

Some of the Principal Issues in the Negotiations for a Common Fund

Commonwealth Secretariat,
Marlborough House,
Pall Mall,
London, SW1Y 5HX.

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<u>Contents</u>	<u>Page No.</u>
Introduction	5
Politico-Economic Issues	5
Objectives	5
Buffer Stocking	5
Diversification and "Other Measures"	6
Macro-Economic Effects	6
Type of Common Fund	7
Source of Finance or Pool of Finance	7
Variants of Pool/Source	9
(a) Absorption of Existing Agreements	9
(b) Fourcade Proposal	9
(c) United States Position	9
Capital Requirements	10
Capital Subscriptions	10
Capital Subscription/Borrowing	10
Burden Sharing	10
Borrowings	11
Financing "Other Measures"	12
Voting Structure and Management	12
Relationship between the Common Fund and ICAs	13
Net Importing Developing Countries	14

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Introduction

1. There is agreement by the international community to establish a Common Fund as a new entity to play a key role in achieving the objectives of the Integrated Programme for Commodities as set out in Resolution 93 (IV) at Nairobi. The objectives, functions, form, mode of operations and management of such a fund are still to be negotiated. Taking into account the evolution of the discussions so far, the main issues in the final negotiations and the ones to which the Technical Working Group may wish to pay particular attention would seem to be as given below.

Politico-economic issues

2. In considering the issues related to the Common Fund, it would be unrealistic to ignore political questions as these inspire many of the technical arguments which are raised in objection against or in support of the Common Fund. The first issue is that the Common Fund as conceived by UNCTAD, represents the first major international facility in which the developing countries are expected to have a significant, if not a predominant voice. It is in fact seen by the developing countries as the first effective test of the concept of economic interdependence. The effectiveness of the Common Fund will therefore determine the content of this new experience in international economic management. The second is that the Integrated Commodities Programme including the Common Fund is an attempt to manage international commodity trade. A number of developed countries, which internally regulate their primary production sectors¹ and insulate them from other national and international forces and from monopsonistic practices that sometimes characterise the market for primary products, find difficulty in accepting regulation of international commodity trade. The Group must take a view on these issues.

Objectives

Buffer stocking

3. The Common Fund was proposed originally to finance buffer stock operations. Developing countries have proposed that it should finance other measures also which are intended to serve the objectives of commodity agreements.

4. The importance of the role of financing buffer stocks depends on the advantages of buffer stocking as a regulatory mechanism in commodity trade compared with other mechanisms and the range of commodities requiring control mechanisms for which buffer stocking is suitable. It is important therefore to give some thought to these issues.

5. Buffer stocking as a control mechanism could be undertaken internationally or nationally with international coordination. In other words International Commodity Agreements (ICAs) could undertake international buffer stocking, or stocking could be undertaken by national authorities with stocking policy being determined, coordinated and financed internationally through ICAs.

¹ The rationale and objectives of intervention by some developed market economy countries in their agriculture are dealt with by Professor Tim Josling in Price Stabilisation and Income Support Measures in Agriculture in the U.S., Canada, EEC and Australia: Lessons and Implications for the Regulation of International Commodity Trade, in Volume I of this publication.

6. In the preparatory meetings now being held for the negotiation of agreements for individual commodities, national buffer stocking has been looming larger than originally envisaged. It is therefore important to consider the financial implications of national as well as international stocking.

7. Financial implications are involved also whether the objective of ICAs should be "pure" buffer stocking or buffer stocking supplemented by other measures such as export quotas and production control. The use of supply management reduces the amount of financing required although it poses a problem about the adequacy of stocks to prevent the ceiling price being pierced. Whether "pure" or more inclusive types of buffer stock arrangements should be adopted is a matter for the ICA concerned. However, some consideration of this issue might be necessary in view of the effect on financial requirements.

Diversification and "other measures"

8. Many developing countries are firm in demanding that a Common Fund should have a facility to finance measures other than buffer stocking which would contribute to achieving the wider objectives of ICAs. The measures include diversification, research and development, productivity improvement, market promotion and the encouragement of processing facilities for natural products competing with substitutes.¹

9. The argument has been raised that there already exist international financial institutions which are providing finance for these measures so that there is no need for duplicating institutions. However, duplication does not necessarily mean wasteful competition any more than the multiplicity of banks means a waste of economic resources. Besides, the important question is the overall objectives which are to be achieved by the ICAs. "Other measures" could be supportive of the pricing objectives and policies of ICAs. There is merit in looking at the need and scope of such "other measures" in relation to the price stabilisation policies and the wider objectives of ICAs.

10. Besides, there is the relevant fact that buffer stocking is a more suitable mechanism for the commodities of some exporting countries than for others. A widely supported commodity financing facility requires a balance of objectives and functions taking into account the varied requirements and interests of the important commodities for different developing countries. The proposal for other supportive measures therefore is construed as an important element in seeking to achieve the goals of the Integrated Programme for Commodities of which the Common Fund is a part.

Macro-economic effects

11. International inflation and international economic instability have become serious problems in recent times; there is increasing recognition that the comprehensive commodity policy that a Common Fund could help to bring about and support, could have significant favourable effects on these problems. Global economic management could be improved by an international device which could provide non-inflationary demand stimulation through developing countries during periods of recession. The Common Fund could also assist in recycling the surpluses of OPEC countries through utilising petro-dollar surpluses for investment in stocks of commodities exported by developing countries. These macro-economic considerations suggest that social returns to buffer stock investments financed through international

¹ See the paper on The Second Window for "Other Measures".

arrangements would far exceed direct commercial returns. If this is the case, it provides justification for the subsidisation of such investments through highly concessional loans to the Fund and the creation of international liquidity for soft on-lending to buffer stock schemes.

Type of Common Fund

Source of finance or pool of finance

12. Given a general indication of the range of commodities that might be suitable for buffer stocking and the scope of activities of the Fund, the very important issue of the type of fund that would be suitable to facilitate or provide financing for buffer stocks must be examined.

13. The developing countries have been supporting the proposal for a Fund as a principal source of finance. Many Group B countries have tended to favour a weak central facility - the pool of finance concept - in which ICAs would raise their financing independently of a common facility. ICAs would deposit their surplus funds with the Fund which, in turn, would lend to other ICAs in need of funds. Some variants of the pool idea admit of a Fund which would be a source also, although to a minor extent. The decision on the type of fund to be recommended would depend very much on how the advantages claimed for the source concept are viewed. The following advantages are possible:

- (i) it would economise on the use of capital for buffer stocking because price cycles for individual commodities tend not to be synchronised;
- (ii) funds could be made more readily available and at a lower cost because of the greater access to credit, and the spreading of risks involved in a multi-commodity operation;
- (iii) the prior assurances on the availability of finance would facilitate the setting up of commodity agreements and the choice of buffer stocking as a control mechanism where this is a suitable device;
- (iv) specialised buffer stock financing would encourage the development of expertise in financial management and of appropriate instruments for the maximum utilisation of potential sources of funds for this type of activity taking into account its special liquidity requirements;
- (v) a common financing facility could provide support for commodities for which an ICA has not yet been established thus enhancing the catalytic role mentioned in (iii);

- (vi) to the extent that the Fund earns surpluses it could make some provision to a Second Window for the financing of "other measures" and so enhance the effectiveness of the individual ICAs in reaching their global objectives;
- (vii) it would provide greater scope than the pool concept for assisting in global economic management and promoting international economic stability;
- (viii) it provides a firm basis for determining country participation in the management and control of the Fund.

14. Possible benefits from this central source concept could be compared with the advantages of the pool of finance concept. Capital savings are possible from the pool concept compared with the situation in which there is no central facility for independently financed individual commodity organisations. In a pooling arrangement their use of assets as collateral for loans would be analogous to that of the commodity bonds which have been discussed from time to time. The savings, however, are not likely to be as large as those from the source concept. The source type of Fund also offers possibilities of raising finance by rediscounting warehouse warrants or through the improved credit rating which the possession of such warrants could provide. It provides also greater scope for acquiring information and expertise on tapping capital markets and utilising whatever potential exists for raising capital for buffer stocks from such markets.¹ It is possible then that the source concept can lead to less demands for capital from individual member countries of ICAs. Prior and ready availability of finance make possible a catalytic role which would not be present in the case of the pool concept.

15. On the other hand, the pool concept may pose fewer management problems in the reconciliation of conflicts of interests between different commodities in terms of capital requirements and the need for maximum limits to borrowings by individual ICAs. Operating via the pool concept avoids the need for making assumptions of commodity coverage, country participation and estimates of capital requirements prior to the establishment of the Fund.

16. One of the possible reasons why the adherents to the pool concept arrive at their view is that they see the pool concept as a means of ensuring the autonomy of the individual ICAs vis-a-vis the Fund. As against this, however, it must be noted that the fundamental decisions which will affect the rate of stock accumulation or disposal will be taken by the ICAs within their provisions, but finance will have to be obtained from some source anyway; in these circumstances, it may be considered that the potential weakening of the ICAs by the central source concept is illusory and deviation from it could both increase costs to the individual ICAs and weaken the effectiveness of the buffer stock as a stabilisation mechanism.

¹ In this connection note may be taken of the fact that the Common Fund could itself issue an instrument to secure its borrowings from the market based on a composite of the stock warrants which individual ICOs pledge with it. Preliminary indications from bankers suggest that this could be quite feasible and simplify the operation of the Fund.

Variants of pool/source

(a) Absorption of existing agreements

17. Some variants of the type of fund proposed involve a mixture of the source and pool concepts. On the one hand, some existing ICAs utilising the buffer stock mechanism - the tin and cocoa agreements - have made their own provision for financing. The accommodation of these agreements within the source concept will involve some dilution of the concept since these organisations must be given the choice concerning the extent to which they would allow existing direct contributions to them to be handed over to the Common Fund or future contributions to be made directly to the Fund.

(b) Fourcade proposal

18. On the other hand, the proposal made by M. Fourcade, the French Minister of Economy and Finance, at UNCTAD IV involved elements of the pool and source types of funds. Under the proposal contributions would be made to individual commodity organisations; when a number of agreements have come into operation, surpluses would be pooled in a Central Fund which would facilitate transfers and use between the individual organisations according to their needs and surpluses. Additional resources could then be contributed directly to the Central Fund including loans from international organisations such as the IBRD, thus reinforcing the source element.

19. When the Central Fund becomes operational, to the extent that it is able to raise its own resources, it would reap the advantages of the source concept. However, initially the catalytic role would not be available and even eventually it seems that the Fund's own resources would be a minor part of total financing since they seem to be meant only for such special situations as exceptional financing needs and to help countries in difficult circumstances to meet their contributions to individual commodity organisations.

(c) United States position

20. While the US supports the pool concept, it seems that there is beginning to develop some acceptance of an element of the source concept, in that, consideration is being given to the provision of supplementary resources direct to the Fund through, for instance, a limited overdraft facility at the IBRD or IMF. This view allows the possibility of a Second Window with funds contributed voluntarily to be used as a source for non-buffer stocking measures.

21. Like the Fourcade proposal, this US view allows only a limited element of the source concept. However, it should be noted that the US is concerned that if buffer stock ICAs are to be established, financing must be adequate since inability to defend the floor price could encourage the adoption of supply management measures which the US now does not support.

22. The extent to which the source concept is included in the above proposals is limited. The important question though is whether its inclusion is so framed as to allow any advantages that might accrue from it to lead to its expansion. It may appear that the concept is being tried in too limited a form to allow this evolution.

Capital requirements

23. Capital requirements of the Common Fund would depend on the type of Fund adopted since some capital saving (through off-setting) might be possible if the principal source of finance concept is adopted. The UNCTAD Secretariat estimated capital requirements assuming a principal source of finance type of fund. If the proposal to be adopted contains a large pool of finance element, appropriate adjustments may have to be made in the estimates of capital requirements.

24. The UNCTAD Secretariat has estimated capital requirements for buffer stocking and non-stocking activities at \$6 billion of which amount about \$3 billion would require to be called initially. The view has been expressed that capital requirements have been greatly underestimated. In the case of one product alone for instance - copper - estimates made by the US show that about \$5 billion would be required whereas the UNCTAD estimates show the requirement at about \$1 billion. While some margin of error in the estimate is to be expected and should pose no serious problems, a large one would have important implications for the viability and financial management of the Fund.

25. The Technical Group may wish to examine the basis on which the estimates have been made.¹ Inadequate financing for buffer stocks could paradoxically increase the amplitude of the swings in prices through the encouragement of speculation. At the same time, the estimates of minimum stock needs of individual commodity agreements must be assessed against the other elements of an ICA dealing with supply management and minimum purchases. However, the Group may wish to note that the forecasting of capital needs is inherently a hazardous exercise and that different assumptions can yield widely differing results.

Capital subscriptions ²

Capital subscription/borrowing

26. In raising the \$6 billion required, the UNCTAD Secretariat suggested a subscription/borrowing ratio of 1:2. Initially therefore, \$1 billion would require to be raised as subscription and \$2 billion as loans. The Group may wish to consider whether this ratio is appropriate in the light of potential sources of funds which might be available to the Fund, the kind of on-lending rate necessary and the interest burden which could be tolerated.

27. If a pool of finance type of fund is to be adopted, then the borrowing potential may be less and subscriptions may have to provide a higher proportion of the capital requirements.

Burden sharing

28. In allocating the capital subscription, the criteria proposed include trade shares in the commodities covered and economic capacity as reflected by total GNP and GNP per capita.

29. The Technical Group may wish to give consideration to proposing alternative criteria taking into account differences that might be required in the pool or source concept. For instance, it might only be possible to take economic capacity into account in a very limited way in the pool concept.

¹ The bases of some of the estimates of the cost of buffer stocking are described in the Paper "Comparative Study of the Estimates of Capital Requirements for Buffer Stock Financing" in this Volume pp 49-78.

² Financial considerations are discussed by CRU in A Common Fund - Financial Organisation, Operations and Management, in Volume 1 of this publication.

30. In examining criteria, consideration would have to be given to the following:

- (i) the type of Fund to be adopted. (The type of Fund to be adopted might itself be influenced by the fact that some criteria such as economic capacity are easier to incorporate in one type than in the other);
- (ii) the proposal that developing countries should have a substantial or majority voice in the management of the Fund;
- (iii) the capacity of some countries to afford capital subscriptions in the convertible currencies required;
- (iv) the possibility of accepting subscriptions in local currencies for some countries; and
- (v) the need for importing countries to make a substantial contribution whether the pool or source type is adopted. In the case of the pool concept contributions would have to be made directly to the commodity organisations.

Borrowings

31. If the source of finance is to be the principal element the scope for borrowing might be substantial. Means will have to be found to facilitate such borrowings. The need for concessional borrowing would depend on what is deemed an appropriate on-lending rate and concessional borrowing requirements would determine the extent to which different sources are relied on. Borrowing in capital markets would be facilitated by guarantees or the extent to which stocks could be used as collateral. Since the stocks would be owned by the individual commodity organisations, the possibility of using warehouse warrants as collateral not only for borrowing from the Fund but also for loans by the Fund from capital markets would have to be explored. The particular liquidity requirements for financing buffer stocks would have to be taken into account.

32. The IBRD had agreed in principle to lend directly to the Tin Council but it is understood that the disbursement conditions were not found satisfactory. There is an IMF Buffer Stock Facility which lends to Governments in balance of payments difficulties to help meet their contributions to buffer stock commodity organisations. Important questions for the Group would be the extent to which the international financial organisations should be important sources of finance for buffer stock financing and whether such lending should be directly to the Common Fund or to commodity organisations as well as to member Governments.

33. If the Fund is predominantly a pool type, the scope for borrowing would be less but the individual commodity organisations would have to borrow from other sources such as the capital markets where Government guarantees and warehouse warrants could be used as security. The difficulties posed for such borrowing by the particular liquidity requirements for financing buffer stocks strengthens the case for a special central financing facility for buffer stocks.

Financing "other measures"

34. Under current considerations, a Second Window is proposed for financing "other measures"; this is because of different requirements in terms, conditions and periods of loans and because also of possible wide differences among participating countries in willingness to make funds available. Developed market economy countries are reluctant to create another facility for lending for these purposes. There is, however, among them some acceptance of a facility which would be financed by voluntary contributions. The developing countries perceive a more formal participation in the financing of these activities including possibly a specified proportion of resources from subscribed capital, transfers from the net income accruing from the Fund's buffer stock facility and voluntary contributions.

35. The Group will need to consider the scope for the Second Window receiving contributions as grants or soft loans from Governments and the basis on which such contributions could be organized. Capital subscriptions on the basis of pledges from groups of countries - developed, non-oil developing and OPEC - as in the case of IFAD could be considered as a possibility. Clearly however, the need for the funds will be determined by the objectives accepted for the Common Fund and on the resolution of source/pool conflict.

36. Assuming that a Second Window is agreed, the conditions under which on-lending will take place from the window would also have to be considered. Among the questions to be examined are:

- (i) would loans and grants be made through commodity organisations or directly to Governments?
- (ii) how should these loans be related to other institutional loans?
- (iii) since concessional distribution of funds and lending for long periods may be necessary for some purposes such as diversification, what arrangements would be proposed for replenishment of these funds and how often should such replenishments take place?

Voting structure and management

37. The voting structure and management adopted would depend very much on whether the Fund is a source or pool type. The Integrated Programme is concerned largely with commodities of substantial export interest to developing countries, and it is seen as the first substantial reform in the implementation of a New International Economic Order. Developing countries, therefore, seek majority control of the Common Fund. Majority capital subscription would enable them to have this; equal capital participation by producing and importing countries based on trade shares and a significant capital subscription by OPEC could also yield this result. However, account has to be taken of the burden which such capital subscriptions may impose on the least developed countries. Besides, net importing developing countries may find a pure trade share criterion unacceptable also.

38. In view of the size of the capital subscription, economic capacity has been proposed as an important criterion in determining capital subscriptions to the Fund. But how large a divergence between capital subscription and vote allocation would developed countries be prepared to allow? An important

rationale for divergence between capital subscription and voting strength lies in the importance of raw materials and especially non-renewable raw materials in economic activity. The question is - what weight should be assigned to non-financial elements in determining voting structure assuming that there is agreement on the position that developing countries should exercise majority control. It should be noted that the developed countries have already exercised voting strength in individual commodity agreements without making any financial contribution to the Fund for buffer stocks. There is no new principle involved, therefore, in assigning majority control of the Common Fund to developing countries even if they do not subscribe the bulk of the capital.

39. In looking at the position of developing countries, account must be taken of the likelihood that Group D countries and China will be members of the Common Fund.

40. In IFAD there has been a complete departure from the principle of vote allocation according to capital subscription. Equality of representation in the Governing Council and the Executive Board have been granted to three categories of countries which are recognized - Category I (developed market economy), Category II (OPEC) and Category III (non-oil developing). Distribution of votes within categories takes into account capital subscription but in Category III complete equality is maintained but on a regional basis with equal representation for Africa, Asia and Latin America.

41. The example of IFAD may offer some useful guidelines and principles for the voting structure and management of the Common Fund. If the principle of majority control of the Common Fund by developing countries is accepted, this could be implemented through the usual allocation of votes in international financial organisations by the equality and proportionality principles. It would require however, the allocation of a greater proportion of votes on the equality principle than has been done in the past.

42. The above considerations relate to the principal source concept. If a pool type of Fund is adopted, since capital subscriptions are not made directly or substantially to the Fund, votes may be determined on the basis of capital subscriptions to the ICAs; in these circumstances, because of the traditional equal allocation of votes between exporting and importing countries in ICAs special arrangements will have to be devised to bridge any divergence between capital subscriptions and votes. It is perhaps pertinent to observe that the commodity problem has become such a symbol of progress in achieving a NIEO that, from a political standpoint, aside from economic considerations, the developing countries may find the pool concept totally unacceptable because it weakens central control and prevents the formation of a global view of the commodity problem.

43. Proposals made so far on voting structure have been based largely on the principal source concept and any deviation from this concept would require some basic rethinking on the voting structure that would be appropriate for this new international financial institution.

Relationship between the Common Fund and ICAs

44. Another important issue concerns the influence which the Common Fund should exercise over policies of ICAs, e.g. pricing policy. In considering this issue, a view has to be taken on the question whether Common Fund influences which could promote the adoption of some general principles in international commodity policy would necessarily be a bad thing.

45. The financing of "other measures" would have to be undertaken on a source basis, e.g. by direct contributions on a grant or concessional basis from Governments or organisations such as OPEC. If a pool type is therefore adopted for buffer stock financing, the two windows will require completely separate management. Thus instead of two windows, two loosely associated or affiliated institutions might be required.

Net importing developing countries

46. The terms of reference of the Group require it to give attention to special concessions which net importing developing countries may need under the Integrated Programme. Where net importing countries are also least developed, they would receive concessions if economic capacity is taken into account in determining capital subscriptions. Would additional incentives be needed for them to participate in the programme and in the Common Fund? Inflation is high not only in developed countries but in developing countries also. In fact in many developing countries, rates are even higher than in developed market economy countries. The favourable effects of stabilisation policies on inflation and security of supplies could therefore be of great benefit to net importing countries. However, the possibilities of such beneficial effects might not yet be fully recognised and might need to be spelled out.

47. The assumption behind the concern for net importing countries is that the Integrated Programme might be price raising. But would this necessarily be the case since importing countries have an equal voice in ICAs? The ICAs are, after all, concerned with pricing policy. The immediate concern is, however, with the Common Fund and this could be regarded as price stabilising and neutral on the question of the price trend. It could therefore be argued that if adverse effects are involved for net importing developing countries by the Integrated Programme, these would emanate at the level of ICAs and it is at this level that remedies should be sought. It is at this level also that some appropriate remedies are possible, e.g. rebates and concessional sales.