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GENERAL ASSEMBLY SECOND COMMITTEE

THE GLOBAL COMMODITIES TRADE

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Introduction

The global distribution of productive assets and wealth remains a heavily debated topic within the United Nations System and the broader international community. The economic base of societies such as Iran, Saudi Arabia, and Venezuela is still widely perceived as being petroleum extraction and refining; with global oil prices currently hovering around $100 USD per barrel and with prices widely expected to remain above $100 USD per barrel throughout 2012[1], oil-rich countries may reasonably be expected to enjoy considerable short-term benefits. Given the centrality of petroleum derivatives and related services to the global economy, it is not surprising that discussions of global commodities prices, particularly in highly developed industrialized countries, frequently focus on global oil prices and supplies. Delegates to the General Assembly Second Committee must delve much deeper, though, into the determinants of commodity prices as well as how the considerable volatility exhibited by many commodities impacts broader domestic and global business cycles as well as respective fiscal positions of commodities exporters and importers. Furthermore, delegates to GA 2 must examine whether or not this volatility is truly inherent to commodities markets or whether it stems more from primarily political developments, including changes in government officials, regimes, or structures, as well as the threat or use of economic sanctions and/or military force. Finally, delegates must discuss the potential justifications and utility of funds to assist countries and their respective peoples when commodity prices decline sharply. As the UN Conference on Trade and Development (UNCTAD) is hosting the Third Global Commodities Forum (GCF) in Geneva in

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[1] Diane Cardwell and Rick Gladstone, "Oil Prices Predicted to Stay Above $100 a Barrel Through Next Year" *New York Times* December 28, 2011.

late January 2012, delegates to the General Assembly Second Committee may wish to examine the deliberations, documents, and outcomes of the Global Commodities Forum.[2]

Hard and Soft Commodities and Demand Elasticity

Simply put, “A commodity is a product, which is of uniform quality and traded across various markets.”[3] “Hard” commodities are typically defined by their greater durability and include crude oil, iron ore, coal, and precious metals, whereas “soft” commodities are defined by primarily by their relative perishability and include most agricultural products such as corn, cotton, livestock, rice, soybeans, and wheat. As businesspeople, consumers, economists, and investors examine commodity prices, they must remain cognizant of the primary determinants of these commodity prices, particularly demand elasticity. Demand elasticity, or technically price elasticity of demand, refers to the “responsiveness (or sensitivity) of consumers to a price change.”[4] Consumers tend to be more responsive to price changes when they have readily available substitutes, when they have a longer market period in which to wait for prices to move in a more favorable direction or to develop and/or find available substitutes, the proportion of income spent on the good or service, and whether the good or service in question is considered to be a true necessity or primarily a desired luxury. Given the above definitions for hard and soft commodities and demand elasticity, it is clear that the relative lack of available substitutes for crude oil as well as the heavy, and in many cases increasing, dependence of the world’s largest economies on crude oil are instrumental in driving prices up. For soft commodities such as corn, rice, soybeans, and wheat, prices have fluctuated wildly in recent years, with rapid and sharp increases in prices causing many lower and middle income families to devote greater proportions of their income to meeting basic dietary and nutritional needs. The impact of rising global food prices, commonly referred to as the global food price crisis, must be properly contextualized in terms of both the roles played by commodity prices such as crude oil in driving up food prices as well as the greater strain exerted on local and national economies by higher commodity prices.

Commodities Exporters and Importers: Must be going through some phase…

The particular climatological and resource endowments of countries are often critical foundations for the structures of their economies. Commodity exporting countries have frequently found themselves subjected to dramatic, and even violent, swings in world market

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[2] United Nations Conference on Trade and Development (UNCTAD), “Global Commodities Forum 2012” 2012. Found at: http://www.unctad.info/en/Global-Commodities-Forum-2012/

[3] *InvestorGuide.com*, “What is a Commodity?” 2012. Found at: http://www.investorguide.com/igu-article-1142-investing-basics-what-is-a-commodity.html

[4] Campbell R. McConnell & Stanley L. Brue, *Economics: Principles, Problems and Policies* McGraw-Hill Irwin New York 2005 p. 356.

prices. When commodities prices rise dramatically, exporters may enjoy windfall profits and governments, businesses, and civil society representatives may believe that perpetual prosperity or sustained higher levels of economic and human development will be attained rapidly. Furthermore, commodity-endowed countries may in time become commodity-dependent countries, meaning that their economic fortunes are inextricably linked with the prevailing world market prices of the particular resource endowments for those respective countries. If these societies become highly commodity-dependent, their own populations and observers may wonder if they are in fact afflicted with the "resource curse." When massive new revenues flood into countries, corruption and conflict are far too often the predictable results.[5] Development initiatives aimed at diversifying the economy may be passed over or relegated to lesser priority status. For commodity exporters that either lack significant access to multiple and/or large foreign markets, particularly for land-locked or small island developing countries, dependence upon one major market for commodity exports may increase that exporting country's vulnerability to exogenous price shocks resulting from global or regional economic slowdowns; a recent *Economist* article noted that with the rapid expansion of copper and gold mining in Mongolia, "more than 80% of its exports are minerals, a proportion expected to rise in a few years to 95%."[6] Given Mongolia's landlocked and mostly isolated location, unless it can dramatically increase its access to other markets, its plans and prospects for economic and human development will overwhelmingly depend on China's continued growth and demand for minerals. Delegates to the General Assembly Second Committee may also wish to examine how widely and equitably gains from increasing commodity prices are distributed; if the gains from increased commodity prices accrue primarily or almost exclusively to large corporations and agribusiness conglomerates, these gains are likely to do very little to reduce and/or eliminate extreme poverty and hunger, the first of the UN's Millennium Development Goals (MDG).

For commodity importers, the risks of depending upon needed or desired commodities being available at acceptable prices can also be quite serious. Exogenous price shocks and disruptions to supply can devastate economies and impede sustainable human development initiatives. When food and fuel prices skyrocket, governments and societies must confront difficult decisions about how to best prioritize their increasingly limited financial resources. Governments may see a potentially damaging impact on their balance-of-trade as costly commodities imports fuel inflationary pressures and limit export growth. The World Bank estimates that the dramatic spikes in commodity prices in 2008 may have increased current accounts deficits in a number of developing countries by as much as 5 percent of Gross Domestic Product and that higher commodities prices push more people and households into poverty,

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[5] Josh Kron, "Uganda's Oil Could be Gift that Becomes a Curse" *New York Times* November 25, 2011.

[6] *Economist*, "Mine, all mine" January 21, 2012.

largely because poorer households typically spend over 50 percent of their income on food, even in the best of times.[7] Longer-term debilitating price increases or disruptions in supply may also "induce permanent shifts in production and/or consumption … in net importing countries, with the result that subsequent global supplies may increase and import demands may decline permanently altering the fundamentals of a market."[8]

In 2008, the world economy was wracked by debilitating price shocks, fiscal crises and extreme volatility in commodity prices. When oil prices peaked at nearly $145 USD per barrel, nearly doubling in price from the summer of 2007, politicians, economists, and consumers sought to analyze the causes of this rapid and crippling spike in oil and food prices. Economists Nouriel Roubini and Stephen Mihm note that "the increase wasn't remotely justified by economic fundamentals; rather, it was a function of investment or speculation driven by hedge funds, endowment funds, broker dealers, and various commodities funds that had invested some of their portfolios in commodities."[9] Commodity-exporting firms and states were often quietly ecstatic about these rapid increases in prices, although the savviest commodity producers remained cautious about how the impacts of these rapid commodity price increases would affect the major economies of China, Europe, India, Japan, and North America. These more sober observers turned out to be quite justified in their concerns. As China, Europe, India, Japan, and North America struggled to adjust to these rapidly rising commodity prices at the same time that major financial institutions began to collapse, "in the second half of 2008, demand for oil, energy, food and minerals fell even further, and the effect was comparable to what happened in the Great Depression: commodity exporters in Africa, Asia, and Latin America saw their economies tumble."[10]

Biofuels

Several interrelated contributing causes are also linked to critical consequences of the 2008 and 2011-2012 global food price crises. Rising fuel prices have pushed up the costs of agricultural production for several reasons: 1) rising fuel prices increase the cost of any agricultural production relying on machines, including tractors and combines; 2) transportation costs to and from markets has increased substantially and raised the overall costs of production; and 3) rising energy and fuel prices have motivated many agricultural producers to focus on

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[7] World Bank, *Global Economic Prospects 2009* 2009. Found at: http://web.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTDECPROSPECTS/GEPEXT/EXTGEP2009/0,,contentMDK:22002680~pagePK:64167689~piPK:64167673~theSitePK:5530498,00.html

[8] Alexander Sarris, "Global Food Price Volatility and Developing Country Import Risks" 2010 p. 182.

[9] Nouriel Roubini and Stephen Mihm, *Crisis Economics: A Crash Course in the Future of Finance* Penguin Books New York 2010 p. 123.

[10] Roubini and Mihm, *Crisis Economics* 2010 p. 123.

producing corn and other crops, including sugar cane, to be processed for biofuels. Biofuels have become increasingly controversial as global corn prices have risen and more corn is diverted from human and livestock consumption to be converted to ethanol. According to the UN High-Level Task Force on the Global Food Crisis, "over the last year developed countries spent about $11 billion USD to support biofuel production, mostly on food crop feedstocks."[11] Countries that are enjoying greater economic prosperity, or at least that were before the most recent financial panics struck global stock markets, because of greater returns for biofuels have consistently resisted any imposition of limits on biofuels productions and vehemently dispute the idea that biofuels are responsible for any significant percentage of the recent food price increases. Brazil particularly disputes that biofuels are responsible for rising global food prices; they consistently note that "Brazil's sugarcane-based ethanol can yield 10.2 units of renewable energy per unit of fossil fuel input, whereas US-backed corn ethanol yields a mere 1.4"[12] Just ahead of the FAO's May 2008 summit on food prices and agriculture, "America's Secretary of Agriculture, Ed Schafer, claimed that ethanol accounts for only 2-3% of the increase in world food prices – a contentious view (the International Food Policy Research Institute – IFPRI says 30%) but one that left the summit irreparably and paralyzingly split over biofuels."[13] While biofuels may occupy an important element in any comprehensive plan to address energy price increases and further instability, it is essential that developed and developing countries reach at least a minimal consensus as to the impacts of biofuels on the global food price crisis.

The Risk Premium

Commodity prices are frequently subject to "risk premiums" because of the possibility of disruption of supply due to armed conflict, economic sanctions, and natural disasters. In early January 2012, continued disputes between Iran and the European Union (EU) and the United States have led to Iranian threats to essentially shut off the Strait of Hormuz and thus prevent major oil shipments from the Persian Gulf to reach the EU, Japan, and the US.[14] Oil prices are not the only commodity prices subject to considerable, and potentially dangerous, risk premiums, however. Staple agricultural products, including corn, rice, and wheat, as well as crops such as cotton and vital industrial minerals have also faced daunting price volatility in recent years, at least in part because some investors have sought to purchase commodities as a hedge against

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[11] UN High-Level Task Force on the Global Food Crisis, "Comprehensive Framework for Action" July 2008 p. 32.

[12] Marcelo Leite, "Demon Biofuel? Brazil Disputes Attacks" *The InterDependent* Vol. 6 No. 2 Summer 2008 p. 15.

[13] *The Economist*, "Only a few green shoots" June 5, 2008.

[14] Clifford Krauss, "Oil Prices Would Skyrocket if Iran Closed the Strait of Hormuz" *New York Times* January 4, 2012.

unstable stock prices.[15] Natural disasters such as earthquakes, floods, and hurricanes can devastate productive areas as well as the shipping infrastructure and routes necessary for products to reach their intended markets but other severe weather events, including prolonged droughts and freezes, can disrupt supplies and shipping and therefore contribute to increased risk premiums for consumers. Changing consumer tastes as well as disputes over trade policies have recently combined to drive up orange juice prices in the United States as sales in the US have fallen by 9% in the last year and the supply of oranges has also been adversely affected by weather in southern Florida and allegations that Brazilian farmers may have sprayed their crops with fungicides that are banned in the US.[16]

Global Commodities Forum

The Third Global Commodities Forum (GCF) will be a critical high-level and ministerial meeting that will focus on the theme of "Harnessing Development Gains from Commodity Production and Trade." The continued, and at times drastic, volatility in global commodity markets imperils sustainable economic and human development for all societies but it is especially perilous for commodity-dependent developing countries (CDDC). The UN Conference on Trade and Development (UNCTAD) is hosting the Global Commodities Forum (GCF) but it is essential that delegates from the General Assembly Second Committee collaborate closely with their colleagues and partners in UNCTAD, the Economic and Social Council (ECOSOC), the Food and Agriculture Organization (FAO), international financial institutions (IFI) such as the International Monetary Fund (IMF) and the World Bank Group, and regional organizations and regional development banks. Furthermore, the discussions at the Global Commodities Forum will build upon previous efforts from GA 2, including General Assembly resolution 64/192 (A/RES/64/192).[17]

As the delegates converge on Geneva for the Third Global Commodities Forum (GCF), they must reflect not only upon the vital factors directly impacting commodity production and/or extraction, including adverse effects on the natural environment, but also the increasing "financialization" of commodities. As UNCTAD Secretary-General Supachai Panitchpakdi noted in the Global Commodities Forum 2011 Report, "although its long-term effects on prices were hard to isolate, it appeared that financialization had exacerbated commodity price swings."[18]

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[15] Graham Bowley and William Neuman, "Companies Hedge Bets at a Cost to Consumers" *New York Times* May 5, 2011.

[16] *Economist*, "A war effort gone wrong" January 12, 2011.

[17] UN General Assembly (UNGA), A/RES/64/192 "Commodities" February 19, 2010.

[18] UN Conference on Trade and Development (UNCTAD), "Global Commodities Forum 2011 Report" Geneva 2011 p. 3.

Unregulated or under regulated trading in derivatives markets, including the now infamous credit default swaps (CDS) and collateralized debt obligations (CDO), is widely believed to be a major cause of the global economic recession and financial crisis that has hampered development initiatives and bankrupted governments, firms, and individuals over the past 4 years. Increasing the financialization of commodities, particularly in an environment of continued deregulation, poses serious concerns for commodities producers, particularly small-scale producers, consumers, and governments. Many commodities are experiencing considerable and sustained increases in demand as a result of critical and continuing demographic pressures associated with growing populations as well as the massive growth in demand by the populations of the world's two largest countries, China and India. In 2008, as the demand for hard commodities like crude oil spiked at the same time that prices for soft commodities staple foods such as corn, rice, soybeans, and wheat experienced sharp increases, investors purchased large numbers of over-the-counter (OTC) derivatives as well as at least $200 billion worth of commodity index funds. These large-scale purchases of derivatives and commodity index funds created significant spillovers between the prices of now inextricably interrelated commodities, making it nearly impossible to accurately disaggregate commodity price data and determine the prices of individual commodities.[19] Through at least April 2011, investment in commodity index funds and associated derivatives continued apace[20], particularly as commodities-related financial instruments were frequently viewed as safer investments. In early May 2011, commodities prices fell unexpectedly, particularly as fuel prices declined[21]; this potential boon for consumers was, however, short-lived and not nearly as dramatic as the price increases of the preceding months and years.[22]

Debates within the Global Commodities Forum (GCF) will likely examine what market and policy instruments provide the greatest possibilities of mitigating the adverse impacts of commodities market volatility while still preserving the benefits of trade liberalization. Embedded within these discussions of how to reduce commodities prices volatility for producers, consumers, and governments will be potentially contentious arguments over the national systems of price supports and subsidies, especially in the context of reduced government expenditures in

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[19] UNCTAD, "Global Commodities Forum 2011 Report" 2011 p. 8.

[20] John F. Wasik, "Stepping Carefully in Commodities Markets" *New York Times* February 9, 2011.

[21] *Associated Press*, "Markets Slip as Oil and Commodities Drop" May 11, 2011.

[22] According to UNCTAD's monthly composite index of all commodity prices, April 2011's composite index was 308; May 2011's index fell to 296 but the index went back up to 304 by July 2011. Commodity prices did fall towards the end of the year, as frequently happens, but the composite index is not expected to fall below late 2010 price levels, meaning they will remain considerably above 2008-2009 price levels for the foreseeable future. UNCTADSTAT, "Free market commodity price indices, monthly, January 1960 – November 2011" 2012. Found at: http://unctadstat.unctad.org/TableViewer/tableView.aspx?ReportId=10241.

many countries. If regulation of commodities index funds and commodities-based derivatives would create distortionary effects in financial markets, price supports for domestic producers and subsidies for exporters as well as consumers will also create distortionary effects in global food and energy markets. Amidst these intricate philosophical and policy discussions of the appropriate levels of government intervention into commodities markets, policymakers must constantly remind themselves of the underlying theme for Global Commodities Forum 2012 (GCF): how to best distribute the gains from commodities production and trade to further sustainable human development.

Common Commodity Fund

In 1989, UNCTAD established the Common Commodity Fund (CCF) to assist countries, especially commodity-dependent developing countries (CDDC) and the Least Developed Countries (LDC), by financing development projects that aim to increase market access for their commodities, design and implement more effective competition and marketing policies for these commodities, and to construct the necessary infrastructure for more effective commodities production and distribution. Originally called for in 1980 at the United Nations Negotiating Conference on a Common Fund under the Integrated Programme for Commodities, the Common Commodity Fund now has 105 member states as well as ten institutional members, including the African Union (AU), the Caribbean Community (CARICOM) and the European Union (EU). Current Common Commodity Fund (CCF) projects include the "Sustainable Credit Scheme to Promote Scaling Up of Enhanced Coffee Processing Practices in Ethiopia and Rwanda," the "Pilot Rehabilitation of the Coffee Sectors in Nicaragua and Honduras" project, and the "Technical assistance for the upgrading of the small-scale fisheries and their integration in the International Trade" project aimed at improving the efficiency and competitiveness of small-scale fisheries in Djibouti, Morocco, and Yemen.[23] These projects typically involve multiple sources of financing, including Common Commodity Fund (CCF) grants, counterpart contributions from the host country cash and promissory note contributions, referred to as Special Drawing Rights (SDR), to the Common Commodity Fund (CCF), and co-financing grants or contributions from related international agencies or donor governments. According to the most recent annual report from the Common Commodity Fund (CCF), at the end of 2010, the CCF held cash reserves of approximately $117.4 million USD and had equivalent Special Drawing Rights (SDR) amounting to $124 million USD.[24] As the Common Commodity Fund (CCF) seeks to scale up existing commodity enterprises and projects, it would seem logical that

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[23] These three projects represent only a small sample of the ongoing projects of the Common Commodity Fund (CCF). Delegates may access a complete of the ongoing projects at: http://www.common-fund.org/data/documenten/Ongoing.10.pdf.

[24] Common Commodity Fund (CCF), "Common Fund for Commodities Annual Report 2010" Geneva 2010 p. 88.

the General Assembly Second Committee would encourage increased voluntary contributions to the Common Commodity Fund (CCF).

Lessons Learned from Recent Commodities Price Volatility

As the UN System, UN member states, commodities producers, exporters and importers, and consumers strive to adjust to volatile commodities markets conditions, it is essential that all of these actors analyze the factors leading to volatile commodities prices and devise solutions to minimize this volatility and its potentially catastrophic effects. Regulation of commodities investment funds is one possibility but recent legislation in the United States and other countries may be intended to limit regulation of commodities funds speculation.[25] International organizations, governments, producers, and consumers may also influence policy responses to volatile commodity prices by demanding, establishing, and/or scaling up funds and programs that provide assistance in times of severe commodity price volatility; the Food and Agriculture Organization (FAO) suggests that governments consider establishing and/or scaling up "safety nets for poor consumers" so that they may afford vital staples while still allowing domestic food producers to enjoy the benefits of higher world market prices.[26] Furthermore, when commodity prices, especially food prices, rise, it is vital that significant gains are realized by the world's poor and small-holder farmers and not strictly by agribusiness conglomerates. Lowering communication and transport costs by improving infrastructure will greatly assist poor and small-holder farmers in commodity-dependent developing countries (CDDC). International financial institutions (IFI) may also assist at critical moments by providing loans and credits to net food-importing countries when rapid food price hikes exacerbate balance-of-payments deficits.[27]

Conclusion

Volatile commodity prices present enormous difficulties for the global economy. Rapid price shocks may engender cost-push inflationary pressures that ultimately decrease aggregate demand, increase unemployment, and may entail long-term structural shifts in production. As commodity price fluctuations force governments, firms, and civil society representatives to reevaluate their expenditures, and in some cases business models, these same actors must confront potentially painful choices. Delegates to the General Assembly Second Committee will want to build upon the debates and documents from the Third Global Commodities Forum (GCF) in Geneva in late January 2012. Consideration of further scaling up of the financial and

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[25] Gretchen Morgenson, "Speculators Get a Break in New Rule" *New York Times* September 24, 2011.

[26] Food and Agriculture Organization (FAO), *The State of Agricultural Commodity Markets: High food prices and the food crisis – experiences and lessons learned* 2009 p. 42.

[27] FAO, *The State of Agricultural Commodity Markets* 2009 p. 47.

technical capacities of the Common Commodity Fund (CCF) will also be an integral component of a comprehensive set of resolutions aimed at mitigating the effects of volatility in commodity price markets. Ultimately, addressing global commodities price volatility is absolutely critical to addressing issues of sustainable economic and human development and reducing and/or eliminating extreme poverty and hunger.

Guiding Questions:

What is the impact of commodity production on your country's economy? Is your country a commodity-dependent developing country (CDDC)? What have been the impacts of volatile commodity prices on your country's economy, including on employment as well as your government's fiscal situation?

Is your country a member state of the Common Commodity Fund (CCF)? If not, does your country plan to join the CCF in the foreseeable future?

What are the best ways to mitigate and/or to prevent excessive volatility in commodities prices markets? Do countries need to consider expanding domestic legislation and international agreements to reduce speculation and high volatility in commodities markets or will these regulations become too potentially onerous and distortionary?

What policy measures have your government enacted to address commodity price volatility? What have been the results of these policies for domestic commodity producers and consumers? How have these policies affected your country's current accounts balance?

How widely and/or equitably distributed are commodity revenues in your country? How have recent commodity price fluctuations affected this distribution of commodity revenues?