**ROBERT THOMPSON**
**Director of Rural Development, World Bank**
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Good morning ladies and gentlemen. I'm very pleased and honored to be invited to address this important meeting about the issue of 'Strategies for Developing Countries Dependent upon Primary Commodities'. This is very timely for us at the World Bank since we are in the midst of reviewing the Bank's strategy vis-à-vis agricultural and rural development.

To open up my talk this morning I'd like to start by reviewing some numbers. There are approximately one and one quarter billion people in the world who live on less than one dollar a day and seventy percent of them live in rural areas and most of them are farmers. Most of them live in countries heavily dependent on production of primary commodities both for their role in GDP generation and export revenue generation, as well as, in supplying income -- what income there is for the lowest income members of their societies. In the lower middle income countries, there is heavy dependence on export earnings from primary commodities. In Africa, 80 percent of export revenues come from agriculture and energy commodity exports. In Latin America it is 50 percent and Asia it is 25 percent. More than 50 developing countries depend on less than three commodities for more than half of their export earnings. This trend is especially true in the case of the heavily indebted poor countries, so called 'HIPC' countries.

Well known to this group is the reality that the volatility of international commodity prices, easily fluctuating from 50 to 150 percent over a very short number of years, creates large shocks to the macro economy, to GDP, to the balance of trade, to the exchange rate, to inflation rates, but also creates great shocks for the incomes of their farmers, many of whom are the poorest members of their society. Small farmers whose family income depends on agriculture commodities can easily see the large variance in those incomes, jumping from year to year and driving them down below the subsistence level at times. In fact agriculture is an inherently risky business with both commodity price volatility and yield variability associated with weather conditions.

Of course, farmers are not the only ones affected by the volatility of commodity prices. Food consumers are as well as the price of food varies in response to agricultural price shocks, and of course the poor spend the largest fraction of their incomes on food, they therefore are particularly hurt from the volatility of prices.

So considering all of these observations, about a year ago at the World Bank we began a review of our agricultural and world development strategy. Another reason we began this review was that last year World Bank lending for agricultural development was the lowest in the history of the World Bank. For the first time in the history of the Bank, lending in this area was below 10 percent of the new lending going into our portfolio. At the same time, most bilateral donors of official development assistance have also reduced their investments in agricultural development over the last twenty years. Most countries themselves have reduced public agriculture research investments over this period, although, at the same time, the private sector has increased it's investments somewhat to partly offset the decline in public investments. Adding to this, most developing countries have a pronounced urban bias in their public investments for the purpose of economic development that favor the cities, particularly the large cities, over their rural areas.

We considered also a number of mega trends that are going on as background of this review of our strategy. Obviously one of these, and one that this group is painfully aware of, is that real commodity prices are very low. In fact, real commodity prices were the lowest in the last several years that they'd been in over a century. Real commodity prices fell by two-thirds in the course of the twentieth century. This is in part due to rapid technological change which has raised productivity in the agricultural commodity production business. More than 200 years ago, Thomas Malthus predicted whereas population would grow geometrically, agricultural production would only grow arithmatically and therefore the world would run out of food. Similar conclusions were reached by the Club of Rome around the time of the World Food Summit in 1974. Lester Brown frequently announces this as a vision of reality, but what Thomas Malthus, the Club of Rome and Lester Brown have all ignored is the rapid technological change going on in this industry and the power of technological change to raise productivity and expend supply of agriculture commodities faster than demand has grown, putting downward pressure on prices.

But it's not only technological change that has reduced commodity prices. OECD recently released a report that showed that the high income countries of the world provided income transfers to their farmers totalling 329 billion dollars last year. That's more than 900 million of the entire wealth on average of the average citizen in those countries, while at the same time, the farmers in the low income countries of the world are often among the lowest income members of their societies.

As we've reviewed our rural development strategy, we've of course taken off from the course of departure that the World Bank's principle mission is poverty reduction. The World Bank will fail to achieve it's poverty reduction objectives until and unless it can do a better job of reducing world poverty. In reviewing our experience and the experience of both presently high income and middle income countries, we conclude that no country in the world has achieved rapid broad-based economic growth without doing something about developing it's agricultural sector. It is necessary to prime the pump of economic development in agriculture when the bulk of the people are employed there and when that sector generates the largest fraction of national income. And, in fact, it is quite clear that an additional dollar of purchasing power put in the hands of a low income farmer will have a significantly larger employment multiplier in a developing country than the same dollar of additional purchasing power put in the hands of a low income urban resident. This is because the farmer will spend most of the increment in income on labor intensive goods that can be produced locally, whereas, the urban resident will spend a significant amount of that dollar on capital intensive goods and goods that are imported. Therefore, you have much greater leakage from the additional dollar of purchasing power put in the hands of the urban resident. That's not to say of course that it's not important to reduce urban poverty – of course it is. But the fact remains that most developing countries have a pronounced urban bias in their own investments in national economic development and it has become increasingly clear that the money they borrow from the World Bank and other institutions is also being focused on development in the cities, with a widening gap occurring between urban and rural incomes and slower than potential rate of economic growth overall.

As we've reviewed this, the experience of our client countries, another conclusion has become clear. To solve the problem of poverty in rural areas it is absolutely essential to create non-farm employment in those rural areas as well as in faraway cities. If the only place we create non-farm employment is in faraway cities, we'll have unsustainable cities as too many people move too quickly from rural areas to the urban areas. So we end up with a situation where increasing productivity in agriculture is a necessary condition for solving the problem of world poverty, but it is not sufficient. We have to also create non-farm jobs, both in faraway cities as well as in the rural areas themselves, to permit diversification of the income streams earned by low income farmers.

With that background let me turn more specifically to the topic at hand, that is strategies for developing countries dependent on primary commodities, and in particular speaking on primary agricultural commodities. Obviously while you are most interested in coffee, we're looking at the full range of agricultural commodities. In fact, the Bank has done relatively little in investing in tree crops for a number of years, but a number of the principles can be generalized across agricultural commodities more broadly.

The first observation I'd make is that the world is rapidly approaching the point where 20 percent of the farmers in the world produce 80 percent of the output, the other 80 percent of the farmers in the world collectively only produce 20 percent of the output. This bifurcation of the structure of agriculture has tremendous implications for the future of this industry. The 20 percent of the world's farmers who collectively produce 80 percent of the output are quite well served by private sector investments and agriculture research. They are quite well served by the multinational agribusiness companies in supplying their inputs and marketing their products, they're doing reasonably well, thank you. But it's the 80 percent of the world's farmers who collectively only produce 20 percent of the output that we're particularly concerned about at the Bank, because that's where the majority of the world's poverty resides. If we are going to be successful there, we've got to be sure that there is technology developed to meet their needs, that there is a marketing system developed to meet their needs, the public policies are developed to meet their needs, and I'd like to take each one of these in turn.

First, on technology. Starting about twenty years ago, a decline in public investments and agriculture research was set in motion as the private sector was equipped with greater patent protection to protect their intellectual property from the investments they might make and biological materials, comparable to the patent protection they'd enjoyed for more than a century for mechanical technologies that they'd developed. And, as a result, the proportion of the world's agriculture research that was done in the private sector expanded rapidly, as the public sector retreated from it's investments. This is meeting the needs of the farmers in the high income countries quite nicely, thank you, because the companies are going to invest in research that will produce technologies that can be sold to farmers in high income countries who can afford to pay, farmers who can pay in hard currency. But the farmers of the developing world are being left behind. Those global companies simply don't have the economic incentive to invest in solving the problems of low income farmers in low income countries. At the Bank we believe that we have to do something to reverse this declining trend in research that will benefit the smaller than average farmers, particularly located in the developing countries of the world.

In their marketing systems, the World Bank and the IMF have pressured developing countries to privatize their parastatals, to remove these seemingly highly inefficient, high cost marketing institutions. But what was forgotten, when the pressure was put on the developing countries to eliminate the parastatals, was that one of the functions they performed very well was linking the smallholders into the regional and national markets. When the parastatals were eliminated and the private sector took over, to the extent that the private sector took over, it is serving the needs of the larger than average farmers quite nicely, but we're finding the smaller producers more and more marginalized. As marketing for them by definition is high cost marketing, they often produce small lots of product, variable quality dispersed over geographic distances, all of these attributes describe high cost marketing. The parastatals absorbed the marketing cost. The private sector has been unwilling to pick them up.

At the Bank we are trying to find ways to be more creative and stimulating agricultural marketing co-operatives and farmer associations to serve the needs of the small farmers. This form of agricultural business played an important role in the agricultural development of high income countries of Northern Europe, North America and Japan, but yet the developing world is strewn with failed agricultural co-operatives. We are trying to understand better why. What will it take to be sure that we have efficient, agricultural marketing co-operatives or producer associations through which farmers can buy their inputs competitively, can sell their products competitively, and end up better off than they are in the present environment where they are underserved.

But there is a necessary condition, that is forgotten in many developing countries, before this marketing system can be very well developed, and that is the gross under investment that is being made in rural infrastructure by the governments of virtually every developing country. The state of roads is miserable, causing transport costs to be exorbitantly high and as a result the price of inputs the farmers pay is much higher than the world market price, and the prices they receive for their products are significantly below the world market price. I was in Western Kenya a few months ago and visiting with some farmers who were paying 500 percent of the world market price for their fertilizer, five times the world market price. This was mainly because of the high transport cost associated with the dismal state of rural roads. If governments either through their own resources or through resources borrowed from international lending institutions like the World Bank, don't invest more in rural infrastructure, they simply cannot reasonably expect their agricultural sector to develop in order to contribute to poverty alleviation in those areas.

Telecommunications is another severe problem in rural areas. The first talk this morning focused a lot on information technology, the Internet and so on. But we don't even have the most basic phone service in many rural areas of developing countries and without even phone service so that farmers can know what different markets are paying, we cannot expect agriculture markets to work very well. Farmers are likely to be open to much greater exploitation by unethical middlemen who can play on the disadvantage that farmers have by simply not knowing what the prices are in other markets.

Now turning to other forms of public policy, in particular, price policy. It's ironic that in the high income countries of the world we have such massive subsidisation of agriculture, 329 billion dollars of income transfers last year to OECD farmers, when those farmers numerically are such a small fraction of their society, in many cases as low as 2% or less of the workforce in those economies. On the other hand in developing countries where farmers are numerically such a larger group, agriculture is taxed out. In fact, there was an important study at the World Bank in the early 1980's that showed the farmers in developing countries were severely taxed, paying significantly higher than the world market price for their inputs and receiving significantly less than the world market price for their outputs and as a result the already low incomes of farmers were depressed even lower, making them even less well off, vis-à-vis their urban brethren.

In those same developing countries, there have frequently been attempts to stabilise internal prices through the parastatel organisations that exist. As developing countries have liberalised their economies, replacing the peristatles with private sector firms, opening up their economies to permit international prices to penetrate into the domestic markets, we've seen significant increases in variability in prices received by farmers in those developing countries.

The variability of prices is always a problem in commodity markets. It's a natural aspect of the annual supply and variability of agricultural commodities in response to variable weather conditions from year to year in the face of inelastic global demand. So we expect a certain amount of volatility, but what we get is even greater or amplified volatility of international prices as a result of the predominance of tariff rate quotas in use throughout the world as a result of the Uruguay Round Agreement in Agriculture which effectively cut the link between internal prices and world market prices in most of the importing countries. And, as a result, international prices become even more volatile than they would be in the absence of those tariff rate quotas. So we have subsidies in high income countries that stimulate larger production than would otherwise occur, reinforced by export subsidies that depress the average level of international agriculture commodity prices and the prevalence of tariff rate quotas amplifying the variability in those prices. Reduce the average price and increase the variance and the farmers in developing countries, and in particular the low income farmers, end up on the whip end of that volatility.

Buffer stock schemes have been tried a number of times at national levels as well as the global level but they've simply never worked. There is an irresistible temptation to politicise the access price and the acquisition price and the release price and, as a result, buffer stocks tend to grow in size and not get released back into the market, and ultimately the buffer stock schemes disintegrate as they simply cannot afford to maintain the inventories with the release price set too high and the acquisition price set too high.

At the global level, the same situation has occurred as has occurred at the national levels. Attempts to support prices by exporting countries, by restricting supply to the market either through production controls or marketing controls or both has also failed. In fact, more often than not they have stimulated larger production and less efficient producing areas that ultimately have created greater competition and further downward pressure on prices in the global market. Attempts by government and by international organisations to artificially support or artificially stabilise international prices have in virtually every case failed. Clearly at the national level governments need to try to create a strategy for economic development that diversifies their economy so they are not so heavily dependent for their GDP generation and balance of trade generation on production of one, two, or three commodities.

Diversification is also important within the farm family income. I've already mentioned the important role that non-farm incomes play in the income generation of farm families in most of the high income countries of the world and, in fact, it surprises a lot of people that even in the US 75% of the farm families earn more than half of their family income from non-agricultural sources. In Germany, it is 80% and in Japan it is 90%, so why should we expect it to be any different in low income countries? A small farmer has very few options for how to increase and how to stabilise family income. If a farmer only has one or half a hectare of land there are few options available to increase income. Either increase the land area some how, or increase the value of the hectare of what he or she grows, or diversify the income by gaining non-farm employment.

So diversification of the farm family income is also important, but at the Bank we have several projects going on to try and find ways to help farmers in low income countries, and particularly the smaller than average farmers, benefit from market based forms of insurance. There is a weather derivatives project going on to try and create viable yield insurance to help stabilise incomes, or help reduce the variance in income associated with the crop yield variability. The Bank is also active in cooperation with the International Task Force on Commodity Price Risk. A group of private sector firms, commodity traders, and academics who are trying to find ways to make it possible for low income farmers and low income countries to avail themselves of the benefits of put options price insurance. Clearly large farmers in most countries have the marketing sophistication to take advantage of the futures and options markets that exist. Small farmers frequently don't. Obviously individual small farmers are not going to buy put options directly themselves, but the market intermediaries, whether they be agriculture co-operatives or other traders with whom they interface, should be able to lay off part of their risk by using those options markets. In fact, as we observe the reality in rural areas in many of our client countries, farm prices of commodities are low not only because transport costs are so high, but also because the market intermediaries confront such large price risk against which they have no capacity to insure that they have to charge a larger risk premium for their marketing services. As a result, the large risk premium charges added to the large transport costs that are incurred means that the farm prices of commodities are so low it depresses farm family income, but it also depresses the incentive for those farmers to produce as efficiently or as much agricultural commodities as they might otherwise produce.

Product differentiation is also a possible way for commodity producers to increase their income. Anybody who is a commodity producer by definition is a price taker. So if you can differentiate your product in the eyes of the consumer, there is some potential to increase earnings either at the national level or at the local level.

However, commodity differentiation does have it's limits. Niche markets are great, they provide opportunities for a limited number of people to earn additional income, but we have to remember that niches fill fast. So whereas there may be an attractive market for a small group of exporters, say in the organic coffee market, it is not a market that is going to be a panacea for all producers. So we are working hard at the Bank to try and revise our agricultural and world development strategy, to find ways to assist the low income producers and low income countries. Through improved technology, through improvement in their marketing system, in the marketing infrastructure that serves them, they will increase the net returns that those farmers can earn from agriculture, but also at the same time, helping them diversify their income beyond agriculture itself, helping those countries to also try and remove perverse disincentives that the farmers suffer under today associated with national price policy interventions.

But I, like Professor Stiglitz, also feel that there are important things that should be done at the global market. We need to do everything possible to create an environment that maximizes the likelihood of broad-based economic growth in developing countries, economic growth that reaches the poorest members of their societies. The developing countries have not benefited as much from trade liberalization under the GATT as have high income countries. There were some positive outcomes of the Uruguay Round Agreement on Agriculture, but there were also a number of negatives as I indicated, such as the tariff rate quotas that have come to fragment the global agricultural markets and accentuate the variability of international prices. We also know that the cascading of protection, where imports of processed forms of agriculture products confront higher tariffs than the raw forms of those agriculture products, means that the developing countries are impeded from developing the value adding industries, and this is certainly an important problem in your industry.

We need a WTO round of agricultural trade negotiations that reduces the subsidies in high income countries both directly to producers as well as to their exports of agriculture products, so that we can remove this source of artificial depression of world market prices. We also need, though not just agricultural trade negotiations, a full round of trade negotiations in which all commodities, all products, in all countries, will simultaneously be considered. Developing countries themselves don't have much to give in terms of liberalization of agricultural trade alone. Their markets are much more attractive to exporters in high income countries then the manufacturing and services areas. So we believe that we do need progress in agriculture trade negotiations but we believe for developing countries to benefit as much as they need to, there should also be a full round of trade negotiations where we have the capacity to trade off benefits in services and manufacturing goods vis-à-vis agriculture.

So to summarise, in the short run, World Bank lending to agriculture development is extremely low, we are reviewing our current strategy for agriculture development lending. Probably in this environment of extremely low international commodity prices, it may be just as well that our lending in support of agriculture development is no higher than it is. On the other hand, with world's population is expected to grow by almost 50% by the middle of this century, and if we have broad-based economic growth, it lifts several hundreds of millions of presently low income consumers out of the poverty in which they presently live. The demand for agricultural commodities will grow and, in fact, we believe the global demand for agriculture commodities will be about double by 2050 what it is today. This means that agricultural commodity price depression that we are in today is likely to be alleviated, in fact there is an old saying that the best cure for low prices is low prices and the best cure for high prices is high prices, and I think that will continue.

I'm a technology optimist. I believe that Thomas Malthus will continue to be proven wrong, that we will have a doubling of agriculture production in this planet by the middle of the century without this causing extremely high agricultural prices. We will continue to have volatility of agriculture prices as there are periods in which supply expands faster than demand like the present and other periods when demand expands faster than supply. But I don't expect the long term trend in agriculture commodity prices to change from what has happened in the last century, that is that over time there is likely to be long term secular trend downward in commodity prices as technology continues to raise productivity, making it possible for both consumers to benefit in the form of low cost food but also for producers to benefit from higher net returns. To do this it is going to take greater investments in agriculture research, it's going to take larger investments in the infrastructure necessary to serve the agricultural sector, and it is certainly also going to require that developing countries are given the access to high income country markets, the opportunity to compete on a level playing field in international markets competing with efficient farmers in other parts of the world and not with the Treasuries of other governments.

And there is one reason to be optimistic, in the next WTO trade negotiations, the developing countries will come out better than they have in the past. For the first time, developing countries make up the majority of the members of the WTO. They never represented the majority of the countries in the GATT. Because they represent the majority of the countries in the WTO and because the WTO reaches it's agreement on the basis of consensus, without the participation of the developing countries in the agreement, there will be no agreement. So we believe it is important to do everything we can to help developing countries participate more effectively. We're trying to do that through analytical support as well as in capacity building to help our client countries participate more effectively in those negotiations.

But at the same time the governments of developing countries themselves also have to remove some of the perverse disincentives they lay out in front of the farmers. They suppress the prices they receive, suppress the incomes that farmers receive and under-invest in the infrastructure that serves those farmers. If we can make progress at both the national level in developing countries themselves, as well as, globally through the international negotiations, I believe there is a bright future for commodity producers in the developing world.

And finally, we believe that rather than government intervention in price formation that use of market instruments to ensure against price and yield risk wherever possible should be used. Thank you very much.