Maryland Journal of International Law

Volume 4 | Issue 1 Article 25

Stabilization of Commodity Prices and Export Earnings: The Coffee and Sugar Agreements

Louis M. Goreux

Follow this and additional works at: http://digitalcommons.law.umaryland.edu/mjil

Part of the International Trade Commons

Recommended Citation

Louis M. Goreux, *Stabilization of Commodity Prices and Export Earnings: The Coffee and Sugar Agreements*, 4 Md. J. Int'l L. 140 (1978).
Available at: http://digitalcommons.law.umaryland.edu/mjil/vol4/iss1/25

This Conference is brought to you for free and open access by DigitalCommons@UM Carey Law. It has been accepted for inclusion in Maryland Journal of International Law by an authorized administrator of DigitalCommons@UM Carey Law. For more information, please contact smccarty@law.umaryland.edu.

STABILIZATION OF COMMODITY PRICES AND EXPORT EARNINGS: THE COFFEE AND SUGAR AGREEMENTS

*Louis M. Goreux**

Coffee and sugar are a major source of foreign exchange earnings for many countries of the Caribbean Basin which are concerned with the wide price fluctuations of these two products. During the post-war period, several international commodity agreements aiming at stabilizing the prices of coffee and sugar were made, but they failed to moderate the sharp price increases which occurred for sugar in 1974 and for coffee in 1976–77. A new International Sugar Agreement was negotiated in October 1977 after sugar prices fell from fifty-five cents per pound in November 1974 to about seven cents, and serious thought is now given to the revision of the International Coffee Agreement.

The first section of this paper reviews the price history of coffee and sugar. The second part draws a parallel between national and international measures of price stabilization. The third and fourth sections deal, respectively, with export quotas and buffer stocks. Finally, the last part shows the need for stabilizing both earnings and prices. The importance of coffee and sugar for the countries of the Caribbean Basin is illustrated statistically in the Annex.

PRICE FLUCTUATIONS

The depression of the 1930s followed by the closure of many export outlets during World War II kept coffee prices and new coffee plantings at very low levels from 1930–1945. For that reason, world coffee production was no greater in 1950 than in 1930. With the rapid European post-war recovery, demand for coffee outstripped supplies by the early 1950s; the coffee surplus was replaced by a coffee shortage and prices sky-rocketed in 1954 after it became clear that the Brazilian crop had been seriously damaged by the frost. High prices from 1950 to 1957 stimulated coffee plantings which consequently led to a surplus situation and low prices from 1960 to 1974. This period of low prices discouraged investments and, in turn, paved the way for the price explosion of 1976–77 which followed the frost of 1975 in Brazil.

Fluctuations of sugar prices on the free market were even wider than those of coffee because of the residual character of the free sugar market.[1]

---

* Assistant Director, Research Department, IMF.

1. Seventy percent of world coffee production is internationally traded. Only one-quarter of world sugar production is internationally traded and only one-

As the price of sugar on this market remained below production costs during the second part of the 1960s, investment in the sugar industry was discouraged and this led to the 1974-75 sugar shortage. In turn, the peak prices of 1974-75 induced exporters and importers alike to boost their sugar production capacities and this led to the present surplus situation.

INTERNATIONAL VERSUS NATIONAL PRICE STABILIZATION

With the elasticity of demand for sugar and coffee in relation to prices being low, a small increase in the volume of world exportable supplies induces a price decline which, percentage-wise, is much greater. Since the increment in the volume of exports is more than offset by the price decline, a large volume of exports leads to a low level of export earnings. The fact that farmers' incomes go down when their harvest is plentiful and that farmers' incomes can be restored by restricting supply is not new; it has been known since the seventeenth century as the Law of Gregory King.

Today, farmers in industrialized countries are protected, at least to some extent, against the vagaries of the market. Such protection results in some cases from government intervention when the prices of certain commodities fall below an agreed floor price and, in other cases, from "deficiency payments" to farmers when their income falls below an agreed parity level. The level of such protection is generally greater in rich countries than in poor which suggests that the power of the farm lobby does not fall when the number of farmers declines. Can such a system be applied internationally to protect the interests of primary exporting countries?

The system of deficiency payments, which aims at protecting farmers' income in industrialized countries, has been successfully transposed from a national to an international context. Under the IMF compensatory financing facility, balance of payment financing is made available at low costs when the value of a member's aggregated export earnings falls below the trend; the member repays when its export earnings rise above the trend. This facility was widely used in 1976 when forty-five countries drew a total amount of $2.7 billion. Similarly, under the STABEX System of the Lomé Convention, countries associated with the EEC can receive loans or grants when they experience shortfalls in their export earnings from specified commodities.[2] These two interna-

---

eighth of it enters the free market; the remaining part is traded under special arrangements with the United States, the EEC and the U.S.S.R.

2. In the IMF scheme, shortfalls relate to earnings from all merchandise exports to all destinations. In the EEC scheme, shortfalls relate to earnings derived from exports of specified commodities to the EEC.

tional schemes are easy to operate because they are limited to financial transfers and do not interfere with the markets or any trading arrangements.

Stabilizing world commodity prices is more difficult than administering an international scheme of compensatory financing. In order to raise world prices, the international commodity agency has to reduce the volume of export supplies either by enforcing tighter export quotas, or by acquiring stocks and withdrawing them temporarily from the market or by combining both actions. In order to lower prices, the agency can only release the stocks it had previously acquired. These operations have to be conducted in accordance with an international commodity agreement which is an international treaty. Such treaties are not easy to negotiate since they involve a large number of importing and exporting countries.

EXPORT QUOTAS

To adjust world export supply with world import demand, buffer stock operations should ideally be combined with the coordination of national production and investment policies. Because such coordination is very difficult to achieve,[3] export quotas are used instead as the main instrument for raising prices in times of commodity surpluses.

A commodity agreement cannot restrict trade among nonmembers of the agreement, but it can and it has to restrict the quantities that members can import from nonmembers. Otherwise, exporting countries would have no incentive to join the agreement since, by remaining outside, they could benefit from higher prices without having to restrict the volume of their own exports. Restrictions on imports from nonmembers are discriminatory trade practices, but they are considered as acceptable according to the GATT as long as they are not a vehicle for unjustifiable discrimination between countries.

During the course of negotiations, one of the most sticky problems usually deals with the distribution of basic quotas (or market shares) among exporting countries and the provisions for adjusting them over time. This was the stumbling block in negotiating the 1977 Sugar Agreement, and the quota issue was resolved only at the very end of the sugar negotiation. A line has to be drawn between what should be left open for later decisions through the commodity council. This can be illustrated by the provision for adjusting the quotas applicable during the last three years of the 1977 Sugar Agreement. One solution would have been to reopen the full negotiation of country quotas after the second year of the agreement. This solution was rejected because it could have had the

3. Coordination of national production policies has been attempted under the 1971 International Coffee Agreement but the results were not very encouraging.

effect of reducing the duration of the agreement from five to two years. This risk was avoided by specifying a fall-back formula for determining future quotas in the event that the quota renegotiation failed. By taking into account recent export performances, this formula avoided freezing market shares among the exporting countries joining the agreement.

The 1977 Sugar Agreement aims at stabilizing prices between eleven and twenty-one cents per pound and export quotas are enforced only in the lower part of the range. They are tightened progressively as prices fall below fourteen or fifteen cents per pound and loosened progressively as prices return back to fourteen or fifteen cents per pound. Above this level, exports are not restricted by quotas.

BUFFER STOCKS

Export quotas can be used only to defend the floor price but buffer stock operations can be used to defend both floor and ceiling prices. Under the International Tin Agreement, the only one with a buffer stock history, stocks are internationally owned. Exporting countries contribute in the form of foreign exchange which is used by the buffer stock manager to buy tin on the world market. Conversely, in the 1977 Sugar Agreement, stocks remain owned by exporters but are controlled by the International Sugar Organization. Members must accumulate minimum amounts of stocks and hold on to them until the price has reached nineteen cents per pound. Exporters have to produce certificates of existence from their government by the end of each month, and certificates must be verified by on-site inspections at least once a year. On the basis of the monthly level of stocks thus established, exporters receive interest-free loans covering the physical cost of storing the sugar. The loans are extended by a sugar fund receiving the proceeds of a sugar levy which, ultimately, is paid by both exporters and importers.[4]

Whether stocks are nationally or internationally owned, the financial implications for exporting countries would be the same, provided the international control of national stocks were tight enough and the manager of the international buffer stock returns any unused cash balance to members.[5] This was the reason for allowing IMF members to use the Fund's buffer stock facility on account of cash contributions made

---

4. The incidence of the levy depends on the relative values of the price elasticity of the import demand and the export supply.

5. The currencies contributed by exporters return to exporters in the form of export receipts when the buffer stock manager uses these currencies to buy the commodity. In the absence of any lag, the effects on the balance of payments of exporters would be the same whether stocks were nationally or internationally owned.

to the tin buffer stock and of sugar stocks held nationally but controlled by the International Sugar Organization.

The 1976 International Coffee Agreement does not contain any buffer stock arrangement. Consequently, restricting export supplies by imposing export quotas implies an increase in the level of stocks held by exporters. Several exporting countries would like to receive financial assistance for holding such stocks, and some importing countries consider that the constitution of reserve stocks when coffee is in surplus would provide a useful hedge against sharp hikes in time of shortages. Following the peak of April 1977, coffee prices had already declined by one-third and they are likely to decline further, provided the Brazilian harvests of 1978 and 1979 are not hampered by frosts. If a coffee surplus were to develop, the 1976 Coffee Agreement might have to be amended along the lines of the 1977 Sugar Agreement so as to include a system of stocks nationally owned but internationally controlled.

CONCLUSIONS

World prices are of no help in planning investments when they fluctuate as widely as the prices of coffee and sugar have done during the last ten years. A major objective of international commodity agreements is to reduce the amplitude of price fluctuations and to break the commodity cycles where periods of surpluses alternate with periods of shortages. Commodity agreements are, unfortunately, difficult to negotiate since they are international treaties among a large number of importing and exporting countries — many of them with diverging interests. Moreover, the measures for attaining the stabilization objectives set in the agreement are not foolproof. Prices are today above their respective ceilings for coffee, cocoa and tin and below the floor for sugar. So far, it has been possible to stabilize world prices only to a limited extent and for a limited number of commodities. It seems, therefore, reasonable to combine price stabilization through commodity agreements with export earnings stabilization through compensatory financing schemes which are easier to administer. The countries of the Caribbean Basin have drawn 268 million Special Drawing Rights (SDRs) under the Fund's compensatory financing facility during 1976 and 1977. The same countries may draw up to fifty million SDRs under the Fund's buffer stock facility on account of their stocking obligations under the 1977 International Sugar Agreement.

ANNEX

THE IMPORTANCE OF COFFEE AND SUGAR FOR THE COUNTRIES OF THE CARIBBEAN BASIN

Coffee and sugar together account for over one-half of earnings from all merchandise exports in the case of four countries of the Caribbean Basin (the Dominican Republic, Belize, El Salvador and Colombia) and between one-half and one-quarter in the case of six other countries (Guatemala, Guyana, Haiti, Barbados, Costa Rica and Panama). Exports from the Caribbean Basin represent thirteen percent of world sugar exports and thirty-one percent of world coffee exports. After petroleum, coffee is the most important export commodity for developing countries. World coffee exports reached the record level of $12 billion in 1977, but the value of world exports of sugar and coffee were about the same in 1976 when sugar prices were at their peak.

Approximately one-half of coffee and sugar exports from the Caribbean Basin is imported by the United States which has played a key role in the various multilateral arrangements for these two products. All producing countries of the Caribbean Basin and the United States have been members of the International Coffee Organization since 1963. Most of the sugar from the Caribbean Basin was exported until 1973–74 under the U.S. Sugar Act or the Commonwealth Sugar Agreement. The latter was replaced after 1974 by the Sugar Agreement between the EEC and associated members under the Lomé Convention. Since the beginning of 1978, the free market for sugar has been regulated by the 1977 International Sugar Agreement with the participation of all countries of the Caribbean Basin and the United States. Under this Agreement, ten countries of the Caribbean Basin have minimum stocking obligations and can make use of the Fund buffer stock facility for a total amount of up to fifty million SDRs.