Common Fund for Commodities

The role of banks and regulators

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Commodities: the first development issue?

1949: Singer and Prebisch
1933: International Tea Agreement (ITA)

- Developing countries as commodity *exporters*
- Interest in stable and 'remunerative' prices
  - ICAs written into ITO and GATT in 1940s
  - UNCTAD from 1964

Supply management, private and public

Private examples:
- Aluminium producer prices (until 1984)
- Central Selling Organisation (diamonds: De Beers)

Public examples:
- International Tea, Wheat, Tin, Coffee Agreements
  - started in 1933, ended in 1989
- Canadian milk, poultry and eggs – up to the present

Futures market regulation

Also originated in 1930s
- Agricultural crisis in U.S.
- Specific regulatory bodies to ensure that speculation is kept within bounds
  - Commodity Futures Trading Commission, founded 1975

Techniques:
- Public reporting of market activity
- Distinguishes between 'commercial' and 'non-commercial' business
- Controlled through position limits on the exchanges

Commodity markets are *volatile*

Various mechanisms are available to cope with this

e.g.:
- **Buffer stocks or quotas** to improve the balance of supply and demand
- **Futures contracts** to lock in prices for individual agents
- **Guaranteed markets**, e.g. ACP sugar and banana protocols
- **Compensatory finance**, e.g. EU's Stabex fund
- Trade with **neighbours**, grow **'non-traded' crops**
- And others besides…

Agricultural policy?

"Since the accession of the UK to the European Community, and the incorporation of the UK into the Common Agricultural Policy, grain price volatility has been greatly lessened, reducing the need for a futures market."

\- Michael Atkin
Agricultural Commodity Markets: A guide to futures trading (Routledge, 1989), p. 56

Growth of European derivatives and commodity markets since late 1970s

New markets:

- ❑ Financial futures from 1982
- ❑ Other financial derivatives from mid-1970s
- ❑ London Metal Exchange adds Al, Ni contracts
- ❑ LME moves from forward to futures trading
- ❑ Oil futures
- ❑ New agricultural futures markets, e.g. Paris wheat, rapeseed, maize (corn)
- ❑ But some markets moved to producer regions, e.g. tea auctions, natural rubber futures

Growth of European derivatives and commodity markets since late 1970s

New instruments

- ❑ options, swaps, index funds

New institutional structure:

- ❑ Over-the-counter (OTC) trading
- ❑ Exchanges demutualised
- ❑ Most (but not the LME) were amalgamated or taken over by international groups
- ❑ Commodity broking was integrated with:
  1. Other areas of commodity business
  2. Investing banking and hedge funds
     - ❖ Now dominated by the banks

Keep commodity markets for commodities

1. Regulate commodities separately from finance
2. Restrict banks to banking functions
   - Implications, e.g. for over-the-counter trade, exchange-traded funds
3. Make the trade transparent
   - Regulator should publish transactions data
4. Restrict 'non-commercial' transactions
5. Stability and security
   → central clearing; position limits

Effects on commodity-dependent developing countries

Most now are commodity exporters *and importers*
- e.g. of fuel and foods

➢ Their interests are more complicated
- distributional impacts of food price changes

Likely effects of tighter regulation:
- Markets become easier to 'read'
- Participation more dispersed
- Fundamentals are better reflected in prices
- Prices less volatile – and maybe lower
  - implications for exports as well as imports?