

Commodity Trade

Concept: Commodity Trade

Author: Adam Sneyd , McMaster University

Date Entered: 2005-08-22

Description When a national government chooses to protect its commodity producers from international competition, does this decision impede the expansion of national income? How can international trade in food or oil impact a state's ability to secure supplies of these commodities? If there are only a handful of powerful buyers, what are the consequences for citizens of countries that are limited to exporting commodities such as coffee, cocoa, or cotton? Is a discussion of these matters limited if it focuses on trade in bulk products without addressing the problems societies face when people, land, and money are made into commodities (Polanyi 1944)?

Perspectives on globalization and autonomy feature prominently in attempts to arrive at answers to these related questions. They inform ongoing political debates over the impacts of international trade in commodities, and national and international policy options to manage that trade.

This glossary article understands the commodity trade story to be about continuity, even though barriers posed by territory and distance to international flows of information, money, and rich people have declined in the present era of globalization (Scholte and Schnabel 2002). Each of the principal and related issues pointed to above — national income, security of supply, commodity dependence, and societal and ecological impact — implies the importance of place. However, knowledge about commodity topics such as the oil situation and the plight of impoverished producers in the Least Developed Countries (LDCs) now spreads rapidly, shaping price fluctuations and shifting public opinion. States nonetheless remain at the heart of the matter. To underscore these points, the past sixty years of developing country efforts to achieve more autonomy through commodity initiatives are detailed below.

After the Second World War, many policy-oriented economists recognized that the legacy of colonial trade patterns had not disappeared with political independence. The economies of many new countries continued to be geared towards producing agricultural goods and raw materials for export. These experts developed theories and supported policy options that aimed to prevent massive commodity price declines such as the price crash that contributed to the Great Depression (Singer 1989, Innis 1995). John Maynard Keynes believed that an international agency to stabilize commodity prices was a necessary component of a lasting international economic order. When countries attempted to establish an International Trade Organization (ITO), International Commodity Agreements (ICAs)

were near the top of the agenda.

The subsequent work of Raul Prebisch and Hans Singer on declining terms of trade showed that price stability was only one aspect of overall commodity pricing problems. In 1958, Jagdish Bhagwati outlined another facet. Countries dependent upon commodity exports faced a vicious circle when the world price of one of their commodities was low. The only way to increase income was to boost production of the good in question, a self-defeating move that reduced its price further still (Bhagwati 1958). Other thinkers such as Nicholas Kaldor focused on how the costs of fabrication, transportation, and distribution made up a high proportion of the final price of commodities. In his view, this trend diminished the percentage of the final price that reached direct producers (Kaldor 1983).

By the 1960s, empirical evidence indicated that commodity producing nations faced price instability, declining prices, and long-term reductions in the purchasing power their exports afforded. Third World governments sought autonomy from these forces and used their numerical majority at the UN to demand management of the commodity trade that would improve their relative economic positions. They established the UN Conference on Trade and Development (UNCTAD), and parties to the General Agreement on Tariffs and Trade (GATT) subsequently accepted the principle of differential and more favourable treatment for developing country exports. However, it wasn't until after the Organization of the Petroleum Exporting Countries (OPEC) leveled the "oil-weapon" in 1973 that the commodity agenda took centre stage in what came to be known as the North-South debate. The commodity initiative was a key component of the demand for a New International Economic Order (NIEO), and it aimed to increase foreign exchange earnings in the South and enable a greater share of those earnings to be retained there. Articulated by the Group of 77 (G-77) in 1975 in the Dakar Declaration, the program sought to create managed supplies or "buffer stocks" of eighteen commodities of export interest to developing countries. Stocks were to be managed to secure stable and higher prices. A special fund was called for to finance these arrangements, and improved measures to compensate producing countries for price fluctuations were advocated. Members of the G-77 also wanted a council of associations to oversee ICAs and coordinate the actions of producer associations such as OPEC.

To secure the General Assembly's support for the NIEO, the G-77 agreed to postpone commodity questions until UNCTAD IV in 1976. At that conference, negotiations on an integrated program for commodities (IPC) commenced, and the need for a "Common Fund" to finance the program was agreed upon. The South proposed a pricing system whereby each commodity's price would be tied to price changes in a basket of manufactures. Viewing this proposal as an invitation to worldwide inflation, the United States became quite skeptical of the process and raised questions about the high costs the North would pay for the IPC, the program's scope, and its failure to rely upon market-based pricing.

Negotiations subsequently bogged down. However, the Common Fund for Commodities did emerge from this North-South battle, though it did so without receiving sufficient funding for the management of stocks. Despite calls made by the conciliatory Brandt Commission in 1980 to stabilize commodity prices at higher levels, many ICAs eventually had to abandon the objective of managing stocks due to insufficient funds. Some ICAs, such as the agreements for coffee and tin, collapsed altogether. Consequently, the South's collective attempt to globalize the management of the commodity trade and achieve the level of autonomy required to transcend pricing problems and restructure their economies met with little success. Many oil exporting states and larger rapidly industrializing countries no longer prioritized commodity issues of interest to the poorest members of the South coalition.

As embedded liberalism gave way to Thatcherism and Reaganomics, non-oil exporting countries were selling fewer goods at lower relative prices to the developed world, and relying upon loans to pay for their increasing import bills. These trends continue to this day. Even with the expansion of world trade, the share of non-fuel commodities in total trade has declined over the past thirty years. Nonetheless, seventeen of the most heavily indebted LDCs in Sub-Saharan Africa continue to depend upon exports of non-oil primary commodities for over three quarters of their foreign exchange earnings (FAO 2004, UNCTAD 2003a). Due partly to their reliance upon exports in low demand, the LDC's share of soaring global export earnings fell to 0.68 percent in 2004 (UNCTAD 2004). World prices for many of their eighteen important export commodities continued to be lower in real terms than in 1980. Cotton stood at 33 percent of its 1980 value, while coffee was at 17 percent (FAO 2004). In the case of the latter, Vietnam's exports flooded the market and depressed the world price, though overall, low prices remained only one part of problem. The purchasing power of LDC exports declined by 25 percent during the 1990s, and price volatility continued to impact the livelihoods of direct producers. Overall, these issues have caused balance of payments problems and led many to take on new debts. The autonomy of LDCs facing such adversity has consequently declined in the recent period, while oil exporters and larger developing countries seem to have achieved more policy space.

To meet the conditions of further financing from multilateral lenders many LDCs have removed inefficient national marketing boards for agricultural commodities. Moves to "get the prices right" have often increased the share of export prices going to direct producers, though their costs have also risen as they have lost access to subsidized credit, fertilizers, and marketing. While this policy option has freed up government resources, the roots of the LDC commodity crisis have not yet been addressed. Developed countries continue to dump their heavily subsidized excess production of sugar, cotton, and other commodities onto global markets, fueling an oversupply situation. Other factors driving down prices include the entry of many lower cost producers, the development of new synthetic products to replace raw materials, and the high tariffs many of the South's

agricultural products face in the North. Given this context, the fact that LDCs have not moved up the global value chain indicates their precarious position. They lack control over many of the sites where value is added to their exports, including processing, shipping, insurance, distribution, and marketing. Regarding processing, nearly all cocoa bean production occurs in developing countries, while only 4 percent of all chocolate is actually produced there (www.maketradefair.org). LDCs face many barriers to entry in the other areas of value addition, as the dominance of transnational corporations (TNCs) is well established (Gibbon and Ponte 2005). The case of coffee demonstrates the LDCs' weakness. Unless the product has been certified by an organization promoting "fair trade," the price paid to producers is often less than 1 percent of the retail price of a cup (www.maketradefair.org). In summary, the LDCs' ongoing reliance on commodity exports indicates that they have failed to diversify their economies and move beyond the legacy of colonialism. In the era of globalization, these states continue to be excluded from the benefits of integration while their autonomy has diminished.

Oil-related issues of energy security and potential environmental catastrophe have overshadowed LDC concerns on the international commodity agenda for two decades, though of late voices for change have been more prominent. UNCTAD has been tasked with identifying the obstacles non-oil commodity exporters face and articulating the means to overcome them. Based upon their work, in June 2004 at UNCTAD XI, the Sao Paulo Consensus included objectives for commodity issues. It sought to move LDC exports up the global value chain, diversify LDC economies, and enhance their access to markets in the developed countries. The Consensus called for increased financial and technical assistance, infrastructure investments, and transparency to ensure that these objectives were realized.

Representatives of governments, international organizations, non-governmental organizations (NGOs), and academics are currently debating many ways forward, and developing potential solutions. Mechanisms to compensate countries for price fluctuations and insulate them from future volatility, including the renewal of the Common Fund's original mandate, are on the table. The head of UNCTAD's commodity division has advocated an aid for trade fund to assist with the costs of diversification and to finance the technical assistance and capacity building required to move up value chains (Puri 2005). Other organizations, such as the World Food Programme, have floated schemes aimed at managing price volatility through insurance and forward pricing. In the developed countries, the fair trade movement has made inroads amongst commodity consumers. For their part, NGOs such as Oxfam support a return to ICAs and the creation of a new institution to manage commodities. Many NGOs, experts, and governments are also backing a campaign to make trade fair by eliminating subsidies in the North. Recently these campaigners claimed some success as the WTO ruled US cotton subsidies and the EU sugar regime to be illegal. A further initiative spearheaded by UNCTAD

envisioned duty-free and quota-free access to markets in the developed countries for LDC exports (UNCTAD 2003b, Puri 2005). Countries of the South also continued to work together to trade more amongst themselves. Many players consider action on commodity questions to be essential to the achievement of the Millennium Development Goals articulated at the UN Millennium Summit in 2000.

Work Cited: **Bhagwati, Jagdish.** 1958. Immiserizing growth: A geometrical note. *Review of Economic Studies* 25: 201-5.

FAO (Food and Agriculture Organization). 2004. *The state of agricultural commodity markets*. Rome: Commodities and Trade Division. (accessed 28 February 2006)

Gibbon, Peter and Stefano Ponte. 2005. *Trading down: Africa, value chains, and the global economy*. Philadelphia: Temple University Press.

Innis, Harold A. 1995. *Staples, markets and cultural change: Selected essays*, ed. Daniel Drache, Montreal: McGill-Queen's University Press.

Kaldor, Nicholas. 1983. The role of commodity prices in economic recovery. *Lloyd's Bank Review* 149 (July): 21-34.

Polanyi, Karl. 1944/2001. *The great transformation: The political and economic origins of our time*. Boston: Beacon Press.

Puri, Lakshmi. 2005. *Towards a new trade 'Marshall Plan' for Least Developed Countries*. New York and Geneva: UNCTAD. (accessed 22 August 2005)

Scholte, J.A. and A. Schnabe. eds. 2002. *Civil society and global finance*. London: Routledge.

Singer, Hans. 1989. Lessons of the post-war development experience: 1945-1988. Institute of Development Studies Discussion Paper No. 260, University of Sussex, Brighton, UK.

UNCTAD (United Nations Conference on Trade and Development). 2003a. *Economic development in Africa: Trade performance and commodity dependency*. Geneva: UNCTAD. (accessed 22 August 2005)

UNCTAD (United Nations Conference on Trade and Development). 2003b. *Report of the Meeting of Eminent Persons on Commodity Issues. TD/B/50/11*. Geneva: UNCTAD. (accessed 22 August 2005)

UNCTAD (United Nations Conference on Trade and Development). 2004. *Least Developed Countries Report*. Geneva: UNCTAD. (accessed 22 August 2005)