Stabilisation of Commodity Market of Interest to Africa

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Summary

Deterioration in the terms of trade and the instability of commodity markets have been identified as major constraints to economic growth and poverty in Africa. The paper which is in six parts discusses some of the measures to stabilise commodity markets and identified the major causes of instability to include the cyclical income fluctuations in the consuming nations as well as supply rigidities in producing countries. Consequences of unstable commodity price were noted to include increased government deficits and national debts, capital flight, preference for short term investment and eventual fall in export earnings and gross national product. A review of the performance of commodity markets revealed the inability of international commodity agreements to stabilise prices due to their flexibility and lack of executive capacity while the long term trends in prices continued to fluctuate downwards. The downturn of prices adversely affected the terms of trade of most African countries since most of them depend heavily on the commodity sector, it worsened their debt problem and constrained economic growth and development. In order to address commodity market instability, measures usually adopted include buffer stock, management of national stocks of commodities, compensatory financing, diversification and market-based risk management instruments. However, not much has been done by African countries to utilise the two latter approaches. In particular, the wide use of risk management instruments had been constrained by domestic regulatory, institutional and legal constraints as well as poor market-place perception of these countries' credit worthiness.

Outstanding constraints, and challenges to the stabilisation of commodity prices were identified to include the small scale nature of production and low level of further processing, poor performance of state and public institutions, poor infrastructure which made production uncompetitive and inadequate market information as well as poor access to productive assets. The problems of lopsided share of benefits of commodity trade and over production were also discussed. In addition, attempts towards successful diversification were found to be hampered by international market constraints including

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subsidies and non-tariff barriers, high risk perception by investors as well as inadequate government support.

The above problems notwithstanding, the prospects for the stability of commodity markets are good based on the widespread adoption of market reforms by African countries aimed at boosting production efficiency. Finally, the paper recommended expanded trade in primary products among African countries removal of restraints on market access, improvement of the competitiveness of primary products, greater use of risk management instruments, reactivation of international commodity agreements as well as improved access to funding, particularly, rejuvenation of compensatory financing schemes so as to cushion the high cost of instability, among others.

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1. Introduction

Exports of primary commodities account for between 80 and 90 per cent of the total exports of many African countries and the long term decline in prices, the deterioration in the terms of trade and the instability of commodity markets are major constraints to growth and poverty reduction in Africa. Some countries have attempted to industrialise and to increase the value added to primary products but only a few countries have succeeded in expanding their exports of manufactured goods. Moreover, in the absence of sufficient skills and capital to diversify production and create alternative employment opportunities to primary production, there has been a tendency to increase the production of primary products leading to further decline in prices.

This paper discusses some of the measures that can be taken to stabilize commodity markets. The commodities selected for analysis are cotton, cocoa, coffee, sugar, rubber, groundnut, copper and crude oil because of their importance for African countries in terms of employment, export income and government revenue.

Section two discusses some of the factors causing the instability of commodity exports; Section three reviews the performance of selected commodities. Section four analyses various approaches to stabilise commodity markets; Section five reviews the constraints and challenges to commodity markets stabilisation in Africa and its prospects. Section seven contains some suggestions and concludes the paper.

2. Causes and Consequences of Commodity Market Instability

One of the major factors influencing the fluctuation of commodity prices is cyclical income fluctuations in the consuming countries. Consequently, the ups and downs in industrial country production have serious consequences for commodity exporters. Prices fall when restrictive policies are imposed to reduce inflationary pressures in the importing countries. The consequent slowing down of economic growth leads to sharp decline in the demand for raw materials. Commodity prices also fluctuate in response to good or poor harvests caused by variations in weather conditions. The prices of tree crops such as cocoa, coffee and tea experience sharp fluctuations because of the multi-year delay in the adjustment of production to shifts in demand.

Volatile commodity markets lead to disruptions in investment planning and contribute to the misallocation of resources. Unstable markets cannot reliably indicate the relative profitability of alternative lines of investment. Consequently, risk-averse investors become hesitant to invest in sectors that are subject to high volatility. The fluctuations in commodity prices also cause government revenues to vary widely with the tendency to increase government deficits and, hence national debts. High price instability of a country's commodity exports impact on the rate of domestic savings and also tend to favour investments (e. g. financial assets) for short gain, whereas low price instability would tend to favour long-term investment in productive assets. In other words, private investment may be channelled into domestic projects with short-term profits rather than

into more risky ventures, even though the latter may reflect the country's comparative advantage. (A. Maizels, 2000). The instability of commodity prices also constrains economic development through the resulting variability in imports of capital and intermediate products.

High export instability tends to exacerbate the general climate of business uncertainty, and can lead to capital flight if savers prefer to invest abroad. At the micro level, unstable markets strongly impact producers and increase their risk aversion. For instance, cash crop producers are tempted to neglect less profitable crops. Unstable earnings might thus discourage farmers from producing for exports and can lead to a future fall in export earnings and GNP. The pervasive impact of instability therefore calls for measures to ensure stability.

The benefits of commodity market stability include better investment planning, higher investor confidence, higher domestic savings, improved business climate, optimal resource allocation and greater production. The direction of such benefits would however, depend among other things, on the source of instability. In stylising the benefits of stability in commodity markets, Newbery and Stiglitz (1981) noted that:

(i) producers gain and consumers lose from price stabilisation if the source of instability lies on the supply side;
(ii) consumers gain and producers lose from price stabilisation if the source of instability lies on the demand side;
(iii) in both cases, gainers could afford to over-compensate the losers, so there are net benefits from price stabilisation.

3.0 The Performance of Commodity Markets

In the 1950s and 1960s, many governments of commodity-producing and consuming countries became actively involved in managing commodity markets through international agreements. This led to the signing of international commodity agreements by producing and consuming countries such as the Tin Agreement (1954); the International Sugar Agreement (1954); the Coffee Agreement (1962); the Cocoa Agreement (1972); and the Natural Rubber Agreement (1980). These are agreements between leading producing and consuming nations about stabilising commodity prices, assuring adequate supplies to consumers, and promoting economic development of producers. In addition, some producer organizations were also established such as the Organisation of Petroleum Exporting Countries (OPEC). Commodity producing countries in Africa were not left out of these agreements although they did not help to reduce either the volatility or the decline in commodity prices. As noted by Maisels (2000), the dominant feature of international commodity markets since 1980 has been a generally depressed level of prices for a number of important commodity exports of developing countries, particularly Africa.

The failure of international commodity and producer agreements was due to the fact that they did not satisfy the five major conditions (Nappi 1979) that are required for success:

1. Association members must account for a large percentage of world production or of that portion of production engaged in international trade. This assures the association that international consumers cannot turn for supplies to non-members following price increases, imposition of export quotas or some other association action.
2. The international demand for the controlled commodity must be characterized by both short and medium-term price inelasticity. This implies that the percentage variation for decreasing demand must be less than the percentage for increasing price.
3. There should be no short- or medium-term substitutes for the commodity. This would mean that the association's price increases and supply restraints could not be countered by the substitution of other products which would satisfy demand at equal or lower prices.
4. Association members must give evidence of cohesion and discipline in the methods used to appropriate the economic rent, whether this is done through the increase of royalties, taxes, or fees. If member countries are numerous and differ markedly in economic scale or political ideology, this condition will not be easily met. So there would be greater risk of a price war and dismemberment of the association.
5. Identified reserves i.e. potential for increased production must be largely located in association member countries.

Table 1. International Commodity Agreements, Membership and Stabilisation Tools

Name	Year Founded	Membership when founded	New Members	Total Membership	Proportion of Total Supply by members (%)	Stabilisation Tools
Association of Natural Rubber Producing Countries (ANRPC)	1970	6	2	8	80.0	
Organisation of Petroleum Exporting Countries (OPEC)	1960	6	6	12	40.0	Export Quota
International Cocoa Organisation (ICCO)	1973	30 (both exporting & importing)		30	82.5	Buffer Stock export quota
International Sugar Organisation (ISO)	1968	63 (both exporting & importing)		63	75.5	Export quota buffer stock
International Coffee Organisation (ICO)	1963	56 (both exporting & importing)		56	97.0	Export quota
International Cotton Advisory Committee (ICAC)	1939	10	31 (both exporting & importing)	41		

Source: International Monetary Fund (IMF):
www.imf.org/external/np/sec/decdo/contents

Table 1 lists some commodity associations, their membership growth and the proportion of world supply of member countries. The data in Table 1 shows that 3 out of 6 commodity associations had membership growth. The growth in membership by OPEC and ANRPC were as a result of a consolidated stance of member countries to keep prices stable which attracted other producing countries, while the growth in membership of the International Cotton Advisory Committee resulted from renewed negotiations between producing and importing countries. Although most of the commodity associations were formed as a result of continued negotiations and agreements to stabilize prices and supply of commodities, their ability to achieve this has been minimal. This was because of their inability to effect increases in export quotas at the ceiling price or reductions at the floor price or maintain stock operations that were profitable.

Some of the major factors that contributed to the poor performance of these commodity associations included

a. The inability of the International Commodity Agreements (ICAs) to adapt to changes in the market, such that by 1996 the economic clauses in them had all elapsed or failed (Gilbert 1987, 1996). For example a shift in tastes towards a particular type or variety as was the case of coffee and rubber in the eighties.

Table 2: STATUS OF SOME INTERNATIONAL COMMODITY AGREEMENTS

	Sugar	*Coffee*	*Cocoa*	*Rubber*
Initial Agreement Date	1954	1962	1972	1980
Status of economic clauses	Lapsed in 1963 and 1983	Suspended in 1989	Suspended in 1988	Suspended in 1996, revived in 1997, suspended in 1999
Number of agreements	4	4	4	4

Source: Gilbert (1995)

b. Difficulty of policing the agreements of ensuring that sales outside quota are either eliminated or kept within bounds.

c. The fact that some of the agreements were started operations in the absence of appropriate market conditions such that they could not intervene to buy stocks; an example was the cocoa agreement. More so since an ICA needs a lot of start-up capital which was not readily available for some. Many of the international commodity agreements therefore ceased to function because of lack of funding for their buffer stocks.

d. Most commodity importing countries also had resorted to sourcing for alternatives especially, synthetic materials.

An Overview of long term trends in Commodity Prices

Prices of commodities experienced swings over the period 1970 to 2002. During the period, years of declines in prices relative to the preceding period ranged from 14 for sugar and crude oil, 15 and 16 for groundnuts, rubber, cotton and cocoa to 17 and 18 for coffee and copper, respectively (Table 3).

Year	Cocoa (US$/MT) – Index	Coffee (US cents/pound)	Copper (US$/MT)	Cotton (US cents/pound) – Index	G/Nuts (US$/MT)	Crude Oil (US$/barrel)	Rubber (US cents/pound)	Sugar (US cents/pound)
1970	673.93	52.01	1411.88	28.93	228.18	2.18	18.47	5.09
1971	538.59	44.99	1080.63	33.88	250.91	2.66	15.08	5.16
1972	642.61	50.33	1070.89	36.26	253.95	2.89	15.05	6.79
1973	1130.82	62.31	1776.56	62.09	391.31	3.24	30.75	6.66
1974	1560.23	65.84	2055.44	65.13	739.06	11.6	34.09	10.65
1975	1245.90	65.41	1236.79	53.09	432.96	10.96	25.44	15.44
1976	2045.76	142.75	1403.06	77.24	422.99	12.23	35.1	13.39
1977	3791.12	234.67	1309.65	71.33	546.86	13.28	36.95	14.01
1978	3404.56	162.82	1365.08	71.95	630.93	13.39	44.71	15.91
1979	3292.82	173.53	1973.01	77.14	562.74	30.21	57.25	19.29
1980	2603.42	154.2	2185.15	93.73	1236.58	36.68	64.62	22.09
1981	2076.55	128.09	1742.75	83.97	1257.42	35.27	50.93	18.93
1982	1741.81	139.72	1481.69	72.51	827.5	32.45	38.9	18.12
1983	2118.70	131.69	1592.47	84.1	965.33	29.64	48.27	17.57
1984	2395.72	144.17	1376.97	80.94	836.58	28.55	43.44	16.03
1985	2254.56	145.56	1417.24	59.92	675.75	27.37	34.42	16.12
1986	2068.31	192.74	1369.8	47.94	993.58	14.17	36.58	18.6
1987	1997.76	112.29	1781.15	74.77	758.5	18.2	44.66	21.44
1988	1583.75	135.1	2599.8	63.52	935.75	14.77	53.75	23.82
1989	1242.20	106.96	2847.21	75.95	817.5	17.91	43.99	22.75
1990	1268.00	89.15	2661.34	82.56	1325.5	22.99	39.22	26.45
1991	1192.61	85.03	2338.5	76.91	1237.83	19.37	37.46	27.77
1992	1099.42	63.66	2284.81	57.94	799.13	19.04	39.08	28.48
1993	1111.27	69.94	1914.96	58.02	1092.15	16.79	37.71	28.1
1994	1395.68	148.53	2305.53	79.72	954.8	15.95	51.07	28.2
1995	1432.54	149.41	2932.04	98.3	909.92	17.2	71.68	31.21
1996	1455.25	120.25	2293.39	80.54	962	20.37	63.59	31.15
1997	1618.74	185.02	2275.19	79.23	988.42	19.27	46.16	28.38
1998	1676.00	132.4	1653.71	65.53	988.75	13.07	32.73	27.13
1999	1135.05	101.67	1572.53	53.13	834.74	17.98	28.83	26.84
2000	903.91	85.05	1814.52	59.05	843.93	28.24	31.35	25.16
2001	1088.37	61.91	1580.17	48	833.16	24.28	27.25	23.88
2002	1779.04	60.37	1560.29	46.26	753.29	24.96	34.91	24.91

Source: International Financial Statistics, IMF (April 2003)

Analysis of mean prices for the period 1970 - 1980, 1981 - 1991 and 1992 - 2002 revealed that it was highest for cocoa in the period 1970 – 1980, copper and sugar in the period 1992 – 2002 while for others it was the period 1981 – 1991 (Table 4).

Table 4. 10 Year Mean Prices of Selected commodities (1970-2002)

Period	Cocoa	Coffee	Copper	Cotton	Ground-nuts	Crude Oil	Rubber	Sugar
1970-1980	1902.71	109.90	1533.47	60.98	517.86	12.67	34.32	12.23
1981-1991	1812.72	128.23	1928.08	73.01	966.48	23.70	42.87	20.69
1992-2002	1335.93	107.11	2017.01	65.97	905.48	19.74	42.21	27.59

Source: Computed from International Financial Statistics Tables

Oversupply and weak demand continued to exert downward pressures on the prices of the commodities. The slow down in the world economy, with recessionary tendencies in some parts, and the previously excessive investment in primary products have been the dominant factors in causing the downturn. This was clearly discernible for the period 1992-2002, when mean prices were below the preceding decades levels (except coffee and sugar).
A graphical representation of the price and percentage change in prices between 1970 and 2002 (See appendix) for sugar, cocoa, coffee, cotton, crude oil, rubber, groundnut and copper, revealed that prices increased for most of the commodities (excluding sugar and crude oil) during the periods when there were negotiations and slightly after.

Table 5

Table 2 – 10-Year Coefficient of Variation (%) in Commodity Prices

Period	Years	Cocoa	Coffee	Copper	Cotton	Groundnuts	Crude Oil	Rubber	Sugar
1	1970-1980	63.0	59.5	25.8	33.9	55.9	89.5	47.4	47.7
2	1981-1991	23.8	23.4	29.6	15.7	22.6	30.9	14.5	19.6
3	1992-2002	21.4	40.0	21.7	24.8	11.2	22.6	34.4	8.5
Period Changes (Percentage points)									
	1 & 2	39.2	36.1	-3.7	18.2	33.4	58.6	32.9	28.1
	2 & 3	2.5	-16.6	7.9	-9.1	11.4	8.3	-19.9	11.1

Source: Derived from IFS data

Table 5 shows that the instability in commodity prices was higher during the 1970 – 1980 periods than the 1981-1991 and 1992-2002 periods. The price variations between 1970 and 1980 ranged from 25.8 per cent (copper) to 89.5 per cent (crude oil). Between 1981 and 1991 the price variation ranged from 14.5 per cent (rubber) to 30.9 per cent (crude oil), while between 1992 and 2002 the price variation ranged from 8.5 per cent (sugar) to 40.0 per cent (coffee).

Table 6. Commodity Exports by Selected African Countries

	Principal Exports		Share of Principal Exports in National Exports
Country	**1**	**2**	
Algeria	petroleum		35
Burundi	coffee	tea	87
Cameroon	petroleum	coffee	61
CAR	coffee	logs	44
Congo	petroleum	logs	89
Cote d'Ivoire	cocoa	coffee	49
Egypt	petroleum	aluminium	42
Ethiopia	coffee	sugar	68
Gabon	petroleum	logs	77
Gambia	groundnuts	groundnut oil	29
Kenya	coffee	tea	54
Liberia	iron	rubber	80
Madagascar	coffee	sugar	39
Malawi	tobacco	tea	68
Mauritania	iron		37
Mauritius	sugar	tea	40
Nigeria	petroleum	cocoa	97
Rwanda	coffee	tea	77
Senegal	phosphate rock	groundnut oil	16
Sierra Leone	bauxite	cocoa coffee	34
Tanzania	coffee	tea	49
Togo	phosphate rock	coffee	42
Tunisia	petroleum	phosphate rock	34
Uganda	coffee		96
Zaire	copper	coffee	50
Zambia	copper	zinc	95
Zimbabwe	tobacco	nickel	25

Source: Bidarkota P.V & Crucini M.J. (1998)

The effect of this instability is clearly underscored by the importance of commodity exports to African economies. For example the share of commodity exports to the total national exports of selected African countries revealed their heavy dependence on the commodity sector. It accounted for more than 90 per cent in Zambia, Uganda and Nigeria, and generally over 40 per cent for most of the remaining selected countries (Table 6). Thus, most of the countries are highly susceptible to the vagaries in the international commodity market. Serious price fluctuation tends therefore to accelerate their economic problems.

Table 7. Terms of Trade of Selected African Countries

Country	Africa	Algeria	Benin	Burkina Faso	Côte d'Ivoire	Ethiopia	Gambia	Ghana	Mali	Nigeria	Sudan	Tanzania	Uganda	Zambia
1970	0.00	-0.25	-0.03	-0.03	0.08	-0.05	0.00	0.05	0.00	0.18	0.01	-0.07	-0.14	0.52
1971	-0.92	-0.37	-0.04	-0.04	0.06	-0.06	-0.01	0.06	-0.03	0.30	0.00	-0.11	-0.22	0.67
1972	0.82	-0.19	-0.05	-0.05	0.10	-0.02	0.00	0.15	-0.04	0.68	0.04	-0.08	-0.13	0.19
1973	2.94	-0.35	-0.07	-0.07	0.15	0.03	-0.01	0.21	-0.08	1.60	-0.01	-0.13	-0.13	0.61
1974	8.85	0.65	-0.12	-0.10	0.24	-0.01	-0.01	-0.08	-0.12	6.43	-0.29	-0.35	-0.18	0.62
1975	-1.22	-0.80	-0.16	-0.11	0.05	-0.07	-0.02	0.03	-0.13	1.79	-0.45	-0.41	-0.18	-0.12
1976	1.98	0.18	-0.20	-0.09	0.33	-0.07	-0.04	-0.03	-0.07	2.36	-0.43	-0.20	-0.13	0.40
1977	1.46	-1.18	-0.24	-0.15	0.40	-0.02	-0.03	-0.03	-0.04	0.74	-0.42	-0.23	-0.18	0.23
1978	-4.55	-2.22	-0.28	-0.19	-0.01	-0.15	-0.06	0.08	-0.18	-2.88	-0.67	-0.66	-0.22	0.24
1979	15.68	1.15	-0.27	-0.22	0.02	-0.15	-0.08	0.15	-0.21	7.11	-0.58	-0.60	0.24	0.62
1980	15.11	3.31	-0.27	-0.27	0.14	-0.30	-0.14	0.13	-0.23	9.29	-1.04	-0.75	0.05	0.22
1981	-7.31	3.10	-0.51	-0.27	0.15	-0.35	-0.10	-0.05	-0.23	-2.65	-0.89	-0.61	-0.11	0.06
1982	-8.27	2.42	-0.44	-0.29	0.12	-0.39	-0.06	0.16	-0.18	-3.86	-0.78	-0.68	-0.03	0.02
1983	-0.03	2.18	-0.25	-0.23	0.25	-0.48	-0.07	0.11	-0.18	-1.95	-0.73	-0.43	-0.01	0.28
1984	3.83	2.51	-0.12	-0.17	1.21	-0.51	-0.05	-0.08	-0.15	2.48	-0.52	-0.36	0.06	0.06
1985	8.51	3.00	-0.18	-0.26	1.22	-0.66	-0.05	-0.25	-0.18	3.66	-0.40	-0.59	-0.33	-0.24
1986	0.81	-1.40	-0.29	-0.32	1.30	-0.65	-0.07	-0.19	-0.23	1.89	-0.63	-0.58	0.13	0.14
1987	4.83	1.19	-0.24	-0.27	0.87	-0.71	-0.09	-0.18	-0.19	3.43	-0.37	-0.64	-0.53	0.13
1988	-0.90	0.12	-0.26	-0.31	0.69	-0.70	-0.08	0.10	-0.29	2.20	-0.55	-0.54	-0.61	0.34
1989	1.75	0.09	-0.13	-0.30	0.70	-0.51	-0.13	-0.26	-0.09	3.69	0.67	-0.63	-0.15	0.43
1990	9.47	3.11	-0.15	-0.39	0.97	-0.78	-0.16	0.00	-0.24	7.97	-0.25	-1.03	-0.14	0.09
1991	5.60	4.67	-0.22	-0.42	0.59	-0.28	-0.16	-0.44	-0.15	3.27	-0.58	-1.21	0.00	0.26
1992	0.91	3.20	-0.24	-0.41	0.53	-0.67	-0.16	-0.92	-0.27	3.61	-0.50	-1.09	-0.37	-0.04
1993	-1.13	2.42	-0.19	-0.44	0.40	-0.59	-0.19	-2.97	-0.15	4.37	-0.52	-1.05	-0.43	0.02
1994	-2.84	-0.26	-0.03	-0.24	0.82	-0.66	-0.17	-0.68	-0.26	2.81	-0.73	-0.98	-0.46	0.34
1995	-7.87	0.16	-0.33	-0.17	0.88	-0.73	-0.16	-0.19	-0.33	4.12	-0.66	-0.99	-0.60	0.34
1996	5.71	4.13	0.00	-0.42	1.55	-0.98	-0.24	-0.44	-0.34	9.71	-0.93	-0.61	-0.60	0.20
1997	2.35	0.00	-0.26	-0.36	1.67	0.59	-0.16	-0.69	-0.18	5.71	-0.99	-0.59	-0.77	0.10
1998	-13.36	0.00	-0.33	-0.41	1.26	0.56	-0.21	-0.77	-0.20	0.64	-1.31	-0.86	-0.92	0.00
1999	-0.72	0.00	-0.33	-0.43	1.45	-1.32	-0.18	-3.48	-0.25	5.27	-0.64	-1.02	-0.82	0.00
2000	20.29	0.00	-0.37	-0.40	1.10	0.00	0.00	-2.97	-0.26	12.26	0.26	-0.86	-1.08	0.00

2001	9.95	0.00	-0.23	-0.43	1.32	0.00	0.00	0.00	0.02	5.67	0.11	-0.93	-1.13	0.00
2002	11.51	7.84	-0.28	-0.50	1.39	0.00	0.00	0.00	0.17	7.56	0.00	-0.82	-0.67	0.00
Average	2.52	1.16	-0.22	-0.27	0.67	-0.32	-0.09	-0.41	-0.16	3.32	-0.45	-0.63	-0.33	0.20

Source: International Financial Statistics, IMF (August 2003)

Arising from the above, the terms of trade of most non-oil producing African countries had been unfavourable and deteriorating (Table 7). This is hardly unexpected based on the decreases in the prices of their primary products exploits relative to the prices of their manufactured goods imports. The situation becomes more worrisome since it is expected that as global income rise, the global demand for primary products is likely to rise more slowly than the rise in global demand for manufactured goods. This is because primary products have lower elasticities of demand. Moreover, new synthetic substitutes are being developed for some of the primary products.

4.0 Approaches to the Stabilisation of Commodity Markets

Measures to address the problem of commodity market instability have included supply management (export quota, buffer stocks, management of national stocks, etc), demand promotion, guaranteed prices, support for diversification, vertical coordination or integration through the value chain, raising the profile of commodity problems in international fora as well as the use of risk management instruments.

Export Quotas: This involves the overall control of supply and the allocation of market shares between participating producing members. Export quotas have been a common feature of international commodity arrangements. They may involve restraining exports in order to improve prices following periods of weaknesses. This is particularly important where commodity markets are threatened with or have experienced a collapse of prices as a result of over expansion of capacity.

The success of export quotas depend upon the coincidence of interest between countries which would bear the brunt of production cut backs or stock accumulation and those of relatively small producers. Quotas are also deemed necessary to avoid major disruptions to markets arising from large sudden and temporary additions to market supplies from non-members. The difficulty with export quotas has been the problem of equity in the allocation of national quotas and the domestic problems of aligning production with the quota level. All the major commodity agreements have included provisions which allowed short term adjustments in quotas which are partly automatic and partly bargained.

Buffer Stocks: This involves buying and selling operations by a buffer stock agency, production controls and the imposition of levies to influence the prices received by producers. The buffer stock agency is an official organisation, operating on a national or international basis to stabilise a particular commodity market i.e. maintaining market price at a defined level or within a range. To achieve this, the management of the buffer

stock has access to stocks of the commodity which can be sold to defend the ceiling price and financial resources which are needed to preserve the floor price.

Management of National Stocks of Commodities

Under export quotas, the responsibility for restricting market supplies, whether through production controls or stock accumulation is transferred to national authorities. In many African countries, this function was carried out through the establishment of commodity boards. In Nigeria, for example, the Commodity Boards Decree No. 29 of 1977 established seven commodity boards which had the monopoly over exports. The commodity boards were to: purchase and export scheduled agricultural commodities, stabilise producer prices, promote the prosperity of the producers and rehabilitate the commodities. However, the boards were abolished in December 1985 as most of them were recording heavy losses due to inefficient operations. The liberalization of trade enabled farmers to earn prices closer to the world market prices but exposed them to fluctuations in the international market.

Compensatory Financing

Compensatory financing is a mechanism for providing finance to producers of commodities to cushion adverse effects of fall in commodity prices. In 1963, the IMF established the Compensatory Financing Facility to make low conditional loans to producers experiencing an unexpected temporary decline in export earnings. Then in 1975 as part of the first Lome Agreement, the European Union introduced its own compensatory financing schemes, STABEX and SYSMIN, to ACP countries. No drawings have been made from the CFF in recent years and the EU programs have been terminated. Commodity producers and exporters in Africa have hardly any instruments at their disposal to offset the adverse effects of instability of their earnings. Most domestic stabilisation schemes such as commodity boards which protected producers from price volatility in world markets have been abolished. The use of modern risk management instruments (discussed below) is not yet widespread among the commodity-producing developing countries. In view of the high economic and social costs of the instability of the prices of primary commodities, the Bretton Woods institutions should provide low cost, unconditional financing to low income countries. Therefore, compensatory finance schemes such as stabex, offer an alternative to offset the adverse effects of unstable export earnings.

B. Diversification

In the medium and long term, the best identified solution for problems of unstable commodity markets is diversification. Since supply management schemes cannot address the underlying causes of instability. The objective of diversification would be to discourage the expansion of production while at the same time stimulating the development of alternative lines of activity. Diversification could be within the commodity sector into the production of non-traditional goods with growing markets, or into the processing of commodities and in manufacturing and service activities.

Diversification would lead to a widening of the range of production possibilities within the primary production sector. It would also lead to increased production

spectrum and to a change in the relative shares of primary products in aggregate output. However, diversification takes time and needs adequate financial support. The long term decline in commodity prices and the volatility have constrained efforts to raise investment and diversify production.

C. **Market-based risk management instruments**

There has been a proliferation of market-based risk management instruments which corporations and government bodies, mostly in the industrial countries have been using to hedge their commodity risk. Trading in these markets occur when participants can find commodity price information for a future date and lock on these prices for future delivery. The contracts or transactions in these markets are commonly known as risk management tools. These tools transfer risks from the market participants who are averse to risks to those who seek risks such as speculators. These tools have been used by governments, traders, and in some cases producers, to deal with price uncertainties in commodities such as coffee, cocoa and sugar. The beneficial effects of market-based risk management instruments include:

- The reduction of short-term price uncertainty and the increase of short-term price stability;
- increase in the predictability of commodity revenues to the government and to the private firms;
- militating short-term adverse effects of price volatility;
- adding flexibility in the timing of selling and buying commodities;
- externalising commodity price risks by shifting these risks to international markets;
- reducing the price risk associated with financing commodity projects; and
- obtaining project financing at better terms.

These market-based risk management instruments include forward contracts, futures contract, commodity swaps and commodity bonds.

Commodity Swap

This is a transaction in which one party pays periodic amounts of a given currency based on a fixed price and the other party pays periodic amounts of the same currency based on the price of a commodity, such as natural gas or gold. Under this arrangement, all calculations are nominally based. It is largely medium-term contracts involving exchange of specified cash flows at specified intervals which can be used to effectively fix a commodity price in advance. Markets for commodity swaps have been largely confined to metals and energy.

Commodity bonds

A commodity bond is a financial security in which the return is linked inter-alia to the price of its underlying commodity (O'Hara, 1984). The purchasers of a commodity bond pays the seller at the outset. The commodity bond pay off is a stated quantity of a particular commodity. (For example, a US$1000 face value gold bond may be redeemable at maturity for 2.50 troy ounces of gold). Some commodity bonds also incorporate an option feature by allowing the holder to receive either the nominal face

value or the designated commodity amount at maturity. These commodity bonds are called commodity convertible or indexed bonds. Some commodity bond issues also allow the holder to receive the nominal face value and to choose whether to exercise an option to buy (or (sell) a certain amount of the designated commodity at a pre-determined price at maturity. These commodity bonds are called commodity-linked bonds. Commodity bonds are designated as long-term instruments and do not trade in organised exchanges. (Where are commodity bonds traded?)

(You list the beneficial effects but these market based instruments are managed by very sophisticated firms and are very expensive. How could African countries engage in these activities with a central agency like a commodity board managing the problem?

By participating in commodity bonds and commodity swaps, African countries can reduce the volatility of their revenue. Commodity-linked bond offers considerable potential in assisting African countries to stabilise the prices of their primary commodity exports. Commodity bonds can provide access to financial markets that would not otherwise have been available. It may therefore lead to improved credit worthiness of African countries. Commodity bonds can also provide an opportunity not only for refinancing debt but also for issuing new paper. It can help producers to overcome cash flow problems when they (producers) forego the opportunity gain above the exercise/strike price. In exchange for this foregone opportunity, they receive credit at terms better than they would have otherwise received. Commodity bonds and long term commodity warrants can smooth commodity proceeds, reduce the variability of profits and net worth and improve investment decision making throughout the periods of toughs and peaks. Commodity bonds can link commodity prices (and revenue) to interest or principal payments (expenses). Commodity-producing organisations can thus lock in their profits and partly ensure their ability to service their debt.

There are however, performance risks such as associated with developing countries' participation in this market. This can be obviated if an international organisation such as the World Bank creates mechanisms to allow these countries to raise funds in the financial markets using commodity bonds. The World Bank could, for example, provide commodity loans to commodity producing countries and issue similar commodity bonds in the international markets. This approach could effectively reduce its cost of financing and thus that of the commodity producing countries.

Forward Contract

Forward contracts are primarily short-term agreements in which a buyer and a seller buy/sell an agreed amount of goods for delivery on an agreed future date at a pre-determined price. In other words, each forward contract is an agreement negotiated between a buyer and a seller, customised to meet the specific needs of both parties. Forward contracts are mainly over-the-counter and tailor-made which are settled by physical delivery.

Future Contracts
Futures contracts are an improved variant of forward contracts. They are agreements to purchase or sell a given quantity of a commodity at pre-determined price, with settlement expected to take place at a future date. It requires the delivery of the commodity in a stated month in the future unless the contract is liquidated before it expires. The buyer of the futures contract agrees on a fixed purchase price to buy the underlying commodity from the seller at the expiration of the contract while the seller agrees to sell the underlying commodity to the buyer at expiration at the fixed sales price. As time passes, the contract price changes relative to the fixed.
Futures contracts are standardised in terms of quality and quantity and place and date of delivery of the commodity. Transactions are mostly squared up before the due date of the contract and contracts are settled by payment of differences without any physical delivery of goods taking place. Future contracts involve margins (collateral) to deal with country party risk (failure to meet obligation by either trading partner) where buyers and sellers are required to pay an initial deposit and margin calls when prices move against them.
In futures market, actual delivery of goods takes place only in few cases. Transactions are made in formal exchanges through clearing house and generally closed out before delivery. The closing out involves buying at different times, two identified contracts for the purchase and sale of the commodity in question, with each cancelling the other out.
These contracts can be used for hedging price risk and discovering future prices. For commodities such as coffee, cocoa, rubber cotton, etc, which are produced by many small producers scattered over a wide geographical area, it is difficult to know what prices are available and the opportunity for producer, processor and merchandiser to ascertain likely cost of the commodities and develop long range plans is limited. Futures trading thus provide the industry with a guide to the present worth of commodities for the future.

An example of the successful use of innovative financing with a risk management instrument has been in a large-scale investment in the Ashanti Gold Mines of Ghana. This followed the introduction of an economic recovery program in1983 with measures aimed at encouraging foreign direct investment, especially in the mining sector. The reform included the establishment of legal-regulatory framework, institutional reform and privatisation which helped to attract private investors. The International Finance Corporation (IFC) invested or mobilised directly about US$400 million in the form of loans and equity for the Ghanaian God Sector. This led to increased gold production of Ashanti Goldfields Limited (AGL) and it is supported with an investment programme over 10 years. It also assisted AGL to access international markets forward gold sales. In this regard, with the technical help of International Finance Corporation (IFC), Ghana was able to arrange for financing of its largest gold mines through the forward sales of gold.

5. Constraints and Challenges to the Stabilization of Commodity Markets in Africa

Various efforts to stabilise commodity markets in Africa have faced a number of problems. Some of these problems are discussed below:

The Small Scale nature of production
The existence of small scale production units in most African countries lead to poor quality of products. This also affects products competitiveness. Agricultural products are collected often by traders from many different producers to achieve some economies of scale. The level of inefficiencies in commodities processing also appears to be rather high and has serious implications for costs thereby robbing Africa of its competitive advantage in producing commodities like cocoa, tea and coffee vis-à-vis the new and more efficient producers in Asia and Latin America.

Poor Performance of State and Public Institutions
These have resulted in poor access to productive assets (credit, land, etc) poor physical infrastructure and very deficient educational system with attendant consequences on productivity and competitiveness. African countries face the challenge of increasing and strengthening institutional capacities in order to facilitate efficient provision of public goods and services which tend to put output from the continent at a disadvantage. There are few sufficiently strong and virile producer associations owing to factors such as high illiteracy level and poor funding amongst the small and scattered producers. The commodity markets in Africa need to evolve around vibrant producer associations. Such associations are expected to be the vanguard of product quality. There is therefore the challenge of forming and sustaining producer associations which will among others champion the cause of producers. There is, for instance, the need to have local institutions that can capably aggregate sufficient volume from many small producers to access the international market for risk management instruments. Such organisations would necessarily require significant technical assistance and training to understand the instruments offered and make them simple and transparent for the small and medium scale producers to understand, appreciate and utilise.

Poor Physical Infrastructure
African countries continue to face competitive disadvantage due to its weak and unreliable transport and communication links and its tardy information technology compared to other regions. Poor physical infrastructure typified by poor road networks results in high transaction costs which discourage the export of goods from Africa. For example, net transport and insurance payments absorbed more than 25 per cent of the value of exports for a third of African countries and exceeded 70 per cent for Somalia and Uganda (Yeats et al, 1997). Areas for improvement would include ports operation, cargo handling facilities and telecommunication infrastructure, as well as the removal of non-physical barriers to transportation (e.g. harmonisation of customs and transit documentation) which would reduce costs and increase export competitiveness. This calls for deregulation and privatisation of some key areas of the economy and preparedness to face the challenges associated with such.

Inadequate market information
Most African countries lack accurate and timely information about safety standards or environmental regulations in their export markets. Moreover, these requirements change quickly and they often create confusion, risks and additional costs to exporters. An example in this respect is the diverse and constantly changing packaging or recycling

regulations in developed countries. Exporting African countries often have to fulfil different standards and requirements for targeting different export markets. The Problems of information also exist with respect to labelling. The criteria for eco labelling scheme for example, are mainly developed in industrialised countries without participation of potential trading partners in developing world like Africa. Additionally, there is insufficient participation of African commodity exporting countries in setting international standards in standard setting bodies like the International Standards Organisation.

(v) **Inadequacy of Training and Education**

The competitiveness of agricultural commodity products is highly dependent on the availability of human resources and managerial expertise. Lack of education and training is very often responsible for the poor performance and low productivity in agriculture with its resultant effect on commodity market stability. A related but sorer problem is the exhibition of lack of trust often shown by inspecting teams from developed importing countries in the quality and monitoring function of hygienic standards done by government inspectors in agro-processing plants from the developing countries.

(vi) **Poor Access to Productive Assets**

Access to productive assets such as land and credit continued to limit many small scale producers in Africa in their quest to increase productivity. Access to capital is a major constraint to the small and medium enterprises which are the main engine of agricultural and economic production in Africa. This has constrained investment in equipment and machinery, quality control measures and adequately trained staff, thereby further limiting the growth in production and further processing activities.

(vii) **Low Level of Value Added**

There is low level of value addition. This is because the processing level of commodities produced in Africa is very insignificant. Bulk of the commodities is exported in raw form. For example, out of Africa's annual production of cocoa which averaged 1,776,000 tonnes between 1994/95-1998/99 or 65.9 per cent of world's total, Africa accounted for the grindings of only 279,000 tonnes or 10.4 per cent of total world grindings. At 12.5; 13.7 and 14.4 per cent in 1999/2000, 2000/2001 and 2001/2002, respectively, the continent's share of world cocoa beans grindings remained below 15 per cent. A similar trend holds for most of the other commodities.

(viii) **Lopsided Share of Benefits of Commodity Trade**

The benefits of commodity trade especially for agricultural produce are lopsided in favour of importers. This has further impoverished the local producers and limit their ability to muster financial resources needed for further processing activities. A value chain analysis of the coffee market reveals for instance, that since 1985, a growing share of total incomes in the chain has accrued to economic agents in the importing countries. The asymmetrical character of power in the coffee value chain explains the unequal distribution of total incomes. "In the producer countries, it (power) is very weak as farming is highly fragmented and the destruction of marketing boards further reduces the capacity of farmers to raise their share of value chain rents. At the importing end of the

chain, there are three major residues of power importers, roasters and retailers. They compete with each other for a share of value rents, but combine to ensure that few of these return to the farmer or producer country intermediaries or governments" (Fitter and Kaplinsky, 2001:16). Thus, while African producers have incurred losses in foreign exchange earnings, traders and firms in the higher steps of the value chain have been reaping significant benefits. According to the International Coffee Organisation (ICO), for example, in the early 1990s, earnings by Coffee-producing countries (exports free-on-board) were some US$10-12 billion, while the value of retail sales was about US$30 billion. By 2003, the value of retail sales was US$70 billion, while producers receive only US$5.5 billion. With the large population in the producing countries, the impact of such a price decline has been devastating in terms of poverty aggravation.

(ix) **Production Control Problems**

There is also over production of many commodities of interest to Africa due to increased productivity by some producers in Latin America and Asia as a result of technical advances of these countries. At the same time, the characteristics of most of the products and the production system are such that falling prices do not provide significant reductions in supply at least in the short-run. Falling prices of commodity do not always prompt the expected supply response. Supply responses to price incentives are asymmetric, periods of rising prices stimulate new investments which are not scrapped when prices fall, but rather are simply not replaced when they reach the end of their productive life.

In addition, there is problem of inability to successfully implement regional or continental producers' association agreements – in the sense of raising prices or slowing their fall. Even though the condition for the success of such agreements do not appear demanding, there is a tendency to be over-ambitious to recognise the need to adjust targets in line with changing market conditions, with politics rather economics governing decisions. This however, provides incentive for low-cost producers to cheat, and for those outside the agreement to increase their production and market share. Above all, the issue of maintaining commitment, including financial support to establish and implement a scheme, is very difficult. The issue then borders on how to ensure compliance through enforcement capability, which itself require the cooperation of the importers to police product quality, which in most cases is voluntary. Although this also requires that importers' agreement on quality standards should be specified. This can be administratively very cumbersome, its neglect can lead to the issue of increased 'free rider' syndrome. At the national level, such problems become very apparent. For example, in a survey of 9 commodity producer associations in Nigeria carried out during this study, four of the seven respondents indicated that the major problems that militated against their effectiveness centred on poor funding, poor patronage and inadequate involvement of members in the activities of the associations. Paradoxically, all the respondents depended more or less exclusively on membership dues to finance their activities. This has weakened the associations, particularly, when assistance from government was not readily forthcoming.

Some Specific Constraints to diversification of Commodity Exports in Africa

The need to focus on promoting diversification has been recognised, however, there are many obstacles to its successful implementation by African countries. Some of these constraints are as a result of internal market conditions while some are because of external economic structure including tariffs and non tariff barriers to export diversification.

(i) International Market Constraints

One main obstacle to export diversification by African countries is the range of tariff and non tariffs barriers erected by developed countries. These include increasing demand for quality and phytho-sanitary standards that can be formidable to the prospective new market entrant, particularly on agricultural exports such as fresh fruit and vegetables.

Industrialized countries also give subsidies and supports to their producers thus putting potential exporters from less developed companies at a competitive disadvantage. For example, in the case of cotton, the World Bank reckons that in 2002, the world market price of cotton would have been more than 25 per cent higher but for the direct support of the United States for its cotton producers. Policies and subsidies are put in place, especially by the EU and US meant to stimulate output for export or reduce import needs. Subsidies for cotton production by the United States for example, amounts to US$34 billion annually, with about 40 per cent of production exported.

Oligopolistic structures of many markets also create increasing gaps between international prices and consumer prices, with the benefits of productivity improvements being appropriated largely by intermediaries and/or consumers. There is therefore, apparent tendency for falling international and producer prices not to be reflected in prices in final markets. The implication of this is that final demand does not rise as world prices fall because the price falls are not passed on into final markets. This reduces the attractiveness of diversification. Large vertically integrated multinational corporations with head offices located in advanced countries also often dominate the supply of retail driven markets to the extent that they effectively close out developing countries effort in entering these markets.

(ii) Lack of a large home market

Many African commodity-dependent countries are too small or poor for their domestic markets to stimulate and absorb diversified production based on their raw material resources. Many of these processing facilities are often small and unable to take advantage of the economies of scale. Moreover, the plethora of these processing facilities also heightens the issue of severe competition with respect to the products from similar plants scattered over the continent. Therefore diversification programs which were as a reaction to sudden surges in world prices, which can be temporary, may suffer serious set backs when demand does not increase in a sustained way and commensurately with supply.

(iii) Lack of financing

Commodity exporters in most African countries, face serious problems of lack of financing because of the prohibitive nature of guarantees required by banks and the lack of specialized financial institutions. The need for collateral and difficulty encountered in the perfection of title documents to lands further accentuates constraints of gaining access to credit. There is need to devise appropriate strategies to encourage increase in the level of investment in commodity production and processing, since dynamic and viable commodity sectors result from high level of investment. Domestic processing is also limited due to obsolete machinery, and exorbitant cost of imported inputs. Sometimes considerable sunk costs in current activities, for instance, trees with long gestation periods coupled with lagged and imperfect response to price changes may discourage diversification into new areas.

The low level of investment in the agricultural and mining sectors of many African countries as a result of limited credit from the financial institutions therefore need to be addressed.

(iv) Lack of required skills and sufficient market information

Diversification into new areas may require new skills and training, many entrepreneurs lack skills in producing and marketing alternative products. Moreover, classic externalities associated with investing in labour training may put off individual private sector entrepreneurs. Many producers especially farmers, also lack adequate advice and extension services. The availability of adequate and sufficient market information (prices, markets, quality requirements) is important for entrepreneurs to make informed decisions. Most low income – commodity-dependent African countries, however, do not have access to continually updated information about the market.

(v) Presence of high risk

Diversification into other products entails risks. However, since production is dominated by small producers in Africa, the few large ones are often unwilling to take the risks involved in producing sufficient output in order to reap economies of scale. This is further amplified because many African countries are poor, and the poorer and less diversified the country, the riskier it is for a local producer to diversify, and the riskier it is for a foreign buyer to support any diversification effort. Production risks also increase when the supply of inputs (seeds and agricultural inputs, intermediate products and machinery) is not reliable. Deficient transport and communications infrastructure also introduce additional risks that are related to timing, which is crucial for just-in-time delivery systems that drive many global commodity chains. Another issue is 'supply' instability which is normally associated with variations in harvest conditions, reflecting weather and, to some extent pests. Other factors include disturbances in producing countries such as political disturbances, international disputes, strikes etc, which need to be addressed in order to stabilise commodity markets.

Moreover, many potential diversification activities never take place because the high profit benchmark expected by financiers cannot be reached. This is because the traditional international financing mechanisms based either on a company's track record or on the proceeds of its sales to known buyers, are difficult to use for non-traditional exports. Higher risks mean that the return on an investment needs to be higher in order to make the venture worthwhile.

(vi) **Insufficient Government support**

In many countries, government support to investors, domestic and foreign, are insufficient while appropriate institutional frameworks such as clear property rights are absent. However, it is well known that Government policies regarding access to, and procurement of foreign-patented technology and/or protection of locally generated technology, as well as institutional support for R&D, are key components in determining a country's diversification capacity. Government has also been noted to be best placed to coordinate an integrated programme to supply side responses effectively, as well as undertake quality control of export commodities especially, where there is preponderance of poor and small scale producers.

(vii) **Rekindling Other Stakeholders Interest**

Another problem is how to rekindle and sustain developed economies interests in stability of commodity markets of interest to Africa. For example, the prices of commodity exports from Africa have remained low while most of the existing commodity agreements collapsed or became inoperative and no new ones are being negotiated because of the attitudes of the developed economies who are the consuming nations. The developed countries have reaped substantial benefits from the steadily declining prices for their primary commodity imports from developing (producing) countries, and appear consequently unwilling to consider measures which would raise these prices

(viii) **Coping with unintended effects of diversification**

Often diversification leads to unemployment, especially, where there is diversification into an activity which employs less of labour and results into displacement of labour. Therefore, although there may be increase in production and aggregate earnings, tackling unemployment which results from diversification often create enormous challenges.

Prospects

In spite of the lingering problems identified in the preceding chapter which adversely affected the stabilisation of commodity markets, as well as the various challenges earlier highlighted, the prospects for commodity markets stabilisation is very bright. This is based on the gradual but growing adoption of market reforms by many African countries which is intended to boost efficiency. Such reforms include opening domestic and export markets to competition and putting in place public and private institutions which are consistent with and supportive of private markets. Other elements of the reforms include privatisation of government agencies and owned assets. These are meant to reduce

government involvement in productive activities and increase private sector participation. The adoption of liberal economic policy including deregulation and privatisation is also aimed at eliminating controls, ensure market discipline, encourage inflow of investment and private sector initiatives. Given the importance of commodity market stability to African countries and the quest by policy makers to address the poverty problem, there is need for creation and sustenance of macroeconomic stability and conducive investment climate.

6.0 Suggested Solutions and Conclusion

(1) **Expansion of Trade in Primary Products among African Countries**

There is need to put in place strategies for increased trade in primary products among African countries. This would imply less dependence on the more advanced countries. In order to do this, there is need to recognise reasons why trade in primary commodities have often been skewed in favour of the developed economies. One of such reasons is the concessional terms of trade which some African countries enjoy from their trade relations with the advanced countries which fellow African countries would be unable to extend to them. There had also been elements of cost advantage for African countries to import raw materials from developed countries – especially synthetic materials because they are cheaper than comparative natural commodities obtainable from the African countries. However there is need to work out arrangements which would facilitate intra-African trade in primary and semi processed manufacturers. For example, regional groupings which would lead to the establishment of manufacturing firms which are dependent on raw materials found in neighbouring countries should be actively encouraged. In this regard, bauxite could be imported from Sierra Leone to feed the aluminium smelter plant in Nigeria which was set up to utilise the abundant gas energy. In the same vein, iron ore from Guinea and Liberia could also be sourced for the iron and steel plants. Promoting regional economic integration through enhanced regional and intra-African trade is one of the New Partnership for Africa's Development (NEPAD). NEPAD is expected to build upon existing great potential for intra-African trade, thus creating additional markets for African exports.

(2) **Removal of Restrictions on Market Access**

The issue of reducing barriers to imports of primary products has been a major concern as a result of the complexity of factors involved. There is need for continuing influence to be exerted on particular countries regarding specific restrictions on a commodity-by-commodity basis.

The introduction of the African Growth and Opportunities Act (AGOA) in 2000 and Everything But Arms (EBA) in 2001 by the United States and the EU respectively are expected to improve market access for African countries.

(3) **Improvement of the Competitive Position of Primary Products**

Many natural raw materials exported by African countries have been displaced by synthetic or by other materials produced in developed countries. Thus, the improvement of the competitive strength of primary products is underscored as they compete for the same market with synthetic materials as inputs into manufacturing processes. The competitive position of these natural products, can be improved either by reduction of price instability and assuming steady supply; improving the technical characteristics of the primary products and developing new uses and reducing the unit cost of production relative to synthetics.

In order to improve the technical characteristics of primary products and develop new uses for these products, there is need for intensive research and technical research. This is however, very expensive and may be beyond the ability of individual countries. A way around this, is for regional research centres on commodity-by-commodity basis to be set up and jointly funded by the producing countries. Similarly, reduction of unit costs of natural products can only be achieved through increased productivity; this in turn requires increased current and capital inputs in terms of more investment.

(4) **Demand Promotion**

Arising from difficulties in the coordination of actions on the supply side of commodities, interests have been rekindled on promoting and managing demand. The challenge here include obtaining agreement on programme objectives; generating financial backing for the programme and sustaining promotional programme long enough to generate the desired results. This requires commitment to cooperation by the producers whose interests are seemingly competitive. However, this can be overcome if financial support for market building activities is internationally-based on pro rata basis relative to market share among virtually all producing countries, while the implementation of such activity should be at national level in conjunction with the national commodity associations.

(5) **Greater use of market-based risk management instruments**

The use of risk management instruments among African countries and traders is very rudimentary or even non-existent or still in the stage of trial and evaluation, because of lack of familiarity, restrictive domestic regulations and lack of international credit worthiness. At the same time, it appears unlikely that primary producers, especially small holders that account for the bulk of commodity production can effectively utilise these new instruments of risk management. There is therefore need to build capacities among producer associations such that these instruments can be accessed by the small holders through them. This also includes the establishment of appropriate legal system to facilitate the use of such innovative financial instruments.

(6) **Reactivation and refocusing of International Commodity Agreements**

Even though privatisation, globalisation and liberalisation have taken the centre stage of economic development initiatives, there is need for world wide fora for

the exchange of views by commodity producing, consuming and trading countries. This calls for the rejuvenation of some International Commodity Agreements in order to provide opportunity for policy, market and technical issues to be thrashed out and make them to react flexibly and timely to new challenges. Such refocusing should also strengthen them to act as early warning system for members, tackle newly emerging issues and problems which are important to specific commodity, be a think-tank and undertake prognostic functions regarding new developments, trends and challenges of specific commodities. This would however, entail more private sector involvement – growers, processors, traders and bankers who are stakeholders in commodity business. Therefore, governments should ensure greater private sector representation in official delegation to International Commodity Agreement as is being done presently in the International sugar Agreement by Mauritius, South Africa, etc.

(7) **Creation of conducive Investment Climate**

There is need for greater investment in the productive sectors of African economies, especially further processing and new productions which calls for the creation of a conducive business climate. Towards this, there is need to create efficient and effective linkage between regulatory and institutional frameworks. Moreover, the establishment of a favourable macroeconomic environment and regime assures investors of minimum political intervention and maximum financial freedom, such as favourable tax and foreign exchange retention.

(8) **Improvement in Infrastructure**

African countries seeking to increase the level of commodity processing in order to stabilise prices need to improve on the provision of infrastructure. This includes accelerated privatisation of infrastructure as well as introduction of incentive framework which will further attract the inflow of investment into infrastructure provision and maintenance.

(9) **Improved Access to Funding**

The need for increased access to finance cannot be over-emphasised. In this regards, existing domestic financial institutions need to be strengthened while external sources should be explored. For example, there is need to refocus the use of compensatory financing scheme to support diversification (horizontal and vertical). This should be supported by the guaranteeing of better market access to a certain degree, such as by relaxing the rules of origin and introducing a quality mark. Compensatory financing scheme can also be used to set up a guarantee fund. This will ensure financial liquidity by allowing purchasers to pre-finance producers, finance credit lines for the purchase of inputs and guarantee producers a stable minimum income.

(10) **Promotion of greater private sector initiative**

The initiatives and innovative actions of the private sector have been known to make the commodity sectors dynamic and vibrant. Such initiatives facilitate the

transfer of foreign capital and technology which are vital for developing new commodity and processing industries. There is need therefore, to promote greater private sector initiatives by eliminating price controls, state monopolies in the commodity sectors and establishment of appropriate legal and regulatory institutional framework that would ensure greater private sector initiative and confidence.

Conclusion

In conclusion, it was observed from the paper that there are numerous constraints to the stability of commodity markets in Africa. Such constraints include low production and productivity, poor performance of state and public institutions as well as infrastructure; low value addition and other constraints to diversification. Although African countries are exposed to the various approaches to stabilisation such as supply management, diversification and market-based risk management instrument, not much have been done in utilising the latter two approaches.
However, there is a general consensus that these two approaches hold the key to the transformation of African economies if properly harnessed and utilised. Without doubt, there are challenges which need to be adequately taken care of. Efforts should therefore be made to employ innovative financing methods much more widely. Diversification of production would also need to be vigorously pursued through the introduction and sustenance of reform programmes. Such initiatives would usher in grater private sector participation, increased efficiency in production and greater competitiveness.

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