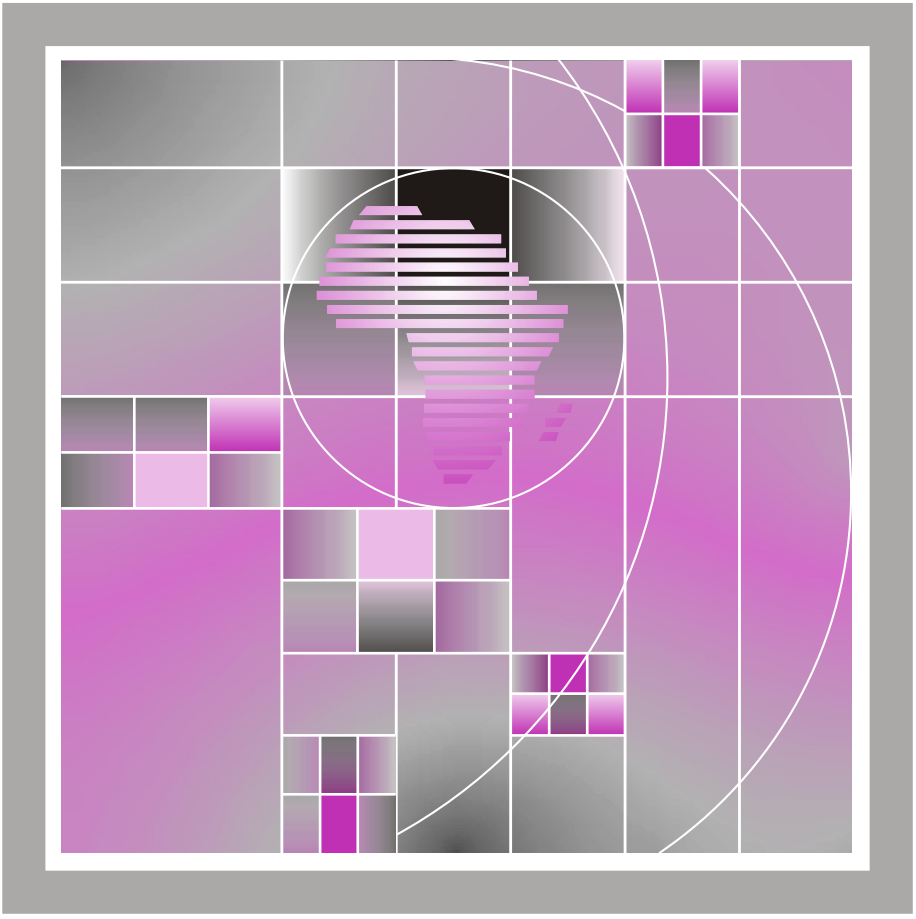
UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

ECONOMIC DEVELOPMENT IN AFRICA

Trade Performance and Commodity Dependence

UNITED NATIONS



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Geneva

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Explanatory notes

- Sub-Saharan Africa (SSA): Except where otherwise stated, this includes South Africa.
- North Africa: Unlike in the UNCTAD *Handbook of Statistics,* in this publication Sudan is classified as part of sub-Saharan Africa, not North Africa.
- Throughout, the term "dollar" ($) refers to US dollars, unless otherwise stated.

Chapter I

Overview of Issues in Africa's Trade Performance

1. Introduction

The emphasis on trade liberalization and export orientation in the past decade has led to a phenomenal growth in world merchandise trade, which has consistently grown faster than output (see UNCTAD, 2003a, chap. 3). Africa has also witnessed an increase in its trade relative to gross domestic product (GDP). Trade (merchandise imports plus exports), as a share of GDP for sub-Saharan Africa (SSA) (excluding South Africa and Nigeria), increased from 45.0 to 50.4 per cent between 1980–1981 and 2000–2001. However, on the whole, Africa's share in world exports fell from about 6 per cent in 1980 to 2 per cent in 2002, and its share of world imports from about 4.6 per cent in 1980 to 2.1 per cent in 2002. This phenomenon has as much to do with the structure of international trade as with the composition of Africa's merchandise trade, the trade policies applied on the continent in the past 20 years, market access and agricultural policies in industrial countries.

More than for any other developing region, Africa's heavy dependence on primary commodities as a source of export earn-

ings has meant that the continent remains vulnerable to market vagaries and weather conditions. Price volatility, arising mainly from supply shocks and the secular decline in real commodity prices, and the attendant terms-of-trade losses have exacted heavy costs in terms of incomes, indebtedness, investment, poverty and development. Previous UNCTAD reports on economic development in Africa have extensively discussed some aspects of these issues, including capital flows and debt, the region's overall economic performance and prospects, and adjustment and poverty reduction (see, for example, UNCTAD, 2000a, 2001 and 2002a).

This year's report attempts to place in perspective the reasons for Africa's poor performance and its declining share in world trade. It reviews the structure and composition of Africa's trade, along with the associated problems of commodity dependence, and it discusses the factors influencing both Africa's ability to diversify into more market-dynamic sectors and its competitiveness. It also examines briefly national and international policy measures adopted in the past to address the "commodity problem", which is at the heart of the continent's trade performance. Finally, it discusses national and international policy measures that may be needed to help Africa overcome some of the hurdles it faces.

2. Africa's trade structure and performance

The structure of developing-country exports, taken as a whole, has changed significantly over the past two decades. Currently, about 70 per cent of these exports are manufactures.[1] This is in sharp contrast to the situation two decades ago, when primary commodities accounted for three-quarters of developing-country exports. These figures, however, hide significant variations among developing regions. Africa hardly benefited from the boom in manufactured exports. At around 30 per cent in 2000, the share of

Table 1

SHARES OF DEVELOPING REGIONS IN WORLD MERCHANDISE TRADE, 1980–2002

(Per cent)

Region	*1980*	*1985*	*1990*	*1995*	*2000*	*2001*	*2002*[a]
				Exports			
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Developing Africa	5.9	4.2	3.0	2.2	2.2	2.1	2.0
North Africa	2.1	1.7	1.0	0.7	0.7	0.6	0.5
Sub-Saharan Africa	3.7	2.5	1.9	1.5	1.5	1.5	1.5
Developing Asia	17.9	15.6	16.9	21.6	24.3	23.7	23.3
Developing America	5.5	5.6	4.2	4.4	5.5	5.5	5.9
				Imports			
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Developing Africa	4.6	3.6	2.9	2.5	2.1	2.2	2.1
North Africa	1.4	1.6	1.2	0.9	0.7	0.8	0.7
Sub-Saharan Africa	3.1	2.1	1.6	1.6	1.3	1.4	1.4
Developing Asia	13.1	15.2	15.9	21.9	21.1	21.0	20.8
Developing America	6.1	4.2	3.7	4.7	5.7	5.8	5.7

Source: UNCTAD, *Handbook of Statistics*.
a Estimates.

manufactured exports in the continent's total merchandise exports had increased by only 10 percentage points compared to 1980 shares.

The continent's share in world merchandise exports fell from 6.3 per cent in 1980 to 2.5 per cent in 2000 in value terms (table 1). Similarly, its share of total developing-country merchandise exports

fell to almost 8 per cent in 2000, nearly a third of its value in 1980, while the share of world manufactured exports remained a little below 1 per cent. In contrast, Latin America's share of global merchandise trade has remained by and large unchanged, while its share of manufactures has risen from 1.9 to 4.6 per cent of global exports. Among the developing-country regions, Asia's performance has been important with respect to both total merchandise exports and manufactures. Its share of global merchandise exports increased from 18 per cent in 1980 to 22 per cent in 2000, while its share of total developing-country merchandise exports increased from almost 60 to 72 per cent over the same period. Similarly, its share in global manufactures trade increased threefold, reaching 21.5 per cent in 2000 (table 2).

The value of Asia's total exports recorded 7 per cent average annual growth over the period under review, compared to a mere 1 per cent for Africa. While the value of Asia's non-fuel commodity exports increased by 5 per cent per year, those of Africa rose by only 0.6 per cent. Africa recorded the worst performance in terms of the annual growth rate of merchandise exports, as well as in the other categories of exports – primary and non-fuel primary commodities, and manufactures (table 3).

While the value of Africa's manufactures increased by 6.3 per cent annually, this seemingly high growth rate is about half the growth rates recorded by Asia (14 per cent) and Latin America (about 12 per cent) and is from a relatively low base. It is also the result of significant growth in labour-intensive and resource-based semi-manufactures from a few countries, in particular Mauritius (garments) and Botswana (rough diamonds). Mauritius increased the value of its manufactured exports from $115 million to $1.2 billion between 1980 and 2000, while Botswana, which earned nothing from manufactures in 1980, exported $4.6 billion worth in 2000. There were also increases in the value of manufactured exports from Lesotho, Namibia and Swaziland in SSA, and from Morocco

Table 2

EXPORT STRUCTURE OF AFRICA AND OTHER DEVELOPING REGIONS BY PRODUCT CATEGORY, 1980 AND 2000

(Per cent)

	1980		*2000*	
	All merchandise[a]	*Manufactures*[b]	*All merchandise*[a]	*Manufactures*[b]
Africa				
Share in:				
Global exports	6.3	0.8	2.5	0.8
Developing countries' exports	20.3	7.8	7.9	3.0
Developing America				
Share in:				
Global exports	5.9	1.9	5.9	4.6
Developing countries' exports	19.1	18.1	18.9	16.8
Developing Asia				
Share in:				
Global exports	18.1	7.1	22.4	21.5
Developing countries' exports	58.5	66.9	72.0	79.0
Memo item:				
Developing countries				
Share in:				
Global exports	31.0	10.6	31.1	27.2

Source: UNCTAD secretariat computations based on United Nations Statistics Division data.

a Standard International Trade Classification (SITC) 0–9.

b SITC 5–8, less 68.

and Tunisia in North Africa. The North African countries increased the value of their manufactured exports from under $2 billion in 1980 to almost $5 billion in the case of Morocco and $4.5 billion in the case of Tunisia in 2000. On the other hand, there were steep

Table 3

ANNUAL AVERAGE GROWTH RATE OF EXPORTS BY PRODUCT CATEGORY, 1980–2000

(Per cent)

Region	*All merchandise*	*Primary commodities*[a]	*Non-fuel primary commodities*	*Manufactures*
Developed countries[b]	5.9	3.3	2.9	6.4
Developing countries	6.0	1.4	3.3	12.4
Africa	1.1	0.6	0.6	6.3
America	5.9	2.2	2.9	11.5
Asia	7.1	1.3	5.0	13.6
Memo item:				
Sub-Saharan Africa	1.3	1.3	0.4	5.6

Source: UNCTAD secretariat computations based on United Nations Statistics Division data.

a Primary commodities (0–4) sections of SITC Revision 3.

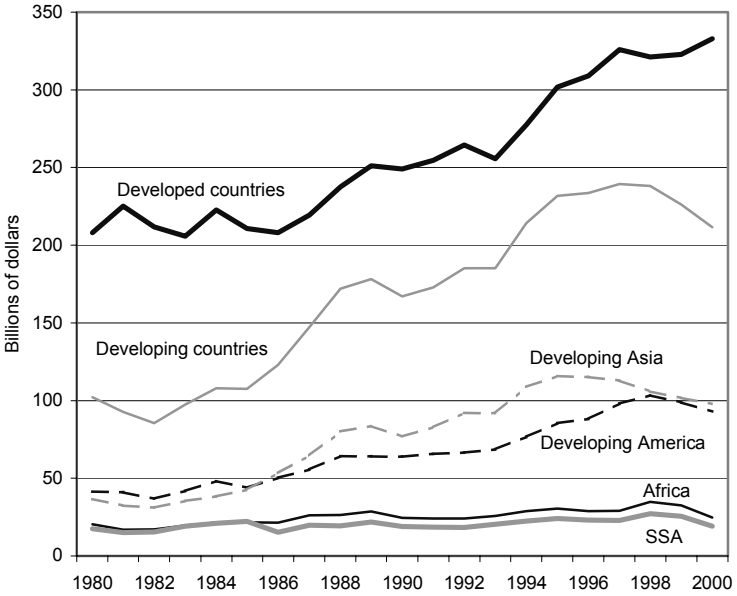
b Less South Africa.

falls in the value of manufactured exports from the Democratic Republic of the Congo, Nigeria, Sierra Leone and Zambia over the period.

Even though Africa has remained commodity-dependent, it has fallen behind other regions of the world in exports of non-fuel primary commodities. Asia outperformed other developing-country regions in non-fuel commodity exports during the period under review (chart 1).

Chart 1

EXPORTS OF NON-FUEL PRIMARY COMMODITIES AT CONSTANT 1980 PRICES[a] BY ECONOMIC REGION, 1980–2000



Source: UNCTAD secretariat computations based on United Nations Statistics Division data.

a The deflator used is the UNCTAD export unit value index for the relevant region.

The trends discussed above indicate that most African countries have been losing market shares in commodity exports to other developing countries, while at the same time most have been unable to diversify into manufactured exports. Africa's difficulties in maintaining market shares for its traditional commodities derive from its inability to overcome structural constraints and modernize

its agricultural sector, combined with the high cost of trading (see, for example, UNCTAD, 1999a: 3–8). Africa has not been able to increase the productivity of its agriculture because of a combination of factors, including land tenure and small-scale farming, rudimentary technology and policies that reduced the role of state institutions in innovation and investment in the sector. As a result, it has lost its competitive advantage in producing cocoa, tea and coffee vis-à-vis the new and more competitive producers in Asia and Latin America. The loss of market shares for cotton and sugar is largely the result of high subsidies and domestic support for less competitive producers in the United States and Europe. The United States is the world's largest exporter of cotton thanks to huge cotton subsidies, which in 2001–2002 amounted to $3.9 billion, double the level in 1992 and $1 billion more than the value of total United States cotton production during the season at world market prices (Oxfam, 2002; see also the Annex at the end of this report). However, according to the estimates of the International Cotton Advisory Committee (ICAC), the cost of producing a pound of cotton in Burkina Faso is 21 US cents compared to 73 US cents in the United States. Estimates by the ICAC indicate that market prices could have been about 70 per cent higher in the absence of government support for the cotton industry in 2001–2002 (Townsend, 2003).

3. Dynamic products

The most market-dynamic products (ranked by growth in export value during 1980–2000) in world trade are manufactures. While the majority of these are high-technology products, some labour-intensive manufactures, notably clothing, have seen rapid growth in world trade as a result of the spread of international production networks and subcontracting (see UNCTAD, 2002c). In Africa, undergarments (SITC 846) are the only important export item among the most dynamic products in world trade (table 4).

However, their share in total African exports is only 1.7 per cent. Moreover, two countries (Mauritius and Swaziland) account for just over 85 per cent of total exports of this product.

Seventeen of the 20 most important non-fuel export items of Africa are primary commodities and resource-based semi-manufactures. On average, world trade in these products has been growing much less rapidly than manufactures. However, trade in some non-traditional commodities has seen considerable expansion over the past two decades. Of such commodities, three are among the 20 most important export items of SSA (namely fish and crustaceans, SITC 034, 036 and 037), accounting for 8.5 per cent of total African export earnings in 2000. World trade in other primary commodities that account for an important proportion of total exports of Africa, particularly agricultural products such as coffee, cocoa, cotton and sugar, has been sluggish, with the average growth of trade in such products in the past two decades barely reaching one-third of the annual growth rate of world trade in all products (i.e. 8.4 per cent over 1980–2000).

This analysis reveals that SSA barely participates in trade in market-dynamic products, which suggests that global demand for most of its main non-fuel commodity exports is sluggish, a situation aggravated by high price volatility and declining real prices. Unfortunately, the continent's dependence on these commodities is unlikely to decrease significantly in the short and possibly medium run. This underscores the need for more concerted and innovative measures to reduce the problems associated with such dependence, in particular within the context of the new multilateral trading system.

Africa's difficulty in breaking into trade in market-dynamic products is also related to the significant changes that have occurred in recent years in international trade in agricultural products. World trade has shifted away from traditional commodity exports

Table 4

20 LEADING NON-FUEL EXPORTS OF SUB-SAHARAN AFRICA[a]

(Shares in per cent)

SITC code	Leading exports	Shares in SSA exports (in 2000)	Rank[b]	Growth in export value[c]	Top four exporting countries in SSA and shares (in 2000)	
667	Pearls, precious and semi-precious stones, unworked or worked	15.3	103	7.8	Botswana (67.2) Angola (10.2)	Namibia (8.3) Congo, DR (6.8)
072	Cocoa	6.6	208	1.6	Côte d'Ivoire (70.3) Ghana (21.1)	Cameroon (7.2) Togo (0.3)
263	Cotton	5.5	193	3.1	Mali (21.7) Zimbabwe (14.5)	Côte d'Ivoire (12.0) Chad (11.7)
034	Fish, fresh (live or dead), chilled or frozen	5.0	75	8.7	Namibia (31.8) Mauritania (19.2)	Senegal (13.6) UR of Tanzania (9.5)
071	Coffee and coffee substitutes	4.7	209	1.2	Côte d'Ivoire (25.7) Ethiopia (21.6)	Kenya (13.0) Uganda (10.6)
247	Wood in the rough or roughly squared	4.0	183	3.6	Gabon (42.7) Congo (17.0)	Equa. Guinea (14.6) Cameroon (8.9)
121	Tobacco, unmanufactured; tobacco refuse	3.9	192	3.1	Zimbabwe (64.4) Malawi (25.3)	UR of Tanzania (4.2) Uganda (2.9)
287	Ores and concentrates of base metals, n.e.s.	3.8	180	3.7	Botswana (38.0) Guinea (34.4)	Congo, DR (6.4) Gabon (5.7)
061	Sugar, molasses and honey	3.0	206	2.0	Mauritius (38.2) Swaziland (19.4)	Zimbabwe (16.4) Malawi (6.8)
248	Wood, simply worked, and railway sleepers of wood	2.8	139	6.4	Côte d'Ivoire (36.7) Cameroon (35.9)	Ghana (12.6) Congo (4.6)

SITC code	Leading exports	Shares in SSA exports (in 2000)	Rank[b]	Growth in export value[c]	Top four exporting countries in SSA and shares (in 2000)	
074	Tea and maté	2.5	195	3.0	Kenya (76.9) Uganda (6.2)	Malawi (6.0) UR of Tanzania (5.4)
057	Fruit and nuts (not including oil nuts), fresh or dried	2.4	132	6.6	Côte d'Ivoire (34.1) UR of Tanzania (17.0)	Mozambique (10.7) Cameroon (9.7)
036	Crustaceans and molluscs, fresh, chilled, frozen, salted, in brine or dried	1.9	77	8.5	Senegal (33.1) Mauritania (23.4)	Mozambique (22.3) Angola (7.2)
846	Undergarments, knitted or crocheted	1.7	5	13.4	Mauritius (69.4) Swaziland (17.1)	Lesotho (4.0) Botswana (2.9)
845	Outergarments and other articles, knitted or crocheted	1.7	50	9.7	Mauritius (53.4) Lesotho (20.9)	Swaziland (11.6) Botswana (5.4)
037	Fish, crustaceans and molluscs, prepared or preserved, n.e.s.	1.6	89	8.1	Côte d'Ivoire (33.1) Seychelles (31.7)	Ghana (15.7) Mauritius (9.8)
011	Meat, fresh, chilled, frozen	1.4	142	6.3	Botswana (47.5) Namibia (31.3)	Sudan (10.8) Zimbabwe (5.7)
292	Crude vegetable materials, n.e.s.	1.3	110	7.3	Kenya (34.5) Ethiopia (21.3)	Sudan (10.1) Zimbabwe (9.3)
684	Aluminium	1.2	83	8.4	Ghana (53.0) Cameroon (39.0)	Kenya (2.7) Swaziland (1.4)
842	Outergarments, men's, of textile fabrics	1.2	51	9.7	Mauritius (57.9) Lesotho (21.8)	Botswana (8.5) Zimbabwe (6.6)

Source: UNCTAD secretariat computations based on United Nations Statistics Division data.
Note: n.e.s. = not elsewhere specified.
a Excludes South Africa.
b On the basis of 225 product groups ranked by growth in world export value, 1980–2000.
c World annual average growth rate, 1980–2000.

to non-traditional ones such as fruits, vegetables, fish and seafood, which have high income elasticity and lower rates of protection in industrial and large developing countries. While there have been significant declines in trade, ranging from 18 to 11 per cent between 1980–1981 and 2000–2001 for coffee, cocoa, tea, sugar and sugar products and textile fibres, international trade in fruits and vegetables has increased by 15 per cent, fish and seafood by 12 per cent and alcoholic and non-alcoholic drinks by 10 per cent. Developing-country exports of temperate products (milk, grains and meats) have also increased marginally, mostly to other developing countries with much lower rates of tariff and non-tariff barriers than developed countries.

Overall, Africa's trade performance reflects its inability to tap into cheaper finance, efficient logistics, and increased capital resources and skills, all of which play a key role in international trade. At the distribution and marketing level, trade is increasingly dominated by supermarkets, the global spread of consumption patterns and new demands linked to production technology. The continent also has difficulties in meeting market exigencies such as the Hazard Analysis and Critical Control Point (HACCP), and sanitary and phytosanitary (SPS) measures arising from WTO disciplines for food exports or additional national requirements.

Furthermore, structural changes in international trade have increased the premium on, *inter alia*, accurate market information, timely delivery and packaging, which have become critical for gaining competitive advantage in global markets. The private sector in many African countries is weak and incapable of competing in world markets, and the continent's underdeveloped and unreliable road and railway networks and communication links (UNCTAD, 1999a), tardiness in information technology, and cumbersome customs formalities greatly increase transaction costs for businesses, particularly in landlocked countries. African countries also lack a strong institutional capacity to provide the necessary support services to

producers and exporters. The continent thus has a great competitive disadvantage compared to other developing-country regions.

4. Price volatility and terms-of-trade losses

African countries depend on two to three main primary commodity exports for the bulk of their foreign exchange earnings, and they have had to contend with the problem of short-term instability of primary commodity prices, which is greater than that of prices for non-primary tradable commodities (Maizels, 1987; Kaldor, 1987). Peaks (or booms) in commodity prices are interspersed by longer troughs (or slumps), which have a large impact on African countries via a variety of channels. Export revenues are a major determinant of these countries' balance of payments position, external indebtedness,[2] fiscal situation, and levels of savings and investment, and hence their aggregate supply and demand schedules. The relative ease of collecting taxes on international trade, and the lack of alternative "tax handles", mean that government revenues in most African countries depend heavily on taxes levied on exports and imports. This makes fiscal earnings highly vulnerable to changes in the value of export earnings. For a group of 19 African countries, trade taxes as a percentage of GDP declined from an average of almost 6 per cent in 1975 to about 5.5 per cent in 1995, but this was still high compared to the average of just over 3 per cent of GDP for other developing-country regions, and less than 0.5 percent in the Organisation for Economic Co-operation and Development (OECD) (Ebrill et al., 1999). According to the Economic Commission for Africa, over the period 1991–2001, import duties comprised 34 per cent and 22 per cent of government revenues respectively in least developed and non-least developed countries of Africa compared to an average of 15 per cent for developing countries.

Price volatility for a few commodities like coffee, cocoa and tea, on which African countries depend heavily, is mainly induced by supply shocks resulting from weather conditions. In recent years, El Niño has exacerbated supply shocks, with significant effects on real commodity prices (Brunner, 2000). For example, frosts in Brazil in 1975, 1985 and the mid-1990s exerted upward pressures on coffee prices. This situation is not helped by the fact that commodity production (particularly tree crops) does not lend itself to making quick adjustments in supply in order to meet changes in demand. Most often, the time lag in the adjustment of supply to changed demand conditions aggravates the problem of slump, as supply becomes pro-cyclical (that is, it increased just at the time when demand decreases). Part of the volatility in recent times could, however, be attributed to speculation in the commodity futures markets.

Secular decline in real prices emanates mainly from structural oversupply in commodity markets. For those commodities produced in the North, for instance, cotton, groundnuts, sugar and wheat subsidies and other domestic support for farmers underscore the significant increases in the marketed surplus. For example, EU agricultural policies have tended to stimulate output for export and/or reduce import needs. EU wheat exports rose by 55 per cent to 22 million tons (increasing the EU's global market share by 6 percentage points to 20 per cent) between 1980–1981 and 1991–1992. The United States' subsidies for cotton production since the 1999–2000 season amount to $3–4 billion annually, and with about 40 per cent of the production being exported, the United States is the biggest world exporter of cotton.

In the case of tropical beverages such as coffee, cocoa and tea, overproduction stems partly from increased productivity due to technical advances by some traditional producers in Latin America and Asia, as well as expansion of land allocated to production (for instance, in Brazil). New producers have also emerged for some of these commodities in Asia: for example, cocoa in the 1970s–1980s

(Malaysia) and tea and coffee in the 1980s–1990s (Indonesia and Viet Nam). Low-quality coffee beans have also aggravated the excess supply problem, as new blending techniques currently available enable roasters to use cheaper and lower-grade coffee that would not have been traded 10 years ago.

Other factors affecting real prices of commodities include new engineering practices and new synthetic and composite materials, which have displaced traditional natural materials in a variety of end-uses. Added to these factors, the unwillingness of the international community to support price stabilization through commodity agreements has meant that exporters have had to adjust to a more competitive trade regime (see Chapter II). The effective breakdown of these agreements in the 1980s has also been responsible for the failure of subsequent efforts to influence prices via supply management or other means (Reinhart and Wickham, 1994: 203).

The downward trend in the movement of relative prices of primary commodities *vis-à-vis* manufactures since the end of World War II has been relatively well established. As Maizels (1992: 11) observed, "the commodity price recession of the 1980s has been more severe, and considerably more prolonged than that of the Great Depression of the 1930s". What continues to be disputed is whether "this postwar trend is a continuation of a much longer underlying phenomenon" (Maizels, 1987: 543). While some studies (e.g. Schultz, 1961 and Kaldor, 1963) have identified significant adverse terms of trade for commodity exporters, others could not find empirically convincing or analytically justifiable trends (e.g. Rostow, 1951; and Bhagwati, 1960, cited in Diakosavvas and Scandizzo, 1991).[3] Among the former group, some studies have identified structural breaks with permanently lower average prices following each break. Indeed, for the same period, 1900–1970, two authors have concluded differently: Spraos (1983) identified no significant trend either way, but Sapsford (1985) found a significant deterioration in commodity terms of trade by introducing dummy variables, which

suggests a structural difference between the pre- and post-war periods (Evans, 1987; Maizels, 1987). Most studies agree that relative commodity prices are nonstationary, but there is disagreement on whether the nonstationarity assumes the form of a deterministic trend, or whether there are structural breaks (Cashin, Liang and McDermott, 1999: 3).[4]

Real prices of non-fuel commodities were relatively stable in the late 1950s and the early 1960s, peaking in 1966. The highest peak registered to date was in 1974, which was preceded by a rise in non-fuel commodity prices accompanied by the oil shock. The late 1970s and the 1980s witnessed a volatile but generally declining trend, with peaks in 1988 and 1997, which preceded the slump of more than 20 per cent (compared with 5 per cent for manufactures) in US dollar prices during the period 1997–1999 in the wake of the Asian crisis (Page and Hewitt, 2001: 5).

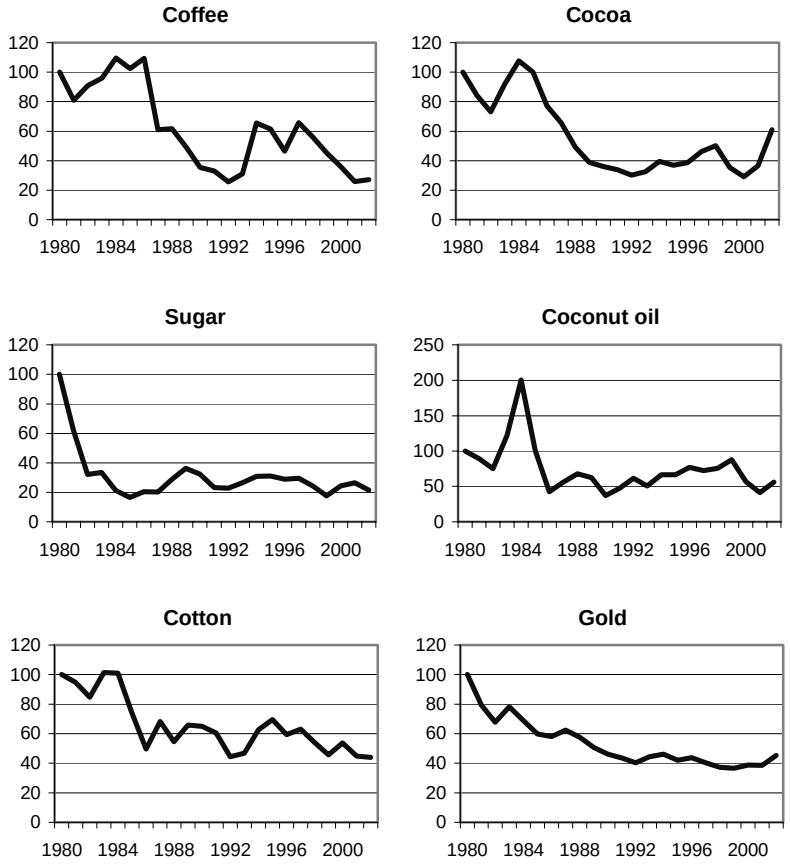
An important characteristic of commodity price cycles is that they are asymmetric. Since 1957, boom cycles have been shorter than slump ones: the International Monetary Fund (IMF) isolates an average of 37 months for booms and 63 for slumps (IMF, 2000, cited in Page and Hewitt, 2001: 5). It has also been observed that the duration of slumps exceeds that of booms by nearly a year, and that the magnitude of price falls in slumps is slightly larger than that of price rebounds in subsequent booms, with the rate of change of prices in booms being typically faster than the rate of change of prices in slumps (Cashin et al., 2002).

UNCTAD's analysis of real commodity prices for 14 products of export interest to Africa between 1960 and 2000 suggests that 12 (bananas, cocoa, coconut oil, coffee, copra, copper, cotton, fishmeal, gold, sugar, tea and white pepper) suffer from high price volatility. The standard deviation of deviations of prices from the trend (i.e. estimated using the Hodrick-Prescott filter) is more than 10 per cent for each of these commodities. In addition, the real

Chart 2

PRICE INDICES OF SELECTED AFRICAN COMMODITY EXPORTS, 1980–2002

(1980 = 100)



Source: UNCTAD secretariat estimates based on UNCTAD *Commodity Price Bulletin.*

Note: Annual price indices deflated by unit value indices of manufactured exports of developed economies.

Table 5

REAL PRICE TRENDS AND VOLATILITY OF SELECTED COMMODITIES, 1980–2000

	Price trends		
Price volatility	*Falling*	*Stable*	*Rising*
High[a]	Cocoa Coconut oil Coffee Copra Cotton Gold Sugar Tea White pepper	Bananas Copper	Fish-meal
Medium[b]	—	Iron ore	Wood/tropical logs
Low[c]	—	—	—

Source: UNCTAD database.

a Standard deviation of deviations of more that 10 per cent from the trend (using Hodrick-Prescott filter).

b Standard deviation of deviations of between 5 and 10 per cent from the trend.

c Standard deviation of deviations of less than 5 per cent from the trend.

prices of nine commodities (cocoa, coconut oil, coffee, copra, cotton, gold, sugar, tea and white pepper) depict declining trends (chart 2), while those of copper and bananas are more or less stable and that of fish-meal has been rising. Non-coniferous wood and tropical logs and iron ore display medium volatility (that is, a standard deviation of deviations of between 5 and 10 per cent from the trend). The first two commodities exhibit a rising price trend, while the real price trend of iron ore has been more or less stable (table 5).

On the whole, problems due to declining terms of trade for SSA commodity-dependent countries are exacerbated by the high price volatility of their major exports such as coffee, cocoa, gold, tea and cotton. The extent of fluctuations in real export prices of SSA compared to the other regions has been summed up in an IMF/World Bank document as follows: "Sub-Saharan exports experienced roughly twice the volatility in terms of trade that East Asia's exports did in the 1970s, 1980s and 1990s, and nearly four times the volatility … that the industrial countries experienced" (cited in UNCTAD, 2001: 38). This situation has been exacerbated by Africa's declining share in world trade and the continent's inability to participate in international trade in manufactures and market-dynamic products.

5. *Impact of commodity dependence on African economies*

Volatility in commodity prices aggravates difficulties in macroeconomic management. It frustrates investment efforts, as it increases uncertainty about overall economic conditions, including exchange rates, return on investments, and import capacity, particularly of critical imports such as oil.[5] Secular decline in commodity prices exercises a permanent pressure on foreign exchange earnings for African countries, in particular because of their high commodity dependence.

Between 1997 and 2001, the UNCTAD combined price index of all commodities in US dollars fell by 53 per cent in real terms (deflated by the unit value index of manufactured goods exported by the developed market economy countries). That is, commodities lost more than half of their purchasing power in terms of manufactured goods: African commodity exporters would have had

to double their export volumes in 2001 to maintain their foreign exchange income at 1997 levels. Tropical beverages and vegetable oil seeds and oils, which comprise about one-fifth of Africa's non-fuel commodity exports, registered the highest rates of decline in real terms (United Nations, 2002: 4–5).

A major explanation for the poor economic performance of the region in the past two and a half decades is the significant loss of resources due to adverse terms of trade. World Bank estimates suggest that the cumulative loss resulting from adverse terms of trade over a period of almost three decades (1970–1997) for African non-oil-exporting countries (excluding South Africa) amounted to 119 per cent of the combined GDP of these countries in 1997, 51 per cent of cumulative net resource flows, and 68 per cent of net resource transfers to the region (World Bank, 2000: 21–22). Research carried out by the UNCTAD secretariat indicates that if SSA terms of trade had remained at 1980 levels, the share of the subcontinent in world exports would have been double its current level. Also, coffee- and sugar producing countries (in the case of the latter, those exporting to the free market) would have earned an additional $19 billion and $1.4 billion respectively, and West African cotton-producing countries an additional $1 billion, if prices for these three products during 1999–2002 had remained at 1998 levels (when they were historically average). But for the decline in the terms of trade and associated losses for non-oil-exporting countries, the investment ratio would have been up by 6 percentage points a year, income growth by an additional 1.4 per cent a year, and the current level of per capita income would have been as much as 50 per cent higher (UNCTAD, 2001: 36; United Nations, 2002: 5).

Furthermore, terms-of-trade losses have also contributed to the debt overhang of African countries. The IMF notes that "almost all countries hit hardest by falling commodity prices are also among the world's poorest. All but two (Brazil and Chile) are clas-

sified as low income countries by the World Bank; over half are sub-Saharan Africa; and 16 are Heavily Indebted Poor Countries" (IMF, 2000: 112, cited in Page and Hewitt, 2001: 4).

According to a recent IMF/World Bank publication, a substantial drop in the prices of their key export commodities explains the deterioration in the net present value (NPV) of debt-to-export ratios relative to ratios projected at decision point for 2001 of 15 heavily indebted poor countries (HIPCs), of which 13 are African. The report indicated that, on average, the export price index of these countries fell by 4.8 per cent, compared to a decline of 1.1 per cent in other HIPCs where debt indicators did not worsen, and that the exports of these countries are concentrated heavily in cotton, coffee, cashews, fish and copper – commodities that experienced large price reductions in 2001. It concluded that the terms of trade declined by 1.5 per cent for HIPCs with the worse debt ratios (IMF and World Bank, 2002a: 26). In 2001, for example, the price of coffee, which is the main export in five HIPCs, fell by 35 per cent. Large price drops were also recorded for other commodities that were the primary exports of at least one HIPC; cotton fell by 19 per cent (Benin, Burkina Faso, Chad and Mali), cashews by 69 per cent (Mozambique and the United Republic of Tanzania), fish by 21 per cent (Senegal) and copper by 13 per cent (Zambia).

It is therefore not surprising that 10 African countries[6] that had been seriously affected by export price declines are currently projected to have the NPV of debt-to-export ratios above the sustainability threshold at their completion point under the enhanced HIPC Initiative. Uganda, one of the six African countries currently at completion point, has already found itself in an unsustainable debt situation on account of steep declines in the price of coffee[7] (IMF and World Bank, 2002b: 17–18), and completion point debt relief for Burkina Faso had to be topped up by $129 million because of the decline in the price of its main export, cotton. On average, HIPCs with deteriorating debt indicators have higher export commodity

dependence, and their exports display a much greater volatility relative to other HIPCs (IMF and World Bank, 2002a: 26).

Commodity price trends also affect the incidence of poverty via knock-on effects on employment opportunities and incomes in commodity producers.[8] The net effect of the secular decline in prices depends on the extent to which world market prices are transmitted to producers and whether higher export volumes (for example, through productivity and yield improvements) make up for falling prices. Most developing countries, however, are not in a position to manage these shocks, because of the lack of instruments and technical expertise owing to their low levels of development. In SSA, for example, agricultural productivity is so low that countries cannot compensate for lower commodity prices by increasing yields. Despite the macroeconomic policy reforms undertaken under structural adjustment programmes, most SSA economies are not in a position to manage commodity price booms (or slumps) any better than they were in the 1970s. On the contrary, the capacity of Governments to mediate these shocks has been severely undermined by some aspects of these reforms.

6. External constraints

(a) Market access

Market access remains a problem, as most of the tariff peaks are in agriculture, including processed products, and most post-Uruguay Round tariffs[9] escalate between raw and semi-finished as well as between semi-finished and finished products, with a greater impact on more advanced stages of processing.[10] Coffee beans and final processed coffee, for example, are subject to tariffs of 7.3 per cent and 12.1 per cent respectively in the EU, 0.1 per cent and

10.1 per cent in the United States, and 6 per cent and 18.8 per cent in Japan. In the case of cocoa, tariffs at the raw, intermediate and final stages are 0.5 per cent, 9.7 per cent and 30.6 per cent respectively in the EU; and 0 per cent, 0.2 per cent and 15.3 per cent in the United States. Japan accords tariff-free treatment to raw cocoa beans, but cocoa products exported at the intermediate stage are subject to a 7 per cent tariff, while final cocoa products are levied at 21.7 per cent.

Average agricultural tariffs are also much higher than tariffs on manufactures, despite the conversion of non-tariff barriers (NTBs) to tariffs (so-called "tariffication") during the Uruguay Round. In the Quad countries (Canada, the EU, Japan and the United States), for example, of tariffs covering 86.1 per cent of tariff lines, agricultural tariffs average 11 per cent compared to 4 per cent for manufactures. The difference between tariffs for agricultural and manufactured products is much higher in the EU, where the average tariff for agriculture is 19 per cent as against 4.3 per cent for manufactures. Corresponding figures for large middle-income countries[11] are 27.4 per cent for agricultural products and 13.1 per cent for manufactures, with coverage of 90.7 per cent of tariff lines. Furthermore, although tariffs are on average much lower in industrial countries than in developing countries, industrial-country tariffs display high peaks (or high protection) for specific products. Tariffs peak at about 1,000 per cent in the Republic of Korea, 506 per cent in the EU and 350 per cent in the United States.

The introduction of the African Growth and Opportunities Act (AGOA) in 2000 and Everything But Arms (EBA) in 2001 by the United States and the EU respectively is a welcome development in market access for African countries. However, an analysis of EBA in 2001 revealed little use of the scheme, owing in part to the fact that the beneficiaries continued utilizing Lomé protocols, which arguably have less restrictive rules of origin than the former (Brenton, 2003). An assessment of AGOA reveals that the addi-

tional benefits represent a modest expansion over the preferential treatment that SSA countries already enjoyed under the generalized system of preferences (GSP) (UNCTAD, 2003b: 2). On the other hand, it is contended that, had it not been for the restrictive rules of origin governing market access under AGOA, its medium-term benefits would have been five times greater (Mattoo et al., 2002).

(b) Value chain

The growing literature on commodity prices and commodity-dependent countries reveals a "disconnect" between prices paid by final consumers and those received by producers, because of higher profits at later stages of the value chain. The stage in the value chain where concentration is largest tends to acquire a large share of the profits, with a smaller share of the final price going to the other stages. The underlying cause of this is oligopolistic markets in which intermediaries largely appropriate the benefits of productivity improvements. For example, while business in several commodities (such as coffee and tea) has been booming in recent years in the markets of consuming developed countries, this is only reflected in higher prices for final (processed) products, not in the prices received by producers in developing countries.

While African producers have incurred income losses, traders and firms in the higher steps of the value chain have been reaping significant benefits. According to the International Coffee Organization (ICO), for example, in the early 1990s, earnings by coffee-producing countries (exports f.o.b.) were some $10–12 billion, while the value of retail sales was about $30 billion. Today, the value of retail sales is $70 billion, while producers receive only $5.5 billion. World market prices for coffee have fallen from about 120 US cents/pound in the 1980s to around 55 US cents, reaching their lowest levels in real terms in 2002 (Osorio, 2002). With an estimated 125 million people in the developing world dependent

on coffee production for their livelihoods, the impact of such a price decline has been devastating in terms of social dislocation, including social exclusion and poverty.

A value chain analysis of the coffee market reveals that, since 1985, a growing share of total incomes in the chain has accrued to economic agents in the importing countries. The asymmetrical character of power in the coffee value chain explains the unequal distribution of total incomes. "In the producer countries it [power] is very weak – farming is highly fragmented and the destruction of marketing boards further reduces the capacity of farmers to raise their share of value chain rents. At the importing end of the chain, there are three major residues of power – importers, roasters and retailers. They compete with each other for a share of value rents, but combine to ensure that few of these return to the farmer or producer country intermediaries or governments" (Fitter and Kaplinsky, 2001: 16).

(c) Subsidies

The World Bank[12] estimates that in 2002 the world market price of cotton would have been more than 25 per cent higher[13] but for the direct support of the United States for its cotton producers. Furthermore, various estimates suggest that in 2002 cotton subsidies by the United States and the EU caused a loss of up to $300 million in revenue to Africa as a whole, which is more than the total debt relief ($230 million) approved by the World Bank and the IMF under the enhanced HIPC Initiative to nine cotton-exporting HIPCs in West and Central Africa in the same year.[14] The cost of lower cotton prices to Mali, according to Oxfam, amounted to $43 million in 2001. This is exactly the amount of debt relief Mali received from the World Bank and the IMF in the same year under the enhanced HIPC Initiative. In Benin, Burkina Faso and Mali, about 11 million people depend on cotton as their only source of

income, and in Benin, for example, lower cotton prices have been associated with a 4 per cent rise in poverty in 2001.

The recently announced EU reforms of the Common Agricultural Policy (CAP), which involve moving away from production- and price-linked subsidies, are a welcome development. It is, however, too early to ascertain the impact of the reforms on output and prices. For many African countries, the principal concern is how soon the coverage of the reforms will be extended to their important export products such as sugar, tobacco and cotton. Farm support systems in OECD countries are having serious consequences in Africa specifically in achieving the poverty reduction objective of the Millennium Development Goals. It is unlikely that the current CAP reforms will change this situation even if they lead to cuts in subsidies. They are focused on domestic support, not on trade, and they contain no new provisions about tariffs or improving market access for African agricultural exports.[15]

7. Implications of recent developments in commodity markets

Two main developments have been observed in commodity markets at the global level. First, while the relative growth of global demand for "traditional" commodities (such as coffee and cereals) has weakened in recent years, that for some primary products has been on the increase. These "new dynamic products" include vegetable oils, fruits, vegetables, fish, dairy products, cut flowers and tobacco. The different demand growth for different products reflects, *inter alia,* changing consumer habits, while growth in trade is determined by market access conditions, marketing and promotion by exporters (United Nations, 2002: 4).

Second, there is an expanding trade in higher-value-added agricultural commodities, in particular processed foods, in consuming developed countries. Demand for these products has exceeded that for basic agricultural commodities. International trade in higher-value-added products is dominated by larger and more vertically integrated firms and, in the retail sector, by global supermarket chains. This increasing integration between trade and production has serious implications for the participation of Africa in international commodity trade in that it determines what is produced, how and by whom.

Many commodities have become differentiated with tailored supply chains created to control them from production to delivery to the consumer. This is in response to the interest of consumers in quality, timeliness of delivery, origin and traceability, and in the environment and social conditions in which these commodities were produced. The best examples of these are fair-trading labels and products that meet minimum environmental standards.

For many firms, production contracts, alliances and other mechanisms designed to coordinate input suppliers, farmers, processors and traders are now important for controlling the marketing chain, thus replacing direct investments (United Nations, 2002: 8). Real profits in the commodity chain are made by those who control critical points along the chain, own established brand names or have access to shelf space in supermarkets (and not by trading houses) (United Nations, 2002: 9).

A major implication of these developments for developing-country, including African, producers is that they must enter into networks if they want to access developed-country markets. These networks disseminate information about markets to producers and enable buyers to obtain information about and develop confidence in the supplier (UNCTAD, 2000b: 7). For specific products, how-

ever, the entry of producers, processors and traders into the value chain depends on product characteristics, technical requirements, market structures and the organization of trade. In the last case, entry may depend on whether the products are "half-channel crops" or "entire-channel crops".[16] Nevertheless, the determining factor in market entry is the capacity to upgrade and produce according to specific requirements relating to quality, health and environmental standards as well as consumer preferences and tastes. The major challenges are how to identify market opportunities and meet the specific requirements for each market. The former necessitates a constant examination of diversification opportunities, as areas of comparative advantage and competitive advantages are dynamic and change over time. As to the latter, technical assistance may be required if African countries are to meet quality and health requirements, particularly in consonance with the WTO Agreement on Sanitary and Phytosanitary Measures.

These developments have triggered attempts in some producing countries towards a deliberate and dynamic transformation and diversification in the commodity sector through combined actions by Governments and entrepreneurs. Governments have taken action to eliminate bottlenecks and adopt appropriate strategies to enhance competitiveness and create new areas of comparative advantage, while entrepreneurs have made conscious efforts to adopt modern business strategies. Production patterns in these countries have thus changed towards higher-value-added and/or more processed products with high growth rates of demand at the domestic and international levels. Africa will also need to transform and diversify its economy, in particular the commodity sector, if it is to retain and expand its share in world trade of traditional, "new-dynamic" and most market-dynamic products.

Chapter II

Past Policy Responses

1. Commodity price stabilization: A historical perspective

The need to stabilize commodity prices and to assure returns that are considered "remunerative" to producers is not a new concept. Historically, two distinctive trends have emerged, one with respect to producers in the "North", and the other with regard to those in the "South".

Volatility in national farm incomes arising from fluctuations in supply and demand of agricultural products has been a central concern of industrialized countries for many years. High rates of industrialization and the growth of the services sector in these countries have reduced the viability of rural communities and regions, which has led to associated social problems. Pressures from rural communities to increase incomes consonant with living standards, through increased exports and protection from competing imports, have led to interventionist measures and income transfers. The farming sector, representing some 3 to 4 per cent of the workforce, has retained great political influence disproportionate to its size in the economy.

Thus, many industrialized countries have persistently pursued protectionist domestic agricultural policies, which prioritize income stabilization and protection of their farming populations at the cost

of some $1 billion a day. Conversely, in Africa, where agriculture employs approximately 70 to 80 per cent of the workforce, a great majority of whom live on less than $1 per day per person, similar concerns have fallen on deaf ears. Not only has the international community not been inclined to go far enough in addressing the issue of income or commodity price stabilization, but poor countries have been encouraged to liberalize their agricultural sectors through structural adjustment programmes in the past two decades.

2. Agricultural market intervention in developed countries

Interventionist and protectionist measures in agriculture have a long history in many developed countries. First, competition in grains, dairy products and meat from the newly settled areas of North America and Oceania, along with an associated revolution in transportation and refrigeration during the last quarter of the nineteenth century, elicited different responses from European countries. Some countries reacted to this competition by intensifying intervention in, and protection for, their agricultural, and especially grain, sectors. This was to sow the seeds of what decades later became the basis for the EU's CAP (see Shonfield and Oliver, 1976: 292–303). The second protectionist wave took place during the depressed interwar period, when agricultural intervention and economic nationalism were adopted or intensified by both importers and exporters. The third wave of agricultural protectionism, associated with the post-World War II era, is derived from four main sources: (a) the post-war reconstruction and concomitant balance-of-payments difficulties experienced by western European countries; (b) the deepening involvement of Governments in alleviating disadvantages associated with income and opportunities for people, sectors and regions; (c) notions of distributive justice for the agricultural sector, which was unable to capture the benefits, but obliged

to bear most of the costs, of rapidly advancing technology; and (d) and the process of forming regional economic groupings. Japan's protectionist agricultural stance was a manifestation of the "administrative guidance" system under which the country slowly and selectively liberalized its trade and participated in the world trading system.[17]

Developed-country Governments have been reluctant to undertake any radical reform measures, despite fiscal implications for taxpayers and additional costs to consumers, because of the political, economic and social costs to a small but politically powerful group in the agro-industrial sector. According to the secretary-general of the OECD, the average domestic price of agricultural products of OECD countries is some 30 per cent higher than international prices; and the cost of farm price support to the average household in the EU, Japan and the United States is some $1,000 a year, much of which goes to the wealthiest farmers (see Johnston, 2003: 8).

3. International stabilization efforts

The impact of price fluctuations and real price declines on the agricultural and commodity sector of developing, and particularly low-income, countries has been much more acute, as commodity production and exports constitute the major source of livelihood of millions of poor farmers. However, unlike in the developed countries, because of fiscal constraints it is almost impossible for the Governments of many developing countries to provide any support to their farmers. Indeed, as was indicated earlier, in the context of a dual economy characterized by a large informal sector, fiscal revenues were largely derived from trade taxes. Thus, at the outset, developing countries looked to the international community for solutions to their commodity dependence and associated problems.

The first serious consideration of the problem in the post-World War II period was in the negotiations leading to the 1948 agreement on the Havana Charter (which was not ratified by member States). Nevertheless, the approach enunciated there was to influence international commodity negotiations in the following decades. This approach was underscored by three guiding principles: intervention in commodity markets by intergovernmental action should be an exception (dealing with severe market disruption) rather than the norm in commodity trade; both producers and consumers should be a party to such agreements; and equality of representation of producers and consumers should be reflected in individual commodity councils or organizations (UNCTAD, 1977).

The search for solutions to commodity problems at the international level was subsequently shifted to the Economic and Social Council of the United Nations (ECOSOC), which established an Interim Co-ordinating Committee for International Commodity Agreements (ICCICA) with responsibility for convening commodity study groups, recommending the convening of conferences to negotiate commodity agreements, and coordinating the activities of study groups and councils administering commodity agreements. The continued downward trend in the terms of trade for commodity-exporting countries, combined with instability in commodity prices and revenues, led developing countries and UNCTAD's Secretary-General, Dr. Raúl Prebisch, to place this issue high on the agenda of the organization's first conference in 1964.[18]

Over the next decade or so, attempts by the international development community to develop a viable international commodity policy were carried out within the framework of UNCTAD, which led to proposals for an Integrated Programme for Commodities (IPC) in August 1974. After intensive debates, the IPC was approved at UNCTAD IV in 1976; subsequently negotiations were launched on a basket of commodities. At the time, the idea was to negotiate the establishment of commodity agreements with economic clauses 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 in order to reduce price fluctuations, and stabilize prices at levels remunerative to producers. Negotiations with respect to such a facility were soon initiated, which later led to the establishment of the Common Fund for Commodities (CFC).

Despite intensive negotiations spanning several years, the only new commodity agreement containing economic clauses that was negotiated within the context of the IPC in UNCTAD was the International Rubber Agreement. This was no accident, as the Association of Natural Rubber Producing Countries went to the negotiating table with a prior agreement, which suggested a willingness to go ahead with its implementation, if need be, without the participation of consuming countries. With the advent of a global recession in the 1980s, some existing commodity agreements (such as those for tin and sugar) were discontinued under the pressure of depressed prices, while economic clauses in agreements such as those for coffee and cocoa were removed. The Agreement establishing the CFC, which was adopted in 1981, entered into force only in 1989, with its first window designed to finance buffer stocks suspended. The financial base of the CFC, as eventually negotiated, was in any case far smaller than originally envisaged, and too small to enable it to intervene significantly in commodity markets.[19]

With recession in the world economy in the 1980s and the subsequent decline of commodity prices as a whole, combined with the breakdown of multilateralism in international economic relations and the ascendancy of market-oriented strategies, intervention in markets (at least in favour of developing countries) was no longer deemed acceptable or feasible. 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. The concept of international commodity price stabilization thus suffered

a major setback. It would seem that, following these events, consuming countries did not have any strong motivation to negotiate, in particular because developing countries by the mid-1980s were not in a position to take collective action on commodity exports because of severe balance of payments difficulties and the debt overhang. Indeed, many of these countries were being encouraged through structural adjustment programmes to produce and export more of their traditional commodities to offset the loss of earnings. The earlier concerns with respect to the availability of supplies in consuming countries in the 1970s were now overridden by a disinclination to intervene in "free markets", which reflected the dominance of private-sector interests. The producer countries had a limited capacity to exercise leverage through recourse to alternative actions, and in certain cases could not reconcile their own differences (for example, conflicts of interests between established and new producers).

In addition to the historical developments outlined above, researchers have advanced many reasons why commodity agreements failed to function, or were simply impossible to negotiate. One school of thought holds that the breakdown of these agreements reflects the difficulties involved in attempts to influence prices via output management, or other means, in a context of supply expansion underscored by productivity increases (Reinhart and Wickham, 1994: 202). A second school underscores the difficulty of agreeing to price ranges that would be "equitable" to producers (Gilbert, 1996: 3) or determining accurately a long-term price trend around which to stabilize prices. Problems in coordinating the interests of different parties to the agreement, as well as the weaknesses or lack of enforcement mechanisms and the problem of free riding (Cashin, Liang and McDermott, 1999: 36; Gilbert, 1996: 5), have also been advanced as reasons. On the other hand, it has been argued that these challenges, as serious as they may be, were not insurmountable had there been sufficient political will, backed by adequate financial resources, to make these agreements work (see,

for example, Rangarajan, 1983). For example, while a commodity such as petroleum shares many of these difficulties (albeit of a slightly different nature), OPEC (the Organization of Petroleum-Exporting Countries), through cooperation among its members (and with some non-members), has been able to maintain a certain measure of price stability in the market, despite the fact that prices have fallen in real terms.

4. Compensatory financing mechanisms

Compensatory financing facilities, designed to compensate for shortfalls and short-term price shocks, have not fared any better, with many commodities suffering from secular price declines. These facilities were also cumbersome, pro-cyclical or too expensive to use. The best-known examples of compensatory finance are (a) the Contingency and Compensatory Financing Facility (CCFF) of the IMF (1988), preceded by the Compensatory Financing Facility (CFF), which commenced in 1963; and (b) the EU's Stabilization of Export Earnings (STABEX).[20]

The objective of the CCFF was to smooth the effects of a temporary, exogenously caused shortfall in merchandise export receipts below the medium-term trend in a particular country. It sought to provide countries lacking either sufficient reserves or the capacity to borrow externally with the capacity to smooth the path of national consumption in the presence of a temporary shock to export earnings. The eligibility requirements for access to the compensatory financing element of the CCFF include a *temporary* export shortfall and/or excess cereal import, which is attributable to factors largely beyond the control of authorities; the country's having a balance-of-payments problem; and a willingness to cooperate with the IMF to address the problem. Access to the CCFF is also governed by strict rules for calculating export shortfalls or excess cereal

import costs, with access limits in the two instances defined by the country's balance-of-payments position, past cooperation with the IMF to resolve balance-of-payments difficulties, and willingness to adopt adjustment policies that would meet the standards of upper credit tranche conditionality.[21]

Schemes like these are predicated on the assumption that temporary shortfalls in export earnings will be self-reversing. It is, however, difficult to distinguish between temporary and permanent shocks, as even those considered temporary might turn out to be of long-term duration. Indeed, as was argued in Chapter I, Section 3, primary commodity prices for the past half-century have been characterized by secular downward trends, and typically commodity price falls do not reverse themselves quickly. In this context, it has been argued that it was not entirely rational for Governments to contract loans to smooth expenditure during slumps without any notion of when the slumps would end (Collier, 2002: 17). To a large extent, the CCFF was under-utilized, as its loans were on non-concessionary terms, and therefore too expensive for most developing countries. It also appeared to have operated in a pro-cyclical manner (instead of being a counter-cyclical balance-of-payments support). As Hewitt observes, "by the 1980s, this [CCFF] had been converted into a high-conditionality bridging-loan arrangement which was no longer operating counter-cyclically as originally intended and was not even cheap" (1993: 79). At their meeting in January 2000, the executive directors of the IMF agreed to eliminate the contingency element of the CCFF, as it was plagued by a series of problems that limited its utilization. They also decided to allow the compensatory element of the CCFF to continue operation pending a later review in accordance with the recommendations submitted by the Policy Development and Review Department.

STABEX was introduced under Lomé I (1975–1979) to act as part of a comprehensive international commodity policy, based es-

sentially on good functioning of International Commodity Agreements (Koehler, 1997). It was to compensate the African, Caribbean and Pacific (ACP) countries' shortfalls in export earnings due to fluctuations in the world price or domestic supply of agricultural commodities. Compensation payment was triggered if there was a loss of export earning to the EU relative to a four-year trend. The shortfall of export earnings on which the transfer was made was based on the gross sum of the shortfalls in individual exports of different agricultural products (commodity by commodity), which, during the mid-1990s, numbered about 50 products and product groups. The scheme underwent a number of changes after its inception, including increases in the number of products covered, compensation conditions and derogation clauses, among others (Koehler, 1997). Initially, Governments could use this payment as they deemed fit. Later, however, payments were expected to be reinvested in the sectors and activities that were the sources of earnings instability, a situation that exacerbated the commodity dependence problem. Much later, STABEX was tied to specific projects (Page and Hewitt, 2001: 37). While the system operated smoothly under Lomé I, during much of the 1980s it ran out of resources and was unable to meet eligible claims. The financial crises grew worse during the 1990s, with persistent low market prices for coffee, cocoa, oil seeds, cotton and tea, resulting in only 40 and 60 per cent of eligible transfers being covered in 1990–1992 and 1993 respectively (Koehler, 1997; see also Page and Hewitt, 2001: 37).

STABEX had limited impact in attaining its objectives, including promoting agricultural diversification, because of its modus operandi. While it has been reckoned to be the fastest-disbursing instrument in the EU's aid portfolio (Page and Hewitt, 2001: 37–38), it has been contended that the time lag between request and disbursement resulted in the latter being pro-cyclical[22] (Collier, 2002: 17; see also Claessens and Duncan, 1993: 8). STABEX stopped its operations in 2000.

5. Domestic stabilization schemes in Africa

In industrial countries, access by both consumers and producers to various types of facilities, such as credit and deposit markets, storage, and insurance facilitates the management of unexpected commodity price movements, and therefore mutes their impact on consumption and income. These facilities are either unavailable or expensive to use in most developing countries, in particular African ones. Access to the international capital market by this group of countries has been limited; further, more often than not, these markets provide easy access at periods when they are least useful. That is, they are pro-cyclical, providing access during periods of high commodity prices when they are not actually needed (Cuddington and Urzua, 1989, quoted in Claessens and Duncan, 1993: 9). These problems partly explain the proliferation in most African countries of domestic price stabilization measures to address commodity problems.

Crop marketing boards and *caisses de stabilisation* mediated between world markets and producers in many commodity-exporting African countries. They offered support (administered) prices, announced at the beginning of each harvest season, to producers and operated (or were supposed to operate) on the basis of buffer funds. In several cases, they also provided ancillary services such as extension and rural infrastructure including, in some cases, health and educational facilities as well as input provision, product distribution and credit.

The record of these boards was mixed, and in the late 1970s and early 1980s some were beset with several problems. A major issue was the difficulty of determining the level of support prices around which incomes should stabilize. In several instances, the value of administered prices was not sufficiently and regularly adjusted to reflect the domestic inflationary situation, exchange rates or the medium-term trend in global prices. In a context of high

domestic inflation and overvalued exchange rates, the real value of support prices was seriously eroded.

These problems notwithstanding, crop marketing boards did play a vital role in the development of the export agricultural sector in several African countries. Therefore, the policy of dismantling them altogether rather than reforming their operations has been questioned in many quarters, including by UNCTAD (1998a). Quite apart from their role in stabilizing prices and ensuring that producers were paid, they were important in providing rural infrastructure, credit and extension services, including seeds and pesticides for fumigation. Nevertheless, these institutions were dismantled in many countries within the context of structural adjustment programmes, thereby exposing commodity producers to the vagaries of world commodity markets. The post-adjustment experiences have been mixed, but, on the whole, real producer prices have reflected the declining pattern of world market commodity prices (UNCTAD, 2002b: 141). The domestic terms of trade have turned more against farmers in those countries that have liberalized, and the shift from public to private marketing agents has not increased the proportion of export prices passed on to producers. Farmers have also suffered negative consequences because key production and marketing costs have risen rapidly, fertilizer prices and transport costs have soared, and lower wages have not helped, since hired labour accounts for less than 20 per cent of the total labour force (UNCTAD, 1998a: 165–176). Consequently, SSA producers are less able to protect themselves from falling commodity prices. Indeed, a recent paper that examined the case of cocoa during liberalization concluded that "market liberalization measures do not appear to have been a resounding success" even considering their limited stated goals. Most significantly, it argues that, following market liberalization, producer prices displayed greater volatility in Cameroon, Côte d'Ivoire and Nigeria (countries that dismantled their marketing boards) than in Ghana (which still keeps its marketing board) (ul Haque, 2003).

6. Commodity price risk management

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 recently focused on the use of market-based mechanisms, such as forward, futures and option contracts as well as swaps, for managing commodity price risks. Technically, these mechanisms permit producer countries to limit the risks arising from unanticipated price movements by passing them over to investors in other countries. While such instruments have been in use for more than a century, mainly in the developed countries, only in the past two or three decades have they become popular as instruments for hedging commodity risk. Some developing-country Governments, including some African Governments, such as those of Côte d'Ivoire and Ghana, have sold forward their cocoa exports, and francophone countries their cotton exports, but the use of these market-based instruments is not widespread on the continent.

Several reasons have been advanced for the restricted use of these instruments in developing countries: unfamiliarity with their advantages and the costs and benefits of alternative contracts available; government policies that militate against their use; the two-year limited horizon of futures and options markets, which render them unsuitable for exports of commodities with longer gestation periods; the difficulty of locating an appropriate hedging tool for specific export commodities; and low creditworthiness, which makes it difficult for developing countries to access other financial markets – for example, for non-standard contracts and longer-dated instruments (World Bank, 1994: 65–66; Reinhart and Wickham, 1994: 208; Page and Hewitt, 2001: 30). The shallowness of the financial sector and the limited number of (unsophisticated) financial products on offer also discourage the use of such instruments in Africa.

In any case, it is doubtful if the futures markets are as suitable

for addressing problems emanating from price variability as they are for the reduction of uncertainty in revenue flows. As observed by Tomek and Gray (1970, quoted in Gilbert, 1996: 17), commodity futures prices are only slightly less volatile than cash prices. This notwithstanding, futures sales do allow Governments to eliminate uncertainty associated with variability over an annual time horizon. On the other hand, while this could increase the collateral value of commodity stocks and permit budgetary control, it does not amount to revenue stabilization or altering the terms of trade in favour of commodity exporters (Gilbert, 1996: 17). The futures market is certainly not the correct instrument for addressing the issue of long-term decline in commodity terms of trade for commodity-dependent countries. It is best suited to managing risks resulting from short-term movements in prices. These instruments have clear limitations, and, in the short term, their widespread use for commodity risk management is unlikely in Africa without technical assistance in building the required institutional infrastructure, experience and expertise.

7. The present state of play

Secular decline in commodity prices, commodity price volatility and associated uncertainty are likely to persist for a variety of reasons. First, structural over-supply in commodity markets is most likely to persist in the short to medium term, as the factors underscoring it (subsidies and other domestic agricultural support in OECD countries in the case of temperate products; and overproduction, in the case of tropical beverages such as coffee, cocoa and tea) are not amenable to short-term solutions. Second, technological innovations and their impact on supply and demand will continue into the foreseeable future. Finally, forecasting commodity prices is a notoriously imprecise art.[23] As was discussed above, international commodity agreements and compensatory financing schemes

have not provided satisfactory solutions to the deteriorating terms of trade suffered by African countries, as there has not been either the requisite political will or sufficient financing to back them up. Similarly, commodity risk management through market-based instruments has severe limitations in the current African context. Domestic stabilization schemes and associated institutions have been dismantled under the banner of market efficiency, and this has created an institutional void with adverse consequences for the livelihoods of millions of African farmers.

As Maizels observes, opposition by developed countries to intervention in international commodity markets remains strong, "in glaring contrast to the widespread interventionist measures adopted by the same developed countries in the operation of their domestic commodity markets, including price support, together with consequential tariff and non-tariff barriers to imports of agricultural products, and of processed commodities generally, from more efficient producing countries" (1987: 547). Maizels concludes that this complex system of government subsidies and support has therefore often substantially reduced the impact of external shocks on the commodity sector of these countries (1987: 548). In effect, the developed countries have found it worthwhile to politically protect a mere 3 to 4 per cent (more or less) of their working population from the adverse impact of volatile and generally declining real commodity prices, but have argued against deploying similar instruments to protect about 70 to 80 per cent of much poorer developing countries' population whose sole livelihood is agriculture.

While support to the agricultural sector is to be phased out under the WTO Agreement on Agriculture, much of this support is still in place, and, as the latest developments in the WTO trade talks in Cancún demonstrated, it is unlikely that the web of domestic interventionist measures of OECD countries will be dismantled anytime soon, considering the strong domestic objections by power-

ful agricultural interests to the liberalization of domestic agricultural markets in accordance with multilateral trade disciplines. Thus, the question of how commodity-dependent African countries could accommodate the declining trend in real commodity prices and its impact in order to attain real income gains demands urgent answers. The final chapter discusses some relevant policy proposals.

Chapter III

Policy Issues

There is on the question of commodities a sort of conspiracy of silence. The solutions are not simple… But nothing justifies the present indifference.

President Jacques Chirac of France, in his address to the Twenty-Second Summit of the Heads of State of Africa and France, 20 February 2003

1. Search for solutions

As was discussed in the previous chapters, two issues need to be underscored with respect to Africa's trade performance: First, more than any other developing region, Africa is heavily dependent on the export of commodities, although paradoxically its share in world commodity exports has declined in the last two decades. Second, the majority of Africa's non-fuel commodity exports have been subject to both high price volatility and a secular decline in real prices (that is, in terms of purchasing power of manufactured imports). The continent has therefore been caught in a downward spiral where such dependence and its attendant ramifications have become a structural feature of many of Africa's economies. Commodity exports are not generating sufficient savings for investment in diversification and in the development of human and physical

infrastructure. Hence, the "commodity trap" in which these countries are caught has become essentially a "poverty trap". For African countries, for which commodity exports represent well over 70 per cent of foreign exchange income, the problem has become essentially a developmental one.

A review of schemes implemented in the past (see Chapter II) suggests that, while policy responses should take into account the characteristics of specific commodities and associated trends in world markets, a variety of mutually reinforcing instruments need to be applied simultaneously, bearing in mind the wider developmental implications of Africa's commodity dependence. Therefore, while solutions centred on specific commodities could help alleviate some of the constraints faced by African countries, the policy challenges of commodity dependence require action on several fronts with the overall objective of addressing the structural constraints of African economies. Most significantly, commodity issues have to be treated as an integral part of development policy formulation and implementation in African countries. This should encourage the development of a stable, transparent and predictable framework, which is a *sine qua non* for the success of diversification efforts in the medium to long run.

This chapter discusses specific policy issues at the domestic, regional and international levels which could (a) make it easier for Africa to accommodate primary commodity dependence in the short to medium term, and (b) reduce Africa's commodity dependence in the long run by diversifying its productive and export base.

2. Domestic policies

The analysis of the African experience in previous sections suggests that the policies aimed at reducing the role of the state in the commodity sector within the context of agricultural trade liberalization have not had the desired outcomes, and that markets have not been able to fill the resulting institutional void. The need to create greater institutional capacity, including in the commodity sector, would necessitate a bigger role for the state than is currently recognized in addressing commodity dependence in African countries, albeit avoiding certain past mistakes (as is discussed in Section 2(b) below). Governments have a critical role in macroeconomic management and in encouraging and promoting horizontal and vertical diversification towards higher-value-added products through an integrated programme of "supply-side responses" such as the provision of fiscal and other incentives, extension services, trade facilitation, market research and quality control. It is therefore essential not only to adapt macroeconomic policies to deal with structural constraints faced by African economies, but also to build up and reinforce institutional capacities. Governments, in partnership with the private sector, also need to promote regional economic cooperation with the objective of overcoming the constraints of small domestic markets and altering the traditional export structure, as well as adapting to the challenges of increasing global integration and the associated challenges of increased competition.

(a) Macroeconomic management

A sound macroeconomic environment is a prerequisite for successful and steady export growth in the commodity sector and for turning the commodity sector into an engine of growth and development. Therefore, Governments have a critical role in ensuring a stable macroeconomic framework underscored by appropriate ex-

change rate, fiscal and monetary policies. In particular, the real exchange rate must be at a level that ensures competitive exports and encourages new investments in the domestic economy; also, fiscal policy has to be conducted in a less pro-cyclical fashion if boom and bust cycles are not to be exacerbated.

The problem, however, is that many commodity-dependent African countries have found it extremely difficult to manage their economies, as commodity terms of trade and price volatility have an impact on macroeconomic variables, such as savings and investment (capital accumulation), fiscal and external balances, exchange and interest rates, debt management and overall economic growth. When commodity prices fall, the lower purchasing power of exports negatively affects the capacity to import capital goods and intermediate products necessary for the industrialization process, as well as fuel and food. Also, adverse commodity terms of trade undermine private capital accumulation as the falling earnings of commodity producers make it difficult to finance investments domestically. A negative commodity price shock is typically followed by currency depreciation, with the consequent impact on inflation, particularly in an open trade regime. In heavily commodity-dependent countries, the value of local currencies is greatly influenced by the commodity sector. Hence, there is a strong causal relationship between movements in real commodity prices and the evolution of the real exchange rate.

Adverse commodity price movements create large current account deficits, which must be financed by increased external borrowing or increased official development assistance. Where external borrowing is used to finance the deficit, it aggravates the external debt burden of developing countries, thereby contributing, in many countries, to unsustainable external debt positions. In fact, commodity price declines were a prominent factor in the emergence of the debt and development crisis of the 1980s and in the continued debt overhang of recent years, as well as in the signifi-

cant deterioration in the external payment positions of many commodity-dependent African countries. Indeed, most of the heavily indebted developing countries are also highly dependent on a few commodity exports.

(b) Institutional capacities

As was indicated earlier, weakening the role of the state and thus institutional capacities in the commodity sector and price liberalization have not had the desired effect of adjustment to a more competitive environment through the free play of market forces. There are important lessons to be drawn from the East Asian development experience, where the state has been an important determinant in policies, as well as in providing support and guidance to the entrepreneurial class. There are a number of areas where the public sector's role and capacity would need to be built up in African countries in order to meet the development challenges of commodity dependence, including the establishment of appropriate institutions. The role and mandate of these institutions should be properly defined and their activities costed within the framework of social and economic cost-benefit analysis. Direct involvement by producers and exporters could also help to ensure that the interests of producers are not sacrificed for those of bureaucrats, or the state.

(i) Research

It is important for countries to develop research and analytical capacities that will enable them to identify a set of sectoral policies that supports diversification and specific stages of generation of high value added; assess the country's potential for entering these activities; and design necessary policies to enable the country to capture a higher proportion of the final products' value added. Gathering and disseminating market intelligence relating to niches (such as fair trade, speciality and organic) and levels of premium

available for higher-quality exports, among other things, also depend on a strong research capacity.

(ii) Public goods

Institutional capacities must also be enhanced for the provision of public goods that address market imperfections, including eliminating segmentation of rural and urban markets and linking them to regional and global markets. Improvements in roads, ports, cargo-handling facilities and telecommunications infrastructure, together with the removal of non-physical barriers to transportation (for example, through harmonization of customs and transit documentation), should reduce costs and increase the price competitiveness of exports, in particular for landlocked African countries.

(iii) Quality improvement

A rigid system of quality assurance could be devised and implemented by defining minimum acceptable quality (for example, in terms of moisture content and percentage of broken beans for cocoa and coffee), backed by a pragmatic enforcement mechanism. This may necessitate an institutional framework reminiscent of national export or crop marketing boards, which involve exporters. As was mentioned earlier, support structures in many African countries (for activities such as marketing, quality control and inspection services) have been weakened with the dismantling of crop marketing boards as part of structural adjustment measures. In several instances, the quality of exports has suffered in contrast to countries (such as Ghana) where the state has retained some quality control over its main exports (see also ul Haque, 2003). Developing quality control systems at the domestic level is particularly important for a scheme like this, as these have not kept pace with industry requirements. For example, while manufacturers are willing to pay higher prices for cocoa beans whose quality enables them to be processed into chocolate with a viscosity suitable for coating

ice creams and the like, these characteristics are not measured in many producing countries (Osorio, 2002). An International Coffee Organization (ICO) programme on minimum quality standards, which came into force on 1 October 2002, has highlighted some of the complex issues that would have to be overcome to sustain such a programme (UNCTAD, 2003c: 186–187).

(iv) Withdrawal of productive capacity

The programme for quality improvement could be complemented with one that funds the withdrawal of productive capacity in high-cost producing countries and of low-quality stocks. Rationalization of agricultural production has been employed by many developed countries in the past. The success of such programmes hinges on the capacity of Governments to mobilize adequate financial resources, both at home and abroad, to compensate those producers who may be required to reduce production, and to encourage related crop diversification and/or substitution programmes.

(v) Diversification

A horizontal diversification programme must incorporate more dynamic, higher-value-added products (such as fruits, vegetables, fish and seafood) as well as temperate products (such as grains and meats) that are unrelated to existing or traditional exports, in order to attain a balance between commodities subject to persistent and short-lived shocks. The strategy of diversification, however, entails the risk of further depressing commodity prices if all countries diversify into the same commodities, as it would be difficult, if not impossible, to avoid a "fallacy of composition" at the regional level (see, for example, Mayer, 2002). The strategy's success will depend on enhanced farmer access to agricultural inputs, including improved seeds and credit, efficient extension services and better cultivating techniques, good rural infrastructure and improved access to land with secure titles.

Overall, land should not be a binding constraint on agricultural production in most African countries, just as scale diseconomies should not be an immediate constraint on labour productivity, which could be increased several-fold by training the labour force, by conducting agricultural research, and by more intensive and appropriate use of biotechnology. Unlike other countries and regions (for example, Asia), which are already at or approaching scientific and technological frontiers and limits of natural resource endowments, in those SSA countries that are furthest from frontier levels, opportunities exist to enhance agricultural productivity significantly. Demand for food and feed grains will continue to increase in Asia and major oil-exporting countries. For example, during the 1990s, 56 per cent of the growth in developing-country agricultural trade was accounted for by sales to other developing countries and 44 per cent by sales to industrial countries. With increasing trade liberalization, African countries would find it advantageous to expand their exports of commodities in line with their comparative advantage of climate and other resources (see Ruttan, 2002).

In addition to horizontal diversification, African countries could diversify into manufactures, which have potential for the coordinated entry of new, export-oriented firms. This could be facilitated, to some extent, by preferential access to the EU market under EBA. Another area in which Africa could develop its potential comparative advantage is the export of services, as these have become internationalized in recent years. This great potential could be realized by developing domestic capacity in certain critical areas, such as communications infrastructure, and competitive pricing of services. These moves would need to be supplemented by domestic regulation and investment policy (UNCTAD, 1998b: 109–135; Collier, 2002: 16). Resource requirements for diversification are beyond what could possibly be mobilized at the domestic level, hence the need for establishing a "diversification fund" (discussed below in Section 3).

Vertical diversification would require state-supported institu-

tions in order to facilitate quality and technological upgrading, including through the promotion of linkages with foreign markets. Business associations, with assistance from Governments and international associations, could undertake market research to identify emerging trends and develop credible national "codes of good practice", which could help in entering and maintaining new markets. Measures such as tariff rebates, tax exemptions, preferential credits and export credit insurance will be invaluable for promoting exports to the new and emerging markets of other developing and transitional economies, including China and Russia, and to existing markets.

Any diversification programme has to be consonant with recent and current developments in international commodity trade. As was discussed earlier, international trade in agricultural products has shifted away from traditional commodity exports to non-traditional ones with high income elasticity and lower rates of protection in industrial and large developing countries. There were significant declines in the relative growth rate of international trade in coffee, cocoa, tea, sugar and sugar products and textile fibres between 1980–1981 and 2000–2001. On the other hand, international trade in new dynamic products, such as fruits and vegetables, fish and seafood, and in alcoholic and non-alcoholic drinks has increased. Developing-country exports of temperate products (milk, grains and meats) have also increased marginally, mostly to other developing countries with much lower rates of tariff and non-tariff barriers.

(c) Regional economic cooperation and integration

It is widely acknowledged that there is a great potential for increasing intra-African trade and creating wider economic spaces. In recent years, efforts at subregional and regional economic integration have been stepped up substantially, including the launch of the African Union in 2001 (to succeed the Organization of African Unity) and the concomitant creation of the African Economic Com-

munity (AEC). However, the full potential of intra-African trade has yet to be fully exploited through greater coordination of efforts aimed at harmonizing customs procedures and reducing tariffs and non-tariff barriers, and at improving transport and communications links through greater investment in developing regional infrastructure. Promoting economic integration through enhanced regional and intra-African trade is one of the major objectives of the New Partnership for Africa's Development (NEPAD), and, considering the strong political support for NEPAD in the international community, it is hoped that the efforts of African countries will be complemented by their development partners. The UNCTAD secretariat's analysis of trade between the Southern African Customs Union (SACU) and the Southern African Development Community (SADC), for example, reveals great potential for increasing trade in primary commodities, including meat, tropical beverages, cotton, diamonds and non-ferrous metals. Furthermore, the analysis suggests that a few resource-intensive basic manufactures, such as cotton yarn, cement and some types of woven fabrics, could also be traded (see UNCTAD, 1998a: 202–207).

Opportunities also exist for intra-regional trade in food items, such as maize, cassava and cassava products, and fish, as well as in live animals and bovine meat, most of which feature in informal cross-border trade in the West African region. In Southern Africa, there is a scope for increasing the ongoing intra-regional trade in water, electricity and services. The recent launching of the Great Limpopo Transfrontier Park, which incorporates existing game parks in Mozambique, South Africa and Zimbabwe, could unlock the great potential for tourism and investment in the Southern African region, as well as promote creative industries such as music, dance and handicrafts. Indeed, one major objective of the Park is to promote biodiversity conservation across frontiers and rejuvenate the socio-economic fortunes of the poor communities in the area of the park by creating more employment opportunities.

3. International policies

National/domestic policy packages are unlikely to be effective without a complementary package from the international community. A robust policy in support of commodity-dependent African countries would undoubtedly need to take into consideration the characteristics of individual commodity cycles and price trends.[24] At the same time, there is a need for a clear recognition of the fact that markets have not provided, and are unlikely to provide, the necessary solutions to instability and secular decline in commodity prices. Hence, what is required is action at the international level to mitigate the adverse effects of market failure by devising and supporting new international initiatives on commodities, consonant with the development needs of commodity-dependent African countries.

A renewed commitment to an international commodity policy arises from the fact that there are obvious contradictions and a dichotomy between market intervention being deemed as acceptable in certain cases (at the domestic level in favour of farmers in developed countries), and not in others (at the international level in favour of farmers in developing countries). Such a commitment, in addition to promoting development, would also need to acknowledge the inherent relationship between poverty and commodity dependence, if it is to make a genuine contribution to international poverty reduction objectives. Policy coordination and coherence at the international level, including among various international trade and financial institutions and the United Nations and its specialized agencies, would be crucial for success.

As was explained earlier, despite criticisms advanced by some observers, many of the schemes advanced in the past to deal with the commodity problematic have some merit. There is ample scope to draw lessons from them, while acknowledging that new policies would need to take into account the functioning of world agricul-

tural markets and recent developments in the multilateral trading system.

For example, the UNCTAD Integrated Programme for Commodities (IPC)[25] sought to secure an international consensus to take action on a wide range of products through a set of measures specifically applicable to each of these products. It stressed the comprehensive coverage of commodities, which reflects the need to secure adequate balance in the treatment of different commodities. Among other things, the IPC was to:

- Mitigate the fluctuations in commodity prices as well as stabilize the earnings of developing countries from their commodity exports at adequate levels and in real terms;
- Create conditions for effective planning of production and investment in producing countries; and
- Enhance the capacity of producer countries to adjust to structural changes and long-term trends to undertake progressive diversification of their economies and to expand the secondary stages of production based on the processing of commodities.

Despite widespread scepticism regarding the efficacy of international commodity agreements, it should be possible to revisit these. Failing agreement between producers and consumers, developing countries could study the feasibility of establishing supply management schemes for a selected number of commodities for which they are major producers and exporters, such as tropical beverages, where over-supply has been a major determinant of secular decline in prices. Once this feasibility is established, the next stage would be to work out a financing mechanism at the international level to help these countries develop a system of supply rationalization and diversification into other products in order to remove excess supply of these traditional commodities from the markets. This might necessitate revisiting the concept of a “diversification

fund" for African countries. The remit of the second window of the CFC could be redefined and its resources enhanced to enable it to take on this additional role.[26]

Two other elements of the UNCTAD IPC could form the plank of any future international commodities policy, incorporating lessons learned over the past 30 years. The first includes (a) enhancing the capacity of producer countries to adjust to structural changes and long-term trends through the progressive diversification of their economies and (b) expanding the secondary stages of production based on the processing of commodities. The second involves paying compensation to producers to cover shortfalls in export earnings in the case of transitory shocks, such as those attributable to subsidies and other production support in OECD countries. A major consideration here will be how to design these schemes in consonance with the current global economic conditions defined by the multilateral trade disciplines of the WTO. Alternatively, derogations from the WTO disciplines could be sought.

(a) Market access

To the extent that more advanced developing countries in Asia and Latin America with a relatively diversified economic base moved from low-value agricultural commodities towards labour-intensive manufactures and higher-value-added market-dynamic products, a space would be created for the poorer countries in the production and export of agricultural commodities, including processed products. This depends, *inter alia,* on increased market access for these products.[27] Furthermore, non-tariff measures, such as sanitary and phytosanitary ones and requirements arising from technical barriers to trade and other contingency trade-protection measures, should be applied in a manner that does not unnecessarily hinder the exports of African countries. Such a process would be facilitated by greater liberalization of OECD domestic agricul-

tural markets through a significant reduction, and finally elimination, of the existing massive agricultural subsidies and support for commodities, such as cotton, groundnuts and sugar, which are of export interest to Africa.

Enhanced market access is critical for the success of any scheme aiming to promote diversification in African countries. Overall, increased market access for African exports, in particular agricultural exports, depends on the outcome of negotiations within the ambit of the WTO. Renewed efforts are now required to deal with subsidies and protection in the agricultural sector in order to reverse the recent setback at the WTO Ministerial Meeting in Cancún. It is critical for the current trade negotiations to achieve enhanced market access for processed agricultural commodities with higher value added by eliminating peak tariffs and tariff escalation in particular. As was discussed earlier, most tariff peaks are in agriculture, including processed products, and most post–Uruguay Round tariffs escalate between raw and semi-finished as well as between semi-finished and finished products, with a greater impact on more advanced stages of processing. Furthermore, although tariffs are on average much lower in industrial countries than in developing countries, industrial-country tariffs display high peaks (or high protection) for specific products.

(b) Compensation for subsidy-related income losses

Pending a positive outcome with respect to the phasing out of subsidies and agricultural protection, a mechanism is required at the international level to ensure that countries providing subsidies to their producers compensate African countries for income losses arising from such subsidies on a *pro rata* basis. This is particularly so considering the loss of income to African cotton producers that stems from subsidies provided by cotton-producing developed countries to their own producers. The president of Burkina Faso, in his

address to the Trade Negotiations Committee at the WTO on 10 June 2003, made the case for compensation on behalf of African cotton producers.[28] The proposed transitional compensation mechanism (TCM) could be adopted for other exports whose long-term price decline could be traced to developed-country agricultural subsidies and other domestic support.

The TCM is to be linked with and limited to the subsidy reduction period. The amount of compensation to be paid annually would correspond to estimated losses calculated on the basis of a reference period covering three years of cotton production. The rate of reduction in yearly subsidies (about 33 per cent according to the proposal) would lead to an equivalent reduction in the amount of annual contribution to be paid to the compensation fund. The contribution of countries to the TCM would reflect their respective shares in the total amount of subsidies granted to cotton worldwide, and the share of each beneficiary country in the TCM would reflect its share in the total cotton production by all beneficiaries. Contributions to the TCM and allocations from it would be based on annual statistics published by the International Cotton Advisory Committee (WTO, 2003). It is, however, important to ensure that resources disbursed through the TCM are indeed "additional" to existing aid budgets, and not simply a re-routing of such budgets of the countries concerned. The subsidy reduction period should also be explicitly time-bound, with provisions for penalties in case of default if the TCM is not to be an excuse for continuing the operation of subsidy regimes.

(c) Compensatory financing mechanism (CFM)

The experience of STABEX suggests that there are a number of positive elements of compensatory financing facilities and that, depending on the conditions governing the operation of such a facility, it could respond to the financing needs of African countries

during commodity price slumps, as STABEX did during its initial years of operation. Research into the operations of STABEX to identify its strengths and weaknesses, and why it eventually failed in its objective, could form the basis of isolating a set of criteria required for the successful operation of a CFM that is responsive to the time-constrained financing needs of commodity-dependent African economies in times of negative price shocks. Such a study could also be extended to the Contingency and Compensatory Financing Facility (CCFF) of the IMF and the CFC with a view to identifying ways of improving them. *A priori* a CFM should be quick-disbursing in order to be counter-cyclical (disbursed during price slumps, and not when prices are recovering), highly concessional and not encumbered by a host of conditionalities. The importance of compensatory financing to addressing African commodity problems in the short term was acknowledged in a General Assembly resolution in 1991.[29]

(d) Official development assistance and debt relief

African countries require sufficient resources in order to invest in improving human and physical infrastructure and undertaking institution building. Thus, higher levels of investment, far beyond the current low levels, are crucial in any drive towards a steady and sustained diversification programme in Africa. This brings to the fore the role of the international community through the provision of much-increased levels of official flows to help bridge the continent's savings and investment gap (see UNCTAD, 2000a for a detailed discussion). Moreover, an exit solution to the debt overhang of African countries is essential if the continent is to invest in the development of human and physical infrastructure. Also, macroeconomic policy advice should be adapted to the specific requirements of each African country, which underscores the need for policy coherence in this area at the international level.

4. Conclusion

Winning the argument concerning some of the policy measures discussed so far would not be easy, in particular because the practical difficulties encountered by some of the traditional price support and stabilization schemes have not disappeared. However, the persistence of the problems of commodity dependence in the past three decades suggests that markets have not been able, and cannot be expected, to solve the problem. It could also be argued that the limited support of the international community for the traditional price support and stabilization schemes was an important factor in their demise.[30] Thus, it is now time for the international community to recommit itself unambiguously to addressing the commodity problem in all its manifestations, exploring with a seriousness of purpose all available means.

As has been discussed in previous UNCTAD reports, the present conditions in Africa are not so different from those of the second-tier newly industrializing economies (NIEs) in South East Asia (such as Indonesia, Malaysia and Thailand) in the mid-1970s (UNCTAD, 1998a: 213, box 8), except perhaps for primary education and higher levels of accumulation. Addressing the secular decline in real commodity prices would require a domestic and international policy package aimed at the structural transformation of African commodity-dependent economies within the context of an improved system of resource allocation. Although essential, such transformation cannot be undertaken solely through provision of better market access and reduction of subsidies.

The international economic environment has changed significantly since the NIEs of South-East Asia embarked on their industrialization programmes. African countries now have to operate within the framework of WTO disciplines (backed by a rigorous enforcement mechanism), which limit the use of instruments deployed by the NIEs, the special and differential treatment measures

notwithstanding.[31] It should nevertheless be possible to envisage derogations, in the context of WTO negotiations, from some of these disciplines to support development programmes, if their objectives are clearly defined. Similarly, Africa could use the WTO system to its advantage by judicious schemes of tariff reduction (or rationalization) within the context of regional economic groupings that enhance market access within the continent, and generally in the developing world.

Without doubt, Africa can only reduce its commodity dependence and launch itself on a high and sustainable growth trajectory within the context of a major overhaul of its domestic policies and complementary international policies. The primary responsibility for overcoming these problems lies with African Governments themselves. With the adoption of NEPAD, Governments have made it clear that they are assuming their responsibilities. However in the light of the above analysis and other research conducted by the UNCTAD secretariat, global economic conditions and externally induced shocks have an important impact on domestic conditions in African countries. It therefore behoves the international community to assume its share of responsibility by supporting a consistent and coherent policy framework that does not frustrate Africa's own efforts at economic restructuring and diversification.

Annex

Cotton subsidies and their effects on the economies of West and Central Africa

Cotton production and exports are vital to several economies in West and Central Africa, where cotton is a cash crop for many smallholders. More than 60 per cent of agricultural export earnings are derived from this crop, which provides direct support to more than 10 million people in the region. It accounted for 40 to 75 per cent of the total merchandise export earnings of Benin, Burkina Faso, Chad and Mali in 2000–2001, and it contributed about 5 to 10 per cent of GDP in these countries (see table). The cotton market has, however, been subject to various marketing and trade interventions, including huge subsidies in recent years. The International Cotton Advisory Committee (ICAC), for example, estimates that in 2001–2002, the United States, the EU and China supported the cotton sector to the tune of $6 billion, which corresponds to total world exports during that year. Over the last 40 years, global cotton production has doubled to 20 million tons in 2001.

West and Central African countries are among the lowest-cost cotton producers, while the United States, Greece and Spain are high-cost producing countries. During the 1999–2000 season, West and Central African countries produced about 5 per cent of world production: the region is the third largest exporter after the United

States and Uzbekistan, accounting for about 15 per cent of world exports. According to ICAC estimates, the cost of producing a pound of cotton in Burkina Faso is 21 US cents, compared to 73 US cents in the United States.

Price collapse

There has been a significant decline in real cotton prices, accompanied by high volatility, with current prices half those of 1960 price levels. Real cotton prices averaged $2.31 and $1.34 per kilogram during the 1960s and 1990s respectively. The decline in cotton prices was sharpest in 1985, when the United States changed its support policies from stockholding to price support. In 1999, changes in the stockholding policies of China, another major stockholder, also influenced the volatility of cotton prices. Between 1985 and 2002, prices declined by about 0.9 per cent a year. Surplus cotton output of about 1 million during the 2001–2002 season greatly dented prices, with the Cotlook A Index falling to 82 US cents per kilogram in October 2001, the lowest level in almost two decades. Synthetics, which currently account for almost 60 per cent of global fibre consumption, have a significant impact on the world cotton market. Technological improvements (including use of high-yielding varieties, chemicals, fertilizers, irrigation and mechanical harvesting, among others) have also played a part in the long-term decline of cotton prices by reducing production costs. SSA countries undertook wide-ranging policy reforms that increased productivity and output during the 1990s to improve the efficiency of their cotton sectors.

Domestic support

Domestic support to cotton production has averaged $3 billion and $0.6 billion respectively in the United States and the EU

Annex table

IMPORTANCE OF COTTON IN WEST AND CENTRAL AFRICAN ECONOMIES, 1990–2001

	Cotton exports								
	Value in millions of dollars			*As per cent of merchandise exports*			*As per cent of GDP*		
	1990–1991	*1998–1999*	*2000–2001*	*1990–1991*	*1998–1999*	*2000–2001*	*1990–1991*	*1998–1999*	*2000–2001*
Country	*Average*								
Benin	120	163	123	52.4	76.9	66.7	6.4	6.9	5.3
Burkina Faso	76	159	105	59.7	65.9	56.6	2.8	6.3	4.4
Cameroon	65	84	83	3.3	5.1	4.6	0.6	0.9	1.0
Central African Republic	13	16	24	10.3	10.7	12.3	0.9	1.5	2.5
Chad	164	195	132	85.9	84.1	75.6	9.1	12.0	8.8
Côte d'Ivoire	152	160	149	5.3	3.7	4.1	1.4	1.3	1.4
Mali	199	473	213	61.9	84.2	38.1	8.2	18.3	9.2
Togo	56	87	32	21.3	32.5	15.6	3.4	6.1	2.6

Source: UNCTAD secretariat computations based on United Nations Statistics Division data and World Bank data.

since the 1999–2000 cotton season. In the United States, cotton subsidies amounted to $3.9 billion in 2001–2002, which was double the 1992 level and $1 billion more than the value of United States cotton at world market prices (Oxfam, 2002). This support accounts in part for the recent decline in cotton prices, as a large share of domestic cotton is exported. For example, producer prices were about 90 per cent higher than world prices in the United States and more than 100 per cent higher in Greece and Spain during the 2001–2002 season. Indeed, the United States minimum price of $1.56 per kilogram is much higher than average world prices of $1.06 per kilogram (2001), and $1.00 per kilogram (2002). The richest 10 per cent of cotton farmers receive more than 73 per cent of cotton subsidies, according to the United States Department of Agriculture, with as much as 25 per cent of subsidies going to the richest 1 per cent.

Impact on rural poverty

In Benin, cotton contributes about 7 per cent to GDP. According to a recent study, a 40 per cent reduction in farm gate cotton prices between December 2000 and May 2002 led to a 7 per cent reduction in rural per capita income in the short run, and is projected to be reduced by 5–6 per cent in the long run. United States cotton subsidies over the same period have cost Benin, Burkina Faso and Mali 1–2 per cent of GDP and 8–12 per cent of earnings, thereby exacerbating balance of payments and domestic fiscal pressures. It has been reported by Oxfam that losses in export revenue suffered by West African exporters often outstrip the level of economic assistance received from the United Sates. Subsidies to United States cotton farmers are more than three times the entire USAID budget for Africa. In 2001, United States aid to Mali amounted to $37.7 million compared to foreign exchange losses of $43 million due in part to United States cotton subsidies; Benin lost $33 million, double its level of aid provision in the same year

(Oxfam, 2002). It has also been estimated that subsidies received by 25,000 United States cotton farmers total 60 per cent more than the GDP of Burkina Faso, where cotton is the source of livelihood for about two million people (*Bridges*, 2003). In 2001, every acre of cotton farmland in the United States was worth about $230 in subsidies, which is equivalent to an average income in Burkina Faso. In Benin, cotton is the only source of cash income for about 100,000 farm households and generates about one-fifth of total household wealth in the country.

Cotton subsidies contribute in no small measure to undermining the efforts of some African countries to tackle poverty. A World Health Organization study of SSA (cited in Oxfam, 2002) suggests that cotton-growing households had better nutrition and higher incomes that those cultivating maize alone, and a 175 per cent increase in cotton production (1993–1998) was associated with a fall in poverty levels from 50 per cent to 42 per cent in cotton-producing districts. Over the same period, poverty increased among farmers growing only staple food (Oxfam, 2002).

Dismantling domestic support

ICAC estimates based on the World Textile Demand Model suggest that withdrawal of cotton subsidies in the United States would reduce the country's cotton production by 1.4 million tons (about 10 per cent of current levels) and increase cotton prices by about 26 per cent (that is, 11 US cents per pound) (Oxfam, 2002). For a variety of reasons, however, complete elimination of domestic support to the cotton sector is unlikely to take place anytime soon. The EU cotton programme, for instance, is regarded as a poverty reduction mechanism allegedly designed to support its low-income regions in the south. Furthermore, the United States Farm Bill of 2002, which guarantees a minimum price of $1.56 per kilogram of cotton, will be in place until 2007.

Outlook

Historically, demand growth for cotton has been sluggish, averaging 1.8 per cent (same as population growth) between 1960 and 2000, with per capita consumption remaining unchanged. In the absence of reforms by the major cotton producers, growth in cotton consumption has been forecast at 0.9 per cent (1.2 per cent in the best-case scenario), and, while prices may recover from their record lows of 2001 and 2002, they are unlikely to reach mid-1990 levels. Projections by the ICAC suggest a modest recovery in 2003, but prices are likely to remain at 50–60 US cents per pound until 2015 (Oxfam, 2002). Thus, the proposal submitted by African producers to the WTO for compensation for income losses suffered by their cotton producers appears to be the only means by which poor producers could have some relief in the short to medium term.

Notes

1 It has, however, been observed that most of the manufactures of developing countries are concentrated in low-skill, low-value-added products (see UNCTAD 2002c: 74).

2 It is therefore no accident that 34 of the 42 Heavily Indebted Poor Countries (HIPCs) are in Africa.

3 See Diakosavvas and Scandizzo (1991), Appendix C, for a list of studies classified by their conclusions (for, against or inconclusive) with respect to the Prebisch-Singer thesis, which identifies a secular decline in the terms of trade of primary commodities (ratio of prices of primary commodities to prices of manufactures).

4 Generally, the criticisms of the Prebisch-Singer thesis, which apply to most attempts at economic measurement, fall into four categories: (a) the arbitrariness of the time span; (b) the omission of major explanatory variables; (c) the statistical procedure; and (d) inadequacy of data (Diakosavvas and Scandizzo, 1991: 233).

5 For example, between 1998 and 2000, the prices of Ghana's main exports, cocoa and gold, fell by 47 and 5 per cent respectively, while the price of oil, a major import for the country, increased by 116 per cent. Between 2001 and 2002, cocoa prices increased by about 76 per cent, while oil prices fell by about 15 per cent (United Nations, 2002: 5).

6 These are Benin, Burkina Faso, Chad, Ethiopia, Gambia, Guinea-Bissau, Malawi, Rwanda, Senegal and Zambia.

7 Uganda's unsustainable debt situation could also partly be explained by the contraction of new loans since the country reached the completion point under the enhanced HIPC Initiative.

8 Smallholders, supplying about 70 per cent of the world's coffee, are directly affected by declines in world coffee prices. In Nicaragua, for example, coffee growing supports more than 40 per cent of the rural labour force. Oxfam estimates that the collapse in world coffee prices

directly affects 125 million people who depend on it for their livelihoods (see United Nations, 2002: 5).

9 Data on tariffs are from the WTO Integrated Data Base (MFN Applied Tariffs).

10 Granting of preferences does not mitigate tariff escalation. Residual protection in developed-country markets, after accounting for preferences, is typically in the more processed products, as is discussed below. On the other hand, while preferential market access might lead to a general reduction in both national and international tariff peaks, in some cases national peaks may actually rise taking preferences into account, as a lower overall average would be used as a reference point (see WTO, 2003: 9).

11 This group comprises Brazil, China, India, the Republic of Korea, Mexico, the Russian Federation, South Africa and Turkey.

12 Cited in the *Memorandum on Coherence between Agricultural and Development Policy* of the Minister of Agriculture, Nature Management and Fisheries and the Minister for Development Cooperation, the Netherlands, December 2002, p. 27.

13 During the 2002 season, world market prices for cotton were at their lowest level in 30 years: 42 US cents per pound (454g) compared to an average price of 72 US cents per pound over the preceding 25-year period.

14 These countries include Benin, Burkina Faso, Cameroon, Chad, Guinea, Guinea-Bissau, Mali (completion point), Niger and Senegal (decision point).

15 See also *The Economist* (2003).

16 The marketing channel is split into two distinct sections in the case of "half-channel crops", with the exporter taking responsibility for the product only up to the point where it is sold to an intermediary. In the case of "entire-channel crops", there is a direct link between the exporter and the importer (UNCTAD, 2000b: 11).

17 For a fuller discussion of the historical background of agricultural protectionism in OECD countries, see Shonfield and Oliver (1976: 292–303).

18 In the resolution establishing UNCTAD as a permanent body of the United Nations at the end of 1964, the General Assembly, among other things, transferred the functions of the ICCICA to the new organ.

19 Originally, it was estimated that, to be able to effectively stabilize the prices of major commodities, the Fund would need about $18 billion, but this was reduced to $6 billion by the time of UNCTAD IV. Eventu-

ally, the Fund was to assume operations with only $400 million (Rangarajan, 1983: 591).

20 Two other compensatory financing schemes are the EU's System for Safeguarding and Developing Mineral Production (SYSMIN) and the Swiss Compensatory Financing Programme.

21 See "Review of the Compensatory and Contingency Financing Facility (CCFF) and Buffer Stock Financing Facility (BSFF) – Preliminary Considerations" at http://www.imf.org/external/np/ccffbsff /review/.

22 For other criticisms of STABEX, see Koehler (1997).

23 For example, the standard deviation of the actual price from the forecast price (by the International Trade Division of the World Bank) for only a one-year horizon was 25 per cent (Claessens and Duncan, 1993: 7).

24 Current research in this area suggests that slumps last much longer than booms and that price falls in slumps are larger than price rebounds in a subsequent boom; for all commodities, the probability of an end to a slump or boom is independent of time already spent in slump or boom (Cashin et al., 2002: 292).

25 The basic outline of the IPC was presented to the Trade and Development Board at its fourteenth session in August 1974. The IPC has five main elements: (i) establishing internationally owned stocks covering a wide range of commodities; (ii) establishing a common financing fund that will make resources available for the acquisition of stocks; (iii) instituting, if circumstances justify it, a system of medium-to-long-term commitments to purchase and sell commodities at an agreed price; (iv) instituting more adequate measures to provide compensatory financing to producers to cover shortfalls in export earnings; and (v) initiating an extensive programme of measures to further the processing of commodities by the producing countries themselves.

26 Considering the distortions that "project funds" could introduce into the budgetary process, such funding could be disbursed through national budgets, but earmarked specifically for diversification activities.

27 As was discussed in Chapter I, the introduction of the EBA and AGOA has improved market access for African countries, but restrictive rules of origin have somewhat limited their medium-term benefits.

28 Address by President Blaise Compaore of Burkina Faso on the cotton submission by West and Central African countries to the Trade Negotiations Committee of the WTO, http://www.wto.org/english/news_e/news03_e/tnc_10june03_e.htm.

29 See General Assembly resolution 46/151, paras. 31 and 32, Forty-sixth session, 18 December 1991.

30 For example, the United States has neither supported nor joined the Common Fund for Commodities, and EU member States would like to reduce the scope for its operations. Indeed, some donors have transferred the first account holdings into the second account funds supporting more commodity projects (Page and Hewitt, 2001: 25).

31 Policies in support of export-oriented firms, FDI and technological upgrading would have to comply with the WTO Agreements on Trade-Related Investment Measures (TRIMs) and Trade-Related Aspects of Intellectual Property Rights (TRIPS). Compliance with these two WTO Agreements would make the task of technological and industrial capacity building onerous for African countries. Any protection offered to "infant industries" in line with GATT 1994 article XVIII (B) and (C) should be only for dynamic sectors that are expanding in line with dynamic comparative advantage; should be sectoral rather than firm-level; and, above all, should be temporary (see UNCTAD, 1999b, Part Two, chap. 3).

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