

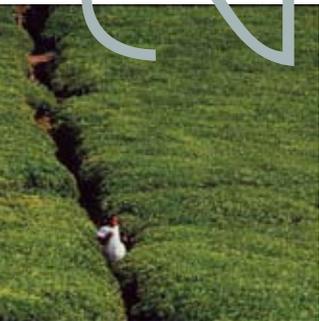
2016

The State of Agricultural Commodity Markets



2006

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Produced by the
Electronic Publishing Policy and Support Branch
Communication Division
FAO

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ISBN 978-92-5-105652-3

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Cover photos, from top to bottom:

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Inside photos:

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About this report

The *State of Agricultural Commodity Markets 2006* is the second issue of this FAO publication. It focuses on the question of why the development and food security needs of developing countries need to be better reflected in the design and implementation of new agreements on further liberalization of international agricultural markets, and on the mechanisms under discussion to achieve this. In the Doha Development Round of the World Trade Organization (WTO), the question of how to safeguard the interests of developing countries, especially the lower income countries, has proved to be highly topical but also problematic, because the issues and arguments are complex and sometimes controversial. The stalling of the Doha Round in July 2006 provided an opportunity to revisit the issues of how future reductions in import tariffs on agricultural products will affect different developing countries, whether there might be any negative repercussions of further liberalization and, if so, how these might be addressed in the formulation of new trade rules.

The first part of this report introduces the major theme by highlighting some of the potential downsides of multilateral trade liberalization for some developing countries, both as exporters and importers of agricultural products. It also describes mechanisms by which these risks might be mitigated.

Reductions in import tariffs have obvious potential benefits for developing country agricultural exporters whose access to markets is improved. However, improved market access for some countries means that agricultural producers in importing countries that are reducing their trade barriers face increased

competition from imports in general and from sudden *import surges* in particular. For many developing countries, particularly those at earlier stages of development, the agriculture sector is the mainstay of employment, income generation, food security and development. In such countries, often characterized by traditional agricultural systems and underdeveloped markets, the agriculture sector may be unable to withstand increased import competition and, as a result, domestic agricultural production, rural incomes and food security could be vulnerable and development efforts might be compromised.

Various mechanisms have been proposed to mitigate the risks associated with further opening agricultural markets to international trade, either by excluding certain *special products* from the full extent of tariff reduction or by permitting the imposition of an additional tariff in the face of sudden increases in imports – a *special safeguard mechanism*. These mechanisms are the subject of the second and third sections of this report. The issues surrounding the designation of special products and the implications of their use are illustrated by case studies of rice and dairy products, two commodities that have proved problematic in international trade policy reform.

On the other hand, some developing country exports currently face tariffs in developed country markets lower than those imposed on exports from certain other countries. Clearly, the value of these *trade preferences* is reduced as tariffs are lowered generally. This problem of *erosion of preferences* has also been highlighted in the Doha Round negotiations. The implications of this erosion and measures to help

developing countries adjust to a loss of preferences are discussed in the fourth section of this report. The discussion of preferences is illustrated and extended by case studies of two commodities for which trade preferences are very significant – bananas and sugar.

The final section of the main report draws some conclusions regarding development priorities in the Doha Round and the various mechanisms that have been proposed to safeguard developing country interests, both as exporters and importers of agricultural products.

The second part of the report reviews recent developments in international agricultural commodity markets and provides background and context for the discussion in the main part of the report. This is complemented by Annex tables, which draw together basic data on trends in commodity prices and trade, providing additional background.

The State of Agricultural Commodity Markets aims to bring to a wider public an accessible discussion of agricultural commodity market issues and related policy matters. Although the findings and conclusions presented rely on recent technical analysis by FAO specialists in commodity and trade issues, this is not a technical report. Rather, it seeks to provide an objective and transparent treatment of the issues for policy-makers, commodity market observers and all those interested in agricultural commodity market developments and their impact on developing countries.

Acknowledgements

The State of Agricultural Commodity Markets 2006 was prepared by a team of staff from the Trade and Markets Division of FAO, led by David Hallam, and under the general guidance of Alexander Sarris.

Acknowledgement is given to the overall contribution of Jamie Morrison and to the particular contributions of Deep Ford on special products, Ramesh Sharma on special safeguard mechanisms, David Hallam on trade preferences, Nancy Morgan on import surges, Concepción Calpe and Adam Prakash on rice, Merritt Cluff on dairy products, Pascal Liu and Pedro Arias on bananas and George Rapsomanikis and Piero Conforti on sugar.

Material for the section on recent developments in agricultural commodity markets was provided by commodity specialists in the Trade and Markets Division: Abdolreza Abbassian, El Mamoun Amrouk, Pedro Arias, Concepción Calpe, Kaison Chang, Merritt Cluff, Piero Conforti, Pascal Liu, Shakib Mbabaali, Brian Moir, Nancy Morgan, Adam Prakash, George Rapsomanikis, Shangnan Shui and Peter Thoenes. Statistical support was provided by the statistical clerks in the Division: Claudio Cerquiglini, Daniela Citti, Julie Claro, Berardina Forzinetti, John Heine, Massimo Iafrate, Daniela Margheriti, Patrizia Masciana, Marco Milo, Mauro Pace and Barbara Senfter.

The Annex tables providing background data were assembled by Pedro Arias and Julie Claro.

The report benefited from detailed review and comment by colleagues throughout FAO. Special mention should be made of the contributions of Shukri Ahmed, Sumiter Broca, Prabhu Pingali, Carlos Santana and Andrew Shepherd.

The report was edited by David Hallam.

The FAO Electronic Publishing Policy and Support Branch was responsible for further editorial inputs, design and layout.

Foreword

Agricultural trade can be a driving force in agricultural development overall, creating incomes and employment. Because agricultural trade expansion can generate incomes and jobs in rural areas where the majority of the poor live, it can have a great poverty-reducing effect.

However, in spite of some progress in liberalizing global agricultural trade, the trade prospects of developing countries are still hindered by trade barriers and trade-distorting subsidies in major developed countries and high tariffs in many developing countries. The attempts of developing countries to improve their export earnings, incomes and employment by adding value to the basic agricultural products face even higher tariff barriers. This is on top of the structural impediments that confront their attempts to enter concentrated markets for processed and value-added products. Many developing countries have become increasingly marginalized in international trade and increasingly dependent on food imports while unable to expand earnings from their agricultural exports.

In broad terms, multilateral trade policy reform is to be welcomed as a potential stimulus for expanded trade and hence growth. The UN Millennium Declaration committed to an open, equitable, rule-based, predictable and non-discriminatory trading system. However, trade rules for agriculture have to be compatible with the development needs and priorities of developing countries. More generally, they need to be compatible with the Millennium Development Goal 1, that of reducing by half the proportion of people suffering from hunger and those living in extreme poverty by 2015.

Not all the developing countries would necessarily benefit in the short to medium run from improved access to

export markets or from further opening of their own markets. This will depend upon their economic structures, their competitiveness and their capacity to respond to new market incentives. Some developing countries, assisted by supportive economic structures, natural resource endowments and a commercial orientation, are already highly competitive and successful in exporting agricultural products. Those more advanced and competitive exporting developing countries are certainly well placed to reap the benefits of a freer global trading system. Furthermore, for those countries, increased exposure to international competition may actually be a stimulus to even greater efficiency.

However, these success stories do not represent the majority. There are fewer examples of such cases among the lower income countries, especially in sub-Saharan Africa. The majority of these countries are less well placed to gain from increased trade liberalization. Many of them face supply-side constraints, in particular lack of rural infrastructures and overdependence on vagaries of the climate for their production. Thus, their agriculture sectors are often uncompetitive and prevent them from capitalizing on new trade opportunities, especially for processed and value-added products. The aid-for-trade initiative will be important to address these supply-side constraints.

Not only will some developing countries not gain from trade liberalization, in some cases they may be adversely affected and, not surprisingly, they see this as a threat to their domestic production and food security. Reducing tariffs means increased competition from imported foods for the locally produced products, and domestic production systems that contribute significantly to food supplies,

rural incomes and employment may not be ready to withstand this. At the same time, for those agricultural products in which countries are more competitive, domestic production may be vulnerable to competition from short-run import surges. For others, the benefits from preferential trading arrangements will be eroded or lost, reducing foreign exchange earnings from their traditional exports. International prices of temperate agricultural commodities that are currently highly protected, including basic foodstuffs, are expected to increase as a result of liberalization, thus leading to higher food import bills for those developing countries increasingly dependent on food imports for their local needs. Because of tightened disciplines on export competition, including export credits and food aid, some countries may also lose access to mechanisms that can reduce their spending on food imports.

Sustainable food security depends on improved productivity in local food production, and developing countries need to have the flexibility and scope to create a supportive policy environment to facilitate this. Trade policy needs to be consistent with domestic agricultural policy interventions, which in turn differ depending on the country's level of agricultural development. It is clear therefore that many countries will need to be allowed some flexibility in the implementation of new trade rules, and also be given assistance (at least in the short run) while they adjust to the new market conditions arising from liberalization. In the language of the WTO negotiations, they need significant *special and differential treatment*.

The Doha Round needs to put in place effective instruments to minimize the number of cases where developing countries may suffer as a result of further global trade liberalization. This need lies behind the call from developing countries for special and differential treatment, and notably in the Doha Round negotiations the call for recognition of *special products* for which the pressure for tariff reductions can be moderated, and *special safeguards* to help offset disruption to their agriculture sectors from sudden import surges. This does not mean

that some developing countries are being protectionist and unwilling to open their markets; it simply reflects concerns about the possible adverse effects on their prospects for food security, poverty reduction and longer-run development goals. Naturally, not all developing countries have the same needs, so there is not a "one size fits all" solution. For instance, whereas some may make recourse to special treatment measures, others may judge it unnecessary or inappropriate given their economic circumstances and interests.

The creation of appropriate mechanisms to deal with the risks associated with trade reform should be an integral part of the WTO negotiations, and is a major focus of this issue of *The State of Agricultural Commodity Markets*.

New market conditions resulting from trade reforms mean that countries have to adjust, and will face adjustment costs. It will require time and resources to get the necessary facilities in place before markets are freely opened to international competition. If poorer countries are to be able to withstand increased competition from imports and benefit from new trading opportunities that may arise from liberalization, they must first overcome local production, marketing and institutional constraints in their agriculture sectors. However, investment in agriculture to bring about the necessary improvements in productivity and competitiveness has been lagging seriously, notably as a result of declining official development assistance (ODA). This trend has to be reversed. In this respect, it is encouraging to note that the meeting of the G8 countries in Gleneagles, United Kingdom in 2005 recognized that a substantial increase in ODA was essential to realize the development objectives and goals set by the international community.

Trade policy reform aimed at providing a fair, market-oriented global trading system by removing or reducing trade-distorting subsidies and trade barriers can make a positive contribution to the alleviation of poverty and hunger. However, it is not a panacea, and the gains from

freer international trade will not be evenly distributed either among developing countries or even within individual countries. Multilaterally agreed trade rules provide the most promising opportunity for creating a fair, predictable global agricultural trading system. At the same time, it is recognized that the potential risks associated with multilateral trade reforms can be significant, and that they need to be mitigated so that such reforms can lead to equitable gains and contribute to reducing poverty and hunger worldwide. FAO is committed to assisting developing countries to participate fully in multilateral trade negotiations to ensure their interests are fully taken into consideration through the provision of information and analyses, as well as through technical assistance and capacity building. This mandate was part of the Plan of Action of the World Food Summit and has continued to be stressed by subsequent FAO Conferences. Action is needed to ensure that the potential benefits from trade reforms are shared by all as equitably as possible and, for that purpose, FAO is committed to assisting countries to improve their productivity and competitiveness of agricultural commodities.

This new issue of *The State of Agricultural Commodity Markets* is intended to raise awareness of the interests of developing countries in the Doha Development Round, focusing on market access issues, and the measures needed to ensure that trade policy reform contributes effectively to the reduction of poverty and food insecurity. In the end, the extent of that contribution will be the real measure of success in multilateral trade negotiations.



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