been taken in home State jurisdictions to curb the supply side of international corruption. For instance, under the United States' Foreign Corrupt Practices Act (FCPA), a United States company engaged in corruption abroad is held liable for its action under United States law. Legislation similar to the FCPA has been enacted in OECD countries that are parties to the OECD Convention on Combating Bribery of Foreign Public Officials. It is widely felt that these anti-bribery laws need tightening, to cover the wide array of sophisticated bribery schemes that occur in practice (including, under certain circumstances, business deals between foreign investors and family members or business associates of ruling elites). Another practical mechanism to curb corruption is to deny entry ("safe haven") to public officials guilty of corruption, their dependants who benefit from corruption, and those who try to corrupt officials, and to identify, trace, freeze or seize – and ultimately confiscate – assets that are proceeds of corruption. However, important complementary actions need to be taken in strengthening surveillance of offshore financial centres.

## **D. Regional frameworks: framing commitment to transparency across developing regions**

55. A number of regional initiatives in the developing world demonstrate political commitment to promoting transparency and good governance. In Africa, major initiatives include the Africa Peer Review Mechanism (APRM) of the New Partnership for Africa's Development (NEPAD). APRM is a mutually agreed instrument voluntarily acceded to by the member States of the African Union as a self-monitoring mechanism. Its mandate is to encourage conformity with regard to political, economic and corporate governance values,

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<sup>6</sup> This is not the case with other extractive industries (such as mining), or of many bulk agricultural commodities, where many major players (mining companies and, in agriculture, some large grinders/traders) are not listed.

codes and standards among African countries and the socio-economic development objectives within NEPAD. In the Asia–Pacific regions, important transparency and anti-corruption initiatives have been promoted by the Asian Development Bank (ADB) (e.g., the ADB/OECD Anti-Corruption Initiative for Asia and the Pacific) and the Asia–Pacific Economic Cooperation (APEC) (Government Procurement Experts’ Group and the Anti-Corruption and Transparency Task Force). In Latin America, the Inter-American Convention against Corruption, negotiated under the umbrella of the Organization of American States (OAS), is a leading example of regional action in the developing world. Political commitments to deny safe haven to corrupt officials and those who corrupt them have also been taken up by OAS and the APEC Forum.

## **E. International initiatives: a new multi-stakeholder form of soft law initiatives**

56. This section focuses on selected cases of a new multi-stakeholder form of soft law initiatives in the area of transparency and accountability in the commodity sector, comprising joint government, industry and civil society organizations. Most prominent among these are the Kimberley Process Certification Scheme (KPCS) and EITI. Some of these international initiatives stem from industry self-regulation and from the traditional standard-setting role performed by intergovernmental organizations, and include major initiatives in the area of corporate reporting and anti-corruption.

57. KPCS is a global certification scheme implemented through domestic law to certify that rough diamonds are from “conflict-free” areas. It essentially consists of a ring-fence mechanism (participating countries can only trade rough diamonds with co-participant countries in KPCS), detailed packaging protocols, certification by competent authorities, and chain-of-custody warranties by companies. In terms of participant compliance, KPCS carries out peer reviews of member States. It is generally acknowledged that the KPCS has reduced the flow of conflict diamonds and there may be some interest in extending similar certification schemes to other commodities prone to being the sources of conflict (e.g. timber and “coltan”).

58. EITI in-country implementation hinges on the establishment of two tiers of reporting in respect of benefit streams from extractive industries: disclosure of all material payments by extractive companies to Governments (“payments”) and of all material revenues received by Governments from extractive companies (“revenues”). Payments declared by the companies and revenues received by the Government are subject to international auditing standards. The audited EITI Report is then disseminated in a comprehensive manner to a wide audience. Despite its external orientation (in terms of endorsement of an international standard), EITI is locally driven and allows some room for flexible implementation. In particular, it is voluntarily endorsed by Governments, and key decisions lie with the implementing country. One additional feature of the EITI approach (as with Kimberley’s) is its hybrid nature, in the sense of some blurring of the distinction between strictly voluntary and mandatory initiatives. In particular, while EITI is a voluntary initiative for Governments, once a country endorses participation in the initiative, the process is mandatory for all extractive companies operating in that country, including State-owned enterprises. Also, although there is no external body to assess compliance, EITI recently established a validation process, overseen by the EITI Board, by which non-compliant members may have their status publicly reduced. There are important complementary approaches/initiatives to EITI, spearheaded by non-governmental organizations and IFIs, such as the “Publish What You Pay” (PWYP) campaign.

59. The ultimate strength of these multi-stakeholder initiatives lies in the credibility and effectiveness of the process, which in turn hinges on stringent reporting and auditing standards, and an external validation process with detailed templates and timescales. These

aspects make implementation technically complex and costly, and raise capacity constraints in several countries. Furthermore, multi-stakeholder initiatives establish accountability mechanisms within complex collaborative networks that enhance the participatory approach but may undermine local incentives to strengthen domestic (parliamentary) institutions.<sup>7</sup> A key issue is to establish a virtuous circle whereby multi-stakeholder dialogue feeds into and strengthens domestic political processes.

## VI. Concluding remarks

60. The need for “remunerative prices” for developing country primary commodity producers has been a recurring theme in policy dialogues regarding how to address the commodity problematique. This is because of the general observation that commodity price cycles are asymmetric, with boom cycles being relatively shorter than slump ones, as well as the secular decline in real commodity prices, until the recent price boom. Attempts during the 1960s and 1970s to address the issue with ICAs with economic clauses have had mixed results. Within the context of the neoliberal development agenda of the 1980s, new efforts at addressing this perennial problem have been biased towards market-based mechanisms. However, the recent food crisis at a time of turbulence in the financial markets, which has subsequently triggered a global economic crisis not seen since the last depression, has rekindled the debate on the best possible mechanisms to address this problem facing poor developing commodity-dependent countries. Is it realistic to revisit the ICAs in their original conception and devise a way of better implementation? Should the search for lasting solutions to the problem continue to be sought within the framework of market-based mechanisms, despite the flaws in the operation of markets exposed by the ongoing financial and economic crisis? Should more concerted efforts be made to devise a solution that combines the best features of ICAs and market-based mechanisms? Is it possible to have a permanent mechanism to tackle the tendency of relative commodity prices to fall in the long run? If not, how can a sustainable balance be attained between supply and demand growth for specific commodities?

61. On the related issue of the management of resource rents, there is a general consensus on the need for transparency and accountability by both host Governments and TNCs. Indeed, several developing countries have embraced various initiatives at the international and multi-stakeholder levels to address these twin problems at the country, regional and international levels. That several regional economic cooperation arrangements have responded to the problem with their own initiatives to complement the international ones is a demonstration of how serious they think the problem is and how urgently it should be tackled. However, the multinational dimension to these issues underscores the relevance of effective cooperation at all levels, and among all stakeholders. What should be the role of development partners (or home country Governments), civil society organizations and host country Governments in addressing this problem effectively?

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<sup>7</sup> See Jones S (2008). Sub-Saharan Africa and the “resource curse”: limitations of the conventional wisdom. working paper No. 2008/14. DIIS. Copenhagen: 34.



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Item 4 of the provisional agenda

**Integrating commodity policies into development and  
poverty reduction strategies: success stories,  
transparency and accountability**

Note by the UNCTAD secretariat

**Corrigendum**

The date of the meeting has been changed to 6–7 April 2009.

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