Gamani Corea and Commodity Price Stabilization

Saman Kelegama[1]

Gamani Corea was a leading economist from the global South who occupied the position of Secretary General of the UNCTAD from 1974 to 1984. His outstanding contribution to development policy and practice has been well recognized and he was a recipient of a number of awards including the Celso Furtado Award in 2004 "for his enduring struggle for political and economic independence of developing countries". During his decades' tenure at UNCTAD his main focus was on bringing about stability to fluctuating prices of global commodities. This paper takes a macro perspective of Corea's approach to commodity price stabilization and highlights some of its successes and failures. The paper is organized as follows. Section 1 looks at the evolution of Corea's thinking on commodity issues and Section 2 provides the background for commodity price stabilization schemes. Section 3 examines the Integrated Commodity Programme while Section 4 examines the Common Fund – two of the most important instruments of the commodity price stabilization strategy advocated at that time. Section 5 summarizes some of the criticisms and failures of the price stabilization schemes. The final Section makes some concluding remarks.

1. Evolution of Gamani Corea's Thinking

Most developing countries were commodity exporters at the time of their independence from colonial rule. Foreign exchange earnings from commodity exports provided the key impetus for development activities in these countries. However, the fluctuations of the commodity prices and the decline in prices had an adverse impact on their economic management and planning.

Corea's doctoral thesis touched on this subject taking Sri Lanka as a case study. Under the supervision of Lady Ursula Hicks at Oxford (wife of the Nobel Laurent in Economics, John Hicks), he focused on the economy's vulnerability to international price fluctuations and highlighted possible policy responses. Later, his thesis was published by the Marga Institute in Colombo titled: 'Instability of an Export Economy' (Corea, 1975).

The fall in terms of trade for the three traditional commodity exports of Sri Lanka (tea, rubber, and coconut) after the Korean war had an adverse impact on the Sri Lankan economy which was over 90 per cent dependent on these three commodities for its exports. Corea's thinking was very much shaped by his experience in Sri Lanka during the early 1950s to 1970 and his actions as a policy maker clearly

[1] Executive Director, Institute of Policy Studies of Sri Lanka (www.ips.lk).

showed that he became a pessimist on commodity export earnings without a strategy in place to arrest the declining terms of trade. He writes: “Unpredictable movement of commodity prices – tea, rubber, and coconut often vitiated the plans and policies of the government”.

At the time when Corea commenced work in Sri Lanka, the Prebisch-Singer thesis of the declining terms of trade of primary commodities and the advocacy of import substitution industrialization as an escape from resultant unequal distribution of gains from trade had begun to influence development thinking. Corea states: “I was inspired by the efforts of Dr. Prebisch and his colleagues and stimulated by the special focus placed on the global development issues. This was an additional dimension to my academic background where principles of classical economic theory gave scant attention to the problems of development. The new focus was hence an exciting supplement to what I had earlier learnt as a student of economics. It remained with me throughout the succeeding years” (Corea, 2008:364).

This line of thinking was further strengthened during his short stints with UNCTAD during 1962 to 1972 when he got an opportunity to work with Dr. Raul Prebish. He participated in 1969 with the UNCTAD team to establish an international agreement on tea and served as the Chairman of the UN Cocoa Conference in 1972 which resulted in a price stabilization agreement to that product.

The OPEC oil price hike in 1973 also played a key role in shaping Corea’s thinking on the need for commodity price enhancement and stabilization. Developing country commodity producers saw in the example of OPEC the possibility of achieving the stable high prices which they needed for development. Lacking OPEC’s political power to achieve these prices unilaterally, they looked to the international community to provide these price changes through International Commodity Agreements (ICA) and this gave birth to the New International Economic Order (NIEO). Corea states that the political significance of the OPEC action was such that the dividing line at the UN Special Session was not between oil importers and oil exporters, but between the developing countries which were pursuing an NIEO and the developed countries which were the guardians of the status quo.

He states: “When I came to UNCTAD there was a feeling that the momentum of North-South Cooperation was beginning to weaken in the background of economic and political developments, particularly the growing stresses facing the developed market economy countries. My assumption of office, however, coincided with the emergence of the new international environment marked by such developments as oil crisis and the increasing awareness of the countries of the third world of the evolving situation” (Corea, 2008:377).

During Corea's tenure, UNCTAD focusing on reforming the international trade system for commodities became the key issue of the North-South dialogue on establishing an NIEO. He argued that the bulk of the commodity producers were in the developing countries while the consumers were mainly in the developed countries. Hence he saw the commodity issue basically as a North-South issue and a part of the wider global development issue.

2. The Commodity Price Stabilization Problem

The international price declines for commodities did not escape the attention of the international policy makers and the first reference to it was made in the 1948 Havana Charter. The Charter rejected the producer cartels of the pre-war period and unilateral action by producers. It highlighted the need for regulating commodity markets. The Charter did not come into existence but its provisions for dealing with commodities were taken up on UN ECOSOC in a resolution, which called upon governments to accept them as guidelines.

In the post-war period, commodity market control under the UN auspices started in 1954 with the International Sugar Agreement and the International Tin Agreement. The subsequent agreements with "economic clauses" were the International Coffee Agreement (1962) and the International Cocoa Agreement (1972). The principle underlying most of these agreements was supply management via an export quota although Tin and Cocoa used Buffer Stocks for fine-tunning the interventions.

Clearly, the Havana Charter/UNECOSOC did not usher a new phase of international action to deal with the problem of unstable prices in commodity markets other than the emergence of a few ad hoc commodity arrangements. It gave rise to a period of frustration and endless discussion between producers and consumers on the need for commodity specific price stabilization arrangements.

Developed countries argued for a commodity-by-commodity approach which ensures that any intervention would complement rather than substitute for market forces.

3. Integrated Commodity Programme

The essence of price stabilization arrangements is a supply management, either through export quotas or stockpiling. It involves the acquisition of stocks as an inherent part of the process of stabilization and improvement of markets. Such action would involve the acquisition of supplies in periods of surplus and the disposal of supplies in period of shortages.

Stock operations as well as quantitative restrictions on the volume of supplies entering world trade had to be utilized for the purpose although the purchase and sales of stocks were appropriate for dealing with short-term fluctuations rather than longer term trends.

None of the commodity agreements in existence recognized the concept of producer-consumer sharing the financial burden of maintaining commodity stocks on an obligatory basis. In the international agreement on tin there was a provision for voluntary financing by consumers but the principle of compulsory contribution had not been written to any international agreement. This principle of common sharing of responsibilities between producers and consumers on a compulsory basis was introduced in the Integrated Commodity Programme (ICP) – the new concept that was promoted by UNCTAD. Moreover, emphasis was given on building buffer stocks for reducing or eliminating price fluctuations. Buffer stock stabilization rests on an implicit premise that private sector storage is inadequate.

Corea saw the commodity problem not as a problem of an individual commodity which needs to be addressed in isolation but as a problem which is common to a wide range of products. It is for this reason that the ICP was devised to include in its ambit as many commodities as possible. It was based on the conviction that the solution for individual commodities if they are not similar to the solutions for other commodities, would not succeed in creating a totally equitable solution in which the producing countries are all able to benefit from the solution. Thus, intervention action in a framework of commodity arrangements was conceived of for a wider range of commodities, rather than just a few taken in isolation. The ICP was mooted in 1974 and was launched in 1976 and at that time there were commodity agreements for 6 products in operation: tin, coffee, cocoa, sugar, wheat and olive oil -- all of which had economic provision for price stabilization.

Corea's plan had an indexation of commodity prices to the prices of manufacturing products. He writes: "…we see the question of direct indexation as very much a part of the price-fixing exercise we contemplate for individual commodities. We feel that any attempt to introduce direct indexation pre-supposes the establishment of mechanisms to bring about effective regulations or control of prices" (Corea, 1980: 160).

UNCTAD felt that in parallel to ICP the establishment of the Common Fund (CF), would increase the prospects of concluding individual commodity agreements. Thus, the CF was considered as a 'catalyst' for the ICP. CF was believed to be a vital arrangement to stabilize and strengthen commodity markets through market intervention.

In sum, the objective of the ICP and CF was basically to provide a floor to the downward movement of commodity prices, as well as a ceiling, so that in the end there will be a regime of commodity markets which operate and function with greater smoothness, greater regularity and stability.

By establishing a series of commodity agreements covering a wide range of exports that are of interest to developing countries and by creating a funding institution for financing these agreements, there was an expectation on taming the commodity markets, by stabilizing their prices.

Under Corea's leadership quite a lot of preparatory work was done for UNCTAD IV in Nairobi (1976). The aim was to obtain a breakthrough for the NIEO with the ICP and CF as the centre-piece of the new order. After a pessimistic initial day at the Nairobi conference, there appeared little hope of a decision. The next day, a Nairobi daily ridiculed UNCTAD referring to it as "Under No Circumstances Take a Decision". The next two days, Corea engaged in negotiating with individual country delegates both formally and informally and explained to them the logic of the ICP and CF. In the last day of the conference there was a major breakthrough and the international community indicated that they were ready for a new global deal for the commodities. The conference agreed on a 2 to 3 year timetable to activate the ICP and mobilize funds for the CF.

After the UNCTAD Nairobi Conference, the commodity issue in the relationship between developed and developing countries occupied the centre stage in the international community. The UNCTAD Secretariat was the third actor in addition to producers and consumers in the negotiation process of individual commodities. UNCTAD established *ad hoc* Committees to overlook the working out of individual products commodity agreements within a defined time plan. They were to be monitored by the *ad hoc* Committees. Corea states that around 35 people were working at UNCTAD on the ICP and CF.

This issue occupied centre stage at UNCTAD deliberations. Corea writes: "From 1965 to 1976 the average number of meetings per year,.. on commodity issues in UNCTAD was about 12. The number rose to 32 in 1977 and 44 in 1978. In the latter year, commodity meetings alone accounted for little under 60% of UNCTAD meetings" (Corea, 1992: 137).

3.1 ICP Implementation

There was mild encouragement from consumer countries for such an agreement after the Nairobi Conference of the UNCTAD. But tea producing countries refused to agree on a scheme of export quotas for tea. India and Sri Lanka were willing to support prices through a scheme of shared restrictions of exports but newer producers like Kenya which had made large investments for expansion of tea production refused to support such a scheme. Such a scheme of export quotas that was acceptable to all which Corea believed in, could have enhanced export earnings of all participants by improvement of price. However, there was lack of unity among the producers which resulted in the failure to devise and implement such a scheme.

While it is easy for producers to reach an agreement on global supplies to support the price objective, the benefits for each country varies with the share of its total global trade. The distribution of quotas is a matter of hard bargaining in commodity negotiating and a potential cause of disagreement among the producers.

Chile did not support copper agreements with economic provisions, while the Ivory Coast did not join the 1980 Cocoa Agreement. International Agreements in jute production (1982) and tropical timber (1983) came into operation, but did not have a provision for price stabilization. It was becoming increasingly difficult to achieve commodity agreements despite the eventual agreement on the CF in 1976. In fact, by the early 1980s the number of commodity agreements that were involved in price stabilization declined and was a complete disappointment to the agreement reached in Nairobi.

There were a number of factors for this. First, there were technical problems like perishable commodities not being suitable for stockpiling for price stabilization. Second, in certain commodities, the quality differences made supply regulation difficult either via buffer stocks or export quotas. Third, there were problems arising from a multiplicity of products flowing from different stages of production (cotton and cotton yarn) or common end users (vegetable seeds and oil). Fourth, were complexities from a high degree of vertical integration in producing countries (e.g., Iron ore) as well as constraints that were due to the ready availability of synthetic and other substitutes for some products.

Corea states: “I believe that unsuitability of a product for stocking in a technical and a physical sense is not, and has never been, a major factor behind failure to establish and implement proposals and ideas for buffer stocks” (Corea, 1992:163). And goes on to say that developed countries established stocks for national security or strategic objectives. Corea (1980: 163) states: “A large part of the reason for the failure of the past efforts to establish stocks under the aegis of commodity agreements was probably the difficulty of overcoming the very vital, central and crucial factor of financing these commodity stocks".

Corea attributes the failure to establish an ICP on the failure to establish the CF. "One of the Central arguments in support of the ICP was the failure to extend the range of stabilization arrangements due to lack of finance for stocking operations. A lack of certainty whether individual commodity schemes could ever turn to a CF was no less important".

He also observes that all energies of the UNCTAD Secretariat and the government were focused on the CF rather than ICPs due to its "innovative and controversial character" (Corea, 1992: 139). The ICP would have amounted to little without the CF and individual commodity negotiation did not make much headway with all energies focused on the CF. This was especially the case for commodities to which stocking operations would have contributed to stabilizing the prices. From the major commodity exporting countries the leadership for working out commodity agreements was lacking. Thus, the timetable of UNCTAD IV Nairobi (1976) had to be revised.

4. Common Fund

The CF was first mooted in UNCTAD – II in New Delhi (1968). The Secretariat argued for the creation of a central fund specifically designed to assist the financing of international buffer stocks as it would constitute a major improvement over the present situation in that the source of funds would then be readily available to support the new commodity stabilization schemes agreed by governments as desirable.

With the CF in place, the total financing needs for the stocking of commodities need not be provided by way of government subscription which would be burdensome for developing country governments.

At one point he argues "to the extent these arrangements do not suffice to improve prices and earnings, or the commodities covered are not amenable to buffer stock and export quota measures, there would be scope for arrangements for compensatory financing, both of a short and long run character, to help meet unforeseen shortfalls".

UNCTAD was of the view that there are merits in terms of financial resources of a CF compared to having a sum of individual commodity funds. Some had argued that a CF should be only examined at the end of the process of commodity negotiations which was not realistic in the view of UNCTAD.

Establishing the CF also was not easy as it needed a constitution with precise articles of agreement. Financing of buffer stocks was the key function of the CF, but there was room to undertake other activities as per the requirement of member governments. But UNCTAD emphasized that it should be a self-financing operation for stocking and other activities.

The borrowing of the CF according to its constitution would be firmly secured by a guarantee of member governments, producers and consumers of individual commodity agreements that uses the fund's resources and collateral of commodity stocks acquired in the process of market intervention. These arrangements were done to give the CF high credit ranking so that it could mobilize more funds from the international capital markets successfully.

Corea argued for the CF using the reality of that time. He argued that action for the CF cannot be rejected on the grounds that it interfered with the laws of the market place when the developed countries spent between US$ 125 – 150 billion a year on agricultural subsidies which deprived the developing world exports of the right to compete in markets. He saw the subsidies essentially as commodity agreements to stabilize and guarantee the incomes of Europe's own farmers.

The CF had two windows -- the first window was supposed to remain a remunerative outlet for investment funds and would carry out borrowing and lending activities against collateral of commodity stocks and the capital or guarantees provided by governments. The second window would operate on the basis of voluntary contributions by donors provided on concessional terms or as grants. The resources of this window would be used for the commodity sectors' diversification, R&D, and promotion of processing activities.

Studies by the UNCTAD Secretariat indicated the financial requirements for the CF which covers several commodities under the ICP to be around US$ 6 billion[2]. It was proposed that US$ 2 billion would be direct contributions from member governments and US$ 4 billion by borrowing (Corea, 1992: 92). In actual practice, US$ 400 million was allocated to the first window. The 2nd window would receive at

[2] Coffee- US$ 1.1 bn, Copper – US$ 1.1 bn, Rubber – US$ 0.21 bn, Tea – US$ 0.09 bn, Tin – US$ 0.27 bn, Sugar – US$ 1.2 bn, Cotton – US$ 0.6 bn, Cocoa – US$ 0.33 bn, and others – US$ 1 bn.

least US$ 70 million to supplement the voluntary contributions for which a target of US$ 280 million was set.

4.1 Problems of the CF

But the CF did not live up to this expectation. The CF could not be developed during Corea's tenure in UNCTAD and it finally came into operation only in 1989, after a delay of 9 years since signing of the agreement. It came into operation when the global scenario had changed and the Cold War was about to end. Some developed countries weakened the support for international commodity agreements to stabilize prices. The victims were the Coffee Agreement (international Coffee Organization Pack – the export quota based pack that operated from 1960 to 1987 with a gap in-between 1973-1980). US, for instance, did not ratify the CF agreement and was not a member of the CF. Most Western Countries had ratified the CF at the start but the support for price stabilization schemes had waned by 1989.

Corea argues that with only Rubber and Cocoa Agreements remaining operational with the provisions for price stabilization, the CF was in the position of a banker with a severely limited clientele. The readiness of private banks to lend to the CF for stocking operations underwent changes by the debt crisis of the developing countries and the negative experience of the International Tin Agreement, which collapsed in 1985 due to excessive stocks (Gilbert, 1996).

This is clearly reflected in the paltry contribution to the CF of US$ 70 million compared to the pledged amount at the time of signing the agreement of USD$ 280 million. The Philippines Government, for instance, had pledged US$ 50 million for the CF during UNCTAD V in Manila (1979) but by 1988 it backtracked on the amount.

Critics of the CF argue that the interest of poorer countries can be promoted by improving productivity, diversification of products, earnings stabilization, etc., than simple commodity price stabilization and the creation of institutions for that purpose (Corea, 1992:85). The argument influenced the African countries who argued for a CF that financed other activities like product diversification, in addition to stockpiling operations. Their support for the CF became increasingly conditional on expanding the scope for the CF to which Corea had reservations.

He states: "the extension of the scope of the CF to include aid activities would have undermined the economic basis of the project and destroyed the major argument in favour of the fund – that it would serve the mutual interest in price stability of both producing and consuming countries and that it will function on sound and strict financial principles" (p.86).

5. Criticisms of UNCTAD's Commodity Price Stabilization

Critics of the Commodity Price Stabilization Scheme as articulated by the UNCTAD have highlighted the following points:

(a) That ICPs are not beneficial for developing countries because developed countries are the major exporters of commodities. Corea's response to this has been that UNCTAD has been selective of the commodities, leaving out grain, an array of minerals, etc., that are mainly exported by developed countries. The calculations done on these by the UNCTAD are presented in Corea (1980:166).

(b) That ICP and CF are against the market fundamentals and basically leading to a bureaucratic process with administrative complications. Here Corea (1980) argues that both ICP and CF were to supplement the market and improve its functioning with greater stability by establishing limits for excessive declines of prices that takes place under an unregulated market system.

(c) That commodity prices will be raised indiscriminately and induce income transfers from consumer to producer countries. Corea (1983) argues here again that it is not correct that prices will be unduly increased on an ad hoc basis and that individual prices will be negotiated between producers and consumers under the commodity concerned in the ICP.

(d) That there will be surpluses due to stockpiling and even over-production that could disrupt the commodity markets. Corea (1980) argues that supplementary measures to stockpiling such as export quotas were going to be used, in order to avoid such surpluses. He goes on to highlight the cases of coffee and tin where commodity agreements already were in operation but there were no surplus but on the contrary shortages which has made the operating aspects of the pricing arrangement somewhat ineffective. Although this was the scenario when Corea wrote on the subject, the Tin Agreement collapsed in 1985 precisely due to overstocking in the face of collapse of demand by developed countries (Gilbert, 1996).

According to Gilbert (1996) the failure of IPC was partly a result of a continuing disagreement on what international agreements were meant to achieve, with producers more interested in the level than the variability of prices, and due to the confusion about the division of the spoils when the agreement did manage to raise the price.

Athukorala (2004) testing the export pessimism embedded in the terms of trade decline hypothesis using Sri Lankan data concludes that it clearly suggests that diversification into manufactures from structurally-weak conventional primary commodities under the market-oriented policy reforms has enabled Sri Lanka to escape from unequal exchange relations in world trade. He concludes “the Sri Lankan experience with manufactured export expansion clearly rebuts the new terms of trade pessimism about gains from diversification into manufactured exports in a traditional primary – exporting country” (p.47).

6. Concluding Remarks

At the UNCTAD Nairobi Conference in 1976 a decision was reached on signing around 16 commodity agreements. However only one new commodity agreement incorporating price stabilization came into effect, i.e., the Natural Rubber Agreement of 1979 which provided market intervention to regulate prices exclusively through the purchase and sale of stocks. It was an addition to the already prevalent 6 agreements which were renegotiated. The original aim of having 16 agreements to cover 90% of total commodity trade of interest to developing countries never became a reality. Developing countries failed to coordinate their positions and plan among themselves a decisive plan of action. By 2000, all the existing commodity agreements had either lapsed or collapsed.

The outcome was basically influenced in the development thinking at that time. In 1979 Thatcher had assumed power and in late 1980 Reagan became the President of the USA, thus throughout the 1980s Supply Side Economics with the emphasis on tax cuts, deregulation, privatization, became the key areas of economic governance. This ideology was quite contrary to market intervention and regulation that commodity price stabilization schemes emphasized, thus there was lukewarm support especially among the developed countries for ICP and CF, the two key components of price stabilization schemes. Moreover, by the late 1980s the Cold War came to an end, globalization gathered momentum, and there was even less enthusiasm for commodity market stabilization. Some of the developing countries that opened up their economies in the later 1970s and early 1980s had a fairly robust manufacturing export base by the mid-1980s with the commodity exports occupying a less significant role in overall foreign exchange earnings. Thus, they did not bother to work out commodity price stabilization schemes under the ICP and CF. All these factors basically reduced the effectiveness of UNCTAD's commodity price stabilization schemes.

There was no indication that promotion and diversification of production to manufactured goods was seen by Corea as the way forward from the decline of terms of trade that commodity exports faced. Even in Sri Lanka when Corea was the key economic policy maker during the late 1960s, he opted for a dual exchange rate policy for export promotion which the IMF referred to as the "wrong step in the right direction". The half-hearted approach to the exchange rate policy was very much influenced by his pessimism on manufactured exports, presumably influenced by the fallacy of composition argument. He may have also felt that the lag in industrial production in developing countries compared to developed countries may make industrial export promotion an uphill task, thus the thinking may have been that full focus on the existing commodity market base would be the way forward.

However, Dell (1988:xii) in his introduction to the 'Essays in Honour of Gamani Corea' indicates that Corea suggested commodity market stabilization as an interim solution till industrial development in developing countries took off: "Dr. Corea did not see the ICP and CF as proving the final and total answer to the commodity problem, which could, in his view, ultimately be solved only through economic transformation of producing countries, notably through industrial development". Whichever way one sees it, one must give the credit to Corea for the conceptual breakthrough he achieved in the ICP and CF which Dell (1988: xii) referred to as the "finest of his achievements".

References

Athukorala, P. (2004), 'Growth of Manufactured Exports and Terms of Trade: Pessimism Confounded' in Kelegama, S. (ed.), *Economic Policy in Sri Lanka: Issues and Debates – A Festschrift in Honour of Gamani Corea*, Sage Publications, India.

Corea, G. (2008), *Gamani Corea : My Memoirs*, Gamani Corea Foundation, Colombo.

-------(2003), 'The Legacy of Dr. Raul Prebisch', *South Asia Economic Journal*, Vol.4, No. 1.

------- (1992), *Taming Commodity Markets: The Integrated Programme and Common Fund in UNCTAD*, Manchester University Press, UK.

---------(1980), *Need for Change: Towards the New International Economic Order*, Pergamon Press.

Dell, Sidney (1988), *Policies for Development: Essays in Honour of Gamni Corea*, Macmillan Press, UK.

Gilbert, C. (1996), 'International Commodity Agreements: An Obituary Notice', *World Development*, Vol. 24, No.1.