UNIT 12 INTERNATIONAL COMMODITY AGREEMENTS

Structure

12.0 OBJECTIVES

After going through this unit, you should be able to:

- explain the trade in primary commodities
- describe the importance and special problems of commodities specially of those of interest to developing countries in the international market;
- discuss the role and significance of international commodity agreements in coping with special problems of commodities;
- explain the efforts of the United Nations Conference on Trade and Development to solve the problems of commodities; and
- discuss major international commodity agreements.

12.1 INTRODUCTION

Commodities are defined as those products which have undergone either little process or value additon. Thus these commodities remain in the original shape. Hence, they are also known as primary products. These commodities constitute major chunk of exports of developing countries. Thus, developing countries face innumerable problems in the trade of Primary Commodities. This unit explains the features of trade in the primary commodities, the factors affecting the demand for Primary Commodities, role of UNCTAD in solving the problems related to commodities and the major International Commodity Agreements.

12.2 TRADE IN PRIMARY COMMODITIES

Commodities play a very significant role in the economies of developing countries. Even now only a few developing countries have diversified their export structure. The commodities constitute 60 to 70 per cent of exports of developing countries. In some cases their share in exports is as high as 90 per cent. The international trade in commodities has certain distinct problems from that of manufactures.

One important feature of trade in commodities is the steady decline in their share in world trade. As Table-12.1 shows over two and a half decades the share of major commodity groups in world trade has declined. The share of food items declined from 14.7 per cent in 1970 to 11.1 per cent in 1980 and 9.7 per cent in 1992 and 9.0% in 1995. Similarly, the share of agricultural raw materials declined from 5.8 per cent in 1970 to 3.7 per cent in 1980 and 2.7 per cent in 1992. It has marginally increased in 1995. The fate of ores and metals was no better. Their share also declined from 7.3 per cent in 1970 to 4.7 per cent in 1980 and to 3.1 per cent in 1992. It has marginally increased in 1995. Fuels had, however, slightly different experience. Their share in world trade was 9.2 per cent in 1970 but shot up to 24.0 per cent in 1980. This was for the special reason of petroleum price hike effected by the OPEC (Oil Producing and Exporting Countries) in 1973. Even the share of petroleum also declined to 8.7 per cent in 1992 and 7.4% in 1995. This has been a secular phenomenon even prior to 1970.

Table 12.1: Structure of World Trade in Primary Products Share by Commodity Groups

	1970	1980	1992	1995
All Food Items	14.7	11.1	9.7	9.0
Agricultural Raw Materials	5.8	3.7	2.7	2.8
Ores and Metals	7.3	4.7	3.1	3.3
Fuels	9.2	24.0	8.7	7.4
Manufactured Products	60.9	54.2	73.5	74.7

Source: UNCTAD, *Handbook of International Trade and Development Statistics 1997.*

In contrast, the share of manufactured products grew steadily. It rose from 60.9 per cent in 1970 to 73.5 per cent in 1992 and 74.7% in 1995. The exceptional year was 1980 when their share declined to 54.2 per cent purely as a result of hike in petroleum prices.

In this context, it is important to identify and explain some of the specific problems of commodities in world market.

12.2.1 Demand for Primary Products: Instability in Prices and Volume of Primary Products

The exports of developing countries considered individually are unstable in the sense that they show a recession and shortfalls in relation to the trend. Any measure of the instability of exports is, therefore, relative to this trend. Instability means the absolute deviation of exports from the trend, whether linear or exponential, giving the best fit.

The average export instability is greater considered individually during the period 1960-81. Demand for primary products depended on the industrial production of developed countries. Most developing countries produced primary products for exports. The industrial production of developed countries was substantially influenced by the business cycles. When there was boom, there would be high demand for primary products. Prices would rise. This rise was also caused by the inelastic nature of supply of primary products. This is for the following two reasons: supply of ores and metals cannot be contracted immediately, when demand falls because the mine owners cannot close the mines.

They have to continue production. Similarly, the supply of plantation crops can also be not adjusted immediately to demand. For instance, the tea plantations take 10-12 years to grow. This leads to a steep rise in prices, decline in prices depending upon the phase of cycle the economies of developed countries are in. This instability also results in instability in volume and export earnings. There has been a consensus that primary products are more unstable than manufactures. Developing countries face more instability than developed countries in international trade of their products. It may be noted here that primary products are not exported by only developing countries. Developed countries also export primary products. In fact the share of developed countries in world exports of primary products has gone up.

To sum up, instability is measured in terms of export price instability, export volume instability and instability in foreign exchange earnings of developing countries. This instability is expected to have the following effects:

a) Temporary pressures on balance of payments;

b) Instability of the revenue of governments for many governments of developing countries depend on export taxes and customs duties;

c) Domestic production structure, specially of developing countries, also gets affected.

12.2.2 Terms of Trade of Primary Products with Manufactures

In addition to instability of primary products, the deterioration of terms of trade between primary products and manufactures is expected to adversely affect developing countries.

There are three measures of terms of trade: (i) Net Barter Terms of Trade; (ii) Gross Barter Terms of Trade; and (iii) Income Terms of Trade/Purchasing Power Index.

Net Barter Terms of Trade: It is measured as a measure which one gets by dividing export price by import price. Arising index is said to be favourable to countries whose terms of trade are being studied.

Gross Barter Terms of Trade: This is a quotient of physical quantities of exports divided by physical quantities of imports. These are measured in index numbers.

Income Terms of Trade: It is calculated as total value index of exports divided by the price index of imports. Most of the studies on terms of trade have taken net barter terms of trade.

It has been argued that the terms of trade between primary products and manufactures have declined compared to manufactures. This decline has caused, it is agreed, a substantial loss of income to developing countries.

12.2.3 Commodity Markets and Transnational Corporations

Commodity markets are not free markets. They have been dominated by oligopolistic and/or monopolistic elements, reflecting the control of TNCs with their dominant market power. Further in a number of commodities government intervention in the market has become quite important. Market for iron ore, bauxite/alumina/alluminium are controlled by the TNCs. Further in sisal four large trading companies control world trade. In cocoa one TNC controls one quarter of world trade. Similarly in diamonds one TNC controls marketing of 80 per cent of world's rough diamonds. There are, however, a few commodities, specially agricultural commodities, in which the control of TNCs is not very significant.

Check Your Progress A

1) What do you mean by Primary Products ?

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2) Enumerate three effects of instability in the prices of Primary Products.

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3) Distinguish between barter terms of trade and gross barter terms of trade.

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12.3 LONG-TERM FACTORS AFFECTING THE DEMAND FOR PRIMARY COMMODITIES

While instability in prices and volume of exports of primary products of interest to developing countries has been studied at length, the long-term factors have also been studied specially in the context of long-term movement of prices of primary products below the level of their prices in the thirties, the depressed period for commodities. These factors can be classified into three categories: (a) technology Driven, (b) changes in the structure of advanced economies, and (c) international debt of developing countries.

Technological Factors: Tremendous advances made in technology have led to important effects on demand for primary products. (i) Substitution effect: Due to fluctuations, uncertainty in war periods the industries depending on primary products took recourse to substitution of these raw materials by synthetics. This further strengthened the forces to develop substitute products, for example, plastics, synthetic rubber, etc. (ii) Technological innovations also sought to reduce the import of raw materials required. Thus there is a steady decline in demand. For instance, mica, due to miniaturization in electrical industry is less in demand. Similarly in the steel industry, the demand for iron ore has declined. These developments are irreversible.

Changes in the Structure of Advanced Economies: Economic structures of advanced economies have radically got altered. Services and high technology industries are dominating them. These industries and services are not raw material intensive. Thus the demand for raw materials has declined. It is also known as 'decoupling' of industry and raw materials.

International Debt of Developing Countries: Most of the primary products producing developing countries are indebted. They have to repay the debt to the creditors. When prices are not favourable, they are exporting more and more to get similar value to repay their debt. Although this is not an irreversible trend, this is going to stay for a reasonably long period. Further countries compete to gain an increasing share of the declining marke by depressing prices.

12.4 INTERNATIONAL COMMODITY AGREEMENTS

It is generally believed that there are disadvantages in the form of costs associated with wide fluctuation in commodity prices and earnings. Commodity agreements have been devised by economists and policy makers to remove excessive instability. Since 1920, there has been international interest in stabilizing commodity prices to achieve orderly marketing. It was not until after World War II that an international mechanism was formally instituted via the United Nations through which such inter-governmental agreements could be negotiated, ratified and implemented. Before this the agreements were to be signed by interested parties without the supervision of a world body, and in almost all cases without the consumers being a party to such agreements. Cocoa was the first commodity which had gone through the stages of design, negotiations and implementation under the auspices of the UN.

In 1947, the Economic and Social Council (ECOSOC) of the UN established a special branch, the Interim Coordinating Committee on International Commodity Agreements (ICCICA) to deal specifically with commodity agreements. Later, in 1965, the United Nations Conference on Trade and Development was set up to deal with the commodity problems of developing countries.

The international commodity agreements are expected to have the following components depending on commodities. A general discussion of these components will be in order.

i) A successful international commodity agreement can be negotiated when 90 per cent of producers and 90 per cent of consumers participate.

ii) Objectives of agreements must be well spelt out.

iii) Buffer stock operation has been considered very effective in stabilizing some commodity prices and volume traded. Buffer stock is built by the agreement parties to perform an interventionist role. The agreement seeks to constrain the price between a 'floor' and a 'ceiling'. Normally, the buffer stock manager must sell at `ceiling' and buy at `floor' price. Maintenance of the buffer stock is expected to be financed by the parties to the agreement. A number of questions arise while operating the buffer stock.

   a) The commodity must be amenable to buffer stock operation. Commodities lose their original quality soon.

   b) Determination of 'floor' and 'ceiling' prices must be well calculated.

   c) When the buffer stock authority should operate must also be well studied and the necessary procedures built up.

Operating the buffer stock is thus a difficult exercise.

Export Control Agreements

Export Control Agreements operate by attempting to force a balance between supply and demand by controls on supply. In principle, supply reduction may be met either by reduction in production, any national stockpiling of exces production or by disposal of excess production. Which of these courses is adopted is largely dependent on the characteristics of a particular commodity. It is difficult to significantly affect production of crop commodities within the harvest year and so here stockpiling or disposal is the normal course. On the other hand, there is a greater flexibility in metal production and in general it is cheaper to store it underground. Export Control Agreements are considered cheaper because they do not entail foreign exchange costs.

Updating Support Price

From time to time it will become necessary to update the price support range of a buffer stock agreement. The same applies to the production or export control price trigger in a control agreement. Factors which might be considered for updating are: (a) changes in exchange rate; (b) changes in the general level of prices; (c) changes in conditions in taste and technology; (d) commodity price; and (e) level of the stock held by the buffer stock authority.

Check Your Progress B

1) What do you mean by International Commodity Agreements?

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2) Enumerate three long term factors affecting the demand for primary commodities.

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3) Enumerate three questions which arise while operating the buffer stock.

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4) Enumerate three objectives of integrated programme on commodities.

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5) State whether the following statements are **True** or **False**.

   i) The commodities constitute 30% of exports of developing countries.

   ii) Demand for primary products depends on the industrial production of developed countries.

   iii) Commodity markets are free markets.

   iv) Most of the primary products producing developing countries are indebted.

   v) The buffer stock manager must sell at floor price and buy at ceiling price.

12.5 UNCTAD AND COMMODITIES

One of the main tasks of the UNCTAD was to find a solution to the commodity problems. As has already been noted, the UN had transferred the task of international commodity agreements to UNCTAD. It has an important committee to study problems of commodities of interest to developing countries and suggest various ways of ameliorating adverse effects of the prevailing commodity trade.

The UNCTAD has done substantial work in studying the problems of commodities. In UNCTAD IV (Nairobi) the developing countries made commodity problem the centrepiece of negotiations with the developed world, and fought hard for two things: an Integrated Programme of Commodities (IPC) and the establishment of a Common Fund for financing buffer stock.

Resolution 93(IV) required the Secretary General of UNCTAD: (a) to convene preparatory meetings leading to international negotiation for International Commodity Agreements on eighteen commodities or commodity groups with an injunction that these should complete their work as soon as possible but not later than 1978; and (b) then to arrange a Commodity Negotiating Conference which should be concluded by the end of 1978.

The UNCTAD's Integrated Commodities Programme is expected to be comprehensive. As an UNCTAD document puts it: "Fundamental to the proposed new approach is the setting of far wider objectives for international commodity arrangements, including improvement of marketing systems, diversification (horizontal and vertical), expanded access to markets, measures to counter inflation, in addition to the traditional objectives of stable and remunerative prices". It is also considered a major sustained and comprehensive attack on commodity problems.

Under the Resolution of UNCTAD, twentyeight months were allowed to the governments to negotiate successfully agreements on eighteen commodities with pricing provisions, agreed supply management measures, compensatory financing, stocking, access, etc. But negotiating international commodity agreements turned out to be as difficult as before.

- UNCTAD Secretariat had argued that there were seven commodities - cocoa, coffee, olive oil, natural rubber, sugar, tin and wheat.
- Since 1976 only one agreement with price provision has been negotiated for natural rubber.
- The renegotiation of the cocoa agreement was very difficult. When it was finally agreed by the US, a major consumer, and Ivory Coast, a major producer, refused to join it.
    - When the Sixth International Tin Agreement was signed the US, the important consumer, stayed out.
    - The European Economic Community refused to join the sugar agreement.
    - In tea, the exporting countries were not agreeing to quotas.
    - Preparatory work on copper did not result in a successful commodity agreement.
    - The major producers of bauxite and phosphate did not want any agreement.

Thus a part of the integrated programme of commodities did not succeed.

12.5.1 The Common Fund

The second component of the IPC, i.e. establishment of a Common Fund to support buffer stocking operations, was considered to be very important. "The Common Fund has widely been considered by the South as a best case for the willingness of the North to start implementing a new intervention/economic order".

The Common Fund was supposed to have two windows. The first was expected to have a capital of $400 million which could have resources of the international commodity agreements. It could also borrow from world money markets. Since only three more ICAs were working - tin, cocoa and rubber - limited money was available to the Common Fund. The second window of the Fund was to have resources to the tune of $350 million of which $70 million was to come from direct contribution from the governments and the rest was to come voluntarily. The second window funds were to be used to promote research into improving productivity and competitiveness of primary commodities.

It is significant to note that when the Fund was proposed it was expected to have power to call upon $18 billion. Later it was reduced to $6 billion. As against this the agreed Fund was to begin with $400 million. In the mid-eighties the Common Fund came into existence when the required number of UN members ratified it. It is now located in Netherlands and focussing on functions assigned to the second window, i.e., research and development.

The IPC did not achieve its objectives because of four major reasons: First, there was no agreement between the developed and the developing countries. Second, there was also not adequate agreement among the developing countries themselves. Third, the world economic scene changed dramatically in the eighties. The developing countries were highly indebted and dependent on developed countries. Fourth, the enthusiasm about the possibility of entering into a large number of international commodity agreements was unrealistic given the historical experience.

12.5.2 Compensatory Financing Facility

It is one of the five elements of the Integrated Programme of Commodities. The compensatory financing facility meant that the facility would lend countries in the years in which their export receipts were below the 'trend' and the countries would repay when their receipts were up. While this proposal was being considered in the UNCTAD, the IMF had already introduced this facility to developed and developing member countries. The IMF has enlarged this facility from 25 per cent quota of the members to 100 per cent. Thus UNCTAD's Integrated Programme of Commodities does not operate this financing facility.

There are a number of criticisms against the IMF's Compensatory Financing Facility.

i) It is argued that quota-linked limits on drawings meant that drawings have been much less than required.

ii) The Compensatory Financial Facility does not achieve the objective of stabilizing export earnings. But this is not a valid criticism. The objective of CFF is to provide funds but not to reduce instability.

12.6 A REVIEW OF MAJOR INTERNATIONAL COMMODITY AGREEMENTS

You have learnt the nature of trade in primary commodities and the role of UNCTAD in solving the commodity Problems. Let us now learn briefly the major international commodity agreements. There have been seven major international commodity agreements.

12.6.1 International Rubber Agreement

Only this agreement was negotiated under the Integrated Programme of Commodities. It was concluded on 6th October 1979 and came provisionally in force in April 1982. However, the agreement came into operational in November 1981 when the buffer stock manager started buying natural rubber in order to stabilize prolonged decline in natural rubber.

This agreement got the support of producers and consumers. Malaysia's share was 41.5 per cent, Indonesia's 23.5 per cent and Thailand's 13.8 per cent. There are three countries who together constitute 88 per cent of world exports. The major consumers of natural rubber are: the US -25 per cent, European Community -23 per cent and Japan - 11 per cent. The main concern of all consumers is assured supply. Tyre manufacturers, specially those of radial tyres, needed more rubber. It was estimated that the supply of rubber would grow slowly. Further, consumers were also afraid of inflationary pressures and rise in commodity prices. It was also felt that high prices of petroleum had raised the prices of products based on petro-chemicals. Hence tyre manufacturers were keen on stable prices.

The International Natural Rubber Agreement used buffer stock operation to maintain prices at specified level. There was expected to be regular review of prices at every 18 months. Sale from buffer stock and purchase by buffer stock agency was made on the basis of stipulated price. This agreement met with mixed success during its operation. It has managed to hold the price within the specified stabilization range despite a very severe recession in rubber demand. It is criticised that it was done at the cost of a continual accumulation of stocks.

12.6.2 International Sugar Agreement

There have been four international sugar agreements in post war period. The first one was signed in 1953, second in 1958, with a five year gap, a third agreement was signed in 1968. After a four year gap a fourth agreement was signed. Negotiation under the auspices of UNCTAD through 1983 and 1984 failed to result in any agreement.

Sugar agreement operated entirely through export controls. It did not achieve much success. One of the reasons for the agreements failure was that sugar is produced by developed and developing countries. Further, holding stocks was yet another problems.

12.6.3 International Tin Agreement

The first year international tin agreement became operational in 1956. These agreements have subsequently venewed and sixth agreement came into force on a provisional basis. Since the US did not become a party under the agreement, the International Tin Council has intervened in the tin market both by negotiated supply restriction and through operation of buffer stock. This intervention has been considered moderately successful.

12.6.4 International Cocoa Agreement

Cocoa trade has a long history of attempting to stabilize through buffer stock operations. In 1956, the UN Committee on International Commodity Agreement was asked by the UN to hold a conference. It passed a resolution requesting Food and Agricultural Organization (FAO) to suggest method of stabilizing prices. The work of FAO cocoa study group resulted in a draft of an international commodity agreement on which an international conference was called in 1965. Since then three subsequent conferences have been held- in 1966, 1967 and 1972. In 1972 the agreement was ratified. It must be noted that the UNCTAD took over from FAO the work of the cocoa study group although FAO continued to give technical assistance. Although a number of conferences were held, the UN negotiation conference which was held in New York. May to June 1966 failed to reach the agreement. The major disagreement was how to decide the floor price at which the buffer stock authority would intervene in the market. But a series of negotiations could not result in an agreement. In 1972 a draft international cocoa agreement was made.

The agreement included three provisions: (i) Minimum price of 23 US cents and maximum price of 32 US cents per year; (ii) a quota adjustment mechanism; and (iii) a buffer stock of 250,000 tons capacity to be financed through a levy of 1 US cents per pound on exports and imports of cocoa. Third international cocoa agreement was signed in 1980 and came into operation in 1981.

The agreements did not succeed because of two major reasons (a) the absence of Ivory Coast was a factor, (b) lack of adequate resources and (c) the buffer stock was completely inactive.

12.6.5 International Coffee Agreement

The first agreement became operational in 1963. The first agreement effectively formalized and gave consumer sanction to this arrangement. There was some rise in prices. The second agreement was terminated in 1972, the consumer export quotas was the most important instrument to stabilize prices. The fourth agreement in 1986 had many difficulties in its conclusion.

i) Renegotiation of quotas was expected to be there under which Brazil the main producer would lose its quota to the new comer such as Indonesia and African countries.

ii) US had joined this agreement for a full six years period. Yet it noted funds upto 1986.

iii) The 1985 collapce of the International Tin Agreement, together with the dramatic fall in oil prices through 1985 and 1986, have considerably reduced public confidence that international control of commodity prices is feasible.

12.6.6 International Olive Oil Agreement

In 1956 and 1963 there were International Olive Oil Agreements. In 1955, under the auspices of the U.N., 11 members participated of which 9 were exporting countries and 2 were importing countries. In 1963 7 were exporting countries and 4 were importing countries. An International Olive Oil Council was established in 1963. The duration of the agreements of 1959 and 1963 was four years each. The Olive Oil Council was expected to make studies of the olive oil market, production, prices, etc. These agreements had price estabilisation objective through price control.

12.6.7 International Wheat Agreement

In the early twenties and the thirties wheat was brought under the control of four main producers. The restrictions included those on acreage and export. The operation of the earlier wheat agreement demonstrated the need for some form of sanction to enforce compliance by participants.

There were six international wheat agreements : in 1933, 1942, 1949, 1953, 1956 and 1959. The duration of the agreements varied from failure 1942 of the agreement to 2-4 years. The major instruments of control had been export quotas and acreage restriction in the 1933 agreement. In the 1942 agreement there were more instruments and the International Wheat Council was established. Other agreements included price and buffer stock. Wheat agreement was only one multilateral contract.

To summarize, the international commodity agreements can only be successful provided that they command consensus in their industries. Concensus may emerge when a dominant leader offers leadership. The existing agreements are expected to be poorly drafted.

Yet UNCTAD has continued to contribute to commodity agreements through providing information, technical assistance and convening various conferences. For example conference on tungston, olive oil, cocoa, etc. While the UNCTAD was reorganized in 1992 at its VIII conference at Castegena meeting, the Committee on commodities was undisturbed. It must also be noted that this is the only international agency studying the subject with a view to stabilize the markets for primary products.

Check Your Progress C

1) What is common fund ?

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2) What is compensatory financing facility?

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3) Enumerate two causes of failure of international sugar agreements.

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4) Enumerate two major reasons for failure of the international cocoa agreements.

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5) State whether following statements are **True** or **False**.

   (i) The common fund was established to support buffer stock operations.

   (ii) Export control agreements are considered cheaper because they entail foreign exchange costs.

   (iii) Since 1976, several agreements with price provision have been negotiated for natural rubber.

   (iv) The second window funds of common funds were to be used to promote research into improving productivity and competitiveness of primary commodities.

   (v) There were six international wheat agreements.

12.7 LET US SUM UP

The share of primary products in international trade has steadily declined. Share of developing countries in world exports of primary products has also declined. Primary products of interest to developing countries face instability in export price, export volume and foreign exchange earnings. This affect adversely developing countries balance of payments, government revenue and also production structure. The net barter terms of trade between primary products and manufacturers have experienced secular decline leading to substantial loss in earnings to developing countries. The UN and its organ UNCTAD have done substantial work on commodities. Further they have attempted to find solutions to instability. The international commodity agreements are considered to be the effective means of stabilizing prices. These agreements use buffer stocking, export quotas and price ceilings as instruments. There are a few commodities on which agreements have been signed. Success of these agreements is not considered to be high. Common Fund under Integrated commodity programme has been established in 1985 only to provide research and development. There have been seven major international commodities agreements. They are : International rubber agreement, international sugar agreement, international tin agreement, international cocoa agreement, international coffee agreement, international olive oil agreement and international wheat agreement.

12.8 KEY WORDS

Commodities: Those products which have undergone either little process or value addition.

Terms of Trade: The quantity of imports that can be bought by a given quantity of a country's exports.

Transnational Corporations: A company owned and managed by nationals in different countries.

United Nations Conference on Trade and Development (UNCTAD): A UN body that has been especially active in dealing with the relationships between developing and industrialised countries with respect to trade.

Buffer Stock Operation: A partially managed system that utilises stockes of commodities to regulate their prices.

Commodity Agreement: A form of economic cooperation designed to stabilize and raise the price of a commodity.

The Common Fund: The fund established to support buffers stocking operations.

12.9 ANSWERS TO CHECK YOUR PROGRESS

B5	i) False	ii) True	iii) False	iv) True	v) False
C5	i) True	ii) False	iii) False	iv) True	v) True

12.10 TERMINAL QUESTIONS

1. Explain the factors causing instability in prices of commodities.
2. Describe the features of the market for primary products.
3. Evaluate the role of International Commodity Agreements in stabilizing prices of primary products.
4. Briefly describe the role of UNCTAD in finding solutions to commodity problem.
5. Explain major commodities agreements. How far these agreements have been successful?
6. Write Notes on:
   (i) The Common Fund
   (ii) Compensatory Financing Facility