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Possible Effects of the Common Fund

by Joachim Betz, Tübingen*

After five years of tough negotiations at numerous conferences about an Integrated Programme for Commodities (IPC) the participating countries agreed in March 1979 on basic and operational regulations for the key instrument of this programme, a Common Fund. In its present version it is closely related to the ideas of the "hard-liners" among the industrialized states and – what is most important – seems incapable of contributing significantly to a solution of the global investment, diversification and price stabilization problems in the commodity sector.

The source of finance model of the UNCTAD secretariat by which the developing countries took their stand was based on the assumption that lack of finance had been "a major obstacle to a commodity stabilization on a broad basis" and had been hampering the successful conclusion of further commodity agreements. The availability of finance in advance of the negotiation of new commodity agreements would thus exercise a catalytic role in stimulating their successful conclusion¹.

UNCTAD's Model

According to the source of finance model the Common Fund (CF) was to raise *all* the money required to finance the IPC and lend money to the commodity associations which would confine their activities to implementing the conditions of the respective commodity agreements (acquisition of stocks, fixing of stock volumes and intervention prices). In difficult situations (when prices plummeted) the CF was to be entitled to stockpile raw materials for which commodity agreements did not, or not yet, exist and manage these stockpiles until appropriate agreements had been concluded.

The total financial requirements of the Common Fund were estimated at \$ 6 bn: one-half would be needed when it was set up and the other half was to be provided as needs arose (through the conclusion of new individual commodity agreements). The financial resources of the CF were to consist mainly of interest-free capital subscribed by the member countries (1 or 2 bn) and borrowings from the international capital market and international organizations such as the World Bank.

A debt-equity ratio (government contributions to borrowings) of 2:1 was considered appropriate in consideration of the terms which the CF would have to impose on the individual commodity agreements (ICAs). Of the equity 20 or 30 % respectively would be provided by developing countries according to a formula based primarily on ability to pay.²

The Common Fund was in addition to finance – through a "second window" – other measures than stockpiling within the framework of the ICAs. The intention was to support stockpiling arrangements by such other measures and to improve the market prospects of non-storable commodities. The measures to be financed were to include vertical and horizontal diversification projects and related adjustment assistance, productivity improvement, market development, research and development, improvement of commodity transport, marketing and distribution. The financial requirements for these measures were calculated at \$ 1 - 1.5 bn. They were to be met by credits to be provided on highly concessional terms.³

Concerning the taking of decisions on the Common Fund the Group of 77 laid claim to a "decisive say" of the developing countries in the CF's governing bodies, by which they meant more than an absolute majority of the voting rights.⁴

The Pool Concept

The pool concept regards the individual commodity agreements as building blocs of the CF. They would themselves raise the money needed to finance their activities, deposit their funds in a common pool (the

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¹ Cf. TD/B/C.1/193, p. 6.

² Cf. TD/JPC/CF/CONF/L. 4; TD/B/IPC/CF/8; TD/IPC/CF/CONF/L. 7.

³ Cf. TD/IPC/CF/CONF/L. 2; TD/IPC/CF/CONF/L. 4; TD/B/IPC/CF/2.

⁴ Cf. TD/B/IPC/CF/4, p. 15; TD/B/IPC/CF/8, p. 14; TD/IPC/CF/CONF/L. 2, p. 10-12.

CF) and borrow from the latter if necessary. The source of these funds would be the ICA deposits with the CF; the member countries of ICAs would have to put up 75 % of their maximum financial requirements for stockpiling operations in cash, and market borrowings against stock warrants (for up to 25 % of the financial requirements) would provide the rest. ICA member countries would also be expected to make available to ICAs callable capital equivalent to 25 % of total requirements for use as collateral (in contingency situations). The callable capital would not be needed in normal circumstances but it would ensure the creditworthiness of the CF.

Each ICA was to be obliged to deposit 75 % of its financial requirements with the CF in cash at an interest rate close to market rates. In return the ICAs were to have a guaranteed drawing right equivalent to 100 % of their financial requirements (and the interest rate on their drawings on CF credits was also to be close to market rates).

The equity capital of the ICAs was to be provided in equal proportions by producers and consumers of the commodity in question who were also to have equal voting rights⁵. Other measures were not intended to be financed by the CF but through existing financial institutions.

The Fund in its Present Version

The end-result of the negotiations in March 1979 was a Fund of much smaller size than envisaged by the developing countries and with greatly reduced functions. The "first window" is now to have a financial volume of \$ 400 mn of which the governments would pay \$ 150 mn in cash (and of this \$ 70 mn would be made available for the "second window") and provide \$ 150 mn as finance on call and \$ 100 mn as callable capital.

The functions of the first window have been reduced accordingly. Its tasks are now to be to

- ☐ facilitate the cash flow of the Fund for the financing of stocks, i. e. for overcoming temporary liquidity problems of ICAs,
- ☐ finance a contingency loss reserve account,
- ☐ generate an income to meet the administrative costs of the Fund⁶.

As for the important relationship of the CF to the ICAs, the latter would now be the true building blocs of the CF and be financed as to 33.3 % of their maximum financial requirements by mandatory government contributions shared equally between producers and consumers. The ICAs would use the fund as their banker, keeping on deposit with it any cash balance not actually needed for stockpiling and assign to the CF all its stock warrants; these would be used, in combination with the callable capital, as backing for the Fund's own borrowing. The callable capital of the ICAs would be pledged directly to the CF; it would amount to 66.6 % of their financial requirements.

The financial volume of the second window has been brought down to \$ 350 mn the major part of which (280 mn) is to be provided by voluntary contributions. Its range of activities is now limited to research and development in the commodity sector, productivity improvement and technical assistance for vertical diversification; market access, improvement of infrastructure, transport and marketing and, in particular, horizontal and vertical diversification (on a broad basis) have been dropped. The second window is to avoid any duplication of the activities of existing financial institutions and establish a close working relationship with them⁷.

⁵ See Note 3.

⁶ Cf. TD/IPC/CF/CONF/11.

⁷ Cf. Resolution of March 20, 1979 (preliminary copy), p. 2.

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The new version does not provide for market intervention by the CF apart from ICAs. The new CF voting rules including the requirement of two-thirds and three-quarters majorities on important issues make it unlikely that the industrialized countries will ever be outvoted.

Judging the outcome of the negotiations by the results on points which the major industrialized countries have always referred to as essentials of a "reasonable" solution, it must be said that these countries have protected their interests on important issues. They had attached particular importance to avoiding being outvoted by the developing countries, preventing market intervention by the CF outside the ICAs and measures for global production planning through the second window and, above all, preserving the autonomy of the individual commodity agreements⁸. The financing of the commodity agreements by producers and consumers alone (and not by withdrawals from a larger chest) was to guarantee care and responsibility in the drafting of commodity agreements and to ensure a realistic approach to the fixing of stock sizes.

The First Window

When attempting to assess the effects of a Fund of the pattern of the agreement of March 1979 on the prices and production of raw materials it is advisable to keep the two windows at first apart.

As far as the first window is concerned, it might be argued with the UNCTAD secretariat that its total volume differs barely at all from the original proposal (for CF and ICAs together) and that compared with previous commodity agreements under which the producers had to provide all the finance by themselves their financial burden has been much reduced although a smaller amount is raised through the Common Fund⁹. Besides, the CF would save money by the linkage of various agreements for commodities with counterbalancing price movements and the risk pooling would ensure them of more favourable terms in the capital markets than could be obtained for agreements covering a single raw material.

There is a great deal of wishful thinking in this argument:

□ Under the new agreement the more important raw material producers have to carry a much heavier

financial burden than they would have done according to the earlier proposal because the producers have now to raise one-sixth of the financial requirements according to their share of the trade whereas all developing countries together were under the earlier proposal to raise 20-30 % of one-third of the whole required finance.

□ With their burdens magnified in this way the producing countries are bound to consider the benefits and costs of their participation in a commodity agreement much more thoroughly and to take other factors beside the general economic benefits of an agreement into account. That is exactly the situation which the Group of 77 wanted to avoid. The more competitive raw material producers will now ask themselves whether it is worth their while to join this kind of agreement at all.

□ If each agreement is negotiated individually, it cannot therefore be ruled out in view of the mentioned financing conditions that particular interests will make themselves felt at an early stage, the more so as the advantages and disadvantages of different agreements for the individual member cannot be compensated by subsequent arrangements, as would have been possible under the Fund as originally conceived, and it is not known which ICAs will eventually be instituted.

□ The combination of interest-free government contributions, slightly easier credit terms from international organizations and normal borrowings in the capital market would have enabled the Common Fund under the original proposal to offer to the ICAs much more favourable loan terms (the UNCTAD secretariat calculated with an interest rate of 4.5 %) than the agreement of March 1979 envisages. The CF's resources are so limited that it cannot give financial assistance to the ICAs nor is it allowed to provide such support because it was decided in the negotiations at the insistence of the industrialized countries that no interest subsidies must be given (to the ICAs) from first-window resources¹⁰.

□ This brings us to the question how the participants in existing commodity agreements are to be induced to join the CF. The member countries of the cocoa agreement (profit to date: \$ 200 mn) showed little liking for arrangements to tie it more rigidly to the prospective CF when they renegotiated the agreement at the beginning of 1979 (whereas the EC countries used their influence in favour of it!)¹¹. The countries operating the tin agreement are evidently also

⁸ Cf. *Süddeutsche Zeitung*, Eine Bank für die Rohstoff-Lagerung (A bank for storing of raw materials), March 22, 1979; and also the remarks of Otto Count Lambsdorff, Federal Minister for Economic Affairs of the Federal Republic of Germany, to Third World ambassadors at the UN in New York, in: *Europa Archiv* 8/1979, D 205.

⁹ Cf. TD/IPC/CONF/11; Statement by the Secretary General of UNCTAD at the opening of the resumed second session of the UN Negotiating Conference on a Common Fund, UNCTAD, Nov. 15, 1978.

¹⁰ Interview at UNCTAD.

¹¹ Interview at UNCTAD.

reluctant to join the CF¹². The members of these schemes could, if at all, only be induced to put their funds in the CF if they could count on reciprocal benefits of a different kind.

□ It is unlikely that there will be more than moderate interest in linking any future ICAs for attractive raw materials with the CF for with actual stocks averaging only 50 % of the maximum the one-third part of maximum financial requirements to be raised by the ICAs themselves corresponds to two-thirds of *average* financial requirements. If a commodity agreement is regarded as sound, these two-thirds of ICA capital will, together with stock warrants, be sufficient to raise the missing one-third on reasonably attractive terms from other sources without any recourse to a Common Fund. The American proposal of 40 % equity for ICAs, it may be recalled, aimed at rendering them entirely independent from outside sources of finance¹³.

□ However, if the CF is not needed by all ICAs, it is not readily apparent how the two essential advantages of a "Common" Fund are to arise at all. The economies from counterbalancing price trends of different commodities will only show up if as many ICAs as possible come into being. Otherwise the potentialities of the CF will be quickly exhausted in a crisis and not be significantly superior to those of agreements which are not backed by a Common Fund.

Besides, a CF will not obtain favourable terms in international capital markets unless the participation of more or less creditworthy ICAs for commodities with different demand patterns results in the view of international financiers in a reasonable amalgam of risks. If too few ICAs join the CF, sound ICAs may eventually obtain better terms outside the CF than in company with less creditworthy ICAs through the CF.

□ There is thus a danger that as a result of the difficulties to be encountered in the negotiations for new agreements (see below) and the meagre material incentives offered by the new CF to the stronger ICAs only the less competitive agreements will in the end seek the protection of the CF which, on the assumption of continuously falling prices for these commodities, would exhaust its potentialities fairly soon. Or else – and this is a more likely outcome – the international community will face a need for constant further capital infusions in support of a few feeble agreements.

It has also to be pointed out that the rather symbolic size of the CF equity (80 mn in cash when the second window's share has been subtracted) is quite

inadequate as a reasonable capital base; at best it will be sufficient to pay the salaries and travelling expenses of a small staff for a few years.

The Second Window

The rationale for the "other measures" to be financed by the "second window" was originally the intention to guarantee the viability of the buffer stocks by parallel measures. By means of horizontal diversification projects (for raw materials in constant surplus) and improvement of productivity, vertical diversification and industrial rehabilitation (of raw materials subject to heavy competitive pressure by synthetics) it was intended to adjust the production structures of the countries concerned to the long-term market conditions and to provide intermediate assistance for income shortfalls in the medium term.

The finance arrangements for these very tasks have however been dropped from the agreement of March 1979 at the insistence of the hard-liners among the industrialized countries (especially the USA) who argued that these tasks had hitherto been financed by international organizations or by bilateral development aid or were matters for the national economic policies of the beneficiary countries¹⁴. A more important ground for their opposition was the fact that horizontal diversification measures necessarily extend beyond the scope of commodity agreements and would amount to regulatory intervention in the sales and production of the raw materials¹⁵.

The second window was thus left with less original and innovative functions which can hardly help effectively to restructure the production of raw materials and could have been performed without difficulty through traditional instruments. Neither does it seem very likely that the second window will in spite of its reduced funds and functions become a "commodity focus" coordinating, as the UNCTAD secretary general was hoping, the activities in the raw materials sphere of the other international financial organizations¹⁶. How could an institution with such a small financial volume (and, in consequence, bargaining power) hope to influence successfully the activities of the World Bank group? The Commodity Division of UNCTAD, it may be remembered, was established with the same objective of coordination some years ago.

Mention must also be made of the financial vulnerability of the second window. Apart from the sum of \$ 70 mn diverted from the first window its funds are

¹² Interview at the German Ministry of Finance.

¹³ Interviews at UNCTAD and the German Ministry of Economic Affairs.

¹⁴ Cf. TD/B/IPC/CONF/L. 6, p. 2.

¹⁵ Interview with the German Ministry of Finance.

¹⁶ Cf. TD/IPC/CF/CONF/L. 9, Annex I, p. 1.

to be raised on a voluntary basis which means that pledging conferences will have to be held each year. The USA refused at UNCTAD V already to enter into commitments for the second window.

Dangers to Raw Material Supplies

An important consideration in this context is the safety of continuing supplies of important raw materials which is of course of central interest to the consumer countries. It depends on continuity of exploration and, above all, mining investments. The latter have declined greatly in the last decade because of higher preproduction expenses and rising political investment costs. The decline has been greatest in the developing countries in which 42 % of the known reserves are located. Lack of capital and know-how makes it impossible for the countries of the Third World to undertake large-scale mining projects themselves. With up to ten years elapsing between exploration and production, a substantial supply shortfall must be expected for important raw materials in the mid-eighties already unless international mechanisms to boost raw material investments (or cover the risks involved) are institutionalized in the near future¹⁷.

In the original drafts for a Common Fund it was assumed that the problem of weak investment activity could be solved by and large by a stabilization of the raw material prices because it would greatly reduce the uncertainty about profit expectations among investors. Even if one does not share this optimistic view, it must be admitted that the list of "other measures" contained elements which, for ores in a satisfactory market position in particular, could have been developed so as to act as a stimulus for raw material investments. The narrow majority with which the US proposal for an International Resources Bank was turned down by the Group of 77 suggests that it would have been possible to find a consensus for it in the framework of the Common Fund. As things are, finance is only provided for international social aid measures for raw materials of which the consumer does not need larger supplies.

Reasons for Acceptance

After this examination of the CF agreement we may ask why it was put forward by the UNCTAD secretariat in the first place and further why it was accepted with only marginal amendments by the Group of 77. There were at least the following reasons:

□ For the UNCTAD secretariat (and the secretary general in particular) the inauguration of a Common

Fund has become a vested interest. Any agreement on a CF, even a truncated one, was considered better than none by the UNCTAD secretariat as it would provide a focal point for continuing efforts on commodities. The developing countries were advised to grasp the opportunity and to use the CF as a springboard for later action. It was an important consideration for UNCTAD in pursuit of its own institutional interests that the CF might be used for an eventual extension of its functions¹⁸. Another reason why the secretariat wanted to see the CF established was the mounting frustration of the "77" at the lack of progress since the conference in Nairobi which turned them more and more against UNCTAD as they thought that it had not been very effective and, neglecting matters of comparable interest to the developing countries, put undue reliance on the CF¹⁹.

□ The role of the Group of 77 in the whole process has in my opinion been exaggerated in press reports and official statements. The Common Fund was a brain-child of the UNCTAD secretariat. The official texts of the Group of 77 were for the most part merely copies of its studies, calculations and drafts. The UNCTAD secretariat certainly welcomed the political backing of the developing countries for its conceptions but the role of the Third World in this matter was on the whole a less active one than commonly assumed.

□ The developing countries showed little skill in the negotiations. Not only were they hampered by an unfortunate shortage of personnel but they seem to have relied chiefly on diplomats as negotiators in Geneva when economists would have been more suitable. These diplomats were ill equipped to counter the constant Group B attacks on financial and economic shortcomings of the CF project. Instead they dwelt at tiresome length on the lack of political will to which they attributed the slow progress.

□ A main reason for the greater acceptability of an attenuated CF to the developing countries was the lack of progress in the negotiation of new commodity agreements. This lack is to a large part due to the reluctance and delaying tactics on the side of the developed countries, their requests for time-consuming studies and the setting-up of research and consultative bodies. These detracted attention from the work on the drafting of international commodity agreements. The tactics of Group B are however only part of the explanation. The main reason for the modest progress in the negotiating of commodity agreements was lack of interest on the part of

¹⁷ Cf. K. Seitz, *Die internationale Rohstoffpolitik* (The international raw materials policy), in: *Aus Politik und Zeitgeschichte*, 17/1979.

¹⁸ Interview at the German Ministry of Economic Affairs.

¹⁹ Cf. *The Guardian*, May 8, 1979, *The Man from UNCTAD*.

important Third World exporting countries which put their short-term economic interests above their possible contribution to the common undertaking of the developing countries. In the case of phosphates, manganese, iron ore and bauxite the biggest exporters – who were also the most competitive ones – showed little interest in an agreement which might freeze their market share or stimulate substitution. In the case of copper, bananas and cotton the producers had difficulties in coming to grips with the question of export quotas; the countries with rising exports were not interested in fixing quotas on the basis of the status quo²⁰. In regard to oilseeds there seemed “to be no desire on the part of the major exporting countries to engage in negotiations ... Their policies have been directed more to increasing their market shares than to stabilizing prices”²¹. For the lack of progress in the negotiations on hard fibres Brazil must accept part of the blame because this country has been inundating the world market at dumping prices with sisal the production of which is organized as a kind of social assistance to the petty landowners in the north-east of the country.

While the UNCTAD secretariat still maintains that early and successful negotiation of a CF agreement has hampered progress in the negotiation of ICAs, it may be argued on the other side that the eagerness of the “77” to see their initial proposal adopted must have lessened as the not very promising commodity negotiations dragged on.

The quoted examples of diverging interests of Third World producing countries demonstrate in my view that the piecemeal approach (commodity by commodity) holds out little promise in the absence of possible trade-offs between individual commodity agreements and explains why the developed countries attached such importance to its adoption.

□ Progressing economic differentiation between Third World countries makes it more difficult for the Group of 77 to evolve concepts of reform which will command a consensus among its members in the framework of the desired New International Economic Order. The difficulties are mostly overcome by indiscriminating summation of the interests of all groups of developing countries. This gives the industrialized countries an opportunity – which they did not hesitate to exploit – to win over some of the developing countries to their ideas by offering them selective concessions. In the case of the Common Fund it is an unquestionable fact that the African countries with poor raw material

resources were interested almost exclusively in the “other measures” while the Latin American states could without great difficulty have been brought round to the narrower concepts of the industrialized countries, so that in the end the Asian countries alone were left as determined defenders of the original Common Fund concept.

Economic and Political Implications

The following points seem to me to be important in an – inevitably oversimplified – summary statement of the economic and political implications of the new Common Fund concept:

□ As, by and large, only relatively innocuous research and development projects will be promoted in the framework of the second window, it is difficult to see how the viability of any prospective commodity agreements could be safeguarded in this way, and it is even more difficult to discern how the production of raw materials can thereby be restructured in the long run. Besides, the limited size of the second window and the limited functions described as “other measures” will necessitate increased activities by existing international financial institutions. With commodity-related activities proliferating in consequence it can be easily foreseen that a reasonably planned and coordinated programme will hardly take effect.

□ The lack of economic and financial incentives to induce ICAs to participate in the CF precludes price stabilization on a broad basis. It is not surprising therefore that the developing countries have of late again shown more interest in the idea of earnings stabilization although the Group of 77 will not, as the German Federal Government for a long time naively believed it would, accept earnings stabilization as an alternative to the CF. Nor do its demands run in the direction of the American ideas for an improved IMF Compensatory Finance Scheme. The Group of 77 demands instead stabilization of earnings in addition to, and independent from, the Common Fund and wants it to be established institutionally apart from the IMF. The end-result of the negotiations may easily be a fund which soaks up resources in spite of its obvious inefficiency, combined with earnings stabilization measures which cost a great deal of money but do not lead to structural adjustments, and commitments outside an institution in which the western countries have no decisive say in the formulation of the terms on which resources are provided. It may well be asked whether it would not have been a better strategy for the industrialized countries to optimize, rather than minimize, the capital base of the Common Fund.

²⁰ Interview at UNCTAD.

²¹ Cf. TD/B/IPC/AC/20, p. 23.