UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

UNCTAD

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Commodity dependence, distribution of value & Export diversification

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Outline

- Commodity dependence
- Why does commodity dependence matter?
- Complex value chains and unequal distribution of value
- Diversification: vertical or horizontal?
- Conclusion

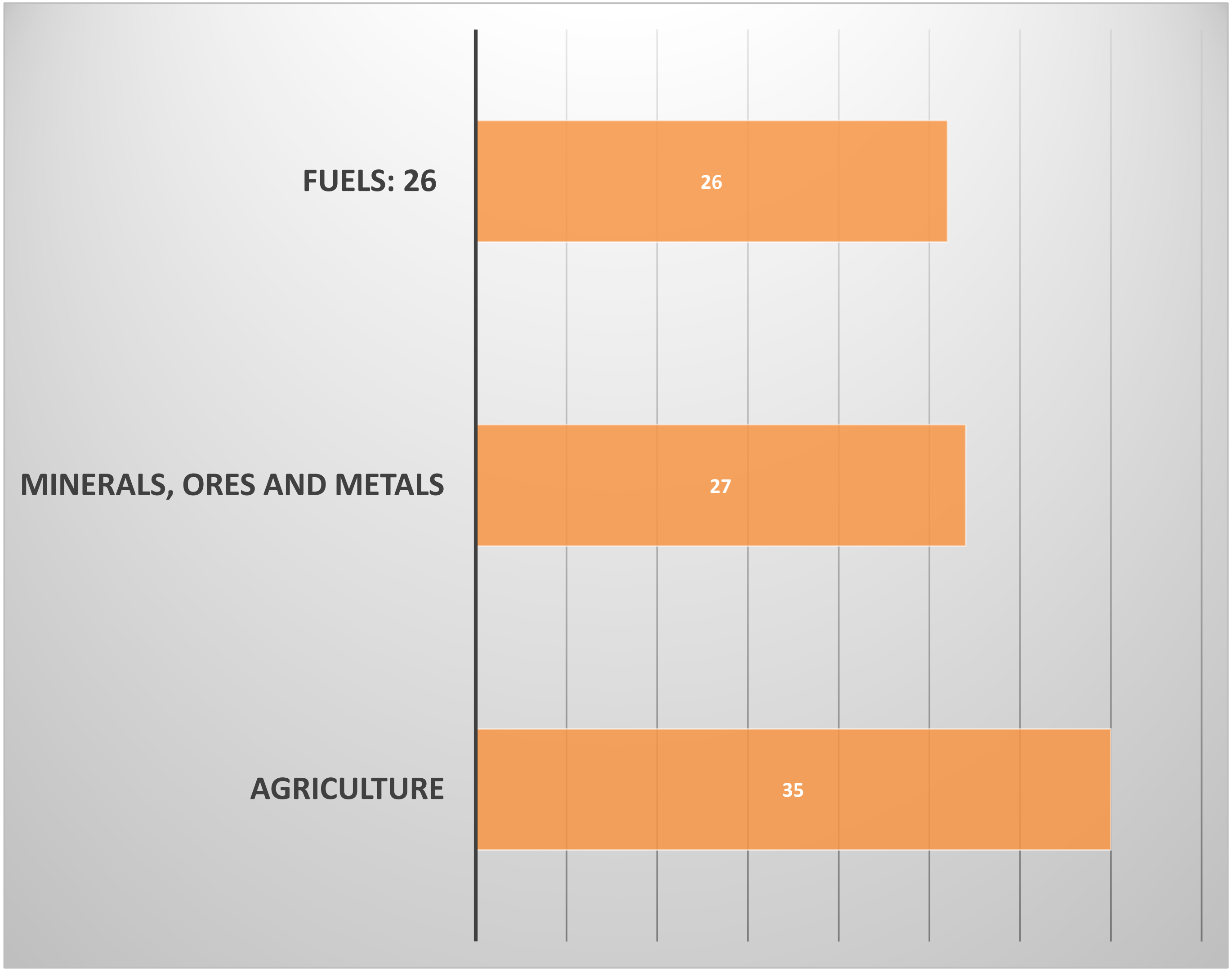
Commodity dependence

- Definition
- Distribution & geography

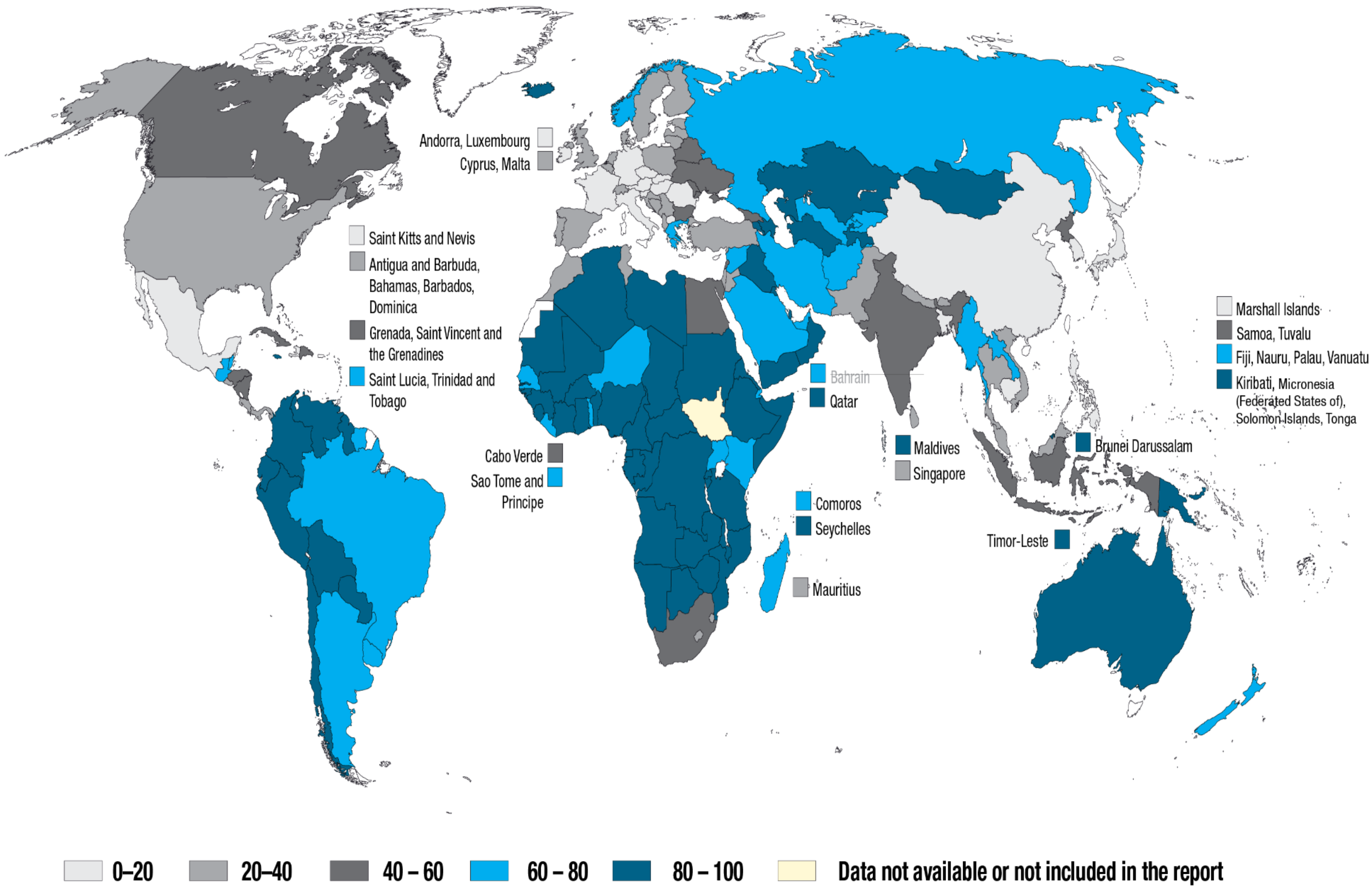
Defining commodity dependence

- Commodities >= 60% of merchandise exports
- Three major groups:
  - Agriculture
  - Minerals, Ores and Metals
  - Energy
- Country depends on a commodity group when:
  - it is commodity dependent (60% merchandise exports) and
  - more than 1/3 of exports are from the commodity group

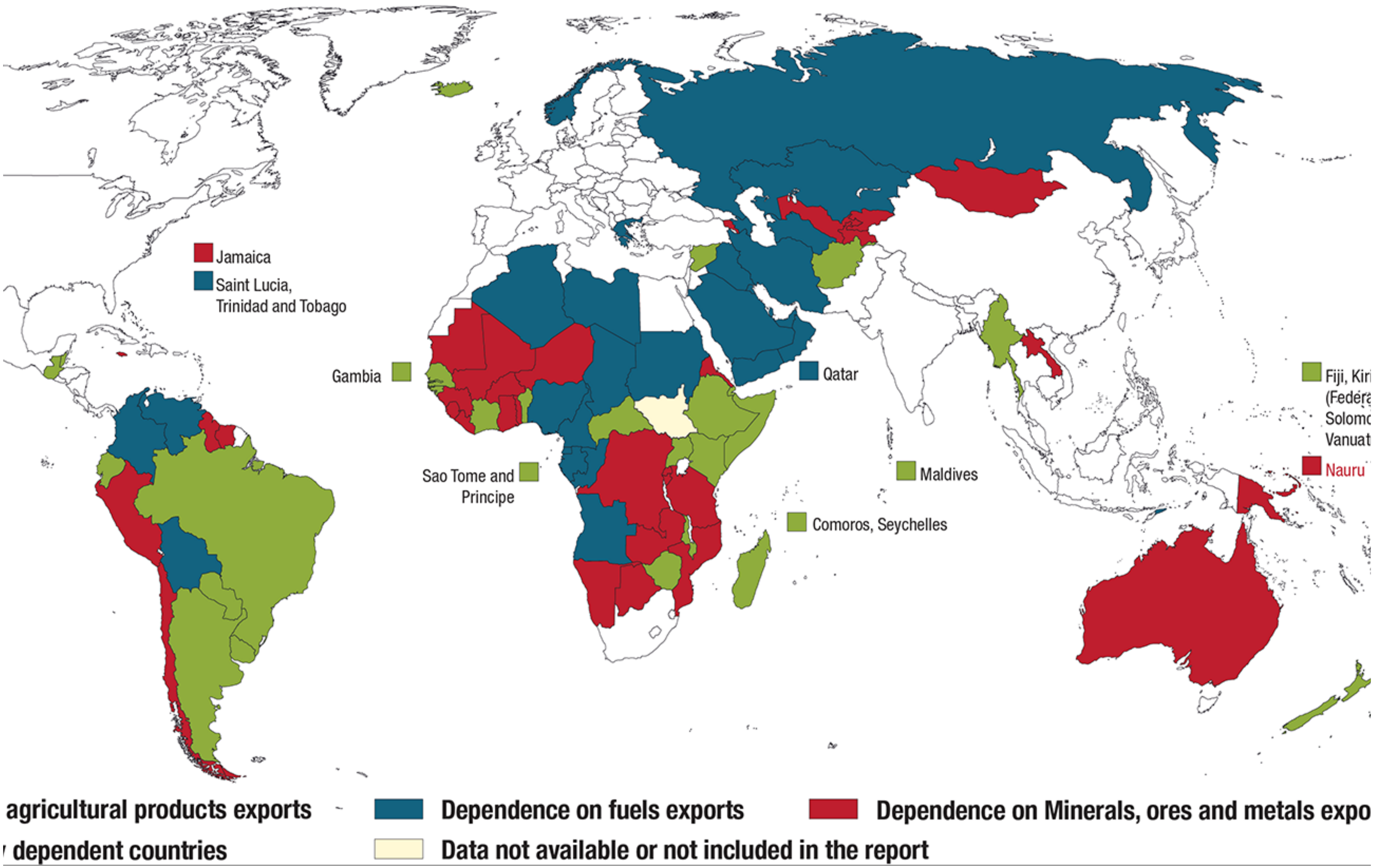
Countries by Commodity Group 2013-17



World Commodity Export Dependence, 2013–2017 average (per cent)



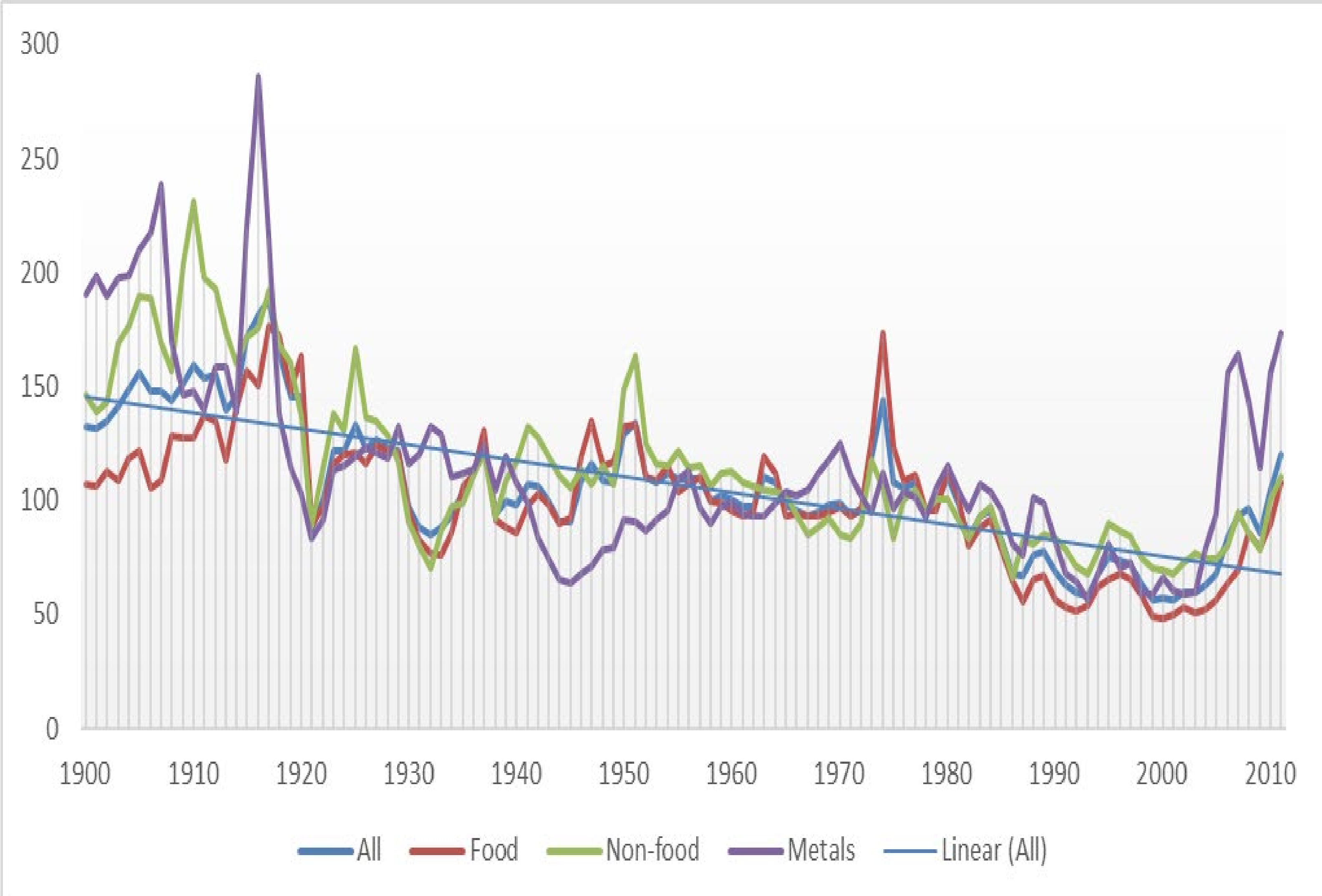
World Commodity Export Dependence by commodity groups, 2013–2017 average (per cent)



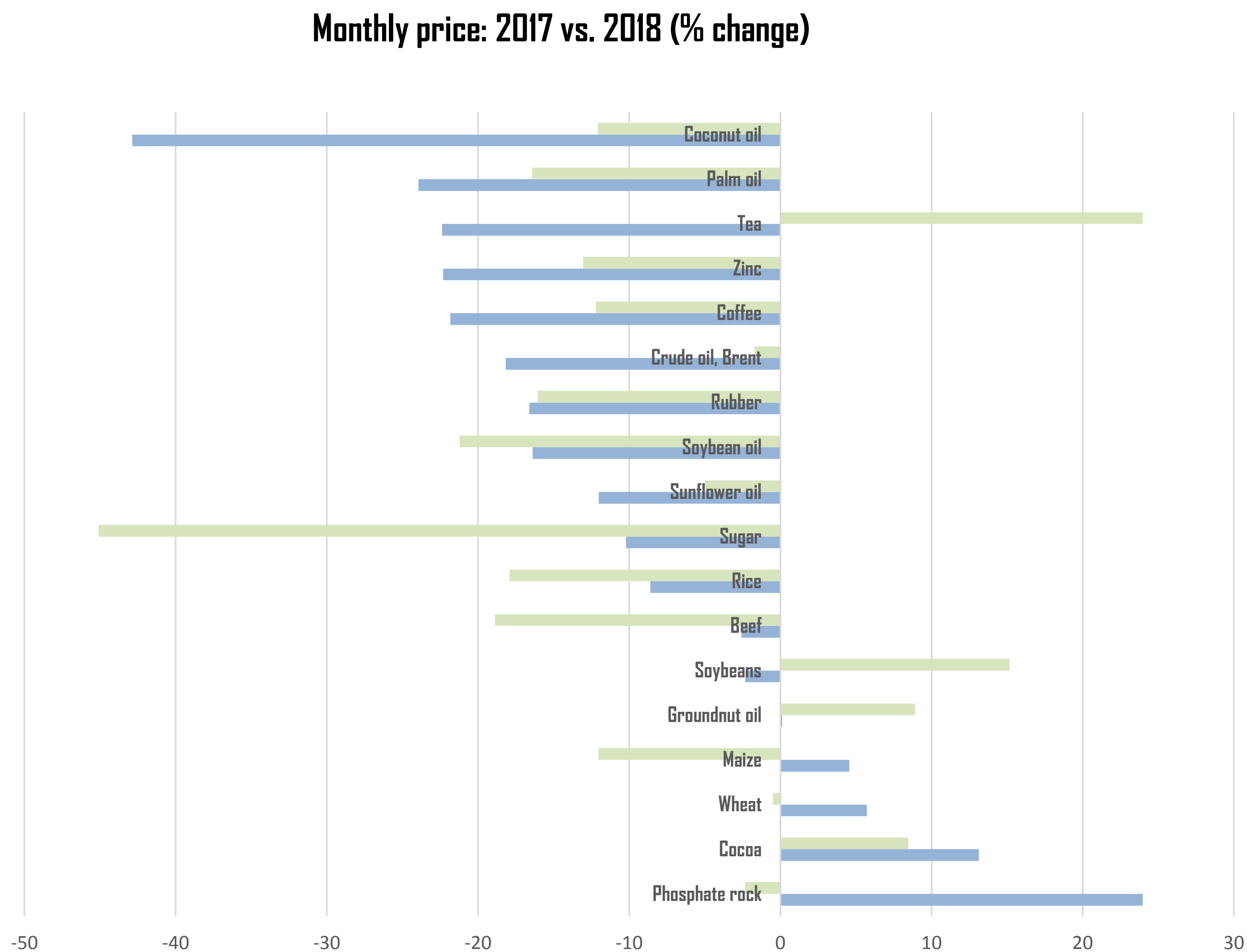
Why does commodity dependence matter?

- Declining prices
- High producer price volatility
- CDDCs stuck at bottom of value chain

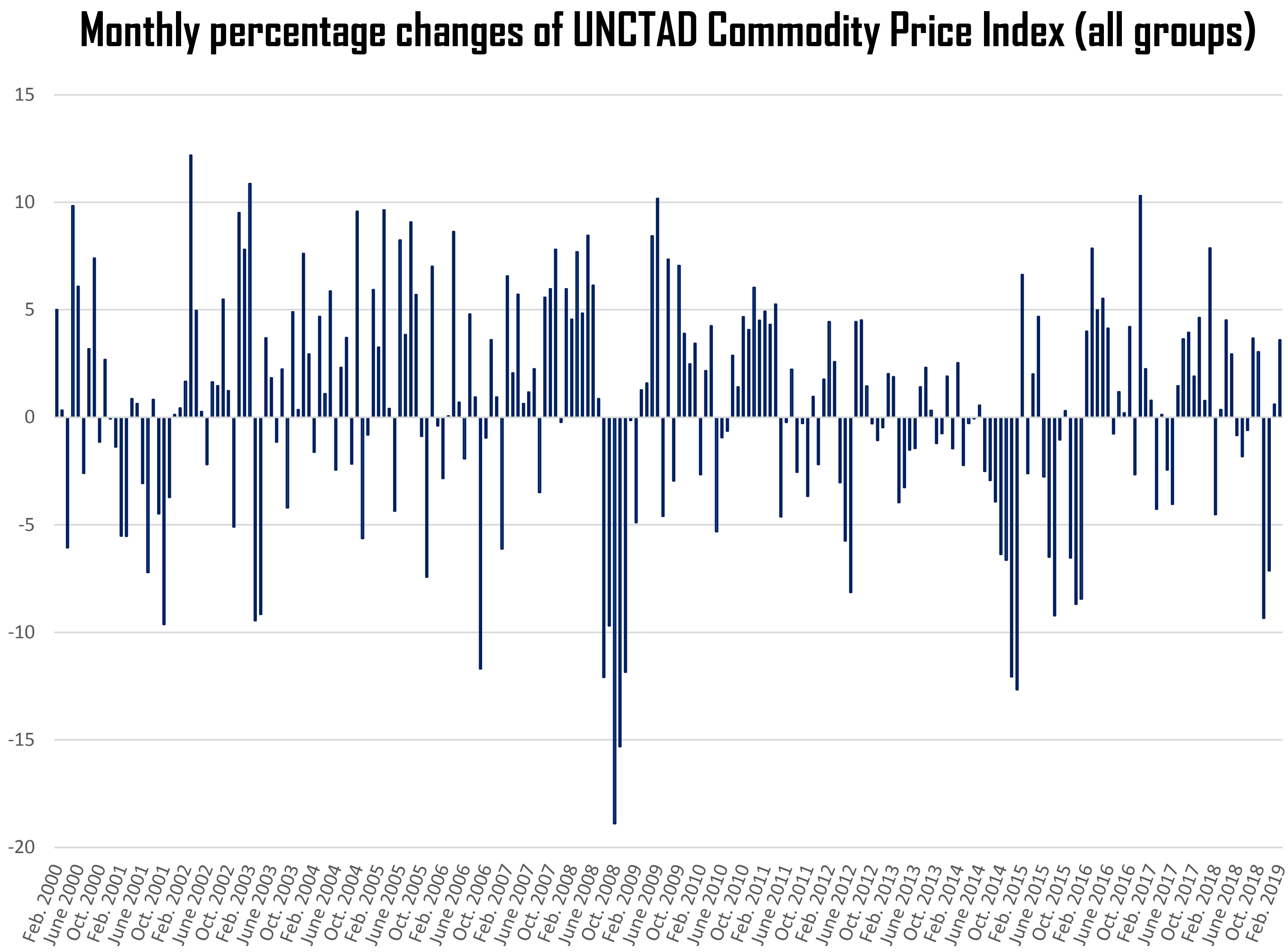
Negative terms of trade



High commodity price volatility



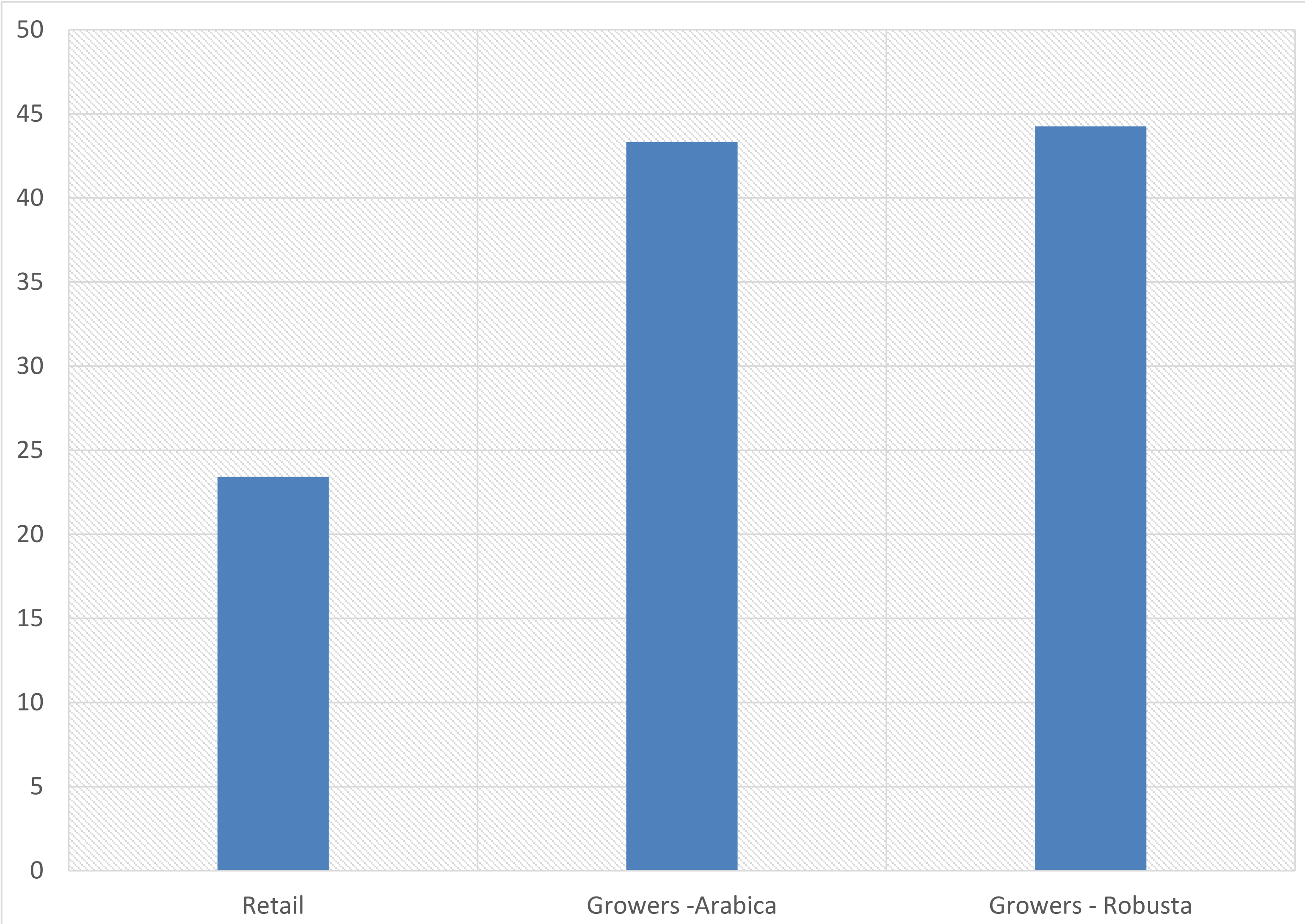
Commodity price volatility



Commodity price volatility

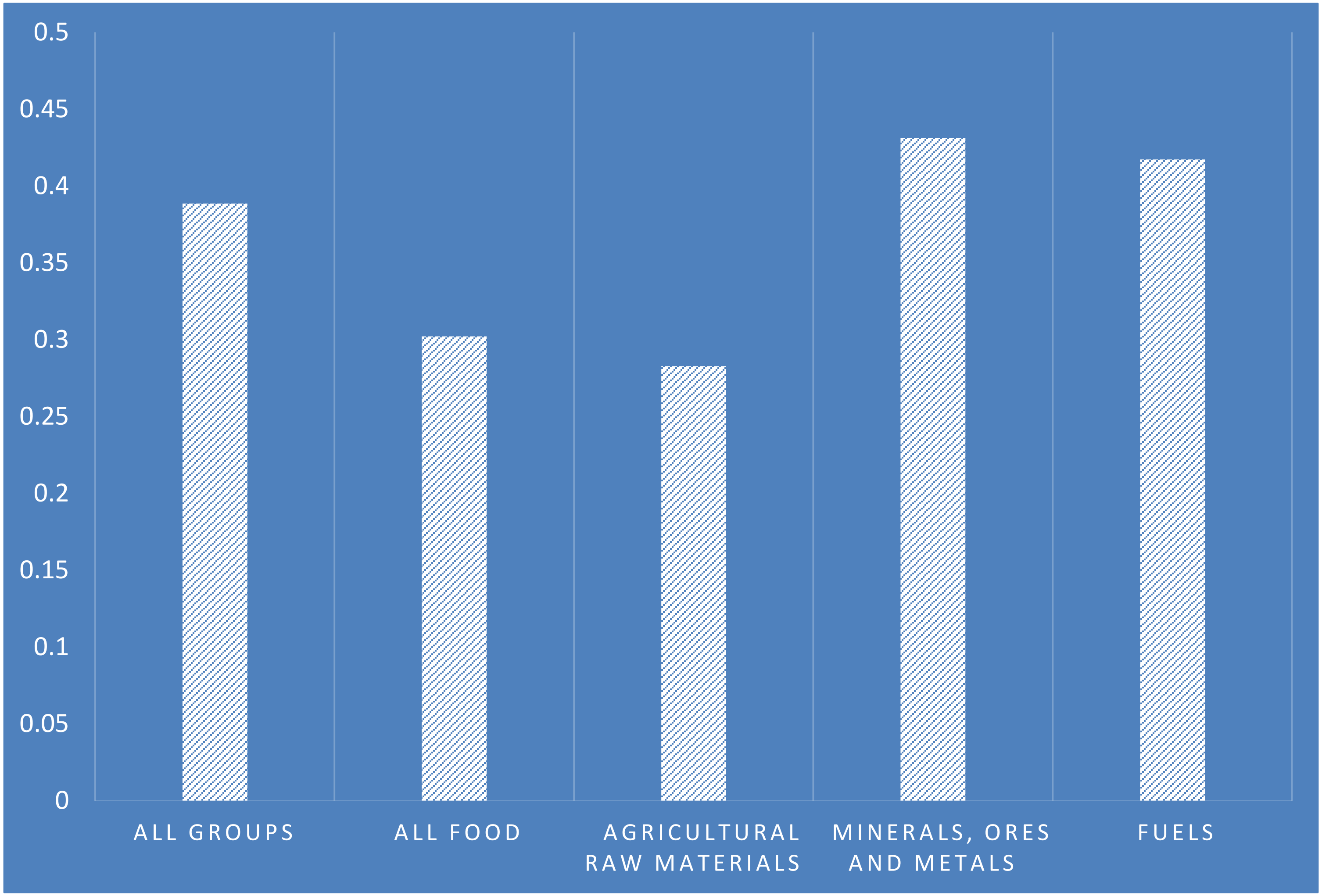
- 59% of the monthly changes from February 2000 to February 2019 were positive; 41% were negative
- 56% of the shocks with an absolute value above 5% were positive; 44% were negative
- The average size of negative shocks was -4.3%; the average size of positive shocks was 3.9%
- Producer prices twice as more volatile than retail prices

Volatility of producer prices almost double retail (1990-2017)



Commodity price volatility

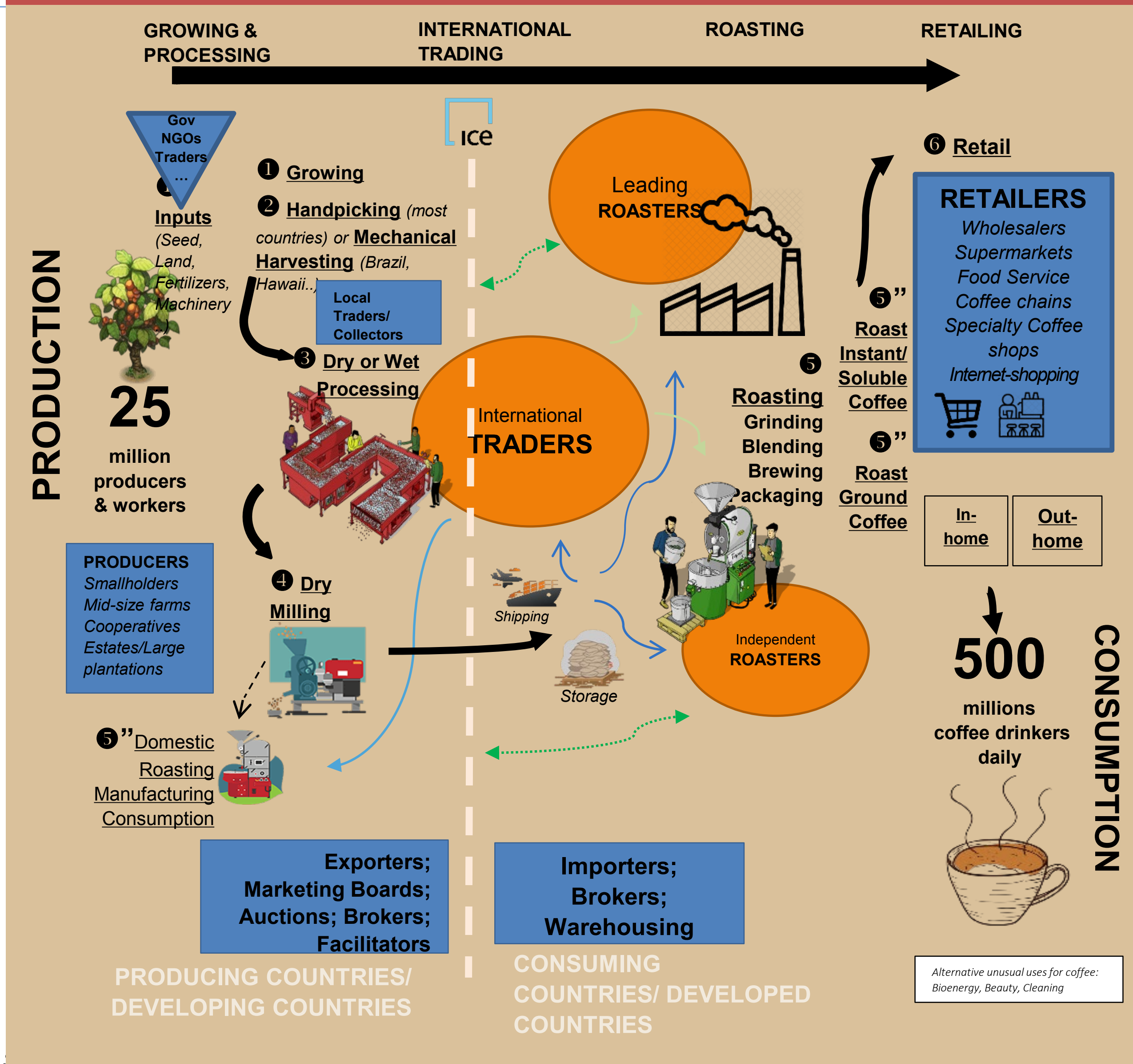
Coefficient of variation of UNCTAD commodity price indices (Jan 2000 - Feb 2019)



Value chains & distribution of value

- Complex value chains
- CDDCs stuck at the bottom of value chain
- Unequal distribution of value

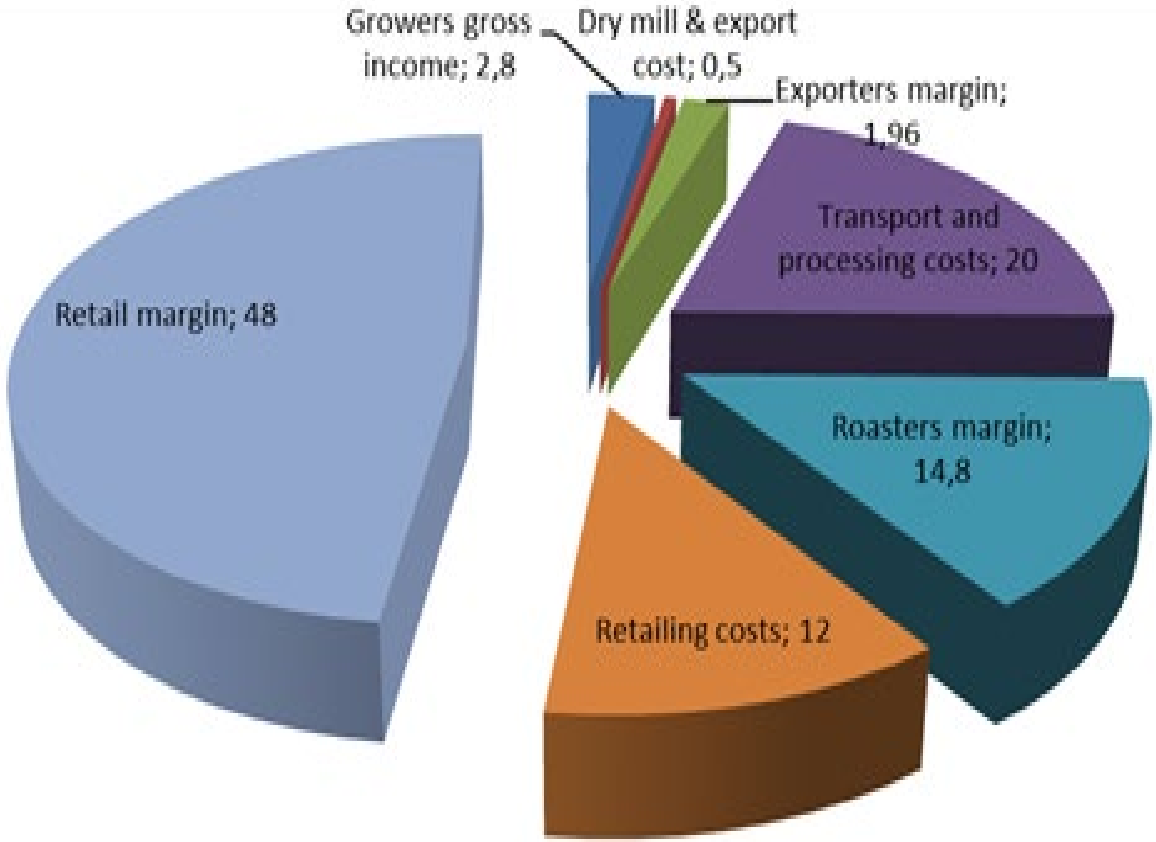
Figure 10 – The Coffee Global Value Chain – From Tree to Cup



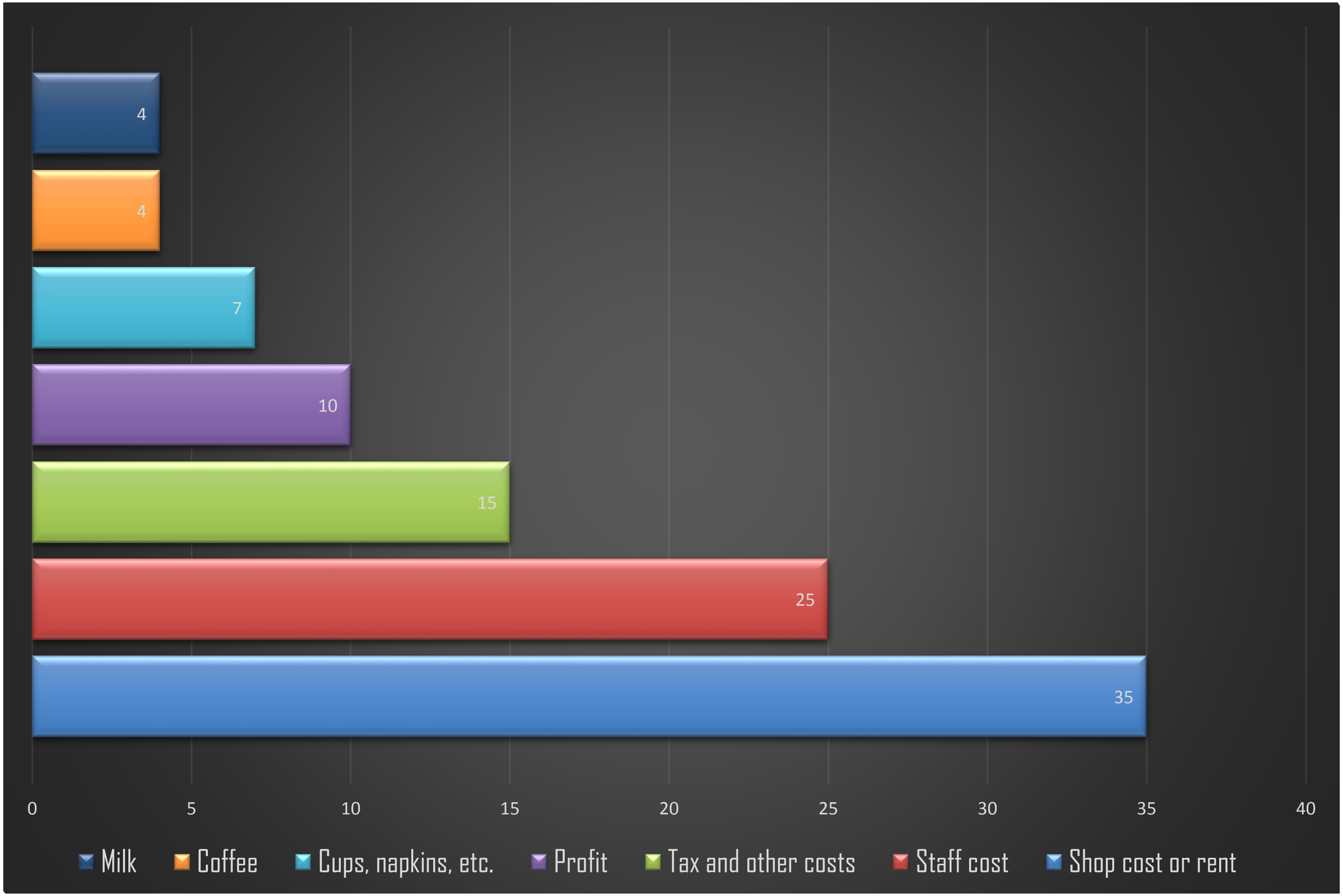
Market concentration along the Global Coffee Value Chain

Source: UNCTAD secretariat

Unfair distribution of value: Ethiopian coffee



Cost structure of a £2.5 cup of coffee (percentage)



Source: Based on data from Allegra Strategies (FT, 21 May 2019)

Why is the producer price so low?

- Oversupply—despite increasing consumption
  - coffee reference price: $.90/lb, a 14-year low; Arabica price on ICE or New York C (Intercontinental Exchange) at $1.20/lb in last 3 years
  - production cost, processing & transport amounts to $1.50/lb.
  - New York exchange, part of ICE, sets reference price

- Dominant actor, Brazil (28% of market in 2018) has low break-even: $0.90/lb. due to mass production & mechanization

- Low producer price raises real issue of sustainability of supply
  - Multinationals, including Starbucks, taking action to secure supply
  - Nestlé, largest coffee buyer: addressing issue requires cooperation

Why is producer price so low?

- Consumers far removed from consumer markets

- Specialty coffees more at risk of supply disruptions:
  - defined as coffee above 80 on Specialty Coffee Association's testing scale of up to 100
  - more than half of coffee consumed in US
  - sales based on personal stories

Way forward….

- Many executives in the industry agree that New York C pricing benchmark does not reflect value of beans:
  - New York C does not take into account differences in quality
  - need different form of price discovery
  - some importers bypass New York C, deal with growers and negotiate price based on cost and profit

- Progressive roasters & traders initiative to pay farmers a fair price
  - Thrive Farmers, an importer, has revenue sharing model giving 50%-75% of beans retail value to growers
  - farmers in scheme make 3 times more profits than their next best offer in marketplace

Way forward….

- Transparent Trade Coffee website offers price information
- Peter Roberts & Chad Trewick launched specialty price guide
  - based on data from 21 importers, exporters & roasters in 10 countries
  - in 2017-2018 whereas market average was \$1/lb, price ranged from \$1.55/lb. to \$9.05/lb. with median of \$3/lb
- Something more structural needed across industry
- Need for international dialogue on fairness in allocation of value

Defeating dependence via diversification

- Moving up value chain and/or…
- Horizontal diversification?
- Contrasting Zambia with Costa Rica

Product & export diversification

- Moving up chain increases revenues & reduces their volatility

- Value addition must be:
  - "deep" for successful vertical diversification
  - part of comprehensive, long-term and realistic diversification strategy

- Value addition must create substantially new product

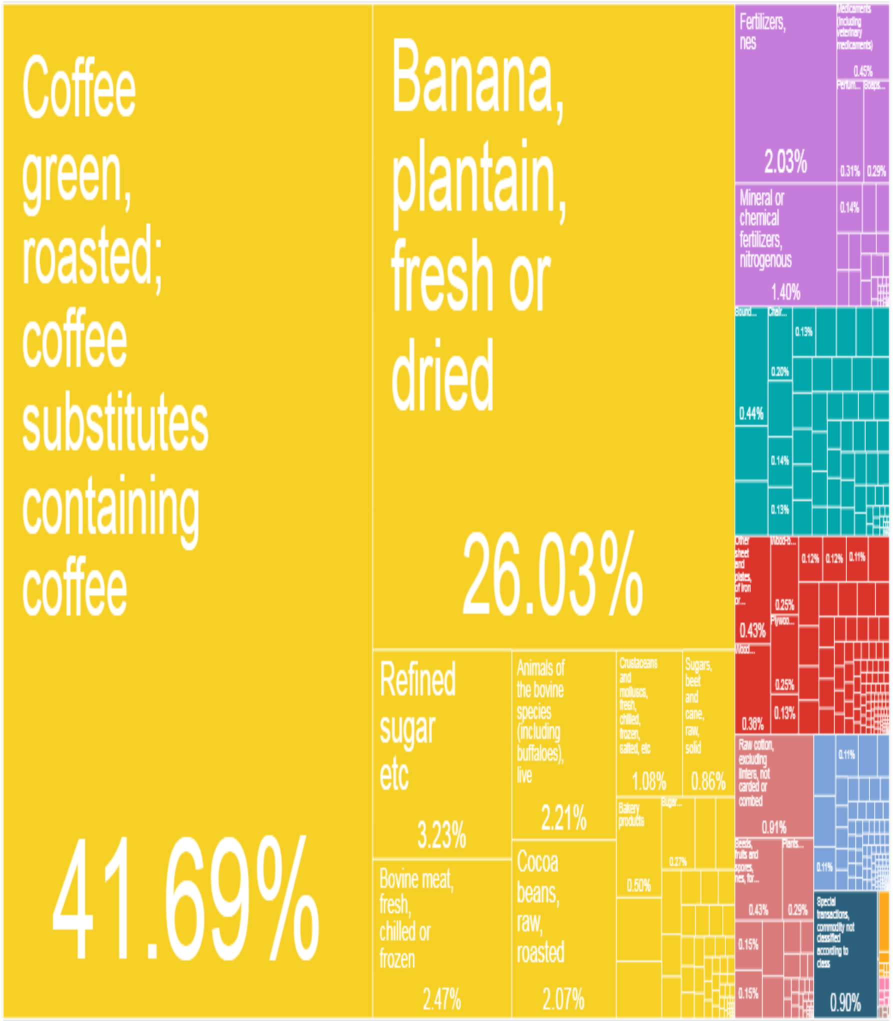
- Climate change has added urgency to need to diversify
  - mitigation efforts
  - adaptation to climate change & to 3rd country mitigation

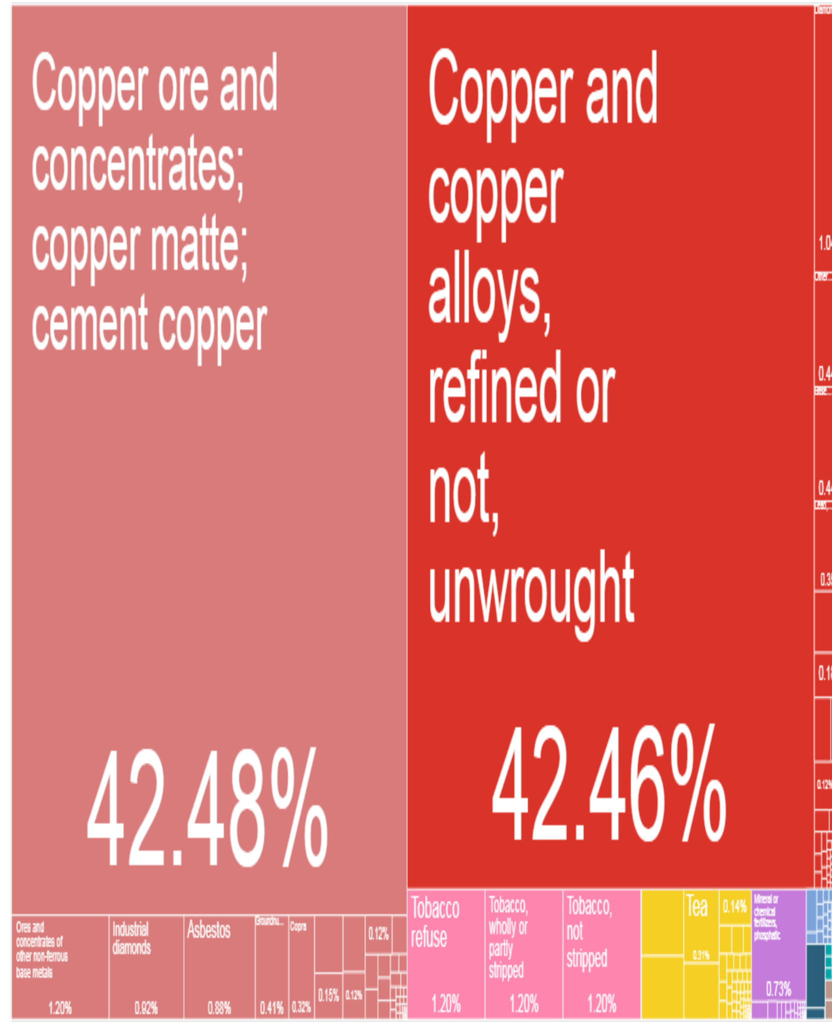
Product & export diversification

- To be relevant, value addition must overcome many challenges:
  - acquiring, adapting, and mastering new technologies
  - access to complementary inputs (cocoa and milk for chocolate)
  - finding market for new product, generally not in domestic economy
  - tariff escalation, non-tariff measures, difficult trade policy environment (see Ha-Joon Chang's "Kicking Away the Ladder")
  - high competition with or market power of established actors

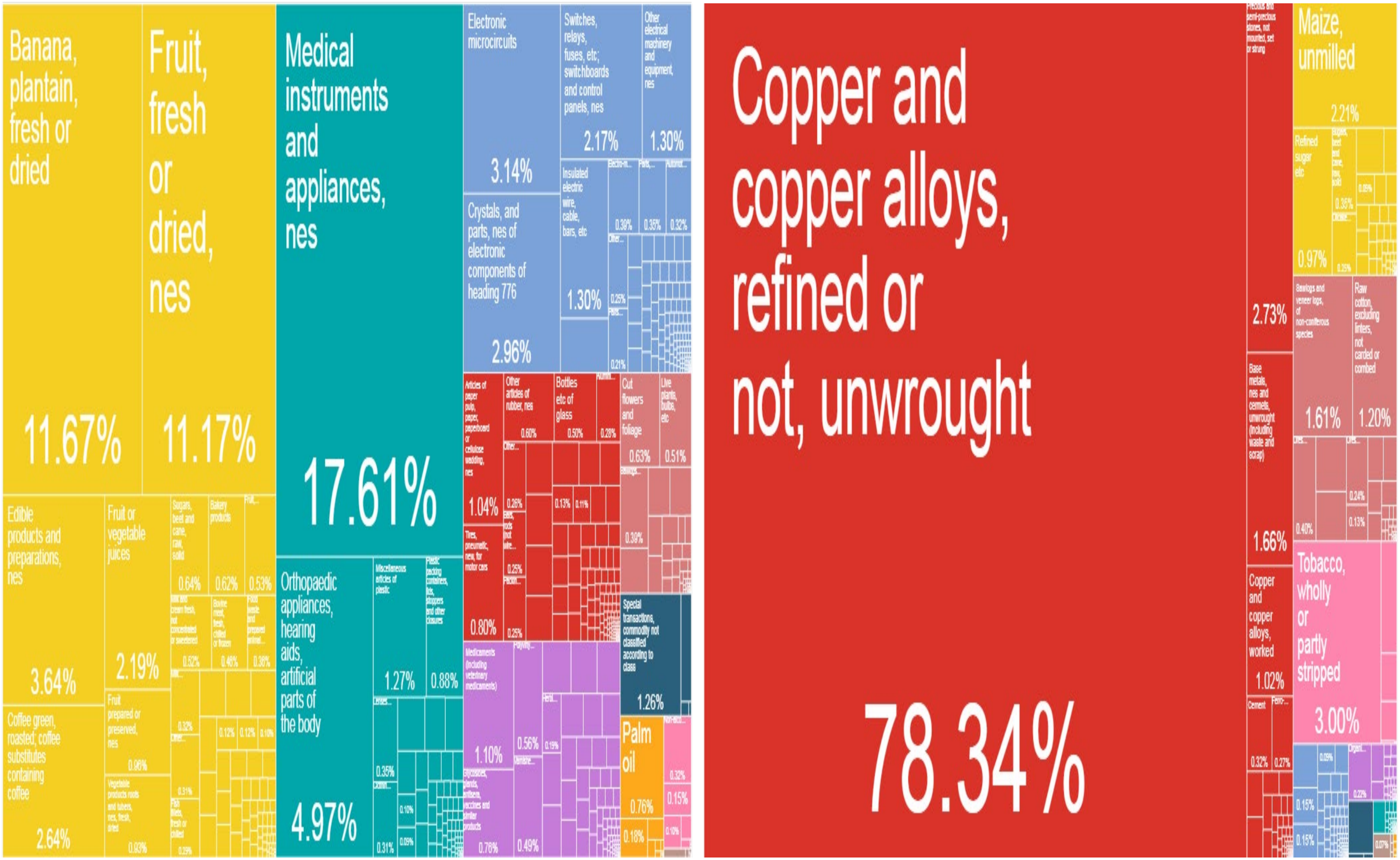
- Diversification more than value addition: horizontal diversification
  - new products in & outside commodity sector
  - choice informed by country's comparative & competitive advantages
  - identify commodities for which value addition could be viable strategy

Costa Rica's and Zambia's exports in 1965...





Costa Rica's and Zambia's exports in 2016



Product & export diversification

- Human capital formation at the core of diversification process

- External factors help to drive successful diversification:
  - foreign direct investment
  - technology transfer
  - conducive & predictable international environment

- Success requires reforms and policies over a long period
  - conducive domestic macroeconomic policies (fiscal, monetary, …)
  - relevant sectoral policies (industrial policies)

Conclusion

- Commodity dependence
- Sharing value fairly
- Horizontal diversification?

Conclusion

- Most developing countries are commodity-dependent, a status associated with slow growth & low human development

- Launch an international dialogue on how to foster fairness in value allocation along value chain
  - UNCTAD to initiate the dialogue?
  - identify ongoing positive initiatives and build on them

- Diversification, particularly horizontal:
  - solution to commodity-dependence
  - best response to effects of climate change

Thank you.