

# International Commodity Problems and Schemes for International Compensatory Financing<sup>(1)</sup>

## The Present Concern with Commodity Policy

Commodity policy has of late been placed in the forefront of international concern by the convergence of several causes. Basically, there are the serious economic and political implications of the fall in commodity prices over the last ten years. The drop in export receipts by exporting countries has exceeded many times their receipts of financial assistance, reviving the demand for Trade as well as Aid. At the same time, being poor and underdeveloped countries with votes in the United Nations, it is felt that exporting countries should not continue to suffer further price declines for their exports to benefit the richer developed importing countries. Again, the difficulties encountered in hammering out a common agricultural policy in Europe and the implications for exporters of primary products of the proposals under discussion have resulted in a declaration by the European Economic Community in favour of the negotiation of international commodity agreements. This declaration has been echoed by the Conference of Commonwealth Prime Ministers. Indeed, a cynic might feel that statements of the desirability of and intention to conclude such agreements has replaced the oft-declared insistence on the harmonisation of agricultural policies as the current cliché in economic diplomacy. Certainly, if recent experience is not seriously misleading, international commodity agreements should not be regarded as a panacea for the present world commodity situation.

The situation has arisen in the main from four causes. The current supply of many primary products is attributable in the first place to the plantings that were stimulated by the sharp Korean

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(1) This paper is personal and has no connection with the author's work as Consultant with the Food and Agricultural Organisation in Rome in February and March, 1962.

boom. Supplies emerged after demand had passed its peak and further depressed prices. Thus coffee trees of the aribica variety, which is usually grown in the Western Hemisphere, have a gestation period of four to five years before they bear and then produce beans for twenty or more years. So the response of supply to changes in demand is inevitably delayed and imperfect. The boom which began in 1949 resulted in a sharp increase in exportable output in the crop year 1955-56. "Average production in the three years starting in 1957-58 exceeded average output in the first half of the fifties by some 65 per cent. Exports increased much more slowly — by about 25 per cent — and about one fourth of exportable supplies remained unsold" (2).

A second cause of the present situation is the sharp rise in the output and use of synthetics during the 1950s. Synthetic fibres have competed against wool and cotton; plastics have competed against timber and metals while synthetic rubber output has risen 70 per cent compared with an increase of natural rubber output by 40 per cent. As a consequence, increases in demand have been shared between natural and synthetic, often going largely to the synthetics. A complex of causes has been behind this technical upsurge, among them being earlier commodity shortages and the development of new uses.

For staple foodstuffs a third cause has been dominant, namely the slower rate of growth of the demand for them compared with the demand for semi-luxuries and luxuries. A study by the National Institute of Economic and Social Research suggests that real incomes increased by 40 per cent but the demand for food went up by only 30 per cent. Increased expenditure on foodstuffs in part reflected more packaging and more processing and none of this increase went to the food producers. As a fourth cause there has been the self-reinforcing increase of supplies as prices drifted lower. In order to maintain incomes, or at least to minimise any decrease, peasant producers tend to put more on the market. For twice as much cocoa Ghana, for example, received £8 million more than previously owing to the drop in prices. This has greatly complicated the financing of the Volta River Project whose total cost is estimated at £70 million of which £40 million is intended to be covered from local

(2) The International Coffee Market: A Note - GERTRUD LOVASY (*Staff Papers*, July 1962), p. 228.

resources. Others have fared even worse. Thus Malaya received less for increased exports owing to the sharp fall in rubber prices. In its discussion of trends in the primary exporting countries the position is summed up thus in the *World Economic Survey 1961* "As in previous years, changes in import prices were generally much smaller than those in export prices. As the latter were almost universally downward — fractionally in Latin America, sharply in southern and south-eastern Asia — there was a widespread deterioration in the terms of trade. It was least in Latin America — where foreign trade had remained remarkably static over the period 1958-1961 — and greatest (about 5 per cent) in Africa and southern and south-eastern Asia, where the incidence of primary commodity price changes was most marked. On the average, the primary exporting countries had to export 2 per cent more in 1961 than in 1960 in order to acquire the amount of foreign exchange necessary to purchase the same volume of imports" (3).

#### The Working of Commodity Agreements

With the plight of primary product producers in the early 1930's and the unsatisfactory nature of commodity agreements during the inter-war period both in mind, Chapter VII of the Charter for the International Trade Organization of the United Nations was drafted in 1946 and sanctioned by the Economic and Social Council in March, 1947. It was recognised that primary commodities were subject to special difficulties arising "out of such conditions as the disequilibrium between production and consumption, the accumulation of burdensome stocks, and pronounced fluctuations in prices" (Art. 46). Inter-governmental commodity arrangements would be employed to deal with such problems after discussion at an open Conference (Art. 49) where both exporters and importers substantially interested would be adequately represented (Art. 51). Regulatory agreements were to be employed only when "a burdensome surplus of a primary commodity has developed or is expected to develop" or "widespread unemployment in connection with a particular primary commodity has developed or is expected to develop" (Art. 52). It was provided that any regulatory agreements negotiated should

(3) *World Economic Survey 1961* (United Nations, New York, 1962), p. 150.

(i) treat non-members equitably; (ii) "assure the availability of supplies adequate at all times for world demand at reasonable prices"; (iii) "make appropriate provision to afford increasing opportunities for satisfying world requirements from sources from which such requirements can be supplied most effectively and economically" and (iv) a programme of economic adjustment should be adopted "to ensure substantial progress toward solution of the problem within the time limits (not more than five years) of the agreement" (Art. 53). These principles were impeccable but, like the Charter itself, have had no complete practical application. For example, in the agreements that have operated since the Korean boom, the largest importer — the United Kingdom — left the International Wheat Agreement in 1953 not returning until 1959; the United States and Western Germany have not joined the International Tin Agreements; in the case of the International Sugar Agreement a big exporter, Cuba, favoured greater export quotas and lower prices while importers with subsidised or protected beet sugar industries were anxious to negotiate smaller quotas and higher prices.

If the hopes again being widely expressed for early and substantial benefits from international commodity agreements are not to be sadly disappointed, attention must be paid to the lessons of the recent past. Such agreements as have operated — in wheat, sugar, coffee and tin — have been both hard to negotiate and hard to work. The International Wheat Agreement, starting in 1949, operated on the basis of negotiated price quotas and thus provided a mutual insurance scheme for importers and exporters. Prices appear to have been favourable to producers and, looking back, the United Kingdom's withdrawal in 1953 is seen to have been justified as the price trend was downwards afterwards. The Agreement has not helped to reduce surpluses and it can be argued that the strength of the Agreement was provided by the existence and policies of the American Commodity Credit Corporation and the Canadian Wheat Board. The International Sugar Agreement was made possible in 1953 by Cuba's willingness to limit exports. It broke down in 1961 because Cuba, owing to internal political changes and her quarrel with the U.S., was no longer willing to promise to limit her exports as before and asked for a quota that other exporters thought impossibly high. Meanwhile her anxiety to sell had driven price downwards. The International Sugar Council continues to meet and a new attempt to re-negotiate is likely

to be made in the near future. Agreements on a yearly basis for coffee started in October 1957 with export restrictions on only Latin American countries. These were joined by the French Community and Portugal on behalf of their African territories in October 1959 and by the United Kingdom on behalf of territories in East Africa in October 1960. Even so, prices have declined and, despite increased sales from 36.1 to 42.8 million bags 1957-60, export receipts fell by \$450 million, i.e. from \$2,290 million to \$1,840 million, 1957-60. The text of an International Coffee Agreement was approved on September 28, 1962, after more than two years of discussion within the Coffee Study Group. Final implementation, which must take place not later than December 30, 1963, requires "actual ratification or acceptance" by similar numbers and trade percentages of importing and exporting countries. The new agreement, like the series of one-year producers' agreements it is to replace, is an export regulation agreement. Its basic export tonnages for the 36 participating producing countries add up to 45,590,000 bags of 60 kilos, of which 32,650,000 bags have been assigned to producing areas in Latin America and 12,920,000 bags to those in Africa and Asia. The new agreement does not include additional obligations to importing countries, although it contains a general undertaking to investigate ways and means of progressively reducing obstacles to increased consumption of coffee. But with world coffee stocks sufficient to meet world shipments for nearly two years, and with a current exportable crop at 53,250,000 bags — nearly one-fifth in excess of world imports — it is not surprising that the decline of coffee prices has not been reversed. However, a firmer agreement might have had no more effect and would probably have failed in the early stages of implementation. The agreement is realistic but no quick results can be looked for in the state of the market or level of prices.

Finally, there is the International Tin Agreement, the only agreement for metals. The first agreement existed from July 1, 1956 to June 30, 1961. The U.S., Western Germany and the Eastern Bloc were not members. It took the form of a buffer stock with export controls. Floor and ceiling prices were fixed with three equal subdivisions between. The International Tin Council met quarterly and the agreement worked quite well. Even so, the market price did drop below the floor price when the buffer stock manager ran out of cash. In the second agreement a higher price range of £880-£965

per ton was fixed. Even so, the buffer stock exhausted its stock of tin and could not further moderate the following price rise. It is arguable whether the resulting situation was worse than if there had been no working agreement. As always, buffer stocks to be successful need substantial funds on the one side and substantial stocks on the other side if prices are to be contained within a closely agreed price range.

This sketch is intended to show the difficulties of international commodity agreements in practice not to suggest that further and continuing attempts should not be made to negotiate workable schemes. Despite the difficulties it is important to strive. But quick and easy victories will not be won in the present state of commodity markets. Recent experience should have a sobering influence. A realistic approach is essential.

#### The Approach to Commodity Problems

It is at least doubtful whether the dichotomy of commodities into tropical food products on the one hand and temperate food products on the other that has been used in Common Market discussions makes for a realistic approach to the issues. The implications involved in the use of this grouping are, firstly, that it divides commodities into one or the other and, second, that it divides countries into underdeveloped and developed. Neither in fact is true. Some commodities are produced in both tropical and temperate latitudes, sugar being perhaps the most prominent. Tobacco is another example. Again, not all temperate countries are developed and wealthy. Many are, like the United States, New Zealand and Denmark. But some are not, like Greece or Turkey. The division is thus not useful as a guide to policy.

But this does not mean that we must go to the extreme of a commodity-by-commodity approach. As a working classification a four-fold division is useful. First, there are the basic foods, like grains; second, there are the supplementary foods which were once luxuries, like spices, coffee, tea, wines and tobacco; third, there are the raw materials, including fibres and synthetics; finally, there are specialised commodities such as gold and uranium which cannot be usefully dealt with as a group. With regard to the first group of basic foods, the International Wheat Council at its review in

November 1961 confirmed its earlier findings according to which the long-term imbalance between supply and market demand for wheat is the outcome mainly of government intervention in production and trade, technological factors and divergent trends in consumption in different regions. While the new International Wheat Agreement, operating since August 1, 1962, is intended to deal with the existing imbalance, efforts should be made in other directions to improve the purchasing power of potential consumers. This is not equivalent to the argument for the disposal of "surplus" stocks to undernourished communities as a form of aid. For while this no doubt serves a useful short-term purpose — both for donor and recipient — it might, if prolonged, interfere with desirable adjustments at both ends. As an improvement of agricultural productivity is frequently the *sine qua non* of sustainable industrial development in underdeveloped countries, it is possible that the receipt of "surplus" foodstuffs, however well intentioned and, let it be admitted, a useful way of disposing of embarrassing uneconomic output on the part of the donors, will retard that improvement of agriculture on which growth should be based. The long-term problem in the case of basic foodstuffs is to match market demand with supplies and this can only come about if the economic development and trade of undernourished countries is fostered. Restriction schemes and surplus disposal are at best short-term palliatives.

Turning to the second group of supplementary foods, here consumers are wealthier than producers and unlikely to increase their demand much when retail prices are reduced. While the precise response of demand to price changes is a matter on which opinions differ, all estimates are low. So an attempt to dispose of, say, more coffee will push price down sharply. And it might in turn increase the exportable surplus. International commodity schemes have, as mentioned earlier, been — and are being — tried. But in this field at least there seems to be strong case for a new departure in commodity policy. The possible form of such a policy is outlined in the succeeding sections.

Meantime, in regard to the third group, raw materials, an important problem is to relate capacity for natural and synthetic materials to estimated world demand. When, for example, the International Rubber Study Group examined the situation in May 1962 it concluded that producers of natural rubber should reduce pro-

duction costs and improve the technical qualities of their output. For the difference between natural and synthetic rubber has greatly diminished in recent years and complementary usage of all types of elastomers is developing. The situation is, it is true, complicated by the increase of capacity for producing synthetic rubber for strategic reasons. Yet this emphasises more rather than less the need for a fluctuating price to show the pace of expansion required. Finally, in the case of specialised commodities, like gold, the pricing is determined by national buying and selling prices. There seems to be no scope for commodity agreements to function.

There is thus no general and overall solution to commodity problems. In some directions agreements might be possible, in others rather unlikely. Meanwhile primary producing countries are subject to sharp short-term variations. Any commodity agreements likely to operate could not offset these short-term movements. Indeed, by trying to do so, they might easily operate against a trend and, like the buffer stock in tin, exhaust either their finance or their stocks. Short-period fluctuations in, for example, sugar prices are largely a matter of changing stocks and the changing willingness of the various stock-holding agencies to hold stocks. Again, it is true that future markets help to moderate short-term changes which are often so large because only a small part of a commodity is sold on a free market. Also, at the extremes of large surpluses or great shortages little can be done to cushion price movements. Yet, it is thought that underdeveloped economies should not continue to suffer the full impact of short-term fluctuations in the prices of their main exports. This brings us to the schemes proposed for a system of compensatory financing.

#### International Compensation for Fluctuations in Commodity Trade

On January 31, 1961, a report with this title (4) was signed by a committee of experts appointed by the then Secretary-General of the United Nations. The report, sometimes referred to as the Crawford report after the name of the chairman of the committee of experts which prepared it, examined "the feasibility of establishing

(4) Department of Economic and Social Affairs (United Nations, New York, 1961), pp. 96.

machinery, within the framework of the United Nations, designed to assist in offsetting the effects of large fluctuations in commodity prices on balances of payments, with special reference to compensatory financing". It might conveniently be discussed under four headings:

- (i) nature of the problem,
- (ii) available means of dealing with the problem,
- (iii) proposed Development Insurance Fund, and
- (iv) related aspects of commodity trade.

#### (i) *Nature of the Problem.*

The problem is set by the greater variations in the value of trade in primary commodities than in that of other commodities. These variations, both in price and in quantum, the variation in prices being usually the greater, have averaged about 12% since the war as against 17% in the inter-war period. Such variations have sharp repercussions in many primary producing countries about half of which rely on not more than three such commodities for over four-fifths of their earnings from their merchandise exports. The causes of these fluctuations are several. Thus they reflect demand from the industrial countries, they follow changes in output due to natural causes, they accompany changes in stock holdings which may in turn have any of several purposes, they are brought about by changes in government policies. None of these causes can be entirely eliminated though few are beyond some measure of control or influence. Fluctuations are therefore persistent. They are usually not entirely offset by earnings in other directions nor does the trend of primary product prices appear to be upwards so that the relative importance of the fluctuations becomes lessened. Necessarily, therefore, they upset the economies concerned and hinder developments of all kinds, economic and social. Incomes change, expenditure on consumption and investment changes, public revenue rises and falls, the ability to import rises and then drops off. Comparing the change in export proceeds of the low-income primary producing countries with the average level of proceeds in the three preceding years, for the years 1953 to 1958 the shortfalls amounted to around \$1.7 billion. That is the sum which would have been necessary in that period if there

had been a plan in operation to offset any falls in export earnings below the three year average level. It compares with exports of primary commodities from such countries of about \$25 billion by the end of the 1950's, or 6.8%.

(ii) *Available Means of Dealing with the Problem.*

Action to offset a fall in export earnings must supply the means to maintain the level of imports. But the means presently available for this purpose are less than adequate. While primary producing countries have a greater need of reserves of gold and foreign exchange than others if they are to cope with the greater fluctuation of their export proceeds, their ratio of reserves to exports was no greater in 1950 than that of other countries and has since declined whereas those of industrial countries have increased. As they stood in 1959 the official reserves would not have been sufficient in 10 out of 46 primary producing countries to cover in the 1950's the largest uninterrupted decline of export earnings from the average level of the preceding three years.

Other sources of foreign exchange are available, notably from the International Monetary Fund which since the increase in quotas in 1959 has enlarged resources. But the Crawford committee felt, despite the larger resources and longer experience in dealing with the special problems of primary producing countries, that there was not, and indeed could not, be sufficient certainty of drawings on the Fund's quotas of the amounts likely to be involved to regard the I.M.F. by itself as answering the need. And while something useful might come from long-term capital transfers arranged on a compensatory basis nothing serious is available as yet. The same is true of other possibilities such as new agencies for long-term external financing. Hence the need for a new departure if international compensatory action is to be on a sound and sufficient basis.

(iii) *Proposed Development Insurance Fund.*

The Crawford committee suggested that a feasible arrangement of compensatory financing would have to take the form of social insurance as it would involve transferring funds to those who are more vulnerable to fluctuating export proceeds from those who are

less vulnerable. The main claimants would be the underdeveloped countries while the main contributors would be the advanced economies. It would thus become a form of multilateral aid, the contributors benefiting from the greater stability of income and expenditure in the underdeveloped countries. The purpose would be to moderate instability and neither to offset it at any one time nor to interfere with necessary adjustments in the economy.

Two types of arrangements are suggested. Under Type I compensation for declines in the proceeds of merchandise exports would be made in the form of grants while under Type II it would be made by loans repayable in whole or part if export proceeds revived sufficiently during a specified period. Naturally Type II would be cheaper to finance than Type I at any given level of compensation. A bigger proportion of shortfalls might for that reason be compensated.

It is suggested that shortfalls should (a) be measured against the average proceeds of the preceding 3 or 4 years; (b) the first 5% or 10% should not be compensated; (c) losses should be adjusted by an index measuring "dollars of constant importing power". The following table from p. 43 of the report shows the possible magnitudes involved.

AVERAGE ANNUAL BENEFITS, 1953-1959, AS YIELDED BY THREE POSSIBLE BASES FOR CLAIMS

Country Group	50% compensation and minimum deduction of:		
	10%	5%	2.5%
	(million of dollars)		
Industrial and high-income primary producing countries . . . . .	12	85	142
Low-income primary producing countries . . . . .	246	383	466
Total . . . . .	258	468	608

The report suggested that contributions from low-income primary producing countries should be based on the level of their export proceeds but those from others should be based on per capita income.

Type II plan would, it is suggested be more proof against successful manipulation than would Type I. It refers specifically to stock movements in this way (p. 47-8): "imagine a country which has storable goods to sell on a scale which will bring in 100 units of export proceeds yearly. Under a Type I plan, this country could gain by making its sales intermittent. Suppose sales in year 1, 2 and 3 were 100, 100, 100. If sales in year 4 were cut to zero, there is a decline of 100 on an average of 100, with an insurance claim of, say, 47. Then by selling 150 in years 5 and 6, the stage can be set for another shortfall in year 7. But total receipts, including compensation, for years 4, 5 and 6 have been raised from 300 to 347. Under a Type II plan, the higher later receipts would give the fund a contractual right to recover at least the bulk of the drawing. This balancing of incentives would reduce the proportion of disbursements which could be captured by such unfair tactics, and would thus justify fuller coverage of shortfalls".

The possibility is mentioned both of combining Types I and II and of making additional uses of the Development Insurance Fund. As regards the first possibility, part of the compensation might be made in grants and the rest in contingent loans or Type II might be available to all countries but Type I only to low-income primary producing countries. As regards the second possibility, crop insurance and the use of funds during a general down-turn in trade to buy capital goods for low-income countries, are briefly mentioned.

Although the effective use of compensatory receipts is highly desirable, this was felt to be a matter for the country concerned, providing its use resulted in more satisfactory economic growth.

Compensatory financing deals — and is intended to deal — with only one aspect of the problems affecting international trade in primary producing countries. There is the need for a whole complex of measures if such problems are to be dealt with comprehensively. Compensatory financing does not attempt to stabilise either price or quantum fluctuations. To this the main approach must be via commodity agreements and arrangements of various types. Three points were made on this by the Crawford committee. First, buffer stocks are likely to be more effective if held and financed as an integral part of international commodity arrangements. Secondly, it is important to recognise at an early stage movements which, if left unchecked, would in time seriously damage the interests of underdeveloped countries. Thirdly, liberal commercial and

fiscal policies, particularly in the advanced countries, would help to foster the growth of exports from the underdeveloped countries. Finally, the Crawford committee felt that the setting up of new institutions to deal with either the insurance proposals or any other should be avoided and new methods should wherever possible operate from existing organisations.

#### Stabilisation of Export Proceeds Through a Development Insurance Fund

A study (5) with the above title was prepared by the Secretariat of the United Nations for the Tenth Session of the Commission on International Commodity Trade. A companion study, A Development Insurance Fund for Single Commodities (6), was prepared also by the United Nations Secretariat. It is proposed to give an account of each of these thorough studies in turn.

The first study consists of three parts:

(1) the recommendation for a compensatory mechanism.

The general argument of the Crawford report is repeated with a wealth of statistical amplification of points raised in the discussion of the Crawford report by the Commission of International Commodity Trade at its Ninth Session (May, 1961). The investigation confirmed the conclusion of the Crawford report at each point. The Crawford report, as mentioned earlier, suggested that a D.I.F. scheme that combined the two types of coverage in predetermined proportions — outright settlement of part of the computed shortfall claim in return for an annual premium, and for the remainder a loan settlement subject to contingent repayment — might well provide a suitable compensatory mechanism through which shortfalls in export earnings could be financed at a cost that was reasonable both in total and in its distribution.

The second part of the study explores this view.

(2) the arithmetic of compensation under D.I.F.

In order to give effect to the principles envisaged by the Crawford committee, a D.I.F. plan would have five ingredients in its compensation calculation:

(5) E/CN.13/43, January 18, 1962.

(6) E/CN.13/45, CCP 62, February 6, 1962.

(i) a "minimum deduction" intended to eliminate from consideration minor deviations in current earnings from the defined trend,

(ii) a "compensation proportion" intended to reduce the compensatory transfer to something less than a complete offset to the computed shortfall,

(iii) a "loan ratio" defining the proportion of computed compensation to be paid in the form of a contingent loan,

(iv) a "repayment proportion" specifying the fraction of any computed increase in earnings above trends that is to be devoted to the repayment of a contingent loan,

(v) a "contingent limit" specifying the period during which a contingent loan remains a liability subject to repayment.

A comparable set of ingredients is required if in distributing the cost of operating a D.I.F. due regard is to be taken of a country's ability to pay and the vulnerability of its domestic economy to sudden reductions in export receipts as well as the risk of fluctuations in its earnings against which it is seeking to insure. A set of three ingredients is proposed:

(i) national income per capita, measured in U.S. dollars;

(ii) an "export dependence ratio" measured by the numerical relationship of export earnings to gross domestic product;

(iii) an "export instability ratio" measured by the numerical relationship of annual shortfalls in exports below the defined trend to total exports, both cumulated over a predetermined period of years.

The U.N. Secretariat study then proceeds to apply formulae based on the ingredients to data for the period 1950-1960 for 114 countries and territories which together accounted for over 98% of world trade outside the centrally planned countries. Annual export proceeds were measured f.o.b. in current U.S. dollars. The arithmetic was confined to the compensatory transactions themselves — claims, settlement, loans and repayments. Allowance was not made for administrative or other costs likely to be incurred by any actual D.I.F. Naturally, too, it had to be assumed that the D.I.F. had a neutral effect on trade, that is trade flowed, or ceased to flow, as though the D.I.F. did not exist. This is a necessary assumption when historical data is being used but it should be borne in mind

that a successfully working D.I.F. would be likely to raise the general flow of trade by its assurance of compensation if export proceeds declined. One of the arguments against exchange control is that it cuts down trade until it balances. Long legs are made equal to short legs. A working D.I.F. should have the contrary effects. Short legs should grow to catch up with long legs. But, of course, historical data cannot reflect, or be made to reflect, such changes.

Clearly, with five ingredients on the compensation side and three ingredients on the contribution side and each one variable upwards and downwards, it is possible to formulate an almost endless variety of different combinations of the ingredients. The U.N. Secretariat calculated the outcome of 17 important variations, summarised in Table 32 of its report. It is sufficient here to consider the broad upshot of this thorough investigation. It was found that between 1953 and 1960 the sum of all shortfalls in export earnings from the trend measured by the average of the three preceding years was just under \$12 billion. Supposing that the first 5% of a decline in earnings was ignored and only 50% of the remainder of the shortfall was offset, the gross claim would have been \$3.3 billion. If there had been no minimum deduction and 75% of the shortfall was offset, the gross claim would have reached \$9.0 billion. Once repayment is brought in, the net cost falls. Thus if the first variety measured above carried a provision that the whole of the compensation should be repaid if export proceeds rose sufficiently during the next three years the net cost would have been no more than one half of the gross cost. As would be expected, the net cost rises as the compensation proportion rises and as the minimum deduction, loan ratio, contingency period and repayment proportion are reduced.

Over the years 1953-1960 the sum of the exports of all the countries considered was about \$730 billion. The range of gross claims would have extended from about 0.45% of total exports under the minimum scheme mentioned above to 1.23% of total exports under the maximum scheme mentioned. The range of net claims under these same schemes would have been from 0.18% to 1.23%. Such, under the specific assumptions, would have been the overall cost of D.I.F.

Just as the compensations could be based on any of several combinations of the five ingredients, so also could the premia be calculated on various combinations of the three ingredients — national



income per capita per annum, export dependence and instability ratio. Three values for each are used in the hypothetical application made in the U.N. Secretariat report — see Table 35 of that report. The general effect is to shift the burden of D.I.F. financing away from the less developed countries towards the industrial countries. Take, for example, the first set of values suggested in the report. The amount “by which 1% of current export proceeds would then have had to be multiplied would have ranged from 0.09 in the case of some of the least developed countries to 0.60 in the case of some of the high income countries and to 0.66 in the case of Uruguay, the country with the highest instability ratio in the period 1953-1960. Most of the primary exporting countries would have been assessed at less than half of the rate that would have been necessary if the required sum had been raised by means of a uniform rate, namely 0.42. Only those primary exporting countries with high per capita incomes or very unstable export receipts — Argentina, Australia, Cuba, Spain and Uruguay, for example — would have been subject to a rate above 0.42. Most of the industrial countries would have been assessed at well over the uniform rate, the exceptions being those — such as Japan and the Netherlands — with abnormally low per capita incomes or high export dependence”. (U.N. Secretariat report, pp. 129 and 134).

Once the basis of compensation was settled, a premium would have to be determined which would produce sufficient revenue to meet the estimated net cost of future compensatory transfers, averaged out over a short period of years. The rate of premium would have to be adjusted from time to time, lowering the rate if revenue was consistently exceeding compensations and raising the rate in the reverse situation.

(3) institutional and operational considerations.

As intended by the Crawford committee, the operation of compensatory D.I.F. mechanism would result in a net transfer of resources from higher income countries to those with lower per capita incomes. Claims would come more from the latter than the former while premiums would come more from the former than the latter. The amount of the net transfer would, of course, vary with the particular scheme. The range for 1953-1960 under the 17

hypothetical schemes of the U.N. Secretariat report was between \$130 million and \$600 million per year. This compares with:

(a) export earnings of underdeveloped countries as a group of about \$25 billion per year;

(b) an average shortfall of export earnings of \$1.1 billion;

(c) a net inflow of official donations 1956-1959 from the industrial to the underdeveloped countries of around \$22 billion per year;

(d) a net flow of long-term official and banking capital averaging 1951-1959 about \$1 billion per year.

Thus D.I.F. net transfers in the range of \$130 million to \$600 million would have increased the funds made available as official loans and grants by between 4% and 18%. As a proportion of total exports of the industrial countries these transfers would have averaged between 0.2% and 0.8% while as a proportion of the exports of the underdeveloped countries they would have come between 0.5% and 2.4%. Both sets of percentages reflect very wide differences in the proportionate contributions of countries on the one hand and in the proportionate benefits of countries on the other hand. The United Kingdom and the Federal Republic of Germany would have made the biggest proportionate contributions. The D.I.F. would have exercised its strongest stabilising effect, of course, on those countries whose instability ratio was more than 6%. Among these were Bolivia, Chad, the Federation of Malaya, Haiti, Hong Kong, Indonesia, Iran, Jordan, Liberia, Libya, Niger, Pakistan, Republic of Korea, Republic of Viet-Nam, Singapore, Sudan, Syria and Uruguay.

This tendency for both contributors and beneficiaries to be concentrated in relatively few countries on either side is naturally of importance in determining membership. Thus under one quite reasonable scheme it was found that five countries — the United States, the United Kingdom, Federal Republic of Germany, France and Canada — would have provided in premiums about 60% of the net cost and, allowing for their claims, would have contributed over 70% of the net transfer through D.I.F. At the same time, if loans outstanding at the end of 1960 are ignored, over three-quarters of the net transfers that would have been effected during the period 1953-1960 would have benefited ten countries — Pakistan, Federation

of Malaya, Singapore, (mainly concerned with entrepot trade), Indonesia, Brazil, Uruguay, Hong Kong (not a primary producing country), India, Colombia and Cuba. Unless any actual scheme included the main contributors it would not be financially viable while if it excluded the main beneficiaries it would not perform the major part of its stabilizing function. Implementation of the Crawford committee's proposals involves membership on the part of both groups.

Even so, on establishment a D.I.F. would require an initial capital large enough to pay the difference between total premiums and total claims for several years until premiums plus any repayments of earlier loans covered outgoings. As usual the size of initial capital would depend on the nature of the scheme being operated. As far as experience 1953-1960 is relevant, it suggests the need for initial capital of between \$3 billion and \$4 billion, although, of course, the whole would not be required in convertible exchange at the outset. Allocation between members would probably bear a close relation to their premium obligations. How the initial contribution and annual premiums would be financed would be a matter for each member government to decide for itself. Neither need be closely related to export proceeds. Similarly, the use of sums received as compensation would be entirely at the discretion of the member government and would reflect the direction of that government's policy, especially in the commodity and development fields. The principal contribution of a D.I.F. system to problems of a structural or other nature facing low-income primary producing countries is envisaged in the U.N. Secretariat report as being "the actual provision of compensation itself" (p. 178).

#### A Development Insurance Fund for Single Commodities

This study considers the applicability of the compensatory mechanism proposed by the Crawford committee to international trade in particular commodities. It does this by setting out a number of illustrative examples of the way in which single commodity stabilisation schemes incorporating the principles suggested in the Crawford report might have operated in the 1950's. Three different types of commodity, exports of which were largely free from international control and came largely from less developed countries, were chosen,

viz. rubber, cocoa and coffee. The study might conveniently be discussed in two stages.

#### Stabilising Export Proceeds

A preliminary examination of the fluctuations during the 1950's of earnings from wheat, cotton, rubber, cocoa and coffee suggests that the scope for a viable insurance mechanism operated among exporters along the lines outlined in the Crawford report but restricted to a single commodity would be limited. On the one hand are the commodities — like wheat, medium staple cotton, soya beans, pig meat, wood-pulp and aluminium — exported in part by higher income countries which might be prepared to bear a disproportionate share of the burden of financing a compensatory scheme. Here the need is less urgent, not only because of the greater ability of many of the exporters to withstand the effects of fluctuations in proceeds but also because world prices of such commodities are usually much less subject to disruptive changes. On the other hand are the commodities exported for the most part by underdeveloped countries. Here the magnitude and concentration of fluctuations in proceeds would raise disproportionately the cost of insurance. As these countries are least able to afford high premiums, the practicability of an insurance scheme for single commodities depends on the extent to which importing countries can be brought in to share costs. Importing countries — usually outnumbering exporting countries — would be contributors only. If they were persuaded to join they would naturally wish to keep down costs. This points to the Type II plan, i.e. contingent loans rather than outright grants.

The likely cost of any such scheme would depend on (i) the proportion of the shortfall to be compensated; (ii) the rate at which repayment of the loan was required and (iii) the period that had to elapse before any unpaid balances were cancelled. On the assumptions that 50% of each shortfall is offset by a loan, that 50% of any surplus above the trend value is used for repayment and whatever is outstanding at the end of three years is written off, then over the period 1951-1960: (a) in the case of rubber, gross compensations would have aggregated about \$653 million and net cost about

\$295 million or about \$30 million per year. The Federation of Malaya and Indonesia would have been the main net beneficiaries; (b) in the case of cocoa, gross compensations would have aggregated about \$157 million and net cost \$63 million with \$13 million outstanding at end-1960. Brazil would have been the main recipient followed by Ghana; (c) in the case of copper, borrowings would not have started until 1957. So of the gross compensation of \$232 million, \$138 million would have been repaid and \$80 million still outstanding. Mexico, Congo (Léopoldville) and Chile would have been the main net recipients.

Once there is an estimate of net cost it is necessary to determine premiums so as to collect that sum. Two alternative methods of assessment are put forward. In the first, the basic criterion for distributing the net cost would be the net value of each country's trade in the commodity. For exporting countries, the stability of overall export earnings would be relevant while in the case of importing countries it would be the stability of imports of the commodity concerned. In the second alternative method of allocating costs, a still closer link is suggested between import stability and premium obligations by limiting the latter to importers. Premiums would then be assessed in accordance with fluctuations in net imports.

While the attraction of any such D.I.F. to exporters is obvious, importing countries would have to think of it in terms of an agency through which part of their foreign aid was channelled. As such it might not rank high because it would distribute aid not according to any broad criterion of need but as an accident of stabilising activities. Furthermore, aid would be tied to a formula which might not work equitably.

If such considerations kept out important importing countries, the rest might decline to underwrite the stability of all exports in the commodity concerned. Again, it might lead to manipulation of the scheme. Thus "it would be in the interests of exporters to maximize the reduction in shipments to participant importers when a decline in price or volume threatened and to minimize the increase in shipments to participant importers when there was a recovery in price or volume that might presage repayment of previous loans. Short transactions in which trade with non-member countries was used for this purpose — exports being directed through them to participants on some occasions and to them through participants

on others — would tend to make a D.I.F. scheme with limited membership difficult to operate" (*ibid.*, p. 41).

Nor would the scheme proposed be appropriate if the commodity in mind did not by and large pass from underdeveloped countries to industrial countries. Thus for such commodities as wheat, rice, soya beans, medium staple cotton, beet sugar, meat, butter and aluminium special arrangements would be required for membership, premiums and receipt of compensation.

But quite apart from such problems, the application of the proposal earlier outlined to a commodity like rubber, cocoa and coffee would be susceptible to pressures from domestic policies to an extent that a general D.I.F. would not. And it would hardly be feasible to exclude all claims for compensation that arose at least in part from changes in price supports, export taxes, subsidies, price agreements, etc. Once ways were found of manipulating the D.I.F. the latter would become a destabilising instead of a stabilising agency. Perhaps the most satisfactory way of reducing the cost of a commodity D.I.F. whilst retaining its stabilising functions would be to increase the loan ratio and extend the contingency period. This would fulfil the purpose of the D.I.F. more fully than if the compensation ratio was reduced.

#### Stabilising Export Prices

A scheme which sought to stabilise the price of a commodity would attract both exporters and importers who would both gain from its working and at the same time be more conventional and therefore more easily understood from the start. In the present context price stabilisation would consist of compensating for movements of market price above or below the trend level. If the market price fell below trend, exporters would be compensated. If it rose above trend, importers would benefit. These compensatory flows would tend to stabilise — i.e. keep on the trend line — the export earnings or import expenditure of the producers and consumers involved. A net transfer to exporters would be achieved partly by charging importers higher premiums and partly by compensating price falls more fully than price rises. Clearly, such a scheme would work most effectively where price movements reflected changes in

import demand rather than changes in supply, for the former bring about bigger changes in the earnings of exporters than do the latter. Where prices do not change widely, the scheme has little to offer.

A horde of statistical problems would need to be solved. A suitable price would have to be chosen and movements of it measured; a trend would have to be determined from which deviations were measured. These apart, there is one further major obstacle. While hitherto D.I.F. has been regarded as an intergovernmental agency, here there are reasons for extending the effects to include producers and consumers so that producers would get the benefit of more stable incomes and consumers of more stable prices. At the end of each period importers might, for example, be taxed if they had paid less on an average than the trend price or receive a refund if they had paid more. In this way D.I.F. would come to resemble the Price Stabilisation Funds of the French franc zone. The study ends with this expression of opinion: "While some skewing of the compensation formulae in favour of the exporting members of the D.I.F. could be justified both as an incentive to exporters to participate and because importing members are generally likely to be better able to withstand the consequences of fluctuations in the price of the commodity, the closer such a scheme came to being a vehicle for development aid the more difficult it would be to provide it with a membership that accounted for the bulk of world trade in the commodity in question and the more likely it would be to impinge on the market for the commodity in a way that might not be in the long-run interest of exporters. However, insofar as such a compensatory scheme did succeed in increasing the stability of the foreign exchange earnings of countries exporting the commodity on the one hand and of the unit cost of the commodity to users on the other, it would have made a valuable contribution both to the development effort of the exporting countries and to the competitive position of the commodity on the world market".

#### The Present State of the Debate

The Crawford report was discussed at the Ninth Session of the United Nations Commission on International Commodity Trade

(C.I.C.T.) in May, 1961. The issues raised were considered in the two U.N. Secretariat reports which were in turn discussed by the C.I.C.T. and by the Joint Session of the C.I.C.T. and the F.A.O. Committee on Commodity Problems in Rome in May, 1962.

The C.I.C.T. in the course of its discussion of the first report (Stabilisation of Export Proceeds through a Development Insurance Fund) unanimously agreed that urgent action was needed to mitigate the impact on primary exporting countries of instability in their export earnings. A majority of delegations felt that additional arrangements for compensatory financing were required and that any mechanism established should (i) deal with fluctuations in export proceeds as a whole rather than with the proceeds of single commodities; (ii) be on a world-wide rather than a regional or other geographically-restricted basis, and (iii) be essentially automatic in its functioning. But some delegations were not convinced of the need for a new system until the possibility of adapting the existing system was fully explored. And it was felt by some that the need for compensatory measures could be obviated by appropriate action to remove the basic causes of instability. Some of these who accepted the need for a mechanism favoured an automatic financing scheme of the type proposed by the Organisation of American States (O.A.S.), which combines automatic loans with full repayment within a five-year period. Two of the merits of the O.A.S. proposal, according to those who supported it, were that by adopting a self-liquidating principle of operation, it would separate trade from aid and, once established, would not require annual appropriations.

Consequently, the C.I.C.T. felt that, despite the urgency of the need for action, it could not endorse any particular measure without further study of the various schemes suggested. It accordingly decided to recommend the appointment of a Technical Working Group composed of representatives of Argentina, Australia, Brazil, Ceylon, France, Mali, Pakistan, Sweden, the United Kingdom and the U.S.A. to examine the various schemes and report before January 12, 1963. The recommendation has been accepted and the Group's report will be considered by the C.I.C.T. in May, 1963.

The second report was discussed by the Joint Session of the C.I.C.T. and the F.A.O. Committee on Commodity Problems.

There was general agreement that a D.I.F. system applied to the export proceeds of individual commodities was subject to serious limitations, administrative and otherwise, and that such a mechanism could not be regarded as either a practical or desirable solution to the problem. As regards the alternative possibility of a compensatory mechanism for particular commodities based on export prices alone, some delegations felt that this alternative was hardly workable. Others held that the difficulties of operation were not insuperable as reference prices could be adjusted periodically. All agreed that further exploration was in any case necessary before a decision could be made.

### Concluding Remarks

Owing partly to their inevitably technical nature and partly to the fact that only the Crawford report has been made available in printed form so far, these schemes have hitherto received less attention than their importance warrants. In addition to the points raised by various delegations at the meetings of May, 1962 it would be useful if those with practical experience in the relevant fields, as well as academic economists, considered the merits of the proposed schemes and possible variants of them. Three lines of thought might be suggested as worthy of such consideration. First, as these schemes attempt neither to influence the terms of trade nor to stabilise market price or output, it might be enquired whether their operation would seriously affect the role of commodity agreements and, if so, how they might do so. Second, none of the reports has considered the benefits that would be enjoyed by recipients of compensatory finance. How much, in fact, would variable and necessarily somewhat delayed compensations to declines in export receipts help to maintain a steadier level of public expenditure. If, as the result of such schemes, governments were able to stabilise somewhat producers incomes, what effect would that have? As Sir Sydney Caine has said (7), the superiority of relatively stable over fluctuating incomes

(7) Instability of Producers' Incomes: A Protest and a Proposal (*Economic Journal*, September 1954).

in encouraging savings and investment has never been tested. Finally, it would be useful if those with practical marketing experience considered whether these schemes would involve changes in marketing methods and, if they would do so, whether such changes would be beneficial or otherwise for producers, merchants and consumers. The implications for stock-holding and disposal might also be explored.

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