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Wolfgang Maennig*

A New Departure in International Commodities Policies?

In the course of the last United Nations' World Trade Conference (UNCTAD) the Soviet Union, Ivory Coast and Bulgaria signed the agreement on the Common Fund for Commodities. The Fund, which was conceived as the cornerstone of a new international commodities policy, will thus come into effect in the near future, probably in the course of 1988. Will this lead to a new departure for international commodities policies?

As early as 1976 the role of the Common Fund was foreseen as that of the central organisation of the Integrated Programme for Commodities (IPC). It is intended to coordinate and facilitate the financing of the measures necessary for the attainment of the aims of the IPC. These aims are:

- ☐ the stabilisation of the prices of commodities via international buffer stocks;
- ☐ the stabilisation of export earnings via compensatory financing;
- ☐ the achievement of multilateral, long-term sale and delivery agreements;
- ☐ support for raw materials processing and promotion of diversification in the developing countries.

These aims are ultimately intended to raise and stabilise the exchange earnings of those developing countries which export raw materials and to provide a more reliable basis for their development policy efforts.

Even without the existence of the Common Fund these aims have been the object of considerable efforts in the last ten years. This gave rise to international commodity agreements with buffer stocks and price stabilisation. Furthermore, the creation of STABEX, SYSMIN and the International Monetary Fund's Compensatory Financing Facility provided for finance systems to compensate for fluctuations in export earnings.¹ It is however evident that agreements of this kind are often not efficient enough, either because they are regionally limited and financially too weak or

because they relate to individual commodities. For this reason one of the central ideas behind the Common Fund is to create a balanced system of regulation for the commodities market and to have shared administration of the finances. Due to significant differences of opinion over form and organisation it was not until 26th June 1980 that agreement was reached on the Common Fund – four years after the Integrated Raw Materials Programme.² The following is intended initially to describe the most important characteristics of the Common Fund.³

The Institutional Basis

The Common Fund is divided into two component funds, known as the first and second "windows".

The "first window" is to be provided with a capital of US-\$ 400 million, to be raised via direct contributions of the fund's member states. This capital is to be used for bridging temporary liquidity problems and for raising the creditworthiness of the fund. The interest earnings are intended to cover the administration costs.

¹ For a critique of compensatory financing systems cf. for STABEX C. D. A. Cuddy: Compensatory financing in the North-South dialogue: the IMF and STABEX systems, in: The Journal of World Trade Law, Vol. 13, 1979, pp. 66-76; and for SYSMIN W. Maennig: SYSMIN: An Evaluation, in: INTERECONOMICS, Vol. 23, No. 1, 1988, pp. 35-38.

² Draft Agreements establishing the Common Fund for Commodities, TD/IPC/C/CONF/L. 15, Geneva.

³ For a more detailed description cf. for example H. Adebahr: Gemeinsamer Rohstoff-Fonds: Zwischen politischem Erfolg und wirtschaftlichem Fehlschlag, in: Wirtschaftsdienst, 1979, Vol. 59, No. 12, pp. 616-622; J. D. Gerber: Der Gemeinsame Rohstoff-Fonds, in: Außenwirtschaft, Vol. 35, 1980, pp. 355-371; B. Stecher: Der „Gemeinsame Rohstoff-Fonds“, in: Europa-Archiv, Vol. 36, 1981, pp. 57-64; also U. Wassermann: UNCTAD: Agreement on the Common Fund, in: The Journal of World Trade Law, Vol. 14, 1980, pp. 541-545.

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The financial resources for intervention on the raw materials markets in order to regulate prices are essentially to be raised from the individual commodity agreements.⁴ The commodity agreements each pay into the fund a third of the contribution specified as a maximum for the accumulation and maintenance of their buffer stocks. For the remaining two thirds of the maximum financial requirements the signatories to the agreement provide guarantees to the appropriate amount. Once these preconditions are met the commodity agreement has the right to cover all costs occurring during the accumulation and maintenance of buffer stocks via loans from the fund. Should these means be insufficient the individual agreements can apply for an additional loan amounting to no more than two thirds of the specified maximum finance requirement. In this context the hoped-for pooling effect becomes evident: if the contributions of a participant commodity agreement are not utilized due to favourable price developments and there is no need for stocks to be built up, the contributions can be requested by another agreement whose commodity is under price pressure. The existence of this pooling effect is however somewhat disputed in some empirical works,⁵ given that price developments on the international commodities markets are relatively highly correlated.

For this reason it is the Fund's actual credit practices which may be of more relevance for the financing of the activities of the respective buffer stocks. The Fund's creditworthiness, backed up by the direct contributions and the envisaged limited liability of its members should enable it to take out loans on the world capital markets at especially favourable conditions and to redirect these towards the individual commodity agreements.

Market interventions are not undertaken by the Common Fund but rather by the individual agreements or, more precisely, by their administration. Consequently the function of the first window can be compared with that of a bank, with which the members can make deposits but also request loans, and which also has access to the international capital markets thanks to its own financial weight and can thus obtain additional means of finance.

The Fund's "second window" has a capital of US-\$ 350 million at its disposal, \$70 million of which originates from the direct contributions of the members with the remaining \$280 million being raised in the form of voluntary contributions by the member states.⁶ Its priorities lie more in the direction of development policy

and it is intended that it should contribute to improving the competitiveness of those commodities from developing countries which are not suitable for reserve storage. To this end the resources of the second window are to be used to support research and development policies and measures for quality and productivity improvements. The building up of the developing countries' own processing industries can also be financed, as well as diversification measures intended to help these states free themselves from their dependency on raw materials exports.

The Common Fund comes into effect:

☐ when 90 states, together accounting for at least $\frac{2}{3}$ of the direct contribution payments of \$470 million, have ratified the agreement;

☐ when the second window has received assurances for half of the stipulated voluntary payments to the amount of \$280 million.

The Fund's coming into effect only became a real possibility in July 1987 once the Soviet Union, Ivory Coast and Bulgaria had signed the agreement and the limit of $\frac{2}{3}$ of the direct member contributions had been exceeded. The signatory states committed themselves to a swift ratification process, so that 1988 could see the Fund actually in operation. The other conditions had already been fulfilled previously.

Chances of Success

It was originally envisaged that the conditions mentioned above should be fulfilled by 31st March 1982. The unexpectedly long delay can be seen as the responsibility of all the countries involved. The reservations of the Eastern Bloc states were especially directed towards the distribution of voting entitlement. A number of developing countries were unwilling to join because of the financial burden involved, something which led Norway and OPEC to offer to take on the membership contributions of a total of ten developing countries. Finally within the group of industrialised countries, above all in the USA, there were fundamental doubts about the Common Fund, given that it could lead to comprehensive regulation of the world commodities markets.

⁵ Whilst for example S. Baron, H. H. Glismann and B. Stecher: *Internationale Rohstoffpolitik – Ziele, Mittel, Kosten – 1977*, p. 15 confirm the presence of a pooling effect, its existence is questioned by, for example, H. G. Johnson: *Commodities: Less Developed Countries' demand and Developed Countries' response*, in: J. N. Bhagwati (ed.): *The New International Economic Order*, Cambridge 1978, p. 244.

⁶ The second window's capital can be replenished three years after the agreement has come into effect.

⁴ Only commodity agreements between producer and consumer countries can join the Common Fund.

Until now the success of the Integrated Commodities Programme has been limited. Since 1976 only one new commodity agreement with price stabilisation measures has been reached (natural rubber). The new agreements on jute and tropical timber are exclusively restricted to cooperation on measures for development. The agreements for tin, sugar, wheat, coffee and olive oil already existed previously. The negotiations for the other commodities as well as the renegotiations for expiring agreements are grinding to a halt. The tin agreement collapsed at the end of 1985 because it had exhausted its finances. The other commodities are also experiencing considerable difficulty in remaining within the stipulated price ranges.⁷ A summary of the currently existing agreements is given in Table 1, which shows that intact agreements with price stabilisation measures only exist for coffee, cocoa and rubber.

The possibilities for renegotiation will remain small even after the Common Fund has come into effect, given that the fundamental problems will not have been resolved. Thus the major problem for the stabilisation of commodity prices lies in the (political) agreement of an economically suitable price range and in the agreement of a system of flexible adjustment.⁸ Especially in the present period of the mid to late eighties with its low price levels there can hardly be any reason for developing countries to be inclined to orient themselves towards market tendencies during price negotiations. However, the experience of the International Tin Agreement for example shows that price agreements set politically at too high a level cannot be maintained for long. In this respect it is unfortunate for the Common

Fund that it should be coming into effect at a time in which certain commodity prices are at record lows and those – occasionally significant – price increases which were achieved in 1987 are counterbalanced by predominantly pessimistic forecasts.

There are, however, additional problems: price stabilisation by means of buffer stocks presupposes that the relevant commodity's storage costs are not too high. This reason alone means that efficient price stabilisation is impracticable for many commodities.⁹ Apart from the factor of perishability it should also be taken into account that many commodities vary considerably in quality. The price structures of these quality variations can change rapidly according to changes in taste or technology. This means an additional risk, i.e. additional storage costs and makes storage administration more difficult. Furthermore it is possible for price stabilisation by means of buffer stocks to produce negative side effects, influencing for example earnings stability and average earnings level.¹⁰

But even some of the Common Fund's characteristic provisions allow room for doubt as to its effectiveness. It is uncertain whether – as intended – the interest earnings from the US-\$ 400 million will be sufficient to cover the costs created by the Fund's administration. This \$400 million is hardly likely to be enough to make the fund a particularly good credit risk, especially when this figure is contrasted with the foreseeable financial requirements of the ten so-called core commodities alone,¹¹ which amounts to at least US-\$ 10 billion for the initial provision plus annual interest and storage costs (without administration costs) of approx. \$1 billion.¹²

An effective increase in creditworthiness and financial resources would only come about if several new

Table 1
International Commodity Agreements

International Sugar Agreement, 1984	No price stabilisation measures
International Coffee Agreement, 1983	115-145 cents per lb. (inner range: 120-140 cents per lb.)
International Cocoa Agreement, 1986	1,600-2,270 SDR per tonne Median price: 1,935 SDR per tonne
International Natural Rubber Agreement, 1979	161.3-242.0 MScents ¹ per Kg Median price: 201,66 MScents per Kg
International Tin Agreement, 1981	29.15-37.89 Malaysia-\$ per Kg (Buffer stock activities terminated as from 24. 10. 1985)
International Jute Agreement, 1982	No price stabilisation measures
International Agreement on Olive Oil and Table Olives, 1986	No price stabilisation measures
International Tropical Timber Agreement, 1983	No price stabilisation measures
International Wheat Agreement, 1986	No price stabilisation measures

¹ MScents = Malaysia/Singapore cents.

Source: UNCTAD: Monthly Commodity Price Bulletin, November 1987.

⁷ Cf. H. Adebahr, W. Maennig: Außenhandel und Weltwirtschaft, Außenwirtschaft, Vol. 2, Berlin 1987, pp. 327 ff.

⁸ Even the suggested "crawling peg" system – a sliding adjustment to market price tendencies – failed to become reality. Cf. D. Kerschull: A crawling peg system for raw materials, in: INTERECONOMICS, Vol. 11, No. 9, 1976, pp. 245-7, for a description of this form of flexible adjustment.

⁹ For an estimation of storage costs cf. J. Colebrook: The costs of storing primary commodities, in: Journal of World Trade Law, 1977, pp. 369-377.

¹⁰ Whether earnings level and stability are diminished depends on elasticities of supply and demand, temporal phasing and relative size of supply and demand fluctuations as well as the size of the price range. Cf. W. Maennig: Die Effekte der Preisstabilisierung auf Erlöshöhe und -stabilität, Berlin 1985 and the literature referred to therein.

¹¹ The core commodities are primarily produced by developing countries and are among their most important export goods (60% of the raw materials apart from oil). They are: cotton, hard fibres, jute, coffee, cocoa, natural rubber, copper, tea, tin and sugar.

¹² S. Baron, B. Stecher, H.H. Glismann, op. cit., 1977, pp. 8 f.

commodity agreements were to stipulate high contribution rates. Since a third of these is then to be paid into the Fund and high financial contributions meet with the resistance of the member states, the endowment seems more likely to be somewhat meager. This unwillingness to transfer financial resources is also manifested in the Coffee Agreement's published refusal to join the Common Fund.

Given such a constellation the Fund's first window must inevitably fall considerably short of achieving the significance originally intended for it, and because of the first window's central importance the Common Fund will hardly be able to fulfil the expectations placed upon it. A correspondingly pessimistic attitude towards the Fund's chances of success became prevalent quite early on,¹³ an attitude which has been reinforced in the course of recent years.

¹³ Cf. for example A d e b a h r, op. cit., 1979; and D. K e b s c h u l l: The foreseeable end of the Common Fund, in: INTERECONOMICS, 1982, Vol. 17, No. 4, pp. 157-8.

There is however a tendency to take only the first window into consideration, often ignoring the second window which, even without buffer stock commodity agreements, will be in a position to work effectively for the commodity-exporting developing countries, given that measures of support for research and development, diversification projects and improvements in competitiveness still retain their significance. Expectations have however been reduced by the second window's relatively limited financial provision of US-\$ 350 million.

The Developing Countries' Search for Alternatives

Even the developing countries hardly see in the IPC or the Common Fund any realistic chances of changing the situation on the international commodities markets to their favour. This context should thus be borne in mind when considering any plans for new financial institutions which may have emerged from the dilemma of the developing countries in recent years.

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The developing countries' lack of market staying-power is seen as one of the reasons for the fall in prices on the commodities markets: instead of reducing supply when prices are low they are often forced due to lack of foreign exchange to maintain or even extend their supply¹⁴ and thus pave the way for further price falls. It is intended that relief in the form of improved supply management should be provided by a *Central Agency* and the Bank of Developing Countries ("*South Bank*") suggested by UNCTAD.¹⁵ All exports from the developing countries of the commodities stipulated are to be dealt with by the central agency. This could increase their bargaining power against importers in the industrialised countries: in addition it would also be a means of preventing for example the undermining of export quotas as in the case of the OPEC cartel, in periods of falling prices. In the case of a recession in demand the South Bank could compensate the developing countries' loss of earnings with appropriate payments – a function reminiscent of the above-mentioned compensatory financing systems such as STABEX. The South Bank would also be responsible for help in building up multinational firms belonging to the developing countries themselves.

Due to unfavourable terms of trade and the shortage of convertible foreign exchange developing countries have been increasingly involved in transactions amongst themselves (South-South trade), often taking the form of compensatory trade.

This compensatory trade is however not without its problems for the developing countries. Only a small proportion – about 4 % – of such trade is comprised of pure barter trade without any financial involvement. Most compensatory trade takes place in the form of buy-back agreements and switch-transactions, based on temporal delays and hence requiring a financial bridge. Secondly, bilateral transactions are as a rule disadvantageous, which is why the tendency is increasingly towards trilateral and multilateral deals with correspondingly high negotiation costs, or to the recognition of the necessity for a central coordination or clearing house. Finally, many compensation deals are mediated by firms based in industrialised countries, especially in the USA and Great Britain. This leads to a reduction in the profit margins for the developing countries and ultimately to a worsening of the terms of trade. Part of these problems could be solved by a

"Third World Bank" as proposed at the third Conference of Banks from Developing Countries.¹⁶ This bank, a consortium of state and private banks from developing countries, would be responsible for converting credits and liabilities arising in the course of trade between developing countries where possible into its own currency units, thus minimizing the use of convertible foreign exchange. It could further provide export credits in the case of exports to industrialised countries and thus reduce any further competitive disadvantage the developing countries might have.

Up till now these projects all remain at the proposals stage, with little response in the political sphere. They may however gain in significance should the predominantly pessimistic expectations for the Common Fund's success be confirmed once it has come into effect.

Concluding Remarks

The Common Fund for Commodities is one of the most important elements of the Integrated Commodities Programme of 1976. The IPC was intended to bring about significant improvements in the position of the developing countries on the international commodities markets. More than ten years later the Programme's results are disappointing on a number of major points, even if the Common Fund is due to come into effect in the near future. The reasons for this lack of success, especially regarding the efforts to stabilise prices have been dealt with above: price ranges for commodities agreements are negotiated according to political rather than market-oriented criteria, which either led to the collapse of existing agreements or barred the way for new agreements; additional factors are high storage costs for commodities and negative side effects, such as destabilisation of earnings.

By contrast those measures were effective which were designed to compensate directly for fluctuations in the developing countries' earnings or to support their modernisation efforts. If the Common Fund should succeed in learning from this experience and thus in pushing, for the present, those measures to the foreground which were destined for the second window, the Fund's coming into effect may still be able to be judged as a partial success. The chances of this happening are good, given that in their search for appropriate and stable prices the developing countries are increasingly turning to instruments other than buffer stocks.

¹⁴ Examples of inverse supply reactions can be found in H. Oberhansli: *Internationale Rohstoffpolitik im Zeichen von Instabilität und Inflation*, St. Gallen 1982, pp. 325 f.; and M. Hoffmeyer, J. V. Schrader: *Preistief auf den Rohstoffmärkten*, in: *Die Weltwirtschaft*, 1982, No. 2, p. 115.

¹⁵ Cf. also D. Avramovic: *Commodity problem: what next?*, in: *World Development*, 1987, Vol. 15, pp. 645-655.

¹⁶ D. Avramovic, *op. cit.*, p. 650.