

The Second Window for "Other Measures"

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

August, 1977.

The Second Window for "Other Measures"

<u>Contents</u>	<u>Page No.</u>
General Background	17
Justification of "Other Measures" as part of the Common Fund	17
Second Window will be Small	20
Costs and Priorities in "Other Measures"	21
Priorities	22
Costs	23
Costs of "Other Measures"	23
Diversification	23
Productivity Improvement	25
Research and Development	25
Crop Storage	25
Supply Management Measures	26
Concluding Observations	27

The Second Window for "Other Measures"

General background

1. It has been widely recognised that stocking operations would be inadequate in many cases for the realisation of the objectives of the Integrated Programme for Commodities. Resolution 93 (IV) listed various non-stocking measures, the implementation of some of which requires financing. In the Manila Programme of Action¹ it was suggested that these "other measures" might be financed by the Common Fund as part of the Integrated Programme. These measures are of particular importance in the case of non-stockable commodities, but they appear to be also required in parallel with stocking operations in certain cases in order to achieve the objectives of Resolution 93 (IV).

2. A wide variety of "other measures" in support of the aims of Resolution 93 (IV) can be envisaged. The UNCTAD documentation on the financing of "other measures"² lays particular stress on diversification and increasing productivity so as to increase competitiveness with substitute (particularly synthetic) products; however there are others, some of a stabilising nature, others of particular relevance to the structural problems of particular commodities, which may be required. For jute and hard fibres, for example, supply management through production rationalisation and export quotas is seen as essential. For jute, tea and bananas diversification is needed and will be important, but expenditure on research and development has been identified as essential in the case of jute, hard fibres, tropical timber, cotton and vegetable oils. Promotional measures have been recommended for hard fibres and tea. Improvements in transport and marketing are needed for cotton, while improved shipping facilities are required for coir and tropical timber. Compensatory financing has been suggested for tropical timber, cotton (for the least developed countries), vegetable oils, coffee and bananas. Crop insurance has been suggested for banana producers. Assistance with the provision of storage facilities in developing producing countries can be envisaged for a number of important commodities. Finance for the processing of crops might be appropriate in some instances.

Justification of "other measures" as part of the Common Fund

3. There is some misgiving in certain quarters, particularly developed countries, over the Common Fund becoming involved in "other measures". Against the background of Resolution 93 (IV), it is difficult to sustain arguments against the Common Fund being actively involved in financing such activities. Such arguments are sometimes couched in terms of the possible duplication of activities now being carried out by other

¹ TD/195, February 1976.

² TD/B/IPC/CF/L.3, December 1976.

international financial organisations. But the argument is untenable. Carried to its logical conclusion, it would render redundant not only the regional development banks but also many of the other existing international organisations. But analogy does not provide the main rebuttal; the essential issue is whether it is feasible to construe the Common Fund playing its key role in the Integrated Programme for Commodities unless it is enabled to be active in the field of "other measures". It is suggested that while the extent of its financial involvement in "other measures" should and would be constrained by the availability of funds, the Common Fund should play a significant role.

4. In Resolution 93 (IV) the international community decided to come to grips with the international commodity problem, as part of its commitment to instal a New International Economic Order. In this connection, it agreed that: (i) a specific programme of action should be taken to sustain development and income in developing countries extensively dependent upon the production for export of primary commodities; and (ii) the Common Fund would be established as a key element in this programme and would serve to assist individual commodity organisations, comprising both producers and consumers, in achieving their long-term goals as enshrined in agreements. Therefore, to the extent that the attainment of such goals requires the introduction of "other measures", indeed to the extent that the price stabilisation and supply assurance goals normally included in such agreements require or can be facilitated by "other measures", then it would be inconsistent to argue that the Common Fund should not be actively concerned with such operations. Indeed, in some commodities of major export interest to developing countries, and which are included in the new open-ended list of commodities to be covered by the IPC, e.g. bananas, measures such as productivity improvements, diversification, market promotion and export receipt stabilisation would constitute important elements of an international agreement since buffer stocking is inapplicable as a price stabilisation device. In such commodities, producer/consumer co-operation would be concerned mainly with non-stocking measures; but action will be important also in cases where buffer stocking is a feasible stabilisation device. Over and above these technical points there is the further consideration that in the context of ensuring that the commodity problem is effectively tackled, it would be important to build into the arrangements for commodities surveillance mechanisms similar to those which have been included in other international systems; this is to ensure that action by one commodity organisation does not destroy economic prospects for another, as that would be an instance of beggar-thy-neighbour policies.

5. An integrated programme; of the kind to which the international community is already committed by Resolution 93 (IV), must include a range of commodities; it must cover those commodities for which buffer stocking is an effective price stabilisation device as well as those for which it is not. In individual cases, "other measures" will be of either limited or of overriding significance; but they must be covered and cannot be defined out of the scope of what is a key instrument in the overall programme.

6. The conclusion that the Common Fund should be equipped to assist individual commodity organisations in achieving their overall goals through providing support in managing buffer stocks and in introducing "other measures", should in no way be presumed to imply interference with the autonomy of the individual commodity organisations. The point is that the Common Fund must be equipped to assist in solving the commodity problem as a whole in a manner consistent with the wider interests of the international community as the international community has already decided.

7. In undertaking its role, the Common Fund must have access to finance. In this connection the reality is that "other measures" will require, in certain cases, financing on longer term than that required for buffer stocking. The nature and type of financing therefore will determine the extent of the role which the Common Fund will be able to play. Prudence will require, and financial management will dictate, that the financing available to the Common Fund for buffer stocking be kept separate and distinct from that required for "other measures"; such strict separation and management will be necessary to facilitate the fund raising activities of the Fund, especially for buffer stocks. For these practical reasons therefore the concept of a Second Window for "other measures" is sound; indeed it is the only feasible way of proceeding.

8. A realistic appraisal of the situation will reveal that the financing available to the Fund for "other measures" will be severely limited, at least in the early stages. Indeed given the reluctance of a certain part of the international community to concede the principle of the Fund being involved in these other activities, the result will be that such financing will be very limited indeed. The UNCTAD Secretariat¹, for example, has calculated that of the \$ 6 billion which has been mentioned as the total resources which should be used as the target for the Common Fund, \$ 1.0 to \$ 1.5 billion might be available for "other measures" and for the stocking of commodities outside the "core" ten.

9. In these circumstances, the relevant question which falls for consideration by the international community is not whether the Common Fund should be actively involved in "other measures", but rather the modalities by which the productivity of the limited funds which might be made available to it for the purpose could be increased through appropriate co-ordinated arrangements with other sources of financing and expertise. Again, in advancing this proposition, the bogey of the autonomy of other agencies being impaired by the activities of the Common Fund, should be laid to rest quickly. What is at stake is how the Common Fund, with its exclusive interest in the problem of commodities, could maximise the beneficial effects of the activities of other agencies whose interests are not similarly exclusive. Joint participation with individual countries and with regional and international agencies in programmes of action designed to achieve specific goals in the field of specific commodities - without

¹ See TD/B/IPC/CF/L.2, December 1976.

deleterious effects on others-appears to be the route which should be prescribed.

10. In other words, given the limited amount of financing which would be available to the Common Fund for "other measures", there should be prescribed a limit to the extent of the financial involvement of the Fund in any specific programme. But to operate under this constraint, it will fall upon the Fund to mobilise other sources of finance and expertise, using its limited financial resources as a catalyst, to implement any specific measures which are, or are likely to be, encompassed within an individual commodity agreement.

11. In its activities related to the financing of buffer stocks, consideration is being given to the Common Fund playing a role in financing internationally coordinated national stocks within an international agreement and national stocks outside of agreements in at least two types of cases:

- (i) where an international agreement is being negotiated;
- (ii) where an international agreement is not likely because production of the commodity concerned is of interest mainly to the developed countries; cotton and groundnuts are cases in point.

The question naturally arises whether the Common Fund should also embark upon "other measures" in such cases. If it is conceded that the Common Fund, in the exercise of its functions under its Second Window, is expected to assist individual international commodity organisations in reaching their long-term goals in a manner which takes the wider international interest into account, then it would be difficult to justify extending the activities of the Fund into these two specialised areas.

Second Window will be small

12. If \$ 1.0 billion were to be disbursed from the Second Window over, say, five years, this would only represent an annual investment of \$0.2 billion a year. This amount may be compared with the total World Bank and IDA approved loans to agriculture of \$ 1.63 billion in 1975-76, and a rough estimate of recent annual commodity diversification investment by the World Bank and other international financial bodies of \$ 0.2 to \$0.25 billion. The Asian Development Bank itself approved loans for agriculture in 1976 of \$ 0.2 billion, and IFAD, investing primarily in food production in the poorest countries, is expected to approve annual loans of \$ 0.3 - \$ 0.4 billion in 1978 and 1979, i.e. more than the Second Window is likely to invest in a year in commodities.

13. Current thinking suggests that the amounts available to the Second Window could be increased by additional grants from member countries, by transfers from the Fund's net income and by borrowing on capital markets. It remains an open question whether such grant funds will be 'additional' or will be a diversion from other avenues of aid. Even if they are a transfer and not additional, it does not necessarily follow that there will be no net gain or loss in terms of world welfare. However, the reality is that such grants are likely to be small. Equally, in the early years of the Fund's life any operating surplus which the Fund would secure on its stocking activities would be both small and be required to support its buffer stock programme. Loans on the capital market would not be easy to raise in the early years either. One is therefore led to the conclusion that a modest Second Window is the only realistic expectation.

Costs and priorities in "other measures"

14. There is a wide variety of possible measures related to alleviating the commodity problem in developing countries, which may be included under the general heading of "other measures" and which would then qualify for support under the Common Fund. Among those which have been mentioned as warranting some priority attention - being related to the stabilisation of commodity prices and export income - are diversification, productivity improvement, the provision of storage facilities, research and development, market promotion, crop insurance and adjustment assistance.

15. There has been some attempt to study the financial requirements arising out of certain of these functions, and the costs which have been worked out are given later. In a very important sense, however, the estimates of costs are merely diversionary and are useful mainly as a ranking device. This is so because the commodity problem has several dimensions, each changing over time. It is neither possible nor useful to enter into extensive debate over the size of the figures and the basis of their estimation. The fact of the matter is that when an institution such as the World Bank was being set up, it was not based on a universally accepted estimate of the costs of world development and reconstruction; the institution was intended to mobilise resources to give a special thrust to the widely recognised need for reconstruction and development; the expectation was, and this has been borne out by the facts, that such an institution would be better able to mobilise resources, act as catalyst and speed up the processes of development. What became important then was a determination of priorities and the policies which should guide its operations. Such functions were left to the Executive Board which was able to respond to changing circumstances as the Board saw them.

16. This is the logic which might guide the establishment of the Second Window of the Fund i.e. an attempt might be made to assign broad priorities for the Fund, due regard being had to two important factors:

- (i) the overriding purposes to be served by the Fund; and
- (ii) the amount and nature of the resources which the Fund has available and is likely to raise.

17. The overriding purposes of the Fund have been fully set out earlier and in Resolution 93 (IV). With regard to the funds available, mention has already been made of the fact that the Second Window is likely to be a small facility, at least in the initial stages. Further, if it is not to be completely dependent on grant and grant-type funds, the nature of the projects which it finances must have a substantial bankable element. This is not to argue a case that the Second Window should not be used for projects which do not have an obvious and determinable 'pay-out' period. Rather, it is to suggest that: (i) the mix of projects in which it participates should generate confidence so that its market borrowing capability for the purpose would not be impaired; and (ii) the arrangements it concludes with other agencies interested in the commodity problem should be supportive of the long-term evolution of the Second Window.

Priorities

18. Given these considerations, there is prima facie indication that the priority areas for action in the Second Window should be (i) the provision of storage facilities for buffer stocks; this, in the normal course of events, should be a bankable project which should finance itself on normal development terms; (ii) productivity improvements; this should also be bankable, the increased yields being adequate to finance the costs; (iii) diversification; while this is not prima facie bankable, there is justification for the provision of blended loans i.e. a mixture of normal development loans and IDA type loans; (iv) research and development; this is not a bankable activity; but part of the commodity problem now existing derives from the fact that research and development expenditure on commodities of export interest to developing countries has been minimal in the past; estimates in respect of certain crops e.g. sugar, indicate that R & D expenditure on sugar cane has been about one-tenth of the expenditure on beet. As a long-term international development item of expenditure, such an investment is likely to yield bankable returns; from a national or project point of view, however, the returns cannot be asserted to be above the bankable line; (v) crop insurance; certain developing countries are particularly susceptible to damage by natural disasters; if commercial insurance is undertaken, the cost is likely to be excessive for such countries. Yet this is part of the international commodity problem and the associated poverty of large parts of the developing world. While therefore subsidised insurance rates may have to be provided to such countries - and to this extent the project is not bankable - it would appear that an international agency should be allowed to mobilise some grant funds for the purpose; (vi) adjustment assistance; in a sense this is an integral part of diversification and compensatory financing for export shortfalls. The absence of such assistance, however, results in continuing over-production of certain crops. The reality of the situation is that unless some form of support can be given to farmers during periods of transition from one crop to another, then it would be difficult to achieve the kind of change which the international community considers necessary. The problem, of course, is

faced quite commonly in the industrialised countries when technological improvements render workers redundant. This type of expenditure is, however, not bankable and calls for grants. It can be accorded a low priority by the Second Window to the extent that: (a) diversification funds are provided in adequate amounts and on long-term; and (b) the available compensatory financing facilities (IMF and STABEX) are liberalised both as to the amount of support provided and the terms on which they are made available ¹

19. Quite clearly, there will be a need for very careful appraisal of individual projects, within each of the above categories, to determine their economic and technical feasibility. But assuming that some grant funds can be mobilised by an international effort, an appropriate ordering of priorities and project mix could ensure that the Second Window working alongside other international and national agencies, could provide significant support for commodities even with limited resources. Indeed apart from research and development, market promotion and adjustment assistance, it is feasible to conceive the financing of projects by the Second Window being on a loan basis with some grant funds coming from Government subscriptions being used as a means of reducing interest costs.

Costs

20. As mentioned before, estimates of cost of the several areas of activity where the Second Window might become involved are not particularly useful as a basis for decision making at the level of principles and goals. Such estimates of costs have not been used as a basis for arriving at other recent international decisions e.g. the Oil Facility and the Supplementary Facility; nor does it appear to have influenced the decision as to the increase in the capital of the IFC. There is value in deriving an impression of the magnitude of the task and the kind of role which an international agency might play in alleviating the worst cases of hardship. It appears that this general approach has guided the preparation of certain crude estimates of costs for some commodities of importance to the poorest developing countries. UNCTAD and the World Bank have prepared some estimates and these are summarised below.

Costs of "other measures"

Diversification

21. There have been no systematic studies of the total finance required for diversification for the 18 commodities specified in Resolution 93 (IV). However, for four commodities, sisal, coir, tea and bananas, certain estimates have been made by the UNCTAD Secretariat. In respect of jute, while it is recognised that diversification would need to be under-

¹ In this connection, the Commonwealth Experts' Group made certain important and far reaching recommendations on the directions in which the IMF compensatory financing facility should be liberalised.

² See Chapter VI, Possible Projects, in TD/B/IPC/CF/L.3

taken in India and Bangladesh, no estimates of costs have been made.

22. For hard fibres diversification financing for sisal was put at \$96 million; vertical diversification for coir would require \$15 million. For sisal the capital cost of diversification is based upon the assumption that producing countries would agree to reduce their production capacity by between 50,000 and 100,000 tonnes.

23. For tea the UNCTAD Secretariat quoted a World Bank Study which was based on the assumption that to freeze net (tea) capital stocks for three years would require a total diversification investment of \$220 million.

24. For bananas, it was estimated that diversification projects would cost \$100 million. To arrive at this figure it was assumed that banana export supplies would be reduced by 10 per cent from the 1973 level of world exports. This would have involved a fall in net export earnings of \$50 million; to derive an alternative revenue on the basis of an average capital/output ratio of 2:1 would require an investment of \$100 million.

25. These four commodities, jute, sisal, tea and bananas, appear to be the commodities most in need of diversification. The Coffee Diversification Fund served a useful purpose between 1968-73; at present it is difficult to see a need for further diversification in coffee; there does not appear to be a present need at this stage for diversification out of cocoa. For sugar there is need for diversification in certain developing countries, for instance, in the Caribbean; the main need for diversification may be said to be in developed countries out of beet sugar. Furthermore, sugar consumption is rising in developing countries and the view is held by some that further investment in sugar production may be required in the next five years if world shortages are to be averted.

26. As a working assumption the UNCTAD Secretariat had assumed that the Second Window would provide 60% of the financing required for diversification. The figures therefore emerge as follows:

Table 1 - Diversification expenditure

	Total	Common Fund financing
	\$ million	
Jute
Sisal	96.0	57.6
Coir (industrial diversification)	15.0	9.0
Tea	220.0	132.0
Bananas	100.0	60.0

Productivity improvement

27. Current studies show considerable potential for productivity increase and yield improvements in two commodities, jute and rubber. For jute it has been suggested that a three year programme, covering one-half of world jute acreage, would cost \$ 45 million. Moves to transfer some jute production from India to Bangladesh, since yields are better in the latter country, would from a world point of view represent an improvement in productivity; such a scheme has not, however, been costed. Nor have estimates of the costs of improving rubber yields, where the potential is considerable, yet been made. But these commodities by no means exhaust the list. There are a number of other commodities where productivity improvements could be secured; oilseeds and vegetable oils, for example, are among these. Although great improvements in yields have been recorded in palm oil output in South-East Asia, there is considerable scope for increasing production of copra in Asia and the Pacific. The application of more fertiliser to existing coconut trees and their replacement later with new hybrid varieties giving higher yields would greatly improve the competitive position of coconut oil vis-a-vis oils produced from temperate country oilseeds and of coconut oil based products vis-a-vis synthetic-based products. If one assumes that equal amounts of investment are applied to increasing yields for rubber and vegetable oilseeds as for jute, then the expenditure on the three commodities is estimated at \$ 135.0 million, which would be spread over at least three years.

Research and development

28. With regard to research and development, the UNCTAD Secretariat postulate an expenditure of \$ 10 million for jute; sisal R & D is put at \$ 1.2 million, while for R & D on rubber, the figure is \$ 4.1 million. All these figures are comparatively small and relate only to three commodities. In the negotiations on individual commodities attention has been drawn in several groups to the need for more expenditure on R & D. There is no accurate way of predicting the required expenditures on R & D. As a rough guide to a target one might postulate, as a reasonable hypothesis, that if one per cent of the 1972-74 average export value of the ten "core" commodities from developing countries might be spent on R & D financed by the Second Window, the cost would be some \$ 186 million; similar expenditure on the remaining eight commodities would have been \$ 73 million, making a total for the eighteen Nairobi commodities of some \$ 260 million per year.

Crop storage

29. The provision of crop storage facilities in developing countries for buffer stock commodities is an integral part of buffer stocking whether these are international stocks, internationally coordinated national stocks or national stocks.

30. No estimates of the cost of providing such facilities appear to have been published by the UNCTAD Secretariat. For selected commodities

it is possible to derive some rough estimates of the likely cost of storage for that part of the total buffer stocks that might be held in the developing producing countries. These estimates, relating to sugar, sisal, jute, cotton, coffee and tea, have been derived by multiplying figures of rental costs provided by the UNCTAD Secretariat¹ by the quantities of the buffer stocks which would be held by developing producing countries on the basis of their share of world exports in 1972-74. The estimated capital costs may be derived very roughly by multiplying the annual costs by 10.

Table 2 - Estimated cost of storage in developing countries for selected "core" commodities

	Stocks to be held in developing countries	Storage costs per year	Annual cost of storage	Capital costs
	thousand tonnes	\$ per tonne	\$ million	
Sugar	3,167	9.60	30.4	304.0
Sisal	104	18.00	1.9	19.0
Jute (fibre and goods)	473	18.00	8.5	85.0
Cotton	309	35.00	10.8	108.0
Coffee	992	26.00	25.8	258.0
Tea	96	33.00	3.2	32.0

31. Only for sugar and coffee are the costs outstandingly high, mainly because of the need to hold relatively large stocks. Insofar as storage facilities already exist the need for finance would be reduced; if finance were to be made available only to the least developed countries costs could be further reduced.

Supply management measures

32. The direct financial costs of implementing supply management measures are small, being concerned mainly with expenditures on administration, control of supplies and verification of records of transactions. More significant under this heading, however, would be the provision of adjustment assistance required as the result of supply management schemes. In the

¹ Second progress report on storage costs and warehouse facilities, TD/B/C.1/198, September 1975.

UNCTAD studies an unspecified amount of adjustment assistance is provided for India in respect of the cut-back in its jute production in favour of an expansion of its rice production. For three other commodities, however, sisal, tea and bananas, the costs of adjustment assistance on the assumption that the whole of it would be provided by the Second Window of the Common Fund, have been quantified. For bananas the sum involved is put at \$ 100 million, representing \$ 50 million for each of two years to compensate for loss of foreign exchange earnings. For sisal, on the assumption that there would be a loss of annual export earnings from \$ 16 million to \$ 32 million; adjustment assistance in two years would be \$ 32 million to \$ 64 million. For tea it is suggested that \$35 million for adjustment assistance would be spread over 4 years. For these three commodities costed by the UNCTAD Secretariat the total cost (all to be financed by the Fund) would be in the range of \$167-199 million.

Concluding observations

33. Clearly, the estimates of cost which have been developed so far are extremely sketchy, almost impressionistic. They are subject to a very wide margin of error. What they do, however, show is that the sums involved in supporting measures to ensure that consumers are assured of supplies and producers receive a reasonable return are not so inordinately high that a limited amount of funds available to the Common Fund for "other measures" activities would be derisory and be of limited effect. If the international community is determined to make a serious attack on the commodity problem, it is necessary to have a coordinated approach in which the several aspects would not be neglected because of a lack of meaningful support. In the final analysis the issue is one of political will, not finance. It is this which will determine whether the Common Fund will be structured to play a significant role in alleviating and eventually solving the commodity problem experienced by developing countries. Finance is only a small part of the problem.