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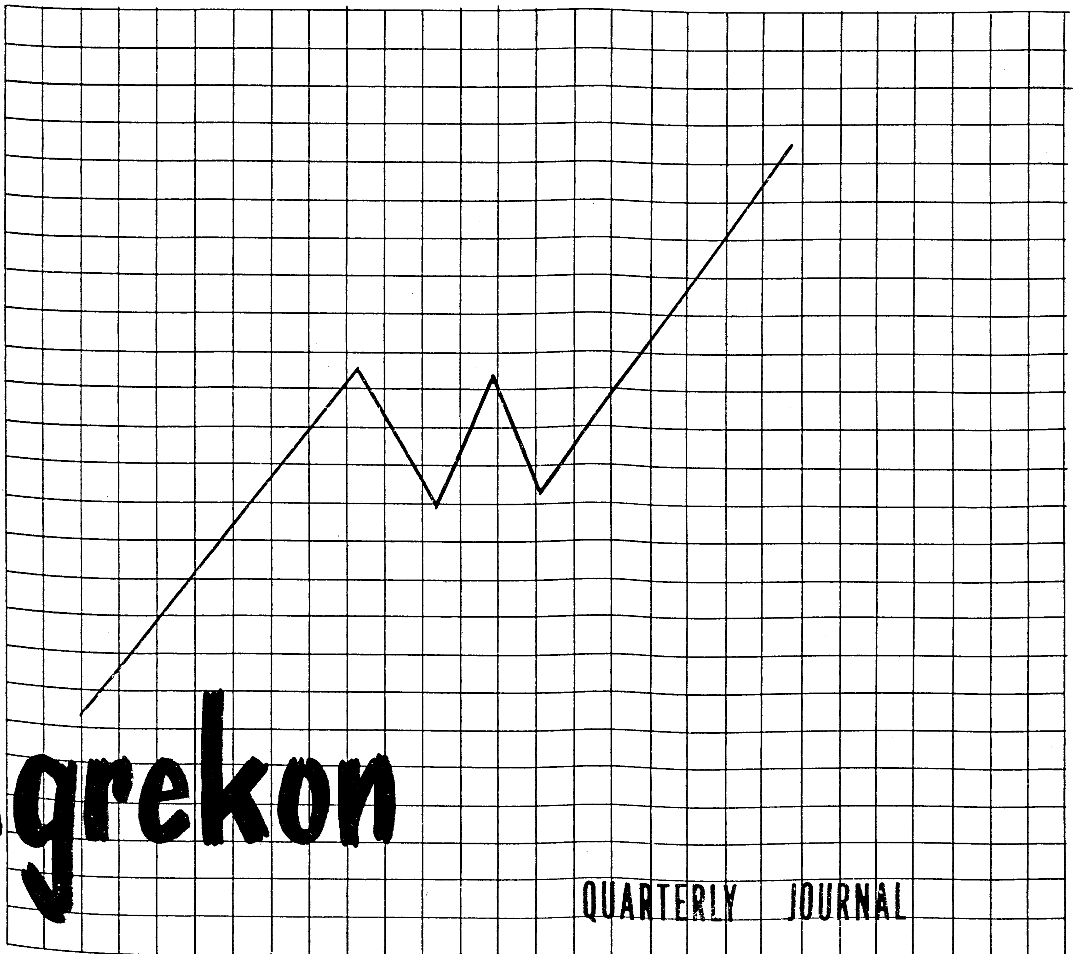

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International Commodity Agreements

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INTRODUCTION

In practice, prices have two functions to perform:

1. They determine the allocation of resources; how much of particular goods will be produced and by which group of producers; and how much of particular commodities will be consumed and by whom.

2. But, in the process of doing this, prices also determine the incomes of individual producers.

The first function is merely a part of the technical mechanism of the economic system operating through supply and demand; but in the second function the social aspect enters the picture, and it becomes a matter of great concern when we are faced with entire communities (or even countries) dependent on the price of a single commodity.

Prices of agricultural products such as sugar and wheat, of raw materials like rubber and of metals, had at times doubled within less than 12 months or fallen to less than half their previous level. Obviously, such fluctuations seriously affect both sellers and buyers. For the actual producers, the fluctuations may be even more violent than indicated by calculations based on world markets, since charges for transport and other services incidental to getting the product to the market tend to vary less - so that the net return to the original producer suffers a more than proportional share of the impact of fluctuation. It is most inconvenient for the individuals concerned to experience such very sharp changes in their incomes and necessary expenditures.

In earlier years (19th century) we were inclined to let supply and demand regulate themselves through the price system, and we regarded the incidental trials of individuals as part of a penalty worth paying for the over-all increase in output which the better allocation of resources accomplished. Today we seek to avoid the pains while still securing the benefits of expanding output. Unfortunately that is never fully possible; and an essential question, in respect of schemes for commodity price regulation, is whether they will have untoward effects on the allocation of resources, on total production and, therefore, on aggregate real incomes.

The commodity agreements with which we were familiar before and immediately after the first world war, were typically concerned with preventing a disastrous slump in the prices on world markets of certain commodities of which the production was concentrated in a small group of countries. The simplest instances were rubber, tin and tea. In each case there were not more than half a dozen main producing countries. For most of these the commodity provided a large share of its exports and foreign exchange earnings; and the markets in which they were sold were free markets, affected only to a minor extent by protective devices - but very vulnerable to general trade fluctuations. Accordingly, if the small group of producers could act together, they could prevent escessive supplies pushing down prices to ruinous levels - and often were able to do so, at least for some time. The essence of the inter-war approach to commodity agreements is typified by a resolution on the subject (adopted by the World Monetary and Economic Conference held in London in 1933) which reads:

"1. In order to assist in the restoration of world prosperity, it is essential to increase the purchasing power of primary products by raising the wholesale prices of such products to a reasonable level.

2. In the exceptional conditions of the present world crisis, concerted action is required for this purpose. Apart from any other measures that may be taken to restore the purchasing power of producers and consumers and thus to increase demand, it is desirable that plans should be adopted for co-ordinating the production and marketing of certain commodities.

3. Any agreements to give effect to such plans should conform generally to the following conditions:

(a) The commodity must be one of great importance for international trade in which there is such an excess of production or stocks as to call for special concerted action.

(b) The agreement should be comprehensive as regards the commodities to be regulated - that is, it should not be narrowly drawn as to exclude related or substituted products, if their inclusion is necessary to ensure the success of the plan.

(c) It should be comprehensive as regards producers - that is,

(i) of assent amongst exporting countries and within these countries a substantial majority of the producers themselves;

(ii) where necessary, or desirable for the success of the plan, it should provide for the co-operation of non-exporting countries whose production is considerable.

(d) It should be fair to all parties, both producers and consumers; it should be designed to secure and maintain a fair and remunerative price level; it should not aim at discriminating against any particular country; and it should as far as possible be operated with the willing co-operation of consumer interests in importing countries who are equally concerned with producers in the maintenance of regular supplies at fair prices.

(e) It should be administratively practicable.

(f) It should be of adequate duration; that is, it should contain provisions for its continuation for such a period as to give assurance to all concerned that its objects can be achieved.

(g) It should be flexible; that is, the plan should be such as to permit of and provide for the prompt and orderly expansion of supply to meet improvement in demand.

(h) Due regard should be had in each country to the desirability of encouraging efficient production."

International agreements were also discussed at the conference, although not at that time realised for coffee, cocoa and cotton. For these products the conditions of supply and demand bore a close resemblance to those in respect of rubber, tin and tea. International agreements, however, actually became effective for two other commodities, namely sugar and wheat. The basic purpose of these agreements was also price stability, but sugar and wheat present various special features:

1. The much wider spread of production among a large number of countries (for sugar, the majority of all the countries in the world).

2. Countries could not be neatly divided into "producer" and "consumer" countries (since most figured in both camps), but only into exporters and importers.

3. The wide prevalence of protection and other forms of special stimulus to each country's own national production.

These peculiarities led to novel provisions in the sugar and wheat agreements, which are relevant to the discussion of new forms of commodity schemes and which emphasise the countries' struggle to maintain a share in the world market for their products.

HISTORY OF THE SUGAR AGREEMENT

There was an international agreement for sugar in 1925, which could be regarded as reasonably comparable with the agreements already described for rubber, tin and tea; that is, it covered only a restricted group of countries interested in the export of sugar, and sought to control or mitigate price fluctuations by prescribing export quotas for these countries.

It was not particularly successful in this objective, because the producers had nothing remotely approaching a monopoly of sugar production. Much the greater part of world sugar output was sold in protected or preferential national markets, and the participants in the agreement were competing merely for the comparatively small residual market - which tended to shrink all the more rapidly as their own efforts to maintain prices offered greater incentives to the protected and preferential national producers.

A much more extensive agreement was therefore negotiated in 1937 which could reasonably be called a world agreement, since its signatories included a high proportion of all independent countries. The general background, as already indicated, was one in which most of the sugar in the world was produced under conditions of high protection or subsidy, or for sale in another country where the producers enjoyed substantial tariff protection.

There, however, remained a so-called free market, the suppliers of which enjoyed no preferential position in that market itself, and which during the previous generation had rarely accounted for much more than 10% of the total volume of production. Of the suppliers to the free market, the majority were in the position of having access to protected or preferential markets for the greater part of their output, and had to sell at free market prices only occasional surpluses or, at worst, only the smaller part of their total output. A much smaller group of countries in pre-war days, practically only the Netherlands Indies, Peru and the Dominican Republic, had to sell nearly their entire output at free-market prices - without any degree of protection or any preferences.

The tendency during the inter-war period had been for the production of the protected producers to increase and for the remaining market to shrink. The United Kingdom's home production of beet-sugar, for example, had increased (under the stimulus of subsidies) from nothing to a point at which it supplied over one-quarter of the country's consumption, while British Commonwealth producers had substantially increased their exports to the United Kingdom and Canada - under the stimulus of the tariff preferences offered by those countries.

The 1937 sugar agreement therefore sought, in effect, to check this increase in protected output, while continuing the attempt to control prices in the residual market by variable export quotas. Under a complex series of provisions, the United Kingdom agreed to stabilise its beet-sugar output at the level existing at the time. The U.S.A. agreed to maintain the regulation and limitation of its domestic output, and the allocation of its imports between certain associated overseas countries, as established by domestic legislation. The European beet-sugar producers in effect committed themselves to refrain from further expansion by accepting comparatively small export quotas. The British Commonwealth producers accepted quota limitations, which were designed at least to limit their further expansion; the residual suppliers to the remaining market accepted export quotas which were to be varied from time to time as need arose in order to stabilise prices.

The 1937 agreement did, therefore, make a very definite move towards preventing further expansion on a basis of protected markets, introducing an element of stability in the size of the market open to the rest of the world.

WHEAT

The wheat agreement concluded after the war faced a somewhat similar situation. There were four important exporters of wheat - the U.S.A., Canada, the Argentine and Australia - and there was a comparatively small number of large importers, of whom the United Kingdom was the most important. All importers, however, were also substantial producers and in many, if not most of them, production was encouraged by protective tariffs, subsidies or other arrangements. The exporters themselves were also not insignificant consumers, and at least in the U.S.A. production was stimulated by the artificial maintenance of prices. The amount available for export, large as it was, constituted no more than a comparatively small percentage surplus of total output over consumption.

As with sugar, therefore, the problem was not simply one of maintaining price stability in a market free from artificial disturbance, but of ensuring that that market was not further artificially reduced. The provisions of the agreement, based on reciprocal promises, were however much less complicated than those of the sugar agreement.

RECENT INTEREST IN COMMODITY AGREEMENTS

The three archetypal agreements - for tin, rubber and tea - had lapsed or been largely modified; but the idea of commodity agreements, as a price-stabilising device, has continued to attract many countries. They have come under renewed discussion from time to time; most recently because of a renewed concern about the trend in primary-product prices generally and, especially, in the divergent movement of primary-product prices and those of manufactured goods. While the latter have been rising, the former have been stationary or falling - so that the terms of trade have been moving against the less-developed countries and in favour of the industrialised countries. The effects of fluctuations are also brought into greater prominence because of their international character, and because of the way in which entire countries have become specialised in the production of individual commodities. This has meant that not merely the private means of individual producers, but also the total revenues of some states, have become dependent on the prices of one or two commodities.

When the price of a commodity such as wheat fluctuated before there were any controls, the change was normally associated with an offset by an opposite change in the size of the harvest; low prices accompanied big crops and high prices followed small crops - so that the fluctuations in money incomes were less sharp than the fluctuation in price. In the international commodity markets of today, however, even though that may be true to some extent of producers of a particular commodity taken as a whole, it is less commonly true for any particular country. If Ghana has a good cocoa crop and the world price falls, Nigeria will feel the effect just as much, even though the Nigerian crop may be no larger than usual - provided there is free trade. In addition to price changes due to fluctuations in supply, price changes may also be brought about by changes in demand rather than by changes in supply; so that it may well happen that producers are actually able to sell less at lower prices than at high - this particularly applies to metals and other industrial raw materials. The income fluctuations are then greater and not less than the price fluctuations.

A third factor for concern arises out of the fact that the luxuries, which the farmer of former generations could afford to pay for only in good times, tend now to become necessities which he must have at all times. Governments also grew accustomed to take some of the farmers' "surplus" income, and they have thus become more vulnerable to price and income changes in general.

Britain's negotiations for entry into the common-market further raised the issue of how far certain primary producer countries, who have had free access to the United Kingdom market can, if the United Kingdom enters the community, preserve an equivalent share of the combined European market in face of the widespread protection extended in Europe to producers of competing produce.

Statements made by countries in this regard usually relate only to agricultural products, because they are undoubtedly the products which are currently giving the greatest difficulty, but analogous problems could arise in relation to non-food products, such as fibres and rubber; to minerals such as aluminium, where the interest of French producers may conflict with those of non-European producers; and in a more complicated way to the field of energy and fuel products, where it is known that the present level of coal production in Britain and the countries of the common-market could not be sustained in free competition with imported oil. Finally, it may before long be necessary to extend the discussion to include the simpler manufactured goods for which some semi-developed countries are now seeking export outlets - and for which a good many others may need to seek outlets in the not too distant future if their development is to continue.

It is, however, significant to note that whilst the inter-war agreements stressed the price stability aspect, later agreements and negotiations place much greater emphasis on problems of quantity; that is, the size of the markets and how they are divided up between principal producers.

In the older type of commodity agreement the danger most prominently before the eyes of the producers and the governments concerned, was that of prices falling to levels below what they believed to be their minimum costs, at any level of production. They were therefore willing to be subjected to drastic curtailment of the volume of their exports in order to preserve what they regarded as remunerative prices. Permissible tin and rubber quotas were at times as low as 40% of the standard quotas, and the Netherlands Indies accepted in the 1937 Sugar Agreement an export quota of less than one third of the level of exports they had attained a few years before.

PROBLEMS IN SCOPE OF AGREEMENTS

An obvious case is sugar, where imports are in direct competition with home-production and where an agreement therefore depends to a large extent on the willingness of the importing country to limit its own production. Oil also is in direct competition with coal and it is very unlikely that the coal-producing countries will accept an agreement to limit their own production of coal in order to import more oil.

If we look at the products produced by the under-developed countries in Africa, we find that cotton is in direct competition with synthetic fibres; oilseeds is in indirect competition with cereals on the one side and butter and olive oil on the other - to say nothing of synthetic detergents.

We also find that, although a foreign product may not be in direct competition with a home product, they may be in indirect competition and have their markets restricted by other policy measures, including excise taxes. Fruits, even where they do not compete fairly directly, may be regarded as in competition with local fruit. Tea and other beverages may to a lesser extent be regarded as in competition with wine in Europe. Both groups are favourite subjects of luxury taxation.

For a good many metals and other raw materials the dangers and the problems are perhaps less serious. The demand for them is likely to grow anyway as industrial output grows. But the field is not free from problems of competition - of synthetic with natural rubber, for example, or of one metal with another.

CRITICISM AGAINST COMMODITY AGREEMENTS AS PRICE STABILISATION DEVICES

When there is an organised marketing agreement for a product, producers' governments are inclined to assume in times of high prices that the boom is going to last and to make their plans accordingly. Unless production can be curtailed, which becomes less likely the more countries are involved and is also undesirable from an economic point of view, prices eventually break down and cause serious embarrassment. The governments of the under-developed countries seem more likely to fall in this trap by pitching their sights too high and committing anticipated future income far in advance. If it then turns out that they have over-estimated their income, all kinds of trouble can follow. This argument is used by persons in favour of marketing agreements aimed at stabilising prices. They then draw the conclusion that the effect of price fluctuations is generally to reduce development or investment expenditure to a serious extent.

To this I cannot readily agree and maintain that fluctuation is not itself discouraging to investment, but that false expectations (fostered probably by marketing agreements), based on failure to recognise the probability of fluctuation, usually leads to unproductive investment. The trade-agreement schemes to my mind face two major difficulties - one of economic principle and one of practical administration.

The difficulty of principle arises from the fact that one basic purpose of the price system is to take a vital part in determining the amount and location of production, as well as the level and distribution of consumption of particular products. Prices rise because either supply is decreasing or demand is increasing, and they fall because supply is increasing or demand is falling. The movement of prices therefore helps to counteract reverse changes on the supply and demand side. If we take the extreme case where the price of a particular commodity was maintained absolutely unchanged, some other measures would have to be taken to offset changes in the real conditions. The danger, however, has always been that where prices have been stabilised at a point where producers find it profitable to produce much more than the market can absorb, either the scheme of stabilisation breaks down or quite different steps have to be taken to reduce output. Accordingly, the more effective a scheme is in creating price stability, the more certain it is that other incentives or controls will be needed to bring about equilibrium of supply - and some approach to the economic location of production. Here as elsewhere control breeds more control.

The administrative difficulties flow from the necessity to establish control. The schemes can be fully effective only if all actual and potential producer countries are brought under control. This is difficult for commodities which are widely produced, and these include nearly all foods and many minerals. Even where production appears narrowly limited geographically, as with tea or tin, it is not long before new producers emerge. In addition, the market conditions for each particular product are closely linked with those of others which are actual or potential substitutes for it; and if you follow an excessively high-price policy, it must always be remembered that it is very difficult to recapture a market once it has been lost. Hence we may find still more ambitious projects for a completely interlocking scheme of commodity controls. The more complex such schemes become, the more they depend on the willingness throughout the world to cooperate in agreed regulation of economic affairs.

The arrangements as to preferential marketing between pairs or groups of countries, whilst they may help in particular instances, intensify the effect of fluctuations on groups not similarly sheltered. For instance, whilst the British Commonwealth Sugar Agreement provides a market in the United Kingdom at reasonably stable prices for the bulk of the sugar exports from Commonwealth countries, the remaining free market has been greatly narrowed and is now particularly vulnerable.

CONCLUSIONS

In theory, properly devised agreements could contribute to the temporary solution of the agricultural protection problem for under-developed countries. In practice, however, the devising of satisfactory agreements is no simple task and inherent in it is the danger - not mentioned before - that such agreements would only result not in the agricultural protectionism of the industrialised nations being reduced but merely in its being frozen. Agreements of this kind would be of value only if they are envisaged as essentially transitional; that is, when it helps in regulating a gradual movement towards free trade and of lessening the shocks to established producers which would result from a more simple and direct approach.

Policies of developed countries should be aimed at the stabilisation of incomes rather than of prices through the maintenance of general economic stability and at measures to widen the markets for products of the less-developed countries; that is, direct tariff cuts, alterations in excise and other taxes on such products. The stabilisation of incomes rather than prices through adjustments of taxation and government expenditures, and the stabilisation of private spending through individual prudence, involve no interference with the economic function of prices and, therefore, have the merit of promoting social and political objectives without endangering long-term economic efficiency. Indirect influences, through the maintenance of general economic stability and the avoidance of the special interferences of protectionism, have the same advantages - with the additional merit of helping to remove the purely accidental or artificial causes of price instability. In this way, advanced industrialised countries can assist the under-developed ones.

THE VALUE OF FARM LAND

When a man buys farm land, he is buying the right to receive the income from the use of that land in the years to come. Current earnings from farm land determine land prices only in so far as they are indicative of returns expected in the future. Therefore, if a buyer expects future income to increase substantially above what it is now, or if he anticipates a small but relatively constant annual increase in returns to land (possibly due to creeping inflation or output-increasing techology), then he believes he can, and may, pay more for land than its present level of earnings might justify. The result will be that he pays a price that requires a lower capitalization rate on current returns than the current returns than the current mortgage interest rate.

-- "Facts and Opinions" (June 1964) Urbana University, Illinois, U.S.A.