

# RAW MATERIALS PRICES AND MONETARY STABILITY

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## MONETARY STABILITY AND ECONOMIC OBJECTIVES

One of the purposes of the International Monetary Fund is to facilitate the expansion and balanced growth of international trade and to contribute thereby "to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy". These objectives, recognized by the Bretton Woods Conference of 1944 at which Professor Gudin was a delegate, are as valid today as they were then. They apply to the developing countries no less than to the industrial countries. The emphasis on one or another objective of economic policy may change from time to time as the immediate problems confronting the economy change. In the United States, for example, the emphasis until recently was on the achievement of a high level of employment. This was because unemployment has intermittently been a serious problem in that country. More recently, some of the large industrial countries, including the United States and the United Kingdom, have placed greater emphasis on economic growth. The emphasis in the developing countries has been consistently on the accelerated development of their productive resources, because low productivity and low standards of living have been endemic in these countries.

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Traditionally, monetary stability was the primary objective of economic policy. Under the gold standard, the monetary authorities were mainly concerned with assuring the stability of exchange rates and the gold convertibility of the currency. That is not, of course, to say that they were indifferent to such matters as unemployment and the standard of living, but these were regarded more as social than as economic problems. In any case, it was generally assumed that policies conducive to monetary stability were beneficial for production and employment. This was clearly evident in the recognition of the connection between monetary policy and business cycles — booms and depressions.

In recent years there has been renewed emphasis on monetary stability as one of the objectives of economic policy. The reasons for this are pragmatic. In the great industrial countries, the achievement of full employment and the persistent high level of investment have resulted in a tendency toward excess demand and strong inflationary pressures. In the developing countries, the determined effort to achieve accelerated development has been accompanied by huge expenditures by governments and an excessively expansionary credit policy. Unfortunately, the demand generated by such policies far exceeded domestic production and the net capital inflow at stable prices. The consequence has been that many of the developing countries, including Brazil, have been confronted with chronic inflation at a very high rate — often exceeding 50 per cent and even 100 per cent a year. Whatever may be said of the stimulus that mildly expansionary policies may give to economic development, it is clear that such a rate of inflation is so disruptive of the normal pattern of economic behavior that it must ultimately retard rather than accelerate development. For this reason, many developing countries have undertaken stabilization programs designed to slow down the inflation and ultimately to eliminate it.

The basic conditions for monetary stability are clear and they are not different for the industrial countries and the developing countries. Inflation is caused by the attempt of one or more sectors of the economy to secure a larger proportion of output for its own use (say, consumption, private investment or Government purposes) than the normal functioning of the economy would distribute to it as income, taxes, and borrowing out of ordinary savings. To secure this larger proportion of output, the government and the business sector depend on borrowing from banks — that is, the creation of money. The addition of purchasing power on such a scale results in excess demand and forces up prices. As the rise in prices reduces the real income of workers, sometimes very considerably, they attempt to restore their real income through an offsetting rise in wages. At times, the workers may attempt to secure higher real wages than the economic value of their contribution to output. When this occurs, there will be a rise in costs, and either higher prices or unemployment. The persistence of any sector in its attempt to acquire an excessive part of the output will inevitably lead to an excess of aggregate demand

and a persistent rise in prices. This is the familiar process of the inflationary spiral.

Once an economy has developed a tendency toward persistent inflation, it is difficult to restore monetary stability. In part, this is because the inflation has distorted the economy so that it is very difficult to determine what is the appropriate distribution of output among the different sectors. Perhaps more important, the persistent inflation leads to exaggerated expectations on what the economy can provide in the way of output to the different sectors. In any case, in order to restore monetary stability it is necessary to restrain aggregate demand to available supply, that is, domestic production plus the import surplus. The indispensable condition for balancing demand with the available supply is a monetary policy that avoids the excessive creation of credit and the abnormal expansion of the quantity of money.

Although it is very difficult to restore monetary stability once an economy has entered into a persistent inflationary spiral, there is an inherent tendency for an economy to maintain monetary stability under appropriate policies. That is because there are forces that tend to limit the rise or fall in prices resulting from economic fluctuations and to bring prices back to a level consistent with world prices. These forces may be regarded as the governors of monetary stability because they tend to dampen excess demand and to stimulate deficient demand while minimizing the impact of economic fluctuations on prices. Their function is to give the monetary authorities time to adjust monetary policies to the requirements of monetary stability. In general, the usual governors of monetary stability operate effectively in the large industrial countries. However, the developing countries require a quite different governor of monetary stability in order to enable them to make their monetary policies effective.

## GOVERNORS OF MONETARY STABILITY

There is nothing novel in the concept of governors of monetary stability. Without designating them as such, economists have recognized that wage rates properly related to productivity and exchange rates closely related to fixed parities tend to prevent excessive price fluctuations. That is not to imply that these governors will be effective without appropriate monetary policies. All that they can do is to prevent the emergence of an inflationary spiral until effective monetary measures are taken.

The first and the most important governor of monetary stability is wage rates properly related to productivity. This is a very difficult concept in the abstract. It may help to make a distinction between wages which reflect the value of the work to the economy and wages which reflect the value of the work to the employer. In a sense, wages cannot

exceed the value of the work to the employer, where it is possible to vary the number of persons employed by a firm. On the other hand, wages can exceed the value of the work to the economy. This would be true if wages were so high as either to hold down the level of employment or to force an inflationary monetary policy. And wages could be regarded as excessive if the balance of payments were to show a persistent deficit, even where there is clearly no excess aggregate demand. In such a case, however, it is customary to say that the currency is over-valued rather than that wages are too high for the economy, although there is no real economic distinction between the two concepts.

While it may be difficult to say whether any given level of wages is properly related to productivity, there can be no doubt that a persistent rise of money wages in excess of the increase in productivity would result in wages higher than the value of the work to the economy. If wages tend to rise with the increase in productivity, the labor costs per unit of output would remain stable. A temporary increase of aggregate demand could cause a rise in prices, but with stability of labor costs the rise in prices would necessarily be limited. Of course, if there were a persistent excess of demand so that prices rose considerably, workers would ultimately demand wage increases to offset the rise in prices. A wages policy in which each rise in prices is immediately offset by a rise in wages would inevitably lead to an upward spiral of prices. A wages policy designed to stabilize the labor cost of a unit of output is not a substitute for a monetary policy designed to maintain a balance between aggregate demand and available supply at stable prices. All that the proper relation of wage rates to productivity can do is to give the monetary authorities time to adjust aggregate demand to the supply before the rise in prices resulting from a temporary excess of demand is built into the economy permanently in the form of higher labor costs.

The second, and much less important, governor of monetary stability is a fixed parity properly related to the balance of payments position. If the international payments of a country are balanced on an average over a period of good and bad years, then a fixed parity will help to support prices stability despite cyclical fluctuations of demand. Thus, in a period of excess demand, when savings generated at a high level of production and employment are not adequate for investment, a decrease in the export surplus or an increase in the import surplus will absorb part of the excess demand and to that extent minimize the impact on domestic prices. Similarly, in a period of deficient demand, when invest-

ment is inadequate for the savings that would be generated at a high level of production and employment, an increase in the export surplus or a decrease in the import surplus will supplement domestic demand and to that extent minimize the downward pressure on domestic prices. It should be noted that the effectiveness of a fixed parity in acting as a governor of monetary stability depends on its being suitable to the long-run payments position of a country and on the country's having sufficient monetary reserves to finance a payments deficit in a period of more than average demand.

There is no doubt that in the large industrial countries, a wages policy properly related to productivity can be helpful in maintaining monetary stability in a temporary period of excess demand. This is because wages are such a large part of total personal income and consumption is such a large part of the gross national product. In the United States, for example, wage and salary disbursements are about 67 per cent of personal income, and consumption expenditures are about 63 per cent of the gross national product. If wages and salaries could be kept from rising relative to output even a considerable increase in other forms of income (say, 15 per cent) would result in only a small increase in aggregate income (5 per cent) and a 5 per cent decrease in real personal consumption would permit a 20 per cent increase in gross private domestic investment or a 15 per cent increase in government purchases of goods and services. The stability of money income in the form of wages and salaries and of expenditures for personal consumption provides a wide base for absorbing a temporary increase in other forms of income and expenditure without a significant effect on prices. And if the excess demand is eliminated without a prior rise in wages, labor costs will remain stable and prices will tend to revert to their previous level when the excess demand is eliminated.

The developing countries do not have such a wide base of stable wages and salaries for absorbing much of the impact of a temporary excess of demand. On the contrary, these countries are subject to relatively large fluctuations in money income originating in the changes of the prices of basic commodities in world markets. Exports of basic commodities are the source of a considerable part of the total money income in developing countries, and total money income can rise or fall sharply as a consequence of a change in world prices of basic commodities. The sensitivity of total money income to world prices is heightened when a country is excessively dependent on one or two basic commodities. Taking annual

averages, the dollar prices of some of the more important basic commodities have had a range of about 100 per cent (low to high) in the period from 1950 to 1965.

RANGE OF U. S. DOLLAR PRICES OF SELECTED BASIC COMMODITIES,  
1960-65

	<i>High</i>	<i>Year</i>	<i>Low</i>	<i>Year</i>	<i>Ratio of High to Low</i>
Cacao (Brazil) ....	50 84	1954	16.91	1965	3.01
Coffee (Brazil) ....	65 65	1954	28.98	1963	2.27
Copra (Philippines)	10 58	1959	5.58	1952	1.90
Jute (Pakistan) ...	300 00	1951	160.00	1959	1.88
Hemp (Philippines)	22 30	1951	10.80	1955	2.06
Lead (Mexico) ...	16 78	1951	8.81	1963	1.90
Rubber (Malaysia)	55 30	1951	22.00	1954	2.51
Sugar (Caribbean)	5 67	1951	2.12	1965	2.67
Tin (Malaysia) ...	151 80	1964	86.90	1954	1.75
Wool (Australia) ..	107 70	1951	47.80	1958	2.25
Zinc (Canada) ....	18 91	1951	11.22	1958	1.69

Depending on the importance of basic commodities in the total output of a country, fluctuations in prices on such a scale can have a considerable effect on total income. Thus, in a country, in which basic commodities constitute 20 per cent of output, a range of world prices of 100 per cent of the low would involve a change in money incomes (at a fixed exchange rate) of 10 per cent above or below the average — that is, between an index of 90 and 110. And in countries in which basic commodities constitute a larger proportion of total output or in which the range of fluctuations in world prices is wider, the impact on money incomes would be even greater. Such countries have an inherent instability of money incomes which makes it extremely difficult to maintain domestic monetary stability. Far from ameliorating price changes, fixed exchange rates make it certain that the full effects of fluctuating prices of basic commodities will be built into the economy and absorbed in a new level of costs.

Consider the problems confronting a country when world prices of its basic commodities rise sharply, particularly in a period of inflation in the industrial countries. The rise in the prices of basic commodities increases the income of the producers. Some rise in wages, salaries or other income of those employed in producing basic commodities would probably occur, unless the producers retained all of the benefits of the price rise for themselves. The increased expenditures of the export sector would soon affect the prices of domestic commodities as not all of the additional expenditure would be on imports. Thus, the real income of

workers would decline. Some rise in wages and salaries would become necessary, particularly if the prices of import goods have also risen. In accordance with the classical analysis, the rise of incomes in the export industries would in time rise incomes and prices throughout the economy.

On the other hand, consider the problems confronting a country when world prices of its basic commodities fall sharply. The fall in prices of basic commodities decreases the income of the producers. Unless incomes of those employed in producing the basic commodities also fall, the entire burden of lower prices would be borne by the producers. The reduced expenditures of the export sector would soon affect the demand for domestic output. The economy would then suffer a depression originating in the export industries. As it would be impossible to reduce money wages, the inevitable effect would be unemployment and a serious balance of payments problems.

## NATIONAL POLICIES TO OFFSET FLUCTUATIONS IN WORLD PRICES

Fluctuations in world prices create an inherently unstable monetary environment in countries highly dependent on the production and export of basic commodities. The governors of monetary stability which operate in the industrial countries are completely ineffective in the face of large changes in the prices of basic commodities. The monetary policy of the developing countries must be directed not only to preventing inflation originating in excess domestic demand, but to offset the domestic effects of fluctuations in world markets for their exports.

There are two types of policy that developing countries can use to minimize the monetary instability that originates in fluctuations in world prices of basic commodities. First, they may follow a policy of offsetting through fiscal and credit measures the domestic effects of changes in world prices. Thus, if world prices of basic commodities decline, the monetary authorities could follow an expansionist policy. The reduced demand for domestic output by the export sector would then be offset by increased government expenditures and easier credit for private and public investment. Theoretically, this would prevent a fall in world prices from generating domestic deflation. Such a policy could not, however, prevent a fall in the real income of the country as the reduced export receipts would pay for a lesser amount of imports. If the country held adequate monetary reserves, it could minimize the decline in imports. At best, the sector producing basic commodities would have a reduction in incomes, but the impact on the rest of the economy would be greatly reduced.

Unless a symmetrical policy were followed when prices of basic commodities rise, such fiscal and credit measures would result in a ratchet-type inflation. In a period of higher prices for basic commodities, incomes would rise and would spread throughout the economy, the higher prices

and costs becoming embedded in the domestic economy. In a period of lower prices for basic commodities, an offsetting fiscal and credit policy would prevent domestic demand, prices, and incomes from falling, at least outside the export sector. Thus, there would be a rising trend of prices and costs, although at a discontinuous rate.

A policy designed to maintain monetary stability would, therefore, have to restrain domestic demand in a period of high commodity prices as well as supplement domestic demand in a period of low commodity prices. The best way to restrain demand when world prices of basic commodities rise above the long-term average level is a tax on exports of such commodities. The tax revenues would, of course, have to be sterilized (held in an inactive account at the central bank in foreign exchange). otherwise the tax would not neutralize the domestic effects of higher commodity prices. Unless the production of basic commodities is particularly profitable, a tax on exports in a period of high prices would reduce the average return to producers below the appropriate supply price. The logical policy, therefore, would be to retain the tax revenues in a commodity stabilization fund to be used to compensate producers when world prices of their basic commodities fall below the long-term average level.

There is another method of offsetting fluctuations in world prices of basic commodities in order to minimize the impact on the domestic economic. This could be done by having fluctuating exchange rates. In a period when world prices of basic commodities rise, the exchange rate would appreciate, although not as much as the rise in world prices. This would have several beneficial effects. First, it would limit the increase in the money income of producers and exporters. Second, it would share the improvement in the terms of trade between producers of export goods and the consumers of import goods, so that real income would increase for all sectors of the economy. Such a policy would not prevent an expansion. That would be inevitable with the increase in the real value of the national output resulting from the improved terms of trade. But it would minimize the secondary effects of the increase in money income and to this extent restrain the expansion.

Conversely, when world prices of basic commodities fall, the exchange rate would be allowed to depreciate, although not as much as the fall in world prices. Through the depreciation, the producers of basic commodities would share the incidence of the deterioration in the terms of trade with the consumers of import goods. The depreciation of the exchange rate would tend to hold up the money income of producers and exporters, thus minimizing the deflationary impact of the fall of commodity prices on the domestic economy. Obviously, a fall in the prices of basic commodities would still have a depressing effect as it would result in a sharp decline of imports, at least to the level suitable for the lower level of real incomes,



There are several difficulties in implementing these offsetting policies. The governments of developing countries would be very reluctant to sterilize the tax revenues (in foreign exchange) they would collect in a period of high prices of basic commodities. The shortage of resources for accelerated development would almost certainly induce governments to use the export tax proceeds to finance their own investment and to make the foreign exchange available to their importers. Later, in order to compensate producers in a period of low world prices of basic commodities, governments would have to create bank credit and issue currency, thus setting the stage for a future inflation. Unless the tax on exports is sterilized in a commodity stabilization fund, a policy of stabilizing domestic prices of basic commodities could result in a ratchet-type of inflation.

Similar difficulties would be experienced with fluctuating exchange rates. If basic commodities were the only exports and import goods were not competitive with domestic goods, the appreciation of the exchange rate in a period of high world prices of basic commodities would have no adverse effects. But minor exports are very important, not only because they employ domestic resources, but because their development is essential to the diversification of the economy. An appreciation of the exchange rate, while not serious for producers of basic commodities when world prices are high, could be disastrous for producers of minor export goods. Furthermore, domestic producers of manufactured goods are competing with foreign producers. An appreciation of the exchange rate would be equivalent to a negative tariff wiping out protection for the domestic industry or even providing a bounty for competing imports. Similarly, a depreciation of the exchange rate when world prices of basic commodities fall would have the same effect as an extraordinary increase in the tariff on domestic manufactured goods. Once accustomed to the depreciated exchange rate, domestic industry would have a vested interest in opposing an appreciation of the exchange rate when world prices of basic commodities rise.

Theoretically, it is attractive to use fluctuating exchange rates to minimize changes in the domestic prices of basic commodities, despite changes in world prices. In practice, such a policy would be very difficult to implement. There is a great difference between fluctuating exchange rates which are a response to changes in domestic cost relative to foreign costs and fluctuating exchange rates which are a response to changes in the terms of trade. The former create neither windfall gains nor windfall losses. The latter create windfall gains and windfall losses for those sectors of the economy not engaged in producing basic commodities. There is a strong probability that a policy of fluctuating exchange rates to offset changes in world prices of basic commodities would tend to be asymmetrical, with much greater response in depreciation and much less response in appreciation. The consequence would be a ratchet-type inflation,

## INTERNATIONAL PLANS FOR STABILIZING BASIC COMMODITIES

Because of the difficulties of operating national plans for offsetting the effects of fluctuations in world prices of basic commodities, it is necessary to have international plans for commodity stabilization. Quite apart from the pragmatic reason that national plans cannot be made to work, there are several reasons why international plans are preferable. First, one of the main causes of fluctuation in world prices of basic commodities is the instability of demand in the large industrial countries. These countries are aware that their own producers of agricultural products depend on domestic stabilization plans to minimize price and income fluctuations. They should be aware that it is no less important for those who produce for world markets to have international stabilization plans to minimize price and income fluctuations. Second, although producing countries all have the same interest in maintaining stable world prices of basic commodities, they have a competitive interest in increasing their relative contribution to supplies in world markets. Finally, consuming countries have an interest in assuring a steady flow of adequate supplies of basic commodities at prices that are fair to them. These diverse interests can be reconciled only through international plans for commodity stabilization.

International commodity stabilization plans have not been notably successful so far. The oldest and most successful has been in tin. This is essentially a producers' stabilization plan utilizing buffer stocks. Although it has done much to limit the range of price fluctuations for tin, fluctuations have been large. The price of wheat has fluctuated within a relatively narrow range, but this is not because of the wheat agreement. It is primarily due to the fact that the two largest exporters (Canada and the United States) carry large stocks that are available to meet world shortages. The sugar agreement has been of little consequence in recent years. In fact, for most producing countries, the stable element in their export receipts from sugar has been sales to the United States at a sheltered price. The coffee agreement has been in operation only a relatively short time. It has the great advantage of including consuming as well as producing countries. In the long run, its success will depend on the cooperation of producing countries in the allocation of sales to consuming countries. Needless to say the stabilization of coffee prices will depend on holding down world production to the average level that can be absorbed at prices fair to producers and consumers.

The present commodity stabilization plans involve considerable fluctuation in world prices. The developing countries need a much higher degree of price stability and of income stability if they are to be successful in avoiding either chronic inflation or a intermittent inflationary drift. From the point of view of resources for development, it is no less im-

portant for the developing countries to have remunerative prices for exports of basic commodities. This would also facilitate the maintenance of domestic monetary stability. But remunerative prices involve difficult decisions on controlling production and these questions are outside the scope of the present paper. Instead, emphasis is placed on two alternative ways of dealing with the domestic monetary instability originating in fluctuations of world prices of basic commodities.

One aspect of the commodity problem is the large change in export receipts arising from fluctuations in world prices of basic commodities. It is not at all unusual for countries dependent on basic commodities to find their export receipts rising or falling by 25 per cent or more in a period of one or two years. In Brazil, for example, export receipts increased by 61 per cent between 1949 and 1951 and fell by 25 per cent in 1952. In Malaysia, export receipts fell by 37 per cent from 1951 to 1952 and increased by 46 per cent from 1954 to 1955. Even high-income countries like Australia find the fluctuations in world prices of basic commodities a cause of serious disturbance in their balance of payments.

A national policy of offsetting the repercussionary effects of a fall in world prices of basic commodities cannot be successful if a country cannot maintain imports at a suitable although lower level, when there is a sharp fall in export receipts. Very few countries, certainly not the developing countries, can afford to hold monetary reserves on the scale necessitated by the large fluctuations in their export receipts. Yet if imports must be reduced very considerably, the measures designed to limit the domestic contraction consequent on a fall in world prices of basic commodities will be ineffective and unstabilizing. Without essential imports, production will be hampered. An offsetting policy for expansion under such circumstances will concentrate demand on domestic goods and, even if not excessive under ordinary conditions, could cause an undesirable rise in domestic prices. These difficulties could be avoided if countries dependent on exports of primary products had ready access to compensatory credits to offset a decline in their export receipts originating in lower world prices of basic commodities.

In February 1963, the International Monetary Fund adopted a policy under which members could expect their requests for drawings to be met by the Fund to offset a shortfall in their export receipts which is of a short-term character and is largely attributable to circumstances beyond their control. While this policy of the Fund must be regarded as a great advance in recognizing the need for compensatory export credits, the amount normally available (25 per cent of the quota) is not adequate to deal with a large fall in export prices over a period of one or two years. Furthermore, because compensatory credits are integrated with quota drawings on the Fund, they have an uneven incidence on members, being much less useful to countries that have not made use of Fund resources than to countries that have already made considerable use of Fund resources.

For this reason, the United Nations Conference on Trade and Development adopted a resolution proposed by Mexico, and based on a study of the Organization of American States, that the Fund consider raising the normal amount of compensatory export credits to 50 per cent of the quota and placing such drawings entirely outside the framework of other quota drawings. The Fund is studying this question and it will, no doubt, make important modifications in its policy on compensatory export credits. In the three years during which this policy has been in effect there have been very few drawings for compensatory export credits. The limited use of the compensatory export credits is primarily due to the improvement in world markets for basic commodities. It does not indicate that compensatory export credits are unnecessary. Under ideal conditions, such credits would be necessary only at infrequent intervals, when world markets are depressed.

The Fund policy of compensatory export credits, if it were liberalized, would enable countries to maintain the essential level of imports in a period when world prices of basic commodities have fallen sharply. The Fund would, in effect, provide special reserve credits under these reserves to take care of such contingencies. The availability of compensatory export credits would enable developing countries to take domestic measures to offset the repercussionary effects of a fall in world prices of basic commodities. The primary effects, associated with the decline of incomes of the producers of basic commodities, would still manifest themselves although in a more limited degree. Thus, compensatory export credits could help to moderate economic cycles in the developing countries, although they would not end them. It should be noted that compensatory export credits of the Fund have to be repaid within three years, with an outside limit of five years, unless repaid sooner when export receipts recover and reserves are accumulated.

The Fund policy of compensatory export credits, if were liberalized they need greater assurance of stability not simply of their own export receipts, but of the incomes of their producers of basic commodities. This can be done in several ways. The most obvious way is through a system of controlling production, exports and imports by producing and consuming countries designed to stabilize world prices of basic commodities. Such a system is very difficult to manage and it may not be appropriate for all basic commodities. There is every reason, however, why exporting and importing countries should study this problem, commodity by commodity, with the intention of devising and implementing the most practical method of achieving a much higher degree of stability in world prices of basic commodities. Of necessity, these studies will take a long time and it may very well be that only a few basic commodities will be found suitable for stabilization by controlling production, exports and imports.

An alternative means of dealing with the stabilization of export receipts and the income of producers of basic commodities would be through an Export Commodity Stabilization Fund. The purpose of such a fund would be to assure (a) countries exporting basic commodities that their export receipts would not fluctuate unduly because of changes in world prices and (b) to minimize changes in incomes of producers of basic commodities arising from fluctuations in world prices. Such an Export Commodity Stabilization Fund would be fully consistent with the maintenance and extension of commodity agreements designed to minimize price fluctuations and with the provision of compensatory export credits by the International Monetary Fund.

A list of basic commodities would be agreed to be covered by the Export Commodity Stabilization Fund. Initially, such a list should include most of the basic commodities produced by the developing countries. The members of the Export Commodity Stabilization Fund would include all the members of the International Monetary Fund. Each member would be given a subscription quota payable in convertible foreign exchange. The quotas would not be the same as in the IMF, but would be much smaller for the developing countries.

The Export Commodity Stabilization Fund would establish a reference range of prices for the basic commodities covered by the Fund. This range would be adjusted from time to time in accordance with price trends. When the price of a covered commodity is more than the upper limit of the range, exporting countries would be required to deposit with the Export Commodity Stabilization Fund an amount in convertible foreign exchange equal to three-fourths of the price excess multiplied by the amount of their exports. At the same time, they would be required to tax their exports an equivalent amount to be withdrawn from their exporters or producers. No country, however, would be required to make a deposit with the Export Commodity Stabilization Fund if the total receipts from its exports were less than the average over some preceding period of years. This would assure a country that a rise in world prices offset by a fall in the volume of its exports would not cause an impairment of its payments position. Deposits made by each country out of excess export receipts would be credited to its account in the Export Commodity Stabilization Fund.

When the price of a covered commodity is less than the lower limit of the range, exporting countries would be entitled to draw from the Export Commodity Stabilization Fund an amount in convertible foreign exchange equal to three-fourths of the price deficiency multiplied by the amount of their exports. At the same time, they would be required to pay their exporters or producers an equivalent amount based on their drawings from the Export Commodity Stabilization Fund. No country would be entitled to draw from the Export Commodity Stabilization Fund if its export receipts were equal to or more than the average over some

preceding period of years. Drawings made by a country would be debited to its account at the Export Commodity Stabilization Fund.

If the debits and credits to the account of a country, resulting from the deposits and drawings, balance out over a period of a few years, the country would in effect have used the Export Commodity Stabilization Fund as a temporary source of reserve credit or as a temporary depository for part of its reserves. A country whose account was in continuous debit for five years could apply to the Fund to have all part of the debit cancelled. The Export Commodity Stabilization Fund would do this where it is clear that the persistent low level of prices for the country's basic commodity exports have so impaired its reserve position as to make this necessary. A country whose account was in continuous credit for five years could apply to the Export Commodity Stabilization Fund to have all or part of the credit balance returned to it. The Export Commodity Stabilization Fund would do this where it is clear that the country needs the reserves or that the accumulated credit balance is more than reasonably adequate to meet drawings in the near future. No country would be required to return any part of a credit balance that the Export Commodity Stabilization Fund has agreed to let it withdraw.

Such a system combines supplementary reserves accumulated by a country with reserve credit provided by the Export Commodity Stabilization Fund, subject to the conversion of the credit into a grant where prices are depressed for a long time. If the world prices of a basic commodity is persistently depressed, the range would have to be reduced. In the meantime, however, the Export Commodity Fund would provide the resources to meet the drawings. Debits which have been cancelled would be made good out of the subscriptions to the Export Commodity Stabilization Fund. When its resources have been reduced to less than one-fourth of the original subscriptions, the high-income countries would be requested to make supplementary contributions. Although the Export Commodity Stabilization Fund is particularly designed for the developing countries, there is no reason why it should not be used by high-income countries with a large proportion of their exports in basic commodities. Such countries, however, would not expect to benefit from the cancellation of their accumulated debits.

## RELATION TO OTHER PROGRAMS

The Export Commodity Stabilization Fund is not intended to be a substitute for programs for stabilizing the prices of individual basic commodities. In fact, the operations of the Export Commodity Stabilization Fund would be greatly facilitated by international commodity agreements. Such agreements would tend to reduce the fluctuations in world prices and thus permit the Export Commodity Stabilization Fund to set a somewhat narrower price range above which countries would be re-

quired to make deposits and below which they would be entitled to make drawings. In fact, if price fluctuations were narrowed by successful international commodity agreements, the Export Commodity Stabilization Fund would have less occasion to cancel accumulated debits and to call on the high-income countries for supplementary contributions.

The Export Commodity Stabilization Fund is not intended to replace the compensatory export credits now provided by the International Monetary Fund. Deposits and drawings under the Export Commodity Stabilization Fund would be based primarily on the behavior or world prices of covered commodities. Some commodities might not be included in the plan, at least initially. Furthermore, export receipts could fluctuate not only because of changes in price but also because of changes in export volume. A country with a shortfall of export receipts due to a crop failure would not be eligible to draw on the Export Commodity Stabilization Fund. It could, however, apply to the International Monetary Fund for compensatory export credits. Finally, the Export Commodity Stabilization Fund would provide credits based on three-fourths of the price deficiency below the range established for each commodity. This necessarily involves a larger price decline measured from the average. Here again, a country should be able to apply to the International Monetary Fund for compensatory export credits to supplement drawings from the Export Commodity Stabilization Fund.

The Export Commodity Stabilization Fund would be an independent institution with its own resources. Its principal operations would be different from those of any other international financial institution. Nevertheless, the functions of the Export Commodity Stabilization Fund should be coordinated with those of the International Monetary Fund. The drawings and deposits of members of the Export Commodity Stabilization Fund would be largely automatic, determined by the behavior of prices and the volume of exports. There would be no need for an elaborate staff or a formal directorate. In fact, it would be most economical to make the Export Commodity Stabilization Fund an affiliate of the International Monetary Fund and to entrust that institution with its management and operation.

## EFFECT ON MONETARY STABILIZATION

The stabilization of world prices of basic commodities is not a cure-all for the inflation problem of developing countries. It is not and cannot be a substitute for appropriate fiscal and credit policies designed to limit aggregate demand to the supply of goods and services available from domestic production and the import surplus. All that the stabilization of world prices of basic commodities can do is to provide a monetary governor conducive to stabilization, so that monetary policies designed to avoid inflation can be made effective.

The stabilization of world prices of basic commodities would perform in its way the same function that an incomes policy performs in the industrial countries. It would assure that one large segment of money income would not fluctuate erratically, thouching off a spiral of rising or falling prices that would undermine cost and price stability. The danger of having a major segment of the economy subjected to the hazards of large price and income fluctuations has been recognized by the industrial countries. Nearly all of them, in one way or another, have policies intended to prevent sharp fluctuations in domestic prices of staple agricultural products and corresponding fluctuations in the incomes of their producers. It is not too much to say that because of the greater relative role of basic commodities in the economy of the developing countries, it is even more important for their monetary and economic stability to avoid large fluctnations in world prices of basic commodities. The responsibility for stabilizing world prices of basic commodities cannot be assumed by the developing countries alone. Indeed, there may be commodities for which stabilization plans cannot be made effective, even with the cooperation of the large industrial countries. Nevertheless, the economic impact of such fluctuations can be minimized through an Export Commodity Stabilization Fund. The large industrial countries have and obligation, as the prime movers in the world economy, to cooperate in such a plan.

The problem of inflation and economic development has been studied in all its ramifications. There may be some economists who remain convincend that inflation is a inevitable accompaniment of development or even that inflation is a desirable means of accelerating development. The fact remains, however, that the positive accomplishments of inflation in accelerating development have been negligible and probably negative. The social and economic disorders caused by inflation have diverted workers and businessmen from the basic objctive of development — to produce more output and to produce it more efficiently. Monetary stability is essential for a long-run development program designed to raise living standards. With or without international cooperation for the stabilization of world prices of basic commodities, it is in the interest of the developing countries that they follow policies conducive to monetary stability. All that is argued in this paper is that such policies will have a better chance of success if they can be undertaken in an environment of greater stability in world prices of basic commodities.