

ESSAYS IN INTERNATIONAL FINANCE

No. 38, June 1962

CURRENT ISSUES
IN COMMODITY POLICY

BORIS C. SWERLING



INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS

PRINCETON UNIVERSITY

Princeton, New Jersey

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International Finance Section

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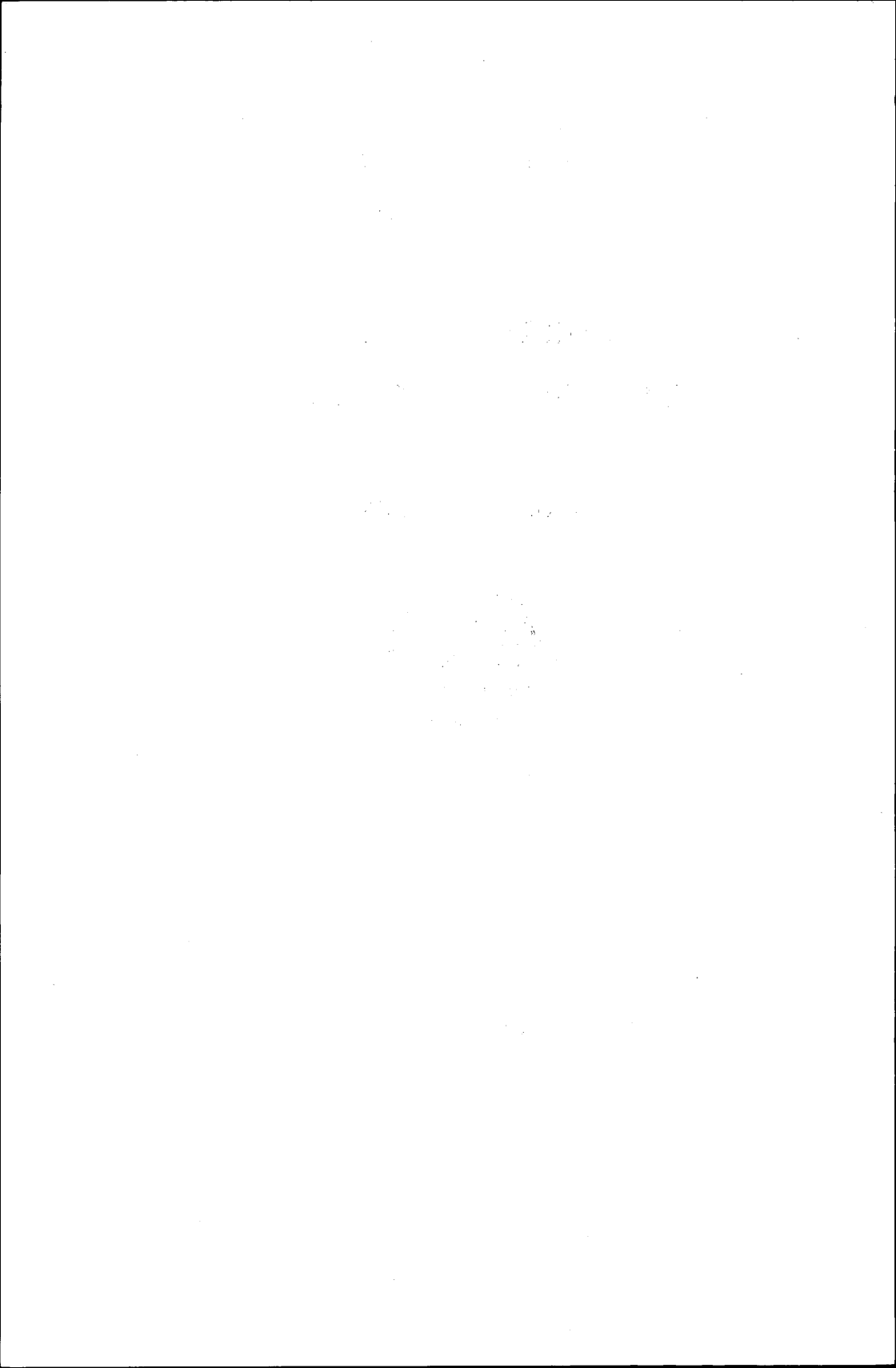


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CURRENT ISSUES IN COMMODITY POLICY

THE treatment of primary commodities poses particularly difficult problems for public policy in the industrial societies of the Western World. Formulation of a common agricultural policy has confronted the original six members of the European Economic Community with one of their severest tests, and complicates the possible admission of the United Kingdom. Historical over-representation of the countryside in legislative bodies inhibits reform of discredited farm policies, in the United States as well as elsewhere. Western Europe is so heavily deficient in domestic supplies that its commercial policies over a broader range of industrial raw materials tend to be less restrictive, though petroleum imports create special problems for the traditional coal regions. A more diversified resource base in the United States places domestic commodity groups more frequently in competition with imported supplies, and extends the list of troublesome products. The Western region seeks public favors for its non-ferrous metals and silver as well as its wool and sugar; imports of petroleum encounter the combined opposition of domestic petroleum and coal; the Southern States are less interested than formerly in a liberal trade policy that promoted exports of raw cotton, and are extremely sensitive to textile imports that compete with their local industry. Members of Congress who espouse liberal political causes simultaneously endorse import quotas or tariffs for individual primary commodities; and those who defend financial orthodoxy, exchange-rate stability, and a balanced budget in the interest of a sound dollar are major defectors on the issue of commodity price supports.

Because the economies of the less-developed countries are so strongly oriented toward export of primary staples, commodity policies have a special relevance to many current problems of foreign relations. It is impossible to ignore the importance of petroleum in the politics of the Middle East; the interest of Southeast Asian countries in rubber, tin, and rice; the pivotal role of coffee among Latin America's exports; or the position of vegetable-oil seeds, cotton, and copper in the economy of particular African nations. The market fortunes of individual products significantly affect the foreign-exchange resources available to less-developed countries for implementing long-range programs for economic

improvement while, at the same time, rampant nationalism in newly independent nations is a continual source of disturbance to commercial markets for world-traded commodities.

The enlarged representation of less-developed countries within the United Nations' membership, by increasing the political leverage of commodity interests overseas, is requiring new accommodations in American policy. By 1958, the Eisenhower Administration had terminated its boycott of the Commission on International Commodity Trade, first established by the Economic and Social Council in 1954, and began to lend a more responsive ear to proponents of international commodity agreements. Particularly in connection with Latin American problems, the new Administration has announced its receptivity to international commodity proposals and has aroused hopes of constructive action. Cocoa and coffee, sugar and wheat, petroleum and lead, tin and bananas do not exhaust the list of products for which international controls exist or are seriously under consideration. The risk is ever-present that the General Assembly, responding to the peculiar democratic calculus of one-country one-vote, will urge precipitous actions and false remedies for complex commodity problems.

Unless new approaches and instrumentalities can be devised in the liberal tradition, the cost to the United States in money and intangibles will be heavy. Certainly nothing could be more unwise than to extend to the international arena the discredited and self-defeating commodity programs that have been operated at home. On the one hand, there is need for wider understanding of the external impact of domestic commodity policies; and, on the other, official review of international commodity measures may lead to certain operational guidelines whose relevance to needed domestic reforms will be too obvious to deny. If the United States does not itself honor the economic precepts and accept the requisite disciplines of a democratic capitalist order, we undermine our own efforts to win men's allegiance in the struggle with Marxist ideology and Communist economic programs.

Trade and Agriculture: Export Considerations

With farming now providing less than 4 per cent of the U. S. national income, the macroeconomist is inclined to regard the sector as of minor importance. That judgment is considerably altered if one focuses on U. S. foreign commerce. Shipments of U. S. farm commodities continue to contribute about one-quarter of our merchandise exports. From an international viewpoint, the major dilemmas of American farm programs arise out of the differential between artificially-maintained domestic prices and the lower prices prevailing for commodities traded in

world markets. The differential requires, on the one hand, various kinds of disposal programs to ensure the export of commodities that would be sold abroad even under free-market conditions and, on the other, tight import restrictions even against products that would not ordinarily be imported into the United States on a strictly commercial basis. Well below half of total exports in fiscal 1961 were comprised of hard-currency sales unsubsidized by the Federal government.

Great ingenuity is being employed in the search for constructive outlets for America's agricultural surpluses, particularly under the Agricultural Trade Development and Assistance Act of 1954, as amended (P.L. 480), whether to meet emergency food requirements or to advance the economic progress of less-developed countries. Rapidly developing countries do have an expanding need for raw materials and food, as well as capital goods, and food may in particular instances be a limiting factor on the rate of general economic growth. Availability of surplus commodities from abroad can on some occasions supplement the kind of project-oriented loan that is issued by the World Bank; on others, it will substitute for emergency borrowing from the International Monetary Fund. Additional resources are enjoyed by the economy; pressure on domestic price levels and the balance of payments is relieved; foreign exchange may be spared to finance other needed imports; a higher level of domestic investment can be sustained; and resources can be shifted to other uses. These and other immediate advantages to the recipient nations can, however, carry longer-term penalties if utilization of imported food and fiber delays the technological transformation of indigenous agricultures, or reduces the incentive to cope with intractable population problems. Programs that supply surplus American food to the world's poor, while simultaneously promising to accelerate economic advancement abroad, make so strong an appeal to our hopes and to our sense of common humanity that rational criticism at home is almost silenced by noble purposes.

Considering the heavy volume of export sales at concessionary prices and the long list of commodities involved, foreign objections to U. S. activities have been surprisingly moderate of late. In part this is because consultative procedures have been developed that remove some of the fear of the unknown and may perhaps also have saved the United States from making some serious blunders. There are other reasons as well. Two commodities experiencing particularly dramatic growth trends since prewar days, inedible animal fats and poultry meat, have moved very largely on a strictly commercial basis. Feed grains are another commodity group showing spectacular expansion in U. S. export shipment. While export subsidies have played some part, the chief incentive

was the need to fill the gap in world supplies of corn that resulted from the disappearance of Argentine supplies in the early postwar period. In wheat, rice, and soybeans, world food shortages similarly justified enlarged American crops in the early postwar years.

In part, the moderate degree of foreign criticism is explained by the impact of U. S. price supports on competing exporting countries, especially those in the less-developed category. For cotton and tobacco, two commodities in which competitive relations with less-developed countries are most direct, domestic programs have operated on balance and inadvertently in favor of foreign areas of supply. In effect, the U. S. price support has acted as an umbrella, placing the supply control necessary to enforce that price largely upon American producers while other countries have won a rising share of the market. For tobacco, surplus stocks have largely been avoided, and export subsidization to date has been minor. Concessionary sales of cotton have operated on a much more substantial scale, including more than one billion dollars under P. L. 480 financing, a peculiar kind of "food" for peace. The United States has, however, served as residual supplier of upland cotton, enduring substantial year-to-year swings in exports in response to variable consumption requirements abroad and changes in U. S. export policy, while less-developed countries have for the most part been able to dispose of their crops on a current basis. Particularly for cotton, probably no single step would have been more disadvantageous to competing exporters than a downward revision in the U.S. price appropriate to the full potential of postwar cotton technology.

The individual commodity most heavily subsidized in aggregate has been wheat (including flour), cumulative sales of which under P.L. 480 alone exceed \$4 billion. Several factors here have worked at cross-purposes: (a) The United States has undoubtedly earned much more than its historical share of this market, although the exporting countries suffering most serious disadvantage (such as Canada and Australia) are hardly in the low-income group; (b) less-developed countries seem to welcome large quantities of P.L. 480 wheat, which far more than compensates them for the unnecessarily high price they must pay for wheat purchased on the commercial market; (c) to the extent that subsidized wheat has made permanent inroads into oriental markets, there have been changes in tastes adverse to the rice-exporting nations of Southeast Asia.

Some of these more agreeable judgments have to be considerably qualified in the light of higher support levels established for 1961 crops. The rise in price supports for grains comes at a time when the most serious consideration is being given to the level of agricultural protec-

tionism that will prevail within the European Economic Community, a matter of extreme importance to the potential commercial market for American grain. The United States can hardly be persuasive in arguing for European grain prices to be closer to world market levels if it widens the gap prevailing at home. Competing exporters might have expressed more serious concern had there not been concurrently an enormous increase in the grain purchases of mainland China, a traffic from which the American products were excluded by virtue of the prevailing trade embargo. In the case of soybeans, a sharp rise in support level helped create a new surplus commodity, whereas moderate shipments under P.L. 480 had previously discouraged holding of year-end carryovers even of prudent proportions. Competitive relations with the tropical exporters of copra, oil-palm products, and peanuts, can now be expected to become more embarrassing.

It may nevertheless be contended that the main victim of surplus-disposal operations is not competing exporters but, by subtle lines of causation, the United States itself. Success in moving surplus stocks abroad removes some of the pressure for correcting domestic agricultural programs; in ignoring the criteria of prices and costs, a technocratic approach exaggerates the efficiency of agricultural production; and budgetary burdens stand sufficiently high to restrain federal outlays in directions more appropriate to society's needs or even to the best interests of distressed farm people. To the extent that foreign aid is warped to favor agricultural exports, surplus capacity in capital goods industries may be under-utilized as compared with visible surpluses of agricultural staples. The needs of the world's underfed people, and the "protein gap" abroad, which might justify some change in the product mix of domestic agriculture, become rationalizations to excuse even heavier subsidization of the farm sector through increased price supports for the commodities having more favorable surplus-disposal prospects. The U.S. is gradually maneuvering itself into a position where it becomes committed to unlimited food relief anywhere in the world at close to a zero price. The attempt to fulfil such an obligation could strain the capacity of the U.S. Treasury, if not of American agriculture, and is as likely to earn the resentment of the world's poor as their goodwill.

Particularly in dealings with the underdeveloped world, what is under test is the viability and flexibility of the liberal institutions of Western civilization. "Sales" for local currency are a mockery of the kind of commercial market transactions we presumably seek to foster. At a time when we urge institutional reform upon the leaders of underdeveloped societies, the United States demonstrates its conspicuous inability to cast off a discredited agricultural policy. Our advocacy of fiscal

integrity is hardly furthered by the legerdemain by which the price-support losses of the Commodity Credit Corporation (CCC) are understated or disguised. Nor is the gross inconsistency between our surplus disposal operations and our own anti-dumping laws lost on perceptive foreigners.

So long as the federal government finances so large a share of agricultural exports, the farmer interest in a liberal trade policy as a means of financing farm exports tends to be undermined. So long as agricultural input industries are attached to the full-scale utilization of domestic agricultural capacity, they will assume less than their optimum role as potential agents of agricultural transformation and modernization abroad. And so long as bilateral transactions are given so high a degree of respectability, there will be incentives to extend 480-type devices to a widening list of commodities and a larger portion of our trade—with broad principles of multilateralism meanwhile undergoing a quiet erosion.

Trade and Agriculture—The Effect on Import Policy

The Congressional popularity of barter transactions is one illustration of unwise directions in which these practices lead. As typically practiced by the CCC, barter is not government-to-government swapping that represents reversion to a pre-money economy, but is instead a highly sophisticated commercial transaction. In practice, the barter contractor has taken up some quantity of surplus agricultural commodities for export, and the CCC has agreed to accept specified quantities of a named imported raw material in return. The double transaction has widened the contractor's opportunity for trading profit and accordingly permitted him to shade the price he charges for the export commodity in direct competition with ordinary commercial sales. Essentially the CCC has created a supplemental demand for the imported raw material, partially on the pretext of national security needs. In the specific case of lead and zinc, agricultural surplus disposal accordingly helped support world market prices as an indirect aid to domestic mineral producers, with some incidental saving of storage cost. But the transmutation of agricultural inventories into minerals contributed to the excessive level of strategic stockpiling, which has itself become a subject of official Congressional investigation.

While barter in this form was advantageous to the level of U. S. imports in the 1950's, tight import restrictions are the more characteristic result of the price-support program. The most contentious restrictions, those on dairy products, involve the output of countries like Holland, Denmark, and New Zealand, with their distinguished commitment to

canons of economic efficiency and liberal trade to which we sometimes appear to pay only lip service. Under Section 22 of the Agricultural Adjustment Act of 1933, as amended, the President is required to impose import quotas or fees whenever a farm product is being or is "practically certain to be" imported in a quantity or manner such as to interfere with a domestic agricultural program. That statutory requirement necessitated an agricultural exemption to the general "no-quota" rule of the General Agreement on Tariffs and Trade (GATT) as originally negotiated, reinforced in 1955 by an unlimited waiver for any existing or future actions under Section 22. In effect, the waiver was a unilateral privilege granted the United States, that violated the balance of rights and obligations negotiated under the GATT and jeopardized future efforts to free agricultural trade from governmental restrictions.

Clearly, the higher the level of domestic farm prices relative to those abroad, the tighter must be the import restrictions at the border. From that viewpoint, the rise in 1961 price supports for raw cotton is especially significant. Higher raw material costs for the domestic textile industry, and a wider differential in favor of foreign mills, has increased the protectionist sentiment of a major domestic industry. It is, moreover, an industry subject to strong commercial pressure from the synthetic fibers and of special concern to Southern Congressmen whose votes must be relied upon for enactment of the Administration's trade-liberalization program. To forestall emergent protectionism, "voluntary" export quotas on textile shipments to the U. S. market were imposed by Japan several years ago, a control system that operated to Japan's own disadvantage as large increases occurred in shipments from other overseas sources, especially Hong Kong. Concern for the level of textile imports, for equalizing burdens among exporting countries, and for enlarging foreign outlets for the industrial exports of less-developed countries, brought U. S. initiative in the negotiation of an international textile agreement, now in force.

The latest phase of the cotton issue is the Section 22 hearing conducted by the Tariff Commission with a view to imposing on the raw-cotton component of imported textiles an import fee equivalent to the 8½-cent-per-pound subsidy paid by the United States on the export of raw cotton. To the American textile industry, imposition of the fee seems only a matter of common justice, removing an unfair competitive disadvantage. To Japan, however, the fee is regarded as an exorbitant burden on a trading relationship already strained by the voluntary export quotas, by the failure of certain Western countries to accord Japan full status under GATT, by self-imposed limitations on trading with the Chinese mainland, and by adverse U. S. tariff action on other

commodities. Japan is, moreover, the leading importer of U. S. agricultural products, currently exceeding even Great Britain and Canada, and utilizes far more American cotton at home than it exports in the form of textiles to the United States. Imposition of the fee would unilaterally alter the commercial relationships negotiated to date, and would in effect transfer a portion of earned export proceeds from foreign hands to the U. S. Customs.

The import-fee controversy does open up the possibility of one novel approach. One purpose of the GATT is to promote *quid pro quo's* among trading nations, whether in the reciprocal lowering of trade barriers or when nations backslide by unilaterally revoking concessions previously granted. It would be consistent with that philosophy if collections from a cotton import fee did not accrue to the U. S. Treasury but instead reverted to the governments of exporting countries, so long as local textile industries were not awarded special subsidies. This may sound like a highly unrealistic suggestion, but it has at least one close parallel and is in the spirit of measures increasingly widely applied. To offset the competitive disadvantage of Belgian agriculture, the Netherlands has imposed a levy on the export of low-cost farm produce to its Benelux partner, and the proceeds have been shared between the two countries [10]*. Financial settlements of a comparable sort have taken on a current importance in the context of the European Economic Community. For one thing, there is the plan for an agricultural fund which will gradually take over part of the public expenditures aimed at supporting national agricultures. Proposals gradually to abolish the preferences of African territories associated with the Common Market have also incorporated the technique of compensatory transfers of funds, while there has been increasing attention to the regressive income redistribution among nations that occurs as the result of high fiscal levies imposed in Europe on such tropical products as coffee, tea, and cocoa.

U. S. Sugar Quotas: A Discredited System

For a number of major commodities from the tropics, the only limitation on U. S. imports is the extent of the commercial market among domestic consumers. More than 10 per cent of all U. S. imports in recent years has been comprised of coffee, cocoa, tea, spices, bananas, etc., imported duty-free and completely lacking in direct domestic substitutes. Natural rubber is also admitted duty-free and, while its synthetic competitor was originally developed as a government enterprise, the industry now operates on a strictly commercial basis. The major restric-

* Numbers in brackets refer to publications listed in the bibliography given at the end of the essay.

tionist program in this area, that for sugar, has encompassed important advantages to foreign exporters, but its evolution affords a striking demonstration of how even a well-conceived commodity program can deteriorate in the course of time as the combined result of its own inherent logic and changing international circumstances.

In the depths of the depression, the traditional tariff proved an unsatisfactory protective arrangement. As the protective margin rose to some 400 per cent on an ad valorem basis, duty-free areas offshore (especially the Philippines) inadvertently enjoyed a strong incentive to expand output, to the competitive detriment of mainland producers and of Cuba, the major foreign supplier. A new sugar program, dating from 1934, relied upon four main features: (1) The total supply of sugar to the U. S. market was limited by government action; (2) statutory provisions prescribed how the domestic market was to be apportioned among the various producing areas, foreign and domestic; (3) the quota premium, the margin by which the domestic price was held above the equivalent world market figure, became the major element of domestic protection, although the tariff was not entirely abandoned; and (4) domestic growers also received a direct subsidy, paid out of funds ostensibly raised by an excise tax but in effect diverted from customs revenues.

While clearly a cartel arrangement that would have violated the anti-trust laws if undertaken privately by the domestic sugar processors, the program was not without its compensating virtues. Improved labor standards in the sugar-beet fields, reasonable prices for domestic consumers, and promotion of international trade were objectives that received far more than lip service. Successive reductions in the tariff of 1930 permitted foreign countries to enjoy a large share of the quota premium on shipments to the U. S. market. Because Cuban sugar could be made available quickly to deficit areas on the Atlantic Coast, administration of the program was relatively simple and sugar prices within the United States could be stabilized within a narrow range. The locational advantages of Cuban supplies were especially important in overcoming the shortages associated with World War II and the Korean Conflict, at which times that island made sugar available without pressing her maximum bargaining advantage. Moreover, the explicit intent was to hold the subsidized industry to a "limited size."

That intent has been defeated by the program's own internal mechanisms. The price target has risen and the absolute margin of protection widened in the course of time, both at the refining stage and earlier in the production process, and despite real improvements in technological efficiency that could have been permitted to work in the opposite

direction. Attractive internal prices have created continuous incentives for domestic interests to enlarge their share of the sugar market, necessarily at the expense of less-developed countries overseas and in conflict with commitments under GATT. Beet-sugar production on the mainland has risen relentlessly to a level almost 100 per cent above the figure anticipated in the initial program and, at present margins of protection, domestic output could expand enough by 1970 to displace completely the 3 million or so tons ordinarily obtained from Cuba [17]. The United States has seen fit to participate in international commodity agreements for this import commodity, without effectively limiting margins of nationalistic protection here or abroad.

Special interest attaches to the bearing of sugar policy on relations with Cuba. On a volume basis, Cuba's position in the U. S. market improved as compared with immediately pre-quota days. However, the unilateral character of the quota system stood in contrast with a long history of Cuban-American reciprocity on tariff preferences. A small independent nation was necessarily sensitive to the fact that the size of its U. S. sugar quota, the most important single decision for its national economy, was determined by legislative and administrative processes in which Cuba had no official representation. The attachment of what was essentially a foreign-aid grant to shipments of this specific commodity was also a mixed blessing. Throughout the 1950's, the annual benefit to Cuba from the quota premium averaged around \$100 million, and the machinery of social intervention assured that this subvention was widely distributed to growers of cane and laborers in field and factory. The associated system of production control had its own serious disadvantages: it undermined the technical efficiency of Cuba's sugar economy, for it deterred rationalization of mill capacity and improvement of crop yields. While a Guevara may argue that the premium American price "enslaved" the Cuban economy by promoting over-concentration on sugar production, in fact the decidedly lower price the island earned on sales to other destinations was at very least a neutralizing factor.

When the United States halted sugar imports from Cuba in July 1960, an excellent opportunity presented itself for working toward more liberal measures. A transitional sugar policy in the period of disturbed relations with Cuba needed to reconcile several related but separable objectives. First, ample sugar supplies had to be obtained from available sources. Second, it was important to avoid permanent commitments so that the alternative of renewing Cuban shipments sometime in the future was not entirely ruled out. Third, the special quota premium had somehow to be allocated among foreign countries. The premium on

Cuban replacements could have been skimmed off, preferably by putting quotas up for competitive bidding,* and the funds so derived set aside for financing general economic aid to Latin America. A portion might even have been earmarked as financial aid to Cuban refugees in the United States or as reserves upon which a freer Cuban government might draw in days to come. Foreign aid would thereby have continued to have some relationship to sugar trade, but the questionable principle of allocating benefits among foreign countries in strict proportion to the volume of their sugar shipments would have been ruled out.

The immediate opportunity for reform was unfortunately lost, and inherent weaknesses in the sugar program have subsequently become major irritants to foreign policy. In particular, the allocation of the former Cuban quota among foreign countries is seriously embarrassing to legislative and administrative processes alike. Either a *quid pro quo* is sought as the price for granting the valuable quota premium, as when farm-minded legislators seek direct benefits for our agricultural exports through the barter of sugar for wheat, or assignment of quotas degenerates into a crude form of political favoritism. Any given allocation provokes envy and dissatisfaction among potential exporters, while vested interests are built up on the basis of temporary arrangements. Experience with sugar quotas as an instrument for supporting income abroad does not augur well for the success of supply-management programs intended to raise farm income at home.

While the Cuban embargo has complicated the logistics of American sugar supply and has seriously disorganized customary patterns of international marketings, a severe domestic shortage has so far been avoided by a combination of temporary expedients and good fortune. Stocks in exporter hands were unusually high in 1960; the European beet-sugar crop that fall was a good one; and carryover cane provided Cuba with an excellent harvest in 1961. Although a major portion of Cuban sales was diverted to Communist-bloc countries under long-term contracts, sugar surplus continued to be the prevailing condition on international markets. Ostensibly, the U.S.S.R. took over the United States' former role as subsidizer of the Cuban economy, but the real extent of the benefit has been difficult to establish under terms of bilateral trading (especially with a considerable volume of military goods thrown into the bargain). Moreover, the appearance of Eastern-European sugar on world markets in 1961 at distress prices implied that some portion of the burden of Cuban support had been shifted to Soviet

* Serious public discussion has been largely confined to an alternative device, the variable import fee.

satellites. Current food shortages on the island indicate that the subsidization is not on a particularly generous scale, and a sharp decline in the 1962 harvest casts a shadow over Cuba's place as an exporter of sugar in the years ahead.

Petroleum Issues and an Academic Proposal

Certain superficial similarities can be drawn between the policy framework of sugar and that of petroleum. For both commodities there is official regulation of U. S. output, a system of import quotas, and contemporary significance of Soviet actions. It was, moreover, a showdown on petroleum policy that precipitated the final breach in Cuban-American sugar relations. But no world commodity can really contend with petroleum in the complexity and importance of the unresolved issues currently posed for public policy. The old international regime, based largely on the market position of American, British and Dutch firms, has been severely eroded and the international price structure seriously disorganized.* The processes of revenue-sharing between oil-producing firms and national governments are highly unsettled. Newly discovered fields in North Africa are coming into production at a time when there is no dearth of supplies from the Persian Gulf and the Caribbean. Exportable surpluses and the strategic significance of the commodity itself help motivate the U.S.S.R. to reestablish its prewar status as a major international supplier. Traditional exporters have thus far been surprisingly insensitive to consequent deterioration in their own positions, and the Soviet Union cultivates their favor by backing the inevitable criticism of the Western companies. New forms of international market control are considered in such an agency as the Organization of Petroleum Exporting Countries; in importing countries, the commodity's competitive position is markedly affected by such official action as the National Coal Board's pricing policy in Great Britain. Nationalization of petroleum properties occurs in producing and in importing countries alike; processes of competition operate differently at producing, refining, and marketing stages; and the enormous importance of transport facilities is reflected in the strategic significance of international pipelines, tanker fleets, and Suez.

For present purposes, attention may usefully be limited to one among this entire complex of issues, but one that has a bearing on a wider commodity group. The minerals, metallic and fuel alike, are peculiarly and increasingly involved in economic relations between the less-de-

* Through discriminatory price concessions on crude petroleum in various new markets, as well as through the intermediary of Italian refining, the Russians have helped distort older patterns of international differentials based on prices at Persian Gulf ports.

veloped and the advanced countries. This trade is doubly hazardous. On the one hand, the changing technology of the industrial system raises or lowers the market value of successive minerals; on the other, these are distributed around the globe in entirely fortuitous fashion. Perhaps basic resources of climate and soil should also be regarded as national windfalls, and yet it is not sheer physiocratic nonsense to distinguish between economic characteristics of mineral and of agricultural products. There are important contrasts in scale of operation, in resource mobility, and in degree of commitment to overseas markets. Certainly agricultural activity is the lot and the life of the poor peasant throughout the world but, even in the less-developed countries, mineral operations tend to be conducted on a large scale by heavily capitalized enterprises servicing metropolitan markets.

Particularly delicate problems of international dealing accordingly arise. Only as short a time ago as the Atlantic Charter (1941), the principle of free access to raw materials meant that overseas territories ought not to be regarded as national preserves subject to preemptive purchasing of scarce supplies. Except as applied to strategic controls against the Soviet bloc, such interpretations have little current relevance. All the recriminations against "dollar diplomacy" or "Yankee imperialism" notwithstanding, we live in an age when exploitation of the weak nations by the strong is inhibited, and indeed precluded, in the West by the moral restraints of the international community. Similarly, and contrary to publicized notions of colonial exploitation, overseas territories with special ties to metropolitan countries have enjoyed preferential market status and thus an advantage over nations enjoying sovereign solitude. The problem of access to raw materials now arises in an inverted form, as excesses of sovereignty become the prerogative only of the smaller nations, and rich portions of the world's natural resources are subject to arbitrary regulation in the fervor of anti-colonialism and political independence. A chaotic Congo reminds us of the economic significance of even so basic a notion as "law and order."

In the interests alike of international commerce and economic growth, the rules of the game by which private enterprise is to operate in the less-developed countries need to be more clearly established. Expropriation, confiscatory tax levies, and excessively uncertain policies, regardless of the appealing label under which they are paraded, impose heavy burdens upon even the best-considered programs of foreign aid. The environment becomes hostile to private savings, domestic as well as foreign; inordinate administrative loads have to be carried even by liberal-intentioned regimes; and the road is paved to Soviet-type alter-

natives, with their unreservedly disciplined approach to capital formation.

Conceivably it may be possible to assert the interest of the world community in more rational mineral policies by a device that simultaneously recognizes that the smaller nations have a special concern for a well-functioning United Nations Organization. The U.N. has urgent budgetary problems, which are requiring new departures in international debt and are calling forth novel suggestions for international fiscal machinery. Professor Tannenbaum has proposed (*New York Times*, April 27, 1961) that the U.N. exercise sovereignty over those portions of the globe not now subject to the territorial jurisdiction of individual nations, and accordingly impose a tax on such international transactions or activities as transoceanic ship crossings, plane flights, or mail shipments. A further possibility is an overt tax on international commodity movements. In both of these approaches, objections may be made on the grounds that the incidence of such imposts is chiefly upon nations that engage most heavily in world trade and which, by the act of trading, are incidentally serving the economic advancement of their trading partners. Equity would seem to require an international tax machinery to bear down more strongly upon trade restraints and autarchic practices.

Conceivably the U.N. might be empowered to impose an international tax per barrel of petroleum produced. Why petroleum? A tax on any one commodity is necessarily open to objections, but petroleum is peculiarly well suited to provide a broad tax base. It is now the most important single commodity on the internationally-traded list; consumption of energy in general and petroleum in particular is closely correlated with level of industrial activity; and practically no country is entirely dissociated from it, either as producer or as consumer. To some of the producing countries it provides a fabulous source of wealth to which particular territorial units, business corporations, or families have no overwhelming claim. A levy would bear more than twice as heavily on the United States as on the U.S.S.R., somewhat in line with our present sharing of U.N. costs, but the Soviet obligation would justifiably rise as Soviet petroleum output expanded. Because the physical quantities involved are so enormous, the per-unit tax rate could be quite nominal, and the marginal choice between alternative fuels very little affected. A vigorous growth trend is built in, so that rising availability of international funds would be provided for in the future. The U.N. would benefit alike from gasoline consumption in private automobiles in the West; from higher production targets in the government sector of the Soviet bloc; and from utilization for strictly military purposes. In modern tax systems, the contribution of commodity levies is trivial as com-

pared with direct taxation of personal and business income, but any international fiscal system must begin on a more primitive level.

However the incidence of the tax might be shared as between producer and consumer, the principle would be established that this key raw material makes a special financial contribution to the international community and, similarly, that the international community has a clear interest in the rational management of petroleum resources. At this stage, the proposal may appear to be of strictly academic interest. But the organizational basis of the world petroleum industry is in a state of flux. One can be sure only that past arrangements are a poor guide to the needs of the future.

*International Commodity Stabilization:
The Havana Charter vs. Contemporary Realities*

While a petroleum levy is not assured a particularly cordial reception from oil-rich nations, the United States is under continuous pressure from primary-producing countries to shore up weak commodity markets by a variety of international measures. The susceptibility of primary products to relatively wide swings in price is well demonstrated by historical experience and fully recognized in economic theory. Nations largely dependent on staple exports are incidentally subject to severe fluctuations in foreign-exchange earnings and in income, if not always in output, with unfortunate consequences for the current wellbeing of their people and the continuity of their developmental programming. The charge is made, not without grounds, that measures taken within the advanced industrial countries over the past several decades to restrain cyclical disturbances and moderate their impact upon susceptible domestic groups have not been matched by parallel action to protect vulnerable groups residing beyond the national border.

That some special measures may be required follows from the fact that commodity price instability has its peculiar international dimensions. While the world's population relies heavily on domestically produced carbohydrates for its basic food supply, the tropical tree crops are particularly heavily represented in international commerce. As compared with staple field crops or the diversified feed-and-livestock economy, tree crops are subject to economic instability in an exaggerated form, since long gestation periods allow intervals of high prices to be protracted, and relatively low harvesting costs permit prices to take correspondingly severe plunges. A more moderate rigidity characterizes supplies of annual crops during the period between plantings: jute, export supplies of which come almost exclusively from East Bengal, demonstrates the sharp price movements to which variations in output can

lead. On the demand side, concentration of the major European market in a restricted territorial area means that local weather conditions have a considerable impact on year-to-year changes in import requirements of food and feed from overseas, and in addition measures intended to "stabilize" prices to domestic farmers frequently tend to destabilize prices abroad. As for industrial raw materials, the flow of world trade reflects successive phases of business cycles, with sizeable variations occurring in the level and location of inventories as between importing and exporting countries. The minerals respond relatively more by variations in physical volume of trade; but price fluctuations are pronounced for a commodity like wool, the demand for which can shift substantially while world sheep numbers change little from one year to the next.

By some indicators, prices of primary commodities have been less variable than before the war, and it is easy to identify various factors that have operated in that direction. Of especial importance has been the more moderate character of postwar business cycles to date, and the temporary coincidence of recession in some major countries with boom in others. Contrary to earlier expectations, U. S. imports appear to have fluctuated less widely than have U. S. exports. With modern production techniques, agricultural yields are not quite so susceptible to the vagaries of nature, and variability in physical supplies is accordingly somewhat reduced. Some individual commodity developments are also relevant. But for the emergence of the American synthetic-rubber industry, with its stable price policy, the full impact of rising postwar demand would have been registered upon a less responsive supply of natural rubber. The increased importance of fuel trade involves traffic in a commodity whose rate of flow can be quickly adjusted, as evidenced by the replacement of Iranian oil after 1951 and the rapid availability of American coal for sale in Western Europe. The existence of U. S. stockpiles of strategic materials as well as agricultural surpluses provides some assurance against major inflation in commodity prices such as was experienced during the Korean conflict.

So long as price variability is of moderate proportions, such devices as national marketing boards or variable export duties provide means for partially insulating exporting countries from the impact of instability externally generated. Considerable attention was given to more ambitious proposals for an international buffer-stock agency during the discussions preceding the Bretton Woods Agreements. In the postwar period, ideas on commodity-reserve currency have received professional attention, a somewhat atavistic approach in an age when the link between money and gold has become increasingly remote. The task of correcting "chronic" surpluses of particular commodities without undue

distress is particularly formidable, whether the structural problem arises from adverse shifts in demand, new sources of supply, or peculiarly immobile resources.

Relief for the special rigidities of primary production was sought through the relevant chapter on inter-governmental commodity agreements in the Havana Charter for an International Trade Organization, a set of principles given independent official sanction by an implementing resolution of the Economic and Social Council on March 28, 1947. Reflecting dissatisfaction with some flagrant monopolistic abuses during the interwar period, the chapter stressed the desirability of an open commodity conference, general agreement among countries substantially interested in the commodity concerned, and equal voting power for importing and exporting countries. In the interest of economic efficiency, a preferred position was to be enjoyed by low-cost producers, the long-run equilibrium price was to be respected, and underlying maladjustments were to be ameliorated by concurrent programs of domestic adjustment. It might justifiably be inferred that reduction in the range of price variability, if not of equal importance to producing and consuming countries, was intended to serve more particularly the interests of those nations heavily committed to primary exports.

A wide gulf separates these principles from the hard realities of post-war commodity agreements thus far negotiated. Participation of importing countries has been neither as extensive nor as effective as was intended. The United States has held off from membership in the Tin Agreement, and the United Kingdom has not affiliated itself with all successive versions of the International Wheat Agreement. In a trading world where importing countries do not necessarily have a clearly defined interest in lower prices, whether because of possible embarrassment to domestic price-support programs or by reason of commitments to exporting countries overseas, even equal representation for consuming countries as a group does not assure that the ultimate consumer's interest will in fact be well served. In the specific case of the International Sugar Agreement it has been Cuba, the major exporter, that has customarily been a major advocate of heavier volume and lower prices. The Organization of Petroleum Exporting Countries (OPEC) seeks to serve as a collective-bargaining unit for producing countries, and therefore cannot readily accommodate membership by the opposite trading partners.

In other respects also, the Havana principles appear as pious hopes rather than operational guidelines. One would be hard-pressed to argue that it was the efficient producers of tin, sugar, wheat, or coffee that earned increasing opportunities for supplying the market, on the basis

of quota privileges emerging from the processes of hard political bargaining. Postwar agreements were conspicuously ineffective in preventing a doubling of the world price of sugar at the time of the Suez outbreak, a record accumulation of world wheat stocks, or a run-up in tin prices in 1961. Nor can it even be argued that it has been primarily the low-income countries which have benefited from one of the two international commodity agreements of longest postwar duration, that for wheat. Here the traditional exporters are the United States, Canada, Australia and Argentina, and the postwar market has been governed less by the International Wheat Agreement than through oligopolistic pricing by governmental selling agencies, particularly the Canadian Wheat Board and the CCC. Poorer countries have had to pay far more than an economic price for their commercial purchases, however much they have benefited from surplus wheat available on concessionary terms. Similarly, the OPEC countries are among the more fortunate members of the less-developed group, and attainment of their goal of price maintenance would be disadvantageous to many low-income nations that import petroleum or its products.

The operation of any commodity agreement in the postwar world is complicated because, notwithstanding the moderation of price variability previously mentioned, new elements of instability have concurrently been emerging. Some of these, because of their peculiarly political character and relation to cold-war strategy, are especially difficult to deal with. The rubber and wool markets have witnessed sudden entry and withdrawal of U.S.S.R. purchasing, on occasion for no ostensible reason other than diplomatic pique. In aluminum and tin, relatively small Soviet exports have had seriously disruptive effects, temporarily at least. The impact on petroleum trade has been more substantial, as the Soviet Union has deliberately cut prices as a means of gaining entry to new markets. Control of Manchurian soybean supplies by a Communist Chinese regime is a supplementary factor of disturbance, potentially important to trade with Japan and Europe alike, while the Communist threat overhangs the rice bowl, the tin, and the rubber of Southeast Asia. Primary producing countries have also by their own actions set in motion serious commodity disturbances. One need only recall Castro's actions in taking over sugar properties, the Iranian oil episode, nationalization of the Bolivian tin mines, and the bearing of political crises in the Congo and the Rhodesias on copper. The latter commodity has also been unsettled by labor strikes closing down individual properties responsible for a significant fraction of total free-world supplies.

The Coffee Glut and Some Operational Guidelines

It may be helpful to consider the case of coffee in somewhat more detail. Its international market position has been seriously weakening since the mid-1950's, following a decade of high prosperity. The carry-over at the beginning of the 1961-62 season stood at about 150 per cent of a year's total trade; excess capacity in the form of bearing trees is difficult to remedy; and prospective trends in commercial production and consumption promise no early or easy solution. Because governments participate so heavily in the crop's export earnings, reduced prices have a decided impact on public revenues and developmental programs. In Latin America, the shift from scarcity to surplus reduced annual export receipts from this commodity by more than half a billion dollars between 1953 and 1960, a loss that necessarily offsets a considerable portion of the funds to be provided by the United States under the new Alliance for Progress program of regional economic aid. Since coffee already enters the major U. S. market duty-free, liberal remedies here are exhausted, though heavy excises on coffee in continental Europe remain a restraint on consumption abroad.

In coffee, as in cocoa and copper, an essential part of the problem is the long-run decline in Latin America's market share as compared with African sources of supply. On the latter continent, coffee has special attractions as a commodity well suited to easing the transition from a subsistence to a cash economy. While Latin American governments tend to absorb a large share of the crop's export earnings, current prices at the producer level are not unattractive on the opposite side of the South Atlantic. The increased use of soluble coffee, itself in part a response to exceedingly high prices of the earlier postwar years, facilitates the market penetration of the weaker types generally grown by African countries, some of whom enjoy the additional advantage of preferential arrangements with the European Economic Community. Accordingly, the burden of carrying unsold stocks has fallen to Latin America, especially Brazil, and African producers have been reluctant to participate in export-restriction plans.

In the interests of hemispheric solidarity, the United States has found it necessary to express its willingness to enter into an international coffee agreement. Potential accession of the major importing country, with its power to enforce import quotas and effectively to police a restriction scheme, easily gives rise to exuberant expectations in exporting countries. There are producers who anticipate recovery of the higher prices prevailing during bygone years of relative scarcity, side-by-side with a larger volume of export shipments. Others hope that present surplus

stocks can somehow be taken over by an international agency, so that problems of inventory financing may be solved and many millions of bags hopefully lost from sight. Still others would look with favor upon the creation of a substantial quota premium for imported coffee, despite the unfortunate outcome of the quota premium on sugar. The more extravagant of these expectations will inevitably be disappointed.

A more modest approach toward relieving some of the burden of carrying excess stocks might perhaps have some merit. Coffee is one of the few major foodstuffs for which the United States depends heavily upon overseas transport. Under various contingencies, the steady flow of commerce might be interrupted, so that coffee came temporarily to be in short supply in the United States even while stocks remained excessive in Latin America. Strategic stockpiling of imported materials has been a national policy and, despite instances of abuse or of untimely purchase, one having its reasonable defense. If large stocks of domestic wheat or corn are justified as contingency reserves, coffee (and sugar) also can make their claim. The United States and the Food and Agriculture Organization urge countries like India to build national food reserves of a basic foodstuff like wheat, obtained at concessionary prices; comparable measures for coffee stocks in the United States may not meet so essential a food need, but might have strong advantages of convenience.

Various approaches are possible. The private trade might be encouraged, by especially low interest rates, to enlarge the commercial inventory. Loans might be extended, as they have been for grain, for the construction of coffee storage facilities on the U. S. mainland. A portion of existing surpluses might even be taken over by the U. S. government, at explicitly sacrifice prices and (except for required rotation) insulated from the market unless the price in the United States exceeded agreed levels. As foreign nickel producers well understand, the existence of such a stockpile weakens the bargaining position of the export industry over the longer run; but experience (most recently in tin) also teaches that subsequent releases from stockpile will be resisted abroad, even at a ceiling price sanctioned by international agreement.

Whatever the approach to the management of existing surpluses, the problem of bringing production and consumption into balance on a current basis remains to be dealt with. Maladjustments in commodity markets may signify the need for public action, but in fact commodity programs employing artificial price supports as a means of aiding distressed groups frequently, if not typically, do more harm than good. The essential source of difficulty in the standard type of international commodity agreement, which merely sets a relatively high price target

and allocates export quotas to enforce that price, is that appropriate canons of economic adjustment, of social equity, and of efficient administration are required to work at cross purposes. Unsalable current output is overt evidence that the commodity is already overpriced, yet the marginal incentive to expand production is held high. Under conditions where the most intensive efforts are required to shift resources to alternative uses, governments and producers in exporting regions retain a special attachment to continued output of the controlled commodity. The enormous advantages of price signals for coaxing rather than coercing needed adjustments are lost and, by a natural law to which Professor Parkinson has as yet paid insufficient attention, an extensive proliferation of control machinery is required to deal with unforeseen impacts in unexpected quarters. Benefits that are strictly proportional to marketings do not meet reasonable criteria of income redistribution, and income transferred via the commodity route can easily involve a shift from relatively low-income consumers in richer countries to quite wealthy producers in the exporting regions.

A second important problem is that, in the quest for immediate gains, sight is lost of longer-run costs. Short-run unresponsiveness of consumption to the higher price level is taken for granted, but the risk of undermining the commodity's market position by encouraging the search for new commercial substitutes is commonly underestimated. Through effects on capital values, better market prices today imply higher cost structures for succeeding generations of producers and dissipation of the intended gains. Temporary measures initiated as transitional aids for "buying time" are converted into permanent crutches. The longer a program is continued, the more firmly vested interests become entrenched, and the more difficult it is to effect necessary reforms.

In the specific case of coffee, is it possible to gear some international assistance to this commodity while gingerly avoiding the more serious of these difficulties? The answer depends on the degree of success in developing three essential features of any defensible international accord: genuine promotion of commercial marketings, definite incentives to reallocate productive resources, and mechanisms for gradually superseding the basic agreement. One possible line of approach would operate through a system of import quotas that created a modest differential between, on the one hand, the export price actually earned on marketings and, on the other, internal prices prevailing in major consuming countries. While coffee is not completely invulnerable to the development of a synthetic substitute, demand elasticities are certainly low in the United States. A rational system of international price discrimination, intended to induce maximum consumption, would require that prices be rela-

tively lower in Europe than here, whereas in fact the existing price structure confronting ultimate users is just the reverse. In conformity with principles of equity in taxation, and in the spirit of GATT efforts to liberalize commercial restrictions against the exports of less-developed countries, pressure would be placed upon European countries to lower their coffee excises. This emphasis on prying markets open is in keeping with the more salutary features of international agreements recently negotiated for cotton textiles. America's present bargaining position with other industrial countries suffers from the fact that its own major concessions to importation of coffee as well as textiles occurred in years past, and its current proposals are less liberal in character.

Aside from international negotiation of the level of quotas for importing countries and the various quota premiums, heavy reliance would be placed upon free-market operations. To that end, the rights to fulfill quotas could themselves be put up for competitive bidding, and the receipts segregated as a special fund. Relevant difficulties arising from the U. S. sugar program would thereby be avoided, as the link would be broken between volume of exports and claims to the premium. The agreement could specify an alternative basis upon which the fund was to be shared among exporting countries, and might include some criteria for its expenditure by national governments. Since the Africans are relatively more interested in the impact of coffee on their agricultural structure and the Brazilians more in budgetary and foreign-exchange aspects, the latter might be relatively generously treated in the financial clauses while the former's share of physical shipments could continue to rise. If political pressures required it and Europe was uncooperative, the mechanism might simply be applied to the American market alone. In that event, the United States would be in an unenviable position as the exclusive target of all dissatisfaction with the agreement's operation, but even then the task of negotiation would be eased by drawing the sharp distinction between volume of export shipments and size of quota premium.

Finally, an agreement could provide for a scheduled increase in quotas and a gradual reduction in internal prices in line with current stock developments. Unless explicit terms along these lines were written into the contract, pressures to renew the arrangement on the former basis would be difficult to resist. Yet it is not encouraging to recall that under the International Wheat Agreement of 1949, which did include a time schedule for specified reductions in the floor price, this "phasing-out" feature was not permitted to become operative in practice.

Compensatory Payments: One-Commodity Approaches

The preceding discussion of cotton, of sugar, of petroleum and of coffee reflect one common theme—the desirability of devising new and unorthodox instrumentalities for international financial transfer rather than relying on artificial market supports for individual commodities. Yet among those whose allegiance to private business enterprise is most solid, intervention in commodity markets is somehow more respectable than direct financial transfers that keep the government out of the commodity trading business and are less disturbing to the price system, the major organizational mechanism of a free economy.

Even in programs directly tied to the production or marketing of individual commodities, there are important advantages in allowing market prices to move freely while making a supplementary financial payment to the producer. On the demand side, at least, prices invite adjustments in the correct direction. As overt financial transfers, production payments call attention to program costs, cast suspicion on individual payments of unreasonably large amounts, and invite consideration of the recipient's income status apart from revenues from the specific commodity in question. Indeed, producer groups favor tariffs, quotas, and other commodity supports in large measure because their public costs are so much easier to ignore or disguise.

Experience with direct payments to wheat growers in the United Kingdom has by and large borne out the advantages of this approach, but the major American effort along these lines has not been conspicuously successful. In the early 1950's, pressures for a higher tariff on raw wool mounted. The size of domestic flocks had been sharply declining for some years and, under standard price-support arrangements, the domestic clip tended to move into CCC hands while the imported product was absorbed by domestic users. Wool-exporting countries of the British Commonwealth were extremely sensitive to any tariff increase, particularly since a duty concession on raw wool had been an important part of the bargaining process out of which the General Agreement on Tariffs and Trade had emerged. Despite the obvious analogy with the much criticized Brannan Plan, a wide-ranging program of direct payments proposed several years earlier, the Eisenhower Administration endorsed a direct subsidy for wool, initiated by the National Wool Act of 1954. This provided a more liberal solution to the contemporary dilemmas, leaving the tariff unchanged; and an unsupported domestic price could be expected to be advantageous both to the domestic clip and also to the level of imports. The Act specified a target volume of domestic output, the use of an "incentive price"

(from the market and from the subsidy) to promote its attainment, and an explicit but limited source of financing.

Although the program has been surprisingly uncontroversial, it has not developed as originally anticipated [18]. With the incentive price set 15 per cent above the pre-existing support level and market prices unexpectedly sagging, the margin to be financed by government proved considerably higher and foreign wool's share of the domestic market considerably lower than envisioned by the program's sponsors. The transfer of essentially customs revenues to producer hands permitted the program to be described as "self-financing"; but it was the rising trend in textile imports that permitted the wool program to balance its books, while the same phenomenon fanned protectionist sentiment throughout the textile industry. The Act was nevertheless extended by an overwhelming vote in 1961, when direct subsidies were introduced for lead and zinc as well (P.L. 87-347). In the mineral case, however, operations are on an explicitly limited scale. Aid is confined to small domestic producers; there is a statutory ceiling on budgetary expenditures; and the applicable quantities are gradually reduced over the life of the Act.

Two proposals, one of academic origin [8] and the second carrying the limited endorsement of the United Nations Secretariat [16], extend the payments approach to international trade, for they would provide compensation for movements in world market prices of specific commodities. A considerable variety of technical arrangements are feasible, but the essential features are as follows: (1) There would be no direct intervention in commodity markets; (2) some estimate would be made, e.g., by use of a four-year moving average, of the trend price appropriate to the given year; (3) if the world price declined below trend by more than an agreed margin, exporters would receive financial compensation proportional to their current volume of exports; (4) the financial burden would be borne primarily, if not exclusively, by importing countries on the basis of such criteria as ability to pay, absolute volume of imports, or shortfalls below their normal volume of imports of the commodity in question. By these routes, interference in world markets would be minimized. The commodity-by-commodity approach has the additional advantage of permitting arrangements to make the maximum accommodation to the economic peculiarities of individual products.

But there are also some very serious limitations, which are fully recognized by the United Nations' report. Mere specification of "the" price to take as the standard is no simple matter, in view of the customary number of sub-commodities experiencing divergent price movement, the shifting composition of a country's trade as among the sub-

commodities, and peculiarities of price quotations as applied to vertically-integrated companies, especially in the minerals. A key assumption of the compensatory plan is that price instability is essentially beyond a single nation's control, but for individual commodities the direct impact of such deliberate national policies as export subsidies or marketing controls is by no means inconsequential, and the volume of exports will also be substantially affected by policies affecting the rate of domestic absorption or internal cost structures. Thirdly, serious anomalies and injustices can arise as between participating countries. With payments proportional to volume of exports, countries enjoying a relatively high volume of exports in periods of low prices will also enjoy larger financial benefits, as compared with those suffering a decline both in price and in volume. Indeed, the incentive to establish claims to benefits may cause countries to export too energetically under depressed conditions, with a destabilizing effect on the price level that creates the need for larger financial settlements. A whole set of problems are created if particular countries choose to remain outside the arrangement. Prices may in fact be responding to destabilizing imports or exports of non-participating countries, and their existence opens up possibilities for manipulating the volume and pattern of export shipments at the expense of the compensatory fund. Yet inclusion of a very large number of participants necessarily complicates decision-making in programs that may themselves be of fairly modest proportions.

The basic philosophy of these proposals for international action would seem to be more appropriate to industrial raw materials than to foodstuffs. In the former, price and quantity can ordinarily be expected to fluctuate in the same direction for the world as a whole, and it is reasonable to assume that the prime culprit is import variations in the industrial countries. For foodstuffs, world price fluctuations are much more likely to be offset by contrary movements in export shipments, due to crop variations and the like. Even when world prices of a given commodity are moving adversely, individual nations may be increasing their market share and so enjoy quite satisfactory exchange earnings, while other countries are doing badly. Inequities of this sort may be removed by a program that uses the nation's foreign-exchange earnings from the individual commodity, rather than movements in the world price, as the trend variable to be stabilized. In other ways, also, specific features can be devised to correct particular defects. Consideration has also been given to the possibility of a reverse flow of payments, though on less generous terms, if the world price (or foreign-exchange earnings) climbs above trend by more than an agreed margin.

However well such matters may be dealt with, any arrangements

that relate income support to the production or marketing of specific commodities are open to serious objections. Production payments are a sensible device for promoting needed expansion of output, but attaching public aid to continued production of surplus commodities smacks of leaf-raking and make-work. Resources are inevitably retained in a low-value use, and there are strong incentives to draw in further resources as well. Individuals and nations generally have sources of income or receipts over and above those associated with any single commodity. Production payments proportional to marketing do not conform with defensible criteria of income redistribution domestically, nor does the behavior of individual commodity prices establish a reliable basis for the allocation of foreign aid internationally. It is technocratic nonsense to assume that production of physical commodities is desirable, regardless of ultimate economic value. Public funds are better devoted to easing needed adjustments, to increasing factor mobility, and to up-grading human skills.

Generalized Compensatory Arrangements, International and Domestic

The logic of international compensatory arrangements would seem to argue for a complete break in the link between financial assistance and commodity output, and for focussing on movements in a nation's overall export proceeds. Of special interest are proposals advocated by a group of experts appointed by the U.N. Commission on International Commodity Trade [13]. An initial capital fund would be established, but most financial features would take their analogy from the field of social insurance. Participating countries would pay annual premiums, and their claims to benefits would be related to historical experience, for which purpose a three-to-five-year moving average of export earnings would be established as the appropriate base. If export proceeds in a given year fell below the base figure by more than a specified margin, some portion of the shortfall would automatically be compensated out of the fund.

While the plan is of contributory design, the social-insurance appearance is something of a facade, for obligations for premiums and rights to benefits would be specified so as to assure that international transfers of income occurred from the richer to the poorer countries. Yet the premium feature is especially interesting. Once the machinery was established, there would exist for the first time an international source of revenue that bypassed the processes of national abstention or country veto with which U.N. fiscal operations are at present plagued. The premium-rate structure could penalize industrial countries with the greatest instability of import expenditures, analogous to the tax incen-

tives encouraging stable employment practices under well-conceived programs of unemployment insurance or incentives fostering accident prevention under modern workmen's-compensation plans. Levies might also compensate for adverse shifts in commercial policies toward primary commodities, a form of expropriation that remains respectable by the standards of the international community of the present day. For the less-developed countries, and not for them alone, premium payments could serve as a kind of compulsory saving in periods of high export earnings and exert international leverage for a degree of prudence difficult to obtain under the pressures of domestic politics.*

The principle that some amount of international income transfers should be distributed proportionally to shortfalls below previous export earnings can nevertheless be debated. Allocation of foreign aid on that basis has little appeal for a country like India, with relatively little fluctuation in exports. Nor may the relatively large benefits that would be enjoyed by a Malaya, whose exports are given to violent swings, be justified, particularly when a portion might well be at the expense of an Indonesia, experiencing something of a secular decline in export proceeds. When the problem is of a chronic sort, the arrangement would usefully afford some transitional help, while the moving-average technique would properly prevent the right to benefits from becoming frozen into a permanent commitment. Payment of large lump sums to governments without strings attached nevertheless invites serious risks of misappropriation, yet the automaticity of the plan is one of its chief attractions to countries highly sensitive on the issue of national sovereignty. Incentives for deliberately manipulating the time pattern of receipts can largely be avoided through well-conceived payoff arrangements, but some residual risk remains on this score as well. The argument would be further complicated if the device were employed to compensate for fluctuations in terms of trade between primary commodities and industrial goods, rather than in the actual export proceeds of individual nations.

A program that protected the income of agricultural producers within the United States by analogous insurance arrangements has a more impressive defense. In this application, the mechanism is quite simple. The grower would be entitled to compensation if his net income from farming in a given year fell by more than (say) 15 per cent below that of his recent experience, as measured by something like a three-to-five-year moving average. Since American farmers are now covered by

* One writer advocates using the reserves of the insurance fund for investment in long-term projects in the less-developed countries [11]. In view of the fluctuating volume of short-term claims, that would not seem prudent policy.

social security, income-tax reporting already provides the essential documentation. Built-in features help ensure that payoffs will go to those who are duly entitled to them. A base period of several years' duration and a moderate range of non-compensated shortfall here, as in the international case, remove most of the incentives for deliberately manipulating receipts, and the tie-in to the income-tax system implies additional policing features. Social-insurance prototypes would also be followed in certain other respects, e.g., a moderate ceiling would be set on the size of insurable income.

The full rationale for such a domestic device has been detailed elsewhere [12]. Broadly speaking, there are advantages of three sorts. First, public policy would be focussed, as it should be, on aiding people rather than products. Persons benefit from consumption-oriented expenditures, such as the fringe benefits that are enjoyed by industrial labor but less easy to adapt to the farm population. Moreover, investment in human capital is less likely to be carried to excess than is investment in physical output, partly because it brings its inherent satisfactions and serves humane purposes. Secondly, the redistribution effected by an income-insurance program would be more reasonable than under present measures, without being crudely egalitarian. All payments would go to individuals who had clearly suffered a decline in income. The sizeable windfall gains now accruing to high-income producers would be avoided, and the level of benefits could readily be adjusted to take appropriate account of supplementary sources of income. Thirdly, the impact on the structure of agriculture would be highly salutary. Payments tied to shortfalls in earnings are less likely to lead to unwarranted investment that builds problems of surplus capacity for the future; the pattern of realized prices would encourage a product-mix in keeping with the changing consumption requirements of a high-income society, rather than being bound rigidly to historical patterns of production; and the program would avoid an artificial build-up in capital values, defense of which becomes a new argument for public assistance under the traditional commodity programs. In the light of such advantages, it is easy to argue that any politically-given level of agricultural subsidy could well be channelled via this route.

Proposals for Circulating Loan Funds

Since many shortfalls in foreign-exchange earnings can be expected to be reversed in the normal sequence of cyclical events, some proposals for international compensatory arrangements, whether in their one-commodity or their generalized versions, include a repayment feature. To that extent, they are brought squarely into the field of international

credit rather than foreign aid. The presumption is that the incidental change in the time pattern of national export receipts will operate externally to help stabilize the volume of world trade and internally to ensure a steadier flow of foreign exchange to meet the needs of domestic programs for economic development. If the level of foreign-exchange reserves should be more or less proportional to the range of variation to be expected in a nation's exchange earnings, then the less-developed countries do require more ample reserves than they now hold, even after taking account of national drawing rights under standard procedures of the International Monetary Fund. Yet claims upon their exchange earnings are so compelling that accumulation of idle balances has high opportunity costs and is accordingly given a low social priority. Considerable attention has recently been given to enlarging the pool of international reserves available to the industrial countries and, similarly, there has been consideration of more generous credit arrangements for the less-developed group, particularly in Latin America [9]. At the Punta del Este Conference of the Organization of American States held in 1961, the United States committed itself to join in a serious exploration of possible loan arrangements that would, with a high degree of automaticity, compensate for fluctuations in export proceeds.

Actual implementation of such a circulating loan fund requires decisions on a number of technical questions closely related to the governing philosophy. Should the scheme be regional or global in scope? Are shortfalls only in export proceeds, or earnings on current account, or the entire balance of payments, of immediate concern, and is the level of reserves also a relevant variable to be taken into account? If shortfalls in export proceeds are chosen, should the full export list be included or only a selected list of primary products? Should the behavior of the individual exporting country's earnings activate the operation, or should the behavior of import expenditures in the major industrial nations be a primary indicator? From what base are "shortfalls" to be measured, if the right to loans is in fact to come in amounts and at times as actually needed? Just how automatic should drawing rights be, how much of the shortfall should be covered, and what should be the interest charges? Should the loan funds be expended entirely at the discretion of the borrowing country, or only for specified purposes? How automatic should the repayment schedule be and how long the period of grace before repayment begins? Should there be obligations on potential beneficiary countries to make advance deposits out of particularly favorable earnings, or should their initial dealings with the fund always occur during a depressed phase of their trading? How much of the finance

should be provided by capital subscriptions, and how much through stand-by borrowing authority?

The list is long, but most are the kind of operational questions that serve to clarify the underlying issues and to which reliable technical answers can be given. Consider, for example, whether an export-proceeds scheme should be limited to a specified range of commodities. It might appear that an ineligible group could readily be chosen either on the grounds that the commodity is primarily an export of the industrial countries (coal); or is a highly processed good originating from the same source (rayon, synthetic rubber); or is a product (wheat, bacon, butter) either of industrial or of the richer primary-producing countries not intended to benefit from such a scheme. Yet these commodity particulars do not stay put: iron ore has recently been invading the export list of the less-developed countries. Difficulties arise, similarly, in attempting to establish the stage of processing at which eligibility is lost. Does one include both raw and refined sugar? only crude petroleum or also petroleum products? aluminum as well as bauxite? There is also the problem of how far to go in incorporating individual commodities that contribute an insignificant share of world trade but are a serious matter for some small country.

The issue of global versus regional coverage raises a different set of equally explicit considerations. On the one hand, the case may be made for commencing with Latin America—because implementation might be speedier, because the United States has special responsibilities in that region, or because the more limited arrangement might provide necessary experience. The contrary arguments, however, seem somewhat stronger. Major commodity fluctuations are world-wide in scope, and the processes of technical review and analysis might appropriately take the global view. The list of strong borrowers would be lengthened, and the possibility of offsets within the borrowing group would be improved, as more countries and regions are included. A scheme confined to Latin America is less appropriate as a strictly contra-cyclical device than one for, say, Southeast Asia with its natural rubber, and would also rule out the strong petroleum exporters of the Middle East. Moreover, a heavily Pan-American flavor would work against multilateralism and in the direction of further formalizing economic blocs; it might also discourage Europe from participating as much in the financing as would be desirable.

This credit approach, despite its clear advantages, involves one serious dilemma. To the extent that all loans are fully repaid, operational questions can be intelligently decided but the arrangement loses a good deal of its attraction for its potential clientele. But insofar as the "loan"

device becomes a cover for implicit income transfers, either by requiring repayment only if export proceeds rise above trend or by forgiving balances still outstanding after a stated period, the approach is open to the objections raised in the preceding section. In the second case, moreover, we are inevitably undermining a liberal economic institution by tactics of confusion. At a time of ideological conflict, when perversion of the language takes its place alongside debasement of the currency as an instrument of nonmilitary warfare, it is especially important that we clarify our own principles. Matters of economic growth and instability, of international income redistribution and structural adjustment, of commodity behavior and financial policy, are inevitably intertwined in world trading relationships. But we should be clear about the specific instruments that are appropriate to particular ends.

Concluding Observations

The search for financial alternatives to commodity price stabilization, along lines broadly indicated in this essay, is very much to be encouraged. In monetary affairs, and regardless of the party in power, the United States and other industrial countries of the Western World tend to follow precepts of economic rationality fairly closely. The interest rate is certainly not manipulated with a view to maximizing the profits of the banking business but, instead, influence is exerted on the price of money in line with the requirements of general economic conditions at home and abroad. In the field of wage policy, Republican and Democratic Administrations alike exhort labor to keep its demands in line with productivity gains, in order to protect the public. But the nation's interest is frequently sacrificed under pressure from the political forces that are peculiarly attached to the market fortunes of individual commodities.

In creating sharp contradictions between our national ideals and our actual practices, such delinquency involves heavy, albeit intangible, costs. Despite our belief in a liberal system of enterprise that rewards productive efficiency, long strides are taken in the direction of a producer-organized corporate state. The rules of the competitive game are bent, so that individuals come to enjoy the profits but the public Treasury is required to bear the losses of private economic activity. In relying on fiat rather than on the price mechanism for guiding economic decisions, we substitute direct controls for less coercive instrumentalities. It is surely impossible entirely to separate direct economic controls from at least moderate forms of political tyranny; and there was more than a remote connection between Cuba's apparatus for sugar-crop control and the local dictatorship against which the present regime was originally

a justifiable reaction. Discrepancies between American ideals and our practices are failures in social morality, to be overcome for their own sake. In a period of ideological struggle, these social gaps provide explosive ammunition for the Communist adversary and may well be regarded as a threat to the nation's security.

Awkward dilemmas are created by a long list of obvious inconsistencies between the domestic and the international features of our commodity policies. Parity between prices paid and received by farmers remains the domestic standard, but at the water's edge we rightly renounce the terms-of-trade approach to stabilizing price relationships between primary products and manufactured goods. We endorse historical share of world markets as a rule applicable to our cotton exports, but would be considerably embarrassed if it were also applied to American exports of soybeans, corn, or inedible fats. International commodity agreements were long resisted for imported commodities subject to severe cyclical instability in industrial demand, but accepted and indeed promoted for an American export like wheat and also for an import like sugar, inasmuch as lower prices in world markets would have proved embarrassing to domestic commodity programs. Concern is expressed for the international competitive position of America's exports; but we forego the advantages of cheap raw materials, whether cotton, petroleum, or the nonferrous metals. In focussing on the external advantages of agricultural surplus disposal, we divert attention from an important by-product, income redistributions of doubtful merit at home.

Much, though by no means all, of the difficulty in international commodity markets is the result of ill-advised national policies. So far as U. S. farm programs are concerned, it would be difficult to improve on the existing apparatus had we deliberately set out to invent a devilish device that would maximize the opportunities for foreign irritation while minimizing the chances of domestic success. Even a program that operates to the short-run advantage of primary-producing countries, like American (and foreign) strategic stockpiling in the 1950's, may subsequently work to their detriment, as we come to recognize that current holdings far exceed the strategic requirements of the 1960's. Principles of surplus disposal, as developed by the Food and Agriculture Organization for farm products, cannot be too helpful in coping with these new circumstances. Nor can processes of technical review and confrontation within international agencies, which appear to have considerable leverage on domestic financial policies, be expected to work as well against organized domestic commodity interests.

The trade in primary products can foster a closer sense of international community or it can be a source of severe irritation to interna-

tional relations. World commodities are characterized by their own peculiar problems of economic structure, cyclical instability, and international competition. With supply regions far removed from consuming centers, their production necessarily involves decision-making that transcends the jurisdiction of any national government. Where the economic magnitude of private business enterprise exceeds that of the local government with which it deals, means of equalizing relative bargaining positions can justifiably be pursued. International commodity problems, moreover, like so many other issues, are encountered in a world strikingly different from that of preceding decades, one plagued by excesses of nationalism as well as by deficiencies of capital.

The perpetual challenge to public policy is to recognize and indeed to anticipate changes in economic conditions and, without costly delay, to alter inherited institutional arrangements accordingly. Commodity programs of the sort criticized in this essay are imperfect, but at least their failings have familiar faces. The line of least resistance is to seek international commodity agreements that merely "bridge . . . incompatible national policies, with limited adjustments to their inconsistencies" [4]. Novel approaches of the sort considered in this essay are necessarily untried and unproved; in all prudence they will be eyed with suspicion; and in some quarters they will be condemned as visionary or dismissed as crackpot. But we live in a period when inherited institutions are under attack from alien quarters and at a time when the international environment is poisoned by strategies of conflict. As much depends upon our ingenuity in devising new institutional arrangements appropriate to present-day realities and in the conciliatory tradition of Western liberalism, as upon our advances in mathematics, physics, or technology.

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Stanford, California
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