

# THE CASE AGAINST COMMODITY AGREEMENTS

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The Charter of Punta del Este, which established the Alliance for Progress, states that,<sup>1</sup>

The American republics recognize that the economic development of Latin America requires . . . a lessening of cyclical or seasonal fluctuations in the incomes of those countries that still depend heavily on the export of raw materials, and the correction of the secular deterioration in their terms of trade.

It supports international commodity agreements and calls for a scheme to compensate countries who export basic products for fluctuations in their export proceeds. There are good reasons to doubt that these measures will accelerate the development of Latin America or, for that matter, any underdeveloped country.

There is little margin for error in dealing with underdeveloped countries. Some of them are just below the threshold of political chaos. Inadvertent mistakes in economic policy, made with our consent, would be a shameful addition to the already long list of obstacles to their growth and stability. Compassion requires at a minimum that we do nothing to make the prospects of the underdeveloped countries less inviting, their circumstances more difficult, and their past more entrenched.

Taking the lead suggested by the Charter, this discussion will be divided into the desirability of stabilization, of alteration of the secular trends, and of compensation for fluctuations in export proceeds.

## I

### STABILIZATION

In actual negotiations of agreements, there is substantial room for disagreement over the meaning of "stabilization." In order to separate it from the question of the desirability of affecting the trend, I shall define stabilization as some reduction in the degree of fluctuation around the trend which would prevail if the market were free of intervention.

#### A. Failure to Take Advantage of Price Swings

If the prices received by producers are stabilized at the trend, producers will have no incentive to increase production when prices are high and no incentive to

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<sup>1</sup>The Charter of Punta del Este Establishing an Alliance for Progress Within the Framework of Operation Pan America, title IV, at 14 (Uruguay, 1961).

reduce output, and shift to other lines, when prices are low. As a consequence, the value of their outputs and their incomes over the cycle will be lower than they otherwise would be.<sup>2</sup>

It may be objected that the supply of primary products is not responsive to variations in the prices received by producers. But this is certainly not true for minerals,<sup>3</sup> and no one argues that agricultural products, even such tree crops as coffee and cacao, are entirely unresponsive to variations in price. Miss Lovasy notes, for example, that changes in the supply of coffee occur through changes in the degree of care provided on old plantations or by their abandonment.<sup>4</sup>

Stabilization would not reduce income over time if schemes were devised to conserve, rather than prevent or destroy, "excessive" production during periods of relatively low prices. The conserved output could be held for sale during periods of relatively high prices. This requires the establishment of a buffer stock which would buy when prices are low and sell when they are dear. Unfortunately, there are several limitations on buffer stocks. First, if the trend is downward, the buffer stock is apt to lose money. When the prevailing price is below the trend, the buffer stock is obliged to buy. When the prevailing price is above the trend, it is obliged to sell. With a downward trend, the prices at which it buys may well exceed those at which it is obliged to sell.

A buffer stock commodity must be storable, fairly homogeneous, and capable of a high degree of standardization. . . . No one government must be able to command so large a share of market supplies, or dominate purchases to such an extent, as to be able to counteract the operations of even a financially strong buffer stock for the commodity concerned. . . .

The requirement of storability implies (i) reasonably high value in relation to bulk, thus ruling out commodities with high storage cost per unit, and (ii) fair keeping qualities, to avoid excessive costs of frequent rotation or of insurance against deterioration.<sup>5</sup>

Though a definitive list of commodities for which buffer stock treatment might work is not available, it is obvious that these requirements serve to limit the potential role of buffer stocks unless one is willing to seek stability around the trend at any cost.

<sup>2</sup> Nurkse, *Trade Fluctuations and Buffer Policies of Low-Income Countries*, 11 KYKLOS 148-49 (1958). The criticism leveled against Professor Nurkse by Kitamura & Yang, *Domestic Stability and Development*, 12 KYKLOS 316 (1959), is inappropriate to the case under examination. They argue, contrary to Professor Nurkse, that it will pay the underdeveloped countries to impose export taxes when the demand for their products increases because the demand for primary products is inelastic with respect to price, *i.e.*, the proceeds from exports will rise not only because of the increase in demand but also because of the imposition of the export tax. But a pure stabilization policy requires payments of subsidies when the demand for primary products falls. If the demand is inelastic, payment of such subsidies will reduce export proceeds. What Kitamura and Yang gain when the demand increases they lose when the demand falls so long as the underdeveloped countries pursue pure stabilization policies.

<sup>3</sup> Aubrey, *International Commodity Markets as a Factor in Development Planning*, in AGENCY FOR INTERNATIONAL DEVELOPMENT, ORGANIZATION, PLANNING, AND PROGRAMMING FOR ECONOMIC DEVELOPMENT 55, 59 (n.d.).

<sup>4</sup> Lovasy, *The International Coffee Market: A Note*, 9 INT'L MONETARY FUND STAFF PAPERS 226, 227 (1962). See also Stern, *The Price Responsiveness of Primary Producers*, 44 REV. ECON. STAT. 202 (1962), and sources cited therein.

<sup>5</sup> GERDA BLAU, FUNCTIONS OF A WORLD FOOD RESERVE—SCOPE AND LIMITATIONS 21 (1956).

### B. Effect of Stabilization on Proceeds

Suppose that stabilization does not change the total receipts of producers over the cycle as suggested above. The only change would be the greater certainty of the proceeds. If the returns to producers are not larger but are more certain, it is not unreasonable to suppose that some producers of some products would increase their output by undertaking new investments. The increased supply would depress the price trend and, if the demand for the product is relatively unresponsive to price changes, the lower price would decrease total proceeds.

Contrary results should be expected with respect to those commodities whose producers are persistently excessively optimistic. With more certain proceeds, there is less likelihood of their over-estimating the market, and the consequent reduction in investment would increase proceeds. Furthermore, if investment takes place only during boom periods, chopping off the booms may reduce total investment. Despite stabilization, producers may be reluctant to invest when prospects for their product are relatively poor.<sup>6</sup>

Which effect—increased or reduced investment—is likely to result from stabilization cannot be established a priori.<sup>7</sup> Until further evidence is available, we must recognize that stabilization may reduce proceeds from some commodities by increasing investment.

### C. Predicting the Trend

The key problem in stabilizing prices or proceeds without affecting the trend is to predict the trend. This is not easy. In discussing proposals for stabilization, the staff of the International Monetary Fund notes that individual commodity markets are “. . . difficult to predict.”<sup>8</sup> And Gerda Blau writes, with respect to the operation of a buffer stock, that<sup>9</sup>

A mistaken effort of counteracting a downward price trend might lead to serious losses and waste of resources. When changes of supplies, prices, and market conditions are studied in retrospect, these elements of cycle and trend often can be disentangled to a fair degree. To disentangle them at the time they occur, however, and to counteract the short-run movements without counteracting the trend, is a difficult task for the manager of a buffer stock who is not endowed with perfect foresight.

A panel of experts chaired by Professor Haberler goes further in saying that<sup>10</sup>

Looking backward over the past the periods when the prices were low . . . seem to stand out clearly from the periods when prices were high. . . . But peering into the dim and uncertain future is a different operation. It is only too easy for an authority to act as if

<sup>6</sup> Byc, *Comment*, 11 KYKLOS 182 (1958).

<sup>7</sup> Haberler, *Discussion*, in HOWARD S. ELLIS (ED.), *ECONOMIC DEVELOPMENT FOR LATIN AMERICA* 342, 365 (1961).

<sup>8</sup> *Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations*, 8 INT'L MONETARY FUND STAFF PAPERS 1, 22 (1960).

<sup>9</sup> BLAU, *op. cit. supra* note 5, at 23.

<sup>10</sup> GENERAL AGREEMENT ON TARIFFS AND TRADES (GATT), *TRENDS IN INTERNATIONAL TRADE* 71 (1958).

the price were exceptionally low . . . only to realize at a later date that the normal long-term price will most probably not be higher and may be lower than the present price. It must then abruptly end . . . its purchases for stock. . . . The final result may be an increased instability for the producers.

#### D. The Importance of Stabilization

Discussions of international commodity problems may attach unwarranted importance to problems created by instability around the trend. Recently the emphasis has been upon the adverse effects on economic development. It seems reasonable to suppose that greater stability of export proceeds would facilitate economic growth. Stabilization of receipts would obviate the abrupt cessation of imports of capital goods for economic growth made necessary by unexpected declines in foreign currency receipts. Investment in facilities to serve the domestic markets in less developed countries would be less risky if those domestic markets were made more stable by regulating export incomes which set the tone of the domestic markets. Potential external borrowing capacity, which is in part a function of export receipts, would be more predictable. However, the over-all evidence gives little support to the notion that export instability retards growth. Coppock has run a wide variety of correlations in an attempt to track down the causes and consequences of export instability. He found for thirty countries over the period 1951-57 that the correlation coefficient between his index of export instability and the rate of growth in real gross national product was  $-.003$ . He comments, "Indeed, this is the lowest correlation coefficient obtained in the entire analysis."<sup>11</sup>

It is argued that economic development is slowed by instability because the programming of economic development becomes sheer guess-work.<sup>12</sup> If this is the case, the best solution may not lie in attempting to stabilize prices around the trend but in developing better measures for predicting the behavior of export proceeds. For example, efforts to obtain better estimates of the number of cacao and coffee trees planted might yield substantial benefits. Indeed, this is necessary if the trend is to be predicted accurately and if a stabilization policy is to succeed. But if improved forecasts of prices and volumes can be obtained, there is less need for stabilization efforts. If prices can be projected accurately, producers will respond in a stabilizing manner to their signals by changing their production and investment plans. The mechanism for obtaining such responses could either be an announcement by some official body of the projected range of prices (which is somewhat risky if there is no competition in the making of forecasts and the basis for the forecast is not fully revealed) or the release of the relevant information to participants in an improved futures market. This approach would no doubt be much cheaper than stabilization through commodity argument.

<sup>11</sup> JOSEPH D. COPPOCK, *INTERNATIONAL ECONOMIC INSTABILITY* 106 (1962).

<sup>12</sup> Wallich, *Stabilization of Proceeds from Raw Material Exports*, in ELLIS, *op. cit.* *supra* note 7, at 344.

Some discussions leave the impression that unstable export receipts slow development by preventing stable investment. However, the programming of a steady rate of investment is almost certain to be less than optimal. Projects come to the construction stage at an uneven pace if for no other reason than the instability of the political decision-making process. Differences in lead-times in project preparation and differences in the ease of obtaining financing for different kinds of projects dictate an uneven flow of investment. As a practical matter, socialist entrepreneurs are no more capable of establishing a steady rate of growth in investment than capitalist entrepreneurs. If the optimum path of investment is unstable, it is not obvious that a stable flow of export receipts will conform more closely to investment requirements for foreign exchange than the present unstable pattern. Of course, if stable export proceeds could be obtained, variations in the investment requirements for foreign exchange could be met by fluctuations in foreign exchange reserves. Thus, foreign exchange not needed this year for capital goods imports could be held over until later. But this procedure runs into the danger that the authorities will not be able to restrain the demand for foreign exchange for consumption imports as the reserves accumulate.

## II

### ALTERING THE TREND

The desirability of altering the trend in commodity prices is separate from the question of the instability of those prices. If the underdeveloped countries who produce a single product were to band together to fix its price and production, it would be rational for them to restrict production no matter whether the demand and supply for the product were more or less responsive to price changes (which determines the degree of price instability), because some quantity sold and some price charged other than the competitive volume and price would maximize their profits. Furthermore, a wise cartel would vary its prices and output in order to maximize its profits as demand and supply conditions shift. Stable prices and sales in a dynamic world would not produce maximum profits.

While a wise cartel would always raise prices and reduce sales below the volumes which would prevail under competition, this is true only so long as competition can be prevented.

#### A. The Problem of Competition

If the prices of primary products are increased above their long-term trend through restrictive action, a greater stimulus to the development of substitutes for the primary products is provided.

An American spokesman recently described to a body of the United Nations how the high price of lead some time back led to its being displaced by aluminum and polyethylene in sheathing for electric cables. Substitution of commodities is always influenced by price changes. If tin becomes too expensive, the familiar beer and vegetable can may

give way to glass containers. Synthetic chocolate coating has been developed and widely used in reaction to high prices of cacao butter. Copper and aluminum are in competition with each other and with some of the newer plastics. Wool and cotton have lost ground to synthetic fibers. Although bananas have no near substitute, the consumer reaction to high prices is to eat other fruits. The distinct possibility that a synthetic and competitive substitute will be found for coffee has been reported by the Stanford Research Institute in a study for the Senate Foreign Relations Committee.

Sometimes substitutions are made almost immediately if price relations change. This would clearly be the case, for example, with respect to different grades of ores; in such a case, prices would have to move together or one grade of ore would lose out completely. Typically, however, substitution involves costly development of new products and/or costly adaptation in processing and manufacturing by the user. Hence, within limits, users are often reluctant to make substitutes. However, once the substitution is made and the costs incurred, there is the same cost-inspired reluctance to shift back to the original product. Hence, substitution is encouraged if artificial supports maintain prices too high for too long, and it becomes difficult to re-establish the original market.<sup>13</sup>

In addition to the problem of the development of substitutes there is the difficulty of preventing new producers from entering the market. This problem has plagued many efforts to raise prices in the past. For example, the American effort to raise the price of copper in the 1920's failed in part because the higher price stimulated production from new mines discovered in Northern Rhodesia and Canada. This difficulty is eased if importing countries—as in the recently signed coffee agreement—agree to restrict imports from non-participants in the commodity agreement. The willingness of importing countries to restrict imports from non-participants obviously depends upon political relations with the non-participants and prospective political relations with non-participants not yet on the scene.

### B. Organizing the Buyers

Many discussions of international commodity agreements strongly urge that representatives of both the producer and consumer nations participate in negotiations. International commodity agreements thus provide a means of organizing not only producers but consumers as well.

The consuming countries have an immense amount of bargaining power if they wish to employ it. The United States Government was able to force down the price of rubber from 85¢ per pound in the beginning of 1951 to 45¢ per pound by July 1951.<sup>14</sup> The United States Government, on direction from the Senate Armed Forces Committee, was also able to force the price of tin down from \$1.82 per pound to \$1.34 in a five day period early in 1951 and to \$1.05 by July 1951 simply by declaring a buyer's strike.<sup>15</sup>

If buyers of primary products are willing to act in concert, they could force the

<sup>13</sup> INTERNATIONAL ECONOMIC CONSULTANTS, *COMMODITY PROBLEMS IN LATIN AMERICA* 30-31 (1959).

<sup>14</sup> GARDNER PATTERSON & JACK N. BEHRMAN, *SURVEY OF UNITED STATES INTERNATIONAL FINANCE*, 1951, at 211 (1952).

<sup>15</sup> *Id.* at 212.

price of any given product below that which would prevail under competition. Commodity agreements, by instilling the idea of cooperation among buyers as well as sellers, only serve to increase the likelihood of such an event. The success of our rubber ventures during the Korean War indicate that we are not prepared to accept competitive import prices during brush-fire wars. While the attitudes of the governments of advanced countries are now generally sympathetic to the underdeveloped lands, it must be recalled that we have been willing to sacrifice their economic interests when domestic needs dictated, as evidenced by our quotas on imports of oil, lead, and textiles. When the age of inflation returns to the developed world, it is not impossible that the advanced countries might employ their bargaining power to prevent cost-inflation by forcing down the prices paid for raw material imports. By furthering the idea of collaboration, commodity agreements enhance both the probability of such an effort and the possibility of its success.

### C. Shifting of Inventories

Commodity agreements which alter trend of prices must, for their success, include means for restricting production. If, with high prices which restrict consumption, production continues unabated, surpluses will accumulate. Even if these are technically not available to the market, they depress the market price because they lead to pressures for larger quotas from the surplus-burdened suppliers. In such circumstances, the trade begins to recognize that prices are not likely to rise in the future, for the surpluses assure adequate supplies in the event of an increase in demand. Consequently, there is little incentive for consuming countries to hold inventories of the product, and the entire burden of holding stocks falls to the producers. The cocoa trade in the United States estimates the cocoa agreement would initially impose carrying costs of \$3.5 million per annum on Ghana alone, and those costs would subsequently rise.<sup>16</sup>

### D. The Allocation of Quotas

Because surpluses condition market prices even when withheld from the market, the ideal commodity agreement requires the supplying countries to divide production (and the market) among themselves. The economic gains to the underdeveloped world in such an allocation would be maximized if, while restricting sales, production of a given product is allocated to the lowest cost producers and to the countries which produce the varieties in the strongest demand. Because the lowest cost producer employs the smallest amount of land, labor, capital, and management to produce the product, such an allocation frees the largest amount of resources for alternative uses, *i.e.*, for economic growth, at any given level of export receipts for the underdeveloped world as a whole. Yet there is nothing in the process of

<sup>16</sup> CHOCOLATE MANUFACTURERS' ASS'N OF THE UNITED STATES OF AMERICA, REALISM IN COCOA STABILIZATION 5 (1961).

allocating quotas which assures this result. The allocations depend on extraneous matters, ranging from the prior volumes of exports of individual countries to the skill, persistence, and eloquence of the country representatives. The allocation depends essentially on the bargaining power of the producing countries and not on their ability to supply at the lowest costs what the consumer wants. As Professor Swerling notes, "One would be hard-pressed to argue that it was the efficient producers of tin, sugar, wheat, or coffee that earned increasing opportunities for supplying the market, on the basis of quota privileges emerging from the process of hard political bargaining."<sup>17</sup> It has been suggested (privately) that the recent coffee agreement affords the producers of robusta coffee an insufficient quota in the light of market trends. The real income of the underdeveloped world as a whole probably would have been smaller if Ecuador had signed a banana agreement in 1950 (as has subsequently been proposed). She later became one of the most efficient and successful producers. The value of her banana exports more than doubled by 1960 while her other major exports actually fell, and her share of world banana exports rose from eleven per cent to twenty-seven per cent.<sup>18</sup>

#### E. Lack of Selectivity

Probably the major shortcoming of international commodity agreements lies in their lack of selectivity. This takes several forms.

First, among primary producers there are countries which do not deserve assistance from the advanced countries by any test. For example, efforts to raise the price of lead would benefit Mexico *and* two countries which should be on the giving rather than the receiving end of help—Australia and Canada. Cotton is exported by both Egypt and the United States, copper by Rhodesia and Canada, linseed oil by Uruguay and the United States, oil by Venezuela and Kuwait (one of the richest countries in the world), rice by Thailand and the United States, and so on. Some notion of the extent of the problem is suggested by the fact that imports of primary products into industrial areas from industrial areas totaled almost \$25 billion in 1961 while they were approximately \$21 billion from non-industrial areas, excluding the Sino-Soviet Bloc.<sup>19</sup> Three different schemes to compensate primary producers for fluctuations in their exports provide benefits to *high-income* countries ranging from five per cent to twenty-three per cent of the total benefits paid out.<sup>20</sup> If we choose to aid underdeveloped countries by raising the prices we pay for their exports, we are faced with the choice of either limiting the commodities in which we operate so that some countries fail to receive appropriate assistance or employing some resources to help countries that by usual tests do not deserve help.

<sup>17</sup> BORIS C. SWERLING, *CURRENT ISSUES IN COMMODITY POLICY 19-20* (1962).

<sup>18</sup> FOOD AND AGRICULTURE ORGANIZATION (FAO), *TRADE YEARBOOK 118* (1961).

<sup>19</sup> GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT), *INTERNATIONAL TRADE 1961* (1962).

<sup>20</sup> CRAWFORD AND OTHERS, *INTERNATIONAL COMPENSATION FOR FLUCTUATIONS IN COMMODITY TRADE* table 8 (1961).

Second, there are primary producing countries whose governments are in disrepute, at home and abroad, because of a lack of democratic procedures. There are also primary producers whose governments pursue foreign policies quite unacceptable to some nations in the advanced class. To provide aid in such circumstances through raising prices will be objectionable to some countries. This may be the most important objection to international commodity agreements, but it shall be only asserted here.

Third, countries differ in their capacity to grow and to use aid effectively. There is increasing recognition of the need to concentrate aid in those countries where there is a reasonable prospect that it will make a difference to the long-run prospects of the recipients. This is not the place to review the differences among underdeveloped countries, but it should be noted that where governments are incapable of organizing themselves and where the seeds of progress have been planted but have failed to grow there is little point in massive infusion of external resources. The primary official instrument for transferring United States resources to underdeveloped countries, the Agency for International Development, is now undertaking a concentration of its aid program. It classifies current recipients into four groups, one of which consists of five countries which may soon no longer receive aid because they are close to self-sustained growth. Another consists of six countries which are regarded as hopeless and which will receive only token assistance; the other two groups differ in their ability to organize themselves for growth and will receive different degrees of attention.<sup>21</sup> Such selectivity is impossible through commodity agreements. Any country which exports product X receives aid if we artificially raise the price of product X.

Fourth, in providing resources to the less-developed countries, commodity agreements cannot select among recipients according to their propensity to invest. If a country enjoys a once-for-all increase in its average annual export proceeds, only part of the increase in real income will be saved and invested for economic growth. This is obviously true if the income goes into private hands and it is more than likely to be true if the income goes to governments. On the other hand, the propensity of U.S. aid missions abroad and of development banks to invest out of resources provided to them is extremely high. The only major exception arises where political and security conditions dominate the determination of the level of aid and its allocation; in such instances the economic circumstances of the recipient are often such as to assure that the bulk of the resources provided to the host government through higher export incomes will not be employed for development purposes either.

This is not to argue that expanded export proceeds and the consequent growth in international trade will not accelerate the growth of the underdeveloped countries. The intimate relationship between economic development and international trade is not denied. Expanded trade will bring gains to the underdeveloped countries as

<sup>21</sup> The (Washington) Evening Star, Feb. 9, 1963, p. A3.

they buy in cheaper markets and sell in dearer markets. The higher real income derived from trade permits larger levels of savings, essential to growth. The overseas borrowing capacity of the less developed countries rises with larger export proceeds. Larger volumes of trade lead to larger transfers of technology and of habits conducive to growth through additional contacts with new ideas and different men. Yet it is increasingly recognized that expanded trade may only lead to a higher level of stagnation if it is not accompanied by internal changes within the economies enjoying larger volumes of trade.<sup>22</sup> The shortcoming of commodity agreements is that they effect international rather than internal changes.

If the advanced countries wish to help the underdeveloped world in ways which will make a difference to its long-run prospects, the aid should be provided through direct transfers to development institutions such as United States aid missions, development banks, and United States private enterprises operating overseas rather than by shifting prices. Acting as agents of change and having a high propensity to invest, their chances of affecting the long-term circumstances of the less developed countries are greater.<sup>23</sup>

It can be argued that there is no real difference in providing aid through higher export proceeds and through direct transfer by development institutions because money is fungible. If, for example, the United States steps up its direct transfers to a country, this may not stimulate the rate of investment (even though the funds are employed in development projects) because the host country may simply reduce some of its expenditures for development. Similarly, it is argued that if the United States puts funds into Project X the net effect is to make possible the financing of Project Y if the recipient government diverts its resources from Project X upon learning that we will finance Project X. Thus, it is quite impossible to deduce the actual net effect of the aid from the project aided except where the United States assists in projects which the recipient country would not have undertaken in the absence of aid.

The logical conclusion of this reasoning is that a donor of aid cannot control the use of his aid unless he influences the proposed uses of all of the recipient country's resources. New techniques of providing aid, particularly that of offering it in the context of a national development plan, have no doubt increased somewhat the donor's influence over the use of resources by the recipient. More importantly, the new techniques have revealed that many countries, with a few exceptions, have great difficulty in establishing priorities for the use of resources. Because they do not have clear-cut priorities of their own, an offer of aid for a particular project will therefore have some effect on the allocation of the total resources used in the recipient economy. Hence, while money is fungible, governments have not been able to take advantage of this fact. Until massive improvements in public administration are

<sup>22</sup> GERALD M. MEIER, *INTERNATIONAL TRADE AND DEVELOPMENT* 184-85 (1963).

<sup>23</sup> The first to make this point was Wallich, *Stabilization of Proceeds from Raw Material Exports*, in HOWARD S. ELLIS (Ed.), *ECONOMIC DEVELOPMENT FOR LATIN AMERICA* 342 (1961).

achieved in the developing nations, this situation will continue to prevail. Therefore, there is a real difference between providing aid through expanded export receipts and through direct transfers via development institutions.

This argument is strengthened by the fact that the provision of aid through higher prices does not provide an excuse to plant Americans on foreign soil, as do the regular aid programs, where they can influence the allocation of resources in a variety of ways and where they can act as agents of internal change.

Fifth, within the recipient nations and within the donor nations, the benefits and burdens of transferring resources cannot be allocated rationally through shifting prices. There are some three or four million farming units in seventy countries which produce coffee. The vast majority of those units are farms with less than five acres under cultivation. But roughly one-third of the coffee is produced by units of over 75 acres.<sup>24</sup> One might argue that the price received by the rich growers should be raised without increasing that received by the poor growers because the rich coffee planters will save and invest a greater part of the additional income. Or one might argue that the price received by the poor should be raised without increasing that obtained by the rich in order to achieve a more equitable distribution of income. I can find no argument that holds that it is a matter of indifference whose income is increased; yet commodity agreements serve to raise the prices received by both rich and poor.<sup>25</sup>

As for sharing the burden of aid within the donor countries, I can think of no product which is a less equitable basis for extracting money from Americans for transfer abroad than coffee. I suspect that very few of the primary products that we import are consumed in increasing proportion to income or wealth of the individual consumer. Of course, the problem goes beyond the question of an equitable sharing of the burden within the United States. At least some of the persons in the United States who will pay higher prices for coffee (or drink weaker cups of coffee in commercial establishments) will be poorer than some of the persons who enjoy increased receipts from higher prices of coffee.

### III

#### COMPENSATION

A number of proposals have been made recently to compensate partially the producers of primary products for fluctuations in their export receipts. The schemes are triggered when export proceeds decline and, depending upon the proposal, repayment is required, if at all, when export proceeds subsequently rise, or after

<sup>24</sup> FOOD AND AGRICULTURE ORGANIZATION (FAO), *THE WORLD COFFEE ECONOMY*, COMMODITY BULL. NO. 33, at 3 (1961).

<sup>25</sup> If the advanced countries could decide which group they preferred to favor there is serious doubt that they could achieve the desired result. The underdeveloped nations probably would not accept language designed to specify the recipients of assistance on the ground that it was an unwarranted intervention in internal affairs.

some specified period of time. In as much as there would be no price fixing or production controls, these proposals go far to meet some of the objections made above to international commodity agreements. However, they have shortcomings of their own.

#### A. Inducement to Instability

It has been noted that if the compensation for export losses takes the form of grants, the proposed mechanisms would place a premium on instability.<sup>26</sup> Governments would have an incentive to withhold exports during a downswing in order to obtain more compensation. It should be apparent that this point also applies to loans, because there is a major gift element in current loans to underdeveloped countries, namely, low rates of interest. Governments of underdeveloped nations are able to borrow from the United States Government at far lower rates of interest than prevail in their own countries or that they could contract on the open market in the United States.

#### B. Modest Results

The scheme under consideration by the Organization of American States has been tested with 135 variations against the actual exports of 48 primary producing countries over the period 1951-61.<sup>27</sup> The test established an ideal norm, namely, a centered five-year moving average of actual exports. It also established a target which called for compensation of two-thirds of the deviations of actual exports from the ideal norm. In any given year (the centered year) it is impossible, in the actual operation of any plan, to know the level of exports for the next two years. Hence, practical norms relying on current and past exports were also calculated.

With compensation equal to two-thirds of the difference between actual exports and the practical norms, the best of the variants succeeded only in offsetting twenty-three per cent of the deviations between actual exports and the target; the target differed by one-third from the ideal norm which was itself fluctuating. The reason for the modest effect lies in the failure of the scheme to affect the availability of foreign exchange proceeds during periods of generally rising exports prior to shortfalls in receipts. If we eliminate those years on the ground that help is not required, the most effective scheme eliminated almost forty per cent of the deviations from the target—still a modest result when one considers that the target is only two-thirds of the ideal, and the ideal is itself fluctuating.

With such modest results, it becomes questionable whether the proposals are worth the cost, which runs from \$590 million to \$2.8 billion as measured by the maximum outstanding indebtedness at any one time. If the governments of the

<sup>26</sup> COPPOCK, *op. cit. supra* note 11, at 147.

<sup>27</sup> Fleming, Rhomberg & Boissonneault, *Export Norms and Their Role in Compensatory Financing*, 10 INT'L MONETARY FUND STAFF PAPERS 97 (1963).

underdeveloped countries were willing to chop off the peaks in their foreign exchange earnings by paying funds into a pool, even though they might not have prior drawings which they were obliged to repay, the effectiveness of the schemes would be substantially increased. However, none of the schemes proposes this, presumably because the underdeveloped countries are unwilling to save for a rainy day.

It might also be noted that several of the variations on the scheme under consideration in the Organization of American States actually destabilized foreign exchange receipts as compared to actual receipts. This suggests that such schemes must be drawn with care lest, with different patterns of trade fluctuation in the future, they harm rather than help.

### C. The Problem of Automaticity

The various proposals call for automatic compensation after a certain degree of decline in exports proceeds. The amount of compensation would be determined by a pre-established rule which would apply to all. Both the notion of a common rule and the idea of automaticity are attractive features of the proposals because they reduce the role of discretion.

However, the desirability of the proposals depends upon the appropriateness of the rule which determines the amount and timing of the compensation. When a country suffers a decline in its export receipts, it should in some measure draw upon its own foreign exchange reserves to meet the problem of paying for imports. The purpose of holding reserves is precisely to offset fluctuations in receipts and payments. Therefore, the rule which triggers assistance should include some reference to reserves. Unfortunately, no satisfactory measure exists of the level below which reserves may not fall without introducing serious dangers.<sup>28</sup> In the absence of a satisfactory rule, automatic compensation loses much of its attractiveness.

Automaticity furthermore would complicate the work of the International Monetary Fund. Many of the underdeveloped countries, though not all, have suffered from inflation and balance-of-payments difficulties. The IMF has sought to help them adopt policies to remove these problems. Its ability to do so rests in part on its control of funds which it lends for short periods to countries in difficulty on the condition of reform in their policies. As the staff of the IMF notes, "If Fund assistance in the compensatory financing of such fluctuations were given automatically and unconditionally, it would seem inevitable that its ability to influence countries toward the adoption of appropriate policies would be seriously impaired."<sup>29</sup> Whether the Fund or some other organization provides the automatic assistance, the effect on the Fund's influence would be the same.

The problems which the IMF seeks to help underdeveloped countries avoid have

<sup>28</sup> *The Adequacy of Monetary Reserves*, 3 INT'L MONETARY FUND STAFF PAPERS 181 (1953).

<sup>29</sup> *Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations*, 8 INT'L MONETARY FUND STAFF PAPERS 1, 22 (1960).

a close bearing on their prospects. Exchange controls, which stem from balance-of-payments difficulties, lead to undesirable and uneconomic protection of inefficient producers. Inflation leads to capital flights which denude countries of resources for their growth. If automatic compensation weakens the hand of the IMF, the net effect may be to slow the economic growth of the developing nations.

#### SUMMARY AND CONCLUSION

There are good reasons to doubt that international commodity agreements will help the less developed countries. They may add to the forces for sustained misery.

If commodity agreements are designed only to stabilize prices around the trend which would prevail in the absence of intervention, the incomes of the underdeveloped countries will be lower than otherwise because supply is prevented from responding to variations in prices. The loss of income can be avoided by employing buffer stocks, but these may lose money if the trend of prices is downward; and there is a limit to the commodities which can be covered through this device. Furthermore, it is extremely difficult to predict the trend, and stabilization operations may have to be reversed abruptly, adding to instability. Finally, stabilization, by reducing uncertainty, may lead to lower incomes by stimulating investment in the production of commodities the demand for which is unresponsive to price.

If commodity agreements are designed to raise the trend of prices, the higher prices may induce the development and use of substitutes which irreversibly displace the supported commodity. Commodity agreements may backfire if buyers, having become accustomed to cooperation through the agreements, decide to combine their bargaining power to reduce prices. As a result of commodity agreements, the less developed countries may be obliged to bear the burden of financing inventories normally carried by the consuming countries. Commodity agreements are not likely to allocate production to the lowest cost producers in the underdeveloped world; as a consequence, the underdeveloped countries as a whole may have fewer resources to spare for economic development. Finally, commodity agreements are unselective among the recipients of help. Some advanced countries would receive benefits by virtue of their exportation of primary products. In contrast to aid granted through development institutions, countries would receive help without regard to their talent or capacity to employ it for development; as a consequence, the income of underdeveloped countries as a whole will be lower than otherwise. The distribution within underdeveloped countries of the increased income resulting from higher commodity prices cannot be controlled by those who bear the cost, and the latter are not likely to be indifferent to the distribution. Finally, commodity agreements may involve a redistribution of income from the poor to the rich.

Measures to compensate primary producers for instability rather than to control prices and production, while meeting some of the problems set forth above, have difficulties of their own. They may add to instability by inducing countries to

withhold exports. The proposed schemes appear to give very modest results, sometimes even perverse results. The automatic features of the proposals, while in principle desirable, suffer from the inability to establish a satisfactory rule for triggering the compensatory mechanism. In addition, the ability of the International Monetary Fund to combat growth-denying exchange controls and inflation will be hampered, thereby diminishing the prospects of the less developed countries.