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# Tropical Commodity Agreements and Structural Adjustment

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## Abstract

This paper examines the links between the abandonment of International Commodity Agreements (ICAs) in the late 1980s and 1990s and the development of structural adjustment policies over the same period. It points to two distinct phases in international development policy, the decisive break taking place around the onset of the Debt Crisis in 1982. Until that time, concerted attempts to stabilise and ameliorate the prices of developing countries' commodity exports had been a central part of much development thinking. But the switch in intellectual fashion towards pro-market economics, combined with the chaotic collapse of the International Tin Agreement in 1985, led to the progressive abandonment of such agreements in subsequent years. The World Bank's Structural Adjustment Programmes (SAPs), in concert with IMF stabilisation packages, encouraged export orientation and the abandonment of parallel domestic instruments of state intervention, such as produce marketing boards.

The paper argues that the SAPs and the ending of market intervention by the ICAs were parts of the same trend in policy, but it would be mistaken to think that one was caused by the other. However, export orientation and the liberalisation of commodity markets contributed substantially to the collapse of commodity prices over these years. By the early 21st century the failure of free markets to meet development goals in this area had become more apparent than ever, leading to a renewal of interest in the "commodities problem" after many years of neglect.

## A change of regime

The years 1980-86 were critically important for international economic policy. Although it did not seem apparent at the time, they were years in which the post-World War Two order was ended and the new institutions of market-led globalisation began to be installed. Concerning the place of developing countries in the world system, this included the beginning of the collapse of the International Commodity Agreements (ICAs) which stabilised the markets in several major commodities on which developing countries depended for their exports. A new type of market-centred international policy, designed and led by the World Bank and the International Monetary Fund (IMF), was soon in the ascendancy, with the Bank's Structural Adjustment Programmes (SAPs) playing a central role.

This paper will examine how and why that change occurred, and why at that particular time. The next section will offer a brief chronology of events affecting international policy for North-South trade between 1980 and 1986, and it is followed by two sections which will discuss the fate of the ICAs and then examine the role of structural adjustment in creating a new order. There is then a section describing the wider context in which these changes were initiated. The final section examines the situation 20 years later, with much of what structural adjustment stood for now discredited and the commodities trade rising back up the agenda of economic development after some 20 years of neglect.

## The chronology

This section lists the main events which affected the politics of North-South trade between 1980 and 1986, leading to the fall of the ICAs and the introduction of SAPs by the World Bank, accompanying the economic stabilisation policies of the IMF. The chronology begins with the accession to power of Margaret Thatcher's Conservative government in the UK, since it pioneered the change in the philosophy of economic policy.

1979 — Margaret Thatcher's first government is elected: cuts back the welfare state, foreign exchange controls, regional policy and other forms of government intervention in order to give freer rein to market forces. Mrs Thatcher was Prime Minister until 1990.

1980 — The World Bank makes its first Structural Adjustment Loan, to Turkey, and a few months later publishes a report by Elliot Berg, which proposed a radical programme to open up developing countries to market forces in order to achieve "accelerated development."

The effective defeat of proposals to create a New International Economic Order more favourable to developing countries. A conference in Manila to establish an Integrated Programme for Commodities ended with a watered down version.

Ronald Reagan elected President of the USA, on a similar economic platform to Mrs Thatcher's. The two became firm allies. President Reagan served from January 1981 to January 1989.

1981-82 — International recession leads to a sharp fall in demand for primary commodities, oversupplies and falling prices.

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| 1982 | Mexico is unable to keep up payments on its external debts, heralding the start of International Debt Crisis. |
| 1984 | Alcan, the Canadian-based producer of aluminium and bauxite, abandons its international aluminium reference price which had served as the basis for aluminium and bauxite pricing around the world. |
| 1985 | The International Tin Agreement (ITA) collapses in disarray as it is unable to continue financing its buffer stock to support the price. |
| 1986 | The World Bank's *World Development Report* contains a long chapter on agricultural trade and prices, which can be seen as a manifesto for policies of market opening, trade liberalisation and export orientation. |
| | A new round of negotiations of the General Agreement on Tariffs and Trade (GATT) starts at the Uruguayan seaside resort of Punta del Este, leading eventually to the foundation of the World Trade Organisation in 1995. |

## The ICAs and the old order

International policy on development can be divided into two distinct phases, with the break coming at Mexico's moratorium on debt repayments in August 1982. This gave a new leverage over developing countries' policies to the international financial institutions (IFIs), especially the IMF. The ICAs were part of the framework established in the 1950s, strongly influenced by the economists John Maynard Keynes and Raúl Prebisch. They were set up to combat the inadequacies of the commodity markets and provide developing countries with greater certainty as to their export earnings from them. They owed their origins to the collapse in prices of primary commodities during the 1930s Depression. Commodity markets, whether for agricultural or mineral products, have long been known for their unstable prices, and Prebisch in the 1940s was one of the men who identified a tendency of commodity prices to fall vis-à-vis other prices over a long period. The other was Hans Singer, who was directly associated with Keynes at Cambridge in the 1930s. Long thought controversial, the Prebisch-Singer Hypothesis has been sadly vindicated by the collapse in prices during the last 20 years.

One of the mechanisms which Keynes proposed at the Bretton Woods conference in 1944 was a programme of commodity price supports under the International Trade Organisation, a projected sister to the World Bank and the IMF. The ITO was negotiated in detail after the war, but the US failed to ratify it. All that was rescued was the section on reducing tariffs, mainly in industry, which became the GATT. However, after 1950 the United Nations picked up the baton and worldwide agreements were negotiated in sugar, tin and wheat. The first ICAs aimed to even out price fluctuations by buying stock off a market at times of surplus and falling prices, and selling it back when a shortage develops and prices rise again. On the tin market, the ITA did this by means of a buffer stock, financed by the producer and consumer countries which were parties to the agreement. This is directly comparable to the Keynesian use of counter-cyclical fiscal policy to even out fluctuations in national demand.

Commodity market intervention received a further boost in 1962 when the first International Coffee Agreement was negotiated at President Kennedy's behest; he

was concerned that unstable coffee prices might promote sympathy in Central America with the revolution in Cuba. The International Coffee Organisation (ICO) started operations in 1964. Because coffee is perishable, it operated not with a buffer stock but export quotas, shared out among the producing countries and periodically revised in line with market trends.

In 1975 the developing countries persuaded the U.N. General Assembly to pass a resolution for the creation of a New International Economic Order (NIEO), more favourable to their needs. A central element was to be an Integrated Programme for Commodities (IPC), which would set up a series of new ICAs on various markets, financed by a so-called Common Fund. This arrangement was finally agreed at Manila in 1980, but without enough money in the Fund to pay for an effective programme.

ICAs provide a form of supply management. This refers to any concerted technique which takes supplies off a market, or puts them back on it, in order to influence price movements. It has taken many forms, including the De Beers company's control of diamond distribution and the Organisation of Petroleum Exporting Countries' (OPEC's) operations on the oil market. Other examples were the control of prices by the aluminium and nickel TNCs until the 1980s. Those examples all worked quite differently from each other: that is no accident, as every commodity market is different. The ICAs are unusual in that they are based on cooperation between the consumer and producer sides of the market; most supply management is conducted by powerful players at some point along the supply chain, be they producers in cases like OPEC, De Beers' Central Selling Organisation and the aluminium corporations, or operators at the buyers' end of modern supply chains, for example the coffee-roasting companies and the supermarkets.

The ITA was long regarded as the model agreement among the ICAs. It operated with little controversy for 30 years before its collapse in 1985, and achieved what no other ICA did: not just to stabilise the tin price but to keep it on a rising trend in real terms. However, this came at a cost as the tin market expanded in volume more slowly than other commodities, such as aluminium, in which a commercially run form of supply management worked along different lines: since aluminium was a recently discovered metal, the corporations that produced it invested heavily in research and development and made sure that the price was not only stable but relatively cheap. In this way they were able to persuade industries to replace older materials with aluminium. An example was the displacement of three-piece, tinplate beverage cans by two-piece aluminium ones during the 1970s and 1980s.

The ITA owed its longevity in part to political factors. Tin is not a particularly big market, so financing the buffer stock was not especially onerous for the consumer members. The three major low-cost producers, Malaysia, Thailand and Indonesia, felt something of a common cause for geographical reasons; as recently as July 2005, Malaysia and Indonesia signed a new pact to cooperate on commodity markets.[1] Support for tin prices also enabled production to keep going in high-cost Bolivia, where few development alternatives were seen, and – perhaps of greater political consequence – in the economically laggardly region of Cornwall in the UK. This, coupled with a paternalistic post-colonial concern for Malaysia, guaranteed the support of the consumer country in which the leading tin market (the London Metal Exchange) was based.

The basis in agreement between producing and consuming countries was both a strength and a weakness of the former ICAs: a strength in that once agreement is struck it is more likely to prove effective, but a weakness in that it can take longer

[1] *Business Times* (2005).

to reach agreement, the formalities can be cumbersome, and powerful players on either side of the market can easily wreck it if they decide to pull out. A further weakness lay, ironically, in their one-size-fits-all nature – the very fault which SAPs have routinely been accused of. While there are some markets where an ICA provides the best mechanism available, there are others where other methods of supply management are probably more suitable.

In the end, for all their differences, both the tin and aluminium price arrangements were brought down by the same cause: the severe recession of the early 1980s, which reduced industrial demand and led to large surpluses of raw materials. The aluminium TNCs were soon undercutting the Alcan reference price in all their sales, and in early 1984 Alcan abandoned the pretence of sticking to the declared price. In the case of tin, the recession coincided with one of the periodic renegotiations of the agreement in 1982. The producer-country members wanted quite a large rise in the prices that the buffer stock would have to defend and had some difficulty persuading the consumers to accept this. But this was to prove their undoing, as the higher price band impelled the buffer stock to make very expensive tin purchases over the next couple of years to defend the floor price. In 1985 the consumer members refused to finance this any more and the agreement went very publicly bankrupt.

It was little more than a fiasco, so embarrassing that it undermined confidence in commodity agreements in general. That gave encouragement to the free-market thinkers behind the governments of the two countries that are at the centre of the commodities trade, the US and the UK. In 1989 the Common Fund for Commodities was finally established, but it was a mere shadow of what was first proposed under the Integrated Programme for Commodities. Bit by bit, as other ICAs came up for renewal, they found that either they had to abandon their market-intervention clauses or the US withdrew. In the case of the Coffee Agreement – perhaps the most important of them all - both happened. The ICO still exists as a forum for countries involved in the coffee trade, but since the 1989 Agreement it has had no "economic clauses" allowing for export quotas. The export quotas in any case had led to frictions between producer members as they haggled over the sizes of quotas. This was particularly marked when new countries were admitted, as established exporters were reluctant to give up market share to them. By the end, the enthusiasm of some of the exporting countries was therefore in any case waning.

## Forming a new order

If the decline of the ICAs symbolised the end of the early period of development thinking, structural adjustment looked forward to the new, market-led approach. During the 1970s there was much discussion about approaches to economic policy, and after Mrs Thatcher's government introduced new policies in the UK, a similar reappraisal concerning development policy took place at the World Bank. In 1980 it published a report by the economist Elliot Berg, which said development could be "accelerated" by overcoming market "distortions" arising from protective tariffs and other obstacles to free trade. The Bank argued that developing countries must "get the prices right" to ensure that resources were allocated in the most efficient manner, after which they would be better able to compete on world markets. An essential element lay in redressing the balance between the urban and rural economies, which it was argued were distorted in favour of the cities and industry. To provide the necessary disciplines of the market and to straighten out the

balance of payments, it was considered necessary to concentrate above all on the export market. "Obstacles" to the free operation of agricultural markets, such as government-run marketing boards, were to be removed. A necessary counterpart was the reduction or removal of import tariffs.

This entailed not just a change in the way the Bank thought about development but also in its role. Just as the IMF started to play a more direct role in developing countries' policymaking in the wake of the Debt Crisis, so the Bank also moved into the policy field. Rather than lending for specific objects of development such as ports and dams – much as a commercial bank might do - the Bank decided that policy guidance in favour of the new pro-market approach was required. The economic structures which got in the way of the market had to be reformed, and so the SALs and SAPs were born. The first was provided to Turkey in March 1980, but soon they became commonplace throughout the Bank's area of operation, and for countries at much lower levels of development than Turkey. Meanwhile, the IMF required stabilisation programmes as a condition for receiving its loans. Offered as a means to enable countries to better meet their international financial obligations, they required the reduction of public spending, especially in "unproductive" areas such as health and education, and the removal of tariffs and other "barriers" to free interplay with world markets.

The Bank played a key role in proselytising this way of thinking. Its *World Development Report 1986* provided what amounted to a policy manifesto for agriculture and trade. It attacked at length the taxation of agricultural exports, both actual and implicit: "Some taxation of export crops involves conventional border taxes or quotas, but frequently taxation is a result of the pricing policies pursued by marketing agencies in the public sector."[2] State commodity marketing boards were therefore among the first targets of the reduction in government's role. Finally, the new doctrines acquired the force of an international treaty behind them, when the General Agreement on Tariffs and Trade (GATT) was supplemented by several additional agreements under the World Trade Organisation (WTO) starting in 1995.

## In the background

While there was no direct link between structural adjustment and the collapse of the ICAs, they were both part of the same political movement within the world economy. The explanations are to be found in the wider story of North-South relations. In the years immediately after decolonisation, the countries of Africa, Asia and elsewhere soon became frustrated by the sense that political independence had not released them from *economic* dependence on the rich world. But they did have majority control over one important organ, the General Assembly of the United Nations. They used it to establish the first UNCTAD conference in 1964 and then to turn UNCTAD into a permanent UN body. They took heart from OPEC's success in pushing up oil prices in 1973, and exporters of other commodities tried to emulate it. The "Group of 77" bloc of developing countries pushed the call for an IPC through the General Assembly in 1975, establishing negotiations for an NIEO. In the developed world, policy was probably in greater disarray than at any time since 1945, destabilised by President Nixon's scrapping of the Bretton Woods currency system in 1971, the oil price increases and rising inflation. Nevertheless, the developed countries continued to hold most of the

[2] World Bank (1986), p. 64.

cards. They played for time in the NIEO negotiations and gradually succeeded in drawing most of the substance from the demands.

From the mid-1970s there was a wave of commercial lending to the better off developing countries, using a new system of syndicated loans, to each of which several international banks would contribute. This was lauded as a pioneering example of private-sector finance for development. Many of the bank deposits which were lent on in this way originated in oil-exporting countries. Middle-income developing countries were persuaded it was a good deal since, with developed-country inflation high, the real interest rates they paid on the loans were low or even negative. When deflated by the rate of change in developing countries' own export prices, one estimate put the average real interest rate as low as -11.8 per cent in 1977. But that changed rapidly after 1979, when the US Federal Reserve Board pushed up its interest rates and the main rate on international loans rose to over 16 per cent. This was followed by a sharp recession, leading to a decline in exports from the developing world. So the indebted countries faced a combination of lower export revenues, increased financing payments on foreign debts and the higher cost of oil imports after OPEC's second price hike in 1979. Allowing for the decline in developing countries' export prices, the real rates on their floating-rate foreign debts were estimated to have risen to 15.9 per cent by 1983 – a 27.7 per cent increase in six years.[3] The situation became untenable and led to Mexico's debt moratorium in 1982, followed by severe difficulties for other highly indebted countries, mostly in Latin America, Africa and Eastern Europe.

One feature of syndicated lending lay in the connections it makes between lending banks, and there was a fear that if one major bank was brought down by defaults it could bring down several others with it. The developed countries turned this to their advantage, exploiting the economic weakness which many of the most influential developing countries were now in. There was an established system of rescheduling payments on "official," or government-to-government, debts at the Paris Club, a secretive organisation in which each debtor country individually met its creditors *en bloc*. The same principle was made to apply to commercial debt reschedulings, and found legal support in certain features of the syndicated loan contracts. So rather than the debtor countries forcing the creditors' hands with a collective default, as they might perhaps have done, they were made to accept terms on which to have the repayment periods extended. The creditors would not negotiate at the Paris Club unless and until a debtor country had arranged a standby loan with the IMF, subject of course to the Fund's policy conditions.

The Debt Crisis helped to change the conceptual climate as the World Bank was able to argue more convincingly that it was necessary to replace the import-substitution policies favoured by many of the major debtors, such as Brazil and Argentina, and open their economies up to international competition and world market prices. The policy path attempted in the 1970s, and chosen by the majority of the world's nations in the U.N. General Assembly, was replaced by policies made at the Washington headquarters of the IMF and the World Bank, in which developed countries held the great majority of votes, and especially the United States. Thus what came to be known as the "Washington Consensus" was born. The same market-led, export-oriented philosophy has been steadily entrenched ever since, acquiring during the course of the 1990s the name of "globalisation." The ICAs, as international bodies, fell outside the World Bank's mandate. But they did not sit easily with the new thinking about letting markets operate freely. A new international economic order has been created, but not one

[3] Singh, A. (1986), p. 422.

in which commodity agreements have found a role or which at all resembles the NIEO sought by the developing countries in the 1970s.

## Twenty years on

Barely 20 years after these big changes it is becoming increasingly clear that the story did not end there. There has been no acceleration of development: many of the poorest countries have on the contrary been in steady economic decline. According to the U.N. Development Programme, 10 of the 32 countries classed as of low human development remain poorer than they were before the Berg Report of 1980, and only nine were at their richest in one of the last two years shown (2002 and 2003).[4] There are numerous other indicators of the failure of market-led globalisation, at least as a programme for development. The structure of many of the poorest countries' economies has degenerated, for example in that they process a lesser proportion of their primary commodities output. According to one summary, "The evidence of economic deterioration in the era of structural adjustment … includes declining per capita income and food production, worsening balance of payments, growing domestic resource gaps, diminishing participation in foreign direct investment flows and rising foreign debt."[5] The record is such that when an African critic argued that the IMF and World Bank "have never been interest[ed] in 'reducing' poverty, much less in fostering 'development'" and that "the road to genuine recovery and development begins with a total break with the failed and discredited policies imposed by the IMF and the World Bank,"[6] his article was quickly reproduced on websites all round that continent.

The policies affecting export commodities have failed more comprehensively than most. The mining industry, which used to be a mainstay of several poor countries' economies, especially in Africa, has now largely abandoned them. The prices of both agricultural and mineral commodities have fallen steadily, while the commodity markets themselves function no better now than they did in the 1940s. Right from the beginning many commentators argued that the doctrine of export orientation was fallible. If one exporting country is advised to increase its exports on a particular market it can well improve its position on it; but, they argued, if several do so at the same time they will cause the market to be oversupplied and the price to fall. The evidence indicates that this is just what happened in several cases, with even the absolute value of all exports declining in the worst of them. Thus, while world coffee exports increased from 3.7m tonnes in 1980 to 5.9m tonnes in 2000, their total value declined from US$12.5bn to $10.2bn; and in cocoa, export volumes increased over the same period from 1.1m tonnes to 2.5m tonnes but, with persistent production surpluses, they fell in value from $2.8bn to $2.5bn.[7]

This phenomenon, known as the "fallacy of composition," is still seen. It was recently illustrated in shocking colours in the vanilla trade, after a series of crises in Madagascar, which usually produces up to half of the world's output. In 1994, the IMF required Madagascar to abandon price controls on vanilla and the nation's reserves, amounting to 2,000 tonnes, were then sold. But in 2000 some 25 per cent of the national crop was destroyed in one of the island's frequent devastating

[4] U.N. Development Programme (2005).
[5] Stein, H. (2003), p. 171.
[6] Dembele (2004), p. 5 of 5.
[7] U.N. Conference on Trade and Development (2003), Tables 3.13.3 (p. 158), 3.13.4 (p. 161), 3.14.3 (p. 175) and 3.14.4 (p. 177).

cyclones, as well as more than 100 tonnes waiting for export. The problem was compounded by a political crisis in 2002. The international price went up from $20 per kg in 1999 to $33 in 2000 and then soared to a peak in 2003-04, variously reported as between $180 and $500 a kg. Partly on the IMF's advice, Madagascans planted more vanilla and the island's output roughly doubled, while new growers entered the market in other countries. As global production went up, but higher prices prompted users to cut back consumption, the price fell back to around $40 per kg by 2005.[8]

It would be incorrect to say that structural adjustment brought about the end of the ICAs, but the two developments were closely linked as part of a broad movement of change in the way that international production and trade were ordered. But over the last two or three years there has been an increasing awareness that a new approach is needed. It was heralded by President Chirac of France when he warned in February 2003 that there was a "conspiracy of silence" about the collapse of commodity prices. Since the WTO's Cancún ministerial meeting in September of the same year, there have been signs of a return to the solid front formerly shown by the developing countries, and a growing readiness by them to refuse demands from the North that they see as unreasonable. Central to much of this new consciousness is an awareness of what has happened to commodity prices over the last 20 years, while the international community's back was turned.

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