

International policy options for commodity vulnerability



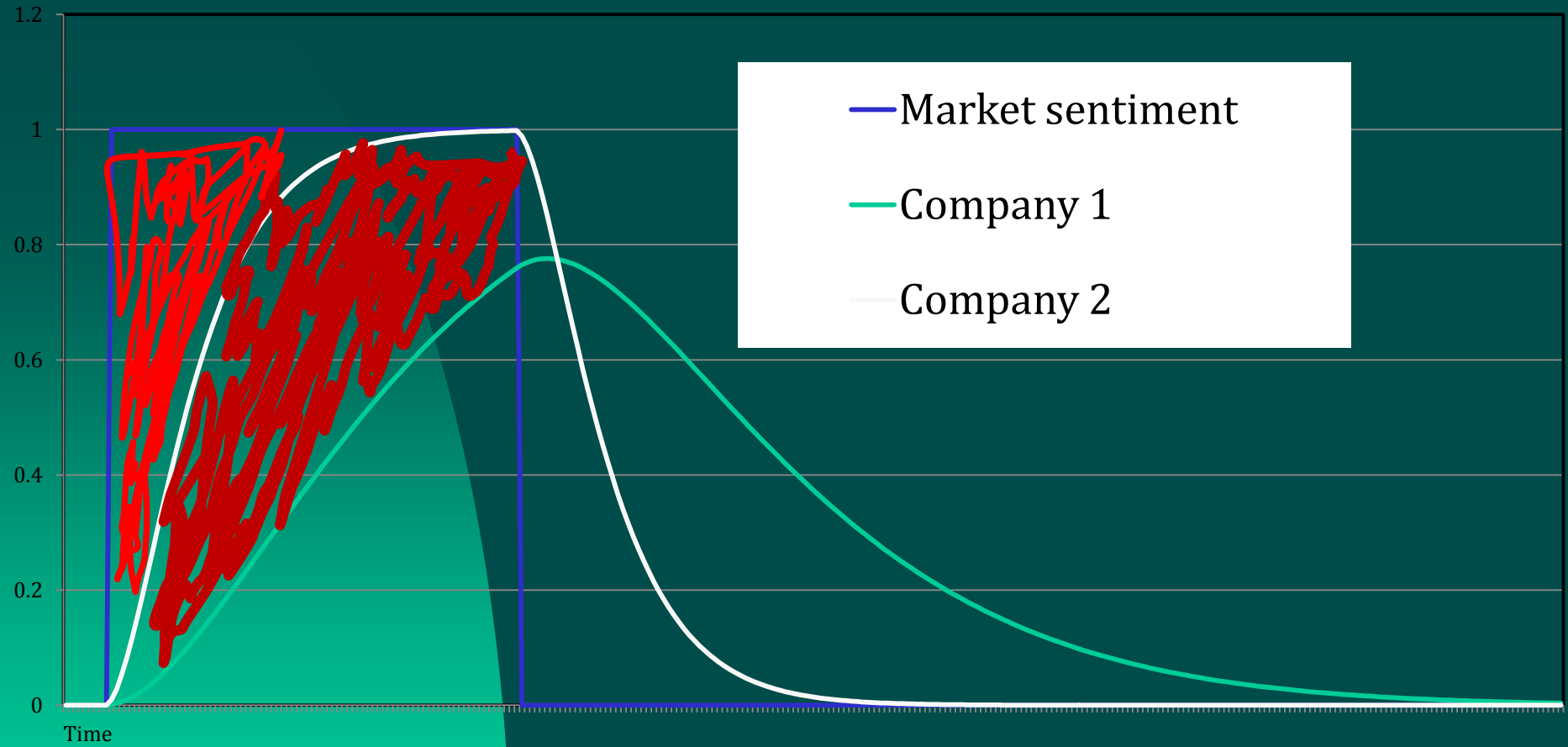
Andrey Kuleshov, Common Fund for Commodities

Why an issue for international development policy

- Commodity markets are inherently volatile. Market prices carry information essential for market efficiency
- Volatility: re-distributes income in commodity value chains, deepens inequality, causes social tensions
- Instability: disrupts investment and production decisions, “dulls supply response” , causes inflation and tests macroeconomic stability
- Vulnerability to markets: the cost of market volatility to CDDCs is higher than other countries

DEVELOPMENT PROBLEM

Supply response dynamics (aka low short term elasticity): commodities lose



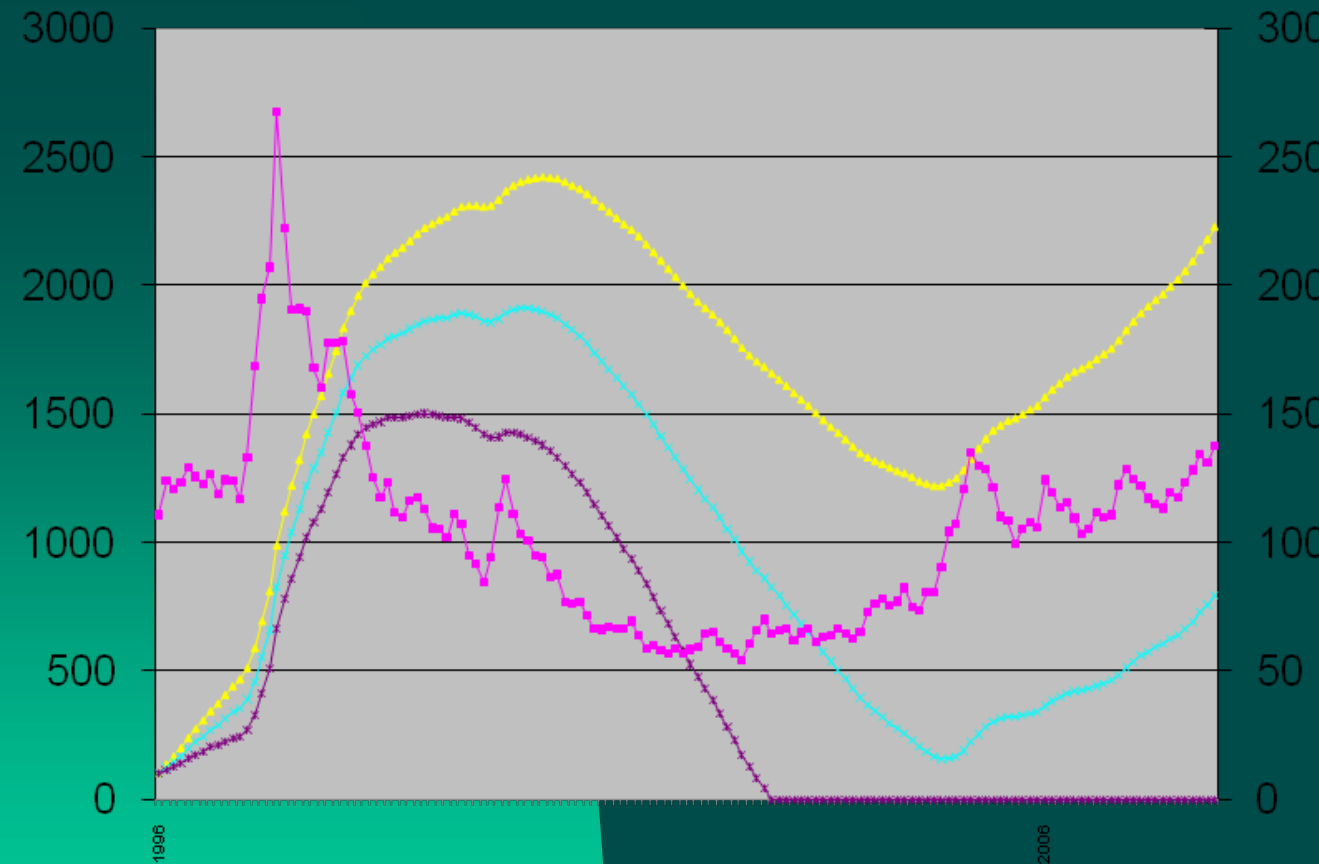
Instability: Destructive Coffee Price cycle

Result:

Producer 1:
profitable at
90c/kg

Producer 2:
marginal at
100c/kg

Producer 3: out of
business at 110
c/kg



Compensatory mechanisms

■ IMF

◆ Compensatory Finance Facility

Strict conditionality, below market rates

Time lags, alleged destabilizing effect

Asymmetry between payment and repayment: incompatible incentives. Absorbed in mainstream programmes and abolished in 2009 as separate facility

◆ Poverty Reduction and Growth Facility (PRGF), ESF

Support BoP in case of sudden and exogenous shock

■ EU: STABEX, FLEX

All-grant, ACP

Imperfect counter-cyclical, sector-oriented

Time lags

Safety nets

- WB's Vulnerability Financing Facility: Global Food Crisis Response, and Rapid Social Response
 - ◆ Fast disbursement
 - ◆ Financing safety nets and prevent loss of productive capacity in a crisis
- Global Index Insurance Facility
- FAO: Food Import Financing Facility: multilateral guarantee to cover food import bills for vulnerable countries

Open issues

- Basis risk:
 - ◆ Support triggered without major need, or otherwise
 - ◆ Support measures reaching wrong population groups
 - Delayed response => limited countercyclical effect
 - Additional or re-distribution of ODA?
 - Distorted incentives: adjusting behaviour to take advantage of support measures
- Make sure that interventions create new assets in beneficiary countries, not simply extend liabilities**

Value of a loan: it's NOT same as concessionality

Asset

Coffee washing facility

- Income:
 - ◆ exports of high quality coffee
- Expenditure:
 - ◆ costs of production
 - ◆ amortization
- External risks:
 - ◆ Price
 - ◆ Competition
 - ◆ Input costs

Liability

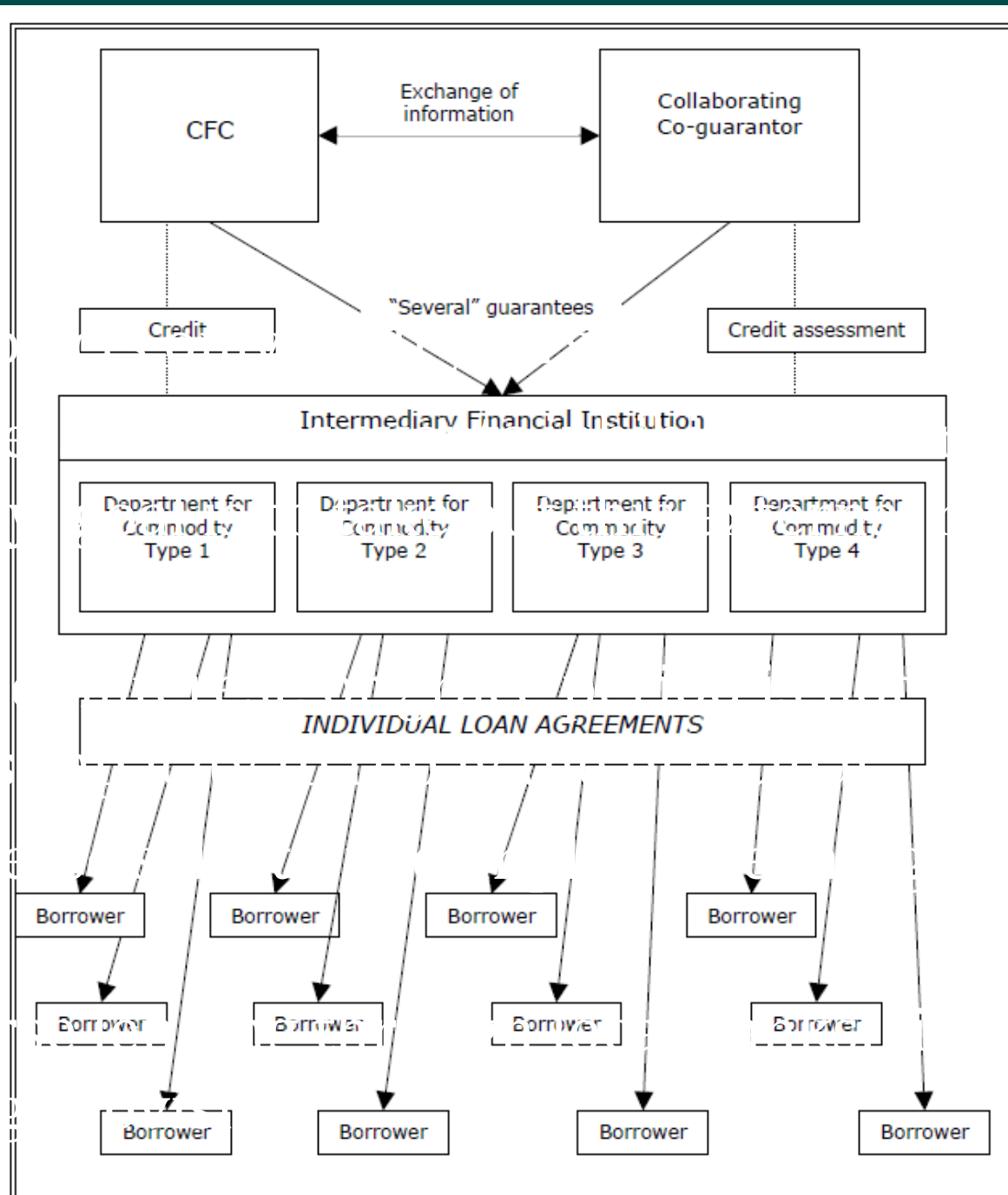
Loan

- Interest
 - ◆ Grace period
 - ◆ Rate of interest
- Principal
 - ◆ Conversion into grant
 - ◆ Privatisation
- Conditionality
 - ◆ Probably should not be there

Counter-cyclical support through loans: long term

- Goal: Focus loan concessionality on cases of adverse market conditions: prevent build up of debt due to adverse circumstances
- How: Separate subsidy element and allocate it as grant [Guillaumont]; different from loan indexation to commodity price (concessionality depends on market)
- Embedded option : floating grace period [OECD]: possibly effective for long-term loans; driven by beneficiaries, time consistency an issue

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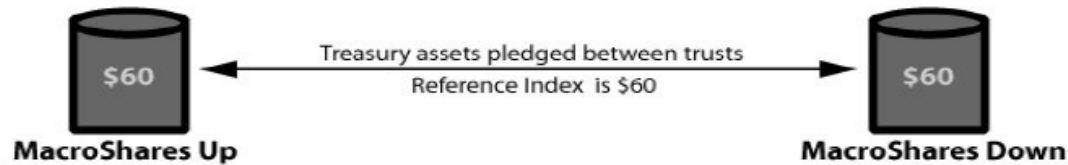
- Specific pro
- Risk of adv
- Risk of adv
- Indexation
- Risk of adv
- Non-recou

Macro-securities

MACRO MARKETS

MacroShares: Illustration

At inception MacroShares Up and MacroShares Down Trusts are equally priced and equally collateralized.



Example 1: Index Rises

MacroShares Up increases in value and MacroShares Down decreases in value proportionally. (excluding accrued income and expenses)



Example 2: Index Falls

MacroShares Down increases in value and MacroShares Up decreases in value proportionally. (excluding accrued income and expenses)



www.macromarkets.com ©



MacroShares: A New Generation of Exchange-Traded Products

Facilitating domestic capacity to manage risk

- Price Risk Management: embed options based on international markets into lending to commodity sector: CFC-ICCO test in Cote d'Ivoire cocoa sector
- Warehouse receipts: reduce seasonal cycle stress on repayments
- Micro-insurance: embed insurance instruments into microcredit facilities to insulate recipients from extremes of commodity cycle

A practical example:

Triplicate - Co-op Union

Player M.S.M. 2005/2006

COPY

COFFEE RECEIPT T.C.C.C. No. B 31878

Name: USAMBARA COOPERATIVE UNION (PFA) LTD

Bag marked: USAMBARA

No. of bags: 156 in words MAA MOJA HUNDRED NA SITA TU

D.T.		01A1-3	
PI	PII	FL	CB

DATE	TIME	LOKRY NO.	WEIGHT CARD	SAFARI REPORT OR TALLY NO.	SERIAL NUMBERS
06-03-2006	1:35 PM	T483AFH	0045928	DATE: 04390 14397	—

Signature by: [Signature] (23)

Measure %: 12.7

WEIGHTED BY	CHECKED BY
<u>[Signature]</u>	<u>[Signature]</u>

LOKRY FULL	13320	Kg
LOKRY EMPTY	5370	Kg
LOAD	7950	Kg
LESS BAGS (156)	156	Kg
NETT WEIGHT	7794	Kg

SPECIAL INSTRUCTION (IF ANY)

SUPERINTENDENT - PARCHEMENT STORE

Receiving clerk

Weighting and tally

Supervisor

Practical example 2:





Common Fund for Commodities



For further details please consult
www.common-fund.org