TRADE AND INTERNATIONAL COMMODITY PROGRAMS

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The search for solutions to problems in international commodity trade has been more actively pursued during the past five years than at any previous time in history. Long negotiations in the Kennedy Round were aimed both at tariff questions and at establishing international commodity arrangements. The need for improved commodity trading arrangements was emphasized by developing countries at the first United Nations Conference on Trade and Development (UNCTAD 1) in Geneva and at UNCTAD 2 in India.

The unique feature of both the Kennedy Round and the UNCTAD discussions is the emphasis placed on seeking solutions to trade problems through organized commodity arrangements. While only limited progress was made, the need for further international market organization is still widely asserted by less developed countries and by at least some important member countries of the EEC. Thus, despite continued hesitancy on the part of the United States to accept this approach (except where market access for U.S. exports is involved), the potential role of international commodity agreements is a live issue and needs to be assessed in relation to trade problems of both advanced and developing countries.

INTERNATIONAL COMMODITY AGREEMENTS

Many have argued that international commodity agreements are difficult to negotiate and administer and that even if these difficulties are overcome, they will lead to a misallocation of resources by stimulating usually too much, but possibly too little, production and prevent movement of production to the lowest cost locations.

The first part of this argument is partly substantiated by past events. Despite attempts since the 1920's, agreements have been negotiated successfully for only five commodities (wheat, sugar, tin, coffee, and olive oil), and only those for wheat, coffee, and tin have operated with a degree of continuity.

Difficulties in arranging and administering agreements stem partly from technical problems surrounding the production and trading of products. Among other things, commodities must be identifiable by grade, in some cases storable, and not subject to competition from close substitutes. Moreover, conflicts of interest between importers and exporters have to be overcome. On competitive imports, importers want low quantities and high prices. On noncompetitive imports they want lower prices with quantities determined by demand. Exporters would like both higher prices and greater quantities. While these limitations are real, there appear to be a number of commodities or combinations of commodities for which compromise of short-term special economic interest to seek broader goals is at least worth discussing and in some cases may even be amenable to effective negotiation.

The argument that commodity agreements have limited usefulness because they lead to misallocation of resources should not be accepted without reservation. This implies that economic efficiency is the sole criterion for judging the effect of a policy action. This kind of judgment can be countered in three ways. First, if I interpret welfare economists correctly, the central burden of their argument is that in today's world of oligopolistic industrial structures and government guidance of economic activity, there is no basis for assuming that the best outcome is achieved by making any given market conform more closely to the perfectly competitive model. Second, it is clear that no government acts strictly on an efficiency criterion either in its domestic agricultural policy or its international commercial policy. Achieving other ends may be worthwhile even at the expense of some economic efficiency. Third, we need to look at the possibility that commodity agreements, if properly designed, can serve a purpose in improving resource use.

It is apparent that the international distribution of production is greatly affected by government policy and all manner of trade restrictions that serve national goals. Both import restrictions and export aids are used to provide income protection for agriculture in all industrialized countries. For less developed countries, import substitution policies and export taxes—usually through export marketing boards—are used extensively and justified on the basis of their contribution to more rapid economic development. Given these conditions, we need to ask whether formalized agreements that have as a central purpose orderly and gradual international adjustment of production have a potential role in the future. If we grant that the case against commodity agreements on efficiency grounds may be ambiguous, then at least two other issues have to be raised.

One issue is whether commodity agreements can achieve greater market stability. A stated aim of all commodity agreements developed during the postwar period has been to moderate price fluctuations. Since the principal reason for price fluctuations is variation in supply, the methods used involve some form of stabilization of the quantities exported or specification of the quantities or proportion of the product traded under the agreed pricing relations.

The second issue concerns the role of commodity agreements in transferring income from rich to poor countries. Many new underdeveloped countries are seeking accelerated rates of economic development. Major capital imports are required to fulfill growth targets and these must be paid for. By far the most important source of foreign exchange earnings for underdeveloped countries has been exports of agricultural commodities and raw materials and, at least in the short run, the most apparent basis for expansion of their foreign exchange earnings is through an increase in the value of commodity exports.

For commodities produced largely in poor countries and consumed largely in rich countries, income transfers may be achieved through agreements that maintain prices above market levels if price-demand is inelastic. For commodities produced in both rich and poor countries, even greater income transfers may be achieved if agreements enable poor countries to increase the proportion they supply of consumption in advanced countries.

Obviously these three effects are not independent. Stabilization of prices may affect resource use simply by influencing producer expectations. In agreements that seek price stabilization, the determination of an appropriate price or range of prices may be weighted heavily by the negotiating power of involved countries. This means that the difference between price stabilization and price adjustment that involves income transfers over time becomes obscured. Further, any agreement designed to perform an aid function by transferring income from rich to poor countries will stabilize prices and may affect resource use.

COMMODITY ARRANGEMENTS AND TRADE PROBLEMS OF ADVANCED COUNTRIES

The only example of a commodity agreement where the main export and import interests are in advanced countries is in wheat. The agreement used involves establishing minimum and maximum prices within which agreed quantities or proportions of trade are conducted. The remainder of trade is left to adjust to outside market forces and policy conditions. In principle, the advantage of this form of agreement is that it seeks to provide a degree of price stability for both exporters and importers without at the same time requiring direct action to control quantities supplied in the world market. It essentially sets up a two-price system for world trade with a primary market where price is controlled and a residual market that absorbs the difference between agreed prices and quantities and the market equilibrium.

The degree of stabilization achieved in this kind of agreement depends on both the price range that is set and the proportion of the traded commodity covered. The burden of maintaining compliance by importers and exporters when market prices exceed the established ranges is the principle problem in implementing this kind of agreement.

The first wheat agreement was established in 1949 and included five exporters and 37 importers. Through 1967 this agreement was revised several times. In each case it included a maximum and a minimum trading price among members and specified quantities or percentages of trade that were to be included. These initial agreements have been replaced by the Wheat Trade Convention arrived at as part of the Kennedy Round. The objectives of the Trade Convention are similar to those of previous wheat agreements and, in addition, certain industrialized signatory countries are to provide annually a total of 4.5 million metric tons of wheat or cash equivalent for food aid. The trading provision of the new convention differs somewhat from previous wheat agreements but the basic concept of establishing maximum and minimum prices for specified quantities of trade is not changed.

The wheat agreements appear to have had some, but probably only a limited, effect in stabilizing wheat prices. From 1949 to 1953 the agreed price maximum was below world market prices, and a saving accrued to importers. Until the last few weeks no real test had been made of the effectiveness of the minimum price range. Prior to about 1964, world trading prices were maintained above the minimum wheat agreement price largely by the storage program operated in the United States, and from 1965 to 1967 a general decline in world food grain stocks maintained prices at relatively high levels.

These conditions are not likely to be repeated in the immediate future. The United States has moved to a two-price program on wheat, and if maintaining the wheat agreement prices on international sales begins to result in a loss of markets, the United States will probably sell wheat below the minimum agreed price if necessary to keep our outlets. Further, world supplies of wheat are in a massive upsurge. World price trends are down on commercially traded wheat and, more importantly, major increases in output of food grains in India and Pakistan as well as other Asian countries may soon lead to little drawing off of excess supplies as food aid. With these market conditions, arrangements under the wheat agreement could break down and result in competitive price bidding and confusion in international wheat markets.

But, will this be reason to abandon the notion of international agreements in solving trade problems of advanced countries? Or, alternatively is this the point at which objectives should be changed and international agreements sought that deal with some of the underlying conditions of market problems? Industrial countries have yet to talk seriously about these kinds of problems in trade negotiations. International commodity agreements that incorporate not only trading prices and quantity ranges but also responsibilities of both exporting and importing countries in limiting and guiding production would be required. It would not be adequate for the United States to approach this kind of negotiation in wheat or even grains alone without being willing to consider items of interest to principal negotiating partners, particularly dairy producers in Western Europe. The scope of international commodity arrangements would have to be broadened as well as deepened, and the notion of reciprocity would be fully as important as in tariff negotiations.

Achieving these kinds of agreements would not be easy. From the U.S. point of view we would probably have to abandon the notion that trade negotiations are largely a matter of opening someone else's protected market. Successful agreements would have to include all major trading countries and would have to seek to coordinate trade and agricultural policies to reduce inefficient production and promote mutual interest. If domestic price-support problems in North America and Europe simultaneously become severe enough, as there are indications they might in the near future, then the basis for mutual coordination may exist.

Regardless of the kind of pressures that arise, there are limitations on the rate at which change can be made. Countries that have high price supports have basic underlying problems of agricultural organization, small farms and inefficiency. Under these conditions, reduction in protection and adjustment in production can proceed only on a gradual and controlled basis. Despite these limitations, detailed discussion to evaluate economic conditions and policies in order to develop agreements that move toward desirable rationalization of trade and production patterns should be sought. In the past, the desire for national protection has largely frustrated attempts to achieve improvement through straightforward bargaining for reduction of national barriers, and I see little possibility that this will change. Seeking agreements that attempt to deal mutually with the problems of importers and exporters and provide the basis for a controlled rate of change might be at least worth trying.

COMMODITY AGREEMENTS AND LESS DEVELOPED COUNTRIES

The second main question on commodity agreements is whether they can or should be used to improve the trading position of less developed countries. Their problem has been cast in the following perspective. The UN has set a goal of achieving a 5 percent average annual growth rate for less developed countries. This would require approximately a 5 percent annual increase in imports, which can be paid for only through aid or foreign private investment from advanced countries or by exports. Even with optimistic estimates of increases in aid and foreign investment, it is apparent that a major increase in export earnings will be required.

Expansion in exports from underdeveloped countries, however, has been slow for a number of reasons. First, there has been a relatively slow growth in demand in advanced countries both because population expansion has been modest and because income elasticity of demand for many of the commodities exported by less developed countries is very low. Second, because of a secular decline in the terms of trade, foreign exchange earnings have increased less than real quantities exported. Imports into advanced countries also have been seriously restricted because of internal price-support policies and efforts to expand domestic production through agricultural protection programs.

The measures suggested by the UNCTAD to expand exports of less developed countries include liberalization of access to advanced country markets through reduction of tariff and quota restrictions, a program to offset the inroads of synthetics into the markets for natural raw materials, and, most importantly, the development of a series of international commodity agreements. Commodity agreements are viewed not merely as instruments to overcome market fluctuations in the short run but also as instruments to increase over time the transfer of income to less developed countries through maintenance of price and through access arrangements into advanced country markets.

Only two agreements of major consequence to less developed countries have operated effectively for any length of time, and both emphasize price stabilization. A buffer stock type agreement was implemented for tin in 1956. This arrangement involved setting a range within which prices are allowed to fluctuate. A stocking agency was established to implement support purchases if prices reached the lower limit and to sell if they reached the upper limit. The arrangement was intended to protect both exporters and importers from extreme price fluctuations with a minimum of direct market interference. Theoretically, if prices are set to bracket the long-term supply-demand equilibrium and if the range is not too wide, a stabilization effect through buffer stocks can be achieved without a heavy financial commitment. Short of this kind of foresight, inability to control upward price fluctuations or heavy accumulation of inventories and burdensome financial requirements may result. The latter occurred with tin in 1958, and the program has since relied more heavily on export quotas as a method of control.

The other relevant case is coffee. A coffee agreement was first initiated in 1962, and a new long-term agreement was signed in 1968 by 66 member countries to be effective until 1973. The agreement prescribes price limits beyond which world prices are not to be permitted to move, and these price limits are enforced through export quotas allocated to member exporting countries in proportion to a historical base period.

The coffee agreement appears to have had some effect in stabilizing world coffee prices, particularly since 1964, with the adoption of adjustable quotas that change even within a marketing year in relationship to price pressures. It may also have succeeded in achieving higher export earnings for coffee producing countries than they would have had without the agreement. But the agreement has also created a major problem: The surplus of coffee in some major producing countries has reached or exceeded total annual export requirements, and total world surplus stocks have become substantial.

Problems of implementation have arisen in both the coffee and tin agreements. Despite these problems, commodity programs as a tool for providing aid probably should not be rejected out of hand. Certain differences in aid and stabilization agreements could become important. First, while stabilization agreements are looked upon as a tool for affecting returns to producers in exporting countries, aid agreements could be more directly incorporated into a development plan and could primarily be concerned with increasing national export earnings without the proceeds necessarily going to producers of the export commodity. This would have a major implication for the problem of supply adjustment and would overcome at least to a degree the resource misallocation effects attributed to marketing agreements.

A second important difference is that participation by advanced countries would force them to consider aid-giving responsibilities along with the question of import prices in deciding the extent and nature of their participation. Also, in the case of competitive imports such as sugar, it would directly call into question domestic price-support programs in terms of their relationship to aid objectives. Further, it would be aid extracted directly from consumers or raw material users in the form of higher prices on imports and would not require government appropriations. This could be a political advantage.

The use of marketing agreements as a tool for expanding aid also has to be considered in terms of whether appropriate institutional arrangements can be established to implement them and in light of their efficiency relative to alternative methods of giving aid. Undoubtedly, establishing effective procedures for administration and control would not be easy. It would at a minimum require broad participation and agreement by all major importers and exporters. In the case of alternatives, both traditional methods of granting aid and an additional approach that relates aid to level of commodity exports have to be taken into account.

Currently the International Monetary Fund operates a modest program whereby compensatory loans are available to less developed countries that have an annual shortfall in foreign exchange earnings due to commodity price declines. This compensatory financing scheme is operated strictly as a program to offset short-term market instability, and recipient countries are expected to repay the loans within a five-year period. The UNCTAD has proposed that the terms of this financing be liberalized and that repayment be made contingent upon recovery of export prices to a specified predetermined level. In effect, this becomes a nonrecourse loan where repayment is required only if trading prices are high enough that repayment can be made out of export earnings above a given minimum.

Whether viewed as a short-term device for achieving stability or as a method of income transfers, compensatory financing schemes have some advantages over commodity agreements. They involve less direct interference in market operations as well as in the policy and production goals of exporting countries. They remove uncertainty from the market and avoid many of the technical and administrative problems associated with commodity agreements. They are attractive to less developed countries inasmuch as a system or formula is established for automatic drawing of funds. It is, of course, only a short step from low interest loans with repayment required only if certain price conditions arise to proposals for commodity related income payments to meet a specific price.

Transferring income internationally through commodity arrangements has much in common with transferring income to farmers through domestic programs, both in terms of effects and the problems involved. Commodity agreements would achieve income transfers through manipulation of prices while compensatory financing gets closer to letting commodity prices seek their own level and making supplementary or deficiency payments. In either case, a major disadvantage is that the greatest amount of aid or income supplement goes to those that sell the most. This is not necessarily the best way of redistributing income either domestically or internationally. For this reason and because of costs associated with their operation, commodity arrangements can be considered an inferior method of providing aid. From the viewpoint of less developed countries, however, they seem to have great political appeal and may have some political advantage in advanced countries.

CONCLUSION

I agree with others that the commodity agreement approach to solving international trading problems would involve many difficulties. Seeking coordinated action among different groups of nations even though institutions are already established for that purpose would be difficult. Further, there are both technical and economic limitations on the role that commodity agreements can or should play.

At this stage I would not venture to guess what proportion of commodity trade could be effectively organized nor do I have an opinion on how much should be conducted under agreements. My only suggestion is that a philosophical resistance to commodity agreements should be avoided by U.S. policy makers, and an honest effort should be made to evaluate the possibilities of improvement through organized international arrangements. In the case of advanced countries, the basic need in trade policy is to seek cooperation that will reduce the chaotic conditions created by import restrictions, export aids, and production that is not in line with market requirements.

Very little success has been achieved in reducing trade barriers through confrontations for tariff bargaining. Given the inherent problems of agriculture, especially in high cost countries, and the fact that the consequences of open ended reduction in trade barriers are immediate and indiscriminate, this is not surprising. No country, including the United States, has been willing to accept these consequences on their high cost agricultural production. The changes required to liberalize trade and adjust domestic policy need to be controlled and implemented at a rate that governments can accept politically. This kind of coordination implies something more in policy than rounds of tariff negotiations and a search by individual negotiators for special advantage in each other's markets.

In the case of less developed countries, their expressed interest in commodity agreements to stabilize export earnings is not aimed at short-term cyclical price swings but really involves a search for upward stabilization that will provide a measure of development aid through commodity trade. While there are disadvantages in providing aid in this way, there are also advantages. Importantly in the case of marketing agreements, the income transfer is disguised, and this may serve to ease the conscience of both donor and recipient countries. The close analogy between domestic price supports and commodity agreements may also mean that commodity agreements would be politically more acceptable in donor countries than either compensatory payments or direct aid. Again, while I have no positive suggestions on how much application commodity agreements might have for this purpose, they should be openly considered in the light of an aid objective and not rejected through a priori reasoning that questions only their effect on efficiency and resource allocation.

Finally, there is another and more general imperative for U.S. policy and trade experts to think through the role of international commodity arrangements. The first postwar era of international commercial diplomacy probably has passed. This era was dominated by U.S. leadership in successive rounds of tariff negotiations that sought to promote the idea of free trade in a traditional sense. But the EEC and the EFTA have now assumed increasingly important roles and, in addition, the less developed countries have succeeded in becoming a cohesive group in the UNCTAD. Not one of these groups wants to talk free trade when it comes to agricultural commodities. Increased organization of international markets is the official position of both the less developed countries and the EEC, while the U.K. and the EFTA have quietly moved ahead with a trade agreements program. With this state of affairs facing us, we can hardly afford to ignore the position of these groups. After all, they comprise most of the rest of the non-Communist world.

PART III

Agricultural Policy Alternatives