Chapter - X

THE COMMON FUND FOR COMMODITIES:
TOWARDS MORE AND EFFECTIVE
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I. INTRODUCTION

The Agreement establishing the Common Fund for Commodities\(^1\) adopted in June 1980 by the United Nations Negotiating Conference on a Common Fund is the principal legal instrument in the context of the Integrated Programme for Commodities. It seeks to establish a new multilateral financial institution of a universal character with the following objectives: (a) to serve as a key instrument in attaining the agreed objectives of the Integrated Programme for Commodities as embodied in Resolution 93(IV) of UNCTAD; and (b) to facilitate the conclusion and functioning of ICAs, particularly concerning commodities of special interest to developing countries.\(^2\) The Fund Agreement has yet to enter into force.\(^3\)

2. Article 2 of the Fund Agreement.
3. The conditions under which the Fund Agreement will enter into force are stated in article 57(1) as follows: "This Agreement shall enter into force upon receipt by the Depository of instruments of ratification, acceptance or approval from at least 90 States, provided that their total subscriptions

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In order to achieve its objectives, the Fund is to exercise the following functions: (1) to contribute to the financing of international buffer stocks and internationally co-ordinated national stocks, all within the framework of ICAs, for which purpose it shall establish a 'First Account'; (ii) to finance, through a 'Second Account', measures in the field of commodities other than stocking viz. research and development, productivity improvements, market promotion and vertical diversification; and (iii) to seek to promote co-ordination and consultation through its Second Account, with regard to these other measures and their financing so as to provide a "commodity focus". 4

This chapter critically examines the financial, legal and institutional structure of the Common Fund as established by the Fund Agreement in order to achieve the set objectives. To put it differently, the task will be

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of Shares of Directly Contributed Capital comprise not less than two thirds of the total subscription of Shares of Directly Contributed Capital allocated to all the States... and not less than 50 per cent of the target for pledges of voluntary contributions to the Second Account specified in article 13, paragraph 2, has been met, and further provided that the foregoing requirements have been fulfilled by 31 March 1982 or by such later date as the States that have deposited such instruments by the end of that period may decide by a two-thirds majority vote of those States...." By June 1985 the Fund Agreement has received 87 ratifications. UNCTAD Press Release TAD/MF/1692, 4 June 1985, p. 3.

4. Article 3 of the Fund Agreement.
to elaborate the basis, form and content of the financial and legal relationship which the Fund Agreement envisages between the commodity agreements and the Common Fund when it comes into existence. The analysis will, (a) to begin with, refer to the provisions in the existing agreements which anticipate the relationship with the Fund; (b) very briefly trace the genesis of the concept of a Common Fund and the evolution of the negotiations which led to its establishment; (c) examine the financial structure of the Fund through brief discussion of the alternative funding structures negotiated and the final outcome; (d) examine in some detail the operation of the First Account including, inter alia, the pre-conditions for availing the facility, its financial basis and limits, and the legal relationship of the associating International Commodity Organisations (ICOs) with the Fund; and (e) analyse briefly the need for a Second Account, its structural and operational principles and the procedure for availing the facility. It may be noted that the analysis only deals with aspects of the Fund which pertain directly to commodity agreements. Therefore, a number of issues which are otherwise of great significance to the operation of the Fund are not in so far as they are not relevant to the discussion at hand, touched upon.
The entire exposition is premised upon the following hypothesis: (1) that a principal reason for the existence of very few commodity agreements with regulatory mechanisms (the reference here is to the buffer stock type of agreement) has been the problems of finances; (2) that the effective operation of the buffer stock arrangement to stabilise prices is hindered by the lack of adequate financial resources; and (3) that commodity development measures which seek to attack the more fundamental problems afflicting a commodity cannot be undertaken without sufficient financial resources. The Common Fund was conceived as a response to these, among other, problems.

Most current agreements contain a provision which defines their relationship with the Common Fund for Commodities when it comes into operation.\(^5\) For instance, Article 25 of the ITA states as follows:

When the Common Fund becomes operational the Council shall negotiate with the Fund for mutually acceptable terms and modalities for an association agreement with the Common Fund, in order to seek to take full advantage of the facilities of the Fund.

Similarly, the IAJJP, which will seek to avail of the Second Account facility, states in Article 29 that

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5. Apart from provisions of ITA and IAJJP cited in the text see article 55 of ISA; article 23 of IOOA; article 42 of INRA; article 32 of ICCA; article 26 of ITTA; and article 22 of ICFA.
When the Common Fund becomes operational, the Organisation
(i.e. the International Jute Organization) shall take full advantage of the facilities of the Common Fund according to the principles set out in the Agreement establishing the Common Fund for Commodities.

The possible legal significance of such a provision is that it commits the members in principle to associate with the Common Fund when it comes into operation. The details of the intricate relationship with the Fund is left to be worked out by the Council, in accordance to the principles laid down in the Fund Agreement. In this respect, it may be noted that the Fund Agreement sets out separate operational principles, in view of their different functions, for the First and the Second Accounts. These aspects will be dealt with presently, after a brief review of the genesis of the concept and evolution of the negotiations which led to the Fund Agreement.

II. GENESIS AND NEGOTIATION

The concept of a Common Fund found its first expression in a proposal made by the famous John Maynard

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6. Of course, the actual modalities of the relationship are left to be worked out between the Council and the Fund.
Keynes. He suggested the setting up of an international body called the "Common Control" on which the governments of the leading producing and consuming countries would be represented. "Common Control" was conceived of as one of the basic international financial institutions in the post-war period along with the IMF and the World Bank. Its object was to be to "stabilise the price of that part of world output which enters into international trade, and to maintain stocks adequate to cover fluctuations of supply and demand in the world market". Without going into the details of the Keynes proposal it will suffice to note that the Fund Agreement "incorporates much of Keynes' proposal".

The proposal for a Common Fund received greater attention when it was conceived of as an element of an integrated programme for commodities which was systematically examined and elaborated in 1974. The UNCTAD secretariat brought out a series of papers on the important elements of the integrated programme, one of which was devoted to examining "a common fund for the financing

8. Ibid., p. 301.
of commodity stocks". The paper introduced the concept of a Common Fund, described the current arrangements for stock financing, and examined the role and efficiency of common financing as well as the viability of a Common Fund. This first outline was followed by a number of papers which sought to elaborate and classify the elements which would constitute a Common Fund. It would require a lengthy detour to trace the developments and evolution of the concept within and without the UNCTAD secretariat, not entirely pertinent to the present discussion. However, the broad considerations in support of the Fund and the evolution of the negotiations may be noted in brief.

In the very first paper, the UNCTAD secretariat set out the general considerations: that greater weight would be attached by governments to solutions to commodity problems if the source and cost of financing were assured; that the amount of outstanding capital indebtedness is likely to be reduced in common financing for a number of commodities as compared to individually financed arrangements; that the spreading of risk through investment in a number of stocking operations would make it easier to attract financial resources; and that the management of

10. TD/B/C.1/166/Supp.2, 12 December 1974: A Common Fund for the financing of commodity stocks: Report by the Secretary-General of UNCTAD.
stocking operations can concentrate in a more specialised manner on purely operational objectives through devolution of the financial management problems in seeking funds and in conducting operations to meet fluctuating and higher costs from commercial and other non-consolidated sources. The specific advantages of a common financing scheme, however, the UNCTAD secretariat correctly noted, would eventually rest on a number of factors, *inter alia*, the sources of finance, the kind of schemes it would seek to support and the structure of the institution to be established.

A summary of the basic principles and the mode of operation of the Common Fund was submitted to the fourth session of the UNCTAD (1976) which adopted the Integrated Programme for Commodities. The main policy paper to the Conference discussed the rationale, mode of operation, the costs of establishing the Common Fund and the source of funds. However, it reiterated that finance had been the chief hurdle in establishing international buffer stocks in the past under the aegis of ICAs. The Common Fund, by financing international stocks i.e. assuring

11. Ibid., p. 8.

12. TD/184, 4 March 1976: Commodities – Action on Commodities, including decisions on an integrated programme, in the light of the need for change in the world commodity economy: Report by the UNCTAD secretariat, pp. 7-11.
finance in advance, would play a 'catalytic' role in stimulating new ICAs. In fact, since the organisation would take a holistic view of commodity markets, it would "inject a new dynamism into international commodity policy". The total financial requirement of the fund was estimated to be of the order of $6 billion.13

Resolution 93(IV), adopting the Integrated Programme for Commodities, requested the Secretary-General of the UNCTAD to convene, no later than March 1977, a negotiating conference on a Common Fund open to all members of the UNCTAD. He was further requested to convene preparatory meetings prior to the conference with a view to elaborating the objectives, the financing needs of the Common Fund and its structure, its sources of finance, its mode of operations, and decision making and fund management.14 Pursuant to the Conference resolution, three preparatory meetings were held in Geneva15 in late-

13. The initial capital requirement was put at $3 billion of which $1 billion was to be provided as paid-up risk capital and $2 billion as loans. Additionally, it was proposed that governments should take up a further commitment of $3 billion which was also to be composed of $1 billion as paid-up capital and $2 billion as loans.


1976 and early 1977. Thereafter, the First Session of the United Nations Conference on a Common Fund was convened on 7 March 1977. Deep-seated differences, which had been revealed during the preparatory meetings, continued to bog down the Conference. It was reconvened in November of the same year which had to be suspended because it could not reach agreement on two significant issues: (i) whether the Common Fund should finance measures other than stocking through a separate account, and (ii) whether the Fund should have resources of its own in the form of directly contributed capital. While the Group of 77 answered both the questions in the affirmative, the Group B countries of the UNCTAD (the developed countries) were opposed to these proposals.

The second session was resumed only in November 1978 which saw considerable progress on both the issues.

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It set the basis for the agreement on the 'basic elements of a common fund' which was reached at the third session held in March 1979. As is the case in such negotiations, compromise solutions satisfactory to all parties were worked out. An Interim Committee was set up for further discussions, which held five sessions in 1979 and 1980. The final draft of the Agreement was adopted on 27 June 1980 at the fourth session of the Conference.

The Conference adopted a resolution establishing a Preparatory Commission for bringing the Common Fund into operation. The Preparatory Commission will continue to exist till the first meeting of the Governing Council of the Fund, whereupon the Fund shall succeed to all the rights and obligations of the Commission. The task of the Preparatory Commission is to finalise a host of administrative, legal, procedural, operational and financial matters.


21. For the resolution see Fund Agreement, n.1, Annex. For the basis of the resolution see TD/IPC/CF/CONF/ICR.2, Preparatory work required to bring the Common Fund into operation. The document is attached as Annex II to the Report of the Interim Committee, ibid.
Evidently, the mere reference to the chronology of the negotiations cannot provide any idea of the range and magnitude of issues which confronted the Conference and the manner in which they were tackled. All that can be said is that the Common Fund, which finally emerged from the negotiations, differs from its original concept of the UNCTAD Secretariat, in terms of its financial structure. Indeed, financial structure is the most critical aspect of a financial organisation such as the Common Fund, as it determines to a great extent the underlying relationship with commodity agreements which would seek to associate with it. It would also influence to a great degree the nature and effectiveness of the Fund when it comes into operation.

III. THE FINANCIAL STRUCTURE OF THE FUND

The negotiations threw up five alternative funding structures: (i) a principal source of funds; (ii) a pool of finance; (iii) a clearing house version; (iv) a guarantor of loans; and (v) variants of pool/source concepts. Since (iii) and (iv) were not really given serious consideration at the negotiations, it would be right to discuss and dismiss them first.

A. The Clearing House Version

This concept essentially relegates the role of the Common Fund to assisting ICOs in bilateral negotiations.
The Fund would aim to "marry the financial requirements of one ICO to the excess liquidity of another; and would not possess any funds entirely under its own control". Such a Fund, as is evident, could hardly act as a 'catalyst' or finance non-buffer stock activities. Moreover, its ability to spread risks and thereby secure low interest loans would be limited. Finally, the 'pool' concept can, as will be seen, meet the objectives of a 'clearing house' in a better fashion.

B. Guarantor of Loans

As guarantor of loans, the Common Fund would collect a range of governmental guarantees, including, possibly guarantees from intergovernmental organisations such as the IMF. These in turn would be used as security by the ICOs in raising loans. This structure, according to a Commodity Research Unit Study, suffered from several problems. First, "the formation of a syndicate of national and international guarantors of common fund borrowing does not enable the fund to take advantage of offsetting movements in ICOs financial requirements."


23. Ibid.
since it does not provide any mechanism for excess liquidity in one ICO to be transferred to another.\(^{24}\) Second, it would not be able to either assist desirable non-buffer stocking activities i.e. commodity development measures, or take due account of the special factors that may affect particular commodity buffer-stock schemes.\(^{25}\) In view of these weaknesses, this alternative was also rejected.

### C. A Pool of Finance

Such an approach proposes that individual commodity organisations i.e. ICOs, bound together by agreements between producers and consumers would raise their own funds. The liquid element of these would be pooled in a Common Fund which would supervise and control subsequent lending to the ICOs linked to it. In other words, "the only centralised finance available to ICAs will come from the surplus funds raised by other ICAs".\(^{26}\) This was in essence the Group B proposal.

The Group of 77 objected to the pooling scheme pointing out that the financial structure of the Fund should be such as to allow it to meet its objectives.

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26. Ibid.
They identified six criteria against which the Funds' viability to be tested: its ability to (a) facilitate the negotiation of international commodity arrangements; (b) minimise the financial burden on member countries, particularly developing countries; (c) take maximum advantage of financial savings resulting from offsetting price movements for different commodities; (d) provide incentives for international commodity arrangements particularly existing ones, to join the Common Fund; (e) finance measures other than stocking and also operations outside the purview of international commodity arrangements; and (f) ensure participation by all countries on the basis of global solidarity. In addition, it recognised two other criteria proposed by Group B as being important: (a) the Fund should be financially and economically viable; and (b) its operations should not prejudice the autonomy of ICAS.

The Group of 77 noted that the pooling scheme (as proposed initially) did not meet the first six criteria in a number of ways. First, a Common Fund as a pool of resources of international commodity arrangements with no initial capital of its own (i.e. directly contributed capital) would not facilitate the setting up of such arrangements. Secondly, the proposed structure would not

27. TD/IPC/CP/CONF/14(Part I), n. 17, p. 12.
minimise the financial burden on countries members of ICAs, particularly developing countries. Nor would it minimise the possibility of raising substantial resources through borrowing. Although all Groups agreed that commercial borrowing should be provided for, under the Group B proposal the Fund would not have a capital structure that would provide creditors with guarantees, since subscriptions, guarantee and callable capital were to be pledged to the commodity agreements rather than the Fund. Thirdly, the Fund would not be able to take maximum advantage of financial savings resulting from offsetting price movements for different commodities since there was insufficient inducement for international commodity arrangements to participate in it. Fourthly, there were insufficient incentives to encourage the participation of all international commodity arrangements, particularly since some could borrow more easily on private financial markets. Fifthly, the proposed structure did not provide for measures other than stocking. The Fund would not be able to maintain its viability since it would be paying interest on deposits of international commodity arrangements nearly equal to that received on loans to them. Finally, there was no assurance in the proposal that in the interests of global solidarity, all countries would participate, since participation would be limited to
countries members of international commodity arrangements which joined the Common Fund. 29

D. Principal Source of Funds

This approach, backed by the Group of 77, envisaged that all funding would be arranged by one centralised fund which would lend funds to ICOs associated with it:

Governments would subscribe to the capital of the fund rather than the individual commodity organisations, and the fund would also be the agency which would borrow from the market, from the governments and from international financial institutions. In turn, the common fund would lend the proceeds to individual commodity organisations as they need resources for acquisition of commodities; these organisations would repay the loans as they acquired cash from selling the commodities. The individual commodity organisations would have their own independent budgets, however, for financing administrative expenses. Trading profits would accrue to the organisations and would be their major source of income. 30

A Commonwealth secretariat paper listed, inter alia, the following advantages as being possible by adopting the

29. Ibid.

30. TP/B/C.1/196, 6 October 1975: A common fund for the financing of commodity stocks: suitability for stocking of individual commodities, country contributions and burden sharing, and some operating principles: Report by the Secretary-General of UNCTAD, p. 25.
principal source of funds mechanism:

(i) It would economise on the use of capital for buffer stocking because price cycles for individual commodities tend not to be synchronised;

(ii) Funds could be made more readily available and at a lower cost because of the greater access to credit, and the spreading of risks involved in a multi-commodity operation;

(iii) The prior assurances on the availability of finance would facilitate the setting up of commodity agreements and the choice of buffer stocking as a control mechanism where this is a suitable device;

(iv) Specialised buffer stock financing would encourage the development of expertise in financial management and of appropriate instruments for the maximum utilisation of potential sources of funds for this type of activity taking into account its special liquidity requirements;

(v) A common financing facility could provide support for commodities for which an ICA has not yet been established thus enhancing the catalytic role mentioned in (iii);
To the extent that the Fund earns surpluses it could make some provision to a Second Window for the financing of "other measures" and so enhance the effectiveness of the individual ICAs in reaching global objectives;

It would provide greater scope than the pool concept for assisting global economic management and promoting international economic stability; and

It provides a firm basis for determining country participation in the management and control of the Fund. 31

A number of objections were raised by Group B against the 'source of funds' concept. Firstly, they raised the issue of idle money. It was, however, pointed out that such a difficulty could be overcome by phasing the contributions to the capital in accordance with actual financial requirements. 32 Secondly, direct government contributions could involve countries in financing


ICAs of which they were not members. In reply the point was made that fungibility of resources is a basic banking principle. Even in the case of a deposit scheme, the Fund might well, on occasion, use the surplus balances of some ICAs to lend to others. Further, there did not seem to be any room for objection as this represented the essence of the offsetting process which was claimed as a distinct advantage in the Group B scheme.  

Moreover, the economic rationales of direct government contributions also relates to: (1) facilitating market borrowing; (2) provision of adequate working capital to resolve initial liquidity problems; and (3) meeting unforeseen cash problems. In other words, direct government contributions will give the Fund an 'image of permanence' and help establish it on a sounder footing, increasing thereby its creditibility and creditworthiness.

Thirdly, it was argued by Group B, that the pool concept responds better to special factors which arise within individual commodity agreements, since the ICAs enjoy considerable financial autonomy. But "...s against this, however, it must be noted that the fundamental decisions which will affect the rate of stock accumulation

33. Ibid.
34. Ibid., p. 67.
or disposal will be taken by the ICAs within their provisions, but finance will have to be obtained from some source anyway; in these circumstances, it may be considered that the potential weakening of the ICAs by the central source concept is illusory and deviation from it could both increase costs to the individual ICAs and weaken the effectiveness of the buffer stock as a stabilisation mechanism. 35

Fourthly, criticism of the principal source of funds concept is that it poses management problems, in terms of resolving conflicts of interests between different commodities in relation to capital requirements and the need for maximum limits to borrowing by individual ICAs. But at the same time, it must be recognised, it helped the development of skills in financial management. It would provide a deeper insight into commodity problems of developing countries and the means to overcome them.

Finally, the argument was that some countries would bear an undue proportion of the cost in relation to the benefits to be had. This argument did not taken into account, as the Group of 77 pointed out, the fact that

benefits would not be confined to producers and consumers of particular commodities, but that "there would be a wider ripple effect in stabilising commodity prices in general, providing sufficient resources for continued economic development and prosperity, and bringing certain welfare benefits". 36

E. Compromise on the Pool Concept

What finally emerged from the painful travail of negotiations appears to be the pool concept suitably modified to make it acceptable to the developing countries. The financial resources of the Fund are: (i) directly contributed capital from member governments totalling $470 million; (ii) cash deposits and back-up government guarantees from individual commodity organisations which associate with the Fund; and (iii) the use of the first two resources to borrow from the international capital markets on favourable terms.

The fact that the Group B countries agreed to make direct governmental contributions (however limited) has led scholars like Laidlaw and Laishley to characterise

the existing arrangement "as a financing facility with combined pool/source characteristics". 37 It is difficult to endorse such an assessment, since it fails to identify the financial structure of the Fund on the basis of an analysis which views the pool or source concept as arrangements integrated into a specific perspective of the Fund. The developing countries had proposed the Fund as a central source of finance visualising an institution which would play a significant role in organising world commodity markets. In as much as the Fund as presently constituted is only designed to play a banking role, the source concept which not only involved the acceptance of a specific financial structure but also assumed a certain role of the Fund, stands rejected. Furthermore, the existing structure will suffer from all the handicaps that a pool concept is beset with and which were forewarned by developing countries during the negotiations.

It may, however, be noted that the UNCTAD Secretariat had, from the beginning, been aware of the possibility that the Common Fund could operate both as a source and as a pool of finance: "In such a combination, individual commodity organisations would be endowed only with a

part of the resources they were expected to need on the average. The rest of the resources would be given to the common fund. The latter would also undertake all borrowing. Individual commodity operations would be committed to hold their cash balances on deposit with the fund. This was considered a better alternative than the Fund acting as a pool of finance for "the terms of borrowing would be improved; and the fund would have some resources available for emergency price support operations and could give impetus to the setting up of commodity arrangements." It was recognised, however, that such an arrangement would be much less effective than the source of finance solution.

IV. DIRECTLY CONTRIBUTED CAPITAL

Who has to contribute how much towards directly contributed capital? How is this contribution to be made?

The Common Fund as noted earlier is divided into two accounts: a First Account solely concerned with the financing of buffer stocks, and the Second Window for measures other than stocking. The directly contributed

39. Ibid.
capital totals $470 million, of which $400 million will
go to the First Account, and $70 million as voluntary
contributions to the Second Account. The Second Account
will also consist of other voluntary contributions
(governmental and non-governmental) of a further $280
million, adding up to $380 million in all.

Fund Agreement requires direct government contribu-
tions of a basic sum of $1 million from each member
state, the rest being drawn from recognised groups of
member states in accordance with their ability to pay.
The Governing Council has been empowered to increase the
shares of directly contributed capital under the follow-
ing circumstances (Article 9 para 4 read with articles
56, 12 and 17 para 4): (1) upon the accession of any
state; (2) if after 18 months of the entry into force
of the Fund Agreement the subscriptions of shares fall
short of $470 million or after review of the adequacy of
the directly contributed capital, the first of which will
take place not later than three years after the Agreement
enters into force; and (3) to meet certain 'outstanding'
liabilities after recourse to 'normal' sources.

The flat and assessed contributions, on present
formulas, will result in the developed countries having
to contribute 51.4 per cent of the directly contributed
capital (on the assumption that all countries join the Fund) and the developing countries contributing 32.1 per cent of the directly contributed capital.

On disaggregation, to illustrate, the United States would have to contribute $73.9 million, Japan $33.7 million, France $20.1 million, the UK $15.1 million, Australia $5.8 million, Brazil $4.5 million, India $2.4 million and Tanzania $1.2 million. 40

The directly contributed capital will be constituted with $370 million 'paid-in' shares and $100 million of 'payable' shares. The 'payable' shares will be called for only in case of an imminent default by the Fund and serve as backing to the Fund's borrowing.

The 'paid-in' capital is to be paid in separate tranches: the first tranche, to be provided in cash on joining, consists of 30 per cent of the $370 million 'paid-in' capital. The second tranche consists of 20 per cent in cash and 10 per cent in the form of promissory notes to be paid a year later. And the third will be

provided two years after a country joins the Fund and can consist entirely of promissary notes.  

V. FIRST ACCOUNT: FINANCING BUFFER STOCKS

First Account operations of the Fund will consist of three-fold activities: lending, borrowing and investment of liquid assets. However, the principal function of the First Account will be to finance international buffer stocks and internationally co-ordinated national stocks i.e., to act as a line of credit to ICOs for financing their buffer stock operations in order to achieve price stabilisation objectives. The Fund Agreement lays down certain pre-conditions for availing the First Account facility.

First, the IOC seeking to use the facility should have been established to implement the provisions of an ICA which provides for either international buffer stocks or internationally co-ordinated national stocks. That is to say, finance will be made available for buffer stocking activities "only within the framework of ICAs". An ICA, it may be recalled, has been defined in the Fund Agreement as "any intergovernmental agreement or arrangement to promote international cooperation in a commodity, the parties to which include producers and consumers covering the bulk of world trade in the commo-

41. Article 11(3) of the Fund Agreement.
42. Article 3(a) of the Fund Agreement.
dity concerned". In sum, the Fund will not finance national stocks outside the framework of a commodity agreement.

Second, the ICO shall have concluded an Association Agreement with the Fund. An Association Agreement is to comprehensively define the legal and financial relationship of the ICO with the Fund. Since the Fund Agreement only defines the more fundamental aspects of the relationship between the ICO and the Fund, it leaves it to the Association Agreement to work out the several intricate legal and financial linkages which need to be established to operationalise the relationship.

Third, an ICO can enter into an Association Agreement only if it has been established to implement the provisions of an ICA which "is negotiated or renegotiated on, and conforms to, the principle of joint buffer stock financing by producers and consumers therein". Levy-financed ICAs are, however, eligible for association with the Fund and therefore the ICCA can avail of the First Account facility. The principle of joint-buffer stock financing is conformed to by the existing commodity agreements like the ICCA, INRA and the ITA.

43. Article 1(2) of the Fund Agreement.
44. Article 7(1) of the Fund Agreement.
45. Article 7(2) of the Fund Agreement.
Fourth, apart from the Association Agreement the ICO and the Fund will have to enter into legal relationship with regard to the provision of guarantee capital, guarantees and where necessary for the pledging or assignment in trust of stock warrants.46

Finally, the Associated ICO will not borrow funds from any third party for its buffer stocking operations unless the Associated ICO and the Fund reach mutual agreement in this respect.47

A. Operation First Account: Financial Basis and Limits

The Fund Agreement, as indicated above, defines certain fundamental aspects of the relationship between an ICO and the Fund. A significant aspect of it relates to the financial ties between the ICO and the Fund; the Fund Agreement outlines the financial basis and limits of First Account operations.

1. Transfer of resources

On associating with the Fund, the ICO is required to transfer to it certain resources which will assume the

46. Article 14 of the Fund Agreement.
47. Article 17(9)(b) of the Fund Agreement.
following forms: (i) cash deposits, and (ii) guarantee capital and guarantees. 48 This is in keeping with the pool concept of the Fund's financial structure. These resources, coupled with the Fund's directly contributed capital, are then to be used to borrow on favourable terms from international capital markets. In drawing a loan from the First Account, an ICO is required to pledge or assign in trust the stock warrants of commodities as security for loans. 49 However, when an ICO intends to sell stocks, the prompt return of stock warrants is provided for. The Fund Agreement specifies the limits to which an Associated ICO can borrow, the interest rate policy, the procedure in case of default and other aspects of the linkages between the ICO and the Fund. The details in this regard are to be written into the Association Agreement.

(a) Cash deposits

On associating with the Fund, an ICO must deposit one-third of its maximum financial requirements (MFR) in cash in usable currencies with the Fund. 50 The deposit

48. Article 14 of the Fund Agreement.
49. Article 14(8) of the Fund Agreement.
50. "Usable Currencies" means (a) the deutsche mark, the French franc, the Japanese yen, the pound sterling, the United States dollar and any other currency which has been designated from time to time.
obligation can also be met, where the Associated ICO holds stocks at the time of its association, by pledging to, or assigning in trust for, the Fund stock warrants of equivalent value.\(^5\) The Associated ICO may also deposit voluntarily over and above its mandatory obligations any cash surplus, on mutually agreed terms and conditions.\(^5\) Finally, the deposit can be made in full or in instalments as agreed to between the Fund and the Associated ICO.\(^5\)

The rationale for requiring cash deposits to be made is that the Fund can employ any unused cash deposits of one Associated ICO for lending to another Associated ICO. This would help limit the Fund’s need to borrow, and reduce the cost of on-lent monies (the gross cost to the Fund of on-lent deposits being the rate of interest paid on those deposits). The Fund would thus need to charge Associated ICOS a reduced rate of interest on their loans.

\(^{cont.\ldots}\)

time by a competent international monetary organisation as being in fact widely used to make payments for international transactions and widely traded in the principal exchange markets, and (b) any other freely available and effectively usable currency which the Executive Board may designate by a Qualified Majority after the approval of the country whose currency the Fund proposes to designate as such”. Article 1(9) of the Fund Agreement.

51. Article 14(2) of the Fund Agreement.
52. Article 14(3) of the Fund Agreement.
53. Article 14(1) of the Fund Agreement.
The MFR indicates the maximum amount of funds that may be drawn and borrowed by an Associated ICO from the Fund. It includes the acquisition cost of stocks which is to be determined by multiplying the authorised size of its stocks as specified in the Association Agreement with an appropriate purchase price as determined by that associating ICO. The MFR can also include specified carrying costs (exclusive of interest charges on loans) in an amount not exceeding 20 per cent of the acquisition cost. 54

The MFR, which is at first fixed in the Association Agreement, may have to be modified, if the authorised size of the stock (say, through the inclusion of contingency stocks) or the price range is altered. Article 17, paragraph (7) of the Fund Agreement leaves it to the Associating Agreement to specify the steps to be taken in the event of the modification of the MFR. It needs to be noted that the modification of the MFR would also mean the corresponding modification of the deposit obligations and thereby the line of credit as well.

(b) Guarantee capital and guarantees

The Fund Agreement, in addition to cash deposits, requires governments participating in ICAs, whose ICOs have associated with the Fund, to provide directly to the

54. Article 17(8) of the Fund Agreement.
Fund guarantee capital to the aggregate value of two-thirds of the MFR "on a basis determined by the Associated ICO and satisfactory to the Fund". This two-third would also comprise guarantees provided to the Fund by participants in an Associated ICO which are not members of the Fund. Such participants are required to deposit cash with the Fund in the amount of the guarantee capital which they would have provided, if they were members of the Fund.

The Governing Council can, however, by a highly qualified majority allow an Associated ICO to arrange either for the provision of additional guarantee capital of the same amount by members participating in that Associated ICO or for the provision of guarantees of the same amount by participants which are not members. Such guarantees will carry financial obligations comparable to those of guarantee capital and "shall be in a form satisfactory to the Fund". The guarantee capital or guarantees have to be provided in usable currencies, and are to be given in aggregate time the amount of instalment of cash deposits made under the first obligation.

55. Article 14(4) of the Fund Agreement.
56. Article 18(5) of the Fund Agreement.
57. Ibid.
2. Lending limits

There is little doubt that the effectiveness of the Fund will critically rest on its creditworthiness, that is, its credit rating in the commercial capital markets. In order to strengthen its position in financial markets, the Fund Agreement lays down the maximum limit to the amount that can be lent to an ICO. This is done, firstly, through specifying the MFR in the Association Agreement to be signed between the ICO and the Fund. Secondly, the Fund Agreement provides that, "the Fund shall make loans to the Associated ICO in an aggregate principal amount not exceeding the sum of the uncall Guarantee Capital, cash in lieu of Guarantee Capital, and Guarantees provided by participants in the Associated ICO by virtue of their participation in that Associated ICO". 58 In other words, as Tait and Sfeir note, "the obligations of the Fund to lend to the associated ICOS is limited not only by the maximum stocking requirements in the association agreement but also by the amount of security received from the ICOS and their members". 59

A weakness of this setting of limitation is that it would perhaps encourage speculation as the limits of

58. Article 17(10)(b) of the Fund Agreement.
59. Tait and Sfeir, n. 9; p. 510.
the buffer stock will be known in advance: "When the limits on purchases are known to exist, private operators would be more likely to unload their stocks on a public stock and thus increase its financial burden and perhaps even cause its demise, in a surplus situation; this is so because each operator might rush to sell 'to beat the clock', apprehensive that the limit on purchases might be reached before he sells, and thus in fact helping cause the limit to be reached. The setting of individual commodity limits would defeat one of the advantages of the common fund."

The UNCTAD Secretariat had, thus, initially sought to distinguish between commodities where the risk of surplus stock accumulation was high and therefore could cause a major drain of resources of the Common Fund justifying limits on purchases, and commodities where such a risk was relatively small and, therefore, did not warrant limits. In the context of the limits, it referred also to the practice and experience of the United States and the EEC in domestic commodity stabilisation, which generally supported the view that limits should not be placed. However, the UNCTAD Secretariat view was eventually not accepted.

61. Ibid.

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The problem of limits also raises the larger issue of whether the yardstick of financial viability should have been used to structure the operation of the Fund. It has been contended that it is questionable whether the viability can be the main criterion for evaluating the success of the Common Fund. Rather, it should have been the criteria of the net overall economic and social benefits which would accrue to the international community, which should have determined its principle of operations.

3. Concept of Fungibility

The Fund Agreement also specifies the circumstances in which a call can be made on the guarantee capital and guarantees provided to the Fund by the associating ICOs. Aspects of these circumstances were the subject of acrimonious debate in the negotiations which, technically speaking, revolved around the concept of fungibility.

The problem confronting the negotiators was to what extent the guarantee capital and guarantees provided by the associating ICO would be fungible, that is, generally available to meet the Fund's own obligations on borrowings from the capital markets even if the ICO for

62. Ibid.

which the guarantee had been given was not in default. 64 The Group of 77 had advocated full fungibility as this would secure the "common" character of the Fund, strengthen its financial viability, increase its ability to lend money to associated ICOs on better terms than existing sources and induce ICOs to associate with it.

Accordingly, the UNCTAD Secretariat proposed that all guarantees be "fungible" if needed by the Fund for its borrowings. The principle would, however, be subject to call first on guarantees of the defaulting ICO and using the value of the forfeited stock warrants of such ICO to repay in first priority any subsequent call on any guarantee which had been given on a non-defaulting ICO. 65 The developed countries, however, viewed the Fund as a broker enabling the associated ICOs to obtain loans, rather than as a lending institution "which itself borrows heavily from international financial markets by offering its capital as collateral". 66 They consequently opposed the proposals for full fungibility.

65. Ibid.
66. Ibid.
The actual provision represents an "uneasy compromise" and introduces the concept of "limited fungibility". It is that "all participants on a defaulting ICO could also be called eventually on their guarantees given as participants in non-defaulting ICOs, on certain conditions, including postponing such call to the last resort". However, the Fund Agreement provides that if the Fund was still not able to meet its liabilities after recourse to all the guarantees provided by participants on defaulting ICOs - including those made available by virtue of their participation in other ICOs - the directly contributed capital is to be increased by the amounts necessary to meet any of its liabilities. In other words, as Parkinson notes, the concept of full fungibility was now replaced by that of "full security".

4. Interest rate policies

Article 17(B) of the Fund Agreement, which specifies the principles of First Account operations, also addresses the issue of interest-rate policy on deposits and loans. It lays down certain principles which should guide the Fund's interest rate policy. These are:

67. Ibid.
68. Ibid.
need to minimise the lending rate, subject to (b);
(b) maintenance of financial viability of the Fund;
(c) non-discriminatory treatment as between Associated ICOs;
(d) inter-relationship among interest rates on loans, deposits, borrowings and investments.

These guidelines have, however, to be located within the Fund's financial structure. For instance, the Governing Council, under Article 17, is required to adopt rules and regulations laying down the operating principles regarding interest rates charged and paid in the light of its "cost of borrowing":

"(4) The Fund shall charge interest on loans made to Associated ICOs at rates as low as are consistent with its ability to obtain finance and with the need to cover its costs of borrowing for funds lent to such Associated ICOs.

(5) The Fund shall pay interest on all other cash balances of Associated ICOs at appropriate rates consistent with the return on its financial investments, and taking into account the rate charged on loans to Associated ICOs and the cost of borrowing for First Account operations".

As is evident, the 'cost of borrowing' is singled out as the primary determinant of interest rate policy. This is
its liquid assets or to the lending rate itself." The first option would allow the Fund to "remunerate ICO deposits at a rate equal to its average return on liquid assets minus a "spread". While under the second option "the deposit rate would be set somewhat below the lending rate". The UNCTAD Secretariat thought the latter approach more appropriate "as the lending rate would also capture the additional elements which are required to be taken into account in the setting of the deposit rate, such as return on liquid assets and borrowing costs".

B. Relationship of ICO with Fund: Principle of Autonomy

Though the specificities of the organic relationship between the Fund and the ICO are left to negotiations between the Fund and ICOs requesting association, the Fund Agreement lays down the general principle that "each carrying out the provisions of the Association Agreement between the Fund and an Associated ICO each institution shall respect the autonomy of the other".

70. CP/PC/6P II/R.1, 26 May 1981: Rules and Regulations for First Account Operations, Main Issues - Note by the UNCTAD Secretariat, p. 15.

71. Ibid.

72. Ibid.

73. Article 7(4) of the Fund Agreement.
The operational relationship between the Fund and the ICOS was originally conceived by the UNCTAD Secretariat as being an integrated relationship "in which each commodity organisation would be actively engaged in managing the fund through membership of its Board of Directors, with the fund, in addition to lending on fixed interest, participating in individual stocks". 74 This was considered a more appropriate approach than the "arms length approach" in which "the management of the fund is kept completely separate from the organisations, the fund acting only on application of the organisation and lending only on fixed interest". 75 The "integrated" approach, it was argued, would lead to a "desirable blend of national political concerns and commercial considerations". Moreover, it would enhance its profitability prospects (of course, also increasing its risks) through sharing in the results of trading operations directly and automatically.

The concept of "integrated" relationship, however, did not find acceptance in the negotiations. The Fund

74. TD/B/C.1/184, 24 June 1975; A common fund for the financing of commodity stocks: amounts, terms and prospective sources of finance: Report by the Secretary-General of UNCTAD, pp. 24-5.

75. Ibid.
Agreement, on the other hand, endorses the principle of autonomy which implies that the Fund merely has the right to call on guarantee capital and on the stock warrants secured by the ICO. Furthermore, it will be the ICO's buffer stock manager who will determine the timing of his interventions in the market guided solely by the commodity agreement.

C. Codifying the Relationship

As already indicated, a gamut of legal instruments will be needed to codify the symbiotic relationship of the Fund with an associating ICO. In the view of the UNCTAD Secretariat, four sets of legal documents will be essential: (a) an Association Agreement; (b) a guarantee capital agreement; (c) a guarantee agreement; and (d) a pledge agreement. 76

An Association Agreement - the jurisprudential basis of the total relationship - will be a "comprehensive document containing detailed covenants setting forth the legal and financial relationship between the Associating ICO and the Fund". 77 The guarantee capital agreement will define the rights and obligations of a participating

76. CP/PC/MP XIII/R.1, n. 70, p. 1.
77. Ibid., p. 4.
member with regard to the direct provision of guarantee capital. A guarantee agreement will similarly embody the rights and obligations of participant who are not members of the Fund. Finally, the pledge agreement will lay down the mechanism for the pledge or assignment in trust to the Fund by Associated ICOs of stock warrants which title evidence to commodity stocks held by associating ICOs. Together, they will establish the legal basis of the relationship between an ICO and the Fund under the umbrella of the Fund Agreement.

In order to facilitate the drafting of model instruments in each of these cases the UNCTAD Secretariat drafted and submitted in 1981, to the Preparatory Commission, preliminary drafts of the first three legal instruments. These documents are yet to be finalised. A study of these draft instruments is not relevant to the discussion at hand. It may only be noted that they will lay down the intricate details of the legal relationship between the ICO and the Fund.

in keeping with the Fund's financial structure in which borrowing plays a key role.

The formulation in Article 17(4) and (5) it seems, calls for some clarification. According to Tait and Sfeir, the reasoning contained in them is somewhat "circular" in as much as it requires that "the loan rate to ICOs should reflect both deposit rates and Fund borrowing costs on loans so that the rates for all ICO loans will be on the same basis irrespective of the source of the funds used. Since interest rates on international markets tend in part to reflect exchange risks, it seems essential that rates charged by the Fund should be currency-specific, as in commercial markets, so as not to subsidise the rate in one currency at the expense of ICO borrowers of other currencies". 69

Secondly, there is the difficult task of striking a balance between adequate remuneration of ICO deposits and the need to minimise the lending rate for they are dialectically intermeshed in relation to the financial viability of the Fund. According to the UNCTAD Secretariat, the Fund would have two basic options with regard to the remuneration of ICO deposits; "the deposit rate could be linked to either the interest rate earned by the Fund on

69. Tait and Sfeir, n. 9, p. 519.
VI. THE SECOND ACCOUNT: FINANCING COMMODITY DEVELOPMENT MEASURES

The Fund Agreement establishes, as noted at the outset, a Second Account "to finance... measures in the field of commodities other than stocking". Commodity agreements can avail of this facility as well. The measures, other than stocking, for which finance will be available are specified in Article 18, paragraph 3(a), of the Fund Agreement:

The measures shall be commodity development measures, aimed at improving the structural conditions in markets and at enhancing the long-term competitiveness and prospects of particular commodities. Such measures shall include research and development productivity improvements, marketing and measures designed to assist, as a rule by means of joint financing or through technical assistance, vertical diversification, whether undertaken alone, as in the case of perishable commodities and other commodities whose problems cannot be adequately solved by stocking, or in addition to and in support of stocking activities.

The developing countries attach great significance to measures other than stocking. These measures represent and attack on the more fundamental problems faced by primary commodity producers; it is the recognition of the objective reality that unless price stabilisation measures are coupled with commodity development measures they would
not in any way modify the basic structure of world commodity trade. The role of 'other measures' is not conceived of as merely supportive to price stabilisation measures but as autonomous measures which need to be undertaken to tackle problems which cannot be solved by stocking.

A. Commodity Agreements and the Second Account

The Second Account will, therefore, finance commodity development measures which seek to improve the structural conditions in markets and enhance the long-term competitiveness and prospects of particular commodities. Commodity agreements inevitably embody objectives which call for measures qualifying for loans and grants from the Fund's Second Account. Illustrative reference may be made here to the IAJJP, ITTA and the INRA.

The major objectives of the IAJJP, it may be recalled, are: to improve structural conditions in the jute market; to enhance the competitiveness of jute and jute products; to maintain and enlarge existing markets as well as to develop new markets for jute and jute products; and to develop production of jute and jute products with a view to improving, inter alia, their quality for the benefit of importing and exporting members. Projects
of research and development, market promotion and cost reduction is among the important means through which the objectives are to be met. In this respect the IAJJP sets up a Special Account for Projects for (i) pre-project activities related to project ideas and formulation of implementable projects, and (ii) for implementation of projects recommended by the Committee on Projects and approved by the International Jute Council. The Agreement mentions the Second Account of the Common Fund as one of the principal sources for financing the projects. In fact, as the Executive Director of the International Jute Organisation (IJO) has noted, "For primarily research and development agencies like the IJO, the second account of the Common Fund was expected to provide a constant and regular source of financial assistance. Early establishment of the Common Fund would, therefore, seem to be a very urgent necessity for the successful functioning of an organisation like the IJO."

The ITTA seeks to promote the expansion and diversification of international trade in tropical timber and

79. See article 22(4)(a) and 29 of IAJJP.

the improvement of the structural conditions in the tropical timber market; to promote research and development with a view to improving forest management and wood utilisation; to improve market intelligence; to encourage increased and further processing of tropical timber in producing member countries; and to improve marketing and distribution of tropical timber exports of producing members. Like the IJO the International Tropical Timber Organisation will formulate and implement relevant projects. And a major source of finance for the projects will be the Second Account of the Common Fund. 81

Among the stated objectives of the INRA are: to improve the competitiveness of natural rubber by encouraging research and development on the problem of natural rubber; to encourage the efficient development of the natural rubber economy by seeking to facilitate and promote improvements in the processing, marketing and distribution of raw material rubber; and to further international cooperation in and consultations on natural rubber matters affecting supply and demand and to facilitate promotion and co-ordination of natural rubber research, assistance and other programmes. In furtherance of these

81. See article 20(2)(a) and article 26 of ITTA.
objectives, the INRA, it was seen, sets up a Committee on Other Measures to undertake economic and technical analysis in order to identify the relevant projects or programmes or other ways and means to attain the set out objectives. And the Second Account of the Fund is mentioned as an important source of finance. 82

B. Financial Basis and Limits

The resources of the Second Account of the Fund will consist of: (a) the part of directly contributed capital allocated to the Second Account on a voluntary basis; (b) voluntary contributions made to the Second Account; (c) such net income as will accrue from time to time in the Second Account; (d) borrowings; and (e) any other resources placed at the disposal of, received or acquired by, the Fund within the framework of the Agreement. 83

The Fund's ability to borrow for the Second Account needs certain clarifications. The power is subject to specified conditions and must be in accordance with the rules and regulations to be adopted by the Governing Council. The conditions are: (i) all borrowing shall be

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82. Article 44(3) of INRA.
83. Article 18(1) of the Fund Agreement.
on concessional terms and its proceeds are not to be re-lent on terms which are more concessional than those on which they are acquired; (ii) its proceeds, for the purpose of accounting are to be placed in a separate loan account; (iii) the other resources of the Second Account or the Fund are not to be charged with losses, or used to discharge liabilities, arising out of operations or other activities of such a loan account; and (iv) the borrowing must have the approval of the Executive Board of the Fund. 84

The Fund Agreement also places certain financial limits on Second Account operations. The aggregate amount of loans and grants are not to exceed the aggregate amount of the resources of the Second Account. 85 Furthermore, the Fund cannot make or participate in loans for the portion of directly contributed capital earmarked for the Second Account. 86

C. Operational Principles

The Fund Agreement has systematically laid down the principles of Second Account operations: these pri-

84. Article 18(4) of the Fund Agreement.
85. Article 18(2) of the Fund Agreement.
86. Article 18(3) of the Fund Agreement.
nciples outline the scope of its operations; identify the criteria which an organisation must satisfy before it can avail of the facility; indicate the procedure in implementing the desired course of action; lay down certain policy guidelines which must guide its operations; and specify some rules for financial operations.

D. Scope of the Operations

The scope of the Funds operations is defined by the enumerated measures in Article 18, paragraph (3)(a), a matter which has already received attention. Here, it is important to underscore the fact that the scope of Second Account operations is limited to measures which have been enumerated therein. The Fund cannot, therefore, in practice, finance measures which fall outside its scope. However, since the clause is extremely general in nature, it can be subject to varying interpretations once the Fund comes into operation, in terms of the principle of institutional effectiveness. In fact, it will be unfortunate if the clause is given too narrow an interpretation.

The scope of the Second Account operations is also limited by the fact that before an organisation can avail of the facility it must satisfy certain criteria laid down
in the Fund Agreement. In the next section these criteria are considered.

E. International Commodity Bodies (ICBs)

A significant principle of Second Account operations is that the Fund cannot make or participate in loans and grants for financing the desired measures unless they are "jointly sponsored and followed by by producers and consumers within the framework of an ICB". The Fund Agreement leaves it to the Executive Board to designate from time to time the appropriate commodity bodies, including ICOs, whether or not they are Associated ICOs, as ICBs as long as these bodies meet the criteria set out in Schedule C of the Agreement.

These criteria are:

1. An ICB shall be established on an intergovernmental basis, with membership open to all states Members of the United Nations or any of its specialised agencies or of the International Atomic Energy Agency.

2. It shall be concerned on a continuing basis with the trade, production and consumption aspects of the commodity in question.

87. Article 18(3)(b) of the Fund Agreement.
3. Its membership shall comprise producers and consumers which shall represent an adequate share of exports and of imports of the commodity concerned.

4. It shall have an effective decision-making process that reflects the interests of its participants.

5. It shall be in a position to adopt a suitable method for ensuring the proper discharge of any technical or other responsibilities arising from its association with the activities of the Second Account.

ICOs, it hardly needs to be pointed out, satisfy the criteria set out and should face no problem in using the Second Account facility of the Fund.

F. Principles of Procedure

The Fund Agreement lays down the procedure to be followed before a project sponsored by an ICB can be financed. It requires, inter alia, that (i) the ICB shall submit to the Fund "a detailed written proposal specifying the purpose, duration, location and cost of the project and the agency responsible for its execution"\(^8^8\); (ii) the Managing Director shall present to the

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\(^8^8\). Article 18(3)(d) of the Fund Agreement.
Executive Board a detailed appraisal of the proposal along with the recommendations and the advice of the Consultative Committee set up for the purpose, and (iii) decisions with regard to the selection and approval of proposals shall be made by the Executive Board by a qualified majority. The first step of "detailed written proposal", so to say, defines the functions of ICBs and the latter two the internal mechanism for the appraisal and approval of projects sponsored by ICBs. A brief examination of these two aspects of procedure may be pertinent here.

Among the primary functions of the ICBs will be to define the objectives in respect of the concerned commodity, the general programmes for attaining these objectives, the specific modes to implement the programme, the criteria upon which projects would be considered eligible for sponsorship and the concrete working out of the project proposal and the manner in which they are to be implemented. In other words; the ICBs in this case will have to be intimately involved in the "project cycle", that is, in identification, preparation, appraisal and implementation of the project. Identification involves the selection of projects of high priority qualifying

89. Article 18(3)(a) of the Fund Agreement.
90. Ibid.
as 'other measures' for receiving financial assistance under the Fund. Preparation would entail a study of the technical, economic and financial feasibility of the project. Appraisal would involve the submission of proposals and the conduct of negotiations with the Fund. Finally, the implementation of the project would mean the monitoring and supervision of the project. In carrying out its functions, the ICOS would need to possess a wide range of technical expertise at its disposal for which it could either make provision within the Organisation or it could rely on cooperation with international organisations like the Food and Agriculture Organisation (FAO), the United Nations Industrial Development Organisation (UNIDO), or the World Bank. In the latter context, it may be recalled that ICOS are empowered under commodity agreements to enter into cooperative arrangements with international organisations.

After the ICB sponsors a project and presents a detailed written proposal, the Managing Director of the Fund will have the project appraised. For this purpose, 'as a general rule', the Fund is required to use the services of international or regional institutions or other competent agencies and consultants specialised in the field. The proposal is also required to be placed before a Consultative Committee which will be established
by the Governing Council of the Fund "to facilitate the
operations of the Second Account". Finally, the pro-
posals must be selected and approved by a qualified ma-
jority. If a project proposal is approved, the Executive
Board could entrust any international or regional insti-
tution or other bodies competent in the field with the
administration of loans or grants made, as well as the
supervision of the implementation of the projects which
are to be financed.

G. Policy Guidelines: General and Financial

The Fund Agreement puts down certain important
general and financial policy guidelines for operating the
Second Account. The general guidelines include, inter
alia, (a) that in determining the priorities for the use
of the resources of the Second Account, the Fund must
give due emphasis to commodities of interest to the least
developed countries; and (b) while considering projects
for approval due emphasis must be given to the commodi-
ties of interest to developing countries, particularly

91. The Consultative Committee is to be established
under Article 25 of the Fund Agreement.

92. Article 18(3) (b) of the Fund Agreement.

93. Article 18(3) (m) of the Fund Agreement.
those of small producers-exporters. 94 These guidelines are in keeping with the needs of the developing countries and have found jurisprudential acceptance in the legal principle of preferential treatment.

The following financial guidelines are stipulated for Second Account operations: (i) the form which financial assistance may assume, that is, whether it is to be a loan or grant, should depend upon, among other factors, "the economic situation of the ICB or the Member or Members concerned and the nature and requirements of the proposed operation". The loans are required to be covered by governmental or other suitable guarantees; (ii) funds are to be provided only to meet the expenses actually incurred with respect to the project; (iii) it shall not refinance projects initially financed from other sources; (iv) it shall, as far as possible, avoid duplication of its activities with existing international and financial institutions, though it may seek to co-finance projects with such institutions; (v) it must pay due regard to the desirability of not using a disproportionate amount of its resources for the benefit of a particular commodity; and (vi) the loans are required to be repaid in the currency or currencies loaned. 95

94. Article 18(3)(n) of the Fund Agreement.
95. See article 18 for these provisions.
Lastly, the Fund is required each time to enter into an agreement with the ICB or the Member or Members concerned, specifying the amounts, terms and conditions of the loan or grant and incorporating appropriate guarantees. This agreement establishes the legal relationship between the Fund and the ICB.

VII. APPRAISAL

Will the Common Fund, as it is presently structured, help achieve the objective of more and effective commodity agreements? In other words, is the Common Fund endowed with a financial basis which can enable it to effectively perform its threefold function: to act as a 'catalyst', provide an adequate line of credit to buffer stocks, and finance commodity development measures. There is little doubt that the final shape of the Fund differs substantially from its original concept by the UNCTAD Secretariat. 96 Perhaps it could not be otherwise, for it would be unrealistic to expect the developed countries to wholly endorse the viewpoint of the developing countries as reflected in the proposals of the UNCTAD Secre-

tariat. However, the slow pace of ratification of the Fund Agreement by the developing countries themselves reveals that there are misgivings regarding the advantages of joining the Fund. What then are the problems and prospects of the Common Fund?

The Fund, it has been seen, was originally conceived of as a central source of finance with a total capital of $6 billion. It is, however, the pool concept which finds a place in the Fund Agreement. The directly contributed capital to the Fund is a meagre $470 million. It is, therefore, argued that the Fund will be unable to play its ‘catalyst’ role effectively because it no longer assures the finance which would encourage the establishment of new commodity agreements.

On the other hand, the Fund is dependent on the prior operation of the commodity agreements whose resources will, on association, be pooled with it. And in view of the present financial structure of the Fund, an ICO of a strong commodity might be hesitant to associate with the Fund if it felt that on the basis of its own credit-worthiness on the market it would be able to borrow directly on better terms. Such an ICO would think twice before associating itself with a Fund which would need to finance commodity organisations established on less sound financial lines, without safeguards against the risk of
exhausting their financial strength in overstocking or inflexibly trying to defend a fixed floor price against long-term market forces. Therefore, the fear that the Common Fund may remain a "house without dwellers", could legitimately arise.

The UNCTAD Secretariat, however, views these matters differently. Clarifying misconceptions regarding the Fund Agreement the UNCTAD Secretary General had noted even during the negotiations that

The original concept... envisaged a Fund that would eventually mobilise about $6 million to meet the expected needs of all commodity stocks under the Integrated Programme. Under the design now contemplated, the Fund would remain in a position of being able to mobilise resources to roughly this order of magnitude and would therefore be able to offer to finance the bulk of the requirements for stocking under each commodity agreement. In this way the Fund could still be a catalyst in helping to bring about these agreements. Under the present design, however, although the Fund would offer to finance the international commodity agreements (ICAs) in advance of the finalisation of the agreements, the actual raising of the funds needed for lending to ICAs would occur as and when the need is established through the creation of the ICAs themselves. This is because the borrowing instruments needed by the Fund to raise resources in the markets - the pledges of stocks as security and guarantees of Governments in the form of callable capital - would become available with the establish-
ment of individual commodity agreements. In the original proposals the possibility was left open for the mobilisation of the requirement for stocking in advance of commodity agreements through direct government subscriptions and possibly, although this was not made explicit, through borrowings as well.... The present design envisages that the Fund could provide... 75 per cent rather than the full requirement of commodity stock financing - the residual 25 per cent be provided by member governments of the individual commodity agreements. The original proposals, however, themselves anticipated that as much as one third of the total requirements for stocking be contributed directly be governments to the Common Fund itself. The essential difference here is that under the present design the portion of the financial requirements for stocks that will be met by direct contribution will be provided by the members of the commodity agreements as the latter emerge rather then by the membership of the Fund in general.98

The Secretariat's understanding has been endorsed by scholars like Chadha who point out that a comparison between the originally envisaged structure and the present one can be quite "misleading", as they differed in their bases.99 Chadha is of the opinion that the resources of the Fund will be adequate to meet the requirements of the ICOs. With regard to the catalyst role of the Fund, he reiterates that it would be improper to

98. TD/IPC/CF/CONF/14 (Part II), n. 18, p. 4.
use the amount of direct government contributions to the First Account as a yardstick for assessing its ability. The proper yardstick is the percentage of the total requirements of ICAs, which the Common Fund would be in a position to provide. While in the original proposals the entire amount required by ICAs was to be provided by the Fund it will now provide two thirds of the necessary resources. Therefore, "the Fund would thus still have a substantial catalytic effect, although it would be somewhat less than what was earlier contemplated." In other words, whatever be the inadequacy of the present financial basis, it ensures that negotiations towards an ICA can begin and proceed with the knowledge that access to finance will finally be assured. This fact, for instance, was recognised by the association of Third World copper exporters, CIPEC, which stated at its 16th Annual Meeting in Lusaka, Zambia, that "the conclusion of UNCTAD's Common Fund should improve the chances of achieving an international commodity agreement for copper". And as Laidlaw and Laishley add "The feeling is the same for other commodities". It may also be noted that the capital that has to be mobilised by the membership of commodity agreements, either by

100. Ibid., p. 27.
102. Ibid.
direct contributions or trade levies, would be much less if the agreement was associated with the Fund than if it had to operate on its own.\textsuperscript{103} Finally, it has been pointed out that every indication suggests that the Fund, with the participation of all credit worthy countries and its directly contributed capital would be able to borrow for on-lending to commodity agreements on more favourable terms than if the commodity organisation borrowed directly from the market.\textsuperscript{104}

An assumption on which the Common Fund has been sought to be established is; that the existence of price cycles, which are out of phase across commodities, implies that the merging of financial requirements will lower total financial requirements. In other words, if it so happened, as in the 1980-82 commodity crises, that all commodities witnessed depressed prices; the amount of finance required for stock financing would be considerably larger; thus not only diluting the case for a common fund but also questioning the ability of the Fund, as established, to make available an adequate line of credit.\textsuperscript{105} In this respect, the UNCTAD Secretariat has

\textsuperscript{103} Ibid., pp. 30-1.

\textsuperscript{104} See TD/B/C.1/L.73/Add.2, Draft Report of the Committee on Commodities on its Tenth Session, pp. 2-3.

\textsuperscript{105} It is one of the reasons why countries have been slow in ratifying the Fund Agreement, Ibid.
pointed out that the scale of resources that the Common Fund can mobilise does not depend upon offsetting price movements. Expert banking advice appears to indicate that the Fund would have little difficulty in raising finance through borrowing to the full extent of its potential commitment to the ICOS associated with it.\(^{106}\) However, it may be pointed out that this will to a great extent depend on the creditworthiness of the Fund in the financial markets.

It appears, therefore, that, after all, the Fund will be able to play a 'catalyst' role as well as provide an adequate line of credit to buffer stocks. However, if so far as its catalyst role is concerned it is important to point out that finance is only one of the several reasons why commodity agreements are difficult to establish. In the chapter on the negotiation of commodity agreements it has been seen that commodity agreements are difficult to conclude for other reasons as well. In other words, the Fund will act as a catalyst only in so far as the element of finance is a chief obstacle in the negotiation of the commodity agreement. While no doubt this has been so as demonstrated by the absence of more commodity agreements than in existence, it would serve little purpose to forget that other conflicts between

106. Ibid.
exporters and importers as well as intra-exporters and importers also pose serious problems in forming new ICAs.

On the Second Account, only one observation may be made. Its chief problem is that it is only to be financed through voluntary contributions. This voluntary nature of the contributions is wholly inadequate and inappropriate for financing commodity development measures. Given the important nature of these measures for the commodity world, their financing should not have been left to the vagaries of voluntary contributions but should have been the subject of an international obligation.\(^{107}\)

On the positive side is the fact that the international community has moved closer to the UN conception of commodity agreements, which views the agreements not as narrow commodity control schemes but as instruments for both commodity development as well as the development of the economies of developing countries which are still

\(^{107}\) As the Minister of Bangladesh noted, "though his delegation appreciated very much the voluntary contributions pledged by various countries to the Second Account, as a matter of principle the Second Account could not be left solely dependent on charities". TD/IPC/CP/CONF/266, 6 October 1980: Report of the United Nations Negotiating Conference on a Common Fund under the Integrated Programme for Commodities on its fourth session, p. 26.
dependent on the export of one or two commodities for their export earnings. Further, it is hoped that the voluntary pledging system "will provide an institutionised and regular persuasion" of member states to make contributions. 108

In sum, it may be said that despite the fact that the Common Fund as it has finally been constituted in the Fund Agreement does not possess all the elements which it should ideally have had, it is an important step taken by the international community towards establishing more and effective commodity agreements.

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