ECONOMIC COMMISSION FOR AFRICA

First session of the Conference of African Ministers Responsible for Trade, Regional Cooperation, Integration and Tourism

Technical Committee of Experts

Addis Ababa, Ethiopia
7-13 February 1996

ECONOMIC COMMISSION FOR AFRICA

First session of the Conference of African Ministers Responsible for Trade, Regional Cooperation, Integration and Tourism

Ministerial Meeting

Addis Ababa, Ethiopia
14-16 February 1996

INTERNATIONAL MARKET MECHANISMS FOR COMMODITIES: AFRICAN COUNTRIES AND FUTURES MARKETS (A TECHNICAL STUDY)

96-171

* Note: For technical reasons, this translation could not be revised
## CONTENTS

<table>
<thead>
<tr>
<th>Chapter I</th>
<th>INTRODUCTION</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chapter II</td>
<td>PRINCIPAL MECHANISMS GOVERNING INTERNATIONAL COMMODITY MARKETS FOR RAW</td>
<td>2</td>
</tr>
<tr>
<td><strong>Section 1</strong></td>
<td>Stock and commodity futures markets</td>
<td>2</td>
</tr>
<tr>
<td>(a)</td>
<td>Characteristics and distribution</td>
<td>2</td>
</tr>
<tr>
<td>(b)</td>
<td>The use of futures markets</td>
<td>3</td>
</tr>
<tr>
<td>(c)</td>
<td>Organization of futures markets</td>
<td>3</td>
</tr>
<tr>
<td>(i)</td>
<td>Negotiation procedures</td>
<td>3</td>
</tr>
<tr>
<td>(ii)</td>
<td>The principle of non-accumulation of losses: the margin system</td>
<td>4</td>
</tr>
<tr>
<td><strong>Section 2</strong></td>
<td>Risk management instruments relating to commodity price fluctuations</td>
<td>5</td>
</tr>
<tr>
<td>(a)</td>
<td>Forward contracts</td>
<td>5</td>
</tr>
<tr>
<td>(b)</td>
<td>Futures and options</td>
<td>5</td>
</tr>
<tr>
<td>(i)</td>
<td>Futures</td>
<td>5</td>
</tr>
<tr>
<td>(ii)</td>
<td>Options</td>
<td>6</td>
</tr>
<tr>
<td>(ii)</td>
<td>The Eastern and Southern African (PTA) Trade and Development Bank sale option: the &quot;price guarantee contract&quot; mechanism</td>
<td>8</td>
</tr>
<tr>
<td>(c)</td>
<td>The stock retention system: the Coffee Retention Scheme</td>
<td>9</td>
</tr>
<tr>
<td>Chapter III</td>
<td>PRINCIPAL FINANCING MECHANISMS FOR THE INTERNATIONAL COMMODITY TRADE</td>
<td>10</td>
</tr>
<tr>
<td><strong>Section 1</strong></td>
<td>Payment guarantee mechanisms</td>
<td>10</td>
</tr>
<tr>
<td>(a)</td>
<td>Guarantees by signature</td>
<td>10</td>
</tr>
<tr>
<td>(b)</td>
<td>Guarantees by deposit</td>
<td>10</td>
</tr>
<tr>
<td>(c)</td>
<td>Documentary mechanisms</td>
<td>11</td>
</tr>
<tr>
<td><strong>Section 2</strong></td>
<td>Principal price and returns stabilization mechanisms for commodity exports</td>
<td>12</td>
</tr>
<tr>
<td>(a)</td>
<td>Product agreements</td>
<td>12</td>
</tr>
<tr>
<td>(b)</td>
<td>Compensatory financing mechanisms</td>
<td>12</td>
</tr>
<tr>
<td>(i)</td>
<td>The IMF compensatory financing facility (CFF) and contingency financing mechanism</td>
<td>12</td>
</tr>
</tbody>
</table>
Chapter IV. FACTORS IMPEDING THE USE OF FUTURES MARKETS BY AFRICAN COUNTRIES

Section 1. Problems of obtaining credit facilities to cover margin calls

Section 2. Problems connected with countertrade and sovereign risks

Section 3. Absence of mechanisms allowing for the use of commodities as guarantees for credit

Chapter V. NECESSARY CONDITIONS FOR ENHANCED PARTICIPATION OF AFRICAN COUNTRIES IN FUTURES MARKETS

I. Prospects of trade liberalization following the Uruguay Round Agreements

II. Measures to strengthen the commodity sector

(a) Measures at the national level
(b) Measures at the regional level

Chapter VI. CONCLUSIONS AND RECOMMENDATIONS

Annexes
CHAPTER I.

INTRODUCTION

1. Commodities have always played a key role in international affairs. On the one hand, commodities being unevenly distributed from a global perspective, yet indispensable for industrial production and other socio-economic requirements, access to their sources of supply has always been considered essential, and a sufficient justification for colonial adventures, annexations of territory and military intervention. Secondly, questions concerning the regulation and stabilization of international commodity markets have been at the centre of many declarations of intent emanating from various international institutions. One early impetus in this direction emerged from the Programme of Action on the establishment of a New International Economic Order, adopted on 1 May 1974, which stated that every possible effort should be made to speed up the elaboration of commodity agreements in order to provide the necessary regulation and stabilization mechanisms to international trade in commodities. The question reappeared on the agenda in the context of the Integrated Programme for Commodities adopted in Nairobi during the fourth United Nations Conference on Trade and Development (1976), and the establishment of the Common Fund for Commodities in June 1989. At the eighth session of UNCTAD, in February 1992, member States reiterated the objectives of the Integrated Programme, and recognized the need to seek new ways of minimizing the risks connected with commodity market instability. In the case of African States, mention must also be made of the Fraser Report, prepared at the request of the United Nations Secretary-General in response to the wish of the Assembly of Heads of State and Government of the Organization of African Unity.

2. Although some of the instruments and mechanisms that have been put in place have been satisfactorily operational over certain periods, the overall results have been disappointing. Commodity agreements have stalled, and the expected support from compensatory financing mechanisms and from the Common Fund for Commodities has not been forthcoming. A better understanding of the workings of international commodity markets is necessary if the various instruments in question are to fulfil a just role in international trade.

3. In the context of the present organization of trade based on competitive market factors, countries with some degree of economic stability have a clear advantage in being able to benefit from market fluctuations. African countries, on the other hand, will find themselves constrained to more or less submit to market demands because they are in a relatively weak negotiating position. There are two main reasons for this:

(a) Many African countries depend for their export earnings on just one or two commodities. Some 98 per cent of Zambia’s export earnings, for instance, comes from copper, while Côte d’Ivoire depends on cocoa for 60 per cent of its export earnings. (See Table 1, which also shows statistics for other African countries). In the result, the economies of countries that are heavily dependent on a restricted commodity mix prosper or suffer in more or less direct proportion with the international trade conditions relating to the commodity or commodities in question. This leads to instability in the terms of trade, thus frustrating development plans;

(b) Most of the raw materials of export interest to African states are traded in accordance with commercial futures markets. The organizational mechanisms of these markets are fairly complex. In

---

1 Oil was a key factor in the Gulf War.


3 After the Chairman of the Group of Experts appointed by the United Nations Secretary-General on 22 March 1989 to study the problems affecting commodity trade in Africa.
addition, the considerable price fluctuations that occur in these markets occasion major risks in trade operations. These risks are generally difficult to manage, and often require specific management mechanisms and techniques. Moreover, access to futures markets is predicated upon the economic weight of the various actors and the conditions in which they operate. African economies being for the most part relatively unstable, are often unable to benefit from the opportunities offered by futures markets as acceptable partners. They are thus rarely in a position to become acclimatized with the rules, demands and workings of the sector.

4. This study paper deals with commodity trade in the futures markets, which are the principal markets in which commodity transactions take place. The study is in line with the ECA secretariat's objective of contributing to the development efforts of African countries. It sets out to analyse the existing mechanisms in international commodity markets, particularly commodity futures, in which significant changes continue to occur, and where African operators are constantly faced with the problems of price volatility and the uncertainties which bedevil trade in many of the commodities.

5. The study examines the operational characteristics of commodity futures markets, their role and basic organizational principles, as well as financing mechanisms, which are an important factor to the sector. (Chapters II and III).

6. International commodity trade transactions are governed by a fairly elaborate complex of rules, to which economically weak countries such as the majority of African States, cannot adhere easily. Problems of financing and of acclimatization to the workings of modern trade operations and risk management usually make it difficult for these countries to actively participate in the commodity futures market place. This aspect is discussed in greater detail in Chapter IV.

7. With the advent of a new international trade framework following the Uruguay round of multilateral trade talks, it has become necessary for African States to introduce a new policy stance on commodities so as to obtain the optimum benefit from the new market potentialities and modern commercial risk management mechanisms and address the obstacles they face in commodity trade. This aspect is dealt with in Chapter V.

CHAPTER II
PRINCIPAL MECHANISMS GOVERNING INTERNATIONAL COMMODITY MARKETS

8. Special mechanisms and instruments to regulate trade have been devised to address the risk factor relating to commodity price fluctuations and provide some measure of protection against unfavourable market patterns. It is in this context that trade strategies based on phased transactions and the use of negotiable instrument have been introduced.

Section 1. Stock and commodity futures markets

(a) Characteristics and distribution

9. A commodity exchange or commodity futures market may be defined as a commercial institution whereby property rights may be traded on the strength of goods available in the future. These rights are transacted in strictly standardized form, known as exchange contracts, or futures, which are registered with a financial agency known as a compensation agency. This agency is responsible for the due performance of obligations relating to the transaction, and steps into the rights and obligations of the contracting parties.
10. Futures trading is carried out publicly, in a central place such as a stockmarket trading floor. The going prices are transmitted through national and international media and, in many cases, serve as points of reference for domestic and international transactions for the commodity concerned.

11. The largest futures markets and commodity exchanges are in the developed countries. They include: the Chicago Board of Trade (CBOT) in which the main contracts dealt in are those of wheat, maize, gold and silver; the New York Mercantile Exchange (NYMEX), for petroleum products, platinum and palladium; the London Metal Exchange, for a whole range of metals; the Tokyo Commodity Exchange for Industry (TOCOM), which deals in gold, silver, platinum, rubber, and cotton and woollen yarn; the Paris Commodity Exchange, for coffee, cocoa and sugar; the New York-based Commodity Exchange Inc. (COMEX), where copper, silver, gold and aluminum futures, and gold and silver options, are traded; the London-based International Petroleum Exchange (IPE) and the New York-based Coffee, Sugar and Cocoa Exchange (CSCE).

12. Commodity futures markets are also to be found in some of the developing countries. Brazil’s Bolsa de Mercadarias & Futuros (BM & F) has been in operation since May 1991, and is the world’s fifth largest futures market; coffee, cotton and cattle (transported or in the paddock) are traded at the BM & F in United States dollars, and several other commodities in local currency, as well as financial contracts. Futures markets and commodity exchanges in developing countries include: the South African Futures Exchange (SAFEX), the East African Tea Trade Association (based in Kenya), the Kuala Lumpur Commodity Exchange (Malaysia); the Rubber Association of Singapore Commodity Exchange (RASCE) and the Zimbabwe Agricultural Commodity Exchange (ZACE).

(b) The use of futures markets

13. The most basic function of futures markets is speculation which consists in the sale and purchase of contracts in order to gain from a rise or fall in commodity prices without having to enter into the process of delivery of the commodity in question. This aspect of commodity exchange is not, however, the principal one.

14. Hedging constitutes the principal function of forward market operations. This function is divisible into: (1) offset hedging, whereby traders act as intermediaries in the trace of a product to protect themselves against the risk of price fluctuation; and (2) fix-price hedging, whereby producers set prices on their commodities on the basis of production and other costs.

(c) Organization of futures markets

(i) Negotiation procedures

1. Standardization of contracts

15. Standardization is essential in forward market negotiations, which usually take place ahead of delivery. It applies to the various aspects of the subject matter, such as the baseline quantity and quality, the conditions of delivery and the mode of regulation. Quantities must be the same for all contracts: 5,000 bushels for maize, wheat and soya; 100 bales for cotton (in the U.S.); sugar, 50 tonnes; cocoa, 10 tonnes; coffee 5 tonnes (in Paris). However, there are variations in different markets. For example, the working quantity for cocoa in New York is 30,000 pounds (nearly 13.6 tonnes) and 10 tonnes in France and in Great Britain.

---

4 Some of the markets use electronic price-listing and trading methods.

Britain. The baseline quality must be clearly defined. Commodity exchanges establish quality benchmarks for the sector. For example, the commodity exchange in Chicago uses the Solf Red Winter No. 2, a specific type of soft wheat, as a standard. Other aspects of the contract, such as the date and time-frame for delivery, shipping conditions and mode of regulation, should also be standardized. The standardization is effected in accordance with a general market regime, within which various options are provided. It falls to the seller to decide upon a given option.

16. Contracts in futures markets are negotiable. A purchaser in the futures market is a purchaser of a contract, and is said to have taken a long position. A seller in the futures market sells a contract, and is said to have taken a short position. To accommodate delivery, the former must resell, and the latter must repurchase, the contract. This mechanism, which first came into operation in Chicago around the 1850s, is at the root of futures trading and the genesis of all modern commodity exchange operations.

2. The principle of compensation

17. To be valid, every transaction in the futures market is required to be registered with a financial institution, which then guarantees its due completion. The role of the financial institution (sometimes called a clearing house, such as in the U.S. exchanges, or, in France, the Caisse de liquidation des affaires en merchandises and Banque centrale de compensation) is to facilitate the regulation of futures trading operations. The transactions are effected through credible brokers registered with a compensations agency, which assumes responsibility for due performance.

(ii) The principle of non-accumulation of losses: the margin system

18. Commodity exchange operations, by their very nature, engender significant market risks. The market spread makes market failure a constant threat; hence the need to guarantee the due completion of transactions and protect the institutions of the market. The compensation mechanism, which accommodates countertrade risk factors, guards against the accumulation of losses and is thus self-protecting. The margin system has proved to be very effective as a protective mechanism.

19. In the margin system, the trader enters into a commitment, concomitantly with the registration of the transaction, to cover about 10 per cent of the nominal price. This portion, known as the margin, covers traders’ losses in the futures market on a daily basis. The compensations agency with which the transaction is registered then issues a margin call equal to the difference between the going price on the previous settling day and the going price on the settling day on which the margin call is issued, multiplied by the total of either the short positions (in case of a rise in prices) or the long positions (in case of a fall in prices). The computation of the going price(s) on the basis of which losses are determined is carried out by experts in futures trading operations.

20. Funds are transferred, with the margin as a guideline, to the compensations agency which in turn, makes good traders’ losses within the limits of deposit maintenance requirements. There are two distinct methods of applying this mechanism. The first, commonly used in the United States, is known as the market-to-market system: the margin is settled in cash, and the "winners" and "losers" treated on a basis of parity. The method preferred in London and Paris is less strict than the market-to-market system. Here, the margin is settled either in cash or by means of bank guarantees. The compensations agency debits or credits the margin account of the trader, as the case may be, and charges agios of exchange on the debit accounts.

21. The central compensation facility is not, however, available to all actors in the futures market place, but only to those that are accepted by the compensations agency on the strength of the financial guarantees.

---

6 Following the introduction in Europe of financial futures, the U.S. system was adopted.
they are able to present; those so included are known as "clearing members". In view of the collateral required (cash or property guarantees), it would therefore not usually be easy for futures traders from Africa to benefit from the compensation mechanism, nor indeed to have access to credit facilities to an extent that would enable them to act upon margin calls. This situation explains the dependence of African countries on licensed intermediaries and hence the lack of transparency in futures trading for African countries.

Section 2. Risk management instruments relating to commodity price fluctuations

22. Apart from the mechanisms described above, which mainly deal with minimizing the cost of transactions and protecting the most vital agencies of the market, there are others designed to manage the risk factors connected with commodity price fluctuations.

(a) Forward contracts

23. A forward contract is an agreement of sale or of purchase of a certain quantity of a commodity on a given date in the future, at a price fixed in advance. Because a forward contract presupposes that the commodity will be delivered, certain exporting countries, such as Ghana and Côte d'Ivoire, sell a sizeable portion of their cocoa through this method. This enables them to guarantee their farmers a certain level of return.

24. Forward contracts may, of course, be formalized within the futures market. Most of them, however, are effected in the off-board market, either directly ("over the counter"), or indirectly through brokers and other agents, by telephone, telex or telefax.

(b) Futures and options

25. Table 2 of the Annex ("Price fixing mechanisms for 29 major export commodities") shows that for many of them, particularly petroleum products, cocoa, coffee, tea, cereals, copper and gold, futures and options market mechanisms are used 8. Most of these transactions, however, do not extend beyond the domestic market. The box on page 7 illustrates how a typical agricultural cooperative dealing in coffee manages the price fluctuation risk factor, in three different situations - no cover, forward cover, and options cover.

(i) Futures

26. A commodity exchange contract in the futures market relates to the sale or purchase in the future of a given quantity of a commodity, at a predetermined price, but not necessarily with a condition that the commodity will be delivered; in the case of forward contracts, such a condition is included. Again, unlike forward contracts, commodity exchange contracts in the futures market are quoted from day to day in the Stock Exchange.

27. Developed countries still dominate futures trading, mainly because the developing countries, including those in Africa, rarely have access to the credit facilities that would enable them to cover margin calls. Though African countries appear to be making some progress in this domain, their participation is still minimal.


(ii) Options

28. An option is a risk management instrument purchased as a safeguard against unfavourable-price fluctuations, with the option (but not the obligation) to purchase the commodity should the market conditions turn out to be favourable. Options are purchased through the payment of a non-renewable premium. This genre of securities trading is a relatively recent development. The first-ever commodity option was a sugar option traded in 1982 in New York’s Coffee, Sugar and Cocoa (CSCE) exchange. There is now a thriving market for gold, silver, coffee, cocoa, sugar, soya, petrol, cotton, aluminium and copper commodity options.

9 Ibidem.
Price fluctuation risk management by an agricultural cooperative

A cooperative, X, sells 2 million pounds of arabica coffee, to local exporters during the months of October, November and December every year, at predetermined prices which are based on the "C" transactions of the New York Coffee, Sugar and Cocoa Exchange, less 10 cents in the pound, representing traders' margins. It wishes to protect its members against a possible fall in prices in the current trading. For 1988, the management proposes the price of 112 cts/lb for coffee to be delivered at the end of the year. It sells 345 contracts in the futures market, each bearing, nominally, 17500 pounds of coffee. By way of guarantee, it deposits $US 862 500 (i.e. $US 2,500 for each contract) in an account with a U.S. bank. In the following months, the prices do fall. There is therefore no margin call. When, in October, the cooperative begins to sell in the delivery market the price has risen to 118 cts/lb. It receives 108 cents in the pound for 2 million pounds, and realizes a profit at 4 cents in the pound on the 115 contracts it has brought to fruition. In December, prices are again on the rise, standing at 125 cents per pound, and the cooperative weather losses in the exchange at the rate of 3 cents in the pound, while receiving 115 cents per pound for the coffee delivered and sold. In both cases, it has the assurance of the agreed price of 112 cents that it has guaranteed its members. Upon sale of the coffee and the coming to fruition of the exchange contracts, the profit realized in the delivery market with the mark-up price of 125 cts/lb is cancelled out by losses in the exchange of 10 cts/lb. Thus, the cooperative loses out in a situation where it cannot cover its price fluctuation margin.

In 1990, the cooperative decides to try options, which are purchased by means of non-renewable premiums, set in this case, at 6 cents in the pound; the total funds outlay is therefore $US 360 000, way below the amount required for commodity exchange contracts in the futures market.

The results are shown in the table below. Prices have fallen sharply at the CSCE exchange during the year, to 61 cts/lb on average. The cooperative has, however, realized a net profit of 73 cts/lb on its options, and the planters have received 134 cts in the pound for their produce. The table shows computations of the sales price on actual sale in three different situations (no cover, futures and options).

<table>
<thead>
<tr>
<th>Year</th>
<th>No Cover</th>
<th>Futures</th>
<th>Options</th>
<th>Maximum deposit guarantees lodged (in $US)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1988</td>
<td>113</td>
<td>112</td>
<td>110</td>
<td>863</td>
</tr>
<tr>
<td>1989</td>
<td>126</td>
<td>116</td>
<td>121</td>
<td>1,823</td>
</tr>
<tr>
<td>1990</td>
<td>61</td>
<td>140</td>
<td>134</td>
<td>863</td>
</tr>
<tr>
<td>1991</td>
<td>79</td>
<td>66</td>
<td>74</td>
<td>2,003</td>
</tr>
<tr>
<td>1992</td>
<td>68</td>
<td>76</td>
<td>72</td>
<td>1,343</td>
</tr>
<tr>
<td>1993</td>
<td>58</td>
<td>63</td>
<td>59</td>
<td>863</td>
</tr>
<tr>
<td>1994</td>
<td>67</td>
<td>59</td>
<td>62</td>
<td>1,523</td>
</tr>
</tbody>
</table>

The figures indicate that in some cases, (during 1988, 1989 and 1991, for example) the cooperative might have come off better by electing not to cover its trading. By covering, however, the cooperative was able to give its members the assurance of a guaranteed price, which, for one thing, made it possible for them to make better investment decisions.
29. For practical reasons, and there being as yet no concerted action at the international level to alleviate the liquidity problems affecting the use of risk management instruments, options have been seen as a more manageable genre of securities than futures, especially for countries which still lack developed banking infrastructures. It is for this reason that some of the developing countries, with the support of their financial institutions, have embarked upon a more participative role in the options market. The Eastern and Southern African Trade and Development Bank is one institution which has invested in capacity building in options mechanisms and in the acquisition of the necessary software for options trading operations.10

(iii) The Eastern and Southern African (PTA) Trade and Development Bank sale option: the "price guarantee contract" mechanism

30. Towards the end of 1993, the Eastern and Southern African Trade and Development Bank introduced a price guarantee contract mechanism.11 It is in effect a sale option which protects traders who purchase it against unfavourable price fluctuations in offshore futures markets. In the early stages, the mechanism is available to exporters in the subregion who already have access to credit facilities for coffee exports;12 the mechanism will subsequently be made available to exporters of other products, such as petroleum products and cotton.

31. An exporter wishing to use the price guarantee contract is required to furnish certain information to the Bank, particularly information relating to the date of the transaction, the reference month (depending on the intended market), the volume of the sale (in tonnes), the sale price level in respect of which the exporter wishes to be protected, and the reference market (New York or London). On the basis of this information, the bank determines the operative margin, after consultations with its broker - in this case, Cargill Investment Services - which acts as an intermediary between the exporter and the futures markets. The protection mechanism takes effect from the moment the exporter undertakes to cover the margin set.

32. Depending on the prevailing market conditions, the exporter may face either of two situations: if the market price exceeds that quoted by the exporter at the time of the agreement, the commodity will be sold at the market price and the exporter will lose the premium he had paid on the price guarantee contract margin; if, on the other hand, the market price is less than that set by the exporter, he will sell the commodity at the market price and seek reimbursement from the Bank in the sum equivalent to the difference between the price he had quoted and the market price. The Bank, for its part, will claim from the exchange the sum paid out to the exporter.

33. The efficacy and viability of this mechanism may, of course, raise a number of questions, not least of which is to what extent the Bank will be able to cover the price fluctuation risks for the subregion in the context of the global commodity trade. Moreover, as the Bank is not itself a direct participant in the commodity market place, it will have to incur certain expenses in fees to the brokers it engages. How will it recoup these expenses? Up to this moment, however, the mechanism has not been in place long enough to warrant such an evaluation, not to mention the fact that it has been introduced at a time when commodity prices have been rising across the globe, following a steady freefall. The circumstances have therefore not been such as to give the mechanism the kind of acid test that would decisively reveal any limitations it may have. The Bank might eventually find it worthwhile to consider devolving some of its activities to a trading subsidiary which would participate directly in the market place.

---

10 According to information supplied by the PTA Bank at the meeting on international commodity market mechanisms, Nairobi, 19-22 October, 1994.

11 The Nigerian Export-Import (NEXIM) Bank has introduced a similar mechanism.

12 Two countries in the subregion-Kenya and Uganda - are already utilizing the mechanism.
34. Nearly 24 African countries export coffee, which is one of the continent’s leading export commodities. However, Africa’s coffee exporting countries are constantly faced with the risks inherent in the volatility of coffee prices which often leads to loss of revenue and market share. The Coffee Retention Scheme is therefore treated as an important topic in this paper.

35. Coffee, like other agricultural commodities, is prone to sharp movements in prices and production levels. Prices may rise at one point, only to be followed by an increase in production levels, leading to a fall in prices as a result of oversupply. Such continual fluctuation has occasioned heavy losses to the economies of coffee producing countries, with a revenue shortfall totalling nearly $US 12 billion over the past four years. In response to this situation, coffee producing countries adopted a framework retention plan with a view to restoring some balance in the international coffee market. The plan came into force on 1 October 1993, when the signatories began to hold back 20 per cent of their coffee exports. Taking into account the variability of market conditions, the plan stipulates that retention would be set at 20 per cent so long as the moving average over 20 days of the International Coffee Organization (ICO) guiding price remained below 0.75 dollars in the pound. Between 0.75 dollars and 0.80 dollars, the retention percentage would be 10 per cent, and would be suspended at the 0.80 dollar mark.

36. Nine months after its introduction, the Coffee Retention Scheme has produced positive results. On 23 May 1994, prices of both the arabica and robusta varieties rose sharply, the former stabilizing at 156.5 cts/lb (from 36.3 cts/lb the previous year), the latter at 118 cts/lb (from 17 cts/lb the previous year). At the same time, another powerful factor came into play: the frost in Brazil, which, as a matter of fact, may have directly contributed to the sharp movements in the international coffee market. The frost, which came early in 1994, was brought about by climatic factors. Brazil being a leading coffee producer, the frost led to a 50 per cent rise in coffee prices in the New York exchange, from 130 cts/lb to 190 cts/lb. Market analysts projected drastic price fluctuations arising from uncertainties concerning projected harvests and available stocks. None the less, the current downward trend in coffee prices surpasses anything that could have been foreseen at the time. Following a spell of high prices and sound export revenues, prices are falling in defiance of expectations. The downward trend comes at a time when production (which reached an all-time low in 1981) falls way below global consumption levels. Market analysts believe that the current downward trend may cancel out the revenue gains of the earlier boom period.

37. Many coffee producers and consumers have, in the past, run up against the pitfalls of massive coffee price fluctuations. As free markets become more widespread, price fluctuations are likely to become even more difficult to predict, so that small-scale producers may be faced with stiffer competition and this will weaken their market power on the international scene. OIC member States should therefore look into more innovative price fluctuation management policy stances while at the same time promoting their respective coffee sectors, particularly through diversification.

---

13 Declaration of the coffee producing countries, issued at the International Coffee Organization council meeting, at its sixty-third session, and discussed at the ministerial meeting of coffee producing countries, held at Brasilia, Brazil, 23 to 24 September 1993.

14 Coffee Retention Scheme submitted at the sixty-third session of the International Coffee Council (ICC), 63-1 (F)Add.1, 27 September 1993.

15 The signatories to the Coffee Retention Scheme are the 28 member States of the Association of Coffee Producing Countries, namely, Angola, Bolivia, Brazil, Burundi, Cameroon, Central African Republic, Colombia, Congo, Costa Rica, Côte d'Ivoire, Ecuador, El Salvador, Ethiopia, Gabon, Ghana, Guatemala, Honduras, Indonesia, Kenya, Madagascar, Nicaragua, Nigeria, Rwanda, Tanzania, Togo, Uganda, Venezuela and Zaire.
CHAPTER III
PRINCIPAL FINANCING MECHANISMS FOR THE INTERNATIONAL COMMODITY TRADE

38. Risk management instruments can contribute significantly to price stabilization, apart from improving the market environment and enhancing access to credit. Thousands of firms worldwide utilize these instruments, and most of them realize significant profits. However, some firms incur heavy losses. Risk management mechanisms should therefore be well organized, and their organization can be ameliorated through effective control and administrative mechanisms at the level of the firm. This would help avoid situations where legitimate covering operations are transformed into speculative adventures.

39. However, commodity price fluctuation risk management mechanisms are not equally available to all firms. This is because participation in this genre of securities is usually costly, requiring substantial funds to meet margin calls and other financial obligations. The financial aspect of the international commodity trade is therefore an all-important factor.

Section 1. Payment guarantee mechanisms

40. The highly competitive environment in which traders operate requires quick business decisions, and bankers serving the traders have to keep pace with this tempo. The financial aspect of international commodity trade is most clearly seen in the context of bank guarantees.

(a) Guarantees by signature

41. This form of guarantee acts as a bond. It guarantees the holder the payment of an indemnity in the event of default by the supplier. The bond is processed in the banking system, the seller's banker entering into a firm undertaking vis à vis the banker of the bondholder. The most common type of bond is a bidding bond. Its value varies, on adjudication, between 5 and 20 per cent of the estimated value of the contract. Upon sale by the firm in the delivery market, the bond becomes a performance bond.

(b) Guarantees by deposit

42. Several different types of payment guarantees exist within the banking system, including:

- Overdraft facilities, i.e. a credit line given by the banker to his customer to enable him to finance obligations such as margin calls in the futures market;

- Negotiated credit facilities, whereby credit is given without collateral on the understanding that the advance will go into financing a certain primary product, for instance, destined for a given commodity exchange transaction;

- Advances on negotiable instruments, whereby the bank accepts the customer's commercial paper, pays on the basis of it, and eventually hands it over to the purchaser; and

- Stock financing, which amounts to a secured payment guarantee.

---

16 Adjudication is the legal transfer in the open market or at an auction, of a good to the bidder offering the highest price.
43. Documentary payment mechanisms play a key role in international trade. They may be defined as mechanisms whereby payment is effected by presentment of documents representing the goods that are the subject matter of the contract. Documentary payment mechanisms do not require guarantees. They are purely negotiable. They may also involve subrogation of the rights of third parties who undertake to pay. In most cases, a bank fulfills this role, by means of letters of credit. In addition, there are standby letters of credit which, apart from being negotiable, give more prominence to the guarantee function than to the strictly documentary function.

(i) Letters of credit

44. Letters of credit have two basic functions:

(1) They serve as a mechanism of payment backed by documents. These documents are not exchanged directly between the buyer and the seller, but through a bank which verifies their validity. The set of documents contained in letters of credit varies considerably, according to the nature of the goods. There are, for instance, administrative documents issued by the country of destination or the country of origin (import or export certificates, customs documents, health certificates, etc.); documents relating to the performance of the contract (weights-and-measures, insurance and warehousing certificates, transport contracts, etc.); accounting documents (commercial and pro forma invoices); and documents evidencing the title in the goods, such as bills of lading.

(2) Letters of credit also serve to guarantee payment, in that they afford the seller some measure of assurance that upon presentment of a valid set of documents constituting letters of credit, he will be paid, either by the issuing bank, or by the endorsing bank. Documentary letters of credit, being a payment guarantee instrument, contains details relating to a sum of money (corresponding to the extent of the banker’s commitment, and hence, the limit of the obligation); a final date of validity as a bank guarantee; a physical or geographical delimitation of validity or enforceability; and a commodity, the subject matter of the obligation.

(ii) Standby letters of credit

45. Standby letters of credit differ from other letters of credit in that they give more prominence to the payment guarantee function than to the purely documentary one. Their versatility has enabled operators to use them as guarantees as well.

46. The use of standby letters of credit has become more widespread in certain sectors, such as the petroleum products market and reinsurance operations, where documentation processes had clogged the flow of transactions. May U.S. banks use them, because the predominance of insurance companies in the guarantee system makes it difficult for the banks to use conventional letters of credit.

47. In most African countries, however, as with much of the developing world, commitments by banks in this domain are rather limited, because banks always have to take into account the risks they incur, based on their assessment of clients’ creditworthiness. The lack of access to adequate guarantee mechanisms has translated into a general inability to participate to any considerable extent in futures and options markets. The limited ability of operators in developing countries to effectively counter price fluctuations in international commodity markets has exposed them to constant revenue shortfalls. In an effort to address

---

17 Endorsement of letters of credit is a banker’s commitment separate from that of the issuing bank which guarantees payment.
this problem, the international community has introduced a number of mechanisms designed, on the one hand, to promote commodity price stability and, on the other, to compensate export revenue shortfalls.

Section 2. Principal price and returns stabilization mechanisms for commodity exports

(a) Product agreements

48. An analysis of stabilization mechanisms through product agreements is contained in an ECA study, Mechanisms for Stabilizing the Export Earnings of African Countries (E/ECA/TRADE/92/19), published in 1993. Product agreements, which include quota systems and stock regulation mechanisms, seek to substitute direct adjustment by quantity for adjustment by price. The cost of such adjustment by quantity is usually considerable. Moreover, stabilization efforts necessitate agreement on the referent price level. The main objective of product agreements, however, is not so much price stabilization as export revenues stabilization. Thus, price stabilization is essentially a means to an end. It is in itself a difficult object to achieve, and may produce mixed results on export revenue stability. Compensatory financing mechanisms are therefore centred on export revenue stabilization.

(b) Compensatory financing mechanisms

(i) The IMF compensatory financing facility (CFF) and contingency financing mechanism

49. Established in 1988, the IMF compensatory financing facility and contingency financing mechanism consists of three main schemes:

(1) The compensatory financing facility (CFF) created in 1963 to provide additional assistance to IMF member States, particularly commodity exporting countries facing balance of payments difficulties owing to export revenue shortfalls, as long as such difficulties are not of long duration; (2) the food facility, or Compensatory Financing of Fluctuations in the Cost of Cereal Imports, established in 1981 to assist member States facing unfavourable fluctuations in the cost of cereal imports; and (3) the contingency financing mechanism which operates within the framework of the IMF structural adjustment programmes, and is designed to help countries in handling unexpected external shocks beyond their control.

50. As illustrated in Table 3 in the Annex, drawings by developing countries in the compensatory and contingency financing schemes reached 11.4 billion SDRs between 1982 and 1992. Most of these drawings (40 per cent of the total) were effected by large exporters of commodities on which their dependence is relatively low, such as Argentina, Brazil, India and the Philippines. African countries accounted for 16 per cent of the drawings, and the least developed countries took up four per cent of the total. Since the early 1990s, however, the LDCs have not made any drawings, and only one African country, Côte d'Ivoire, has had recourse to the contingency financing mechanism. The low level of drawings by developing countries appears to be directly linked to the altogether too rigorous conditions of access and the relatively high interest rates on purchases. It should be noted that the contingency financing facility was designed to provide financial assistance to countries facing short-term balance of payments difficulties which were reversible. Analyses of shortfalls incurred by developing countries, however, reveal enduring structural imbalances in the commodity market. Clearly, contingency financing schemes are not a very suitable mechanism to remedy deficit patterns of that nature.

---

18 Examen de l'évolution des mécanismes de financement compensatoire des déficits de recettes d'exportation, UNCTAD, 1993 (TD/B/CN./11).

19 Ibidem
(ii) Compensatory financing mechanisms introduced by the EEC

The STABEX scheme (System of Stabilization of Export Earnings)

51. Established under the first Lomé Convention (1975-1979) and revised in subsequent conventions, STABEX is designed to compensate export revenue shortfalls for African, Caribbean and Pacific (ACP) countries in respect of selected agricultural export commodities destined for the European Community. It is governed at present by the fourth Lomé Convention (1991-1995). Since its establishment, some 3.4 billion ECUs have gone into the STABEX scheme, out of which 1.5 billion ECUs (1.4 billion SDRs) consists of funds allocated under the fourth Lomé Convention, which makes provision for the transfer of funds as grants to be used in the sector affected by the shortfall, in diversification and commodity processing. Table 4 in the annex shows the number and total amounts of STABEX transfers between 1982 and 1992. Total STABEX transfers reached 2.4 billion SDRs, with nearly 40 per cent going to Côte d'Ivoire, Cameroon and Senegal. Coffee and cocoa, the two main commodities produced by ACP countries, took up more than 60 per cent of the STABEX transfers.

52. None the less, the persistent depression of the commodity price levels in the world market for the principal export commodities of ACP countries and the enduringly low levels of their exports to the European Community brings into question the effectiveness of the STABEX scheme as a compensatory financing mechanism. Having been intended as a support to ACP countries to enable them to overcome short-term export revenue shortfalls, the STABEX scheme in its present structure is clearly not the most appropriate answer to problems arising from enduring structural imbalances in the international commodity trade for the major export commodities of ACP countries. This situation, which is especially true for coffee and cocoa, necessitates a readaptation of the mechanism to the needs of the countries it was designed to benefit. To serve African countries adequately, the STABEX scheme should have a channel to which ACP countries bedevilled by export revenue shortfalls can have access on favourable terms. Furthermore, if the conditions necessitating the entry of a given country into the STABEX scheme continue to prevail beyond the projected time-frame, the assistance commitment should in such cases be prolonged or a new credit line opened to cover the one already in place.

The SYSMIN scheme (System for Stabilizing Exports in the Mining Sector)

53. Since the coming into operation of Lomé II, 1.3 billion ECUs have gone into the SYSMIN scheme, of which actual commitments amount to 451 million ECUs. African countries with sizeable mining sectors have been the principal beneficiaries of these funds, with about half of the total assistance going to Zaire and Zambia. Funds amounting to 480 million ECUs (450 million SDRs) have gone into the SYSMIN scheme within the framework of Lomé IV. Since 1991, three countries have had recourse to the scheme: Namibia, to overcome a crisis in the uranium sector; Zambia, to cover revenue shortfalls affecting its copper exports; and the Dominican Republic, following a downturn in its gold mining sector. However, the effectiveness of the SYSMIN scheme has suffered as a result of delays in the disbursement of funds as well as uncertainties regarding its future direction.

(iii) The Swiss Compensatory Financing Programme

54. Established in 1988, the Swiss Compensatory Financing Programme is designed to provide financial support in respect of revenue shortfalls affecting LDCs for exports to Switzerland of selected agricultural commodities. An initial allocation of 40 million Swiss francs (19.8 million SDRs) was made. This was later increased to 90 million Swiss Francs (49 million SDRs) for a four-year period from 1991. The funds are disbursed to support structural adjustment programmes, and to help stabilize export earnings, overcome domestic factors affecting production and promote diversification.

55. Like similar IMF and EEC programmes, the Swiss Compensatory Financing Programme has not adequately met the financial resource needs of the countries concerned. Of course, all these schemes were
intended to cover export revenue shortfalls of short duration on a contingency basis. However, the amplitude of the shortfalls which developing countries have actually experienced and their tendency to persist, have resulted in enormous losses in export earnings, with adverse repercussions on the balance-of-payments standing of the countries concerned. Clearly, the existing compensatory financing mechanisms had not been established with such a situation in mind. The resources at their disposal, and their mode of operation, have proved to be ill-suited to the increasing trade difficulties faced by developing countries.

CHAPTER IV.

FACTORS IMPEDING THE USE OF FUTURES MARKETS BY AFRICAN COUNTRIES

56. It is clear from the foregoing review of international commodity markets that the countries with some degree of economic stability are in a better position to participate fully in them. Many of the export commodities coming from Africa are traded in the international commodity markets, yet Africa’s participation in these markets is minimal. African countries have not made much headway in grasping the workings of international commodity markets, and in particular, the technicalities of risk management instruments, and this, in addition to the economic factors mentioned earlier, constitute a major barrier to Africa’s full participation in the sector.

Section 1. Problems of obtaining credit facilities to cover margin calls

57. It would be easier for African operators in international trade to use risk management instruments if they had access to the necessary foreign exchange and credit facilities for guarantee deposits, commissions and margin calls. As noted earlier, margin calls, though not costs, require the availability of financial resources such as foreign exchange and credit facilities. Many operators, however, do not have access to credit because they are considered to be an inordinate risk, particularly when they cannot provide collateral security; this handicap is often coupled with difficulties in obtaining foreign exchange owing to poor export revenues or to the operational and regulatory environment on the domestic scene. These constraints have adverse effects on commodity price fluctuation risk management possibilities as well as on exporters’ room for manoeuvre vis-à-vis other market risks.

Section 2. Problems connected with countertrade and sovereign risks

58. Default in risk management commitments may be caused by intra-firm factors. In the case of African countries, however, default often also results from the official policy mix and policy measures.

59. At the level of the firm, default in risk management transactions may be the result of bankruptcy. More often, however, it is attributable to an inadequate grasp of elements such as the implications of certain price clauses in delivery-market contracts, the workings of risk management instruments, and the implications of selecting certain categories of risk management contracts. In addition, there have been instances where a staid, profitable and creditworthy firm defaults on its commitments as a result of government actions. This happens, for example, where the government moves to block access to foreign exchange required for guarantee payments and other financial commitments, or where a central bank or other supervisory body determines that the contract price for a given commodity is too low and that the transaction is therefore illegal. Such measures have led to the insolvency of many of the smaller trading firms as a result of countertrade failure, and often ultimately to enormous losses by trading houses and even some of the larger banks.

60. As a result of inadequate follow-up mechanisms for and inaccurate evaluation of countertrade risks, particularly at the close of the 1980s and during the early 1990s, trading houses have often had to endure cash-flow crises, necessitating more and more bank bailouts. In addition, many banks have discontinued commodity financing services, and those that have maintained them have instituted more stringent countertrade risk evaluation mechanisms, with the result that credit lines for a number of developed countries
have dwindled, and trading houses are now faced with a credit squeeze. The cash-flow problems and the retrenchment of commodity financing have, over the past few years, resulted in a situation where developing country-based countertrade operates in an environment of particularly strict banking rules and conditions. African countries, in particular, are adversely affected by this new trading environment, not least because decentralization and liberalization of trade structures have resulted in the fragmentation of supply and further weakened the market position of these countries in the primary-commodity sector.

Section 3. Absence of mechanisms allowing for the use of commodities as guarantees for credit

61. In their risk management operations, trading houses often endeavour to introduce risk management mechanisms used in the mainstream banking system, such as letters of credit issued by a bank. African traders, however, often lack the necessary guarantees for letters of credit.

62. Stock pledging is one of the more widespread risk management mechanisms. A stock of commodities that is the subject matter of a hedging operation, or any durable commodity such as gold, may be pledged as security. With secure stocking facilities, controlled by an internationally recognized supervisory agency, local stocks can be pledged as well. The Sudan, for instance, once received bridging credit in respect of its cotton exports, on the security of the stocks in the sheds at the material time. Evidently, for such arrangements, it is necessary to have the pledged commodity stocks inspected and to verify that the form of security provided is valid under the law of the country concerned.

63. Few African countries, however, possess depots of a quality conformable to international standards for stock pledging arrangements. Furthermore, even where they have sufficient stocks that can be pledged, insurance coverage is inadequate. One possible solution is for local banks to acquire depots and issue bills in respect of pertinent hedging operations. For banks based in African countries, this formula may actually represent an advantage over foreign banks.

CHAPTER V.

NECESSARY CONDITIONS FOR ENHANCED PARTICIPATION OF AFRICAN COUNTRIES IN FUTURES MARKETS

64. It is clear, in view of the obstacles described above, that broadening the participation of African countries in futures markets calls for new initiatives. These include: boosting the productive capacity of the primary commodities sector, promoting financing mechanisms as well as capacity-building and institutional development for risk management operations, and working out a more flexible supply-side export strategy conformable with the needs of the international market.

(1) Prospects of trade liberalization following the Uruguay Round Agreement

65. The application of the Final Act of the Uruguay Round of multilateral trade negotiations presents new possibilities, but also new problems. The problems relate to the need for policies transcending the trade arena and the need to place the various modalities of application under the direction of multilateral agencies. The possibilities will emerge from trade liberalization and improved market access. For African countries, however, the benefits resulting from trade liberalization are not likely to be very significant - at least not in the short term - owing to the erosion of preference margins.

66. There is, in addition, some degree of concern as regards the possible adverse consequences of trade liberalization in respect of agricultural commodities for African countries that are net importers of food products. As with market access, the problem here relates to these countries' relative lack of the necessary resources and capacities that would enable them to take full advantage of the agricultural reform programme. To counter the possibility of African countries being excluded yet again from the benefits of trade liberalization in the agricultural sector, agricultural and technical assistance may have to be provided, in the
short to medium term, to stimulate productive capacities in the agricultural sector and hedge against any adverse consequences.

67. In a broader perspective, however, improved market access could create the necessary conditions for greater access to the futures and options markets. Such a development would enable African countries to take in hand the risk factors that traders and intermediaries will no longer be able to assume on their behalf. African countries would then have to internalize counterrade risk management mechanisms in an environment where a larger number of market actors will be involved. They would, in particular, have to employ techniques designed specifically to optimize their transactions and effectively manage the pertinent risk factors. In addition, they would have to adopt trade and supply-side export strategies that are more flexible and more suited to the workings of futures and options markets.

II. Measures to strengthen the commodity sector 20

68. African countries must also look into ways of strengthening their market position as producers and exporters of primary commodities. In this connection, a number of possible measures at the national and regional levels may be suggested.

(a) Measures at the national level

69. Each African country should direct its policies towards boosting the commodity sector. The following aspects, in particular, might be considered:

(1) Food products and industrial raw materials (for domestic consumption or for export): an effort will have to be made locally to boost food production as well as the production of industrial raw materials for local consumption. In addition, domestic marketing and distribution systems should be improved upon. Such programmes should include more favourable pricing mechanisms for producers; research and development programmes to enhance productive capacities; promoting the services sector; and giving small-scale producers and women traders greater access to credit and marketing facilities.

(2) Non-industrial raw materials for export: given the risk of oversupply in the non-industrial raw materials sector, productive capacities should be optimized in order to boost export revenues. Ideally, this strategy should primarily be implemented by small-scale producers. For large-scale producers of non-industrial raw materials, an effective, research- and development-driven supply management strategy should be worked out. In countries that are heavily dependent for their export revenues on a restricted mix of commodities or on just one commodity (cocoa, coffee and sugar for example) and which are already bedevilled by the problem of oversupply, the emphasis should be on introducing policies and mechanisms designed to develop new, viable export commodities and giving more priority to the production of processed and manufactured goods. The newly industrialized south-east Asian countries achieved their remarkable industrial growth through this kind of vertical diversification and, more recently, other countries in that region, such as Malaysia and Thailand, have adopted the same approach. In that connection, however, a number of obstacles face African countries; these relate principally to the absence of adequate diversification strategies, shortage of financing and technical competence, and lack of the necessary physical infrastructure to facilitate trade in processed and manufactured goods.

(3) Diversification

70. The experience of African countries in efforts to diversify the production of primary commodities shows that countries with the more diversified economies have achieved greater success over-all. Diversification efforts in Cameroon, for example, have taken place in a favourable environment of abundant

---

agricultural and mineral resources and suitable climatic conditions with sufficient variety from one part of
the country to another to allow the cultivation of a wide range of agricultural commodities. On the other
hand, efforts to diversify production in the agricultural and livestock sectors in Senegal have been slowed,
by drought, unequal distribution of rainfall, and locust invasions.

There are, more generally, a number of other factors which have an influence on a country’s ability
to diversify; factors such as domestic and external outlets for non-traditional commodities; financing,
possibilities for diversification-related investments; infrastructure capacity; manpower capacity; and the extent
to which research-and-development programmes, information and promotion services are available. These
factors are interrelated in various ways. For example, market access is a necessary condition for securing
a niche in the external trade arena, but it must be complemented by access to the technical and financial
assistance which is necessary for the development of viable export activities; again, the success of investment
promotion efforts at the national level depends on the availability of other support measures and ancillary
services (such as infrastructure, information systems, etc.) and appropriate exchange-rate policies.

The need for support by the international community for efforts by African countries to diversify
their economies and scale down their reliance on primary commodities was reaffirmed in the United Nations
New Agenda for the Development of Africa in the 1990s (UN-NADAF), in connection with which various
commitments have been made. To set in motion the implementation process of the New Agenda, the United
Nations Secretary-General initiated negotiations on the establishment of a special facility to finance
diversification programmes for primary commodities in African countries, during the 48th and 49th sessions
of the General Assembly. Following those negotiations, the General Assembly adopted resolution A49/142
which urges, inter alia, that the establishment of the Special Facility be incorporated in the renewal
programme for the African Development Fund, operated by the African Development Bank (ADB).

Diversification of African economies is one of the six priority programmes of the United Nations
Programme of Action for African Economic Recovery and Development (UNPAAERD). It was in the
context of that Programme that ECA held an inter-agency workshop on diversification, from 13 to 17
February at Yaounde, Cameroon. In the context of follow-up activities, ECA, as a key agency, intends to
organize various projects designed both to assist African countries in working out diversification
strategies and to provide them with the necessary technical support to formulate and implement diversification
programmes. The conclusions and recommendations of the inter-agency workshop may serve as a
springboard for that initiative.

(4) The key role of financing

Most of the measures suggested above can only be implemented successfully if financial assistance
is available for the development of viable export promotion programmes. A coherent supply-side export
strategy, for instance, requires that surplus stocks be held in reserve by producers, and this would necessitate
financing to cover the cost of keeping the stocks in the depots. Similarly, diversification programmes for
primary commodities require access to financing facilities. Existing financing facilities should be re-
examined and re-adapted to the needs of African countries.

(5) Strengthening national institutions to facilitate access to risk management mechanisms:
certain domestic regulations and policy stances make it difficult for traders in African countries to effectively
utilize risk management mechanisms. As already demonstrated, an official action regarding banking
transactions may block a trader’s access to risk management instruments. Such restrictions vitiate the ability
to cover risks connected with commodity price fluctuations.

One possible solution would be to call upon banking institutions to come to the assistance of traders
by easing the conditions of access to risk management instruments, or accepting part of their commodity
stocks as security for credit facilities. For many banking institutions, however, participation in the risk
management arena does not go beyond the transfer of government credit instruments to marketing boards
which, with trade liberalization, are becoming fewer and fewer. Moreover, banks tend to be sceptical about stocking arrangements as security for credit. An alternative approach would be to call upon public bodies or exporters’ associations to take up such arrangements and then provide assistance in overcoming any attendant obstacles. Exporters’ associations could, in particular, organize and coordinate training programmes, and run information systems covering various aspects including pricing-related data. They could also serve as credit guarantee agencies, possibly in a direct role involving, for instance, conversion of credit lines provided by local banks into offshore credit lines which can then be used in risk management operations; and acting as intermediaries for options purchase transactions or in the operation of joint guarantee mechanisms, similar to that envisaged by the Government of Cameroon. The role played by exporters’ associations in credit guarantee mechanisms may also be indirect, where, for example an association provides training on optimum utilization of credit facilities and better understanding of the obstacles to such utilization. The assistance and/or intermediary function need not, of course, replace more focused efforts in strengthening financial facilitating mechanisms in the private sector (by local banks, in particular) and familiarizing private-sector market operators and agricultural cooperatives with modern marketing techniques.

(b) Measures at the regional level

76. Supply-side export strategies: flexible export strategies to manage supply, which should ideally be formulated and implemented within the framework of concerted action, should be within the purview of specialized regional institutions already in place, such as the Inter-African Coffee Organization, the African Timber Organization, and the African Groundnut Council, among others. The Inter-African Coffee Organization, which is already active in the futures and options markets in the context of its coffee transactions, could, in addition, be the focus for African coffee producing and exporting countries to formulate a stronger common position in that sector at the regional level. In this context, and within the scope of its mandate, the Inter-African Coffee Organization should seek possible solutions to problems concerning production, processing and marketing, in order to bring about optimum conditions in the supply-side aspect of commodity trade. In the same vein, the African Timber Organization, which plays an important role in the formulation of timber production policies, could also serve as a focal point to coordinate timber export strategies. The African Groundnut Council is well placed to formulate strategies designed to enhance the market position of African groundnut producers in commodity trade at the international level. The actions and strategies outlined above could be undertaken in collaboration with specialized national and international institutions, possibly within the framework of joint programmes. In addition, the African Regional Centre for Technology could endeavour to strengthen African countries' technological capacities in order to improve export quality and capacities in the various sectors.

77. The first step, however, should be to conduct feasibility studies covering national production structures, market conditions for individual products, import substitution possibilities for individual countries, likely consumer reactions, pricing enhancement possibilities and the likely results. It should be borne in mind, however, that pricing enhancement and management strategies are short-term measures to help counter financial difficulties facing producer countries and, ultimately, finance a broader mix of imported commodities essential for reconstruction and development. In the long-term perspective, producer countries should institute policies designed to diversify production and marketing structures in order to boost export revenues.

78. Marketing, distribution and transportation: another area of cooperation African countries should explore relates to harmonizing and coordinating their marketing, distribution and transportation policies for export commodities. A great deal of the trading operations for primary commodities is in the hands of transnational corporations which are thus able to strengthen their market position in respect of these commodities. African countries can, none the less, boost their own market position by, for instance, establishing marketing cooperatives and economic interest groupings in respect of processed goods such as packaged tea and instant coffee. By so doing, they will be able to circumvent existing marketing and distribution circuits, to gain direct access to their target markets using their own trade marks for
manufactured goods. In that context, there will be a need for harmonized trade policies; adequate transport infrastructure; suitable warehousing facilities; qualified personnel; and effective, up-to-date information systems capable of providing a broad range of data on pricing, market opportunities, and supply-and-demand patterns for various commodities.

79. **Promotion of intra-regional trade:** In view of the payments constraints experienced by a number of African countries in the external trade arena and the risk of a long-lasting downward trend in industrialized countries' demand for primary commodities, it has become imperative for African countries to evolve new policies and mechanisms to promote intra-African trade. Appropriate economic and commercial integration structures are already in place; what needs to be enhanced are financing, insurance and credit facilities, particularly for small- and medium-scale enterprises; as well as transport and storage facilities.

**CHAPTER V. CONCLUSIONS AND RECOMMENDATIONS**

80. Is the present condition of raw materials markets irreversible? What future lies in store for Africa's primary commodities sector? Can Africa utilize the existing risk management mechanisms in order to achieve export revenue stability? These are the issues raised by the profound changes currently affecting the primary commodities sector, particularly in the context of the march of liberalization and the preponderance of transnational corporations in global markets.

81. It is an acknowledged fact that whenever a primary commodity is traded in a competitive market environment, imbalances come into play which the various market actors must endeavour to manage. Various agencies in the primary commodities sector have sought to evolve mechanisms and instruments designed to tackle problems arising from such imbalances. On the whole, these mechanisms play a useful role, but they have not been very effective; at least, not as regards African economies. While it is true that many African traders have not been able to utilize securities markets because of limited knowledge of the workings of those markets, or because they lack the necessary resources to manage the attendant risk factors, it is also clear that even those who have gained access to securities markets continue to fall victim to an unfavourable market equation in which African countries, negotiating from a weak position and relying on market operators of no great importance, are constrained to sell on the buyer's terms and buy on the terms of the seller.

82. The main drawback facing African countries in this sector, however, relates to the inability of their products to compete favourably in the international market place. The spectre of dwindling outlets is becoming a distinct reality as African economies, in the face of diminishing demand for their exports as a result of technological progress and import substitution, continue none the less to rely for their export revenues on traditional commodities.

83. As a matter of fact, the question of market access for African export commodities was raised during the Uruguay Round of multilateral trade negotiations. In view of the inevitable erosion of preference margins, representatives of African countries at the trade talks made it known from the outset of the debate on market access, that Africa stood to gain from the introduction of compensatory measures such as additional concessions in respect of outlets. Studies have shown that preference margins have in fact receded, particularly in the case of tropical produce and, to a lesser extent, natural resource-based commodities as well. African countries' concern as regards the erosion of preference margins arises from their heavy dependence on tropical and agricultural commodities. The erosion of preference margins is likely to adversely affect their overall export revenues because it will result in loss of competitiveness and market share.

84. Particular attention should no doubt be given to the implications, for African countries, of the reform programme envisaged by the Agreement on Agriculture. It is expected that the reduction or discontinuation of agricultural support programmes in the developed countries may, in the long term, stimulate agricultural production in African countries, enabling them to boost their food exports. On the other hand, food prices
are likely to increase in the short-to-medium term, a development that will destabilize the economies of a number of African countries that are net importers of food and food products. Technical and financial assistance from donor countries and multilateral financial institutions is therefore essential to provide short-term financing for food imports and help boost agricultural productivity and infrastructure in the countries concerned.

85. In sum, therefore, it is absolutely essential for African countries to transform their production and marketing structures. In this context, governmental action could, with the support of the international community, be focused on a number of priority areas, particularly: development of infrastructure and services to support production and marketing; strengthening technological capacities to enhance quality and competitiveness; diversification to boost the value-added element through transformation; enhancement of the investment and credit environment; and strengthening regional and subregional markets. In the domain of securities, African governments should work out clear and coherent risk management strategies; delineate the scope of market operations; utilize appropriate skills; institute and administer rigorous control mechanisms; adopt appropriate measures for the evaluation and analysis of market risk factors; and maintain close supervision of risk management operations. These measures should be instituted within the framework of a sound supervisory and control structure for firms and other business associations. The first step, in the context of the measures and strategies outlined above, would be an appropriate reorientation of government policies as well as a major effort to give impetus to information and training needs.
### 1. STATISTICS

Table 1: Dependence of African countries on primary commodities

<table>
<thead>
<tr>
<th>Country</th>
<th>Primary commodities as percentage of total export revenue</th>
<th>Product and percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mauritania</td>
<td>99.9</td>
<td>Iron ore:45.0/Fisheries:42.0</td>
</tr>
<tr>
<td>Zambia</td>
<td>97.7</td>
<td>Copper: 98.0</td>
</tr>
<tr>
<td>Rwanda</td>
<td>97.9</td>
<td>Coffee: 73.0</td>
</tr>
<tr>
<td>Niger</td>
<td>97.9</td>
<td>Uranium: 85.0</td>
</tr>
<tr>
<td>Burundi</td>
<td>95.1</td>
<td>Coffee: 87.0</td>
</tr>
<tr>
<td>Uganda</td>
<td>95.0</td>
<td>Coffee: 95.0</td>
</tr>
<tr>
<td>Namibia</td>
<td>95.0</td>
<td>Diamonds:40.0/Uranium:24.0</td>
</tr>
<tr>
<td>Somalia</td>
<td>94.7</td>
<td>Live animals:76.0</td>
</tr>
<tr>
<td>Malawi</td>
<td>93.4</td>
<td>Tobacco:55.0/Tea:20.0</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>90.0</td>
<td>Coffee: 66.0</td>
</tr>
<tr>
<td>Burkina Faso</td>
<td>88.9</td>
<td>Cotton: 48.0</td>
</tr>
<tr>
<td>Sudan</td>
<td>88.5</td>
<td>Cotton: 42.0</td>
</tr>
<tr>
<td>Mali</td>
<td>84.3</td>
<td>Live animals: 58.0/cotton: 29.0</td>
</tr>
<tr>
<td>Togo</td>
<td>83.3</td>
<td>Phosphates:47.0</td>
</tr>
<tr>
<td>Guinea Bissau</td>
<td>82.0</td>
<td>Cashew nut: 29.0/ Groundnuts: 23.0</td>
</tr>
<tr>
<td>Tanzania</td>
<td>79.3</td>
<td>Coffee: 40.0</td>
</tr>
<tr>
<td>Mozambique</td>
<td>76.3</td>
<td>Fisheries: 27.0/Shrimps: 16.0</td>
</tr>
<tr>
<td>Chad</td>
<td>72.0</td>
<td>Live animals: 58.0/Cotton: 29.0</td>
</tr>
<tr>
<td>Senegal</td>
<td>71.6</td>
<td>Fisheries: 32.0</td>
</tr>
<tr>
<td>Zaire</td>
<td>68.7</td>
<td>Copper: 58.0</td>
</tr>
<tr>
<td>Ghana</td>
<td>68.5</td>
<td>Cocoa: 59.0</td>
</tr>
<tr>
<td>Sierra Leone</td>
<td>63.2</td>
<td>Diamonds: 32.0</td>
</tr>
<tr>
<td>Kenya</td>
<td>61.5</td>
<td>Coffee: 30.0</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>56.9</td>
<td>Tobacco: 20.0</td>
</tr>
<tr>
<td>Gambia</td>
<td>48.0</td>
<td>Groundnuts: 45.0</td>
</tr>
<tr>
<td>Lesotho</td>
<td>46.2</td>
<td>Mohair: 24.0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Commodity</th>
<th>Price formation mechanisms</th>
<th>Share in total world production (2005)</th>
<th>World price basis and contract exchanges</th>
<th>Future and options markets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wheat (Embargo)</td>
<td>Meloche, producer price based on domestic and international markets</td>
<td>185.7%</td>
<td>International</td>
<td></td>
</tr>
<tr>
<td>Soybeans</td>
<td>Direct quotation, often on the basis of price information from regional and international sources</td>
<td>90.2%</td>
<td>International</td>
<td></td>
</tr>
<tr>
<td>Sugar</td>
<td>Direct quotation, often on the basis of price information from regional and international sources</td>
<td>18%</td>
<td>International</td>
<td></td>
</tr>
<tr>
<td>Coffee</td>
<td>Direct quotation, often on the basis of price information from regional and international sources</td>
<td>90%</td>
<td>International</td>
<td></td>
</tr>
<tr>
<td>Cocoa Beans</td>
<td>Direct quotation, often on the basis of price information from regional and international sources</td>
<td>90%</td>
<td>International</td>
<td></td>
</tr>
<tr>
<td>Palm Oil</td>
<td>Direct quotation, often on the basis of price information from regional and international sources</td>
<td>90%</td>
<td>International</td>
<td></td>
</tr>
<tr>
<td>Rice</td>
<td>Direct quotation, often on the basis of price information from regional and international sources</td>
<td>90%</td>
<td>International</td>
<td></td>
</tr>
<tr>
<td>Cotton</td>
<td>Direct quotation, often on the basis of price information from regional and international sources</td>
<td>90%</td>
<td>International</td>
<td></td>
</tr>
<tr>
<td>Cocoa</td>
<td>Direct quotation, often on the basis of price information from regional and international sources</td>
<td>90%</td>
<td>International</td>
<td></td>
</tr>
<tr>
<td>Tobacco</td>
<td>Direct quotation, often on the basis of price information from regional and international sources</td>
<td>90%</td>
<td>International</td>
<td></td>
</tr>
<tr>
<td>Rubber</td>
<td>Direct quotation, often on the basis of price information from regional and international sources</td>
<td>90%</td>
<td>International</td>
<td></td>
</tr>
<tr>
<td>Lumber</td>
<td>Direct quotation, often on the basis of price information from regional and international sources</td>
<td>90%</td>
<td>International</td>
<td></td>
</tr>
<tr>
<td>Pulp</td>
<td>Direct quotation, often on the basis of price information from regional and international sources</td>
<td>90%</td>
<td>International</td>
<td></td>
</tr>
<tr>
<td>Paper</td>
<td>Direct quotation, often on the basis of price information from regional and international sources</td>
<td>90%</td>
<td>International</td>
<td></td>
</tr>
<tr>
<td>Oil and fats</td>
<td>Direct quotation, often on the basis of price information from regional and international sources</td>
<td>90%</td>
<td>International</td>
<td></td>
</tr>
</tbody>
</table>

Note: The table provides a summary of price formation mechanisms for various commodities, including the share of world production, the basis of world prices, and the markets where futures and options are traded. The data is as of 2005.
Table 3.

Drawings and payments effected under the Compensatory Financing Facility (CFF) and the compensatory and contingency Financing Facility (CCFF) (1982-1999)

| Source: IMF data, quoted by UNCTAD secretariat. |
|---|---|
| **Total drawings in billions of SDRs** | (Number of drawings) |
| Developing countries | 1.6 | 2.6 | 0.8 | 0.8 | 0.6 | 1.2 | 0.7 | 0.8 | 0.1 | 1.9 | 1.2 | 11.2 |
| (21) | (22) | (11) | (7) | (8) | (6) | (10) | (4) | (2) | (9) | (3) | (203) |
| Eastern Europe and Israel | 0.07 | - | - | - | - | - | - | - | 1.1 | 0.3 | 1.4 |
| (16) | (7) | (23) |
| Total | 1.7 | 2.6 | 0.8 | 0.8 | 0.6 | 1.2 | 0.7 | 0.8 | 0.1 | 3.0 | 0.4 | 12.6 |
| LDCs (total) | 0.1 | 0.1 | 0.01 | 0.04 | 0.04 | 0.1 | 0.02 | - | - | - | - | 0.41 |
| (2) | (6) | (1) | (2) | (2) | (2) | (1) | (16) |

<table>
<thead>
<tr>
<th><strong>Total payments in millions of SDRs</strong></th>
<th>(Number of payments) a/</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developing countries</td>
<td>0.5</td>
</tr>
<tr>
<td>(34)</td>
<td>(40)</td>
</tr>
</tbody>
</table>

Source: IMF data, quoted by UNCTAD secretariat.

a/ The payments are effected in quarterly disbursements, between the third and fifth year after a drawing, hence the greater number of payments as compared to drawings.

Table 4.

STABEX transfers (1982 - 1999)

<table>
<thead>
<tr>
<th>Transfers in millions of SDRs</th>
<th>(Number of transfers)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACP countries</td>
<td>277</td>
</tr>
<tr>
<td>(38)</td>
<td>(37)</td>
</tr>
<tr>
<td>LDCs among ACP countries</td>
<td>37</td>
</tr>
</tbody>
</table>

Source: EEC data.
II. BIBLIOGRAPHY

1. UNCTAD (1992), A NEW PARTNERSHIP FOR DEVELOPMENT: THE CARTAGENA COMMITMENT.

2. ECA (1993), MECHANISMS FOR STABILIZING THE EXPORT EARNINGS OF AFRICAN COUNTRIES (E/ECA/TRADE/92/19).


6. UNCTAD (1993), "TECHNICAL AND REGULATORY CONDITIONS INFLUENCING PARTICIPATION IN, AND USAGE OF, COMMODITY EXCHANGES BY BOTH BUYERS AND SELLERS OF COMMODITIES". (REF. UNCTAD/COM/16)


8. UNCTAD (1993), "MARKET-BASED COMMODITY PRICE RISK MANAGEMENT INSTRUMENT - A BASIC DESCRIPTION".

9. INTERNATIONAL COFFEE ORGANIZATION (1993), TEXT OF THE DECLARATION MADE BY COFFEE-PRODUCING COUNTRIES.


11. UNCTAD (1993), COMPENSATORY FINANCING MECHANISMS. (REF. TD/B/CN/11).

12. UNCTAD (1993), "TRADE AND DEVELOPMENT REPORT".