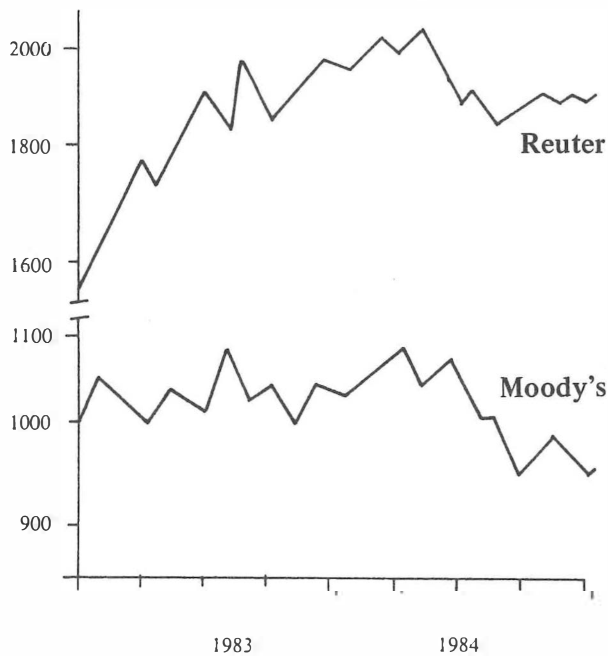
Selected price indices for raw materials

Fig 1

Moody's and Reuter (1931=100)



From the cover of a recent book by Philippe Chalmin and Jean-Louis Gombeaud: Les Marches Mondiaux en 1984/85, Editions Economica, Paris 1985.

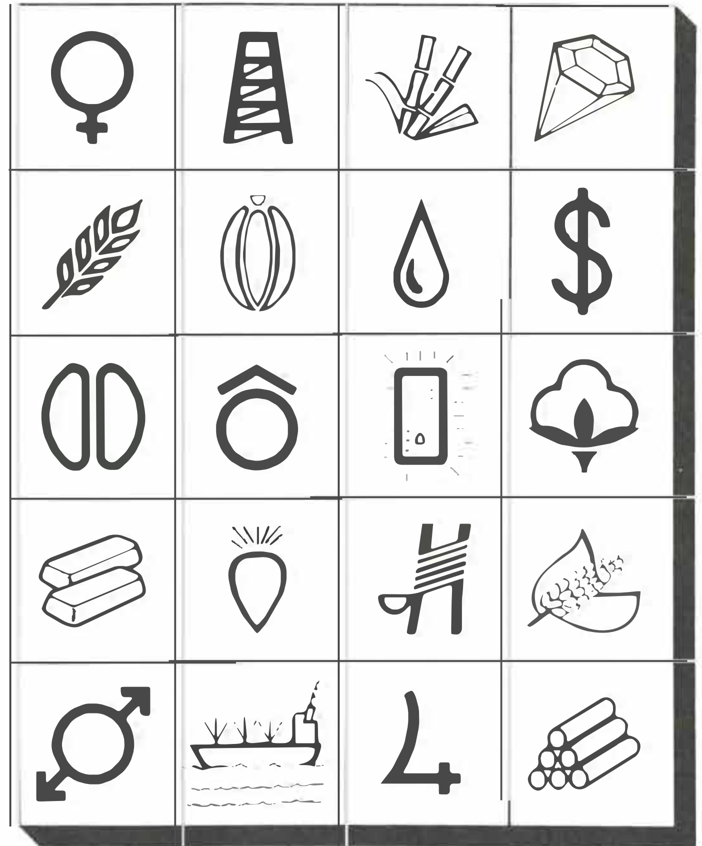
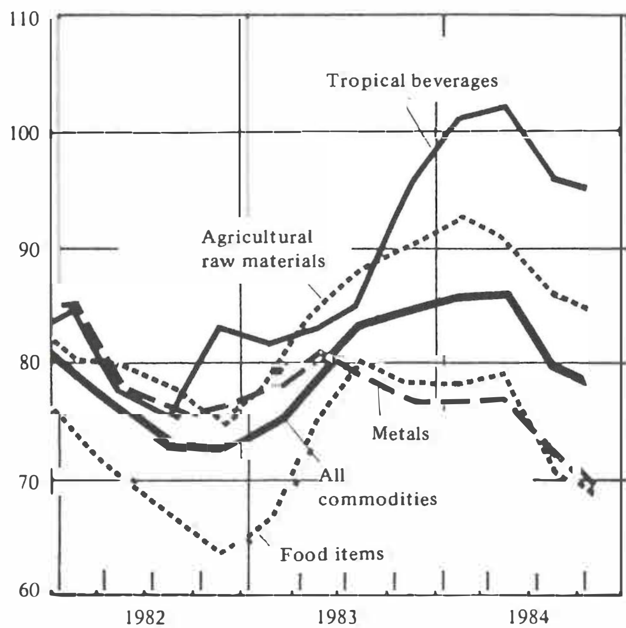


Fig 2 IMF

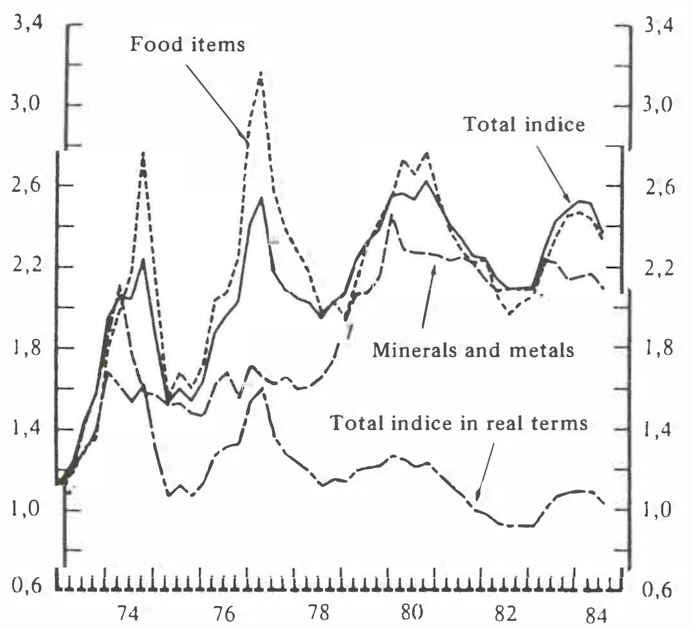
(1980=100, in USD)



Source:
IMF, *International Financial Statistics.*

Fig 3 UNCTAD

(1972=100, in SDR)



Source:
UNCTAD

International commodities markets in perspective – structural and institutional changes

By Philippe Chalmin
Translation by Paul Scott

The 1970s have brought a radical modification to the commodities markets. In this article Philippe Chalmin looks at the financial, monetary and technical environment in which these changes have taken place, at the institutional changes that have followed, and at the new power structure in the commodities markets of the 1980s.

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Looking back, the 1970s appear to be a turning point for commodities. On the one hand we saw moments of very strong conjuncture for the market as a whole, which allowed commodity prices to return in real terms to their highest historical levels, i e to those of the Korean war or the 1921 crisis. On the other hand the 1970s over and above their graphical appearance, were marked by a certain number of changes of a more structural nature which the analyst will henceforth have to take into account when he seeks to report on and, all the more so, to modelise, the market of a specific product. Certain of these structural changes today seem irreversible, while others are much more the fruit of evolutions linked to the international market environment itself.

An unstable environment

Perhaps the most important change which the commodity markets have known is that they are now evolving in an unstable financial and monetary environment. It is true that historically commodities have a long tradition of instability, an instability which has been linked to the difficulty of producers to maintain a level equal to offer and consumers to adjust their demand. But until 1971/74 commodities were the only market for which instability was tolerated (whith the exception of the stock exchange, of course). It is also necessary to stress that the instability of commodity markets was in fact limited to a few products (notably tropical products), and that the state intervened directly on numerous national markets (grain, oil, seed) and that producer price structures (oil, metals) left only a marginal place to the unstable free market.

Without wishing to exagerate the idyllic character of this period, it is possible to consider that those commodities (sugar, coffee, wheat and tin), which people tried so hard to stabilise without believing it too much (Havana Charter of 1948), were in fact the "dancers" in an international economy which, with its fixed exchange rates, its colonial and monetary zones, its cartels, lived on stability.

In this sense, the 1970s have brought a radical modification to this commodity market environment. Already the "international monetary non-system" is characterized and even depends on the total instability of means of payment and their rates to such an extent that this instability, still inconceivable in 1970, has become a way of life, almost a virtue. It is not our intention nor in our competence to analyse the advantages and disadvantages of international monetary and financial destabilisation, we confine ourselves to noting the amplifying effects on the commodity markets. Unstable elements in an until then stable universe, they could only be affected head on by the destabilisation of their environment. Nearly 15 years later a few lessons may be learned: primarily about the great institutional changes which characterised these markets.

But first attention must be drawn to another instability, that of the *technological environment.* Certainly technical evolution is not in itself something new. But it appears to a non-scientific person such as the author that the process has strongly accelerated in the sense of a greater substitutability of raw materials. Today no product is sure of its market, of its outlets: the example of sugar and isoglucose is in everyone's memory. All agricultural products by the expedient of biotechnology are affected: as are metals amongst themselves and in relation to composites, for example. This, of course, poses problems when we endeavour to plan the long term demand trends of a product. From now on it will be ne-

cessary to take into account the traditional usages, their eventual decline, new usages such as they can be foreseen, possibilities of substitution.

Institutional changes

The first element which nowadays characterises the commodity markets is undoubtedly the predominance of price fixing systems in *the futures markets*. The futures markets have in effect passed from a secondary market level, in the heart of the American plains or the British docks, which excited a few speculators, to the world markets fixing in an indisputable way the prices of the majority of goods exchanged in the world. The futures market phenomenon, at the beginning contested on moral and ethical grounds, has become irreversible. It developed from market instability by offering dealers a possibility of risk cover, and the market immediate information of its transactions. When we talk of the price of wheat, maize, soya, coffe, cocoa, sugar, copper, lead, zinc or tin, the world price, that on which all transactions are based, will be the futures market price. Recently the futures market has also made openings for products until now dominated by producer price systems.

The *producer price* notion has historically been linked with the metals and oil markets. On these markets, given the oligopolistic position of a small number of producers, generally multi-national, it was possible for a cartel or a dominant firm to fix a producer price and practically impose it on the market. Today the producer price system still survives for a few minor products (cobalt, vanadium) but it disappeared about 10 years ago for copper, 3 or 4 years ago for nickel, molybdenum and platinum, in 1984 for aluminium, and we are probably even now seeing its disappearance for oil. Today the "world" prices of aluminium, nickel and copper are those fixed at the London Metal Exchange or at COMEX in New York. Tomorrow the price of oil will perhaps be that of NYMEX in New York.

It is moreover necessary to consider the very notion of "world price". Very often it affects only one part of international exchanges. Between themselves and the national systems as a whole, the "States" have established protective structures. In itself this is nothing new, but it has largely survived and even developed against pressures for a liberalisation of trade coming especially from the IMF. It should be pointed out, however, that in the field of agriculture, the American and European systems in 1985 seem to be moving towards a relative overture to the "world price".

Certainly the debate is still continuing: to know if oil can be likened to another raw material, if 20 per cent worth of world commerce can support the price fluctuations which we are accustomed to for less important raw materials. In any case it is clear that each time an efficient futures market has developed for a given product, ie a futures market offering an important volume of transactions and therefore considerable speculative activity, then the producer prices have had to be withdrawn. The suppression in October 1984 of the Alcan World Price, when the aluminium multi-nationals still dominated the world market, shows the strength of this movement.

Supporters of the futures markets rightly insist that it is when the market is sufficiently vast that we have a system close to absolute efficiency, the perfect competition of economy theory. These are disputes of schools of thought which we will not enter into. Nevertheless it is necessary to insist that on the futures markets, the last 10 years have brought important shifts which have perceptibly modified market behaviour:

- On the one hand the instability of commodities has been on the increase: the price variations which the markets accustomed us to before 1970 are 2 or 3 times more important today, due to the role of sounding boards of monetary and financial world conflicts which has been transmitted to the futures markets.
- But on the other hand the behaviour of the actors on the markets has evolved profoundly. Traditionally, most of the operators were satisfied making so-called "fundamental" analyses, ie comparing, for a given period, the relationship between offer and demand. In future this analysis will be limited to looking for trends and the market will be much more dictated, day to day, by so-called "technical" or "graphical" analyses mainly taking into account the behaviour of speculators on the market at a given moment: the "chartist" analysis is fundamentally a kind of psychoanalysis of the speculator.

This phenomenon has been re-inforced since 1975/76 by the appearance of common investment funds on the futures markets. These funds, allowing small savers to participate in large operations, are generally managed according to computer programmes and can at any moment concentrate an important mass of operations on a given market.

Thus it is estimated that in the United States there are between eighty and a hundred common investment funds managing about one billion dollars entrusted by investors. It is however necessary to point out that this development of the futures markets is happening much more in the financial field than that of commodities strictly speaking. Invented to take account of the instability of commodities, the futures markets have become the managing tool of the instability of monetary and financial systems. Thus in

1984 out of a total of 148 million contracts exchanged on the American futures markets, 49.5 per cent were financial contracts (finacal futures = rate of interest, currency, stock exchange index) and 12.7 per cent contracts for precious metals. Agricultural products, the traditional force of American futures markets did not represent more than 32 per cent of the total volume processed.

With this development of futures markets, and the weakening of producer price systems, it is not surprising that attempts at market stabilization have been marked by tangible failures. Here the 1970s saw the emergence of efforts, within the framework of an improved North–South dialogue, to stabilize the commodity markets. This was the real meaning of the famous Resolution 93. IV at the 4th UNCTAD held in Nairobi in 1976. Eight years later we must note the futility of these efforts. The common fund, which was to be the axis of the system (and which was a pale imitation of the 3rd International Institution which Keynes would have liked to create at Bretton Woods), whose creation had been decided during a negotiating conference in 1980, has still not obtained a sufficient percentage of ratifications to come into effect. Today the project has been practically abandonned. Of numerous products which were to have been the object of a stabilization agreement, only three or four can today claim some resultats and even these seem very precarious.

In the months to come the cocoa and rubber agreements will be faced with what look to be difficult negociations marked by the ill-will of producers and consumers alike.

Coffee and tin, which are at the moment examplary cases, are also threatened by internal dissension: problems of "non-member markets" for the coffee producers, quota and smuggling problems for the tin producers. As for sugar, cotton, copper, tea, these are best not thought about nowadays. The idea of stabilization of commodity markets is today probably at its lowest since 1976. Moreover this stabilization seems quite futile in the present market environment. Who would have thought, watching the evolution of coffee or tin prices on the London markets in 1984, an evolution marked by important increases, that in New York for coffee, and Kuala Lumpur for tin, the same products quoted in dollars would have shown the greatest stability and that the increases in the pound against the dollar alone would explain the behaviour of the London prices?

Nowadays it is fruitless to try to stabilise the world price of commodities when the very expression of this price is marked by instability. Lastly, when we analyse the cost of this stabilisation, we can reasonably wonder about its efficiency: as an example, the director of rubber buffer stocks believes that each year the International Rubber Agreement costs Malaysia/Singapore 23.6 cents/kg, ie about 10 per cent of the present reference price.

Without being prophets of gloom and doom, we can reasonably suggest that the efforts towards stabilisation of commodity markets (including oil) whether these efforts be the uniting of producers in cartels or international agreements bringing together producers and consumers, will have less and less chance of success with the exception of specific market configurations. Moreover it should be noted that the efforts realised in another direction, in order to stabilise the export receipts of developing nations thus allowing them to palliate the problem of the instability of their ressources linked to those of export product prices, are themselves relatively limited: we know the problems experienced by STABEX in the European Economic Community (EEC) in 1982 and 1983. In the framework of the Lome III Covention the STABEX budget has only been increased so as to maintain its present level in real terms.

As for the IMF, the terms of compensatory financing, certaily important in value (2.84 billion SDR in 1983) remains relatively restrictive in its use. As for the UNCTAD projects worked out during the Manila Conference, these today seem quite mythical.

This general failure of market stabilisation, logical when the causality is relocated at the level of their environment, has also allowed phenomena until then marginal to develop, particularly for commodities, such as barterings or compensation.

Traditionally, the barter or compensation operations carried out were limited to industrial products on a more or less fixed market, commodities to a great extent escaped. The novelty of the last few years has been the development of bartering or compensation agreements dealing at least on one hand with commodities. In this sense the famous purchase in July 1984 of 10 Boeing 747s by Saudi Arabia paid for in oil to a total value of 1 billion US dollars is quite exemplary, but we could also mention numerous agreements between Brazil and Nigeria or Iraq with Malaysia, etc...

The novelty lies in the fact that in such operations we include commodities which have at their disposal fluid international markets, able therefore at any time to be exchanged against a currency, against the dollar. There are several reasons for the need to include these products and "these dollars": balance of payment and IMF inspection problems for very many importing and exporting countries, lack of foreign currency, will to escape production control measures (as was the case for the Saudi oil in relation to the OPEC quotas). Today we can consider that in world trade, bartering, compensation or clearing agreements represent 30 per cent - 40 per cent of total exchanges. However, if we exclude the direct trade between States which has always existed, the experts are in agreement in estimating the new barter/com-

"Today the 'world' prices of aluminium, nickel and copper are those fixed at the London Metal Exchange or at COMEX in New York".
Photo from the cover of the 1979 Annual Report of COMEX shows 100 troy ounce gold bars. At present gold, silver, copper and aluminium are traded at COMEX.

pensation phenomenon in 1984 at 5 to 10 per cent of the world trade value. At this level it is more than a fashion, but we can nevertheless wonder as to the permanence of a phenomenon which in itself is regressive (and which is fought by an organisation such as the IMF).

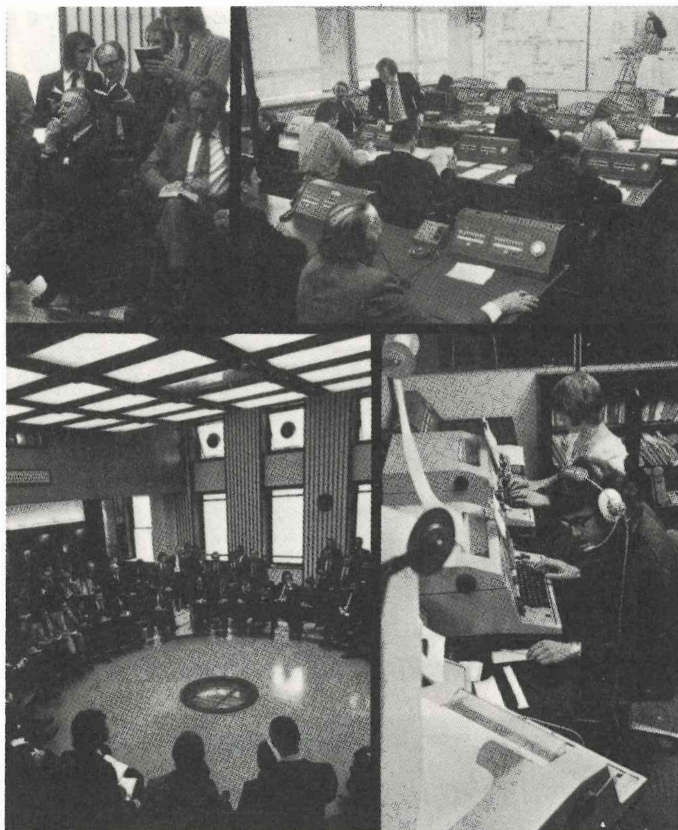
In any case it can have a notable influence on the flow and markets of many basic products.

Finally, we must stress that the notion of commodities itself has evolved considerably from primary products towards products more and more transformed: from ores to concentrates and metals (it is only in the last ten years that GATT has classified metals among commodities and not amongst the products of the metallurgical industry), from the cocoa bean to the butter, from wood to plywood, from seeds to oils... This movement has been accelerated by the will of numerous producing countries to transform their raw materials before exporting them. The behaviour of markets has not been altered for all that, the notion of value added remaining greatly diffused.

These institutional changes on the markets have also been accompanied by changes at the power structure level, which we would now like to analyse briefly.

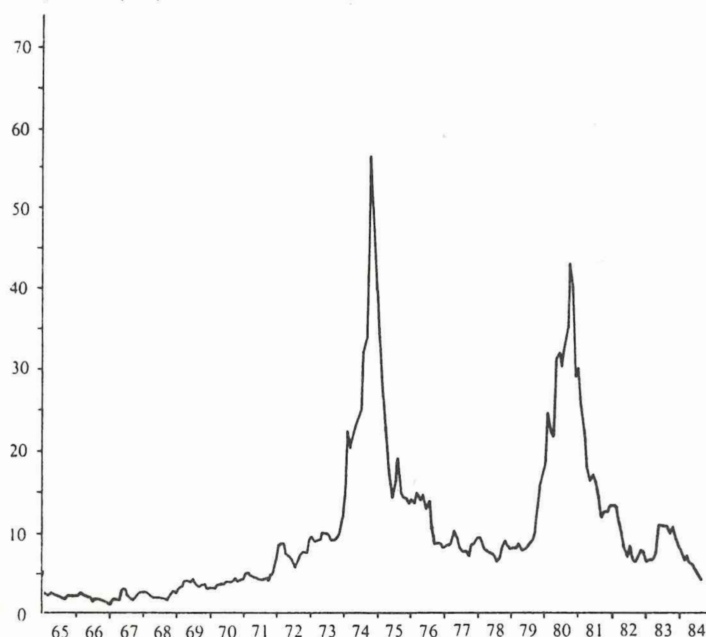
New power structures

Retrospectively the 1970s appear to the analyst as years of exception. They were marked in fact by the general and relatively durable recovery of the commodity markets in a context of economic recovery mixed with inflation and monetary instability. They were also marked, for most products by production crises, at least by an increased control by the producers on their market. Food weapon, commodity weapon, green or black power, the word was fashionable and became almost a reality. The historical error of the US wheat embargo against the USSR at the 4th of January 1980, like that at another level, of OPEC, was that they did not take into account the evolutions of the early 1980s. Today we have, more or less, returned to a generalized situation of overproduction be it animal, vegetable or mineral commodities, a situation characterising the markets of the 50s and 60s. Today we have come to confirm the assumption which the historian Paul Bairoch presented in his analysis of the price cycles of commodities. He said that commodity market cycles are roughly characterized on half Kondradieffs by periods of sudden relatively brief crises, 2 to 5 years, generally followed by long periods, 15 to 25 years, of price depression, pe-



From the cover of a guide to the London Metal Exchange and London Commodity Markets, published by Rudolf Wolff & Co Ltd, a leading member of the LME and LCM, 50 per cent owned by the Canadian TNC Noranda.

Fig 4
New York Sugar Futures
(Cents/lb)



riods obviously marked by overproduction.

Such were the 20s and 30s, the 50s and 60s and such are the 80s. Our mistake, that of the economists and politicians, has been to think that the 1972–77 "crisis" was the starting point of a new era in the international commodity markets. Evidently it is nothing of the sort and the analysis of the situation of the last four years clearly shows this. Certainly there are tensions here and there linked to meteorological or political accidents; the cocoa market in 1983, that of oils in 1984, will have been marked by short feverish attacks. But this is nothing when we see the futility of the efforts of oil producers to stem a much deeper crisis linked to their indebtedness and the relative drop in consumption. This is nothing when we look at the war in which the cereal exporters indulge, with subsidies used to assure an outlet onto the few markets, more or less solvent, which are still open. This is nothing when we consider the stagnation of the world sugar price which, at the beginning of 1985, was equivalent on the New York Stock Exchange, to a quarter of the cost price for the most efficient producer in the world. Paradoxically the power on the commodity markets today belongs to the solvent consumer. It is clear that the flexibility of offer in relation to a fall in price is much weaker than most economists had previously considered it. The Third World countries, but also Western mining companies, caught in the cycle of indebtedness must produce and export. In 1984 we saw a relative recovery in Western economies, but for the first time the commodity markets and particularly those of metals did not follow.

Here then, somewhat scattered, are a few conclusions from a spectator about the commodity markets of the last ten years. From an institutional point of view, certain changes seem to be irreversible:

- fluidity of markets, around the futures markets when, notably in the agricultural field, the United States as well as the EEC are questioning their respective systems of isolation
- a more temporary failure of stabilizations at least as long as instability lasts.

On the other hand, in 1975 we might have thought that a new era in bargaining power had opened on the commodity markets. Clearly nothing of the sort has happened and the early 1980s marks a return to a relative "normality" of the markets, normality characterized by an excess in offer and depressed rates. Still, what was tolerable because of its relatively limited scale and in the context of the 50s and 60s, is in the 80s no longer on a scale which we know, nor in a context that we know. It is up to us to find and imagine new solutions of adaption. ■