

Briefing Paper

THE INTEGRATED PROGRAMME FOR COMMODITIES¹

In 1976 UNCTAD IV adopted an Integrated Programme for Commodities (IPC) designed to improve prospects for developing country (Ldc) exporters. But six years later, the heart of the IPC, the Common Fund, remains unratified by many Ldcs, most commodity agreements are under pressure, and world prices of several commodities have fallen to an all-time low. This Briefing Paper analyses the problems facing Ldc commodity exporters, and outlines progress on the IPC and its main alternatives.

Commodity trade issues

Many Ldcs are still highly dependent upon commodity exports for their foreign exchange earnings. For non-OPEC Ldcs, commodity exports were 62% of total exports in 1978. There are, of course, major variations between Ldcs. Several major Ldcs depend significantly on manufactures for their export earnings. For example, 56% of India's export earnings, 49% of China's, 36% of Bangladesh's and 86% of South Korea's are from manufactures. Nonetheless, many Ldcs are dependent upon one or a few commodities for the bulk of their exports. Countries like Mauritania, Uganda and Zambia depend on one commodity for 85-95% of export earnings. Even relatively diversified and large economies have a high dependence on three or four commodities, eg Brazil (64% of export earnings), Malaysia (71%) and Philippines (75%).

The main issues with which Ldcs have been concerned in commodity discussions have been the level of prices, instability in prices and revenue, the barriers to Ldc processing of commodities, and the role of transnational corporations. These problems require different solutions, some of which may be in conflict. As a result there is some ambiguity in Ldc positions, particularly over whether it is a higher price or more stability that is sought.

Prices

In recent years commodity prices have fluctuated considerably, but their overall trend in real terms appears to have been downwards (see graph), at least since the early 1950s. The real prices of agricultural commodities fell steadily from the early 1950s to the early 1970s. Following a recovery in 1973-74, and again in 1977, they reached their lowest level since 1950 in 1982. A long-term trend

in non-oil minerals and metals is less easy to discern, with high levels in the late 1960s and 1973-74. But by 1982 these prices were also at a 30-year low.

The export purchasing power – after taking out payments for fuel imports – of the low income oil-importers was 30% lower in 1980 than in 1970 and (according to the World Bank) will only recover by 12% at most by 1990. Middle income oil-importing Ldcs, on the other hand, because of greater increases in production and better prices, have been able to increase their export purchasing power (net of fuel imports) by two-thirds in 1970-80. The middle income countries now account for over 90% of Ldc export earnings, and hence would benefit most – in absolute terms – from higher commodity prices.

Current low price levels are a result of:

- the international recession, reducing demands for raw materials;
- increased supplies of some agricultural commodities such as cotton, sugar and cocoa; and
- high interest rates leading to the run-down of stocks to historically low levels, eg for wool, zinc, nickel and copper.

These low prices have contributed to rising balance of payments deficits for many oil-importing Ldcs, already adversely affected by the oil price rise and high interest rates on their debt. Prices should recover somewhat if the global economy emerges from the current recession. However, in the absence of a sustained growth in world demand (such as in the 1950s and 1960s), the long-term downward trend in real prices for many commodities is likely to continue.

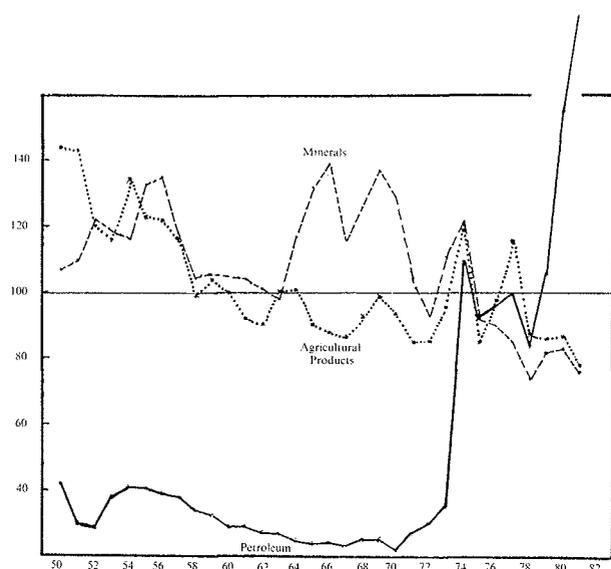
Price and revenue instability

The prices of many Ldc export commodities have been very unstable, with sugar, cocoa, coffee and copper being particularly liable to large fluctuations. In the 1970s, the prices of 33 non-oil commodities fluctuated an average of 12% each year, compared with 5% per year in the 1950s and 1960s. A major source of instability for both agricultural and mineral commodity prices is the level of private stocks, which varies considerably in response to the

¹ This paper draws heavily upon 'Primary Commodity Exports and the Developing Countries in the 1980s', a paper prepared for the North South Institute, Canada, by Arch R. M. Ritter. We are grateful for their permission to use this material.

*The Institute is limited by guarantee.

Commodity prices in real terms 1950–81. Constant US\$ (1974–76 = 100)^a



^a Deflated by the index of CIF prices of dcs' manufactured exports, to measure the changes in purchasing power of ldc's exports of primary commodities in terms of imports of manufactured goods.

business cycle and to the level of interest rates. In addition, the consumption of industrial raw materials will be disproportionately affected by changes in the level of world demand because they are largely used in the fabrication of machinery and consumer durables. For many agricultural products, fluctuations in supply due to climatic factors are a major source of instability.

Greater stability in commodity prices is usually preferred by both producers and producer governments in order to enable more rational private and public sector planning to take place. The price which producers receive will often not be closely related to the world (or border) price. Fluctuations in the world price may be absorbed by changes in government and marketing agencies' incomes from taxes and distribution margins, in which case it is the government, not the producers, which suffers, and gains, from price fluctuations. The lack of financial resources, it is argued, prevents ldc exporters from collectively stabilising prices through international market intervention. Therefore an important aim of the IPC is to provide resources for price stabilisation through International Commodity Agreements (ICAs) and the Common Fund (CF).

However, what is more important to ldc governments is export earnings instability rather than price instability. It is the former which makes domestic planning most difficult, to the extent that recurrent expenditure is financed by taxes on export earnings. Where price fluctuations counteract volume fluctuations, they may actually have a stabilising influence. It has also been argued that export earnings instability is a problem confined to a few of the smaller ldc's – such as Zambia, Chile, Ghana and Mauritius – with open economies depending on a small number of commodity exports so that neither price nor export earnings Pakistan, Brazil, etc – have both a lower share of exports in national income and more diversified exports so that neither price nor export earnings instability presents a serious obstacle to develop-

ment planning. Such arguments have led some to favour compensatory financing as a more appropriate answer to earnings instability on the grounds that it can concentrate resources on those countries most affected.

Commodity processing

An important objective of many ldc's is to capture more of the potential benefits of their commodities through local processing of their resources. There has been some progress in increasing processing in ldc's; between 1970–72 and 1978–80 the proportion of major commodities exported from ldc's in raw form decreased from 65% to 58%. Advances were made in cocoa, oils, fibres and iron, though there was little progress for copper, lead and fish. However, a major barrier to increased ldc processing is the tariff structure of the developed countries (dcs). In their raw forms most minerals and tropical foodstuffs (though not temperate foods) face low or zero tariffs. But, as the degree of processing increases, most tariff rates escalate, thereby discouraging further processing in ldc's. Industrial country tariffs rise from 3% for imported raw materials to more than 20% as the degree of processing increases. It has been estimated that removing the tariff on processed varieties of eight important agricultural products would increase the value-added in ldc processing by 20%. Even after the Tokyo Round of tariff reductions, raw material, semi-processed, and finished imports of dcs from ldc's will face average tariffs of 0.4%, 4.1% and 6.9%, respectively.

The situation has improved slightly for ldc's as a result of the Generalised System of Preferences (GSP), under which dcs offer ldc's lower tariff access for many processed commodities. However, these are subject to certain limitations. For instance, in order to protect employment and income in certain sectors, many GSP schemes grant minimal, if any, tariff concessions to tropical products (such as groundnut and palm oils) that could compete with temperate agricultural products. In addition, there are a number of non-tariff barriers restricting imports of processed commodities from ldc's. The EEC's Common Agricultural Policy imposes prohibitive levies on some agricultural imports (eg processed sugar, rice) while under the Multifibre Arrangement most dcs have placed quantitative restrictions on the volume of imports of textiles and clothing from ldc's. There seems little prospect of any further liberalisation at present, given the high levels of unemployment in dcs and their powerful agricultural lobbies.

However, it should be emphasised that there are other factors limiting the expansion of ldc processing. Processing and manufacturing activities require adequate supplies of skilled personnel, and an efficient infrastructure, which many of the poorer and smaller ldc's do not possess. Because of such factors, the middle income ldc's have been able to develop their processing at a much faster rate in the 1970s than the low income countries. For some commodities, the processed form involves more careful handling and higher transport costs. For these, the location of processing near to the market would be more economical even without tariffs. Finally, the benefit to ldc's from processing more

raw materials domestically must be balanced against the costs in foreign exchange. Some processing activities – such as aluminium production – use large amounts of energy and capital, but create very few jobs. Scarce resources could be used for more labour-intensive forms of industrialisation.

Transnational corporations (tncs)

The presence of tncs in many commodity markets is a dominant one which may limit the ability of governments to take action to stabilise commodity prices or to increase the degree of processing in producer countries. Ldc control over the management of their sales of primary commodities can be limited by the dominance of tncs on the buying side (as in the case of cocoa or coffee), or the selling side (phosphates, tin), or where they are vertically integrated (bauxite, tea). Ldcs' export earnings may be adversely affected by tncs' use of transfer pricing in the case of vertical integration, or by their ability as buyers to keep prices depressed. The position of tncs can also be an important obstacle to increasing ldc processing of commodities. For example, it has been argued that on the basis of their strength in the market they can control the transfer of technology to ldcs by various managerial practices, and can ensure that their subsidiaries in ldcs do not produce goods for export. Even where such action is not taken, there are many factors which may make it difficult for companies based in ldcs to compete with tncs (or their subsidiaries). The sheer size of tncs means they are able to achieve economies of scale in manufacturing (lowering production costs), marketing (building up brand name loyalty) and distribution (developing links with retail outlets) which few ldc companies can achieve independently.

In order to resolve this problem various initiatives are being discussed at an international level to monitor and control the activities in commodity markets. A major constraint is financing, for the investment in production capacity, research and development, promotion, and developing a distribution network. On processing it has been suggested that increased finance be made available to ldcs for such investment, through existing multi-lateral institutions and also through the 'second window' of the Common Fund. But it is unlikely that finance will be sufficient to remove ldcs' dependence on tncs. Other proposals therefore include:

- a. codes of conduct on restrictive business practices, and on the transfer of technology, under which reviews would be held of the proportion of output exported, or of training provisions in technology agreements;
- b. providing expertise to ldcs in contract negotiation with tncs;
- c. technical assistance to ldcs in research and development in production methods, and in marketing; and
- d. increased availability of international market information.

The Integrated Programme for Commodities

In response to the call of the 1974 UN General Assembly for a 'New International Economic Order', the 1976 UNCTAD Conference held in Nairobi adopted the Integrated Programme for Commodities (IPC) in order to tackle these

problems. Eighteen commodities, comprising 87% of ldc commodity exports, are accorded priority status by the Programme. Its objectives are:

- a. commodity price stabilisation;
- b. 'just and remunerative pricing, taking due account of world inflation';
- c. the expansion of processing in ldcs;
- d. improved access to markets by ldcs; and
- e. improvements in marketing, distribution and technology.

To achieve these objectives, the IPC is designed to include the measures discussed below.

International Commodity Agreements (ICAs)

In order to stabilise prices, authorities for ten storable commodities (coffee, cocoa, tea, sugar, cotton, jute, sisal, rubber, copper and tin – the 'core' commodities) were to be established. These were to be empowered to buy when market prices were low and supply plentiful, sell when prices were high, as well as to restrict exports and allocate export quotas to prevent prices from falling too low in cases of serious surplus. The international stocks of foodstuffs and minerals would also provide a security function for the global economy, ensuring the availability of minimum supplies if production shortfalls became acute.

The efforts to establish ICAs for a range of key export commodities have been disappointing (see box). Agreements have been concluded only for cocoa, coffee, sugar, tin and rubber, none of which have been very successful. The failure to establish a large Common Fund (see below) is thought by some to be an important reason for the weakness or non-existence of ICAs. Without the catalytic financing that such a fund could provide, many ldcs are unable to finance large buffer stocks. But there have also been problems with the principles on which the ICAs should operate, as well as many technical problems. For instance, ldc commodity importers have been suspicious of ICAs on the grounds that they could raise, as well as stabilise prices; it is still not clear whether ldcs would be satisfied with stabilisation, and whether this should be linked to import costs or to some other index.

As a result of the perceived failure of producer-consumer co-operation (in the ICAs), some producers have proposed collective action by ldcs in order to replicate OPEC's success. It is doubtful, however, whether there are any commodities, other than oil, in which there is a sufficient degree of common interest and lack of substitute products, for such action to be taken. In several instances (as the box shows) it has been disagreement between producer ldcs, especially where export quotas are involved, which has proved the major stumbling block.

Also, while the ldcs maintained a superficial unity during the general IPC negotiations, there were significant conflicts of interests. Resource-poor countries, including both newly industrialising countries (such as South Korea and Hong Kong) and some of the least developed, would not benefit from higher commodity prices.

The Common Fund (CF)

In order to economise on the financial resources required to fund the ICAs, it was proposed that

problem, though in practice this conditionality is rarely enforced.

The scheme was liberalised in 1966, 1975 and again in 1979 when members were allowed to increase their borrowings to 100% of their IMF quotas. At the same time the definition of export earnings was expanded to include, for the first time, earnings from tourism and workers' remittances. A major innovation in 1981 was the decision to allow countries, especially low income ldes, to claim compensation under the CFF for increases in the cost of their cereal imports. These claims may be integrated with claims for shortfalls in export earnings, subject to an overall limit of 125% of the country's IMF quota. However, such schemes are unsatisfactory to some ldes because payments can be made conditional on fulfilment of certain criteria, political or economic. In addition, such schemes may protect inefficient producer countries since they do not distinguish revenue reductions due to price fluctuations and those due to output reductions, although the latter may be a function of domestic policy inadequacies.

The EEC *Stabex* scheme for 44 commodities (mostly agricultural) was established first by the 1975 Lomé Convention, then revised in 1979 by Lomé II. It offers softer finance than the IMF scheme and there are fewer strings attached. Money is paid as interest-free loans (or grants for the least developed countries) and is calculated on the basis of export earnings shortfalls for each of the commodities. However, its geographical coverage is limited to the African, Caribbean and Pacific (ACP) signatories of the Lomé Convention and, normally, to their exports to the EEC only. Its financial resources are also limited: \$121m in 1980 compared with claims of \$287m.

Most EEC members, including the UK, are opposed to either the extension of *Stabex* to non-ACP least developed countries or a financial topping-up on the grounds that this would divert money away from project aid. With the limited funds available, *Stabex* would only have been able to meet a quarter of the legitimate claims made for 1981, had member states not made additional contributions, raising coverage to a half.

In order to cater for ACP minerals exporters, a further part of the European Development Fund was earmarked under Lomé II for *Sysmin*. This provides finance for specific mineral development

projects and is not a revenue stabilisation scheme. Its aim is to increase investment in, and production of, minerals by ACP countries, in order to safeguard supplies for the EEC. Conditions attached to the loans ensure that EEC economic interests are protected, including penalties for attempts at supply restriction and intervention in domestic pricing policy.

The UNCTAD Secretariat has recently proposed a new compensatory facility, labelled the *Complementary Facility*, which would be established either independently, or as part of the Common Fund, or in association with the IMF. The proposed scheme would cover only the 18 IPC commodities plus 5 others (rice, maize, tobacco, zinc and lead). Like *Stabex*, but unlike the CFF, it would compensate ldes for shortfalls in earnings from individual commodities although its coverage would be extended to all destinations (like the IMF scheme). The estimated cost (up to \$120bn) and the duplication of existing schemes, have led some ldes to oppose this proposal, while others have criticised its narrow product coverage.

Summary

The Integrated Programme for Commodities has made little progress since its inception in 1976. The Common Fund has yet to be ratified and has been so curtailed in size and structure that many ldes are sceptical of its utility. Only one new International Commodity Agreement has been generated (rubber) and the developed nations remain unconvinced of the need for international buffer stocks. Compensatory financing, seen as a means to stabilise revenues directly, has been liberalised and extended. But it still only covers a modest part of ldes' terms of trade losses.

© Overseas Development Institute, London, 1982.

ISSN 0140-8682

Briefing papers present objective information on important development issues. Readers are encouraged to quote or reproduce material from them for their own publications, but as copyright holder, ODI requests due acknowledgement and a copy of the publication.

The status of ICAs

Only one new agreement has been reached under UNCTAD auspices – for *natural rubber* – and it finally came into force in April 1982. The agreement seeks to keep rubber prices within a fixed price range by use of a buffer stock. Despite purchases of around \$200m to date the INRA stock manager has been unable to prevent a decline in prices to a level lower than in mid-1976. Six producer countries, led by Malaysia the world's largest producer, have jointly agreed therefore to withhold some exports in an attempt to redress prices, and other measures may be adopted.

Agreements outside UNCTAD have existed for some commodities on and off since the 1930s. The *sugar* ICA's export restriction agreement has had some success, but the raising of trade barriers and the development of substitutes in the US is harming Western hemisphere producers and EEC subsidies to sugar exports have further weakened prices. The EEC is the only major sugar exporter (20% of world market) that has not yet joined and its absence greatly weakens the agreement.

The *coffee* agreement aims to keep prices within a range, established annually, by variable export quotas. The 1982/83 Brazilian crop was halved by last year's frost and this has helped to raise prices recently. However, the International Coffee Council faces long-term problems in allocating quotas amongst the producers. This is likely to be the major difficulty in the re-negotiation of the agreement due by September 1983.

The international *tin* agreement was extended at the end of June this year, though there were signs of weakening support from consumers. The new (sixth) agreement has been signed by the EEC, but the US, which was a member of the fifth agreement and has a large strategic stockpile, has decided not to join. The agreement provides for a buffer stock and for possible export controls. In February 1982 the 'mystery buyer' who had succeeded in raising

prices substantially withdrew from the market. The price consequently fell 20% to the ITA's floor price and the buffer stock manager intervened. The 'mystery buyer' is believed to have been acting on behalf of tin producers in order to help negotiations for a higher buffer stock price range. The dissatisfaction with the ITA has led Malaysia to propose a producers' cartel, initially comprising the three Asian nations (Thailand, Malaysia, Indonesia) who produce four-fifths of world output.

The *cocoa* agreement, re-established in August 1981, also appears to be in difficulty. Buffer stock purchases, financed by a levy, appear to be unable to bring the price up to the floor price, because the stock overhang is very large. The major exporter (the Ivory Coast) and the major importer (USA) have refrained from joining the agreement so that its utility is further impaired. Loans of \$75m from three Brazilian banks to finance additional buffer stock purchases appear to have had little effect on the market.

An UNCTAD-sponsored *tea* producers' conference in May 1982 was asked to agree export quotas. Given the difficulty of reaching a compromise between large, slow-growing 'old' producers, such as India and Sri Lanka, and smaller, faster-growing 'new' producers, such as Kenya, this has proved impossible.

No agreements have been reached on the other four Nairobi 'core' commodities – *copper, cotton, jute* and *hard fibres*, and the likelihood of reaching agreements for these is slender. Failure may provoke producers to attempt independent action through producers' organisations such as CIPEC. For the 'non-core' commodities (bananas, bauxite, meat, iron ore, manganese, phosphates, timber and vegetable oils), various commodity development measures have been advocated. Until the Common Fund has been ratified, however, and 'second window' finance made available, there is unlikely to be much progress in these negotiations.

EEC AND THE THIRD WORLD: A SURVEY 2 Hunger in the World

Edited by Christopher Stevens

Relations between the EEC and the Third World have recently been dominated by the deepening world recession that has caused unemployment in the EEC and growing poverty in the Third World. Because hunger is the most stark manifestation of poverty, *Survey 2* takes for its title and for its theme the European Parliament's first major statement on EEC-Third World relations: the report on *Hunger in the World*.

A number of controversial questions are asked in the *Survey*. How long does it take EEC food aid to reach those in need? Why is it that food is very often the major export of the least developed, and therefore the hungriest, countries in the world? Most crucially: do the EEC's policies alleviate or exacerbate hunger in the world? To answer these and other questions, the issues of agricultural and industrial protectionism and the Third World, as well as the plight of the least developed countries are examined.

ISBN 0 340 27772 6

192 pages, 1982

£5.95

Published in association with Hodder & Stoughton and the Institute of Development Studies, Sussex.