

# Fair trade and the crisis in world commodity prices

June 2005

**Imagine trying to survive on just one fifth of what you were earning twenty years ago. This is the reality for millions of poor farmers who have seen the value of their produce plummet.**

Over the past twenty-five years the price of some tropical agricultural products has collapsed. The impact on many of the world's poorest people has been devastating. While millions of farmers are sinking further into the spiral of poverty and debt, working ever harder, producing more, but receiving less, some buyers and retail companies are recording record profits. Despite many voices highlighting the problems in the major commodity markets, so far policy makers have failed to take decisive action.

This paper examines the causes of this crisis, its impact on real lives and offers some recommendations. It will show that fair trade has been critical in shielding thousands of vulnerable producers from the worst effects of the crisis and show how we need to take action to tackle the structural problems that underlie the crisis. Primarily this briefing paper calls on all those committed to fighting poverty through trade – whether voter, consumer, policy-maker or parliamentarian – to do what they can to make sure that this issue receives the attention and action it deserves.

## **The scale of the crisis**

Millions of farmers and many poor countries depend on the sale of primary agricultural products (commonly called agricultural commodities) for their survival. These range from products such as tea, coffee, cocoa, sugar, rubber and cotton to products such as vanilla or nutmeg. Given the massive increase in the trade of these tropical goods worldwide in recent years, you would be forgiven for assuming that developing country farmers would be doing well. But the opposite is the case. The prices for the most of these commodity products are just twenty per cent of what they were 20 years ago. The price of tea, coffee and cocoa alone has fallen dramatically (by 70 per cent) between 1996 and 2001.

***The fall in the price of 10 commodities cost developing countries \$242.5 billion in 2002 alone – that's five times the total world annual aid budget.***

In 2002 Tatu Museyni in the village of Kishimundu in Tanzania received less than one third of the price she received for the harvest from her thirty coffee bushes in 1998.

She said:

*"The price of coffee is destroying me. It is destroying this whole community. I cannot even afford to feed and clothe my children....Now I cannot pay for the school fees and books. Sometimes they are chased out of school because they cannot pay."*

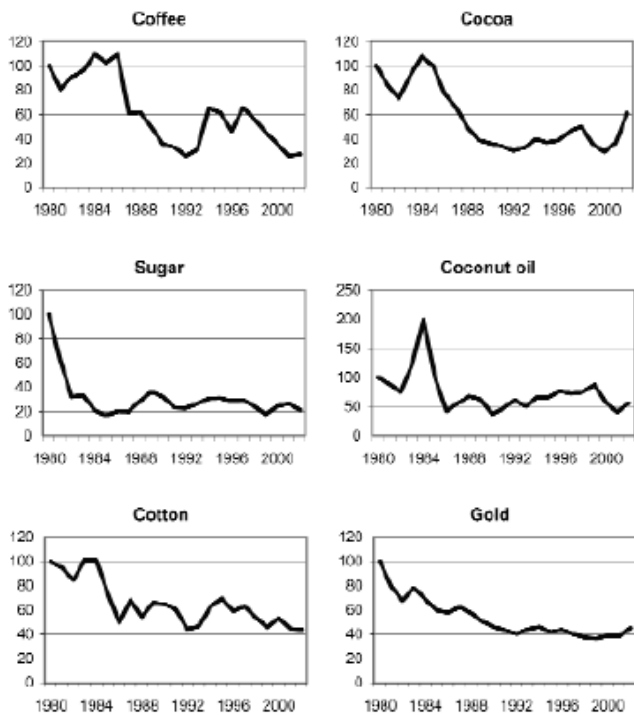
Peter Robbins, "Stolen Fruit: the tropical commodities disaster". Zed Books, 2003

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"The Commodities Challenge: Towards an EU Action Plan", Oxfam Submission to the European Commission. January 2004

## PRICE INDICES OF SELECTED AFRICAN COMMODITY EXPORTS, 1980–2002

(1980 = 100)



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

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

IATP, "UNCTAD XI: Challenging the Commodity Crisis" June 2004

### The impact of the crisis

- Two billion people worldwide make their living from agriculture. The majority of these live in the developing world, either working on plantations or their own small plots. For many countries agricultural commodities are the primary source of revenue. For example 80 per cent of Burundi's export income comes from coffee alone. This dependence makes countries vulnerable to the such dramatic and long-term decline in prices.
- For millions of farmers and their families these statistics mean poverty, poor nutrition, not being able to afford school fees or medicines and having no way to invest for the future.
- For the countries reliant on the foreign exchange they earn from these products, the crisis means they cannot afford to invest in their health or education systems, their debt mounts as their ability to make the payments declines and they have no means to invest in supporting future industrialisation strategies.

In short the crisis in commodity prices is robbing individuals and countries of the chance to trade their way out of poverty and condemning them to future aid dependence

### The price of a cuppa?

The recent dramatic decline in the price of tea has led to real hardships for tea workers and smallholder producers, plus a series of estate and factory closures in south India and the state of West Bengal. For thousands this has meant selling their tea below the cost of production or no job and no pay. For most of those affected there are no alternative opportunities for employment or income, so the social consequences have been devastating, with acute malnutrition on the rise and housing conditions rapidly deteriorating. Traidcraft Exchange is working to bring all stakeholders together in the Indian tea sector – including the smallholders, workers, estate owners and managers as well as the European tea purchasers to look at the underlying causes of the crisis and how each actor can use their position to bring about change

### Causes of the crisis

The causes of this crisis can be boiled down to a two key factors:

1. Oversupply – too many people are producing the same products.
2. Increasing concentration in the power of buyers, who are then able to force prices down.

The crisis has been compounded because some of the policy tools to combat it have become less politically acceptable over the past twenty years. In the past the international community set up international

commodity agreements. These were not perfect, but they helped to keep prices stable. But as the world's policy makers now espouse the efficiencies of the market system, these types of solutions are out of favour.

### **Bad advice**

The oversupply of tropical commodities has been worsened by advice from some development agencies and donors such as the World Bank and International Monetary Fund (IMF). As part of their conditions for loans and debt relief, they encouraged countries to export tropical commodities – because according to economic theory this is where they have ‘comparative advantage’ and the foreign exchange they earn could be used to pay off their debts. The problem has come with lack of co-ordination. If too many countries are advised to ‘diversify’ into the same product or to produce more and more poor quality products, this floods the market and reduces prices. For example Vietnam increased its coffee production from 10,000 to 90,000 tonnes between 1985 and 2001 to become the world's second largest exporter. But world oversupply led the price to plummet by 70 per cent between 1997 and 2001 impacting not only Vietnam itself, but other developing country coffee producers such as Mexico and Kenya and threatening the livelihood of an estimated 25 million people who depend on coffee worldwide.

### **Unfair trade**

In some instances rich countries produce the same tropical products as poorer countries, but with the support of government subsidies. This has exacerbated oversupply. In part, this has happened because some governments decided to directly compensate producers for lower prices, rather than dealing with the oversupply and market concentration issues that cause the problem in the first place. For example the European Union gives €1.5 billion per year to support its inefficient sugar beet farmers which is then dumped on the world market below the cost of production, lowering the price received by more efficient sugar cane farmers around the world. There is a similar situation with the US and cotton which has been the subject of a dispute at the World Trade Organisation (WTO).

### **Market concentration**

Fewer, more powerful buyers are able to play producers (or even countries) off against each other and force prices down. In the past producers clubbed together to negotiate as co-operatives or in some countries state-marketing boards did this job for them. But the power of co-operatives has been dwindling and under advice from some donors many state marketing boards were dismantled. Unfortunately one of the unforeseen consequences of this intervention has been lower bargaining power and lower prices for farmers. For more information on this market concentration aspect of the commodity crisis, see Traidcraft briefing paper “Are International Supply Chains increasing poverty?”.

### **Wrong time**

The crisis in tropical product prices deepened throughout the 1980's. At the same time, the types of policies that would help – intervening to ensure the market worked for the poor – became more and more politically unacceptable. So when a number of international commodity agreements broke down in the 1980's there was no political will to save them and a key possible tool for discussion and resolution of the over-supply problem was lost.

#### **The Contribution of Fair Trade**

Through guaranteeing a fair price, Traidcraft, along with other fair trade organisations around the world, has made a difference to the lives of millions of producers and farmers, many of whom are affected by the commodity crisis. However we also recognise that this contribution must be complemented by action to tackle the underlying causes of the crisis. Implicit in the fair trade model is a recognition that sometimes you have to intervene to make markets work for the poor. It is therefore important that as well as demonstrating the feasibility of, and consumer demand for, a better way of trading, the fair trade movement is also standing with poor producers and farmers around the world to demand a more just international trading system.

“The State of Agricultural Commodity Markets”, FAO 2004

“The State of Agricultural Commodity Markets”, FAO 2004

“Bitterness at EU sugar subsidies”, BBC News, 27/09/2002

## Tackling the crisis

In order to tackle this crisis, policy makers need to be prepared to be flexible. There must be a recognition that the unfettered free market does not work for everyone in every circumstance and that in some cases we must intervene to ensure that trade can indeed become a tool for development and poverty alleviation.

## Recommendations

### 1. Manage supply

In order to stabilise prices we need to urgently manage international supply. This means eliminating oversupply and planning future production to prevent a re-occurrence of oversupply problems. For example in 2003 the International Coffee Organisation (ICO) estimated that if five million bags of the lowest grade coffee were destroyed, this would lead to a 20 per cent increase in coffee prices and an additional \$700-\$800 million in income for coffee producing countries. We also need to urgently end the rich-country subsidies that contribute to oversupply.

### 2. Support diversification into other products

We need to help producers to move into new areas of production and into value-added production. But in doing this, we must again learn the lessons of the past, so that not everyone 'diversifies' into the same thing. Diversification must be based on an assessment of real market conditions in domestic as well as regional and international markets. Additional resources, such as a Diversification Fund could be helpful.

### 3. Support more value-added production

Ideally as supply is managed and prices stabilise, this will create resources to help producers move into more value-added production. But we also need to make sure that rich-country policies do not undermine the ability of producers to do this. First and foremost this means not undermining local businesses in their own markets by forcing countries to open up too soon to foreign competition. (see Traidcraft briefing paper "EPAs: the hidden danger"). It also means ending the punishing tariffs and spurious standards that prevent countries from exporting manufactured or processed goods.

### 4. Break down corporate concentration

To make sure that farmers get a decent slice of the value of their products, it is important to strengthen their bargaining power vis a vis the large and powerful buyers. There are two sides to this. The first is to encourage and support more collective negotiating by farmers. This is fundamental to the fair trade way of operating. The second is to begin to breakdown some of corporate monopolies that are abusing their power and size to push prices ever-lower. For more information on this see Traidcraft briefing paper "Are International Supply Chains increasing poverty?".

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