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Financial Alternatives to International Commodity Stabilization

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Financial Alternatives to International Commodity Stabilization 1/ Boris C. Swerling

Modern societies apply certain concepts of the "social minimun" in sustaining domestic groups whose incomes are either cyclically or chronically depressed. Presumably, postwar programs of foreign aid reflect an extension of this attitude to the international plane. The brilliant success of the European Recovery Program, however, leads to a certain impatience with the fact that U.S. aid programs to the less developed countries have failed to obtain more impressive short-term results than they can thus far claim. Even while the Congress is becoming increasingly disenchanted with foreign aid, the rising political power of the less developed countries (LDC's) in the various agencies of the United Nations has been adding to the external political pressures on behalf of an enlarged aid effort.

One immediate result of those pressures is the United Nations Conference on Trade and Development, scheduled to begin on March 23, 1964. When UNCTAD was originally proposed, international commodity prices had been undergoing a period of sustained decline, and the immediate outlook was grim. While much of the present discussion proceeds in that same context, in fact commodity prices have of late been strengthening on an increasingly wide front and, broadly speaking, have entered upon a phase of cyclical strength. Economists are not soothsayers, and no one can predict how long the present upswing will continue nor what the level of commodity prices will be ten years hence. But their present strength, even if temporary, provides certain real opportunities for public policy, upon which it is well to capitalize.

In canvassing the various alternatives, we may well bear in mind a caveat expressed in an English Bank Letter of a decade ago: "There is a constant temptation to imagine that real problems can be solved by more ingenuity--by creating new pieces of machinery." 2/

I. Unpromising Aproaches

In the spirit of that remark, let us consider, first, a variety of actual or proposed policies that receive a good deal of attention from time to time but that make little economic sense:

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2/ Barclays Bank Review, November 1952, Vol. XXVII, p. 69.

1. International buffer stocks

(a) While the strategic stockpiling program of the U.S. (and, secondarily, of certain other countries) played an important role in the price rises for raw materials culminating successively in the Korean and the Suez commodity booms, the more relevant questions at the present time bear on the rate at which the U.S. will dispose of its surpluses;

(b) with respect to natural rubber and tin, which come exclusively from imports, regular disposal programs are already in operation, and a disposal program has also been announced for aluminum which, while manufactured domestically, is processed largely from imported bauxite and by a heavily concentrated industry;

(c) by contrast, (and despite the enormously excessive supplies of lead and zinc currently on hand) domestic political pressures have to date precluded the disposal of these two non-ferrous metals, which happen to be produced by a considerable number of interior states, though in relatively small amounts in each;

(d) so far as the U.S. export list of agricultural commodities is concerned, principles of surplus disposal again take precedence over any immediate program of buffer stock accumulation;

(e) while there may be some question about how the burden of holding current stocks should be shared or where the existing stocks should be located, these involve mainly the financial relationships between the U.S. and the other industrial countries. The U.S. Congress would hardly be likely to provide the funds for transferring its own commodities to the control of any international agency, and it is difficult to see where alternative sources of financing would arise.

2. Commodity basket approach

The Notion here is that a buffer stock agency would respond to movements in a general commodity price indicator, rather than the price movements of a single commodity, buying a fixed basket of commodities when the price indicator fell below a certain level and selling on a price rise.

(a) If all commodity prices rose and fell simultaneously and in the same proportion, this approach would introduce no additional complications;

(b) under the assumed circumstances, there would be no need for a general price index since the movement of any one commodity would do for all;

(c) in fact, and particularly at the present time, broad price swings are characterized by a good deal of price dispersion;

(d) dealing in terms of a commodity basket would serve to widen the degree of price dispersion, perversely raising the market price of any commodity that happened to be in temporarily short supply during the buying phase, and lowering the price of any commodity that was in surplus during the selling phase. 3/

3. Commodity reserve currency

This proposal, which would in effect monetize the commodity basket by having international purchasing power created in the buying phase and withdrawn in the selling phase, merely adds a further degree of objectionableness;

(a) The analogy sometimes drawn between such an arrangement and the open-market operations of a central bank is clearly false. Central banks deal not in real commodities but in debt instruments, which have a positive return, a low storage cost, and involve no risk of deterioration or absolescence with the passage of time;

(b) the more appropriate analogy is with the Commodity Credit Corporation, whose operations have hardly been so successful as to warrant international emulation;

(c) one of gold's chief virtues as a monetary standard is that inherited stocks so far exceed current output (and storage costs per unit of value are so nominal) that the interplay between current production and current non-monetary consumption is not the determining consideration in establishing the market price. As this has become less true of silver, we have been forced to demonetize silver, and we have been systematically moving away also from the use of gold as money, replacing it with various credit instruments.

(d) under these circumstances, monetizing a whole set of real commodities would clearly be a highly regressive step.

4. National food reserves in less developed countries

Some large contracts have been signed under the Agricultural Trade Development and Assistance Act ("P.L. 480"), with the specific purpose of building food reserves in order to stabilize directly internal food prices and indirectly the general price level in the recipient countries;

(a) the experience has been that these stocks have in fact moved very quickly into consumption, either because local consumption requirements have been underestimated or because local production projections have been overly optimistic;

(b) that outcome was only to have been expected, because the injection of these commodities has tended to encourage domestic demand and discourage the production of domestic food supplies;

3/ See dissent by Professor H.C. Farnsworth in, Food Research Institute, Stanford University, International Commodity Stockpiling as an Economic Stabilizer (Stanford, 1949), p. 124, footnote 5.

(c) indeed, inadvertantly, this form of food aid has contributed to the same kind of perverse price incentives that have so long plagued Soviet agricultural systems: the LDC's typically provide heavy protection for their manufacturing industries, and so the terms of trade of domestic agricultural producers tend to be strongly adverse. 4/

(d) it is a mistake, however, to conclude that U.S. price supports and related programs necessarily operate to the disadvantage of the less developed countries: (i) despite the export subsidy on U.S. raw cotton, the U.S. support program for this commodity may well be regarded as the most important single foreign-aid program operated by the U.S., since it has provided a price umbrella for the expansion of production abroad; (ii) for this very reason, a shift at this late date to a more rational system of U.S. cotton pricing would be a severe blow to cotton-exporting LDC's; (iii) this same line of argument holds, with only minor modifications, for tobacco as well.

5. Stabilizing the terms of trade of primary producing countries

Inasmuch as LDC exports tend to be heavily concentrated on primary commodities while their imports are more largely of manufactured goods, the notion that the price relationship between these two groups of commodities should somehow be "stabilized" has a good deal of innate appeal:

(a) Since this, approach is an application of the "parity" feature of domestic farm programs, the U.S. can scarcely object on philosophical grounds, but the failure of our farm policies to attain anything like parity prices certainly argues against the internationalization of this particular policy objective;

(b) the fundamental defect of the terms-of-trade approach is that this particular statistical ratio is a highly unreliable indicator of the well-being of the relevant primary producers: neither internationally nor domestically does a rise in the ratio necessarily mean that the producer group is better off, nor a decline in the ratio that the position of the group has deteriorated.

(c) moreover, emphasis on terms-of-trade comparisons falls within the "devil" school of economic explanation, attributing fault to others rather than facing up to failings that are the responsibility, or remedies that lie within the control, of the primary producers themselves.

4/ A more rational form of aid would proceed in either of two alternative ways: (i) supply the LDC's with cheap fertilizer, rather than with cheap agricultural produce; or (ii) provide funds for financing, in their countries, internal programs of agricultural price supports, which have been such an important stimulus to farm output in the industrialized countries.

6. International commodity agreements: General

Because "free market" and "world market" prices are inherently unstable, various efforts are made to "stabilize" the international price of individual primary products through multilateral agreements:

(a) Inasmuch as such efforts never have as their purpose the mere evening out of fluctuations over time, they run against the fundamental weaknessess that inhere in all artificial market-support arrangements;

(b) in particular, proper canons of economic efficiency, of production adjustment, of consumer response, and of adminstrative ease tend to work at cross purposes; adverse long-run elasticities in supply and demand tend to be underestimated, etc.;

(c) in short, any favorably effects on income distribution are far more than offset by adverse repercussions on resource allocation, and even the income effects undergo serious erosion, the longer the agreement remains in effect.

7. International commodity agreements: Multilateral wheat contract

The field of commodity policy is shot through with a large number of widely-held misconceptions and widely-circulated rationalizations. For this reason, the International Wheat Agreement, particularly as it operated in the period 1949-53, warrants somewhat more specific attention:

(a) theoretically, exporters agreed to provide contract quantities at a stated ceiling price, and importers to accept contract quantities at a stated floor; within this range, the price of wheat was expected to move freely;

(b) in fact, for most of the period, the free-market price was above the IWA ceiling, so that the Agreement in effect served as a rationer of relatively cheap wheat among various claimants and, at the same time, sanctioned subsidization of an agreed volume of U.S. exports;

(c) at such times as the free-market price eased, the Agreement provided a justification for the Canadian Wheat Board and the Commodity Credit Corporation together to hold the IWA price artificially high, and indeed it was held well above the IWA floor;

(d) had the price been permitted to fall to the floor, and Agreement quantities in fact been "put" to the importers, the entire mechanism would have broken down, for it is ridiculous to expect such relatively poor importer countries as India to subsidize even temporarily, the price received by such relatively wealthy exporters as Canada and Australia, let alone the U.S.A.

II. Alternatives: Means of Financing

Thus far our approach has been severely critical and highly negative. Clearly the U.S. can hardly, in good conscience or as a matter of pratical politics, enter the UNCTAD in such a frame of mind. Fortunately, there are a different set of proposals, far less widely circulated but potentially offering a great deal of promise. Let us now proceed to survey the international landscape, seeking to identify various points at which the international community has already established, or might assert, a right to intervene in income flows to serve international purposes. In particular, we shall be on the look-out for sources of economic rents, whose appropriation leaves the allocation of resources largely unaffected, and whose expenditure opens up new and exciting possiblities for promoting international accomodation.

1. Quota premiums

Whenever, by national import quotas or international export-control agreements, the supplies of a commodity to an importing country are artificially restricted, there is incidentally created a quota premium. Traditionally, the premium has accrued to the exporting countries, proportionally to their volume of trade and, indeed, this premium has been one of the elements of perverse incentives at work, tending to erode the control machinery from within. There is no inherent reason why the premium need be handled in this way, and in fact alternative mechanisms have also operated:

(a) Under the U.S. petroleum quotas, the quota rights are distributed among the various domestic producing companies, not on a country basis, and are transferrable. Accordingly, even those domestic companies that have no overseas properties and import no petroleum share in the proceeds of the quota premium, a fact that gives the entire domestic industry a direct financial interest in the perpetuation of the control system but is a source of considerable irritation to such an exporting country as Venezuela;

(b) The U.S. import quota system for sugar has traditionally operated on the basis of country quotas, of which by far the largest was enjoyed by Cuba. With the breakdown in U.S.-Cuban trade relations and the embargo against imports from that island, a legislative decision was made to supplement country quotas with a so-called "world market" quota, against which an import fee would be levied. The theory was that the exporting country would receive the international price, and the quota premium (which had benefited Cuba to the extent of several hundreds of millions of dollars annually throughout the 1950's) would accrue to the U.S. Treasury. By reason of the characteristically Soviet talent for agricultural mismanagement, the Cuban sugar crop was greatly diminished, and the world price has since risen to or even above the internal U.S. price, making necessary the abandonment of the import levy.

(c) Under the Common Agricultural Policy of the EEC, a complex set of commodity controls is being erected. Their common feature is some means of insulating the internal price of individual products from the corresponding price prevailing abroad. Frequently, the institutional device employed is a variable import levy, on the pattern of the U.S. sugar import fee, which will then go into an Agricultural Fund to be used for assisting domestic agriculture in various ways, including the provision of subsidies on the extra-European shipment of any surpluses. These provisions are a crucial part of a bargain negotiated with the French, who in turn accepted a lower degree of protectionism on local manufactures. Moreover, crucial fiscal issues involved in the sharing of burdens and benefits from these imports were the proximate cause of the breakdown in negotiations over the possible admission of the U.K., the world's major importer of foodstuffs.

Import levy systems and protectionist tariffs on primary commodities place the LDC's in double jeopardy. Not only is their access to markets restricted, but a portion of their potential receipts are absorbed into the public revenues of the protectionist country. In the interest of equity, the national exchequer should suffer, and not benefit, from the imposition of trade restrictions.

2. Compensation for violations of GATT

We have recently undergone a series of international unpleasantries concerning poultry, to the point where Europe and the U.S., with an incongruous cry of "Chicken", have been on the point of unleashing the dogs of economic war. In moderating this dispute, the GATT established an independent panel which, in an "advisory" opinion, established the damage to U.S. trade at $26 million. 5/ Accordingly, the U.S. was permitted to revoke its trade concessions on an equivalent volume of trade from the EEC.

This form of recompense is peculiarly perverse in character. Because U.S. exporters have lost certain markets, the U.S. is granted permission to penalize its consumer interests by raising the prices they will have to pay on selected imports. A preferrable settlement, involving the granting of compensatory trade concessions on other agricultural imports into the EEC, was presumably ruled out by the uncertainties then surrounding, respectively, the EEC's own Common Agricultural Policy, and the prospective "Kennedy Round" of trade negotiations. By analogy with legal concepts of "damages", preferrable form of compensation would have been some overt financial penalty, representing the capitalized present value of some determinable portion of the $26 million trade loss.

3. Excise taxes

(a) Tropical products. There are at present afoot strong pressures from the LDC's for the removal of excise taxes currently in effect in certain importing countries on such tropical exports as

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5/ General Agreement on Tariffs and Trade, Press Release, GATT/819, November 21, 1963.

coffee, cocoa, sugar, tobacco, and tea. To the extent that the excises operate in the range of price over which consumption elasticies are significant, as has sometimes been the case, the LDC's would stand to benefit through increased volume of sales. But in those instances where inelastic portions of domestic demand curves prevail, the interest of the LDC's might be better served if the taxes continued to be collected by importing countries, but specifically earmarked for international uses.

(b) An international levy on petroleum. The logic for beginning an international fiscal system on the primitive basis of imposing an international excise tax specifically on petroleum has been developed more fully elsewhere 6/ but may be briefly summarized as follows: The value of petroleum resources is peculiarly a by-product of modern technology; the fact that particular pieces of territory happen to be sitting over pools of oil creates the fortuitous basis for fantastic personal and national wealth; and insofar as the tax is shifted to consumers, the rate of consumption of petroleum is peculiarly related to stage of industrial development. Moreover, national and local governments characteristically tax petroleum and its products heavily.

4. Direct appropriation of economic rents

Compared with the use of alternative shipping routes, an enormous economic rent (or, alternatively, consumer surplus) is potentially available through the exercise of bargaining power over such international waterways as the Suez and Panama Canals. Here, too, is a possible source of funds available for international purposes. Moreover, here (and in the petroleum case), consumers would be somewhat readier to pay the higher bill if the use of the funds were earmarked for specific international purposes rather than accruing to the peoples (or, more likely, the governments) of the strategically located countries.

A second example is provided by the international fisheries. Here, too, establishment of some degree of international hegemony could incidentally insert a degree of rational behavior, while moderating international conflicts and providing a source of general-purpose funds. 7/

6/ "Current Issues in Commodity Policy", Essay in International Finance No. 38, Princeton, June 1962, pp. 14-17.

7/ The author is indebted to Mr. Neal Potter for this specific proposal.

III. Alternatives: The Expenditure Side

Let us now turn more explicitly to the pattern of expenditures appropriate to these international pools of funds.

(a) There is a serious risk that funds accruing in large chunks to LDC governments will tend to be squandered. Wiser expenditure of the foreign exchange accruing to Argentina from commodity exports during World War II, or to Brazil from the coffee boom that lasted well into the middle 1950's, would have brought more lasting benefits to their respective economies.

(b) International funds would seem to be best applied to the furtherance of more strictly international projects, particularly since these are the very ones likely to receive less than their due under national programs of economic planning. Clear instances here would be the Indus River project, silt-removal from the mouth of the River Plate, development of the irrigation and hydro-electric potential of the Jordon River, or even the twinning of the Panama Canal.

(c) Given the volume of revenues arising from such devices, decisions on the national distribution of the total might well be left pretty much to the LDC's themselves. Such a procedure has at least one clear advantage--it lessens the degree of direct confront tion between the LDC's and the industrial countries. By analogy with the evolution of the European Economic Community from patterns of economic cooperation developed out of the European Recovery Plan, appropriate patterns of economic and political cooperation might incidentally be expected to emerge among the LDC's.

(d) Moreover, in the process of effecting such combined decisions, the LDC's may conceiably develop more rational systems of international representation than exist under prevailing rules of one country one vote. The "population explosion" has its external--in terms of the number of individual countries--as well as its internal dimensions. These large numbers create serious problems for the international community. Not only are complications introduced into the processess of formal representation before international bodies but, in addition, economic burden of conducting the world's diplomatic business mounts in geometrical proportion, and the economic viability of the smaller political units comes increasingly under question.

IV. International Compensation of Export Shortfalls

Let us turn finally to certain policy alternatives that fall more strictly in the area of international financial policy. It has been proposed that, when export proceeds fall off temporarily for reasons not the responsibility of the primary-producing country concerned, some international mechanism be established for providing external financial support to the economy. The International Monetary Fund has already announced its decision to make one tranche beyond the gold tranche available for purposes of compensating export shortfalls, on terms applicable to other IMF lending. 8/ Various further steps have received

8/ International Monetary Fund, Compensatory Financing of Export Fluctuations (Washington, February 1963), pp. 23-26.

a good deal of international attention,[9] differing primarly as to whether the assistant should be in the form of grants or credits, whether the funds should be available as the outcome of some automatic formula or at the discretion of the dispensing agency, and what portion of the shortfall should be compensated.

If it be granted that the scheme need not be symmetrical with respect to pay-in and pay-off, further interesting approaches become possible. For example, the contributions to an international compensation fund might be proportional to the cyclical decline in import expenditures by various industrial countries, while the allocation of such funds might proceed on an entirely different basis. Moreover, safeguards could be built in against the squandering of very large sums by politically weak regimes or seriously mismanaged economies.

One of the most serious defects in policy planning in the LDC's is a tendency to behave as if any upward movement in export prices will continue forever. While compensatory financing arrangements have hitherto tended to be discussed during phases when the LDC's initial approach to a compensatory financing agency would be strictly as borrowers, the present strengthening of commodity prices provides an excellent opportunity for identifying unanticipated windfalls as such, and siphoning them off whether in building a reserve of international buffer funds against the inevitable future decline in export proceeds, or for purposes of internal stabilization in the LDC's. Economic "stabilization", after all, implies that excessive rises, as well as declines, in prices and incomes have undersirable consequences.

V. Concluding Observations

This survey of various stabilization devices leads to the conclusion that reliance on artificial support of commodity markets tends invariably to bring unsatisfactory results, and increasingly so, the longer the control mechanism remains in operation. On the other hand, promising fiscal and financial approaches warrant exploration in new attempts to deal internationally with unsatisfactory levels of foreign-exchange earnings of primary producing countries. Within the past year, the IMF has taken a path-breaking, if less than giant, stride in the direction of making funds available to LDC's suffering temporary losses in export earnings. We have also considered several novel approaches (some of them perhaps ranging from the merely impractical to the strictly radical) for reconciling conflicting international interests through overt financial settlements.

9/ United Nations, Department of Economic and Social Affairs, International Compensation for Fluctuations in Commodity Trade, E/CN 13/40 (New York, 1961).

These conclusions underscore the need for pragmatism in developing arrangements for assisting primary-producing countries. The newly-emerging countries are seriously misguided in looking for doctrinal guidance at this stage in their development either to Marx, who glorified the contribution of the industrial proletariat, or to Schumpeter, who idolized the role of the industrial entrepreneur. Instead, let us look to the work of John R. Commons 10/ whose concerted search for instrumentalities of social accomodation needs now to be extended from the domestic to the international scene. Indeed, one of the great tragedies in the history of American economics has been the failure of the so-called "Institutional School" to devote as much effort to the analysis and reform of actual economic institutions as did the original institutionalists.

10/ Cf. A.G. Gruchy, Modern Economic Thought, The American Contribution, (New York, 1947), chapture 3.