New EU Action Plan on Agricultural Commodities, Dependence and Poverty and a specific action for cotton
In April 2004, EU ministers adopted an Action Plan on agricultural commodities, dependence and poverty. They also adopted a proposal for an EU-Africa partnership on cotton, which is a specific application of the Action Plan.

The adoption of the Plan is a clear signal of the importance that the EU attaches to the issue of agricultural commodities in the fight against poverty. It demonstrates a strong commitment from the EU to support Commodity Dependent Developing Countries (CDDCs) in addressing the specific challenges that they are facing, in the short and long term.

The EU does not pretend to have the ultimate solution to the “commodity problem”. It thinks, however, that this set of pragmatic action proposals will generate progress, if implemented on a large scale by the EU and other international partners with the leadership of the concerned countries. This brochure summarises EU views and proposed actions in this important development area.
Background: Agricultural commodities – a source of revenue for millions of people

Internationally traded agricultural commodities, such as coffee, cocoa and cotton are, directly or indirectly, major sources of employment and income for millions of people in developing countries. Through taxation and redistribution, they make major contributions to the provision of basic services such as health and education in these countries. Take cotton for example – in West and Central Africa alone, more than 15 million people depend on this crop for their livelihood.

Many countries’ economies, export earnings and national budgets are very highly dependent on agricultural commodities. In Burundi, for example, export revenues depend for almost 80% on coffee. In more than 50 countries, three or fewer primary commodity exports constitute at least 20% of export revenue. These countries are located mainly in Sub-Saharan Africa, but also in the Caribbean and Central America. Many of them are Least Developed Countries, landlocked or small island states.
Agricultural products constituting more than 20% of total merchandise exports of developing countries:

- **Sugar**: St Kitts & Nevis 35%, Cuba 35%, Belize 26%, Guyana 24%, Fiji 23%, Mauritius 20%, Swaziland 20%
- **Coffee**: Burundi 79%, Ethiopia 64%, Uganda 59%, Rwanda 56%, Sierra Leone 32%, Nicaragua 27%, El Salvador 24%, Guatemala 24%, Honduras 23%
- **Bananas**: St Lucia 54%, St Vincent 37%, Dominica 27%, Ecuador 24%, Costa Rica 21% (Panama 23%)
- **Cotton**: Burkina Faso 39%, Chad 37%, Benín 33%, Mali 30%, Togo 23%, Somalia 23%
- **Cocoa**: Niue 71%, Sao Tome & Principe 69%, Ivory Coast 36%, Ghana 24%
- **Tobacco**: Malawi 59%, Zimbabwe 22%
- **Cashew nuts**: Guinea Bissau 48%
- **Pumpkins**: Tonga 44%
- **Copra**: Vanuatu 43%, Kiribati 42%
- **Soybeans**: Paraguay 39%
- **Nutmeg**: Grenada 38%
- **Vanilla**: Comoros 34%
- **Tea**: Kenya 26%
- **Groundnuts**: Gambia 20%

Today, many commodity dependent developing countries (CDDCs) and their producers face acute and very damaging problems, brought about partly by the nature of the markets in which they operate. The price characteristics of the agricultural commodity markets have caught many countries in a vicious circle of declining income and investment, stagnating competitiveness, persistent poverty and dependence. Their commodity sectors have difficulties in adapting to increasingly harsh international competition and changes in the international market environment.

The interconnection between commodities, dependence and development is not a new issue, but it has long been absent from the international debate and development cooperation. Now, it is receiving more attention again, but the economic and political environment has changed. International market intervention has been abandoned. Domestic markets have been liberalised. There is increasing market integration and concentration on the part of the large commodity traders, processors and retailers. Sustainable development issues have gained momentum. All this poses major challenges for producers and commodity dependent countries. For many countries urgent measures are required to defend the sectors.

**What can be done? The EU vision**

The EU believes that traditional commodities still have a key role to play as a sustainable source of employment, income, export earnings and poverty reduction in the most dependent developing countries. The problems of the sectors and countries can be solved and challenges addressed, but not overnight – there is no magic formula. The situation needs to be addressed in a coherent way by the countries themselves and by the international community. The affected countries must ensure the necessary domestic response. The international community must stand ready to offer its full support, including in ensuring a supportive international framework. Both CDDCs themselves and the international community need to put the issues of commodities and productive sectors firmly back on their development agendas.

Achieving results will require gathering CDDCs, donors, the international private sector and other stakeholders around a shared and coherent
support strategy. Although many things are already being done, there is a need for a joint strategy which ensures that all actors pull in the same direction, while not stepping on each others toes. A package of measures is required, and one that tackles both the trade and development aspects of this situation.

In the beginning of 2004, the European Commission outlined its vision for support to CDDCs, in a proposal for a joint EU Action Plan on Agricultural Commodity Chains, Dependence and Poverty(1). On 27 April 2004 EU Ministers adopted the proposal. There is thus now a coherent and joint EU Action Plan on this important development issue.

The overall objectives of the Action Plan are to improve incomes for commodity producers, and to reduce income vulnerability, at both producer and macro level. The Plan outlines concrete actions in response to six major challenges facing CDDCs: Addressing commodity chains and dependence as a priority; Coping with price decline; Managing commodity risks and accessing finance; Diversifying around traditional commodities; Integrating with the international trading system; and Enhancing sustainable corporate practices and investments.

I. Addressing commodity dependence as a priority at national and international level

The abandonment of international market intervention and the domestic market liberalisation in the 1990s, left commodity producers in developing countries largely on their own to struggle with the demands of the market. Often the private sector has not taken the place previously filled by the state and service vacuums have been created. This in a market that is becoming increasingly demanding, as concerns price, quality, volumes and other issues.

Despite the importance of commodity sectors for poverty reduction and the difficulties they experience, national development strategies in CDDCs have largely left these issues aside. At the international level, International Commodity Bodies (ICBs) are faced with the task of re-formulating their objectives and working methods for the new context in which they are operating.

The EU response will be to

• support CDDCs in the design of commodity chain strategies aimed at sustainably improving the competitiveness and returns to labour for commodity sectors and reducing the vulnerability of producers;
• undertake assessments and where necessary pursue reform of International Commodity Bodies and their strategies, in order to match the new challenges. This will aim to ensure that they contribute effectively to market functioning, sustainable development and other common interests of the individual commodity sectors, and to commodity chain strategies in CDDCs;
• develop commodity cooperation with international organisations – such as UNCTAD, FAO, the World Bank and the Common Fund for Commodities – in accordance with their specific comparative advantage. This will help enhance expertise and develop innovative tools needed to assist the CDDCs develop and implement their commodity strategies.
II. Coping with price decline

Commodity prices have been falling for a long time. To retain incomes, effort must be put into increasing competitiveness, profit margins and the share of consumer prices that goes to producers. But CDDC commodity policies often do not sufficiently address the high production and transaction costs that undermine their international competitiveness. Similarly, they do not always do enough to respond to the changing demands of buyers in terms of quantities, reliability, quality etc. Furthermore, in many small developing countries, credible policy implementation and economies of scale in input supply, production and processing are easier to achieve on a larger regional playing field. Therefore, there is a need to better exploit the potential benefits of regional integration.

The EU will

• support CDDCs in the implementation of commodity chain strategies at the national level. This can include actions to improve capacity and support services at producer level, strengthening and upgrading of producer organisations; ensuring essential infrastructure for commodity producing areas; pursuing reforms at the macro level; and developing and exploiting regional integration;

• help develop regional support services for commodity development. For example, supporting regional networks of farmer organisations, commodity branch organisation, and trade associations; quality-enhancing services (certification, testing, market information); technology development and market development research; transport networks; and investment promotion;

• assisting CDDCs to pursue regional integration, in particular in the framework of the EU-ACP Economic Partnership Agreements.
Price decline

Commodity prices demonstrate a long-term declining trend. Between 1970 and 2000, prices for some of the main agricultural exports of developing countries, such as sugar, cotton, cocoa and coffee, fell by 30 to 60 percent (constant dollars). This trend has been driven mainly by significant productivity gains, which enable producers to produce at lower unit cost. Other factors have also increased supply: pressure on countries to earn more foreign exchange but few potential activities with which to do so; devaluation of national currencies of many commodity-producing countries following structural adjustment programmes; entry of new areas into production; and production subsidies in certain countries. The demand for commodities has not kept up with the supply.

For some commodities, such as coffee, cocoa and rubber, international market intervention has existed in the past to stabilise prices. For various reasons, these have by now been abandoned. The EU does not see any scope for a revival of the market intervention mechanisms of the International Commodity Agreements at the present time. Key conditions are not in place that would allow such schemes to be successful. It is unlikely that they will materialise in the near future. CDDCs need other ways to cope with declining and volatile prices.
III. Managing commodity risks and accessing finance

Free markets for agricultural commodities tend to be characterised by cyclical trends: relatively long periods of low prices, and short periods of high prices. There is important short-term volatility within these cycles. Volatility is an important problem for producers – some argue that it is of greater concern to growth and development than the long-term price decline. Volatility creates uncertainty and reduces the willingness and capacity of farmers to invest. Since banks are often reluctant to lend to the risky agricultural sector, entrepreneurs may find themselves unable to upgrade production and technology, and to finance inputs, marketing and processing.

The volatility may also create insecurity for other actors in the value chain, increasing downward price pressures. It leads to macroeconomic imbalances: curtailing export earnings, debt service capacity, imports, credit availability, government revenues and provisions of basic services such as health and education.

To assist countries to cope with market volatility, the EU will

- act to extend producer access to market based commodity price risk insurance. Against a premium, this gives producers the possibility to guarantee a certain price for a given date while still benefiting from price increases above this secured level;
- support the development and piloting of new financial instruments, and the creation of the institutions needed for such instruments to be made available to CDDC producers;
- support piloting of the use of market based insurance tools at the country level and continue to explore alternative international lending arrangements, in order to help cushion national budgets and foreign exchange against the effects of commodity shocks;
- ensure that in the short term, resources such as “Flex” and budget support are provided to CDDCs, to mitigate the adverse impact on poverty of shortfalls in export earnings. This will include seeking to improve access to the EU “Flex” instrument which aims to safeguard macro-economic and sectoral reforms and policies that are at risk as a result of falls in export revenue.
IV. Diversifying around traditional commodities

CDDCs mostly export a small range of commodities without much value added. This situation creates vulnerability. Furthermore, it means that producing countries forego further value and income that they could receive from their commodities. Diversification is commonly seen as the remedy to both these problems, but few CDDCs have managed to make significant changes in recent years.

This failure to diversify their export base is often blamed on the trade protectionism of developed countries. But the problem is much more complex than that. Most CDDCs are LDC countries, or benefit in other ways from preferential access to developed markets. They are more constrained by supply side capacity than by market access issues. On the other hand, market entry can be a problem when it comes to coping with quality and other standards etc. Overcoming these constraints is not facilitated by small domestic markets and the high risk prevailing in many CDDCs, nor by the difficulties of local entrepreneurs to compete with established market operators. While market access issues must be addressed where they exist, a coherent strategy needs to also address the broader supply capacity of CDDCs and seek to secure livelihood diversification to reduce risk.

The EU will

- help to inform government choices relating to diversification strategies. For example, the Commission is currently supporting the development of a methodology to evaluate the potential competitiveness of national coffee sectors, including the options of diversification;

- support livelihood diversification for commodity producers, through increasing assistance to productive sectors in rural areas, and increasingly incorporating responses to challenges relating to globalisation, commodity markets and trade rules into rural development strategies;

- assist governments to put in place the enabling conditions to exploit the potential for developing local, national and regional food markets. In this context, it will be important to monitor the implications of international trade and agricultural policies;

- valorise the many existing EU private sector support instruments in the context of CDDCs commodity and diversification strategies, including the important Investment Facility of the European Investment Bank.
V. Successfully integrating with the international trading system

A range of trade related issues of relevance to CDDCs are at stake in the ongoing negotiations in the World Trade Organisation (WTO), in particular on agriculture. To meet the development objectives of the current Doha Round of negotiations, the international community will need to reach agreements that address the concerns of developing countries and increase their prospects for poverty-reduction and growth. Duty- and quota-free market access for all products should be ensured for LDCs to all developed and most advanced developing country markets. The EU already has such access through its Everything But Arms initiative. Preferential market access for other developing countries is also important and should be generous. Finally efforts in WTO should be accompanied by trade-related technical assistance, as well as specific support actions to ensure that developing countries can fully exploit the potential which liberalisation brings.

The EU will

- act to secure a development friendly outcome in the Doha Development Agenda in WTO. This implies ensuring that the needs of the CDDCs are adequately addressed, including by ensuring that due attention is paid to products of specific interest to them, both traditional products and those which show potential for diversification. To achieve this, the negotiations need to proceed in earnest;

- continue to monitor the impacts of its domestic agricultural support policies and pursue reforms whilst continuing the move towards support systems that avoid trade distortion;

- maximise access to the EU market for CDDCs, particularly those which do not enjoy either LDC or ACP preferences, through ensuring continued generous and predictable preferential market access. This may include consideration of the revision of the current rules of origin requirements on which the according of preferences is based;

- support all developing countries in taking advantage of their market access, including through capacity building and increased awareness of existing possibilities.
VI. Enhancing sustainable corporate practices and investments

The international commodity companies and retailers play a central role in framing the future of commodity sectors. Mostly, they are the most powerful actors in commodity chains, a situation being reinforced by the ongoing concentration on the side of commodity buyers and the parallel fragmentation on the side of the producers.

In addition, commodity processors and retail chains are increasingly integrated within the commodity chain. This helps them ensure stable access to supply, better control the chain and enables them to trace their products down to production levels. Large companies thus have a significant role to play in developing production and trading practices that are sustainable – environmentally, socially and economically. Increasingly, they are also showing an interest in internalising sustainability concerns – socio-economic and environmental conditions at producer level – into their business operations.

The EU will

• promote Corporate Social Responsibility (CSR) internationally, including by supporting public awareness and transparency on existing fair, sustainable or ethical trade initiatives – whether led by civil society, private sector or government;

• assist CDDCs to benefit from CSR, including by supporting them in building the capacities needed to adhere to the related codes and criteria. This can for example involve participation in public-private partnerships for sustainable commodity production, and support to non-governmental initiatives aimed at helping the supply side of trade flows in sustainably produced goods;

• promote competition on commodity markets, including by encouraging all countries to take up certain core principles on competition (such as non-discrimination and transparency and an undertaking to outlaw hard-core cartels) in domestic laws and regulations. The EU will pursue these issues in various relevant international fora, including the WTO and the international network of competition authorities.
An EU-Africa partnership on cotton

As an application of the Action Plan on Commodities, the EU is proposing a special partnership on cotton with African cotton producing countries(3). This is not least a response to concerns about this issue raised by a number of cotton-producing African States in the context of the WTO.

The fall in world cotton prices has had a serious impact on several African countries, where cotton is the main source of income for an estimated 2-3 million farmers. In some of the less developed countries, it represents the main cash crop and the largest source of export receipts and government revenues.

Production costs in Africa are amongst the lowest in the world and African producers are potentially competitive global players. However, subsidisation regimes have played a role in distorting world markets, prohibiting African producers from fully exploiting their comparative advantage. The World Bank (2002) found that global liberalization would increase the world cotton price over the baseline scenario by an average of 12.7% over a 10-year period. The largest gains in trade would go to Africa which would increase its exports by an average of 12.6%.

African cotton sectors are also affected by the general decline in international prices and in some countries, a decline in yields. If unchecked, this trend would mean that the cost of production will eventually be higher than declining revenues. The cotton markets in Africa are increasingly liberalised, allowing for the entry of private sector companies and greater competition. However, reforms also result in new challenges, such as the securing of input credit to farmers and action to deal with shocks in commodity prices, which diminish farmers’ income, government budgets and foreign exchange reserves.

Cotton subsidies and border protection

With 19% of world production and 36% of world exports in 2002, US cotton policies impact significantly on international markets. Subsidies to the 30,000 US cotton farmers paid under domestic or export support schemes amounted to $3.6bn in 2002. Whereas US cotton production has remained stable over the years, an increasing part of it is exported to growing textile producing countries. These rapidly changing trends exacerbate the distortive effect of US subsidies on international markets. At the same time, the US market remains fairly protected and cotton imports are minimal.

EU cotton production is relatively low at 2.5% of world production. Support to its 100,000 farmers amounted to an average of €800m per year during the 2000-2002 period. In 2004, the EU has adopted a reform of its internal regime to minimise any trade-distortion of its domestic support. The EU is a net importer of cotton. It imports more than 50% of its cotton needs, and is the largest world importer of cotton. All ACP and LDC cotton and cotton products, including textiles and clothing, enter the EU duty and quota free. No export subsidies are paid.

China is the third country that subsidizes cotton production to supply to its textile market. In recent years, China has been a net importer and increasingly imports from Africa.
Production and exports of cotton lint

Production of cotton lint in African countries

Real Price Indices, 1960-2003 (1980=1.0)

Source: ICAC, 2002-03

Source: ICAC, 2002-03 (represents 87% of sub-Saharan Africa)

Source: World Bank/ICAC data. A Index=cotton
The proposed EU-Africa cotton partnership has two components: obtaining fairer trade relations on cotton in the context of the Doha Development Agenda (DDA) of the WTO; and supporting the competitiveness of the cotton sector in the concerned regions.

I. Obtaining fairer trade conditions on international cotton markets

- At the WTO, the EU supports an effective and specific solution on cotton within the agricultural negotiations.

- Internally, the EU has recently reformed its own cotton regime. This will reduce its trade-distorting impacts. It wants to secure a commitment from major players in international cotton markets to follow this initiative and undertake reforms with respect to trade distorting domestic support. The Commission will establish a mechanism that allows it to monitor the impact of the EU subsidy schemes and reform measures on cotton production and trade.

- Also, the EU calls on other developed countries and the more advanced developing countries to follow its[4] in providing unrestricted access for cotton from the poorest countries in the world.

- The EU also proposes that all countries eliminate all forms of export subsidies on cotton.

- Finally, the EU will provide trade-related technical assistance to help developing countries to defend their cotton-related interests in the multilateral trade context.

II. Supporting cotton producing countries and regions in Africa

In complement to its efforts relating to the international trading system, the EU stands ready to assist African cotton producing countries directly in consolidating the competitiveness of their cotton sectors. With this objective, it wants to assist countries implement comprehensive development strategies or plans for their cotton producing regions. These could among other things include:

- strengthening of cotton related institutions and policies that work in the interest of farmers;
• increased attention to risk strategies to cotton, through a focus on self-insurance, use of risk markets and compensatory finance;
• capitalising on chain integration opportunities or certain niche markets, such as organic/fair trade cotton or specialty textiles or garments;
• enhancing capacities in the area of technological innovations and quality improvements. The EU will participate in the development of a universal cotton classification system.

The EU also wants to ensure that the potential of Economic Partnership Agreements for cotton sector development is fully exploited.

An EU-Africa Cotton Forum is being organised on 5 and 6 July 2004 to activate the EU-Africa Cotton Partnership and draft a road map for its implementation. This will involve discussing concrete national cotton strategies by cotton producing countries; and potential donor support to cotton.

Economic Partnership Agreements:

The EC is fully committed to assisting CDDCs to pursue regional integration. It is convinced of the many potential benefits that this could bring. As regards the ACP countries, the negotiations on Economic Partnership Agreements (EPAs) with the EU will be a main instrument to foster such integration. The negotiations will address issues relating to ACP trade performance both with the EU, with other countries and between themselves. Issues covered will range from market access to trade related rules, including sanitary and phyto-sanitary standards. Interlinked development co-operation activities will help the ACP to use this framework to support regional integration and trade including the development of commodity sectors. The Commission, in cooperation with the ACP partners, will seek to ensure that the issue of commodity dependence is given proper prominence throughout the EPA negotiations.