

PRIME MINISTER

UK COMMODITY POLICY

You will remember that before the summer Mr. Channon circulated the report of an official group which had studied commodity policy. This identified two main options:

- (i) to go on paying lip service to the merits of regulation of commodity markets whilst in practice seeking to steer clear of commodity schemes;
- (ii) to adopt a deregulatory approach to commodity policy, saying openly that the Integrated Programme on Commodities (IPC) of UNCTAD had outlived its usefulness and advocating a more market-orientated route towards economic growth.

Officials recommended the deregulatory approach, but pointed out that this could increase the pressure for extension of compensatory finance schemes, and also increase the pressure for greater liberalisation of north-south trade in both directions. They also felt that with a new approach of this kind the UK might need to put forward "constructive proposals to meet developing countries' legitimate concerns". The choice is summarised in paragraph 1.15 of the report at Flag A and the presentation is discussed in section 9, Flag B.

All the Ministers concerned have agreed that the deregulatory approach is right. But some predictable differences have emerged. Sir Geoffrey Howe and, in lower key, Mr. Channon have emphasised the need for care in presenting this change of policy. Sir Geoffrey Howe in particular argued that we should keep the change private, that we should be prepared to go along with proposals for study groups on particular commodities, and with commodity agreements which do not involve market intervention provisions and that we "should not hold out unreasonably against consensus language". His reasons are partly to help relations with developing countries and partly

that he believes a more conciliatory approach of this kind would be more likely to lead to agreement with Community partners on the need to keep out of commodity agreements which involve intervention.

The Chief Secretary on the other hand felt that Sir Geoffrey Howe's approach would risk us being sucked into more commodity agreements of all kinds. ✓

There was at one stage pressure both from the Chief Secretary and from Mr. Tebbit for a meeting to resolve this difference, but the Chief Secretary now thinks that officials can do further work on presentation and substance in preparing for future international meetings (particularly another meeting of UNCTAD next year) and that this will give an opportunity to thrash out differences at Ministerial level if necessary.

It seems right that you should now give your own views. A possible line to take would be:

- (i) ✓ to agree that a firm approach should be taken on future commodity agreements, supporting deregulation and aiming to avoid any further commitments; we should ^{only} ~~aim~~ ~~to keep involvement in study groups and the like to an~~ ~~absolute minimum, going along with them only if that is~~ necessary to avoid more extensive commitments;
- (ii) ✓ to note that further work is to be done to prepare for future international meetings and that this will provide an opportunity to discuss the presentation in greater detail if necessary; but that your own preference is for more rather than less openness about the UK's position: no-one should be surprised or aggrieved by this, bearing in mind our experience of the collapse of the international tin agreement;
- (iii) any new proposals to help developing countries in this area will need to be judged against the principles underlying the deregulatory approach and new expenditure commitments will need to be avoided;
- (iv) the collapse of the international tin agreement has

shaken confidence in commodity agreements amongst consumers and producers alike, as shown by the surprising degree of movement in the renegotiation of the cocoa agreement, and we should take every possible advantage of this in the coming months to try to move our Community partners towards our own position.

Content to write in these terms?

DH

David Norgrove
3 September 1986

Yes - not

*we must not let
'production' reverse
the actual decision*

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From the Private Secretary

8 September 1986

UK COMMODITY POLICY

The Prime Minister has seen Mr. Channon's minute of 30 June and the report by officials about UK commodity policy circulated then, and the subsequent correspondence.

The Prime Minister agrees that the UK should now adopt the deregulatory approach described in the report by officials. We should take a firm line on future commodity agreements, aiming to avoid any further commitments. We should, in the Prime Minister's view, only go along with proposals for further study groups and the like if that is necessary to avoid more extensive commitments.

The Prime Minister is concerned that too low key and private a presentation of the policy could lead in practice to a reversal of the actual decision to go for a deregulatory approach. Her own preference is for more rather than less openness about the UK's position: no one should be surprised or aggrieved by it, bearing in mind our experience of the collapse of the international tin agreement. She has noted that further work is to be done to prepare for future international meetings and that this will provide an opportunity to discuss the presentation in greater detail if necessary.

The Prime Minister is very doubtful about the need for further proposals to help developing countries in this area. But if there were to be any they would need to be judged against the principles underlying the deregulatory approach and should not involve new expenditure commitments.

Generally, the Prime Minister suggests that the collapse of the international tin agreement has shaken confidence in commodity agreements amongst consumers and producers alike, as the surprising degree of movement in the renegotiation of the cocoa agreement illustrated, and we should take every possible advantage of this in the coming months to try to move our Community partners towards our own position.

VC

I am sending a copy of this letter to the Private Secretaries to members of E(A), the Foreign Secretary, the Attorney General, the Governor of the Bank of England and Sir Robert Armstrong.

(DAVID NORGROVE)

Michael Gilbertson, Esq.,
Department of Trade and Industry.

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MR NORGROVE

I told Pongy Vint
that as the strength of
the papers, I wasn't prepared
to make out with
5 August 1986 the PMS views.
Did you intend to put
them back in at some
stage?

UK COMMODITY POLICY

Tony Lane (DTI) called to ask me if the Prime Minister might circulate a note summarising the conclusions of the exchange of notes that followed Paul Channon's submission of 30 June. *W*

If you think this is appropriate 'form' you might simply send a note to Paul Channon making the following points:

1. It is agreed that a firm approach will be taken on commodity agreements to support deregulation and avoid any further commitments. Efforts should be made to bring our community partners onside.
2. Given the presentational problems of this approach, it would be helpful if it could be offset by a package of constructive proposals that suggest alternative ways to help developing countries cope with low commodity prices. Officials should explore such options, bearing in mind the need to keep these a free market approach and avoid any new expenditure commitments.
3. The Prime Minister would like to be informed of the final proposals.

hw
pp . NORMAN BLACKWELL

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REVIEW OF UK COMMODITY POLICY BY THE INTERDEPARTMENTAL POLICY
COMMITTEE ON COMMODITIES

Department of Trade and Industry
Foreign and Commonwealth Office
H M Treasury
Ministry of Agriculture, Fisheries
and Food
Law Officers' Department
Cabinet Office
Bank of England

PART I - SUMMARY AND CONCLUSIONS

Introduction

1.1 This review considers whether and in what ways UK Commodity Policy can and should be changed to reflect experience since it was last considered by Ministers collectively in 1983, and especially in the light of:-

- (i) The collapse of the International Tin Agreement in 1985;
- (ii) Experience with other International Commodity Agreements (ICA);
- (iii) The failure of the UNCTAD Integrated Programme on Commodities (IPC) to achieve its objectives;
- (iv) The implications for developing countries of the heavy fall in commodity prices in recent years;
- (v) Other major developments affecting the external position of commodity producing developing countries;
- (vi) The need to develop a UK line for UNCTAD VII next year.

1.2 UK Policy on Commodity Agreements was comprehensively reviewed in 1981 and confirmed by Ministers collectively in deciding the line for the 6th UNCTAD Conference in 1983. Ministers then agreed that the UK should respond positively to the developing countries' concerns over commodity earnings; and should in particular:-

- (i) Join individual commodity agreements including price stabilisation agreements, where they are shown to be feasible, cost effective and beneficial to producers and consumers alike;
- (ii) Support UNCTAD's Integrated Programme for Commodities (IPC).

1.3 The IPC was established in 1976 in response to developing countries' concerns over low and unstable commodity earnings. (See Parts (V) - (VIII)). Its objectives include:-

- (i) The encouragement of individual commodity agreements of various kinds, including most importantly those with price stabilisation provisions (buffer-stocks or export controls);
- (ii) A Common Fund whose primary purpose is to link together the buffer-stock financing arrangements for commodity agreements (and whose secondary purpose is to finance research and development etc);
- (iii) Schemes to provide compensatory finance to developing countries for shortfalls in their commodity export earnings (as distinct from prices).

1.4 We have reviewed each of these elements under the following headings:-

PART II The Economic Arguments for and against International Commodity Agreements (ICA), particularly those with price-stabilisation provisions;

- PART III The Developing Countries and the UN, including the economic importance of commodity earnings to many third world countries, and the political importance which commodity policy has therefore assumed in UNCTAD;
- PART IV European Community and Legal Aspects, including the extent of Community competence;
- PART V The Existing International Commodity Agreements to which the UK is party;
- PART VI The Lessons from the Tin Crisis and experience with other agreements with price intervention mechanisms.
- PART VII The Common Fund, especially continued UK commitment to membership;
- PART VIII Compensatory Finance Schemes, existing and proposed;
- PART IX International Presentation of UK Policy, especially at UNCTAD VII next year and in the preparations for it.

Conclusions

1.5 On economic grounds, both the possibility and the desirability of international intervention to stabilise commodity prices over any sustained period are to be questioned. (See Part II below). Experience bears out these doubts. The price-ranges, set under Commodity Agreements have much more often kept prices up than down, so on balance they have operated against the interests of consumers. They may also have encouraged substitution. Recent experience has suggested that any price stability will be short-lived; and when agreements fail and prices fall suddenly they may cause disruption.

1.6 However, many of the poorest countries in the World are heavily dependent on commodity earnings, which often comprise over 90% of their exports. Many of these have suffered heavily as a range of commodity prices, since 1980, have undergone a deep and prolonged slump. Commodities are a major issue in the UN, especially UNCTAD, where the UK has to adopt a position, along with other developed countries, which takes account of every aspect of our economic relations with the developing world including debt and the Baker Initiative, GATT and the New Round, and new initiatives to encourage private investment and the problems of agricultural surpluses. (See Part III).

1.7 Nevertheless, commodity price-stabilisation schemes have proved an unsatisfactory means for developing countries to sustain their long term growth causing much disruption when they fail. Few are now left. The UK should work to discourage their renewal, and the formation of any new ones. Where they are agreed the UK should seek to avoid joining them. (See Part IV). Somewhat different conclusions might follow for an International Commodity Agreement on a commodity already covered by the CAP because such an agreement could be one instrument for controlling surplus production and reducing the cost of the relevant CAP regime. Any such case would need to be examined on its merits.

1.8 For the Cocoa and Rubber Agreements, where Ministers have already agreed UK objectives for renewed negotiations, these should remain the position of the UK officials if and when negotiations resume.

1.9 However, the above aims must be pursued through the Community. Community Law imposes severe constraints upon a Member State's freedom of action regarding the negotiation of and participation in Commodity Agreements. Decisions in this field are taken by qualified majority. Our first aim should be to carry a majority of Member States with us, failing which we should always work to keep a blocking minority beside us. This will involve compromise with countries whose scepticism of Commodity

Agreements is less profound than our own though the views of some are changing. (See Part IV).

1.10 If, notwithstanding the UK aims recommended above, the EC engages in negotiations on a new or renewed commodity price stabilisation scheme we should seek to ensure that its provisions comply with the economic criteria in paragraph 6.6 below and the financial criteria in 6.7. These take account of the lessons of the tin collapse, which was deficient in both these respects. (See Part VI).

1.11 International Commodity Agreements or arrangements involving no form of economic intervention and no prospect of it raise no substantial policy issues of a general kind and should continue to be dealt with ad hoc on their individual merits. (See Part 5.5).

1.12 The Common Fund Agreement is a dead letter and will probably not come into force. Lest it does, we should canvass among Community partners to see how far they share our view that in the changed circumstances the Common Fund Agreement makes no sense; any suggestion that the Community itself should adhere to it should be discouraged. If there are proposals to activate the Second Account or to create something similar we shall have to consider these. (See Part VIII).

1.13 The UK should continue to make clear in UNCTAD that it does not support and will not join any new facility for compensatory finance. It should point to its participation in the existing IMF and Lome facilities, and to the commodity arrangements (still to be worked out) to establish a parallel facility for some non-Lome poorest countries. Any general proposals for improvement in this area should first be considered in IMF or in IBRD. We should be ready to consider any proposal in this area that may come forward in IMF or IBRD. (See Part VIII).

1.14 There is no requirement for an immediate public announcement of Ministers' decisions on the recommendations above.

Any announcement would anyway need to be carefully phrased, if . was not to complicate our EC Presidency and provoke more resistance from our EC partners to our efforts to persuade them to adopt our tough position. But the decisions will need to be explained and defended in the international arena as events require: these will include not only negotiations to renew individual Commodity Agreements, but also more general debates on North-South issues in UN bodies. Commodity issues loom large in such debates, and especially in UNCTAD, whose quadrennial conference takes place next year. UK commodity-policy must be capable of standing up to pressure in UNCTAD, and for this purpose it must be capable of being presented as part of a consistent approach to the developing world. Officials need guidance now on the line they are to take.

1.15 There are two main approaches to this problem of international handling:-

(i) To go on paying 'lip-service' to the regulatory orthodoxies of the IPC in public and in principle while working for all the objectives recommended above in private and in practice. We would probably be rumbled. And we would remain under strong pressure to give effect to some aspects of the IPC, in order to justify the support in principle that we were still professing;

(ii) Alternatively to adopt a 'deregulatory approach' to Commodity policy in its broadest North-South context. This would involve saying openly that the IPC had outlived its usefulness and advocating a more market orientated route to achieving economic growth in place of further efforts to regulate world trade. This would tie in with the Baker Initiative with its emphasis on structural adjustment, and the New GATT Round with its emphasis on trade liberalisation. But it could also mean that we might need to put forward

constructive proposals to meet developing countries' legitimate concerns. And the deregulatory approach would require the liberalisation of North-South trade in both directions, and would inescapably focus attention on the developed-countries' own restrictions on imports from the developing world, notably of food and textiles. Ministers have indicated that they are prepared for these restrictions to be put on the table for negotiation; they should only adopt the 'deregulatory' approach if they wish to confirm this (though even then our EC partners may block our efforts).

1.16 Both the "lip-service" and the "deregulatory" approaches to international handling have important practical consequences. The "lip-service" approach would keep the UK under pressure to adopt commodity schemes of one sort or other: the "deregulatory" approach to liberalise our own trade and to work out effective proposals for UNCTAD and elsewhere. Detailed decisions will probably not be needed until the first half of 1987 on the line to be taken at UNCTAD VII. But in the meantime a steer is needed on which of the two approaches Ministers wish to adopt, both for the initial preparations for UNCTAD VII, and for other international exchanges.

1.17 In our view the balance of advantage lies with adopting the "deregulatory" approach now. If we avoid a decision on the basic shift in policy involved in adopting this approach, we risk being completely stuck with the "lip service" approach with too little time at a later stage to persuade others of the benefits of a basic change in direction.

1.18 If Ministers agree to adopt the "deregulatory" approach, officials will follow this line in on-going work from now on, and seek to persuade our Community partners and other Western countries to accept this in working out common positions for presenting to the developing countries. Ministers will be

informed of reactions to our new approach and will be consulted ;
significant developments occur, in particular in preparation for
UNCTAD VII. They will also be consulted if international or
domestic pressure suggests that some wide-ranging public
announcement is desirable.

PART II - THE ECONOMIC ARGUMENTS

2.1 The general economic argument for commodity price intervention schemes are assessed at Annex A. The fundamental point is that from an economic point of view such schemes can only be justified if there is an identified market failure to which market intervention through a commodity agreement may be an answer. The professed aim of market intervention is to iron out short term fluctuations in prices by setting floor and ceiling prices, but without affecting the long-run trend. The case for doing so is that the prices of commodities are apt to fluctuate sharply in response even to modest variations in supply and demand. This is because neither output nor consumption can be varied significantly in the short run in response to price changes (for example it takes up to seven years to bring new natural rubber capacity into production).

2.2 Price fluctuations can be ironed out through purchases and sales from a buffer stock, which has to be sufficient to absorb fluctuations in supply and demand. In the case of perishable commodities, the buffer stock needs to be turned over regularly. There may also be agreed production or export quotas. Quotas are more likely to raise market prices, act as a barrier to new producers and thus be against the interest of consumers.

2.3 Price stability, if it can be achieved, is valued by both consumers and producers. For producers it can stabilise income and assist long-run planning by reducing uncertainty though at times of supply shortfall eg from crop failure, a rise in price may in itself prevent a sharp drop in income. Consuming industries can plan more easily if they can assume price-stability: it reduces the need for precautionary stockpiles and forward price cover. But support buying imposes a cost on consumers as well as on public funds. Building, holding and operating of the buffer stock have to be paid for. If the floor and ceiling prices are such that the agreement does indeed stabilise price fluctuations without affecting the long-run trend, purchases for the buffer stock at certain times will be matched by

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sales at others. But if, as tends to happen, the price range fails to respond sufficiently to pronounced trends, a too rapid accumulation or rundown of stocks would render the economic provisions inoperable. With both a buffer stock and quotas a downward movement becomes more difficult to correct as growing stocks overhang the market. (In recent years the Cocoa and Rubber buffer stocks have only made purchases).

2.4 There are fundamental questions whether price stability is desirable even if it can be achieved. To muffle price changes may be to muffle market signals; price reductions are one of the means by which market forces can moderate a recession; and price increases help to moderate a boom. To cocoon producers and consumers from either may affect desirable commercial flexibility. Use of futures trading can help to protect both producers and consumers from unpredictable movements in market prices eg as a result of sudden climatic changes, without introducing the rigidities and distortions which follow from intervention in markets.

2.5 As to achievability, there is an inherent difficulty in distinguishing short term fluctuations in prices from longer-term trends, except of course in retrospect. To claim that it can be done in advance by agreement within an international group of officials is to claim greater foresight on their part than the operators in the market themselves possess. This inherent difficulty is compounded by a political one. Price-ranges have to be set by agreement among the Member countries. The producing countries often have a more intense interest in getting them up than the consuming countries have in getting them down. As so often, the more concentrated and better organised lobby tends to win the argument. The tin experience was partly the consequence of setting the price range too high, and keeping it there too long.

2.6 The above disadvantages of price-fixing can be reduced if there are effective veto-proof procedures for adjusting the agreed price-range in the light of market movements. But too-ready

adjustment defeats the object of stability. It thus remains doubtful whether a worthwhile degree of price-stability can be achieved for any sustained period without the risk that market developments will overtake the agreed price arrangements. And when an agreed price-range has to be abandoned, the result is more disruptive than the free movement of the market.

2.7 The foregoing paragraphs consider commodity agreements in the context of freely operating markets. However, for some important commodities such as sugar the UK market is subject to a highly regulated CAP regime which imposes substantial costs on consumers and taxpayers. In these cases commodity agreements could lighten the financial burden on the UK by increasing pressure for restraint on production both in the EC and in the World.

2.8 The economic case for compensatory finance is different: here no attempt is made to stabilise the price, and consumers are unaffected: instead fluctuations in earnings (which may be due to price-fluctuations or eg to crop-failures) are compensated from public funds. Such schemes are to be preferred in that they are less distortive of markets, but they are more expensive to governments (if not to consumers). Although there are provisions for repayment in most schemes, these are not always adhered to, so that the arrangements become in effect a form of aid without any guarantee that the funds in question will go to the most needy or be utilised in the most productive way.

PART III - THE DEVELOPING COUNTRIES AND THE UN

3.1 Many of the poorest developing countries are heavily dependent on export of primary commodities. Annex B(i) shows the degree to which a number of these countries rely heavily on commodities to sustain their economies. Countries whose export earnings consist of over 90% of commodities include Ethiopia, Zaire, Malawi, Tanzania, Guyana, Zambia and Chile, while another 61 countries with GDP per capita up to \$1500 have a dependence rate of over 50%. The problems are exacerbated by marked swings in export earnings derived from particular commodities. Annex B(ii) shows how the terms of trade of exporters of primary products have fluctuated sharply in the last 15 years but also brings out that in recent years the general trend has been markedly downwards; although the rapid fall in oil prices and the weaker dollar in particular will have improved the picture. This recession has been both unusually deep and lasting, transferring large sums from poor countries to rich ones, and aggravating both protectionism and the debt crisis. Another recent feature has been the changing pattern of demand for commodities, with higher productivity and increasing use of substitutes both acting to depress prices.

3.2 The difficulties now facing developing country producers of primary commodities were emphasised in a recent letter to the Prime Minister from the UN Secretary General. This said:-

"The prices of primary commodities are at present so low as to deny developing countries the possibility of earning their way out of debt and underdevelopment. Furthermore, excessive fluctuations in those prices are disruptive to sound domestic policies, investment, smooth servicing of debts and even to political stability. The present international mechanisms to support their commodity revenues are modest in relation to needs, and some of them are not functioning. The seriousness of the

problem is recognised in the United Nations discussion but corrective action is lacking. The time has come to act concretely and in the light of changes in the world economy".

3.3 UK policy on commodities has been influenced by political considerations at least as much as economic ones. They were, for example, decisive in the decisions to join the 6th International Tin Agreement in 1982, and to sign and ratify the Common Fund.

3.4 Commodities have been regarded by developing countries as a priority area for international action since the early 1970s. The UN General Assembly's 1974 call for a New International Economic Order (NIEO) for example, emphasised the importance of commodities to LDCs' economic development. UNCTAD became the main forum for advancing aspects of the NIEO in general and commodity-policy in particular. UNCTAD's 1976 Integrated Programme for Commodities (IPC) was an essential part of the effort "to achieve stable conditions in commodity trade, including avoidance of excessive price fluctuationstaking into account the special needs of developing countries....". OECD countries were willing to agree, since international price-stabilisation agreements for commodities were a familiar instrument of economic co-operation designed to benefit both consumers and producers. They were anxious to demonstrate a constructive response to the calls for a NIEO, and price-stabilising commodity agreements appeared a sensible way of doing so. However, this has led some developed countries to turn a blind eye to defective commodity agreements.

3.5 In this way, support for commodity agreements, and other aspects of the IPC, especially the Common Fund - has become part of a UN litany, and repeating it a test of orthodoxy. Although some OECD countries may privately share the UK's growing reservations about commodity agreements in particular, and the IPC in general, only the USA has so far been willing to admit such reservations in public. Meanwhile, the UK has been constrained to continue to express support for the IPC as a whole whilst

disagreeing with most of its components. A significant recent example was the UN General Assembly Special Session on Africa where we had to go along with a consensus line calling for more ratifications of the Common Fund and embracing commodity agreements as part of an overall approach.

3.6 Because of its importance to most developing countries, policy on commodities needs to be set in the wider context of international economic, trade and development issues, in particular current problems of high indebtedness and trade liberalisation in the GATT. The compatibility of OECD countries' agricultural policies with opposition to market intervention commodity agreements also needs to be considered.

3.7 On debt, recent thinking is encapsulated in the Baker Initiative put forward at the IMF meetings in Seoul in the autumn of 1985, for which there is broad support from both developed and developing countries. The proposals are designed to strengthen the case by case approach to debt issues by giving an impetus to the resumption of bank lending to debtor countries and by promoting the provision of increased IBRD policy-based lending. The Initiative indicated 15 middle income debtors which might benefit. Many commodity producing countries in Africa and South East Asia have yet to be mentioned in this context. Agreement has already been reached on the re-cycling of revenues through the IMF Structural Adjustment facility for the benefit of the poor countries. Some progress has been made with the most heavily-indebted countries, eg through increased IBRD policy-based lending, involving the adoption by debtor countries of adjustment policies. Support from the international financial institutions and banks will be conditional on measures to increase the adaptability and flexibility of the debtors' economies, so that they can adjust more readily to changes in the economic environment. The Baker proposals emphasised in particular the increased reliance on market mechanisms, for example, supply side actions to mobilise domestic and foreign investment, labour market reform and the development of financial markets, together with market opening measures to encourage foreign direct investment and

capital flows, as well as to liberalise trade, including the reduction of export subsidies. They emphasised the need for ready adaptation to market forces rather than attempting to resist them eg by fixing commodity prices.

3.8 The prospect of a new GATT Round starting later this year has also sharpened perceptions of trade relations between developed and developing countries. It is hoped that developing countries will play a full part in these. The debt crisis has made it all the more important for developing countries that the developed countries should resist and roll back protection. Developing countries will be unable to create more broadly-based economies or service their debts without strong export sectors. But to allow greater access for LDC manufactured products, developed countries will in their turn expect greater access to the markets of the more advanced developing country exporters. This means that the problems arising out of the commodity slump, which require the dismantling by developed countries of their barriers to the trade of developing countries, will be easier to handle if there is progress by the Newly-Industrialising Countries (NICs) towards "graduating" into the full obligations of the GATT.

3.9 We need to take account of the way presentation of our commodity policy may affect our relations with other countries. The UK has important bilateral relations with a number of commodity producing developing countries, some of whom may not receive much benefit from any dismantling of trade barriers, particularly if, as in the past, this is concentrated on manufactures. A number of these countries, particularly in Africa, are members of the Commonwealth. Other countries are also important commodity producers and at the same time important markets for our goods. Our line on commodities must therefore take account of any effect our position might have on these countries' relations with us.

3.10 The UK's line on commodity policy therefore needs as far as possible to be welded into a consistent policy towards economic relations with the developing countries generally, taking account

of our policy on aid, our endorsement of the Baker strategy for dealing with wider debt and development issues, and our support for "graduation" by the NICs in the New GATT Round. The primary commodity problems are part of the focus on structural adjustment programmes in the poor countries concerned. They are relevant to the activities of the World Bank, the IMF and the GATT, as well as UNCTAD.

PART IV - EUROPEAN COMMUNITY AND LEGAL ASPECTS

4.1 A critical question is the extent to which HMG's actions are constrained by our membership of the European Community. The report of an interdepartmental sub-committee of Legal Advisers on the extent of the Community competence over the three elements of the IPC is at Annex C.

4.2 Under the Treaty the general principle in relation to commodity agreements (established in an ECJ judgement in 1979) is that their objectives fall within the Community's external commercial policy under Article 113. This means that decision-making on Community participation is by qualified majority. As regards the central issue of the financing of a buffer stock, the Community may undertake responsibility for this itself: even where the financing is left to Member States, with the result that their participation alongside the Community would be necessary, (that is, it is a mixed agreement), it is still possible that they could be obliged by Council Decision to join the agreement and to bear their share of the financing (see paras 14-19 of Annex C). Such a Decision would probably cite Articles 113 and 116, both of which operate by qualified majority. To prevent the adoption of such a Decision it would be necessary to muster a blocking minority in the Council (eg UK, FRG and one other).

4.3 In practice the Council and the Commission have reached a political compromise called "PROBA 20" in which the Community and its Member States take part in international negotiations on IPC commodity agreements on the basis of a common position. As this compromise has operated in practice, the need to reach a common position gives an individual Member State with strong views a considerable opportunity to influence the Community line but can also place it under considerable pressure to compromise. On balance it remains in the UK interest to support the "PROBA 20" arrangements. However once a common position has been agreed by the Council the UK is bound by it (Para 15 of Annex C). Thereafter we could not withdraw from negotiations on a new

commodity agreement, or refuse independently to become a party, long as it accorded with the Community's common position. General obligations under Community law would make it difficult to sustain a case that a Member State may unilaterally withdraw from an existing agreement (Para 20 of Annex C).

4.4 In general it is in the UK interest to be part of a common EC position. This both avoids unnecessary exposure and helps to increase our influence. While there are some signs of increasing sympathy within the Community (such as West Germany and Belgium) for UK views on commodity agreements, other Member States tend to attach greater weight to the views of developing countries. This could mean that the enforcement of sound financial management, in a specific agreement, could lead to a political battle (but see Part VII below on compensatory finance).

4.5 The Court has not given a ruling on the extent of freedom still enjoyed by Member States under an agreement in respect of which both they and the Community have competence. If a qualified majority of Member States wished to proceed to join an agreement in which the financing of a buffer stock was left to Member States, and the UK did not, there might be grounds to challenge the validity of any Council Decision constraining it to do so. But there is a significant risk that such a challenge would fail. (See para 17 of Annex C). If it did, the result could be the loss also of the degree of de facto freedom that we enjoy under "PROBA 20" and an unwelcome extension of Community competence. It seems unlikely that this risk would be worth taking.

PART V - EXISTING INTERNATIONAL COMMODITY ARRANGEMENTS

5.1 International Commodity Agreements date back to the 1930s. At the time of the establishment of the UNCTAD Integrated Programme for Commodities (IPC) in 1976 a number of them already existed, including the Tin Agreement. The intention of the IPC was to provide a focal point for discussion and negotiation on eighteen commodities. These are:-

bananas	manganese
bauxite	meat
cocoa	phosphates
coffee	rubber
copper	sugar
cotton and cotton yarns	tea
hard fibres and products	tropical timber
iron ore	tin
jute and products	vegetable oils including olive oil and oil seeds

5.2 International Commodity Agreements are of two fundamentally different types:-

- (a) those with price-intervention mechanisms - buffer stocks and/or export controls. It is only this type which has substantial economic and financial effects;
- (b) those mainly concerned with any or all of consultation, information exchange, research and development and market promotion, but not price-intervention.

5.3 Since 1980 only four price-intervention agreements have entered into force. (Detailed descriptions are at Annex D). Three have involved buffer stocks, the International Natural Rubber Agreement, the International Cocoa Agreement and the 6th International Tin Agreement (Tin also had provisions for export

controls). The fourth, the International Coffee Agreement involves only export quotas. The UK is party to all four agreements. The Rubber and Cocoa Agreements have recently been under negotiation for renewal. In both cases the UK and other consuming countries have insisted on stringent conditions as a result of which the negotiations so far have not succeeded.

5.4 Six International Commodity Agreements without price intervention measures have been negotiated, on Jute, Tropical Timber, Olive Oil, Wheat, Sugar, and Dairy Projects. There have been unsuccessful efforts to construct commodity agreements on Tea, Bananas, Cotton and Hard Fibres. There are also less formal consultation arrangements on a number of commodities such as Lead and Zinc.

5.5 The UK is party to all these agreements without price-intervention (described at Annex E) and the consultative bodies. As long as they do not provide the pretext for agreements with economic provisions to arise, they raise no substantial general questions of policy and should continue to be treated on their individual merits, including their cost effectiveness and taking account of any contingent liabilities that may arise. The caveat applying to CAP agreements (Para 2.7) also applies here. In the case of existing arrangements, some of which contain references to the growth of full scale economic provisions, the opportunity of renewal should be taken to challenge such objectives.

5.6 Among the commodity-agreements that do involve price-intervention, there are fundamental differences in the economic/financial provisions of the Tin, Rubber, Cocoa and Coffee Agreements:-

- (i) Only in the Rubber and Coffee Agreements is there a sufficiently high level of producer and consumer members of the agreement. The Tin agreement does not include Brazil, a major low cost producer, or

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the US, a major consumer. The Cocoa Agreement does not include the major producer, the Ivory Coast, or the major consumer, the US.

- (ii) The Tin Agreement had provisions for buffer stocks and export quotas. The Coffee Agreement relies only on export quotas. The Rubber and Cocoa Agreements include buffer stocks with no export or production quotas.
- (iii) Only the Tin Agreement permitted substantial borrowing or dealings in the futures market. The Rubber, Cocoa, and Coffee Agreements preclude dealings in the futures markets, while their borrowing provisions are clear, limited, or not provided for.
- (iv) Unlike the Tin Agreement, the operations of the other Agreements are clear and reasonably transparent. Members receive regular reports of activities. The Tin Council was not properly informed of the Buffer Stock Manager's dealings.
- (v) Contingent liabilities borne by members of the Coffee, Rubber and Cocoa Agreements are limited. The Rubber buffer stock is funded by cash contribution, Cocoa by a levy on the trade. The Coffee Agreement has no buffer stock. Unlike the case of the Tin Agreement, there should not be significant contingent liabilities arising out of these agreements, whatever happens to the market price.
- (vi) The Rubber and Coffee Agreements were based on agreed price-ranges which reflected reasonably well the market trends at the time they were negotiated; Tin much less so.

- (vii) Unlike the Tin Agreement, the Rubber and Cocoa Agreements contain some effective veto-proof provisions for price adjustment, under which in defined circumstances the price-range must be adjusted to follow market developments. The size of the coffee quota automatically adjusts to movements in market prices.
- (viii) The Cocoa and Coffee Agreements operate in US dollars. Tin operated in Malaysian Ringitts which are closely tied to the US dollar. The Rubber Agreement is based on a small basket of currencies and is thus better placed to deal with currency changes.

PART VI - LESSONS FROM THE TIN CRISIS AND EXPERIENCE WITH OTHER ECONOMIC AGREEMENTS WITH MARKET-INTERVENTION MECHANISMS

6.1 The guidelines approved by Ministers in 1983 before the UNCTAD VI Conference in Belgrade, are given in paragraph 1.2 above.

6.2 Since then experience with commodity agreements and particularly with Tin has provided lessons, both on the desirability of such agreements themselves, and on the particular provisions to be sought if the UK is to participate in them.

6.3 The Tin Agreement failed with such disastrous consequences because it was defective in two separate respects:-

- (i) Its price provisions were defective. The agreement attempted to defend a price-range far above what would have been provided in a free market, with no effective veto-proof provision for bringing the price-range into line with the market;
- (ii) Its financial provisions were defective, in that executives of the agreement were left free to accumulate contingent liabilities in the course of their operations to support the price, which were not specifically contemplated by its terms and were not transparent to members. Moreover, when shortcomings were suspected the terms of the agreement were such that a small group of countries could block the provision of adequate information by the Buffer Stock Manager.

6.4 By contrast, although buffer stock purchasing under the Cocoa Agreement was suspended in 1982 when financial resources were exhausted and the price could no longer be supported, there were no contingent liabilities for members. Its price provisions were defective, but its financial provisions were not.

6.5 Against this background we have considered the other commodity Agreements to which the UK is party. So far as price levels are concerned there is, and can be, no infallible means of ensuring that a range agreed in advance will not be overtaken by market developments. So far as financial provisions are concerned however, it is possible to ensure that members' financial liabilities to the body and each other are clear, that the body's powers are specific and limited and that members are adequately informed of its activities under the Agreement. In this way it should be possible to avoid significant contingent liabilities.

6.6 As far as the price-provisions and other economic requirements are concerned:-

- (i) There should be the widest possible participation covering all major producers and consumers. Without the participation of all major producers and, though less important, consumers, the Agreement may be undermined by outsiders who follow commercial policies which conflict with the objectives and operation of the Agreement;
- (ii) (a) if export or production quotas are envisaged, it is necessary to avoid arrangements which will have the effect of raising prices to artificial levels which would be contrary to consumers' interests and at the same time encourage the use of substitutes. It is also important to avoid creation of a two-tier market as a result of lack of participation by significant importers and exporters;
- (b) even if these criteria are met, it should be remembered that quotas are rigid by nature and inflexible in practice because of difficulties in negotiating changes in allocations. Existing producers may, for

example, block reallocation of quotas to new entrants, as Brazil managed to do in the case of coffee. Moreover, consumers may be penalised if supply responds insufficiently quickly to market demands;

(c) in spite of these problems, export or production quotas can work to the overall UK advantage^{eg.} in the exceptional cases and products already subject to highly regulated CAP regimes where they may result in a reduction of the financial burden on the UK by increasing pressure for restraint on production.

(iii) The initially agreed price range should equate closely to the underlying trend of the market. If prices are set significantly above the underlying market trend the agreement runs the risk of building a large buffer stock right from the outset, and it is unlikely that any price revision mechanism will react quickly enough to halt this process.

(iv) There should be effective, veto-proof mechanisms allowing prices to be adjusted quickly to underlying changes in the market. Although a number of agreements have contained price adjustment mechanisms, they have usually required agreement by the membership before they were triggered. This effectively prevented any change in the Tin Agreement. The Rubber Agreement has provisions for adjusting the price range but these have not had sufficient effect to halt a build-up of the buffer stock. Effective, veto-proof mechanisms are needed which can react to movement in trends. Too frequent an adjustment will however tend to act against the stated objectives of dampening short run price fluctuations.

- (v) There should be adequate provisions to take account of currency fluctuations. Most Agreements have been denominated in US\$. The Rubber Agreement was set against a basket of currencies. This reduces the risk of currency fluctuation undermining the Agreement.
- (vi) There should be clear limit on the size of the buffer stock - at such a level that it cannot build up to a significant proportion of the annual consumption in the commodity. This reduces the ability of the Agreement to run strongly against market trends for any length of time. It also limits the financial commitment. The lower the proportion of annual consumption that the buffer stock represents the less it overhangs the market, as in the case of Tin.

6.7 An agreement which met these requirements would have a reasonable chance of stabilising price-fluctuations for a period of years, provided that the underlying market-trends were not too sharp. However, there could be no guarantee that it would succeed in this. If it failed, the consequences would depend on the financial provisions. These should contain:-

- (vii) No facility for borrowing under the Agreement. Failing that, it should be tightly controlled by the members and strictly limited by the Agreement.
- (viii) Limitations on forward commodity trading. Futures trading should be precluded in order to avoid a recurrence of the Tin situation. Forward Trading where permitted, should be strictly circumscribed in the Agreement.
- (ix) Transparency of operations and full control of the buffer stock by members. Members should get full

and regular reports of the operations of the buffer stock.

- (x) Clear and unambiguous financial powers for the Agreement's executives, with contingent liabilities strictly limited and clearly specified. Contingent liabilities were brought into sharp focus by the collapse of the Tin Agreement. In order to avoid similar situations occurring in the future, the Treasury have drawn up a detailed note aimed at identifying the types of contingent liability involved and proposing a framework within which they can be identified at an early stage. This note is at Annex F. It lists four distinct areas where contingent liabilities may arise, namely through:- sources of finance; asset depreciation; termination; and operations of the agreement. In future all international agreements of any kind will be studied to identify potential liabilities. Sponsor Departments are responsible for alerting Ministers and Parliament to any risks, in addition, they are requested to review existing outstanding liabilities (and to review the field of potential liabilities) in the annual public expenditure survey.
- (xi) Explicit provisions to deal with any winding up of the Agreement and the international body concerned in the event of insolvency. The need for this provision has been clearly demonstrated in the aftermath of the Tin crisis. It avoids the presumption that agreements will go on indefinitely and is therefore a useful discipline in itself.

PART VII: THE COMMON FUND

7.1 The Common Fund is intended to provide a joint pool of finance for commodity agreements, including existing and new ones. Although the UK and 10 other EC Member States have ratified the Common Fund Agreement, the US has not, and not enough capital has been contributed to bring it into force. When agreed in UNCTAD in June 1980, it was regarded as the centrepiece of the Integrated Programme for Commodities. The UK signed and ratified the agreement primarily for political but also for economic reasons. Other countries, particularly the US, were even more doubtful than the UK about the economic justification for the Fund but nevertheless accepted it. However, some countries, like France, believed that there was an economic case for it.

7.2 The Fund has two accounts (details at Annex G). The First Account was to contribute to the financing of buffer stocks in International Commodity Agreements and indirectly to encourage such agreements. The Second Account was to provide finance for "other measures" such as research and development, market promotion etc. The Fund was to be financed mainly by directly contributable capital (DCC) from Member States, totalling US \$470m. Most of this DCC was for the First Account; the Second Account was intended to be financed mainly by voluntary contributions with a target of \$280m.

7.3 In ratifying, the UK was committed to a DCC contribution of about \$15m (\$10m to be paid into the Fund with the remaining \$5m on call). On ratifying the UK also pledged a voluntary contribution of £4.27m to the Second Account.

7.4 The Fund will enter into force when 90 countries have ratified and the DCC reaches US \$315m. Both criteria must be met. Ratifications have now reached the trigger point of 90 countries (including the EC Member States with the exception of Portugal; the Community is entitled to join in its own right - it has signed but not ratified) but the necessary DCC level has not yet been reached. Although the US, a major contributor, signed the

Agreement, they have publicly announced that they will not ratify it. For the Fund to enter into force, therefore, it will require the other major non-ratifiers, the Soviet Bloc, to sign and ratify the Agreement. They have not expressed any intention to do so, but there remains a risk that they might do so with mischievous intent.

Current Situation

7.5 Events since 1980 have undermined the principles on which the First Account was based. The failure of the Tin Agreement and the possibility that there will not be a new Cocoa Agreement with a buffer stock means that only a new Rubber Agreement (if concluded) would be qualified to associate with the Fund. The First Account could not operate as intended on this basis.

7.6 Apart from our commitments to the initial financing of the Fund, contingent liabilities may arise in the course of the Fund's operation.

7.7 There is therefore a case for examining whether the UK can disengage from the Fund Agreement.

Legal Position

7.8 The position under International Law is that although it is unusual for a Contracting State to withdraw its instrument of ratification before an Agreement has entered into force, it is possible and not unprecedented.

7.9 But would withdrawal of the UK's ratification (or alternatively its subsequent withdrawal from the Fund after it had entered into force) be compatible with Community Law? This question is dealt with at Annex C, but in summary there is a risk that having regard to Community practice in this area the Court might hold that continued participation in the Agreement was required. The risk would be reduced if the UK could prevent the

Community itself from adopting a Decision enabling it to become a Party to the Fund. This would require us to muster a blocking minority of Member States (eg UK, FRG and one other).

International Considerations

7.10 Whilst British doubts have grown about the Fund's merits and the substantial costs of its entry into force, we have felt inhibited in speaking out against it internationally when other developed countries have preferred to let sleeping dogs lie. An additional consideration for us is that some countries argue that even if the Common Fund does not come into existence the problems will still remain and that the funds pledged to that Account should be used independently to provide assistance in solving them. We would need to consider such proposals on their merits and when they arise.

7.11 We could expect no support in the Community at this stage to withdraw from the Common Fund. Other Group B countries (with the exception of the US) appear to be content to run the small risk of its entering into force in its present form in order to avoid the political difficulties of changing their mind, even though privately most admit that the Common Fund in its existing form is now a dead letter.

7.12 Thus both the political and legal arguments appear for the moment to weigh against unilateral withdrawal of HMG's ratification. At the same time we need to do what we can to reduce the risk of the Fund coming into force. This points to working in the Community and Group B for a consensus that the Fund now makes no sense. If this canvassing is successful, a number of EC and Group B countries may emerge willing to withdraw their ratifications and willing to prevent the Community itself from joining the Fund. If not, unilateral withdrawal could be reconsidered but it would then be necessary to reassess the risks of being taken to the European Court of Justice.

7.13 The search for compromise could lead to a proposal that the Second Account alone should come into force. If so the UK should resist it. The Second Account is tied in with the Common Fund as a whole.

PART VIII - COMPENSATORY FINANCE

8.1 Compensatory financing mechanisms differ from price stabilisation agreements in that they leave prices free while compensating producers for fluctuations in their earnings. In some cases eg STABEX the whole of their cost thus falls on public funds. International schemes of this sort exist already, but ambitious and comprehensive further ideas to compensate shortfalls in commodity earnings have been on the UNCTAD agenda for years. At UNCTAD VI in 1983 the UK was among the countries supporting a resolution that these should be further explored by experts.

8.2 Existing schemes include the IMF's Compensatory Finance Facility (CFF) which derives in part from a UK initiative, and which provides financial assistance to developing countries (not just producers of primary commodities) who experience balance of payments difficulties arising from export shortfalls that are temporary and beyond their control. The IMF recognises export shortfalls caused by either demand or supply factors such as "a decline in world demand or a crop failure brought about by natural calamity". Users of the CFF must at a minimum satisfy the IMF that they will co-operate with the IMF in efforts to solve their balance of payment difficulties (for upper tranche drawings they must in addition demonstrate a record of co-operation). Most claims on it concern shortfalls in agricultural earnings. The CFF plays a useful role and if proposals came forward to enlarge it we would be prepared to consider them.

8.3 The other major compensatory finance schemes are the EC's STABEX and SYSMIN Schemes under the Lome Convention. These are designed to stabilise earnings from exports by African, Caribbean, and Pacific States to the Community of certain products when they are affected by fluctuations in either prices or quantities. STABEX covers 66 ACP States and 48 agricultural products. It has been proposed to introduce a similar scheme for four of the poorest, non-Lome countries. Countries can make claims in respect of individual commodities when export earning fall below the permitted level while meeting the dependency criteria.

8.4 The UNCTAD Secretariat has been peddling a proposal for a new facility on a worldwide basis, designed to finance shortfalls in commodity export earnings by soft loans; and also to finance structural adjustment projects designed to reduce price fluctuations. These proposals are narrower than the IMF and STABEX schemes in that they would only cover the 18 commodities on the UNCTAD Integrated Programme for Commodities. But they are broader in being less conditional; and in applying to a wider range of countries, with less stringent stipulation as to their dependency on the commodity concerned. It is estimated to cost US\$10bn at 1982 prices over 5 years. Under pressure from the G77 to adopt such a scheme at UNCTAD VI, the EC countries, including the UK supported the establishment of an 'Independent Group of Experts' to consider the need for any additional compensatory financing facility. The Group reported in 1985. Its conclusions had the merit that they concentrated on the causes rather than the effects of supply instability; and they suggested that loans triggered by export earnings shortfalls in specified commodities should be applied to reduce these causes. But views still differ on the need for a new scheme. The US, Canada, Australia and New Zealand have now started to distance themselves from any further work in UNCTAD on this issue. But the EC countries have not, and risk being dragged into unwelcome commitments by allowing discussion to continue until there is no way back.

8.5 UK spokesman continue to argue that in the light of the existing IMF and STABEX schemes, together with the World Bank schemes for structural adjustment loans, there is no need for any new compensatory financing facility. This position has recently been put in writing to the UNCTAD Secretariat in the terms at Annex H.

8.6 The UK's scepticism is not shared in the Community and the West Germans have their own expensive proposals for a "global STABEX". The majority of the Community wish to present an open mind on the need for a new facility, mindful that the failure of price-stabilisation agreements and the Common Fund leaves the

cupboard rather bare, and anxious to be seen "doing something" for developing countries suffering from the effects of low commodity prices at UNCTAD VII next year.

8.7 The extent of Community competence on compensatory financing would depend on its detailed objectives and nature. The Community (as distinct from its Member States) could consider joining such a scheme, either if it fell within the Common Commercial Policy or if it was agreed that the Community should fund it as aid, as happens with STABEX. In the first case this could be decided by qualified majority, in the second unanimity would be required.

8.8 Thus there is reason to fear that the current discussions on compensatory finance in UNCTAD, though overtly exploratory, may slowly jostle EC countries into a position where, without major political embarrassment, they cannot back out of incurring heavy financial commitments. Officials therefore recommend that the UK continue to warn that it is not persuaded of the need for a new compensatory finance facility, and does not contemplate subscribing to one. If despite such warnings a new scheme emerges and gathers support, Ministers could consider whether it would be in the UK interest to leave the discussions having regard, among other considerations, to the Community implications.

PART IX - INTERNATIONAL PRESENTATION

9.1 If Ministers accept the recommendations in this report, which amount to a marked change in previous policy, questions of announcement and presentation arise. There is no need to make any immediate announcement unless Ministers wish. Indeed, given our imminent assumption of the EC Presidency there is advantage in lying low. It may be harder to move the Community attitude on commodity issues closer to our views if an announcement is made now which sets out a policy known to a tougher than that of our partners. The decisions will fall to be implemented, explained and defended:-

- (i) When individual commodity agreements come up for renewal (as the Cocoa and Rubber ones have in recent months);
- (ii) In the regular business of specialist UN bodies concerned with commodity-policy (eg the UNCTAD Committee on Commodities);
- (iii) When ad hoc resolutions in UNGA and other UN bodies include questions of commodity policy (eg the Resolution passed at the recent UNGA Special Session on Africa);
- (iv) At UNCTAD VII due next year;
- (v) As the Community, and the developed countries generally, prepare common positions for (ii)-(iv).

9.2 It was because of the importance assumed by commodity questions in these bodies, and in the wider debate about economic relations between North and South, that HMG went along with the IPC etc in spite of doubts (which some other countries shared) about their wisdom and practicability. Western countries generally were influenced by developing country pressure for the adoption of the IPC and opposition to it appeared fraught with

political and perhaps commercial dangers. If Ministers abandon this line of least resistance, now that its drawbacks stand more clearly revealed; how should that decision be presented, and what are its implications for the stand HMG takes regarding general economic relations between North and South?

9.3 There appear to be two main options. The first is to carry on paying lip-service in public to the principles of the IPC while working behind the scenes to frustrate it in practice. This would involve (as in the recent cases of Cocoa and Rubber) stipulating what we hope will be unattainable conditions for the renewal of International Commodity Agreements with price-stabilisation provisions, while professing still to support them in principle. It would involve eg continuing to lend our name to UN resolutions which reaffirm the principle of price-stabilisation, while working to ensure that they come to nothing in practice.

9.4 The advantage of this course is that it would avoid any overt change of policy. This is a great advantage. But it has several disadvantages. First it would involve dealing with our partners in bad faith. The pretence would have to be kept up for a long time, and would almost certainly be rumbled sooner or later. Second it would involve continuing to encourage by our lip-service the view, which cannot ultimately be in our interest, that the development of poor countries would be helped by ever-greater regulation of the international economy. And third, lip-service to the principles of the IPC would keep us under pressure to deliver: if not one thing (eg price-stabilisation) then surely another (eg compensatory finance) etc etc. So we should still be on a slippery slope.

9.5 The alternative is the deregulatory approach. This would involve admitting openly that the attempts to regulate world commodity markets had misfired because they were misconceived; and arguing that poor countries and rich ones should adopt a more market-oriented route to economic growth, involving deregulation: freer trade and investment: structural adjustment.

This would involve welcoming private inward investment to diversify their economic base, and to build up a broader spread of export industries (though the capacity of some developing countries to diversify and attract private investment should not be overrated).

9.6 One advantage of the deregulatory approach is that of credibility: it would involve advocating for the economic development of LDCs much the same sort of reorientation of policy as we have adopted for our own. Another is that it would tie in with several concurrent international developments. The Baker Initiative with its emphasis on trade liberalisation and structural adjustment. The New GATT Round as the forum for negotiating a balanced programme of trade liberalisation. The new Multilateral Investment Guarantee Agency (MIGA) as one means of easing the path for private equity investment in LDCs. The Tokyo Summit statement on the need to tackle agricultural surplus production. The IBRD/IMF Structural Adjustment Facility.

9.7 The deregulatory approach however has two important disadvantages. First it would take time to sell to our Community partners and to other consumer countries (though less so in the USA). Secondly, it would focus attention on the developed countries' own trade and investment policies affecting LDCs, and notably on their trade barriers to many LDC products, particularly food and textiles. The deregulatory approach should not be adopted therefore unless Ministers are prepared to put these trade barriers on the table for negotiation: in the case of textiles they have of course already decided to do so, and as a result of a British initiative, the Community is already committed to dealing with the phasing out of the MFA in the New GATT Round. In other respects too the deregulatory approach fits in with HMG's policies: we are working for reform of the CAP, partly to reduce the international friction it causes. Moreover HMG has, by virtue of abolishing exchange controls, and its promotion of the MIGA, a good record of freeing private British capital to flow to those developing countries that welcome it. In these respects HMG's

policies already take account of some of the foreseeable pressures that could result from the adoption of a deregulatory approach in UCTAD.

9.8 Officials will be seeking Ministers' endorsement of all the briefs for UNCTAD VII during the first half of 1987. At that time they will work up detailed proposals for Ministerial approval on both substance and presentation of commodity issues taking into account proposals by the UNCTAD Secretariat and views of other countries. In the meantime, however, a steer is needed on the line to be taken on HMG's behalf in the continuing business described in para 9.1 above.

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ANNEX A

THE ECONOMICS OF COMMODITY AGREEMENTS

1 Over the years, commodity agreements have taken a variety of forms ranging from those which have provided only for information sharing and research and development to those which have involved active intervention in the market. In what follows, the emphasis is on agreements which provide for active market intervention by means of a buffer stock and/or export quotas.

2 For any agreement to be justified on economic grounds, there would have to be an identified market failure for which the effects of an agreement would be preferred to either unrestrained operation of market forces or other forms of Government intervention.

3 The prices of some commodities may be subject to sharp fluctuations in response to modest changes in supply or demand. This stems from the low short term elasticities of supply and/or demand common to many commodities. This gives rise to calls for commodity arrangements aimed at reducing the extent of price fluctuations.

4 Why might sharp and market commodity price fluctuations represent a market failure? One possible reason is that traders and potential traders in commodities may face difficulties in obtaining information about supply and demand. Another reason is a possible divergence between private and social risks. Thus, a lack of sufficiently developed markets for the sharing of risks in investments associated with the commodity may mean that risk-averse private interests are deterred from involvement in the market.

5 It is usually argued that more stable prices for commodities (which may be inputs into industrial processes) are desirable because they reduce the degree of uncertainty for producers and consumers, and therefore allow (or encourage) appropriate levels

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of investment in the producing and downstream industries. Additionally, it is often contended that commodity agreements result in greater security of supply and cheaper supply over the long term if producing countries are faced with more stable prices. It is important, however to remember the other influences which could continue to disrupt supply (for example, weather variations, wars).

6 It has however, to be said that hard evidence of market failure in the commodity field is rather limited. In normal circumstances most commodity markets work pretty efficiently with participants being made to hedge and use forward markets to reduce risk. Even where there is a history of price fluctuations, it is not clear why the information available to a buffer stock manager should be any more complete than that available to other market participants (of whom many perform similar roles) nor is he better able to make use of it.

7 Where a commodity agreement with provision for market intervention is being considered, attention needs to be given to the precise rules governing intervention behaviour if the market failure is to be overcome in an efficient way. Essentially, the objective should be to ensure that the market price is able to follow a path consistent with long term market clearing. This implies that on average buffer stocks should be kept at a very low level.

8 In assessing the pros and cons of commodity agreements with market intervention, it is important to recognise that consumers and producers will be affected in rather different ways and their attitudes may consequently differ. Moreover, the implications of an agreement with only a buffer stock are usually different from one which includes export quotas. For example, a buffer stock acts directly on price and much less on supply. Quotas act directly on supply and only indirectly on price, and are only satisfactory to the extent that they can be adjusted to market developments.

9 In the main potential disadvantages of price intervention commodity agreements to consuming countries reflect the failure of agreements to achieve their stated or presumed objectives, namely that the prices of commodities follow their long term market clearing paths. There are practical problems in operating agreements which suggest that such failures are almost inherent. First, it is inherently difficult to distinguish short-term price fluctuations from longer term trends, except in retrospect. Moreover, political factors may frustrate attempts to adjust the floor and ceiling prices in response to market conditions. This may be particularly problematic where downward price adjustments are involved with the result that commodity prices tend to be supported through the accumulation of buffer stocks.

10 If commodity agreements maintain market prices above the natural market clearing level a transfer of resources from consuming countries to producing countries results. Such resource transfers confer benefits on producers through, for example, the greater ability of LDC's to service debts and/or to sustain a higher level of imports and is a form of direct aid. However, the lack of transparency of the transfer may well lead to a sub-optimal allocation of aid. This is aggravated under a quota systems where "aid" is liable to be allocated according to often arbitrary and indefensible criteria. Recipients may also allocate such receipts in a sub-optimal manner.

11 An agreement which supports prices in the short term will lead to a distortion of relative prices and this may cause further misallocations of resources in at least two respects. First, it may undermine the principle of comparative advantage by protecting less efficient producers from competitors (a particular problem if quotas are involved). Secondly, it may distort the allocation of resources to invest, for example, by raising returns to producers of the protected commodity. Thirdly, in so far as a commodity agreement led to an appreciation of the exchange rate, there might be losses of output and employment in the non-cartelized sector to set against any gains in the agreement protected sector.

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12 An agreement made for one commodity may encourage producers to argue for agreement for other commodities, or if this fails, to consider cartel formation if there is a prospect for maintaining prices above long term market clearing levels.

13 For producing countries greater stability of prices is usually seen as a means of stabilizing income. This may not be the case, particularly in agricultural commodities where good crops are associated with low prices and vice versa.

14 For consumer countries participation in a price intervention commodity agreement will often involve the commitment of national resources to a relatively unproductive use (involving both Exchequer and resource costs).

15 If an agreement succeeds in sustaining prices in the short/medium term above longer term market clearing levels, supply will be over stimulated while consumers will be encouraged to substitute other commodities for the one in question with the result that the agreement cartel breaks down as individual members seek to maximise their own interests. In the shorter term there is a danger that clearing levels may solidify the market shares to the advantage of inefficient producers. This will normally be the case with agreements including quotas.

16 Finally and theoretically, it can be argued that commodity agreements could reduce the level of economic activity in the consuming (industrialised) countries leading to a reduction in demand for the commodity over and above that due to the relative price effect. However, the group of commodity agreements presently in place is unlikely to have much effect on the level of economic activity because the commodities covered by agreements are relatively insignificant.

Summary

17 Many of the inherent shortcomings of commodity agreements referred to above such as the attempt to support unrealistically

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high prices are clearly evident in the operation of the CAP. The CAP regime for certain important commodities in structural surplus, such as dairy products cereals and sugar, already imposes substantial costs on UK consumers and taxpayers in the form of excessive prices, price support, and often stocks. It is a major objective of UK policy to promote significant improvements in CAP arrangements. In these circumstances carefully designed commodity agreements which acted in such a way as to reduce excessive world production and bring production and consumption more into balance could reduce the CAP burden on the UK consumer and taxpayer.

18 The desirability of commodity agreements largely depends upon whether or not the market intervention is needed to counteract market failure, and if so, whether the market price remains close to the long term market clearing level. It seems unlikely though that the economic case for any commodity agreement will be very strong since markets appear to function reasonably efficiently except where they are already regulated by agricultural policy such as CAP. If an agreement is desired nonetheless, there are a number of conditions that need to be met if it is to operate so as to minimise any adverse economic effects of intervention and to allow the price to follow a course consistent with long term market clearing, as follows:

- (i) participation covering all principal producer and consumer countries;
- (ii) floor and ceiling price adjustment mechanisms under which neither producers nor consumers have undue influence and which can react quickly to underlying changes in the market or other relevant economic conditions such as currency fluctuations;
- (iii) a clear limit on the size of the buffer stock and/or effective quota adjustment provisions;

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- (iv) a clear limit on the borrowing powers of the council and a known and agreed cap on the liabilities of participants;
- (v) transparency of operation and full control of the buffer stock.

Extent of Commodity Dependence by
developing country according to income level
1978-1983

Annex B(6)

Country GDP/per capita in 1982 I	Extent of commodity dependence a/ (b) 1983 II	Commodities involved by III
I. Below \$500 COUNTRIES LISTED IN ASCENDING ORDER OF GDP PER CAPITA		
Democratic Kampuchea (79)	47.9	Fish, Rubber, Timber
Bhutan* (102)	n.a.	Jute
Laos People's* Dem. Rep. (103)	51.5	Coffee, Timber
Bangladesh* (115)	33.7	Fish, Jute, Non-bovine Meat, Tea
Ethiopia* (137)	94.6	Coffee, Cotton, Hides and skins, Vegetable oils and oil seeds
Chad* (147)	63.6	Cotton, Fish
Nepal* (153)	49.6	Cereals, Jute, Milk and butter, Roots, Timber
Mali* (157)	78.0	Cotton, Vegetable oils and oil seeds
Burma (162)	97.0	Cereals, Fish, Rubber, Timber, Tin
Zaire (182)	95.8	Coffee, Copper
Burkina Faso* (185)	83.3	Cotton, Bovine meat, Hides and skins, Vegetable oils and oil seeds
Guinea-Bissau* (191)	67.8	Timber, Vegetable oils and oil seeds
Equatorial Guinea* (195)	90.4	Bananas, Cocoa, Coffee, Fish, Timber
Mozambique (200)	73.8	Cotton, Fish, Sugar, Tea, Vegetable oils and oil seeds
Malawi* (213)	95.6	Cereals, Sugar, Tea, Tobacco, Vegetable oils and oil seeds
Uganda* (229)	94.6	Coffee, Cotton
Afghanistan* (232)	34.9	Cotton, Fruits, Hides and skins
Comoros* (237)	82.9	Spices, Vegetable oils and oil seeds
Lesotho* (240)	73.1	n.a.
India (244)	38.0	Cereals, Fish, Iron ore, Jute, Tea
United Rep. of Tanzania* (247)	92.1	Coffee, Cotton, Hard fibres, Tea, Tobacco, Vegetable oils and oil seeds
Rwanda* (251)	93.1	Coffee, Tea, Tin
Burundi* (261)	95.0	Coffee, Cotton, Tea
Mauritania (265)	95.7	Fish, Iron ore
Central African Republic* (270)	77.7	Coffee, Cotton, Non-bovine meat, Timber, Tobacco

Country GDP/per capita in 1982 I	Extent of commodity dependence a/ (%) 1983 II	Commodities involved b/ III
I. Below \$500 (continued)		
Cape Verde* (278)	80.6	Bananas, Fish
Benin* (288)	77.3	Cocoa, Coffee, Cotton, Fish, Vegetable oils and oil seeds
Somalia* (295)	95.1	Bananas, Fish
Sri Lanka (304)	62.0	Rubber, Tea, Vegetable oils and oil seeds
Togo* (307)	69.6	Cocoa, Coffee, Cotton, Phosphates, Vegetable oils and oil seeds
Haiti* (315)	38.5	Bauxite, Cocoa, Coffee, Hard fibres
Madagascar (324)	95.2	Coffee, Fish, Spices, Sugar
Sao Tome* and Principe (331)	47.9	Cocoa, Vegetable oils and oil seeds
Pakistan (336)	29.0	Cereals, Cotton, Fish
Angola (341)	5.6	Coffee
Kenya (351)	66.8	Coffee, Fruits, Tea
Niger* (354)	94.7	Cereals
Gambia* (357)	57.2	Fish, Vegetable oils and oil seeds
Maldives* (360)	66.1	Fish
Sierra Leone* (375)	68.9	Bauxite, Cocoa, Coffee, Fish, Vegetable oils and oil seeds
Yemen* (382)	3.5	Coffee, Cotton
Vanuatu* (389)	83.4	Bovine meat, Cocoa, Fish, Vegetable oils and oil seeds
Liberia (395)	98.8	Cocoa, Coffee, Rubber, Iron ore Timber
Guinea* (404)	97.5	Bauxite, Cocoa, Coffee, Vegetable oils and oil seeds
Democratic Yemen* (419)	3.0	Cotton, Fish
Senegal (430)	70.9	Fish, Phosphates, Vegetable oils and oil seeds
Kiribati (433)	10.7	Vegetable oils and oil seeds
Sudan* (462)	98.1	Cereals, Cotton, Hides and skins, Roots, Vegetable oils and oil seeds,

Country GDP/per capita in 1982 I	Extent of commodity dependence a/ (%) 1983 II	Commodities involved b/ III
II. \$500 - \$1 000		
Guyana (523)	98.1	Cereals, Bauxite, Sugar
Samoa * (532)	76.8	Bananas, Cocoa, Roots, Timber, Vegetable oils and oil seeds
Zambia (562)	98.5	Copper
Indonesia (589)	16.0	Timber
Tonga (604)	65.8	Bananas, Roots, Spices, Vegetable oils and oil seeds
Solomon Islands (634)	82.4	Fish, Timber, Vegetable oils and oil seeds
Djibouti* (636)	0.8	-
Ghana (657)	68.5	Bauxite, Cocoa
Morocco (678)	62.0	Fish, Fruits, Phosphates
El Salvador (698)	74.0	Coffee, Cotton
Honduras (708)	82.0	Bananas, Bovine meat, Coffee
Papua New Guinea (712)	84.8	Cocoa, Coffee, Copper, Timber, Vegetable oils and oil seeds
Egypt (721)	25.0	Cotton
Thailand (748)	66.0	Sugar, Rubber, Fish, Roots
Philippines (769)	47.0	Copper, Sugar, Timber, Vegetable oil and oil seeds
St. Christopher & Nevis (805)	54.4	Sugar
Botswana* (824)	15.2	Bovine meat, Copper, Hides and skins, Non-bovine meat
Cameroon (825)	60.0	Bauxite, Cocoa, Coffee, Timber
Zimbabwe (834)	58.8	Cotton, Tobacco
Dominica (837)	50.2	Bananas, Vegetable oils and oil seeds
St. Vincent & the Grenadines (838)	70.4	Bananas, Roots
Nigeria (862)	4.3	-
Ivory Coast (885)	87.3	Cocoa, Coffee, Timber
Swaziland (892)	80.8	Fruits, Sugar
Grenada (956)	69.0	Bananas, Cocoa
Lebanon (970)	27.0	Fruits
Belize (971)	68.2	Fish, Sugar

Country GDP/per capita in 1982 I	Extent of commodity dependence ^{a/} (%) 1983 II	Commodities involved ^{b/} III
III. \$1 000 - \$1 500		
Nicaragua (1013)	86.0	Bananas, Bovine meat, Coffee, Cotton
Bolivia (1062)	45.0	Tin
Saint Lucia (1082)	60.3	Bananas, Vegetable oils and oil seeds
Mauritius (1087)	68.5	Sugar
Jordan (1109)	50.0	Phosphates
Costa Rica (1113)	72.0	Bananas, Bovine meat, Coffee
Turkey (1114)	54.0	Cotton, Tobacco
Guatemala (1133)	66.0	Bananas, Coffee, Cotton, Sugar
Peru (1179)	63.0	Copper, Fish
Tunisia (1219)	11.0	-
Dominican Republic (1261)	76.0	Cocoa, Coffee, Sugar
Congo (1337)	4.1	Timber
Algeria (1393)	1.0	-
Jamaica (1414)	80.3	Bauxite, Sugar
Colombia (1424)	72.0	Bananas, Coffee
Ecuador (1445)	29.0	Bananas, Cocoa, Coffee, Fish
Chile (1457)	91.0	Copper, Fish, Fruits
Cuba (1494)	86.0	Sugar

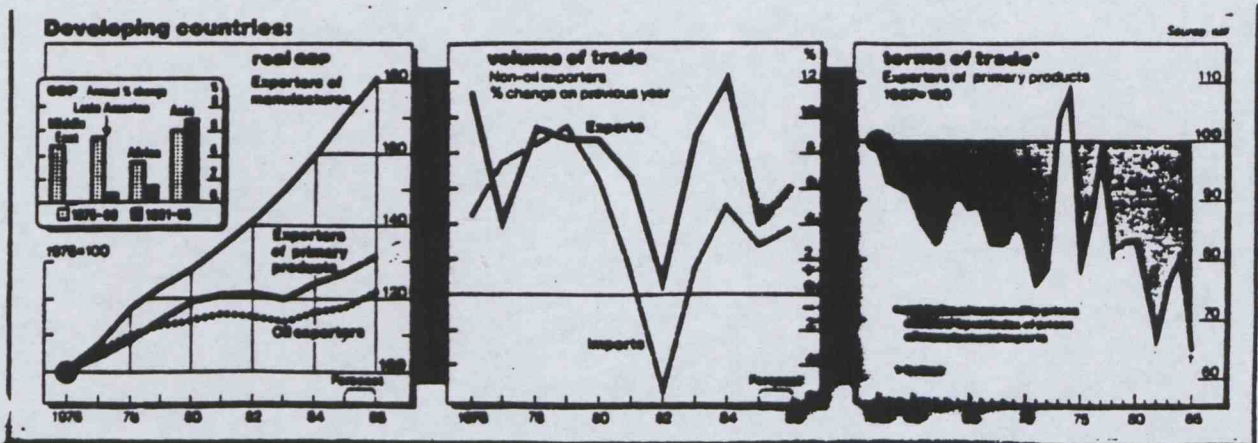
Sources: UNCTAD secretariat calculations; data provided by the Commission of the European Communities and World Bank.

^{a/} Least developed countries.

^{a/} Exports of primary commodities (not including oil).

^{b/} Commodities averaging in 1961-1983 over 1.3 per cent of total exports for least developed countries, over 2.5 per cent for other low income countries (below \$500), and over 3 per cent for all other developing countries.

Annex B(11)



Annex C

COMMUNITY COMPETENCE : COMMODITIES

1 The aim of this paper is to determine the extent of Community competence over commodity agreements, the Common Fund and Compensatory Financing. It is necessary to summarise briefly the relevant provisions in the EEC Treaty, the case-law of the Court of Justice and the practice on commodity agreements before assessing the legal position on the division of powers between the Community and the Member States in this area.

I. THE EEC TREATY

2 The provisions of the EEC Treaty which are relevant to the question of competence for commodity agreements are Articles 5, 113 and 116. In view of their importance, these Articles have been set out in their entirety below.

Article 5

Member States shall take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of this Treaty or resulting from action taken by the institutions of the Community. They shall facilitate the achievement of the Community's tasks.

They shall abstain from any measure which could jeopardise the attainment of the objectives of this Treaty.

Article 113

1 After the transitional period has ended, the common commercial policy shall be based on uniform principles, particularly in regard to changes in tariff rates, the conclusion of tariff and trade agreements, the achievement of uniformity in measures of liberalisation, export policy and measures to protect trade such as those to be taken in case of dumping or subsidies.

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2 The Commission shall submit proposals to the Council for implementing the common commercial policy.

3 Where agreements with third countries need to be negotiated, the Commission shall make recommendations to the Council, which shall authorise the Commission to open the necessary negotiations.

The Commission shall conduct these negotiations in consultation with a special committee appointed by the Council to assist the Commission in this task and within the framework of such directives as the Council may issue to it.

4 In exercising the powers conferred upon it by this Article, the Council shall act by a qualified majority.

Article 116

From the end of the transitional period onwards, Member States shall, in respect of all matters of particular interest to the common market, proceed within the framework of international organisations of an economic character only by common action. To this end, the Commission shall submit to the Council, which shall act by a qualified majority, proposals concerning the scope and implementation of such common action.

During the transitional period, Member States shall consult each other for the purpose of concerting the action they take and adopting as far as possible a uniform attitude.

II CASE-LAW OF THE ECJ

3 The most important case on commodity agreements is Opinion 1/78 on the draft International Agreement on Natural Rubber, concluded in 1979. The Court held that commodity agreements are instruments of commercial policy coming within Article 113 of the EEC Treaty. In the Court's view, a highly developed commercial policy cannot be restricted to measures of trade liberalisation but must extend to measures aimed at regulation of the world market,

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even though they might have development aid features or repercussions on economic policy. Thus, the Court held that the mechanism of a buffer stock falls within the common commercial policy as its purpose is to regulate trade.

4 The Court stated that the Community's competence in any particular case depends on the objectives of the individual agreement. If the objectives of the agreement as a whole fall within the concept of commercial policy, then the Community will have exclusive competence notwithstanding the presence of specific clauses relating to other matters, such as technological assistance. In the case of specific arrangements for the financing of a buffer stock, the Community will be exclusively competent where the financing is a matter for the Community. If the Member States are responsible for financing, then they must participate in the agreement alongside the Community, which will not have exclusive competence. While precise arrangements as to financing remain to be determined, Member States must be allowed to participate in the negotiation of the agreement. It follows from the Court's Opinion that if the Council were to decide by a qualified majority under Article 113 to enter the financing of an agreement with a buffer stock in the Community budget, the participation of Member States would be excluded.

5 In the case of the Rubber Agreement, the Court found that the financial arrangements for the financing of the buffer stock occupied "a central position in the structure of the Agreement", though the Court was careful to leave the decision as to financing to be settled by the Community authorities. In the event, Member States were made responsible for the financing and both Community and Member States therefore became parties to the Agreement.

6 It would appear from Opinion 1/78 that provisions for the administrative budget of a commodity agreement with an institutional structure do not in themselves settle the question of the competence of the Community and the Member States. The mere fact that financial obligations are imposed on Member States does not imply Member States' competence : the nature of these obligations and their place in the structure and objectives of the agreement have to be determined in each case. This is in line with

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Opinion 1/75 (OECD costs), where the Court declined to attribute any importance to the fact that the financial burdens of an agreement were to be borne directly by the Member States.

III PROBA 20

7 The practice of the Community authorities has developed somewhat differently from the case-law of the Court of Justice. In 1981 the Council, in agreement with the Commission, adopted the PROBA 20 arrangements which enable the Member States to participate with the Community in certain international commodity agreements on the basis of a common position. The agreements covered are those relating to IPC Commodities (the UNCTAD integrated programme for commodities). Products within the CAP are excluded. The Common Fund Agreement is also excluded.

8 Under the PROBA 20 arrangements, agreements are signed and concluded jointly by the Community and the Member States, who jointly participate in the operation of the agreements on the basis of a common position.

9 It would follow from Opinion 1/78 that, in principle, certain commodity agreements could have been concluded by the Community on the basis of Article 113 without the participation of the Member States. However, the Council and the Commission have accepted that all the agreements covering IPC commodities are to be mixed. It must be stressed that the PROBA 20 arrangements do not have the force of law. They represent a political compromise. They have been accepted by the UK along with other Member States as being in our general interests, but if their application to a particular agreement were to be challenged in the ECJ, it would be open to the Court to find that aspects of those arrangements were not compatible with Community law.

IV COMMODITY AGREEMENTS

10 Existing Agreements may be divided into three categories:

- 1) Agreements on IPC commodities with regulatory provisions ie rubber, cocoa, tin and coffee. These Agreements are mixed. In the case of cocoa, the

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financing of the buffer stock is not from contributions from Member States, as in the *two other Agreements with buffer stocks* but from levies on cocoa;

- ii) Agreements on IPC Commodities but without regulatory provisions ie jute, timber. These also are mixed Agreements;
- iii) Agreements on CAP products ie olive oil, sugar. At present these do not have regulatory provisions. The Community alone is a party. There is a third Agreement - on wheat - within this category, but because there are development aid aspects, Member States are parties to it along with the Community.

11 Although the first two categories of Agreements are treated in the same way under Proba 20 (ie both Community and Member States participate in the Agreements), Member States' claim to competence for the Agreements with regulatory provisions has a strong legal basis only as regards the financial provisions; in the absence of the Proba 20 arrangements the Community would have a good claim to exclusive competence for the Cocoa Agreement, which is not financed directly by Member States.

Negotiation and conclusion of IPC Commodity Agreements by Community and Member States

12 In practice, a negotiating mandate for the Commission, and a common position for Member States, are usually adopted by means of an informal decision of the Council entered in the Council minutes, rather than by formal Decision citing a Treaty base. Even where a common position for Member States has been adopted by an informal decision, the decision constitutes a binding Community act. It is therefore in the interests of Member States to seek to prevent the adoption of a decision (formal or informal) if they wish to block Community action. In the absence of agreement on a common position, neither the Commission nor the Member States can participate in the negotiation of a commodity agreement.

13 As regards signature of an Agreement, the practice is that if the Community objectives set out in the common position have been successfully met during the negotiations, the Commission will

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propose a Decision to be adopted by the Council relating to signature of the Agreement. The previous practice was that the Decision, which would be taken under Article 113, would relate to signature (and, at a later stage, provisional application and/or ratification) by the Community alone. Signature, provisional application and ratification by Member States was not dealt with by Community legislation. Decisions adopted while that practice was still current relate to Tin (82/809), Cocoa (81/850) and Rubber (82/254). Under the Commission's new practice the Council Decisions in question are taken under Articles 113 and 116 and impose obligations on both Community and Member States to sign and provisionally apply the Agreement in question: see Coffee (83/539), Jute (83/328), and Tropical Timber (COMM(84)339 Final). In the case of the last two Decisions the UK successfully resisted the inclusion of wording proposed by the Commission imposing an obligation on Member States to ratify. For the Tropical Timber Decision wording was agreed which does not explicitly impose an obligation to provisionally apply the Agreement; Member States simply state their intention to apply the Agreement provisionally.

Analysis

14 On the basis of the above brief summary of law and practice the following conclusions may tentatively be put forward.

15 In negotiations regarding a new commodity Agreement, the UK will be bound by any common position which has been agreed by the Council. If the UK wishes to withdraw from the negotiations, it may not do so if its withdrawal would prejudice achievement of the objectives of the common Community position (by, for example, reducing the level of imports/exports to be included in the Community's total) or if its withdrawal might prejudice the eventual question of whether the UK would sign the Agreement (on which see below). The legal obligation to avoid prejudicing the Community's common position arises from Articles 113 and 116, on which the Community's common position is implicitly based, and, more generally, from Article 5 of the EEC Treaty. There would not seem to be a positive legal obligation upon the UK to be represented at every meeting of a negotiating conference. However,

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complete withdrawal from the negotiations would have to be examined in the context of the Community's common position and of the question whether the UK was free to decide not to participate in any new Agreement resulting from the negotiations.

16 The freedom of a Member State to act independently of the Community as regards becoming a party to a new Agreement has to be assessed in the light of each specific Agreement and its position under Community law. It is clear however that if the Council were to adopt a Decision under Articles 113 and 116 enabling the Community to sign and obliging the Member States to sign also, the United Kingdom would be obliged to act in accordance with the terms of that Decision, unless it was prepared to challenge the validity of the Decision in the European Court of Justice. The same applies to a Decision on provisional application.

17 It has become the practice for the Community and Member States to coordinate their position within international organisations of an economic character under Article 116 on matters of particular interest to the Common Market but which lie outside Community competence. On this basis, it is arguable that it is legitimate to use Article 116 to compel Member States to sign a mixed commodity agreement with financial provisions for which Member States remain competent. However, an alternative argument could be advanced to the effect that Article 116 may only be used where the Community has failed or is unable to exercise its own competence over matters which fall within the common commercial policy. It may not be used where competence is reserved to Member States. This argument is consistent with the Rubber Opinion, where the Court held that if Member States financed the buffer stock under a commodity agreement this would imply "the participation of those States in the decision-making machinery or, at least, their agreement with regard to the arrangements for financing envisaged and consequently their participation in the agreement together with the Community". In the event, however, of a challenge in the European Court of Justice to the validity of a decision adopted under Articles 113 and 116 obliging Member States to sign an agreement with regulatory provisions, there is a significant risk that the Court might rule that Member States were bound by such a decision. Moreover, even

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if the Court were to hold that a decision under Articles 113 and 116 was not binding on Member States, there is a risk that the Court might resile from the position it took in the Rubber Opinion and find that the financing of an agreement with regulatory provisions should be implemented through the Community budget in accordance with Article 199 of the EEC Treaty, in which case the Member States would lose their competence to participate in the agreement. It must be stressed that the extent of these risks (and whether or not they are worth taking) can only be assessed on the facts of each particular case.

18 Unless the United Kingdom were prepared to challenge in the Court of Justice any decision taken under Articles 113 and 116, it would have to seek to prevent the adoption of such a decision. Measures under Articles 113 and 116 can be taken by qualified majority. It would therefore be necessary for the United Kingdom to secure a blocking minority (leaving aside the possibility of invoking the Luxembourg compromise) to prevent the adoption of a Decision obliging it to sign the Agreement in question. As regards ratification of the Agreement the position is more complex. Although the Commission hold the view that an obligation to ratify a commodity Agreement may be imposed upon Member States by a Council Decision under Article 116, the UK and some other Member States have so far successfully resisted the adoption of any such Decision on the ground inter alia that an obligation to ratify would infringe the constitutional requirements of States and their Parliaments. This argument should stand a good chance of succeeding before the ECJ.

19 It is unfortunately the case, however, that the Council has adopted two Decisions obliging Member States to apply provisionally an Agreement (Coffee and Jute), and provisional application is scarcely distinguishable in its practical legal effect from ratification. Thus, while there would very likely be sufficient support to oppose the adoption of a Council Decision imposing an obligation to ratify an Agreement, the same would not necessarily be the case in respect of an obligation to apply an Agreement provisionally. The United Kingdom would be obliged to comply with such a Council Decision in accordance with its terms.

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20 A Member State may unilaterally denounce or withdraw from an Agreement only if its withdrawal does not conflict with its obligations under Article 5 of the Treaty to facilitate and ensure the fulfilment of the Community's obligations, including obligations under the Agreement entered into by the Community under Article 113. Since the provisions of commodity agreements are frequently interlocking, and it is not possible for the Community to carry out its obligations under such agreements without the participation of all Member States (and vice versa), it may be difficult to argue that a Member State is free to denounce an agreement unilaterally.

V COMMON FUND

21 A Common Fund for Commodities is to be established by an Agreement which was opened for signature in 1981, but is not yet in force. The Common Fund would contribute through its First Account to the financing of international buffer stocks within the framework of international commodity agreements, and through its Second Account would finance and promote measures other than stocking.

22 The United Kingdom has already ratified the Common Fund Agreement. If the United Kingdom wished to withdraw from the Agreement, it would first have to consider its position under international law. Although it is unusual for a Contracting State to withdraw its instrument of ratification before an Agreement has entered into force, it is not unprecedented. As a matter of international treaty law it would be possible to withdraw ratification before entry into force, although it would be advisable to consult the Depositary first (the UN Secretariat).

23 There remains the question whether withdrawal of the UK's ratification (or its subsequent withdrawal from the Agreement under Article 30) would be compatible with Community law. The Community signed the Agreement on 21 October 1981. The Council seems to have agreed that the Community should participate "alongside the Member States as from the start of the Fund's operations". The same informal Council Decision concerned the way in which the Community was to participate in the Agreement.

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24 Although, therefore, Community competence for the Agreement cannot be challenged, the extent of Community competence is unclear. It seems to have been agreed that the Community should not contribute to the Second Account, unless the Council otherwise agreed, (but the 1986 EC Budget shows token entries in budget items 9700 and 9701 for a Community contribution to both the First and Second Accounts). Irrespective of competence arising from its financial contributions, the Community may have a claim to competence by virtue of its participation in the commodity agreements which may associate with the Common Fund.

25 An argument may be advanced arising from the nature of the Agreement itself that it is not legally essential for all Member States and the Community to be parties to the Agreement together. Under such an argument the respective powers of the Community and Member States are parallel, and all of the obligations of the Agreement may be undertaken without the necessary presence of all of the Member States. There would be no logical or legal incoherence if only the Community or only some Member States contributed to one or other Account in the Common Fund, and enjoyed the corresponding rights in its machinery (though the Commission might argue that such a situation was politically incoherent and reduced the international standing of the Community as an entity).

26 Even if such an argument can be substantiated on the facts, however, it is clear from the Council decision referred to above that it was intended and agreed that the Community and Member States should participate together in the Agreement. (Eleven) Member States have ratified or acceded to the Agreement. Quite apart from the political risks inherent in unilateral action of this nature, the possibility cannot be excluded that the ECJ, were it to become seised of the case, would be disposed to treat joint or continuing participation in the Agreement as one of the Community's tasks the achievement of which each Member State was obliged to facilitate under Article 5 of the Treaty of Rome. The risk would be reduced if the UK were able to marshal a blocking third to stop the adoption of a Decision enabling the Community to become a Party to the Agreement. Action by the UK to withdraw its instrument of ratification should therefore not be undertaken without prior consultation with other Member States and the Community, after which the position should be re-examined.

VI COMPENSATORY FINANCING

27 The objective of compensatory financing is to reduce instability in commodity export earnings of developing countries. The means to achieve such reduction have not yet been agreed upon. It appears likely that any scheme would as a minimum provide compensation for shortfalls in export earnings.

28 A system of compensatory finance will be within Community competence if it is capable of coming within the common commercial policy (CCP). The common commercial policy covers measures concerned with the regulation of trade. In the view of the United Kingdom and of the Council Legal Services the test of whether a trade measure is capable of coming within the common commercial policy is whether its objective is to regulate trade. However, the Commission's view is that the scope of Community competence depends on the effects of the measure.

29 Insofar as compensatory financing was restricted to the goal of providing compensation for shortfalls in export earnings, it could be argued that since it is not its aim to regulate the conditions or volume of world trade, it would not fall within the CCP. It appears, however, that compensatory financing might also tackle the causes of instability in export earnings (see 1984 UNCTAD report of experts on compensatory financing). It could be that measures taken for this purpose might have a bearing on the regulation of trade. If the payments went to restructure the industry so as, for example, to reduce oversupply of the commodities in question, the objective might be to alter trade movements. In such a case, it would appear that the scheme would fall within the common commercial policy.

30 Another factor that is relevant in considering where competence lies is the source of the finance. The compensatory financing scheme known as STABEX, contained in the Lome Convention, is financed by the European Development Fund, to which Member States are the contributors. Commission involvement in STABEX can be said to be on behalf of Member States and in respect of their money; it does not indicate Community competence for this or other

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similar schemes. It has however apparently been agreed within the Community to extend STABEX-type operations to a number of developing countries not covered by the Lome Convention. This will be financed from the Community budget under provision for aid to non-associated countries. (The covering Regulation for the budget line is made under Article 235.)

31 In summary, if a compensatory financing scheme were restricted to compensating for shortfalls in export earnings, the scheme might not fall within measures coming within the common commercial policy. If it were agreed that the Community should fund the scheme as aid, the Community would have competence to that extent. If a compensatory financing scheme were to be negotiated which had wider objectives than compensation, those objectives would have to be examined to see whether they were concerned with the regulation of trade and therefore were capable of coming within the common commercial policy.

COMMODITY AGREEMENTS WITH PRICE STABILISATION PROVISIONS

Detailed descriptions of the four agreements are set out below.

International Tin Agreement

2 This came into force in 1982 with a buffer-stock mechanism, backed by export controls where necessary. At the outset of the agreement the UK contributed £7.8m to the buffer stock and paid an annual administrative contribution of some £50,000. It was beset by the following problems from the start:-

- (a) surplus of production over consumption;
- (b) price range set higher than free market level; and no automatic mechanism to review it (it could only be altered by agreement);
- (c) inadequate participation, allowing only provisional entry into force of the Agreement with consequent reduction in the buffer-stock ceiling, so the ceiling on the buffer-stock was too low in spite of its being buttressed by production quotas;
- (d) imprecise borrowing limits.

3 The market price of tin was on or near the floor, and the buffer stock manager (BSM) was buying, from the outset. Under the terms of the agreement the BSM was permitted to borrow sufficient to finance a stock of 20,000 tons of tin metal. No limit was placed on his forward transactions. The lending banks placed a limit on the facility offered to the BSM, but there was no limit on the borrowings from brokers. The failure to control the BSM's forward dealings deferred, but also aggravated, the crash. The collapse came when the price fall left his forward dealings uncovered, his borrowings not secured, and his credit exhausted.

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On 24 October 1985 dealing in tin was suspended on the LME. The agreement collapsed but the International Tin Council remains formally in existence. No decision has yet been taken on its future.

The International Rubber Agreement (INRA)

4 The principal objective of the Agreement was to reduce the degree to which natural rubber prices fluctuated in the short-term whilst at the same time ensuring that prices continued to follow the long-term market trend. To this end provisions were included in the Agreement for a degree of automatic adjustment of the price range to reflect movements in the market. Partly as a result of this the rubber agreement, unlike tin, has not had to defend completely unrealistic prices and average monthly prices have varied less during the Agreement than they did during the 70s. It has however accumulated a buffer-stock of 360,000 tonnes which suggests strongly that up to the present this increased price stability has been obtained by providing an element of price support.

5 The maximum financial liability for the UK is limited to the cash requirements of financing the buffer-stock (which has a defined ceiling). To date the UK has invested £5.75m and the maximum additional call for the UK is approximately £2.25m.

6 The Agreement is currently being renegotiated. The first session was inconclusive. The second session, also ended inconclusively, on 23 May and a third session has been scheduled for 6-17 October 1986. The UK line for these sessions has been considerably strengthened to take account of the lessons learnt from the tin collapse eg by calls for greater automaticity in price adjustment and a lower starting point for the reference price.

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International Cocoa Agreement

7 The current Agreement came into operation in 1981 with a buffer-stock as the intervention mechanism. It also contained a provision to lower (or raise) the price range if rapid buffer-stock buying (or selling) indicated that the range was out of line with market reality. This proved to be the case shortly after the entry into force of the Agreement, and 100,000 tonnes of cocoa beans were rapidly bought into the buffer-stock and the price range lowered by 4 US cents/lb. This purchase exhausted the funds then available but did not prevent a slide in market prices. Buffer-stock purchases have been suspended since 1982. There have been no sales.

8 The moribund Agreement currently has assets in the form of 100,000 tonnes in the buffer-stock plus more than US \$200m in cash collected as a result of the 2c/lb levy on transactions involving members of the Agreement.

9 The Agreement is currently being renegotiated. Four Sessions have taken place. At the most recent, in February 1986, the UK and other consumers adopted a tougher approach on the outstanding questions of price adjustment. Apparently as a result of this hardening of position the Ivory Coast, the largest producer, announced that they would not participate in any new cocoa Agreement and withdrew from the Conference.

10 During consultations in the margins of the Executive Council (2-6 June 1986) the Ivory Coast professed itself ready to return to the Conference. There are considerable doubts however that the final round of negotiations in Geneva (7-11 July 1986) will result in an Agreement with economic provisions. If there is no such Agreement there may be pressure for a non-economic Agreement to maintain a forum for the exchange of information.

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International Coffee Agreement

11 The current Agreement came into operation in 1983 in succession to the 1976 Agreement and with unchanged economic provisions. Export quotas are the main instrument for ensuring that prices remain within a target range of 120-140 US cents/lb, which is reviewed annually. Quotas are adjusted automatically in response to movements in the indicator price. The Agreement provided an effective floor to the market after the reintroduction of quotas in 1980, but its inability to hold prices within the ceiling was demonstrated in 1984 and the limited value of a dollar denominated price range was underlined in 1984-85, when European prices were rising as the dollar indicator fell. It has constrained supply to the market but provided no assurance of steady supply within the quotas; and it has diverted surplus production into a heavily discounted non-member market, leading to serious trade distortions.

12 In early 1986, serious damage to the Brazilian crop because of drought led to prices not only soaring above the target range, but staying there. Under the Agreement's provisions therefore, export quotas were automatically suspended with effect from 19 February 1986. Quotas will only be introduced if and when the market price returns to the target range. This return to a free market should allow supply and demand - in total and for specific coffee varieties - to adjust to a pattern more in line with market realities.

ANNEX E

INTERNATIONAL COMMODITY AGREEMENTS (WITHOUT ECONOMIC PROVISIONS)

1 International Jute Agreement

Concluded 1982. Entered into force January 1984 for 5 years. All major producers and consumers are members.

The main features of the agreement are to improve the structural conditions in the jute market and to maintain and enlarge existing markets as well as developing new markets for jute through projects on research and development, market promotion and improvements in market transparency.

2 International Tropical Timber Agreement

Concluded 1983. Entered into force April 1985 for 5 years. Wide membership including all major producing and consuming countries. No agreement yet on Headquarters or Executive Director.

Main aim of agreement is to provide a framework for all work on all aspects of the tropical timber trade. Main provisions are to promote research and development, improve market intelligence, to encourage re-forestation and the development of national conservation policies. These aims will be met through the implementation of projects in these areas.

3 International Sugar Agreement

Concluded 1984. Entered into force January 1985 for 2 years only. All major producers and consumers are members.

The agreement is of an administrative nature only and is aimed at improving the statistical output of the International Sugar Organisation in order to provide a sound base for negotiations for a future agreement with economic provisions. There have been some informal consultations between the EC and other major sugar

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producers, but these have so far failed to find any common ground. It is therefore likely that the current agreement will be extended when it expires in December 1986.

4 Internataional Olive Oil Agreement

Agreement concluded 1979. Entered into force January 1980. Expires in December 1986 having been extended for 2 one-year periods. Re-negotiating session scheduled for June 1986. It is likely that any new agreement will follow the same terms of the existing one. Many major consumers and producers are members. The Community dominates world trade in olive oil, producing and consuming about 75% of world production.

The existing Agreement's aims are concerned with measures to expand the international trade in olive oil and to promote research and development activities.

5 International Wheat Agreement

Agreement concluded in March 1986 and scheduled to enter into force in July 1986 for 5 years. This new agreement will replace the 1971 Wheat Agreement.

All the major producers and consumers are expected to join the agreement which will principally provide a forum for consultation and the exchange of information designed to increase market transparency.

6 International Dairy Agreement

Concluded under the Tokyo Round of Multilateral Trade Negotiations. Entered into force 1 January 1980, unlimited duration. Most of the major producers and consumers are members.

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Main aim of the Agreement is to achieve the expansion and liberalisation of world trade in dairy products, through the provision of a comprehensive information and cooperation mechanism.

7 Arrangement Regarding Bovine Meat

Also concluded under the Tokyo Round of Multilateral Trade Negotiations, and entered into force on 1 January 1980 for an unlimited duration. Most of the major producers and consumers are members.

Its main aim is to promote the expansion, liberalisation and stability of the international meat and livestock market by facilitating the progressive dismantling of obstacles and restrictions to world trade.

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Types of Contingent Liability

4 The tin experience has prompted an examination of where contingent liabilities may arise in international agreements:

(a) Sources of Finance

If the body is empowered to augment the funds directly contributed by member states, eg through borrowing, a liability could arise in the event of default. The agreement may not specify limits to the kinds or amounts of additional financing. This may be provided by contributions from Member States or from external sources. Whether or not the Agreement specifies the contributions to be made by members there may be further liability. That liability may be 'joint and several', meaning that one member may be sued for recovery of all the debts of the body, subsequently claiming from others their share of the 'joint' liability. But recovery may be a lengthy process entailing financing costs, and total recovery may be difficult in practice. If the UK was sued for all the debts, this cost would score as public expenditure. If the joint liability was subsequently recovered, this would probably score as negative public expenditure.

(b) Asset Depreciation

The UK has made a percentage contribution to the finances of a body which is ultimately refundable from liquidated assets. The absolute size of the refund will be less than the initial payment, involving a loss, where the assets have depreciated. A special case would be the fall in value of an accumulated commodity stockpile which drives down the market price at which the remaining stock is valued. Liquidating the stockpile may itself be responsible for the depreciation. The public expenditure treatment depends on the exact nature

of the transaction. The likely effect is a net public expenditure cost equal to the difference between the payments and proceeds of the liquidation.

(c) Termination

There may be no clear provisions for the distribution of assets and/or liabilities when the body is wound up, either prematurely or at the end of the period for which the agreement is in force. The order in which residual assets (including uncalled payments due from parties to the agreement) must be used to meet outstanding liabilities may not be specified. No formula may be provided for distributing the remaining net assets or liabilities among the parties to the agreement. As in (b), the likely effect is a net public expenditure cost equal to the difference between the initial cost and the monies recovered. But again this would depend upon the detailed transactions involved.

(d) Operations in Connection with the Agreement

Regardless of the limits on national liabilities written into an agreement, courts may hold Member States liable in certain circumstances for losses incurred outside the apparent scope of the agreement regulating the body to which they belong and over which they should exercise control. In this context particular care will be needed to control the acts of agents acting for the body. Where the Government is held responsible for the liabilities incurred, these losses would normally score as public expenditure.

5 The list is unlikely to be exhaustive, given the variety of forms in which contingent liabilities could arise. For example, they could occur in the absence of reserves accumulated for the purpose in the case of property deals, leases and redundancy payments to the staff of the international body concerned. Where the uncertainty of calls on the Exchequer goes beyond the timing of budgetted contributions circumscribed in the agreement, there

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is a contingent liability to be evaluated as such and reported to Ministers and where necessary to Parliament. Departments are responsible for alerting Ministers and Parliament to any risks. In addition they are requested (Prime Minister's minute of 23 May 1986) to review outstanding contingent liabilities (and to review the field of potential liabilities) in the annual expenditure survey).

Evaluating Contingent Liabilities

6 In evaluating the possible public expenditure consequence of all forms of contingent liability, full account must be taken of the legal and political framework of the agreement. The UK may see the budgetary implications of a bodies' activities in a particular light. But the view may not be shared by a sufficient number of other parties to the agreement. Contingent liabilities on the UK expenditure programmes may not therefore depend on whether the UK can take unilateral action to prevent costs arising to the agreement (with possible implications for member governments), but rather on whether the parties acting collectively within the decision-making rules of the Agreement are likely to do so. The politics may be complicated by conflicts of interest among member states (as between producers and consumers in commodity agreements for example) or the division of votes among a large number of small members which halts effective decision making. EC competence makes it particularly important to identify the essential UK interests early on so that they may be incorporated in the Commission's negotiating mandate. To carry the Community, it may be necessary to take the case through all stages up to the Council of Ministers. The UK may in the end have an interest unique among EC members which must be protected even at the high political cost of invoking the Luxembourg veto.

7 Political difficulties increase the uncertainties and risks. They suggest that it might be preferable in practice (and if necessary at some political cost) to preclude a liability by so far as possible securing a form of agreement which prevents it arising in the first place (although it may not be possible to

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limit all potential liabilities in this way). In practice political constraints are likely to make it impossible to adjust the terms of an agreement (and its associated liabilities) once the agreement enters into force. Nor will it often be an attractive option politically to withdraw from an agreement at a later stage even if such a step would eliminate a contingent liability.

8 The phase of initial negotiations leading to an agreement with terms which Ministers are asked to endorse is therefore crucial. A checklist of actions by the Treasury and other Departments may be useful to ensure that no obvious points are missed when officials assess a new agreement. Such a list is provided at the end of this note. A collective recognition of the possible public expenditure significance of contingent liabilities should also sharpen the analysis presented to Ministers by highlighting the areas of financial danger in particular policy proposals, and ensuring that proper legal scrutiny has been applied bearing the more likely contingencies as well as the "worst case" in mind. But once identified, none should be acceded to in the negotiations, either passively or by active agreement, without testing the political costs of its removal. Contingent liabilities reported to Ministers should therefore be the minimum possible subject to stated political constraints.

A Checklist of Actions

- (i) Departments study the outline of draft international agreements to identify potential contingent liabilities.
- (ii) Treasury to be consulted at an early stage with an evaluation of contingent liabilities which it may prove necessary ultimately to accept.
- (iii) Departments to consult legal advisers (FCO/DTI or MAFF) on the draft terms of the agreement,

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establishing what legal changes may be necessary to minimise all contingent liabilities.

- (iv) Treasury to advise on whether Parliament needs either to be informed or give assent to the contingent liabilities in question separately from assent to the text of the Agreement from which they arise.
- (v) Submission to Ministers on joining, amending or extending an international agreement should contain a full statement on contingent liabilities cleared interdepartmentally stating why it is considered necessary to accept them, what the potential public expenditure implications are or how they would be financed.
- (vi) Departments should continue to monitor the outstanding contingent liability and make any necessary reports to Parliament. If further contingent liabilities are spotted or are proposed to be incurred subsequent to an agreement coming into force, the steps leading up to Ministers being consulted should be repeated again.

COMMON FUND FOR COMMODITIES

1 The Agreement to establish the Common Fund for Commodities was adopted by consensus in UNCTAD on 27 June 1980. The following is a highly simplified account of how the Common Fund is intended to work under the Agreement.

2 The Fund has two Accounts which are operated almost entirely separately. The First Account is in effect a Bank for financing buffer stocks operated by International Commodity Organisations (ICOs - the bodies established to implement International Commodity Agreements - ICAs). ICOs have to choose whether to be members of the Common Fund. Those which become members are required to deposit their cash surpluses with the First Account. The Second Account (sometimes known as the "second window") is more akin to an aid fund which is intended to support commodity development measures such as research and development and measures to improve productivity.

The First Account

3 The First Account is to have directly contributed capital of *\$470m divided into shares of \$10.000 each. Thirty seven thousand are paid-in shares and ten thousand are payable shares. The UK is to subscribe \$10.51m in paid-in shares and \$4.59m in payable shares. The paid in capital is to be subscribed in the form of promissary notes. The payable shares are only called up if the Fund gets into difficulties.

4 The First Account would remove the need for national contributions to ICA buffer stocks. The DCC would allow borrowing at reasonable rates which should theoretically, reduce the demands on the members of commodity agreements. When an ICO associates with the Fund under an Association Agreement it must determine its "Maximum Financial Requirements" (MFR) for buffer stocking. When it is not holding stock it must deposit with the Fund in cash one

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third of its MFR, and give guarantees of the remaining two thirds of the MFR. This is called "guaranteed capital" When the price of a commodity falls to the intervention level and the ICO buys stock, it first draws down its cash deposit and then it borrows the balance of its requirements up to the limit of the MFR from the Fund. The credit worthiness of the Fund is assured by its capital, the guarantees from the ICO members and by holding the warrants for the stocks acquired.

5 Though the Common Fund was a major element in the Integrated Programme for Commodities, under which 18 commodities were nominated for negotiation of possible Commodity Agreements, there are only two commodity agreements involving buffer stocks which are at present possibilities for association with the Common Fund - rubber and cocoa.

6 The voting arrangements are a complicated compromise between the UN system of one vote per country, and that of the older financial institutions where voting is proportionate to financial contributions. Each country has 150 basic votes plus additional votes related to directly contributed capital plus eventually further votes related to guarantee capital. The Agreement lays down which decisions may be taken by simple majority vote, or by a qualified majority of two thirds or by a highly qualified majority of three-quarters. It was expected that Group B would hold just over 40% of the total votes and the G77 around 44%

The Second Account

7 In addition to \$70m of DCC targetted, a target of \$280m was set for voluntary contributions. So far \$255m has been pledged ensuring that the condition of 50% of the target before entry into force has been met.

8 In December 1980 the United Kingdom pledged a sterling amount then equivalent to \$10m (£4.27m). The Second Account may only borrow on concessional terms. The Second Account was intended to offer loans and grants for commodity development measures aimed at

improving the structural conditions in markets and at enhancing the long-term competitiveness and prospects of individual commodities'. Funds must be channelled through an International Commodity Body (ICB) which must be an intergovernment organisation open to all Member States of the UN, concerned with trade, on/of promotion and consumption issues? a specific commodity. The membership must represent an adequate (undefined) share of exports and imports of the commodity. The ICB must have an 'effective decision making process that reflects the interests of its participants' and be in a position to discharge its responsibilities in connection with the Fund. This would probably rule out study groups and maybe some Food and Agriculture Organisation Inter-Governmental Group of Experts.

9 Projects currently under consideration in various fora pending availability of finance could easily absorb all Second Account contributory resources if they were all approved. An UNCTAD Secretariat document prepared for the December 1985 Committee on Commodities listed all the projects and costings, totalling \$519m. Many important issues are still to be resolved on the detailed operation of Accounting: eg selection procedures and criteria, loan terms, the eligibility of projects in individual countries benefitting individual countries (OECD countries argued these were not covered). These must be resolved before it will be possible to judge whether funds are likely to be well spent.

10 The Second Account is in effect an aid agency.

* All these figures were expressed in the Agreement of Units of Account, after conversion at the exchange rate at the date of the Agreement of \$1.32.

COMPENSATORY FINANCING OF EXPORT EARNINGS SHORTFALLS

COMMENTS BY THE UNITED KINGDOM

At the conclusion of the 14th Special Session of the UNCTAD Trade and Development Board in June 1985 the Secretary General was requested to convene an Inter-governmental Group of Experts (IGE) to analyse "the need for a new facility as well as to undertake further work on the rules and modalities of any additional complementary facility". Comments were requested from Member States of UNCTAD, as well as the World Bank and IMF, for consideration by the IGE. This note should be read in conjunction with the letter from the EC and its Member States dated 4 May. The United Kingdom would like to emphasise the following elements which are particularly important.

2. It is the view of the United Kingdom that no case has yet been made out to justify a new compensatory financing facility in addition to the facilities provided by existing arrangements. The IGE Report concentrates on the effects of supply instabilities on fluctuations in export earnings. These are indeed important. However, the remedy for the resulting payments problem does not necessarily involve providing assistance to improve commodity production and its supporting infrastructure and services. Within particular countries there is an individual requirement to encourage the best use of scarce resources (including land and finance) in accordance with regularly updated perceptions of what is the most effective development strategy overall. That may, for instance, require action to encourage production of one commodity in place of another, or of domestic food supplies in place of exportables. A facility aimed only at commodity-related investment is not therefore the most appropriate instrument to deal with these issues. Measures taken to deal with the consequences of unwanted instabilities also have to conform with other rigorous priorities. Parastatal marketing controls and organisations, for instance, are being sharply questioned in many countries because of the strain they put upon budgets at the expense of basic services like health and education. This means that such devices, however appropriate they may seem when looking purely at the problems of a single commodity, may be ruled out for wider and more important reasons.

3. Against this background it appears unrealistic to suppose that a single, unified approach will be able to address the very differing and changing problems of both individual countries and their commodities. Each country's problems and resources need to be examined so that countries can chart the course best calculated to permit them to resume and to expand their overall growth, in a

way which also serves to meet the fundamental human needs of their people. This requires the closest comprehension of the overall problems of each country, and not solely those which appear to relate to its commodities. To take one example from the purely commodity aspect an irrigation scheme or some similar investment may appear to be necessary to correct supply instability. Yet the most urgent need for that country overall may well be for a quicker-yielding investment less subject to sociological and other difficulties of implementation and less likely to impose an extra recurrent burden upon its staff and budget.

4. The communication from the European Community and its Member States referred to the recent developments and extension of the STABEX system, which will tackle the instability of export earnings from commodities for a wide range of countries. The IMF operates a compensatory financing facility (CFF) for shortfalls in export earnings where these are judged temporary and largely attributable to circumstances beyond the control of claimants. The World Bank and other established international financial institutions lend for development and economic reconstruction and, in the commodity area, look particularly at the choices between different types of economic activity open to producers whose means, labour and time is often tightly constrained.

5. As a result of a long process of evolution described in the Expert Group Report well established and substantial facilities already exist to assist countries to recover from shortfalls in export earnings. These include the financing of structural adjustment down to sub-sectoral level, as well as explicitly for rehabilitation of commodity production. Although we endorse the World Bank view that focus on individual commodities is not the best approach to structural adjustment, the Bank itself does rightly support such investments as part of an overall country strategy where this is appropriate, as it has done for instance for the copper tailings leach plant in Zambia. The very strength of the existing schemes is that they cover the problem of fluctuation in export earnings simultaneously from a number of directions. The contribution which each of the established agencies already makes can only be usefully appraised from an overall perspective which acknowledges the multi-faceted aspect of the existing scheme.

6. The UK considers that having regard to existing facilities a new facility is likely to be counterproductive. Overlapping jurisdictions, acknowledged by the Experts' Group in its discussion of double compensation, would confuse the outlook for the various agencies and add to uncertainties for borrowers as well as lenders. The reviews of existing facilities by the international organisations concerned (for which there is provision for example in the IMF's procedures)

help to ensure that the various schemes are capable of meeting the real needs of developing countries. The UK considers that the IGE should give greater weight to further consideration of the range of existing schemes and the contribution they can make towards the overall objective, consulting with the established bodies as necessary for this purpose. Supply side instability should be further studied, drawing where possible on the expertise of existing bodies.

7. The UK remains willing to contribute constructively to discussions of the Expert Group's report. We believe that this should focus on a detailed appreciation of the contribution which the existing agencies can make and an in-depth analysis of supply side instabilities. The UK will review its continued participation in this exercise in the light of the further work, including consideration of these points.

LONDON

16 May 1986

