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REPORT ON THE FIRST MEETING

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1. Introduction

The Global Commodities Forum (GCF), held in Geneva 22–23 March 2010, was organized by UNCTAD and co-sponsored by the Common Fund for Commodities and the State Secretariat for Economic Affairs of the Swiss Federal Department of Economic Affairs. It was also supported by other stakeholders, including industry associations both in Geneva and internationally. It was attended by more than 500 participants, including ministers and other policymakers, commodity producers, traders, financiers, consultants, academics and other experts, many of whom spoke and gave presentations in both plenary and parallel sessions at the meeting.

Over a two-day period, the speakers, moderators and participants of GCF discussed the key perennial issues of the commodity economy, such as instability of commodity markets, problems of commodity policies, sustainability of commodity supply chains, access to commodity finance and logistics and some others. There were around 50 presentations, contributing to an important debate on commodity production, markets, trade, finance and other issues, including how to face challenges for further development of the global commodity economy.

2. Rationale for the Global Commodities Forum

Many developing countries depend on commodities for their economic well-being. As demand for commodities in the long term is going to increase, thus posing major challenges for their sustainable and efficient production, there is a very real need to consider how to make the commodities markets more stable and policies better designed, so that the benefits would be more equitably distributed between commodity producers and consumers. Thus, it is important that an appropriate economic return could be delivered to commodities producers, many of whom are in developing countries. There are a number of policy actions to consider. These could include, *inter alia,* the development of policies to ensure that countries producing commodities do not face the so-called "resource curse" and, of equal importance, measures could be taken to mitigate or reduce the adverse effects of price and commodities market volatility, which cause so much uncertainty and hardship to many of the most vulnerable people in developing countries.

There is a clear need to ensure that commodities markets are more effective in serving the interests of the real economy, and that financial market speculators do not, through excessive influx or unwinding of liquidity in commodity futures markets, disturb the performance of commodity producers, consumers and intermediaries. Markets should serve the interests of these stakeholders whose livelihoods are involved in commodities production, shipment, consumption, rather than being subject to manipulation directed at the single-minded purpose of providing a short-term financial return. Solutions must be found to ensure that the prevailing terms of trade between countries are balanced and that regulatory interventions are optimized, with a view to protect the most vulnerable stakeholders without providing an impediment to trade.

With all of the current problems facing the commodities economy in mind, UNCTAD has launched the Global Commodities Forum as an annual event to be held at the United Nations. The GCF will target problems and issues in a multi-stakeholder context, by convening a series of annual meetings to address the perennial issues afflicting the global commodities economy. Whilst many organizations and institutions are dealing with commodity issues and are trying to develop international production and trade in commodities, the GCF will provide an all-embracing approach to resolve issues of common global concern. The aim is to find recommendations for an appropriate market and regulatory policy mix to deal with a gamut of commodity-related problems, some of which are identified within this report.

Through the GCF, UNCTAD and its partners can play a key role in providing a neutral pathway, augmented by information resources, to help address the volatility of markets and overcome development difficulties, particularly in commodity-dependent developing countries (CDDCs).

3. Main issues covered at the first GCF

The issue of commodity price volatility resonated among ministers and other high-level speakers throughout the GCF plenary and parallel sessions. While commodity booms and busts continue to cause harm, the financialization of commodities markets – using various instruments such as commodity indices as a competing asset class – has added to the problems of the commodities sector worldwide, particularly in CDDCs. Where fundamental factors are traditionally assumed to be the primary driver of price discovery (and therefore price fluctuations), there has also been a belief that recent shocks to commodities markets have arisen from price spikes, caused partly by excessive speculation. As a result, the recent financial crisis has fuelled controversy concerning the effect of commodity speculation on volatility. As a consequence, the first GCF focused on market volatility during many of the discussions at plenary and parallel sessions.

While some see volatility as a result of the interplay of commodity market fundamentals, others believe that the growing tendency to consider commodities as yet another financial asset class has increased the role of a new breed of market speculators. These speculators, mainly from the investment banking community, who buy and sell commodity-based indices and other related instruments, are, it is said, at the root of the problem of higher traded volumes and through their position-taking strategies behind the related excessive price volatility. At the same time, the representatives of commodity exchanges stressed that commodities that are not traded in commodity exchanges had a tendency of showing even bigger volatility. Also, they expressed views that price fixing and subsidies make demand less elastic and contributes to price volatility. It is becoming increasingly clear that, whether caused by market fundamentals or such non-fundamental factors as excessive speculation, the excessive volatility is a major problem, not only for CDDCs but also for all participants in the commodity supply chain.

Excessive price volatility creates a climate of uncertainty and unpredictability for vulnerable producers, CDDCs, consumers in importing countries and, in particular, least developed countries. While prices for many commodities are still lower than their historical peaks in real terms, small-scale commodity producers in CDDCs only receive a small fraction of those prices, which does not permit them to maintain sustainable livelihoods.

The financial crisis has further exacerbated the plight of commodity producers and users, who find their access to credit drastically diminished as a result of the restrictions in financial liquidity arising from the crisis itself.

In addition, since the current accounts of many CDDCs are closely linked to commodity prices, medium- and long-term investments in commodity-related infrastructure and logistics in CDDCs that could help support the most vulnerable in those societies are suffering from the unpredictability of markets. Meanwhile, national budgets and related sovereign wealth funds are not always in a position to cushion falls in export revenues.

4. GCF Inaugural Plenary: setting the stage

At the GCF's Inaugural Plenary it was stressed that:

- Commodities remain essential for the development of more than 90 developing countries, which are dependent on commodities for more than 50 per cent of their export earnings;
- Developing countries' objective of stabilizing commodity markets, using buffer stocks for example, has still not been met;
- While commodity exchanges provide important price discovery and risk management tools, the recent crisis underlines the need for price stabilization mechanisms without excessive market intervention;
- The price boom that began in 2002 came to a halt in 2008, when commodity prices slumped. The global economic crisis that followed is bound to make it more difficult for CDDCs to achieve internationally agreed development goals, including the Millennium Development Goals (MDGs);
- While demand for minerals has started to pick up again, and the demand for oil in particular is projected to grow, access to finance remains challenging for CDDCs; and
- Long-standing issues, such as the need for good governance (for example, in the equitable distribution of rents), revenue management and the taming of corruption, must be addressed by CDDCs if their extractive industries are to become a real engine for development.

Other points raised at the inaugural session included demands to:

- Open up world markets for processed primary commodities from developing countries;
- Scale up successful projects and programmes for improved commodity processing and diversification of rural economies;
- Develop commodity policies that do not "trickle down" but "pour down" to the poor in CDDCs;
- Ensure economic, social and environmental sustainability and halt the effects of climate change on commodity production; and
- Foster human rights and human security.

The Inaugural Plenary of the GCF set the stage for the entire two-day meeting, and the outcome of discussions relating to energy markets, minerals and metals markets, sustainability, market volatility and parallel sessions is reflected in the following sections 5–11 below.

5. Energy markets

Energy market turbulence has been best illustrated by oil prices, which tripled to nearly $150 per barrel in July 2008, from about $50 per barrel in January 2007, falling back to less than

$40 six months later. Since then, the price of oil has more or less stabilized in the $65–$85 per barrel range.

Many GCF participants noted that market fundamentals have played a major role in oil price movements, and that speculation also profoundly affected the scale and speed of price changes. Since speculation is fuelled by uncertainty, it was pointed out that a lack of transparent and full data on the real extent of global supply and demand balances, as well as the level of country inventories, have exaggerated price movements. In other words, "price discovery" was taking place on the basis of incomplete information. Participants observed that, during the recent market cycle, there were more opportunities for short-term speculation because of increased volatility. However, it was noted that there is a need for speculators to provide liquidity and price discovery, thereby offering an opportunity to hedge risks, but that it must be possible somehow to distinguish between "good" and "bad" speculation. It was suggested that the use of reliable good data and measures to ensure market transparency are very effective tools in providing early-warning mechanisms for commodities markets. A recent initiative by the United States Commodities Futures Trading Commission (CFTC) to single out and measure price movement in physical and financial markets was welcomed.[1]

Some participants expressed the view that, in order to achieve relative stability in oil markets, excessive speculation should be eliminated and that prices should be contained within an acceptable range for both producers and consumers. It was suggested that measures to manage mutually agreed stock balances and complementary financial techniques should be discussed among all stakeholders.

Inventory levels have a profound effect on market prices. Participants pointed out that the release of inventory data is, in itself, "market-moving". It was noted that, while market inventories were at comfortable levels, a sudden drop in market supply from a major producer would pose a challenge to price stability.

Participants discussed subsidies in relation to the price elasticity of supply and demand. They said that steps need to be taken to make both supply and demand more price-elastic. On the demand side, this could be achieved by reducing subsidies, since subsidies insulate consumers from price fluctuations. Energy and material conservation measures could also contribute to price elasticity of demand in the medium-to-long term. Better forecasting and early warning systems could also contribute to better investment decisions and more elastic supply.

The situation is different in emerging economies and many CDDCs, participants noted. When growth in international demand comes from these countries and when domestic prices in these same countries have no direct link to international oil prices, speculators are able to push prices considerably above or below the required supply-demand levels because of the level of domestic subsidies that have to be overcome. It was suggested that prices in emerging countries should be more closely linked to international prices if price stability is to be achieved.

The sustainability of China's growth at the current pace, and structural shifts in the energy sector, were seen as a source of uncertainty. These structural shifts are driven by environmental concerns and related policy changes in high-income countries with a view to developing carbon-free sources of energy and pursuing "decarbonization" of existing sources

[1] The CFTC implemented a new transparency initiative on 4 September 2009 when, for the first time, it began disaggregating its weekly "Commitments of Traders" reports and releasing index investment data collected from an ongoing special call on swap dealers and index traders in the futures markets.

and “the greening of energy”. This is being done through the legal and policy framework, including subsidies to encourage the use of alternative energy sources.

Participants recommended considering the risks associated with the supply of crude oil from the standpoint of both oil importers and oil exporters. Oil importers are primarily concerned with security of supply and an inadequate increase in supply, as shown in the International Energy Agency’s minimum forecasts scenario for 2008–2014. In the meantime, oil exporters are concerned with the risks of global oversupply of oil and gas due to the high probability of major oil output increases in countries such as Iraq, Brazil, Canada and the Bolivarian Republic of Venezuela.

The discovery of major reserves of shale gas in the United States, and the diminishing role of the latter as a major gas importer have introduced changes in the geography in liquefied natural gas (LNG) trade flows, especially from Qatar and Algeria. That in its turn is putting pressure on existing trade practices and namely long-term contracts on gas supplied by the Russian Federation and is increasing the share of spot and futures market trade in gas in Europe.

In view of the enormous uncertainties facing the energy sector, participants emphasized the importance of coordinated efforts and ongoing dialogue. Some argued that a realistic oil price is necessary for stable oil markets and for ensuring continued investment in the energy sector. Reference was made to the call by the 6th Ministerial Meeting of the European Union–Organization of the Petroleum Exporting Countries (OPEC) Energy Dialogue for an urgent and global response to the challenges posed by financial markets to the stability of the oil markets. Key issues to be considered by any global energy dialogue could include how the security of energy demand and supply can be linked to future environmental policies and the development of alternative energies. There was reference to progress by OPEC countries in improving the environmental credentials of oil. These include progress in carbon capture and storage technology that has helped reduce the rise of CO^2 emissions. Some specific projects were pinpointed, including a South American mechanism for preventing greenhouse gas emissions by keeping fossil fuel reserves unexploited in areas of high environmental fragility and cultural value.

Participants also noted that the final outcome of the Doha Round of trade negotiations is an important factor which will affect the future of the energy sector.

6. Minerals and metals markets

The price boom in the minerals and metals markets that began in the middle of the decade reached its peak in early 2008, a trend that resulted in increasing investment in mining. Record profits of mining companies encouraged them to engage in new capital-intensive projects. But by early 2009 prices had fallen considerably and production cuts ensued. In consequence, some mines were closed and some projects were stalled already in the second half of 2008, with a concomitant effect on productive capacity. Since mid-2009, a gradual recovery has taken place, and global growth forecasts through next year suggest this trend will continue. Participants noted that, since economic growth forecasts for emerging economies are quite optimistic, the prospects for metals price growth should also be positive.

There has been a shift in non-ferrous metals production from North America and Europe to Asia, Latin America and to some extent Africa, experts said. Notwithstanding this, production enhancements may be countered by a reduction in budgets for exploration and may, therefore, affect medium-term production prospects.

Among the challenges for the metals industry that participants highlighted were:

- Possible trade restrictions, such as new carbon border tariffs and "carbon levies", which may result in World Trade Organization action;

- Challenges presented by the three strands of sustainable development (economic, environmental and social);

- Possible changes in investment flows and relocation of operations in response to changing costs. To meet these challenges, the metals industry and world mineral community at large need to ensure the supply of a wide range of materials to meet evolving demand, and while remaining profitable, respond to changing demand flexibly;

- The need to develop and implement new technologies to maintain competitiveness, enhance environmental performance and reduce energy intensity; and

- The need to ensure transparency and efficiency in the markets for raw materials, metals and products.

Participants commented that three major producers dominate the iron ore market, while around 40 per cent of iron ore production is fragmented among smaller-scale producers. And since steel production is actually becoming more concentrated, the large-scale producers are becoming stronger in price negotiations. One producer based in India alone produces 65 per cent of all consumed iron ore, and the same process of consolidation is expected in China, although it may take time.

At present, prices for iron ore are fixed annually, but it was suggested that the market may adopt a mechanism similar to that used in non-ferrous metals markets (for example, copper, lead and zinc). This process may also take some time. Prices are currently negotiated between trading parties, influenced by majors, and are not determined on a commodity exchange or by a similar central price-determining arrangement. An international trading floor for iron ore and steel, similar to the New York and London metal exchanges, could be established in a producing country, experts said. Discussions then ensued as to whether price determination for iron ore and non-ferrous metals should be defined by long-term contracts or by commodities exchanges. No precise shared conclusion on this issue was reached.

Regarding the prospects for least developed countries, according to a study by the International Council on Mining and Metals, around half of 33 countries specializing in mining did not perform well and were experiencing difficulties associated with the "resource curse".[2] At the same time, in recent years Chile had become South America's most successful economy, relying significantly on mining. One of the world's 20 poorest countries two decades earlier, Botswana had grown quickly in part because of the production of diamonds and had become one of Africa's high-income economies. Experts urged examination of the critical success factors that have enabled some countries to benefit from substantial resource endowments and avoid the "resource curse". Countries need to consider seriously following

[2] Resource curse is a concept of weaker growth performance of resource-rich countries compared to resource-poor countries. It is partly related to so-called Dutch Disease, e.g. currency appreciation due to increase in export revenues from primary commodities, then translated into higher domestic prices and adversely affecting diversification and export-led growth of the rest of the economy. Fluctuations in terms of trade in commodities, bad governance, corruption and some other factors are also a part of resource curse story.

the practical steps that might be taken by the industry, governments, local communities and aid agencies to enhance these success factors.

It was recognized that the Natural Resource Charter could provide a useful tool to mainstream best practices along the whole value chain. Although the Charter was directed primarily at policymakers in resource-rich countries, it also catered for extractive companies and their home governments.

7. Socio-economic aspects of sustainability

It was suggested that sustainable development can be placed at the centre of development policies and business strategies. Furthermore, transnational corporations (TNCs) can create a sustainability framework which operates globally and according to one set of rules. A representative of a major TNC indicated that the paradox which exists is that natural resource-rich countries tend to score low living standards despite their wealth, and that is a concern, which is shared by global mining companies. Accordingly, corporate strategy needs to address not just business and investment challenges within resource-rich countries but it also needs to carefully examine issues pertaining to socio-economic factors, the wider economy and politics. Companies must plan how to maximize the effectiveness of programmes for social well-being, via public goods and services provision, local procurement and employment. Economic benefits can be captured by host countries not only through reinvestment of taxation revenues at national and local levels but also through the positive spillover effects of foreign companies activities on local business linkages and employment.

Examples were provided to illustrate the magnitude of such economy-wide effects (India and South Africa) and a case of public–private partnership for a comprehensive regional development involving the company, the national government and a multilateral financial institution (Madagascar). Such programmes are planned so as to take into account broader infrastructure needs such as ports and roads and they have a potential of contributing to trade facilitation benefiting the international trade of other industries.

The perspective from a government was presented by a high-level speaker who presented a South American case study, which highlighted the way a country can plan upstream resource development. The case illustrated ways of harnessing oil resources while pursuing an equitable national development plan. It showed how coordination by a host country government could mitigate risks and manage rewards, while taking into account the prevailing social and economic reality.

The case study, together with related examples, envisaged the following:

- A framework of trust between foreign companies and the government, enshrined in a new constitution and a stable legal system;

- A model, which includes cooperation between foreign companies and local counterparts;

- The use of different models, such as State ownership with shared production agreements, complemented by outsourcing agreements and *ex-post* compensation modalities;

- Involvement of national companies in downstream stages of refining and marketing;

- Planning the rate of resource recovery and discussing the right formula to reach a targeted recovery rate, working to reach a consensus which relates to the economics of use of resource deposits;
- Enabling corporate social responsibility delivery from the foreign company but ensuring this does not “crowd-out” State/national provision;
- A need to transfer technologies and know-how to local enterprises;
- A need to evaluate ownership of investing companies to provide for government to retain shares of investing companies; and
- The requirement to identify and discuss profitability in the context of the country’s long-term growth plan.

Discussions highlighted the importance of a true partnership to insure transparency and adequate management of revenues by both companies and governments. It was noted that investing companies are always open to downstream opportunities to exploit infrastructure externalities that may come with plant investments (water, electricity, etc.). On the other hand, countries need to create policies which work both in terms of a national development strategy and which will also enable them to compete for investors who require a financial return and a conducive and predictable regulatory and legal environment.

8. Market volatility

At the same time, the financial crisis hit resource-rich countries stronger than other groups of countries. Thus, a research by the Revenue Watch Institute, which involved detailed assessments of economic data from more than 80 countries, revealed that gross domestic product (GDP) volatility during financial crisis had been more extreme in resource-rich countries than in other countries. Taken as a group, GDP weighted average growth rates for resource-rich countries plunged by 7 percentage points from 2008 to 2009, (from about 5 per cent growth to 2 per cent fall) in comparison with around 4 per cent negative growth for developing countries, a small deviation from 7 per cent growth to 5 per cent growth for emerging economies.

As far as price volatility is concerned, the GCF panellists and other participants pointed out that they were driven in part by speculative euphoria. New types of speculators, including so-called “noise traders”, were believed to be major contributors to the financialization of commodity markets. These traders base investment decisions on volatility/momentum models, chart-based analysis, financial return (yield parameters) versus other financial assets, arbitrage opportunities and commodities as a portfolio diversification instrument. Speculation also includes arbitragers (playing on differences between various exchanges) and “carry-traders”, who are financial investors buying physical commodities in storage facilities with a view to profiting from price increases in the commodity over time, which often may exceed the cost of storing and money invested in that activity. Carry-trade activities are commonly conducted by global investment banks. As a result of the involvement of the new breed of speculators, there was a massive flow of money into – and out of – commodities on a regular, short-term, basis.

Participants noted a variety of additional causes of price volatility, including the following:

(a) A decade of synchronized economic growth caused strong demand, fuelled by the emergence of new and powerful Asian economies;

(b) Fundamentals, reflecting inelastic nature and hence lagged in time shifts of supply and demand;

(c) Information asymmetry and lack of transparency;

(d) Geopolitical events;

(e) Demand for light crude oil being in short supply for refineries;

(f) Reaction to the United States dollar exchange rate fluctuations;

(g) Wider use of futures markets for risk hedging and the expansion of derivatives;

(h) Technological revolution and innovation;

(i) Low efficiency in using resources at a time when there is a need for more resources; and

(j) Oligopoly in certain markets.

During discussions concerning market risk and volatility, representatives from both traditional and new commodity exchanges defended the role of organized markets in promoting price transparency and discovery, and in the provision of risk mitigation instruments. As far as regulation is concerned, it was felt that regulation should exist to facilitate markets and eliminate fraudulent activities, but not to fix prices. Examples were given by presenters as to how supply and demand levels would have been negatively affected had prices been fixed. Moreover, evidence was provided showing that non-exchange-traded commodities markets are just as prone to volatility as markets served on exchanges.

Representatives of commodity exchanges stressed that markets are transparent, and that they are already heavily regulated. They insisted that the drivers for price will always be supply and demand, and market fundamentals cannot be ignored. It was suggested in response to a question from the floor that speculators who ignore market fundamentals “will be crushed in the end”.

A brief survey of the views of GCF plenary sessions’ participants on the role of commodity exchanges showed that the majority of them believed that exchanges are an effective way to facilitate price discovery, implying also indicating whether markets are under stress to match supply with demand. This seemed to be supported by vote among delegates at the GCF in support of the development of exchanges and related activities within CDDCs.

At the same time, during the GCF, a growing consensus emerged that better regulation of the markets was needed to avoid the escalation of prices which do not necessarily reflect market fundamentals. It was recommended to regulators and policymakers to strike a balance in framing new international norms. Many participants agreed that controls on the futures market activities may be required to prevent repetition of the 2008 bubble. In this light, regulation should be working in favour of market development and regulation of commodity derivatives as part of the reform, and experiences in managing volatility should be widely shared. At the same time, it was emphasized that market interventions should not impair liquidity and that there is a need to increase access to commodity market information as well as market transparency.

A number of measures were proposed to control excessive volatility, including stabilization funds, multi-tier tax schemes working on agents' expectations, long-term contracts (but such contracts were identified to have inherent difficulties in pricing). It was emphasized that International Commodity Agreements should not be excluded in tackling the problem of volatility. Other proposals include international organizations such as UNCTAD to play more active role in the search for better commodity price discovery mechanisms.

9. Parallel sessions

The parallel sessions at the GCF focused on the following:

- How has access to commodity finance been affected by the global financial crisis and what lessons have been learned?
- How can banks adapt themselves to new risk capital requirements and which alternative techniques can a trader use to secure both short-term and long-term credits?
- What are the latest legal and regulatory issues in commodity trade finance? How is Basel II affecting the commodity finance marketplace?
- How are new techniques in supply chain financing and logistical tools supporting trade and finance in commodities?
- Which risk mitigation techniques can be best deployed to the advantage of developing countries producers and exporters of commodities?
- How can we deal with price risk management and the speculative activities of new categories of speculators?

It was noted by participants that the effect of "credit crunch" (a sudden and dramatic reduction in global financial liquidity deterioration of banks balance sheets and a concomitant reduction in credit) arising from the financial crisis meant that banks experienced a sharp increase in the cost of capital and were forced to become more selective in their business decisions. Moreover, even after receiving liquidity from public sources, banks continued to be reluctant creditors and were initially using liquidity to address their own balance sheet problems. At the same time, it was noted that the regulatory environment, which added pressure for the increase of banks' capital ratio, led to deleverage of banks' balance sheets and the sale of their assets. While less capital is now allocated to commodity finance, the banking system found its equilibrium due to the contraction of business size resulting from the sharp decrease of commodity prices.

Participants noted new trends in commodity financing, including, for example, a shift from uncommitted financing lines to committed ones and from balance-sheet lending to transaction-based finance. It was pointed out that one important lesson from the crisis has been that traders (borrowers) need to diversify sources of financing, by examining options for committed financing lines, revolving credit facilities, diversifying financing to include different financial institutions and increasing creativity.

The recent crisis has changed the landscape for banking in emerging markets. While international banks are struggling with capital constraints, local banks in emerging markets are very active in providing commodity financing and are well positioned compared to international banks in domestic markets. Emerging banks (such as in Brazil and China) are providing substantial facilities for smaller traders. More efforts are needed from international banks to regain the emerging markets where they have a role to play along with emerging local banks.

A proposal to create a formal body to represent the interests of the commodity financing industry has been put forward by some financial institutions and gained support from the participants. The main objective of this body would be to lobby governments, regulators and relevant international organizations and institutions so that the special features of commodity financing could be better understood and effectively taken into account when designing future regulations.

On the regulatory front, there is a big concern regarding the impact on commodity financing of both Basel II and the future Basel III. The aim of Basel II was to create a level playing field by defining internationally coordinated regulatory capital requirements. It was emphasized that Basel II had had a significant impact on commodity finance. The revision and final implementation of Basel II would need to take into account representations concerning the negative impact of Basel II on trade finance. Those representations, as distilled from the observations of a substantial number of banks, essentially fell under four headings:

(a) The emphasis of Basel II on counterparty rather than product or performance risk, leading to the estimation of capital requirements as an increasing function of the probability of default and loss given default and to the attribution of insufficient importance to the mitigating factors lowering the risk of trade-finance instruments;

(b) The application of the one-year floor to the effective maturity of exposures in estimating the determination of capital requirements for credit risk;

(c) The minimum data requirements for estimating the probability of default and loss given default; and

(d) The status of the United States Export–Import Bank as manifested in the risk weight for claims on or guaranteed by the institution.

It was noted that the substance of these representations reflected more the way in which Basel II was being implemented and applied than the rules themselves. As regards the rules, several participants highlighted the lack of clarity in drafting Basel II, for example in relation to the significance of risk mitigation factors.

It was emphasized that Basel II was a "soft law", to be implemented by financial regulators who decided to follow it. It was pointed out that, in the European Union, Basel II would be implemented through directives, which require member States to achieve a particular target without dictating the means of achieving that result. This would add to complexity, since the agreement could be implemented differently across countries, depending on legal culture.

During sessions covering logistics and collateral, presentations were made which described in detail the interlinkages between finance and management of physical commodities within the supply chain. The importance of new supply-chain financing approaches and related supply-chain-related technologies were emphasized. Central to the development of this type of finance is that lending is based on the value of the commodity collateral for which funding is sought and that this collateral is under the control of the banks or their professional agents (collateral managers). However, it was noted that many banks only wish to lend to certain parts of the supply-chain. This is partly explained by the fact that there are often a multitude of different trade counterparties with different banking relationships along the supply chain itself, or that the supply chain is constantly evolving as commodities move from the point of supply to the point of demand.

A few banks were identified as providing adequate solutions in meeting customer needs – not only in providing financial management but also providing services in working capital management, as well as being a partner with the logistics companies. However, participants pointed out that, in the current risk climate, renewals of liquidity are currently being made on tougher terms, in the amounts, tenor and security, and this has placed more pressure on collateral managers. This has resulted in tighter collateral management and increased security from both the buyer and seller. Bankers are returning to the traditional letter of credit and open account transactions backed by bonds, or credit insurance policies.

Participants also highlighted the challenges in the provision of such aspects of logistics as legal issues, security and how the commodity is controlled, insurance issues, sophisticated monitoring and how the use of information technology is developing in the trade finance scheme. Other challenges identified are the verification of declared information, structure, assets, track record of clients and the ability to enforce insurance policies when local courts rule in favour of the collateral manager. There was also a potential risk of nullifying insurance policies if it does not respect local laws.

The role of information in the supply chain was emphasized by participants, particularly how information flow within supply chains can be enhanced and the challenges faced in maintaining flow between multiple parties. The replacement of paper documents with a Web-based technology was promoted as an efficient means of facilitating the flow of information through e-banking and e-payments and, in particular, e-trade finance-related digital documents. It was pointed out that this vision to eliminate all paperwork from trade requires goodwill from all parties in order to be successful.

Turning to export credit and the private insurance sector, it was noted that insurance companies have played a vital role in supporting banks through the financial crisis. According to the Berne Union (leading association for export credit and investment insurance worldwide), global imports of goods decreased by 24.9 per cent from 2008 to 2009. While private insurers reduced their short-term business, the government-backed export credit agencies (ECAs) have gone back to the market by increasing their support to exporters. The medium- and long-term new commitments which usually are supported by governments witnessed a rapid growth during the same period. Thus, commitments covered by Berne Union members rose by 23.6 per cent from 2008 to 2009.

It was recognized that, in general, the private insurance industry was more resilient during the crisis, contrary to the banking sector, in which many banks experienced restructuring or even bankruptcy. During the past 18 months, the insurance market has operated soundly. Underwriters have used their capacity to recycle the existing lines of credit or deal. Some also changed their price structure.

One of the national ECAs for a developed country presented its experience in coping with the current financial crisis. In order to help large national companies obtain working capital financing, cover the risks left by private insurance, meet the demand for medium- and long-term insurance in OECD countries and deal with delayed payments in some emerging markets, the ECA has raised its statute limit. It was expected that, with the improvement of the market situation, the demand for the risk coverage in OECD countries will decrease in late 2010. When expanding into new business, this ECA took measures to better control the risks, such as enhancing cooperation with banks, using external expertise to conduct part of risk management and eventually to monitor portfolio in the future.

10. Main outcomes

During the GCF, the following main issues were identified:

(a) The external accounts of many CDDCs, which are closely linked to commodity prices and to medium- and long-term investments in commodity-related infrastructure and logistics, are often adversely affected by negative terms-of-trade changes related to commodity market unpredictability;

(b) The financialization of commodities markets, for example by using their futures markets as a basis for developing yet another financial asset class, has added volatility to the other problems of the commodities sector. At the same time, some private sector participants, including representatives of commodity exchanges, stressed that commodities that were not traded in exchanges displayed higher levels of volatility;

(c) Access to finance at all stages in the commodity supply chain has been reduced as a result of the financial crisis;

(d) Due to adverse terms-of-trade changes, Dutch Disease and "resource curse" symptoms, many CDDCs endowed with mineral resources or fertile lands continue to be trapped in the paradigm of monocultural economies and related underdevelopment and massive poverty problems;

(e) As prices for many commodities did not reach their historical peak in real terms and in many cases continue to fall, so too does the ability of small-scale commodity producers in CDDCs to maintain sustainable livelihoods;

(f) With access to commodity finance becoming more complicated, the providers of commodity finance also had to face a tighter regulatory environment due to Basel II, and their interests were not adequately represented by, for example, an international association to ensure that the needs of commodity finance market participants are addressed and that this also benefits developing countries.

It was agreed that regulation is important for commodities markets and that, during the recent cycle of boom and bust, regulation was at best inadequate. To a measure, so did trading markets, to the extent that there was extreme market volatility.

The problem of price volatility

This was addressed by many speakers at the GCF and it is best illustrated by the example of oil with its huge price swings, especially in 2008. While market fundamentals have played a role in oil price movements, many believed that speculation has also profoundly affected the scale and speed of price changes.

It was noted that, since speculation is fuelled by uncertainty, the lack of transparent data on the real extent of global supply and demand balances, as well as the level of country inventories, exaggerated price movements. GCF presentations and discussions pointed to a strong correlation between oil and other commodity prices, as well as between oil and the dollar. It was suggested that volatility has increased as a result of speculation by financial investors and accordingly it must be possible to distinguish between “good” and “bad” speculation.

Good data and transparency were cited as ways to build early-warning mechanisms and to better assess probability of excess volatility. A recent initiative by the United States Commodities Futures Trading Commission (CFTC) to single out and measure price movements in physical and financial markets was discussed and welcomed by many experts and participants.

There was consensus that better regulation of the markets is needed. Participants agreed that controls on the futures market activities may be required to prevent repetition of the 2008 bubble. In this light, regulation should be working in favour of market development and regulation of commodity derivatives as part of the reform.

Investment

It was noted that the financial crisis, while causing market turbulence, has also affected investment. Record profits were posted by mining companies in 2008, but by early 2009 prices had fallen considerably and production cuts ensued. In consequence, some mines were closed and some projects postponed, with a concomitant effect on productive capacity. It was mentioned that part of these cuts was due to a restriction on the financing capability of international banks to finance projects.

Access to finance

It was commented upon that, while international banks have been struggling with capital constraints since the crisis, local banks in emerging markets have been very active in providing commodity financing and are well positioned compared to international banks in domestic markets. Banks in such emerging economies as Brazil and China are providing substantial facilities for smaller traders. Notwithstanding this, concerns mount regarding the impact on access to commodities arising from Basel II, the regulatory framework designed under the auspices of the Bank for International Settlements. As a result of the financial market crisis and the effects of Basel II, small and medium trading companies are calling for increased financial support. Unlike larger trading companies, smaller players are feeling more strongly the brunt of the financial and economic crisis, and face a significant credit contraction.

It was suggested that access to commodity finance, especially in CDDCs, had been impaired by a lack of voice for commodities in international regulatory and other initiatives, such as for example in the drafting and implementation of the Basel II rules. It was suggested that an international association might be formed to improve access to finance and to provide a lobbying force for international commodity trade finance and borrowers in CDDCs.

Socio-economic aspects of sustainability

In relation to the sustainability issue, GCF experts and participants suggested that the corporate strategy of TNCs needs to address not just business and investment challenges within resource-rich countries but also the socio-economic context in which they operate. Companies must plan how to maximize the effectiveness of programmes for social well-being, via public goods and services provision, local procurement and employment within CDDCs.

Managing revenues

There was a suggestion to develop “fiscal contracts” for resource-rich countries, whereby part of the revenues from exports of mineral resources would be redistributed to citizens, who would then be taxed on these accrued revenues. The rationale for this measure was that, when people are paying taxes, they have an incentive to hold governments accountable on how they spend their money: the higher the taxes as a share of revenues, the greater the accountability in a country.

Transparency and best practice

The importance of initiatives such as the Extractive Industries Transparency Initiative (EITI) was underlined. EITI was presented as a global initiative developed to address the resource curse through transparent revenue management schemes. It is a multi-stakeholder process involving governments, the private sector, the civil society and the international financial institutions. EITI establishes international codes and standards for companies to publish what they pay and for host governments to disclose what they receive.

The Natural Resource Charter

It was recognized that the Natural Resource Charter, which is in development, is a useful tool to mainstream best practices along the whole value chain. Although the Charter was directed primarily at policymakers in resource-rich countries, it also catered for extractive companies and their home governments.

Resource curse

It was suggested that perhaps commodity exporters and their Central Banks that pursue minimizing the effects of Dutch Disease would give to sovereign wealth and stabilization funds a more prominent role as an effective policy tool to manage foreign exchange inflows originating from exports of commodities that could not be absorbed by their economies.

11. Conclusions

The Twelfth Session of the United Nations Conference on Trade and Development (UNCTAD XII) was held at Accra, Ghana, from 20 to 25 April, 2008. At its closing plenary meeting, the Conference adopted the Accra Accord, which forms the basis of UNCTAD’s work for the following four years. The Accra Accord, *inter alia*, mandated UNCTAD to “contribute to building effective multi-stakeholder partnerships with a view to identifying innovative approaches to resolving commodity-related problems” (Accra Accord, Para. 93(c)).

The wide and deep debate initiated by GCF made a substantial contribution to addressing in an informal and multi-stakeholder format the key issues of commodity economy, trade and finance, and should help UNCTAD to better implement its mandate in partnership with key stakeholders. It was suggested that the GCF might become an annual event. Since ways of integrating commodity policies into national, regional and international development strategies are at the heart of the Accra Accord, the GCF plays a crucial role in identifying potential policies which could be implemented to try to overcome the perennial problems of the commodity economy.