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Briefing Paper

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WHITHER THE COMMON FUND?

Introduction

Since the Integrated Programme for Commodities was proposed, first in 1975 and then more widely in March 1976 at the Fourth United Nations Conference on Trade and Development (UNCTAD), it has provoked much debate and thought on the operations of world commodity markets and how they can be improved in a way that helps developing countries (Ldcs). This debate will be taken a stage further in mid-November 1978 when a ministerial meeting is to be held at UNCTAD headquarters in Geneva, to negotiate on the form and content of the Common Fund (CF), the financial backbone of the Integrated Programme.

The aim of this briefing paper is threefold: *first* to examine briefly what issues have been raised at two earlier UNCTAD ministerial meetings on the CF, *second* to attempt to understand why there has been agreement or disagreement on these issues, by looking at the various interests of the major negotiating countries, and *third* to anticipate the topics likely to be raised in the November meeting, on which some compromise is possible.

Background

In its Integrated Programme, UNCTAD envisages structural changes being made in the markets for at least ten 'hardcore' commodities (cocoa, coffee, copper, cotton, hard fibres, jute, rubber, sugar, tea, tin) with the possibility of extending this treatment to a further eight commodities (bananas, bauxite, iron ore, manganese, meat, phosphates, timber, vegetable oils and oilseeds). To implement these changes two new sets of institutions are thought to be necessary. On the one hand, international commodity agreements (ICAs) will be set up by producers and consumers of each commodity to adjust supply and demand largely through the establishment of buffer stocks, although other measures such as export quotas or promotion may also be undertaken. On the other hand, a financial organisation will be required both to help raise funds to finance these buffer stocks and to act as a pool or bank for funds which individual ICAs are able to raise independently. It is the 'Common' element of this financial organisation which gives it its attraction, and its name – the Common Fund. For, it is argued, one large organisation acting on behalf of all ICAs will be able to obtain better terms on the capital market than a single ICA. In addition, by pooling their separate finances (raised from consumers and producers) the total sum necessary to finance all 10 (or 18) ICAs should be lower, assuming that while some commodities are in surplus and stock managers are

building up stocks (and so in need of finance) others will be in deficit with stock managers selling stocks onto the market (and so depositing finance).

The CF has been the subject of negotiation at two ministerial meetings held by UNCTAD in March and November 1977. It has also been aired at the meetings of Commonwealth Heads of State (in 1977 and 1978), at the Paris Conference on International Economic Co-operation (in 1976-7) and at the summit talks held in London (1977) and Bonn (1978), amongst others. Despite this intellectual and political effort, it now seems that UNCTAD's plans for an active CF by the end of 1978, which together with ICAs would stabilise the prices of 18 commodities, are unlikely to be fulfilled. Accordingly the deadline for the Integrated Programme has been deferred to the end of 1979.

Past meetings

The preliminary debate focused on the need for a CF; and, if one were to be set up, its basic principles and the rules of operation needed to ensure its ability to meet its goals. The first criticism put forward by many 'Western' developed countries (dcs) in particular the US, Germany, and Japan, was that the economic benefits which the CF would be able to offer were probably overstated¹. For most commodities, where producers and consumers were able to agree on price targets (and, by implication, on the size of buffer stocks or export quotas) there would be little difficulty in raising capital to finance the schemes provided they were viable. If the Ldc producers or consumers were unable to meet the cost of commercial loans the IMF had a special buffer stock facility which would be open to them. The major problem rather would be getting consumers and producers to agree on these targets. Where ICAs already existed, as in tin, cocoa, and coffee, which were in surplus, members might not be willing to deposit their finances with the CF – preferring instead to place them where returns were higher or where there was greater control over them. The 'pool' concept might be attractive to ICAs needing to build up stocks – but would it be sufficiently attractive to ICAs with funds in hand? In addition, some studies suggested that commodity price movements tended to be synchronised. Thus, instead of a surplus on one commodity matching a deficit on another, the tendency would be for all commodities to be in surplus together or all in deficit.

For these reasons the case for incurring the costs of a new institution was not at all clear to many dcs. Ldcs

* The Institute is limited by guarantee.

on the other hand argued that the establishment of a CF would remove a major constraint and result in the appearance of many ICAs. There would also be political gains to be derived from a new institution if its governing body had more representatives of ldc's than the IMF. They were supported by one or two radical dcs, such as the Netherlands, Norway, Sweden, and Finland, who from the very beginning have been in favour of direct government contributions to the CF.

At the end of the UNCTAD ministerial meeting in March 1977 the need for a CF was still unresolved. However by June 1977 in the final stages of the Paris Conference on International Economic Co-operation, agreement was reached between the 27 dc and ldc representatives on the need for a CF, 'a new entity to serve as a key instrument in attaining the agreed objectives of the Integrated Programme for Commodities as embodied in the UNCTAD Resolution'.² This was greeted as a remarkable change in policy, in particular on the part of the US administration, which up to then had strongly resisted anything to do with international commodity agreements.

Having excluded the option of *no* CF, there remained the major task of working out the details of *a* CF: the principles on which it would operate and the extent of its operations. It was the absolute failure to resolve differences in these two areas even after four weeks of negotiation that caused the November 1977 meeting to be abandoned at the request of the ldc's.

The developing countries (and their dc supporters) envisaged a CF which would act as a catalyst, a source of funds for setting up new ICAs. Until a CF of some \$6bn (as proposed by UNCTAD) existed, they felt there would be little progress in the talks on the individual ICAs. The dcs, however, felt that a CF should play a residual role only, acting as a clearing house for the funds raised by consumers and producers of existing commodity organisations. As ICAs existed then for three commodities only the sums handled by the CF would be very small – certainly a lot less than \$6bn.

A second argument arose over whether or not the CF should be expected to supply finance for activities other than buffer-stocking. For several commodities, UNCTAD and many ldc's suggested, buffer stocks would be unable to stabilise prices except at great costs. In the case of jute, for example, for which there is a long-term falling demand a support price could only be met by an ever increasing stock, or by a fixed stock and ever decreasing export quotas. Measures to raise productivity, improve the quality and promote the use of jute would have more effect on the price level. Even for some commodities where stocks are economically viable, these could be reduced (and thus the costs of price stabilisation) if complemented by other measures such as research and development or diversification into new crops.

In accordance with the wider aims of the Integrated Programme³ some ldc's went further than UNCTAD in arguing that the finance for such measures should be available to any producer of the 18 commodities whether or not their commodity had yet been covered by a commodity agreement.

As the finance for buffer stocks would be part of a revolving fund of short term credits, whereas the finance for these other measures would be required over a longer term, UNCTAD proposed that they should be funded by a separate account, a 'second window'. A maximum of \$500m would be made available through the second window for the first three years of the CF's operations. If it proved a success the size of the second window and its functions could be expanded.

This idea was opposed by the dcs although they did recognise that a CF without a second window would have little to offer many African and Asian producers. The major contention of the dcs was that these measures were being dealt with already by such organisations as the World Bank and other regional development banks. Even if it was thought that existing arrangements were inadequate the creation of a bureaucracy to administer a second window would be an expensive way to correct these deficiencies.

Disagreements over the size and role of the CF were reflected in the different opinions on how the CF should be financed. In its original plans UNCTAD had estimated that one half of the CF's total financial needs ie \$3bn would be required initially. The issue was how much should be contributed by the governments of participating countries and how much should be borrowed on the capital market. The higher the proportion borrowed (ie the higher the debt-equity ratio) the higher the interest rates the CF would have to charge to commodity organisations borrowing from it. The higher the contributions however (ie the lower the debt-equity ratio), the higher the cost to participating governments, and if the contributions were assessed on the basis of share in world trade or per capita income, the higher the cost to dcs. As a compromise UNCTAD suggested a debt-equity ratio of 2:1, so that the initial \$3bn would be made up of \$2bn of loans and \$1bn of government subscriptions, with the same rules applying to the second capital instalment.

The majority of the 'Western' dcs rejected this idea out of hand. They argued that a debt-equity ratio of 2:1 was unrealistic – the CF would be unable to borrow on this basis except at high rates of interest. But this did not mean they were in favour of increasing the paid-up capital through higher government contributions. On the contrary, they felt that the responsibility for commodity price stabilisation should not be shifted from consumers to producers; individual commodity organisations should be required to finance the major part of the CF's capital, raised by the consuming and producing countries represented in them. On this basis individual commodity organisations would deposit with the CF in cash 75% of their maximum financial requirements, raised from member governments of the organisations. The CF would provide the remaining 25%, borrowed on the capital market, but underwritten in full by guarantees or callable capital from the member governments. In other words there would be no direct government contributions. With regard to the second window however, they took the view that if one were to be set up, it would have to depend on voluntary contributions from governments.

Common interests in a Common Fund?

In principle, the proponents of the Integrated Programme for Commodities argue, all countries whether developed

or developing have common interests in setting up the CF. The benefits of the CF would accrue to all producers and consumers of the commodities covered by the Programme as a result of price stabilisation. Producers would be able to plan their investment with greater confidence about returns and governments their general expenditure with a clearer prospect of likely foreign exchange earnings. Similarly consumers would be able to plan their future consumption without the risk of sudden unpredictable price fluctuations. Why then have there been such differing attitudes towards the CF?

The outstanding reason is that many of those countries who would be expected to bear most of the cost (see Table), being both important consumers and having high per capita incomes, ie the 'Western' dcs, are not convinced that the CF is necessary to achieve price stabilisation or even that it is likely to do so.

Second there is the argument that even if the objectives were achieved with the assistance of the CF the distribution of the benefits would be uneven. As the Table

shows, the least developed ldc's would have the largest proportionate benefit as some 56% of their exports would be covered by the Integrated Programme, assuming that all 18 commodities are included. On the other hand, in absolute terms the dcs would receive most of the benefits of price stabilisation, as they account for more than two thirds of world trade in the 18 commodities.

Third, if the aim is to assist developing countries, contributions to the CF may be a less effective means than other aid expenditure. Moreover they may well be at the expense of other aid. In the case of Britain the net effect on the aid budget is unclear; it is possible that contributions to the finance for buffer-stocking activities would be met by the Department of Trade (DoT) or the Ministry of Agriculture (MAFF), while the Ministry of Overseas Development (ODM) would only be responsible for donations to the second window. Even if the funds do not come from ODM in the first instance, they could still be indirectly attributable to the aid budget in the long term, if ODM's expenditure is trimmed to take account of that by MAFF or the DoT.

Table. Interests in the CF – some indicators of benefits and costs, by country and group

Country	Indicators of potential for benefit			Indicators of costs (\$m)	
	% share by value of the 18 commodities in: Imports ^a	% share by value of the 18 commodities in: Exports ^a	% share by value in world trade of the 18 commodities ^a	Direct contributions based on UN scale of assessment	Direct contributions based on shares in world trade
US	12.1	9.0	13.7	125	69
Japan	28.6	0.3	9.2	43	46
Germany	10.8	1.3	6.2	39	31
UK	12.5	1.4	4.8	23	24
France	10.1	3.1	4.3	29	22
Canada	4.7	12.7	4.2	15	21
Total dcs	9.7	4.3	58.5	344	293
CPEs	na	na	10.7	116	53
OPEC	4.3	4.0	3.2	11	16
Ldcs – with > \$400 annual per capita income	4.9	5.3	16.9	20	85
– with < \$400 annual per capita income ^b	5.7	49.2	8.9	8	45
– least developed	6.0	55.7	1.8	1	9
Total non-oil exporting ldc's	3.1	8.1	27.6	29	138
Total	8.8^c	8.5^c	100	500	500

^a Average of 1970–75 except for the six dcs for which the average is of 1970–73.

^b Excluding least developed countries.

^c Average

Source: *The Common Fund, Report of the Commonwealth Technical Group*, Commonwealth Secretariat, London, September 1977; and Helen O'Neill, *A Common Interest in a Common Fund*, UN, New York 1977.

Current state of play

Since December 1977 several attempts have been made to align these differing interests and so to salvage the negotiations on the CF. In April prime ministers from both developed and developing countries in the Commonwealth, accounting for nearly one-fifth of world trade in foodstuffs and raw materials, met in London specifically to review the progress on the CF and to increase the understanding of each other's positions. In June Gamani Corea, UNCTAD's Secretary General, began a series of informal consultations in different capitals at which he proposed various compromises on the fundamental

elements of the Common Fund. As a result of these efforts there have been encouraging signs of a convergence of views so that when the negotiating groups reconvene in November although the same issues will be raised as at previous meetings, this time they may produce some form of agreement.

The most notable development perhaps has been on the issue of the second window. At the Commonwealth Ministers' meeting Britain accepted first the need for measures other than buffer-stocking to be included in

the CF, and second the responsibility for encouraging the rest of Group B to adopt this view. But the size and scope of the second window would have to be strictly limited to avoid duplication of other institutions' work and the cost would be met by voluntary contributions. Following this line one of Gamani Corea's proposed compromises is that the second window would begin operation upon establishment of the CF with only \$200–\$300m (instead of \$500m as originally proposed) financed from contributions already pledged by certain governments to the CF, which could be supplemented by additional contributions. While this scheme may be sufficiently modest to satisfy most dcs without offending the ldc's, there is a danger that it may not win the support of the US Congress which is set against a second window of any shape or size. If it causes Congress to drop its support of the CF, it is feared that the second window may yet prove to be the enemy of the first.

On the more substantial issue of the financial structure of the first window Gamani Corea has offered even greater concessions to the dc position. The volume of direct contributions to the paid-in capital of the CF has been cut from \$1bn to \$500m. This would be used to meet the administrative costs of setting up the CF and to enable the CF to borrow on capital markets at reasonable terms. It has been suggested that the contributions be composed of a minimum equal share, plus a share based on an ability to pay formula from which least developed countries could be made exempt. The Table gives an estimate of different countries' contributions on this basis and on the basis of countries' shares in world trade of the 18 commodities. In comparison with 'Western' dc aid disbursements in 1977 of \$14.8bn the sums involved are not large. Nevertheless there are problems as the US, Germany, France, Canada, and Britain still find it difficult to accept the principle of direct contributions. In addition they are worried that by giving financial support, however small, to an institution with few predetermined modalities they are setting an undesirable precedent. For these reasons they are prepared to consider direct contributions only if these are kept in a separate account from the finance for buffer-stocking. In other words contributions would be available for meeting the administrative costs of the CF; they could not be used as a basis for borrowing or for lending.

The other major issue is the finance of the individual commodity agreements. As yet there has been little compromise on either side. Though still supporting the view that the CF should be the prime source of funds, UNCTAD has proposed that 25% of the finance needed for buffer-stocking be raised by commodity organisations from their members and deposited with the CF. The remaining 75% would be borrowed by the CF on the capital market and loaned to the commodity organisations as necessary. But this 75% would also be fully guaranteed by callable capital pledged to the CF by the members of the commodity organisations. Such guarantees would strengthen the CF's creditworthiness and at the same time increase the responsibility of consumers and producers for the costs of buffer-stocking. There seem to be two problems with this approach. First, ldc's may find it difficult to make guarantees of callable capital without borrowing it or cutting back on planned expenditure. Certainly the costs of setting up commodity agreements under this scheme may not be acceptable to them. Second, many dcs still argue that a far larger share of the finance needed for buffer-stocking should

be raised initially by the commodity organisations. Their official position is that this should be as much as 75%, but it seems that they may be prepared to settle on 60% with the remaining 40% to be raised by the CF.

Conclusion

These are the three issues upon which the meeting in November will focus: direct contributions, finance of commodity organisations, and the second window. It is difficult to anticipate what agreements, if any, will be reached. But there is a growing feeling that agreements are urgently needed. This may be for three reasons. As the Fifth UNCTAD Conference draws nearer there is pressure on both dcs and ldc's to resolve their differences and set up the framework of the CF so that when they meet in April 1979 the discussion will be constructive and forward-looking rather than a bitter confrontation.

More specifically, the failure to agree on the functions and structure of the CF is holding up the talks on the individual commodity agreements. Since the inception of the Integrated Programme preparatory meetings have been held on all but two of the commodities apart from the three already covered by international agreements. Only in the case of sugar have the talks produced an ICA, though it appears that rubber producers and consumers may reach agreement by the end of the year. Until the facilities made available to them by the CF are known, consumers and producers are unable to discuss the details, especially the costs, of price stabilisation schemes.

Finally, there remains the task of working out the modalities of the CF's operation and the basis for its management. Once the terms upon which commodity organisations borrow and lend the CF resources have been specified carefully the issue of management should be less important. Both consumers and producers would be represented with the votes distributed partly on the basis of equality, partly on the basis of contributions, although the relative weights have yet to be agreed upon.

If the November meeting results in setting up a CF, the facilities it offers commodity organisations will probably be a lot more limited than originally favoured by the ldc's; its size, at least initially, will be small and commodity organisations will be expected to contribute to it. As a result there may be no more than eight commodity agreements using the CF in the medium term covering tin, coffee, cocoa, sugar, rubber, tea, jute, and possibly copper, which together account for more than 80% of non-oil ldc commodity exports. Only when these have been set up will the real test of the CF begin.

¹ For a clear exposition of this argument see: K. Laursen, 'The Integrated Programme for Commodities', *World Development*, April 1978, pp 423-35.

² *Comminiqué*, 2 June 1977.

³ that 'concerted efforts should be made in favour of the developing countries towards expanding and diversifying their trade, improving and diversifying their productive capacity, improving their productivity' . . . (UNCTAD Resolution 93 (IV)I).