The Failure of International Commodity Agreements

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IT IS, if I am not mistaken, the goal of all free countries with government by law to diminish poverty, squalor, and drudgery for the greatest number of their citizens, and to expand opportunities to all self-respecting, responsible citizens to develop their personal potential. This goal includes the obligation of the nation to respect the dignity and integrity of all men of good will.

If this national goal is accepted, the economy must have the institutional framework to promote the gradual improvement of the real income of the people by improving the productivity of human, natural, and man-made resources. This requires, in the production of goods and services, more division of labor, specialization, and increased efficiency from research, innovation, and better management. But in order to have some orientation for such endeavor it is essential to give the consumer the sovereign power to allocate resources to the satisfaction of his needs and of his more and more refined wants. This provides the powerful incentive to all people to make the effort to earn the money to get the goods and services they want. Such an arrangement is ideally guaranteed in the market with freely moving prices by the daily plebiscite in which housewives and the consumer in general express their preference in francs and centimes, or dollars and cents.

In the modern economy, in which this allocation of resources applies to all goods, durable and nondurable, to houses and motor vehicles, and to all services – educational, medical, culinary, artistic, and to entertainment, travel, insurance, recreation, and multi-

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tudes of others – economic growth is bound to accelerate and to become all-pervasive. Such dynamic growth, to be stable and continuous, requires a high degree of mobility of human resources, such as shifts from the production of goods to the performance of services.

Such economic growth or development, which requires above all stability of the national currency and the discipline of monetary and fiscal policies to keep inflation in check, calls also for an optimum of foreign trade. It is generally agreed that the promotion of peaceful relations in this turbulent and dynamic world requires economic development in all countries, particularly those with still predominantly rural living conditions. This development in formerly colonial and other industrially retarded countries is definitely needed for the healthy development of the advanced nations, because industrial economies maintain growth and stability by a reliable flow of essential raw materials.

The Need for Leadership

Of all the conditions for increasing the income of the people in the world's rural countries, by far the most strategic are continued healthy and stable growth of the leading industrial countries and their avoidance of prolonged economic stagnation or contraction. Any idea of accelerating growth in underdeveloped countries by sapping the strength of industrial nations belongs in the moth-eaten fabric of ideas of Marxian determinism and the fata morgana of the dictatorially-ruled "paradise for all proletarians." Since these grand ideas have been tried for close to 40 years in a laboratory experiment with several hundred million people, they have lost their luster and gaudy colors.

Today, the economies of industrial and developing countries are mutually interdependent, as is the guardianship of peaceful cohabitation of nations. Hence, while the industrial countries need an adequate and growing flow of primary material from developing countries, they will pay for these, as well as for manufactured goods from light industries, by exporting to those countries an increasing volume of manufactured producer and consumer goods, and will also help them to industrialize gradually.

If this mutually beneficial exchange is to flourish, all nations must act in accordance with their optimal comparative advantage, i.e., the opportunity to produce and sell at lower unit costs. To let this principle work requires optimal diminution or removal of hindrances to trade expansion, not only import quotas and customs duties but the whole arsenal of nontariff trade impediments in lieu of duties.

All the proposed solutions have one common denominator. They suggest that, by setting up international and regional world-wide administrative machinery to control and regulate prices for optimal financial liquidity of developing countries, the pace of raising the income of the poorest people in the most agrarian countries can be accelerated at will, and that more perfect equity and justice in distribution among independent nations can be attained.

A Dubious Device

Perhaps the most persuasive and yet the most dubious proposal to remedy the instability of foreign exchange earnings of developing countries is the device of international commodity agreements, abbreviated in the literature as ICA. This form of intervention in the international market for primary commodities is an excellent example that makes clear where the generating power originates that drives a national economy, and how complex and delicate a self-adjusting system the market economy actually is. When I speak of the market economy, I do not mean a laissez-faire system with no rules, but a competitive private enterprise economy with effective enforcement by the government of regulations, quality standards, and rules for competition.

International commodity agreements are arrangements between contracting governments, aimed at preventing precipitous price declines of a primary commodity on the world market, in order to avoid serious balance of payment and illiquidity problems for the governments of the exporting countries. But the attempt to forestall disastrous price declines also demands that brakes be put on too steeply rising prices, because such increases may unduly stimulate expansion of production, with resulting sharp price declines later.

This remedy for price instability consists basically of a type of market intervention that was adopted in the late twenties and early thirties on the European continent, in the United States, and in other parts of the world: farm income support through guaranteed minimum prices for specified agricultural commodities. These price support policies amount to a compulsory government-controlled cartel, with innumerable variations in detail. Since more than 30 years of experience with this policy have accrued in the industrially advanced countries and in the world market, it is relevant for our discussion to summarize the *modus operandi* and the economic results of this remedial counteraction to price instability.

Once the government supports the price of a commodity, the price can theoretically still move, but only above the so-called "floor" or guaranteed minimum. By political compromise this level is deliberately set above equilibrium, which by definition is the price that would clear the market. The politically set level is meant to be remunerative to the high cost or marginal producers, the low income farmers on whose behalf price stabilization is mainly established. It is therefore unavoidable that the price, and the elimination of any risk of its change by government guarantee, will act as a forceful incentive, especially to efficient producers, to expand the area for the specific crop. To counteract this the government imposes an area limit, the so-called "acreage allotment." Some sort of base is needed for its determination; usually a historical base is chosen, such as each farmer's actual average acreage of the crop cultivated in several base years. However, the common experience in all countries is that the combination of a profitable guaranteed price with the acreage allotment acts as a still more effective incentive for increasing output per unit of land on limited acreage by more intensive farming. More fertilizer, better seed, more irrigation, better pest and weed control, more cultivation, and various other methods are used. Hence, the government has to buy and store more grain to keep the price at the support level.

The Sorry Results

Up to this point the results of this intervention are already remarkable:

1. There is no longer any mobility of the geographical location of production. It is frozen from the moment the allotments are established.

2. The unintentionally subsidized intensification of production has created surpluses that exceed effective demand.

3. Therefore, the government has to finance and operate storage of commodity stockpiles.

4. Hence, the government at taxpayers' expense has entered the commodity business.

5. The price can no longer move upward but is tightly pinned to the "floor." Instead of a price support or the guarantee of a minimum price, one has a fixed, totally inflexible price.

6. This fixed price still governs producers, processors, everybody

in the trade chain, and consumers. The price signals are set in false position for all of them. Although an excess supply exists, everybody can act only according to the price which indicates shortage, namely by consuming less, by substituting other commodities. The processors and the speculative trade reduce stock carrying because the government keeps the excess stocks at public expense.

7. In other words: without any intent to do so, the government has socialized stock carrying.

8. As a further result, the most effective commodity price and supply stabilizing institution, the commodity exchange with its trading in future delivery contracts, is made idle.

However, even those are by no means all the side effects. The Treasury has to pay for moving the commodity into and out of storage and for storing it, as well as for losses when the surplus is disposed of. Thus, there are innumerable secondary beneficiaries of stockpiling excess output, such as railroads, truckers, labor union members, and many others. All these receivers of windfalls acquire a vested interest in maintaining farm price supports. Much worse is the fact that the market in farm real estate discounts the subsidy-earning value of the acreage allotment. Hence, price stabilization of farm products boosts the value of farm land; in due time higher land prices and rents on leased land increase the costs of farming and force more intensive use. This is another unintentional side effect.

Marketing Quotas Assigned

When the excess production begins to bleed the Treasury too badly, the next step is to tighten the cartel by efforts to control the supply in the market. In addition to the acreage allotment the government imposes on all farms a marketing quota, which is established by subdividing a national quota prorated in accordance with individual acreage allotments. This national quota is fixed by a precarious government estimate of how large the domestic consumption and the net export may be one year later. Since the marketing quota tends to be smaller than the output, it immediately poses the problem of a black market and the necessity of suppressing it by heavy penalties. Output that exceeds the marketing quota can be stored, converted, or consumed by the farmer, but it cannot be marketed legally. Even in countries with a customarily law-abiding farm population, the temptation to profit by disposing of such illegal supply by barter or other black deals is strong, and actual enforcement is difficult.

The cartel price-fixing for agricultural commodities also unintentionally subsidizes increased production of the same commodity in other countries. Price-fixing thus creates effective competition abroad. Since it is politically unpopular and difficult to lower the guaranteed price level even when costs of production are declining, stabilization by political decision is practically identical with "stabilizing upward."

Finally, the greatest ordeal for the government agency responsible for operating the cartel is the obligation to dispose of the accumulated excess stocks so as not to undermine the fixed price. Such disposal would be simple if it were done by destroying the supply. Grain could be burned or dumped in the ocean, although even this costs money. But powerful social, moral, and political taboos prevent this solution for any major nonperishable food commodity. Only in the case of coffee in Brazil was destruction used as a market-corrective action. Therefore, the government must seek to release the excess of staple food commodities in foreign countries as gifts, on credit, or with lowered prices. Except for the gifts, this amounts to dumping, and has a deleterious impact upon producers in the recipient country, and secondarily on the exporting country's foreign markets and on its foreign economic relations.

A Commodity in Quarantine Still Affects the Market

It is a psychological fact that a commodity kept off the market by a government, in quarantine, so to say, is still a powerful factor influencing both the price and the actions of all parties in the market. Grain "in jail" is still grain, because if it is not destroyed it will in due time appear as market supply.

National commodity markets are a remarkably effective system of communicating vessels in which millions of interested consumers, retailers, wholesalers, speculators, and farmers keep the flow going. The idea of inserting into the market, via detours, major quantities of supply, under perfect quarantine or segregated from the ordinary supply, belongs in the realm of fiction. Only private charity distribution can minimize the impact on the market. Even the ably administrated food stamp plan of the late thirties in the United States proved that free food did not cause additional consumption of food, but actually subsidized consumption of other goods and services. To change the determined consumer's preference in his family budget decisions takes far more than free distribution of goods, the more so the poorer and prouder he is.

The cartel operation produces still other undesirable side effects. In many instances, particularly for industrial raw material products in agriculture such as cotton, jute, hemp, and sisal, the raised fixed price gives the greatest incentive to producers of substitutes. This exerts pressure on consumption of the original product, say cotton, at the expense of the farmer, whose marketing quota will be cut if national consumption shrinks.

The industrial temperate zone countries, which make a virtue out of the backwash of domestic political necessity and subsidize exports of agricultural raw materials such as cotton, thereby slide to the next necessity of granting more subsidies. Manufacturers of cotton textiles, who have to compete in the foreign market as well as in the domestic one, now need a subsidy to restore equal raw material costs. And so there are three recipients of subsidies: the farmer; the exporter of the farm product; and the manufacturer who uses the raw material.

However, I have not nearly exhausted the appalling record of unforeseen and unwanted distortions of economic processes caused by government intervention that attempts to remedy instability of commodity prices. Subsidized surplus disposal by gifts diverted to other countries can assist private charity that reaches the destitute, the sick, and helpless widows and orphans. But it cannot cure the causes of poverty. Only increased productivity on farms, in craftshops, in factories, and in the wholesale and retail trade can do that. It is here that the disposal of surpluses from abroad does its greatest harm. The majority of people in underdeveloped countries are small farmers who earn their cash income by selling farm commodities. Dumping such commodities in their market may be a boon to some of their customers in the cities, but the farmers resent it, and it diminishes the incentive for them to produce more.

One Control Leads to Others

I have yet to give the reasons why I believe that, whatever action may be taken to mitigate the impact of unstable commodity prices on the balance of payments of developing countries, the International Commodity Agreement method is not only inadequate and dubious but outright harmful to the best interests of the developing countries and to world trade in general. Basically, the sobering experience of sovereign governments of advanced nations with this enigmatic cartel policy in their national markets applies also to the immeasurably more difficult situation in the international commodity market.

The worst feature of all market intervention with price fixing is that, while dealing with one commodity or a few closely related commodities, this inevitably changes the relations between the price of the regulated commodity and the prices of all other commodities and services. The insertion of one rigid price into a range of flexible prices for some 160 or 170 agricultural products is like a boy who knows nothing about the meaning or the effects of the different positions turning switches at the control board of an automated factory. The far-reaching adjustments that farmers and all other affected parties must make to the accidental price relationships caused by fixing the price of one commodity are unpredictable. Therefore, such isolated treatment of the price mechanism for one country contributes more uncertainty tomorrow than there was instability prior to price fixing. The case for all such trouble-multiplying cures rests on the assertion that the adjustment of supply and demand under the rule of flexible prices does not function – an assertion that contradicts all evidence and economic experience.

The intent of stabilization is realized so long as the stabilization is upward. When, however, larger stocks have been accumulated and their disposal is unavoidable, the same consequences arise as in the case of price supports in domestic markets. Necessity commands that besides regular commercial sales, concessional sales be undertaken, or part of the supply be given away. This procedure leads to serious disorganization and corrosion of markets. The United States, with $6 billion worth of agricultural exports, disposes of over 30 per cent in the form of concessional deals. This is not done on principle. Far from it. It is simply the accumulated backwash of an ill-chosen method of social income support.

Enforcement of ICA regulations is even more difficult than is enforcement in single countries. When one begins to speak of "policing the markets of coffee beans," I wonder how one dares suggest the feasibility of such control in vast areas where the United Nations is faced with the problem of preventing the murder of rural people by armed bands.

Problems of the Board

Aside from the dubious state of effective government administration, a serious question is whether competing countries can possibly agree on export or production quotas and thus freeze the geographical location of production, or administer shifts in location. The board of an ICA must try to achieve principles of equity and justice for all signatory parties to the multigovernment cartel. Originally, commodity agreements included exporting countries only and thus represented producer interests exclusively. They led to defensive policies by importing countries and their effect was nullified. Naturally, the enthusiasm of producers diminished as consumers won equal representation on ICA boards. Yet, without importing governments, such cartels are doomed.

Today, all such agreements include major importing as well as exporting countries. This demands far more wisdom than the fairest and ablest board possesses. Suppose one exporter earns 80 per cent of foreign exchange from the commodity, another 20 per cent. When quota restrictions are necessary to raise the price, will the exports from both countries be cut by the same percentage? If not, what principle shall determine the degree of discrimination and the number of years it shall last? If drastic changes in costs of production or handling or transportation of the regulated commodity occur, which apply to one or more countries but not to all, shall all nevertheless receive the same price? If the commodity comprises a range of qualities, with lower grades produced at disproportionately lower costs, shall quotas treat all the same? Such questions indicate that ICA's are bound to end up with all kinds of soft political compromises on the main points of control over supply, and even of price arrangements.

Subsidizing the Competition

As soon as there is a serious contingency of substitution for the commodity by other natural, processed, or synthetic products, ICA price stabilization begins to sound the death knell for the original commodity. I indicated earlier that in many cases price supports operate, via detours of economic processes, to the long-run detriment of the cartelized producers. To prove my point that ICA's may become deadly poison I have only to mention the cases of rubber, wool, linseed oil, or tungnut oil.

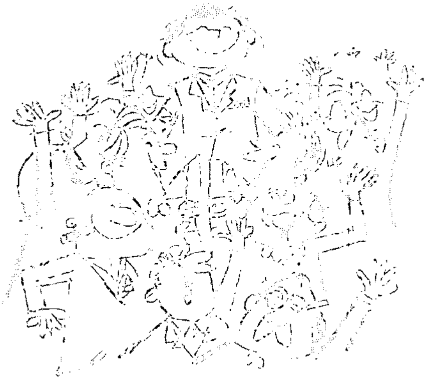
Natural rubber was one of the commodities on which price stabilization ideas were tested in a world-wide experiment under Dutch and British management. The attempted producer-exporter cartel was mainly instrumental in pushing rubber plantations into other tropical areas, in stimulating experiments with other latex-yielding crops, and in boosting synthetic production of plastomers with large government subsidies in industrial countries. To kill the remaining industrial use of linseed oil, tungnut oil, or soybean oil, one need only fix the prices internationally.

Five ICA's are at present in existence: on wheat, sugar, coffee, olive oil, and tin. Only four, excluding olive oil, are important. The one for wheat is proclaimed by its supporters the outstanding success. It can be proved beyond discussion that the ICA's for wheat, sugar, and coffee amount to no more than sanctimonious declarations of good intentions. They have neither stabilized the incomes of the exporting countries nor avoided the whole range of unintentional distortions of world trade that do far more harm than good. Insofar as the wheat agreement has given some semblance of stabilizing price – though not income – it was due to the fact that the governments of the United States and Canada shouldered the burden of carrying the gigantic excess stocks. But both governments have had to enter into a multitude of noncommercial disposal arrangements that violate the principles of truly competitive international trade.

There is one little defect in all plans for administering economic progress at specified growth rates, which the econometricians usually fail to mention: no genius, no power in this world, has the ability to forecast the future supply, the demand, or the price for any commodity, or to predict the performance of one or of many national economies one, three, or five years from now. The most fabulous computers have not changed this situation one bit. We now know much faster and more accurately what has happened up to today. But as to the future, we get the wrong guesstimates also much faster, and with more scientistic trimming.

Restrictive compulsory cartel policies that raise prices to benefit high cost producers and artificially throttle output and supply to maintain such arbitrarily fixed prices, belong in the tool chest of the static society and its dirigism. Such policies are technically possible, but they are the antithesis of what the dynamic economy of an open and free humane society requires.

I expect much sound development in those primary material exporting countries that succeed in taming the monster inflation and, relying on their producers' ability to compete, pave the way for sound private investment of foreign capital, as the transfer of funds from government to government diminishes. ◈



WINNER Take All!

EDMUND A. OPITZ

THE CENSUS of 1960 turned up one hundred and ninety million souls living in these United States. Of this number, roughly one hundred and eight million qualify to register as voters. This is 56 per cent of the nation, and this body of people constitutes the electorate of the United States. But, of the number of persons eligible to register, only eighty-one million have actually done so; twenty-seven million have not, for reasons ranging from indifference to intimidation. The total vote cast in the 1964 Presidential sweepstakes was roughly sixty-nine million. This is 64 per cent of the electorate, but it is only 36 per cent of the population. The 1964 election was won by a candidate who garnered forty-two million votes. This figure translates into 60 per cent of the votes cast, 51 per cent of the registered voters, 38 per cent of the electorate, and only 22 per cent of the population. This is "the majority" which, in the eyes of some political theorists, confers a mandate on the victorious party to impose its program on the reluctant "minority" of the nation, that is, on the other 78 per cent!

This is the theory of majoritarianism, ardently espoused by some articulate intellectuals. Here, for example, is Professor James McGregor Burns of Williams College. Dr. Burns declares that "... as a liberal I believe in majority rule and majority rule is a question of adding up 'bodies' (or, I hope, adding up minds)." Professor Burns believes that men who embrace the conservative position have thereby foresworn what he calls the numbers game, this game having been staked out by liberals as their very own. "Because as

The Reverend Mr. Opitz of the Foundation staff is active as a lecturer and seminar leader.